INTRODUCTION

ICAS – the professional body of accountants – has much to contribute to a debate on tax devolution.

Tax devolution means any form of control of taxes passing from Westminster to Holyrood, whether under the Scotland Act 2012, the current campaign for full 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 least successful, practices.

ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. This paper is not written with a political perspective. ICAS is apolitical and will not take a stand for or against the Scottish independence referendum proposal. From a public interest perspective, the ICAS view remains that it is our role to share ICAS insights into the many complex issues and decisions involved in tax system design, operational experiences and practicalities. 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.

The ICAS contribution so far in the context of the Scottish independence referendum debate has been to issue two papers on tax as well as provoking deeper debate around the future of pensions. Six questions were asked in our first tax paper “Scotland’s Tax Future; What tax system would Scotland want?” on design principles and approaches. The practicalities that both the Scottish and UK Governments and people of Scotland would have to embrace to see tax devolution happen were the subject of our second paper “Scotland’s Tax Future; The practicalities of tax devolution”.

The Scottish Government issued “Scotland’s Future Your Guide to an Independent Scotland” in November 2013 (“the Guide”, also known as the “White Paper”), HM Treasury has also issued a number of discussion papers, and a considerable body of neutral analysis has emerged to offer insights and information into the impacts and effects of the independence referendum resulting in a ‘Yes’ vote. At the time of writing, the other political parties in the ‘Better Together’ campaign are finalising their approaches. ICAS members have also had the opportunity to hear from experts, politicians and both sides of the campaign at a key conference.

At the start of 2014, it seemed appropriate to reflect on the development of the debate so far and consider what progress has been made in addressing the topics in our first two tax papers. But the single biggest issue emerging over recent months is that many individuals, CAs or not, struggle to access the explanations they need to understand the place of our tax system in our economy – the big picture tax debate – even before the issues of independence or further devolution are factored in. The lack of simple numbers in the independence referendum debate so far has seemingly not been helpful. In this third tax paper, ”Scotland’s Tax Future; Taxes explained”, the aim is also therefore to go back to some basics, address the information gap, and suggest an approach to understanding the role of tax in the referendum debate.
EXECUTIVE SUMMARY

It is nearly two years since ICAS issued its first tax paper, asking six questions on what tax system would Scotland want. Some answers are emerging, and the importance of the economic and political context in shaping the answers is becoming clearer. In particular, notable progress has been made by way of some credible and informative expert analysis, and the Scottish Government’s response is included in "Scotland’s Future Your Guide to an Independent Scotland". From the questions still being put to the ICAS technical team, it seems that the volume of detail sometimes overwhelms and the presentation of the few numbers in the White Paper leaves a gap, particularly about the impact of oil and gas tax revenues on Scotland’s spending capacity. The need for independent and unbiased analysis remains; and the desire for numbers is growing. Further insights are offered in the rest of this paper, consistent with the ICAS aim of informing the debate without taking sides.

Firstly on tax system design, the White Paper indicates the way forward after a ‘Yes’ vote in the referendum is, in practice, to replicate the UK tax system for a transitional period (the number of years are not specified) with the potential for change in future. Minor amendments, exactly the same as Westminster might propose in the annual Budget adjustments were included, principles were proposed, but the Guide is virtually silent on further detail. What would happen next? The competitive strategy on corporate tax rates is aspirational, perhaps because of concerns that the cost of tax competition with the rest of the UK might outweigh the benefits1; that is not a criticism if the eventual outcome of this debate is simply that better informed decisions can be made.

Some have suggested that the White Paper focussed more on the emotional drivers to a decision on independence than the financial analysis. A lot of the economic commentary provided about the financial position in the White Paper is based on the past, yet the vote is not to change the past – the numbers for the future are the ones that logic should say matters – and these may be very different.

