CIPFA The Chartered Institute of Public Finance & Accountancy

Scottish Parliament Finance Committee

A Scottish Approach to Taxation: Call for Evidence

A Submission by:

The Chartered Institute of Public Finance and Accountancy

And

CIPFA Directors of Finance Section

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the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

The CIPFA Local Government Directors of Finance Section is the professional forum which comprises the Section 95 Officers under the Local Government (Scotland) Act 1973 of all 32 local authorities in Scotland. The Section provides opinions on matters concerning the management and operation of Scottish local government finance and also serves as a learning forum for the exchange of experience and information on these issues.

Further information about CIPFA can be obtained at www.cipfa.org

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1. Executive Summary

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) and the CIPFA Directors of Finance Section have combined our professional resources to provide a joint submission to the Finance Committee. Within this submission, all references to CIPFA will indicate the views of both bodies.

1.2 CIPFA advocates that the Scottish Approach to Taxation should be outlined in a clear and concise framework. This will include:

- a definition or purpose of the approach in Scotland;
- an expanded and comprehensive set of principles for taxation and;
- clear links to policy aims for taxation in Scotland

1.3 CIPFA proposes that the definition or purpose of the Scottish Approach to Taxation should be linked to overall aims and vision for public services contained within Scotland's Programme for Government.

1.4 CIPFA has previously developed a suite of principles which we consider that any system of taxation should be assessed against.[1] CIPFA believes these principles have a lot of commonality with the four principles outlined by the Scottish Government. However, the need for clear principles is relevant to testing and assessing proposed taxation policies.

1.5 To achieve this aim within the framework CIPFA would recommend the expansion of the principles to include the principles of buoyancy of the tax base and accountability. These are important factors that are missing from the current approach.

1.6 The last element of the framework to make up the Scottish Approach to Taxation is the link to the aims and objectives of taxation policy. This should be linked to the relevant Scottish Programme for Government priorities and plans. The framework approach will therefore encompass the definition or purpose of Scotland's approach, the supporting principles for taxation policy and the stated policy aims and objectives.

[1] CIPFA, A Fairer Local Tax for Scotland http://www.gov.scot/Resource/Doc/248701/0071648.pdf

1.7 Our research indicates that the Scotland Act 2016 provides devolved tax raising powers covering 30% of total taxes raised in Scotland. Of this 71% is drawn from Income tax.[2] CIPFA concludes that the Scottish Government will have a heavy reliance on a single form of taxation for revenue raising, i.e. Income Tax. The challenge for the Scottish Government is to mitigate this reliance and seek a wider range of fiscal levers to plot an effective course through the financial challenges ahead.

1.8 In order to support the principles of accountability, the Scottish Government should consider what is required of public financial management systems[3] to support greater devolved fiscal powers. This would include the financial planning information, monitoring and measurement of performance to ensure public services are financially sustainable over the longer term.

1.9 CIPFA would recommend that the Scottish Government ensure that local taxation powers within local government are kept separate from Central Government intervention. CIPFA would further advocate that a wider range of tax raising powers are provided to local government in Scotland.

2. The Framework and Principles for the Scottish Approach to Taxation

2.1 In order to develop Scotland's own unique approach to taxation, CIPFA supports the view that a framework is required rather than a set of principles alone. The purpose of the framework is to provide clear and transparent information to citizens on the approach of the government, its methods for assessing tax policy proposals and its aims for taxation policies implemented.

2.2 CIPFA believes it is important to encourage public engagement to assist government in developing new ideas and ways to improve the emerging tax system in Scotland. Engagement can take place at a

[2] Source GERS 2013/14 – Scotland's devolved tax income following the Scotland Bill based on 2013/14 figures. And, Reform Scotland: 'Scotland's new powers - Tax and welfare' March 2016

[3] CIPFA, Public Financial Management: A Whole Systems Approach http://www.cipfa.org/cipfa-thinks/keystones

number of different stages in the taxation policy process, i.e. at development of ideas, developing policy options and implementation plans through to drafting the relevant legislation and monitoring implementation.[4] The framework should also set out the methods the government will employ to fully engage with citizens in development and implementation of policy at each key stage.

2.3 The Scottish Government will decide its aims and objectives for taxation through development of its programme for government and budgetary requirements. Therefore, CIPFA anticipates this this part of the framework will change as the programme changes and develops.

2.4 Below the aims and objectives in the framework are the supporting principles. CIPFA's previously developed taxation principles include:

- Accountability
- Fairness
- Stability and predictability
- Buoyancy of the tax base
- Transparency and clarity
- Ease of collection and administration

2.5 We have made a comparison with the four principles set out by the Scottish Government in the call for evidence to the principles developed by CIPFA above. The outcome of this comparison is that CIPFA would advocate expanding the range of these principles. CIPFA advocates that the buoyancy of the tax base and the principle of accountability need to be considered in any assessment of taxation and should be included in an expanded set of principles.

2.6 The final element of the proposed framework approach is to demonstrate the link between taxes and policy aims. This will provide transparency over the purpose and objective of any particular tax, e.g. to change a behaviour or the promote employment and growth etc.

[4] HM Treasury and HM Revenue and Customs Tax Consultation Policy, March 2011 https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/89261/tax-consultation-framework.pdf

2.7 In summary, the main aim of the Framework is to provide a clear linkage between the Scottish Programme for Government, the principles that underpin any assessment of new tax policies and the aims for any particular new tax policy or policy development. The Framework will also provide an understanding of tax policy for the Scottish Fiscal Commission, which would assist with its statutory duties to provide independent forecasts of the Scottish Government taxation levels.

3. The scope for a fundamentally different approach to taxation in Scotland

3.1 In order to consider if there is scope for a fundamentally different approach in Scotland, we first need to understand the context in which that approach has the opportunity to develop. CIPFA's view[5] is despite any changes by the UK Government on the timing of its aim of eliminating the budget deficit, the challenges faced by public services are far from over.

3.2 Firstly there is the longer-term demographic changes. The ONS estimates projects that the overall UK population will grow from 2014 to 2039 by 15%. In Scotland this is projected to be 7.5% over the same period.[6] The total population of pensionable age relative to that of working age is also set to rise, even taking account of changes in state pension age under existing legislation. These demographic changes pose many long-term challenges for public services about how to meet the cost of health, social care and pensions in the future.

3.3 Secondly, a further factor to consider is the impact of 'Brexit' and the choices that the Scottish Government make in response to the vote in the UK to leave. While the UK economy has not suffered the immediate economic shock that many predicted post the Brexit vote,[7] research does point to a slowdown in economic growth in the near-

[5] CIPFA Manifesto, a call for sustainable public services, 2015
[6] The Office of National Statistics, National Population Projections: 2014-based Statistical Bulletin, October 2015
[7] BBC – Brexit Britain – what's happened so far' September 2016 http://www.bbc.co.uk/news/business-36956418

term and this could have knock on effects on resources available for public services.[8]

3.4 Thirdly, while the Scottish Government has obtained a significant level of devolved powers, the majority of tax revenue raised in Scotland comes from Income tax which makes up 71%.[9] This means that there is a large reliance on a single form of taxation. Reform Scotland suggest that Income tax itself is unlikely to provide the tools to encourage economic growth.[10]

3.5 There is also a need to consider in the approach to taxation the totality of funding arrangements in the context of the challenges above. Outside of revenue raised in Scotland through taxation, there remains the arrangements for funding via the Barnett formula from the UK Government. If this remains constrained or even shrinks through adverse impacts on tax levels nationally, or through prolonged austerity measures by the UK Government, then options for funding services in Scotland become more limited.

3.6 CIPFA would advocate that there remains a need for Scotland to consider in its approach the system of Public Financial Management. The Scottish Government should consider how planning and managing more devolved powers effectively would assist in mitigating any risks associated with a large reliance on a single revenue source.

3.7 CIPFA considers public financial management to be of utmost importance; this is the system by which financial resources are planned, directed and controlled to enable and influence the efficient and effective delivery of public service. It spans a range of activities including planning and budgeting, management accounting, financial reporting, financial controls, and auditing, all of which contribute to effective, transparent governance and strong public accountability for the use of public money.