And as for the practicalities, it appears that the transition costs – the one-off costs to set up a new tax system in Scotland to take over all of the operations currently carried out by HMRC, as well as taking over administration in all other non-devolved areas – have yet to be fully explored or explained. They apparently have been accepted as being in many hundreds of millions of pounds2; what if transition costs were at a lot higher? With the dependency on HMRC to operate an independent Scotland’s tax system in that transition phase, there is a likelihood that the timescale for adoption of new policy changes and benefits might be some years away. At what cost and timescale does it affect voters decisions, if at all, and are voters satisfied with the information they have been given? Perhaps it is time for a better understanding of the cost-benefit analysis on public finances – at a UK level as well as for Scotland - as well as consideration of alternative constitutional options for Scotland and the rest of the UK.
WHAT ABOUT TAX PRINCIPLES AND TAX SYSTEM DESIGN?

ICAS’ first tax paper described the nature of a tax system – the types of taxes charged, such as income tax, VAT, property taxes, the rates of tax, tax reliefs and the machinery of tax administration by the tax authority.

To make progress on answering the ICAS questions in the first tax paper requires informed analysis and expertise. Much has been contributed by The Scottish Government’s Fiscal Commission, who reported in detail in November 2013 on the principles of a possible tax system for an independent Scotland and informed the direction adopted in the White Paper. Although comprehensive in coverage, the Fiscal Commission report did not take its analysis beyond general recommendations, in that there were no proposals of costings of tax rates and tax bases for an independent Scotland, rather the view that the Scottish Government “should assess the optimal balance of tax rates and bases for key taxes”.

The White Paper gave very little detail on tax, beyond the usual manifesto pre-election assertions on topics indistinguishable from those that might and do appear at Westminster, and as the White Paper points out, also matters wholly for the Scottish Government after the next Holyrood elections. It only discussed in any detail corporation tax, which raises only about 9% of the total UK tax, so effectively ignored where the greatest components of our individual tax burdens would come from.

The White Paper does however propose that ‘Independence Day’ will see Scotland have no change to its tax system – adopting a ‘copy and paste’ approach to adopt the UK tax legislation in its entirety. Very short term necessity has forced the hand on this decision more than principles, but the practicalities have at least started to be considered. Whether or not it matters to the voters is for them to decide, but the tax future spelled out so far is no different from that at a UK level.

1 Institute for Fiscal Studies Briefing Note BNI41 ‘Taxing an independent Scotland’
2 “Scotland’s Future Your Guide to an Independent Scotland” page 575, applying 1% as an illustration of “a small proportion” to the annual Scottish budget.
TAXES EXPLAINED: SCOTLAND’S PLACE IN THE UK TAX SYSTEM

The first ICAS tax paper raised the need for a country’s tax, economic and social systems to be integrated. As already stated, the numbers in the White Paper were not particularly forthcoming. Arguably, Westminster and/or the other political parties could also do more to explain UK tax and spending, or perhaps we all just need to pay attention to the information currently made available. Considerable progress has been made in the availability of breakdowns and analysis of tax revenue and spending from a UK to a Scottish level, particularly in the work of the Institute for Fiscal Studies.

In an attempt to inform the independence referendum debate, consideration of devolution alternatives, and shape future questions, and in view of the short term “copy and paste” proposal in the White Paper (that an independent Scotland would initially adopt the entire UK tax system), the starting point is to understand the current UK tax system, and how it affects Scottish taxpayers.

The total UK tax take for 2013 was £475.6bn, and the percentage across tax headings is shown below ignoring for now North Sea oil and gas revenues.

Figure 1  Split of UK and Scottish tax receipts, 2012/13

4 HMRC ‘Facts and figures about what we do’ 2013
It is not widely understood that income tax is the single biggest source of tax revenue, followed by VAT and national insurance contributions at virtually identical levels. Employment, where income tax and national insurance contributions are both paid, is the most highly taxed income. These are where the UK Government really raises tax. But further examination shows us that the same UK tax system currently lays a differential tax burden on the Scottish population in two key areas, discussed below. These arise because of differences in income and lifestyle patterns between Scotland and the rest of the UK.

Firstly, as regards income tax, Scotland does not have the same level of top income earners – the ‘London and south East factor’ – so income tax is a lower percentage of the total tax receipts. For example, the top 1% of taxpayers pay 25% of income tax at a UK level, the top 1% of taxpayers pay only 17% of income tax in Scotland. The flatter income distribution in Scotland matters to any government considering whether to raise more tax from the rich to support the less well off, for example. The number of Scottish taxpayers who paid tax at the top income tax rate of 50% in 2011/12 was around 13,000. To give some context, they would fit in one end of Murrayfield stadium, or could just about squeeze into The Hydro in Glasgow. What is the scope for substantial additional tax revenue from that small number? Even if there are no behavioural changes (greater attempts at avoidance, or from the highly paid moving away from Scotland for example – as the French have recently discovered) another 10% on the top rate of tax might raise maybe £240m (derived from HMRC statistics that show total tax paid in 2011/12 by the highest band of 50% taxpayers in Scotland was about £1.2bn, so a rough cut of 10% would be one fifth of that). This is less than 0.4% of public spending in Scotland, but there always are behavioural changes so the scope here should be regarded as limited. It seems that research could helpfully demonstrate the optimum top rate of income tax in Scotland; the one that maximises total tax revenues, but is not so high as to result in the behavioural changes that would actually result in a reduction in those revenues? That might better inform how income tax changes might be made in Scotland.

This is not just a matter of how the rich are taxed. At lower income levels, the flatter income distribution also means that a simple change, such as an increase to the level of tax free personal allowance, has a greater proportionate effect, and tax revenue cost, in Scotland when compared to the rest of the UK. For example, in Scotland, in 2011/12, taxpayers who would benefit from such a change paid 30% of total income tax, for the rest of the UK the figure was 23.4%.

The second key difference in how the UK tax burden in Scotland is borne differentially from the rest of the UK is that Scotland’s population apparently spends more on smoking and drinking alcohol, so consumption and indirect taxes – the ‘sin taxes’ borne – are higher. When the topical issue of alcohol pricing, tax and health is considered, does this mean they should be even higher? The White Paper is silent on using tax for public health benefits, yet whether minimum pricing or tax is the reason for increasing prices, the impact on the consumer price sensitivity is the same. The current debate in both Parliaments on this continues. What we do know however is that cross-border shopping is likely to increase with a tax differential, as it does for those in the south of England who buy wine in France. If there’s money to be made in the tax differential some people will attempt to take advantage of that, leading to a need to increase tax enforcement and border policing efforts.

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7 Institute for Fiscal Studies Briefing Note BN141 ‘Taxing an independent Scotland’ available at www.ifs.org.uk/bns/bn141.pdf
TAXES EXPLAINED: THE IMPORTANCE OF OIL AND GAS TAXES

What really is the importance of the oil and gas tax revenues to the finances of the UK and a potentially independent Scotland? Back to the numbers and the things it might be helpful to clarify.

Perhaps surprisingly, a number of matters are not in dispute between the independence referendum campaigns. The North Sea has been producing oil profitably for over 30 years, with substantial benefits to the UK Treasury. The UK tax revenue is currently in two broad streams; one based on the profitability of the extraction activity and one based on the eventual selling price of what is produced. Substantial oil and gas reserves remain in the North Sea, but it is increasingly difficult to extract them profitably; whilst new methods are being invested in, there’s still a shared uncertainty over just how much of what is estimated to be there is likely to be extracted, and how the additional cost may reduce profitability. Because the extraction costs are rising, the tax revenue stream based on profitability is likely to reduce even if the same volume is extracted and the price is unchanged as the profitability, on which tax is paid, is reduced. Oil and gas prices (denominated in US dollars) are highly variable and these affect both the UK tax revenue streams from profitable extraction and the selling price based taxes. Factors affecting the price include instability in the Middle East, fracking production in the US and the US dollar: sterling exchange rate – mostly well beyond a Scottish or UK Government’s control. For all these reasons there is considerable uncertainty of the future tax revenue streams, regardless of the outcome of the referendum vote.