3.8 The potential for radical reform and reduction to the complexity of some of our tax and benefits system is likely to be easier if control

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[8] LSE, The consequences of Brexit for the UK and living standards, 2016: Estimated UK incomes in a range between 1.3% to 2.6% lower in the medium term within the UK as a result of Brexit. http://cep.lse.ac.uk/pubs/download/brexit02.pdf

[9] Source GERS 2013/14 – Scotland's devolved tax income following the Scotland Bill based on 2013/14 figures.

[10] Reform Scotland: 'Scotland's new powers - Tax and welfare' March 2016

over the vast majority of tax and benefit powers rested with the Scottish Government. Any radical reform made to the current devolved powers would need to consider its impact on potential tax competition within the UK and, possible changes to the Scottish Government block grant funding from Westminster under no-detriment principles.

3.9 The no-detriment principle has an impact in two ways. Firstly providing for no-detriment on initial transfer of tax and/or spending powers and secondly as a result of policy decisions post devolution.[11] These are termed policy spill over effects and could prove both problematic to measure and administratively difficult to monitor. CIPFA views that the combination of current devolved powers and no-detriment principles are likely to limit scope for radical reform of the current tax and welfare powers.

4. Administrative and Governance limitations

4.1 Arrangements to govern the Scottish Government's devolved powers are contained within the agreement reached between the UK and Scottish Government on the fiscal framework. The Scottish Fiscal Commission will support this process through its new statutory duties to provide independent forecasts of revenues from devolved taxes and to lay reports before the Scottish Parliament on its forecasts.[12]

4.2 CIPFA supports the above arrangements but also encourages the Scottish Government itself to consider if it has all the available tools to manage and monitor the long-term financial sustainability of public services and the impact of its approach to taxation.

4.3 This includes what is the current financial position of the Scottish public sector and how affordable and sustainable are the budget plans for the Scottish Government. This means understanding the risks being faced and also looking at forward implications on the financial position of the government.

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[11] The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework, paragraph's 44-53 for policy spill over effects: February 2016
[12] The Scottish Fiscal Commission statutory remit – The Scottish Fiscal Commission Act 2016 http://www.legislation.gov.uk/asp/2016/17/contents/enacted

4.4 CIPFA believes that the Scottish Government must be able to answer some key questions in order to underpin the success of the Scottish Fiscal Framework. These include:

- What is the current financial position of the Scottish public sector?
- What will be the impact of the medium to longer term financial plans, both revenue raising, borrowing and investing plans?
- What is the fiscal impact if further devolution takes place?
- How affordable and sustainable are those plans and what risks are being faced?

4.5 In considering any administrative or governance limitations within the emerging system of Scottish Tax, CIPFA acknowledges the improvements that have been made in measuring outcomes in Scotland through the National Performance Framework. However, CIPFA believes there is a need to develop supporting long-term measures of financial performance and financial sustainability. The development of a Scottish Balance Sheet and supporting fiscal sustainability measures will provide the appropriate level of information for the Scottish Government.[13]

5. Separation and enhancement of Local Government Taxation powers

5.1 CIPFA supports the view that local government taxation should be set and raised locally without intervention by the Scottish Government. This would restore the setting of local taxation to local control and improve local accountability.

5.2 To further enhance local accountability CIPFA would support the development of measures (though legislation and/or regulation) to allow for a wider range of local discretionary taxation options to be available to local authorities. This would provide alternative means of supporting local service expenditure.

5.3 CIPFA recognises that there may be a number of other specific taxes that are capable of making contributions to funding for a local authority in particular locations and which may also have policy benefits in terms of influencing behaviour. A high profile example

[13] CIPFA: Scotland Future in the Balance – The Scottish Referendum, June 2014

would be road user charging (congestion tax/charges). A further option, again locality related, would be a tax on tourism.

5.4 CIPFA considers however that these should not be seen as a substitute for a primary local taxation system, or for the re-localisation of the business rate, which are likely to have a much more radical impact upon the balance of funding in Local Government. The introduction of the ability to raise other taxes provides a way to spread local taxation across a wider base and reflect the use of local services.

5.5 Further, such additional taxes can be directed to investment in the area that is the particular source of the tax. For example, in Hamburg, Germany, the culture and tourism tax raised locally is re-invested in culture, sports events and promoting tourism rather than going into the general pot of local taxation.[14]

[14] Introduction of the culture and tourism tax in Hamburg, http://www.hamburg-travel.com/service/culture-and-tourism-tax/