The two main matters in dispute are where the referendum campaigns differ.

• What future tax revenues should be expected? The key forecasts under discussion by the campaigns are those in the White Paper, and those from the UK Government established Office for Budget Responsibility (“OBR”)⁸. Both of these expect tax revenues to decline quite sharply in the short term, how quickly and by how much, and what the longer term position is are disputed.

• How the North Sea production areas would be apportioned between Scotland and the rest of the UK. The two main methods are; on a head of population basis, and on a geographic basis. There is no definitive agreement on the exact methodology to be used on the second; on where would you draw the line in the North Sea to decide what belonged to which country. The methodology currently favoured by the Scottish Government uses the straight line drawn out to sea and used for fishery demarcation purposes. Other approaches have been raised but this is beyond the scope of this paper – just note this is another matter that can affect tax revenues from North Sea Oil and Gas.

The question most commonly put to ICAS is around what the oil and gas tax revenues debate is really about; the analysis beyond the ‘shouting’ and the sound bites. A wish to be informed of what the numbers are, in the context of public finances, that would in turn impact the lives of individuals in Scotland. Arguably this may not have been clearly, or simply enough, communicated yet, by either campaign. It requires consideration of the tax and spending decisions made by any government with control of the revenues, and it comes back to the numbers, all of which is explored below.

TAXES EXPLAINED; SOME SIMPLE NUMBERS

In the explanation below, the figures used are the latest official UK ones (not in dispute), those for 2011/12, and 2012/13 for tax revenue and public spending. The geographic allocation of oil and gas tax revenue per head in Scotland, (which is expected by the White Paper to be the position following a vote in favour of independence, and perhaps the more likely, as well as more generous to Scotland) is used.

<table>
<thead>
<tr>
<th>Public Finances, per person</th>
<th>2011/12</th>
<th>2012/13</th>
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<tbody>
<tr>
<td></td>
<td>£</td>
<td>£</td>
</tr>
<tr>
<td>Scotland</td>
<td></td>
<td></td>
</tr>
<tr>
<td>North Sea Tax Revenue</td>
<td>1,885</td>
<td>1,050</td>
</tr>
<tr>
<td>Other Tax Revenue</td>
<td>8,730</td>
<td>8,947</td>
</tr>
<tr>
<td>Total Tax Revenue</td>
<td>10,615</td>
<td>9,997</td>
</tr>
<tr>
<td>Public Spending</td>
<td>(12,227)</td>
<td>(12,265)</td>
</tr>
<tr>
<td>Deficit (a)</td>
<td>(1,612)</td>
<td>(2,268)</td>
</tr>
<tr>
<td>UK</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Tax Revenue</td>
<td>9,100</td>
<td>9,200</td>
</tr>
<tr>
<td>Public Spending</td>
<td>(10,951)</td>
<td>(10,998)</td>
</tr>
<tr>
<td>Deficit (b)</td>
<td>(1,851)</td>
<td>(1,798)</td>
</tr>
<tr>
<td>Scotland net lower/(greater) deficit than UK (a)-(b)</td>
<td>239</td>
<td>(470)</td>
</tr>
</tbody>
</table>

Source: Government Expenditure and Revenue Scotland 2013 pages 33 and 51

The tax paid per head in Scotland is higher than for the rest of the UK due to oil and gas tax revenue. Government spending is also higher in Scotland. So for all the implied wealth and spending power in the higher tax revenue figure which is often quoted, a significant amount of it is spent in Scotland already, on for example, free personal care, economic development and rural transport subsidies. These are matters that already substantially devolved to the Scottish Parliament.

But what of the future, and the expected decline in oil and gas tax revenues? After all, it’s the future that is being voted for, not the past. The White Paper uses the Government Expenditure and Revenue Scotland figures, and estimates these receipts at £10.6bn for 2011/12, but it also states (on page 75) that these will reduce by just over a third, to a range of £6.8-7.9bn, by 2016/17. As it happens, the latest figures for 2012/13 produced actual revenue on a Scotland geographic share of £5.6bn, lower than any of the Scottish Government’s scenarios or the OBR forecasts from just a year earlier. Evidence indeed that the only thing you know about any forecast is that it is likely to be wrong. The reasons identified for this are the additional investment needed to try to maintain production levels giving rise to immediate tax relief, but declining production for the years concerned.

9 Government Expenditure and Revenue Scotland 2011-12, available from www.scotland.gov.uk/Publications/2013/03/1859/1
10 Office for Budget Responsibility: Economic and Fiscal Outlook, March 2014, available from Institute for Fiscal Studies Briefing Note BN141 “Taxing an independent Scotland” available at www ifs
Whilst the Scottish Government may be updating its oil and gas forecasts as a result of this unpredicted outcome for 2012/13, the snapshot so far is as follows:

### Oil and Gas tax revenues total

<table>
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<tr>
<th></th>
<th>Actual 2011/12</th>
<th>Projected 2016/17</th>
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<tbody>
<tr>
<td></td>
<td>£bn</td>
<td>£bn</td>
</tr>
<tr>
<td>UK</td>
<td>11.34</td>
<td>3.20</td>
</tr>
<tr>
<td>Scotland</td>
<td>10.00</td>
<td>6.80-7.90</td>
</tr>
</tbody>
</table>

Taking the £7.35bn midpoint of the White Paper range for 2016/17 of £6.8bn-£7.9bn and a Scottish population of around 5.3 million, that works out at around £500 per head of a reduction in tax revenue from the 2011/12 numbers to the White Paper projection in 2016/17, and a per person adjustment of a much lower level of £42 for the UK comparison; a net £458 because the tax reduction is spread over the entire UK population of 63.7 million rather than just the 5.3 million for Scotland. For completeness, the OBR projection at a much lower estimate of £2.69bn (assuming still 84% of the UK official projection) is also shown.

So if nothing else changed from 2011/12 except the oil and gas tax receipts, what would the figure look like in 2016/17?

### Scotland lower/(greater) deficit than the rest of the UK per person

<table>
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<th>2016/17</th>
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<tbody>
<tr>
<td></td>
<td>White Paper</td>
</tr>
<tr>
<td>Actual 2011/12 as above</td>
<td>£239</td>
</tr>
<tr>
<td>Reduced oil and gas tax receipts</td>
<td>(458)</td>
</tr>
<tr>
<td>Projected Scotland net greater deficit</td>
<td>(219)</td>
</tr>
<tr>
<td>than the rest of the UK</td>
<td></td>
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</tbody>
</table>

A very different picture of Scotland’s relative financial contribution emerges; having a lesser deficit than the rest of the UK is not the scenario, as oil and gas tax revenue looks unlikely on its own to fund the additional spending in Scotland.

And that’s before any additional austerity measures reduce spending, personal tax cuts feed through, or indeed social equality measures might increase spending, depending on the government of the day’s approach and the devolution settlement arrived at.

In the absence of full governmental forecasts of these amounts, this illustrative impact of Scotland’s financial position should enable the debate to be carried forward at a level capable of being clear of jargon, clear of clouds of economic statistics and accessible to all voters.

The key points for understanding then are:

- the extent to which in Scotland, both tax and spend are currently higher than the rest of the UK,
- the potentially dramatic impact that even the more optimistic forecasts of reducing tax revenues has in funding any independent Scotland
The questions that then follow are at a specific level,

- what are the specific costs of spending impacts and tax measures in any vision for the future, whatever the constitutional outcome?
- What assumptions of economic growth might be made, to give rise to additional tax receipts?
- how would any Oil Tax Fund be built?

The White Paper commented on tax that ‘there is no requirement to increase the general rate of taxation to pay for the services we currently enjoy in Scotland’ but did not offer further explanation. Whilst it is a phrase open to wide interpretation, addressing the question put to ICAS, of what the various high level promises and variables mean at a level that can be understood by voters, seems the least the parties should be considering.

No doubt these simple calculations will be challenged, debated or cheered, depending on the reader’s perspective. The purpose of offering these is to bring the debate on such a serious constitutional issue to the day to day realities; improve on them if you will, please, clearly and simply; that is how this debate becomes better informed.
TAXES EXPLAINED; DOES THE CORPORATE TAX RATE MATTER?

The corporation tax rate debate, reported as a key plank of economic growth strategy and one massively affected by competitive pressures and restrictions from well beyond UK shores, is one that is now better informed by work by both the Institute for Fiscal Studies and the Fiscal Commission.\(^{11}\)

The context for considering the corporate tax rate debate is important. Firstly corporate tax rates across Europe have been declining steadily for years. ‘Everyone’s at it’; and the declining rates were the foundation for the Organisation for Economic Co-operation and Development concerns about the ‘race to the bottom’. Too close to the bottom is where reduced corporate tax rates mean lower corporate tax revenues which raise too little tax to be affordable without cutting public spending. In recent years in Europe austerity measure put a halt to this decline, but is that likely to be temporary? More likely than further rate cuts is probably the extension of certain tax reliefs, possibly more affordable than a wholesale rate cut, particularly if targeted, sectoral reliefs are used rather than across the board measures.

The assumptions in the economic study previously quoted by the Yes campaign, from 2011\(^2\), are also relevant to understanding the contribution it made to the debate, given the context explained above. That study was based on a differential corporate tax rate with the UK and its competitors; but is the outcome achievable in practice if this pattern of competitive tax rate behaviour continues – when you have no control over other jurisdictions? Not necessarily, was the answer from the Institute for Fiscal Studies and the Fiscal Commission commentators\(^3\) who raised the issues of the challenges in terms of competitor responsiveness, administrative practicalities and business costs. Further thoughts are developing – different solutions in mind, alternatives that look more like a collaborative or federal system across UK jurisdictions with shared tax rules. Perhaps that is why the White Paper reflected these greater insights; in more muted tones it suggested ‘offering a timetable to a reduction of rate by up to 3’\(^{16}\). On other corporate tax base matters the White Paper in general promised the status quo; the future potential for specific allowances and reliefs identified no different from those discussed or implemented by Westminster, indeed perhaps all too familiar.

This is not to say that economic competitiveness or inward investment attractiveness has nothing to do with corporate tax rates, rather it is about more than the tax rate. If Scotland is so successful at attracting inward investment already, is a tax rate cut really necessary? Inward investment decisions have a number of complex factors; the most attractive country in Europe for manufacturing inward investment is Germany, whose corporate tax rate is over 30%.

After the initial ICAS tax papers were published, the public debate moved on elsewhere on the tax burden on international businesses, and whether they pay their ‘fair share’. It is worth noting the policy tension that arises when governments on the one hand, attract international businesses with favourable tax regimes, and on the other hand criticise them for making tax efficiency decisions which result in them paying less tax. The relationship between any independent Scottish government and international businesses, including major oil and gas tax revenue contributors will be hugely important because of the influence they might wield, controlling so much of a country’s tax revenue. This debate elsewhere raises a new question; what the tax transparency policy would be, and how the influence of a small number of very significant taxpayers would be addressed.
At just about four months before a decision date, it is not surprising to ICAS members that those in business across the UK are considering the possible consequences on their businesses of a ‘Yes’ vote; indeed this is the least that might be expected of competent professionals. Corporate governance codes and shareholder expectations require informed and careful assessment of business risks and communication to stakeholders on the actions and expectations of the company boards appointed to look after their interests. Every business in Scotland would have to deal with administrative change if there is independence or further corporation tax devolution. Opportunities or concerns over losses apart, cross border businesses will have a lot of work to do on their tax positions. A new tax border between Scotland and the rest of the UK means duplicating tax work and two tax authorities; corporation tax groupings fail to apply, loss and profit offsets will cease, taxable profits will be have to be allocated across border, separate payrolls may be needed for employees in Scotland and the rest of the UK, VAT groupings too will cease. A flurry of corporate restructuring activity might then be expected after any ‘Yes’ vote, but in reality nothing can be implemented until the principles of any new Scottish system and its operations are agreed with HMRC and Revenue Scotland’s administrative systems put in place. Given Revenue Scotland won’t even be established as a separate tax authority until 1 January 2015 at the earliest, the flurry might turn into a whiteout for a time at least.

TAXES EXPLAINED; THE PRACTICALITIES OF TAX DEVOLUTION

The second ICAS tax paper addressed many of the issues requiring a response; experience has been gained and some direction has been provided in the White Paper but with scant detail in some areas or on related costs.

The first challenge might be the nature of the agreement for sharing services and costs under which the White Paper states that HMRC will operate the tax system for an independent Scotland in a transitional phase. The experience to date in discussions between the Scottish Government and HMRC, with regard to the administration of the first devolved tax, Land and Buildings Transaction Tax is highly informative. There were concerns over cost allocations, IT system changes and accountability issues, and the result was that the Scottish Government did not then choose HMRC for tax administration. These issues could still arise, but at a much more significant level. HMRC would be the monopoly supplier in that period and the entire Scottish exchequer revenue would be at stake – quite a challenge for a speedy negotiation, against a tight timetable. Should this be necessary, it might be speculated that, at best, HMRC would operate the system for a few years at most but not incorporate any system changes for Scotland alone.

The second challenge would be timescale; a need for the Scottish Parliament to pass all the necessary tax legislation to replicate the UK system and revenue raised, or alternatively find, and legislate for, alternative tax revenue sources. The timescale for doing either is not achievable unless there is a simple replication of the UK system, perhaps why that is now the proposal, although even then some of the cross border issues will need to be addressed quite specifically. Interestingly, the Scottish Government’s latest draft tax legislation, the Revenue Scotland and Tax Powers Bill, is substantially a ‘copy and paste’ from the UK system, so devolution has already headed down this track. Either that is a good thing, because familiarity and continuity are welcomed, or it could be a bit of a disappointment, or arguably reflect a slight misrepresentation, to those who believed the “brave new world” of tax system design and simplicity would be heralded by tax devolution or independence.

HMRC’s operation of the Scottish tax system would also assume HMRC’s cooperation. HMRC is being separately focussed on greater efficiencies, and is already carrying out many fundamental restructuring changes – arguably struggling to deliver one system never mind two - so unless a considerable financial benefit accrued, why would it wish to devote resources from its core duty? It may agree to operate the UK system until Revenue Scotland has its own system up and running, but that might also mean only operating the UK system. This could lead to a delay before any tax system changes passed in an independent Scotland (or one with more tax devolution) could actually be implemented, for quite a number of years.

It is probably in everyone’s interest to be clear about the HMRC system constraints that could foil any attempt to devolve taxes further, very quickly, regardless of political or organisational will. Even extraction of the right data could be problematic, once it is borne in mind that only about half of the population in Scotland pays income tax at present, and no corporate tax records by business presence for Scotland exist because the UK tax system ignores this differential.
And then there are operational matters; Revenue Scotland would need to build an entire organisational team to operate all taxes HMRC does now, as HMRC does not operate equally across the UK on a geographic basis but to quite an extent is centralised, and has specialist and processing centres. Many senior technical and policy positions are in London, including the vast majority of oil and gas specialists, whose expertise Revenue Scotland might find essential. National Insurance staff are based in Newcastle. This means that a “draw the line at the border” basis to split activities is simply unworkable.

At a personal level, HMRC staff in Scotland may be considering the future too. Again numbers can help to put this in context. At the date of the referendum, Revenue Scotland is likely to employ around 30 staff; HMRC has at present just under 60,000 staff in total, with around 8,000, or 13% in Scotland. Even if Revenue Scotland is never, as is proposed in the White Paper, more efficient than HMRC, then a population share of staff (8.3%) would suggest the appropriate staffing level would be around 2,700 less, going well beyond its share of current headcount reduction plans in HMRC. Whilst there will be redeployment opportunities, the impact on the potentially significant numbers of HMRC staff who find themselves with the wrong skills/in the wrong country may be seriously disruptive for many, with a period of months, if not years, of uncertainty.

There has been no public discussion on the costs of tax independence or further devolution. These fall into two categories. Firstly, transition costs, the costs of change, including setting up the new organisations required to operate independently after any ‘Yes’ vote or decisions on further devolution, even before any decisions were made as to how to change the system; money spent to stand still in terms of what the tax system does, but to prepare it for future changes independent of the rest of the UK. Secondly, operating costs, once the system has been built. As noted above and in the White Paper, costs were described as ‘a small proportion of an independent Scotland’s total budget’. How small is small? No further explanation is in the White Paper, meaning it falls short of the informative and detailed financial memorandum that might be expected to accompany even the smallest piece of parliamentary legislation at Holyrood or Westminster at the moment.

By illustration, “small” might be 1%, which would be around £650m, but 5% would be £3.25bn. It is not clear whether that would be for each year of transition, but there is no suggestion or evidence that a whole country’s operating system could be set up in just one year. Examples from other countries can point towards the scale of costs which might be incurred. In New Zealand, for example, changes to the tax system which are less complex than those for an independent Scotland are costing around £750m. The cost for an independent Scotland could be significantly greater, especially considering the scale and the complexity of the legacy systems which might be inherited from the UK. What it is really going to be, and how it is to be paid for is a question that still needs to be answered.

The potential must exist for a shiny new tax system to be more cost effective operationally, but that depends significantly on the system adopted, and tough decisions being made, as well as the level of investment made up front; the greater the investment, the greater the hoped for potential saving, but its still money being spent in the short term from the public finances.
This is not to take a political stance, but perhaps to learn from others and propose a different perspective. When East and West Germany’s reunification happened, as a chosen constitutional change, the costs and consequences of doing so were acknowledged. A ‘solidarity charge’ was levied, a few per cent on the tax rate for most, for a fixed period of time. It may be easier to say from the outside, but the transition cost was not worried about, or hidden. Perhaps a proud acceptance of the facts, those principles mattered more than the tax bill.

Finally, it is worth remembering that VAT raises nearly three times as much as corporation tax revenues. If EU membership is not in place on Independence Day then, whilst an equivalent to VAT might be legislated for, it would not be VAT as the rest of our EU trading partners know it, so the EU rules on cross-border transactions for example, would not apply. Businesses trading across the EU would have administrative headaches and cash flow implications. If EU membership is in place at that date, the detailed negotiations taking place to achieve membership need to include more detailed issues, such as costs for all Scottish households.

All UK households currently benefit from the 5% reduced rates of VAT on electricity and gas, and zero rating on children’s clothes, both achieved by a specific negotiation at EU level; whether and at what level that might continue depends on the outcome of any future negotiations over an independent Scotland’s place in Europe.
CONCLUSION

This paper updates ICAS observations on the ongoing debate about Scotland’s Tax Future. It addresses only three out of many significant areas; The importance of North Sea oil and gas tax revenues, the corporation tax rate debate, and the costs of tax independence or further devolution.

Greater awareness of our tax system and the decisions all our political parties might make, regardless of the vote on 18 September, might be no bad thing for us all.