INSTITUTE MEMBERS IN SCOTLAND

14 January 2011

Scotland Bill Committee
Scottish Parliament
Room TG.01
Edinburgh
EH99 1SP

Dear Sirs

Consideration of the Scotland Bill 2010 and Relevant Legislative Consent Memoranda

Attached is a response from ICAEW Scotland to the Scotland Bill Committee's call for written evidence on the above.

If you would like any further information, discussions or to receive any of the research documents referred to in our response, please do not hesitate to contact me, or my colleague Fiona Ormiston, using the contact details below.

Yours faithfully

Keith Proudfoot

Keith Proudfoot
Regional Director, Scotland
ICAEW

E keith.proudfoot@icaew.com

Response to call for written evidence on the Scotland Bill 2010 and relevant legislative consent memoranda

14 January 2011

INTRODUCTION

The Institute of Chartered Accountants in England and Wales Members in Scotland (IMS) welcome the opportunity to respond to the call for written evidence on the Scotland Bill 2010 and relevant legislative consent memoranda. IMS serves over 1400 ICAEW members across the private and public sectors in Scotland and represents the views of ICAEW members who work in Scotland for Scottish and international organisations. Across the UK, ICAEW members' expertise and experience is fed into the corporate strategy of the Institute to help form and influence policy.

ICAEW operates under a Royal Charter, working in the public interest. The regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world-leading professional accountancy body, the ICAEW provides leadership and practical support to over 134,000 members in more than 160 countries. Strengthened by the expertise of our whole membership, particularly those in the UK/EU who are interacting with government and institutions on similar economic issues, ICAEW is working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.

For more information go to www.icaew.com.

General

In our recent **Priorities for Sustainable Economic Growth in Scotland document,** launched to MSPs in November, ICAEW members in Scotland identified three priority areas that we believe Scottish politicians must focus on in the next legislative term to support the drive for sustainable economic growth:

- accounting and financial services regulation and management
- managing public finances
- encouraging enterprise and sustainability

In terms of enhanced financial responsibility for Scotland, we highlight in our document the following issues:

- increasing Scotland's devolved economic powers presents both opportunities and risks
- inward investment should be supported by ensuring that taxation in Scotland is as simple as possible and does not adversely affect inward investment decisions
- with the UK tax system in need of a fundamental overhaul, any further changes to taxation in Scotland must be carefully considered and implemented, always bearing in mind that tax regimes should be as simple as possible and should not disadvantage business or the population in any geographic area.

OUR RESPONSE TO KEY QUESTIONS

We have chosen to respond to questions 1-7, 11 and 13, as set out in the committee's call for written evidence.

Question 1

You asked: The aims of the Scotland Bill and the White Paper (*Strengthening Scotland's Future)* are that it will —enhance the financial accountability of the Parliament and Government in Scotland, improve working arrangements between Westminster and Holyrood Parliaments and Governments, and extend the powers and functions of the Scottish Parliament and the Scottish Government. In your view, do the proposals in the Bill and the White Paper achieve these purposes?

In our view, the work of the Calman Commission and the publication of **Strengthening Scotland's Future** are the first steps of a long journey which could lead to enhanced financial accountability of the Parliament and Government in Scotland.

However, as the proposals stand, tax-raising powers would be, in our view, too limited.

The Scottish Government would need the power to potentially vary **all** taxes to enable it to cater for varying economic circumstances. For example, if the revenue from Income Tax was less than forecast, there is little Holyrood would be able to do to compensate. Only with full fiscal independence could other taxes be varied to compensate.

For example, under the Scotland Bill as currently proposed, the Scottish Government would be unable to vary the tax base, change personal allowances or tax bands, vary Corporation Tax, or alter National Insurance – giving it no ability to compensate for fluctuations in the economy, nor provide any direction on overall fiscal policy.

This could be likened to Scotland being given its own car, receiving a brake and accelerator but no steering wheel.

Question 2

You asked:
What is your view on the approach proposed in the Scotland Bill to substituting the revenue from taxes levied by the Scottish Parliament for some of the grant from the UK Government which presently supports the Scottish budget?

On the face of it, since the amount of devolved tax revenues will be exactly equal to the amount by which the grant is reduced, this appears to be a fair arrangement, allowing the Scottish Government planning opportunities to stimulate the economy by varying this rate, which is the task facing any Chancellor in using the tax lever to boost the economy.

However, as highlighted in our answer to question 1 above, should economic circumstances vary there is no scope for making good a shortfall.

In our view, the UK Government would potentially benefit more than Scotland by growth stimulated in this way.

For example, if the Scottish rate was set at 9% in place of the 10% taken off the 'federal' Income Tax rate, 11.1% growth in Scottish employees' total taxable income and self-employed profits would be required just to replace the lost revenue.

If the total basic rate Income Tax paid in Scotland was £6 billion and tax rates were left as they are this will be shared equally between Holyrood and Westminster (i.e. they get 10% each out of the current 20% basic rate).

If we assume the Scottish rate at 9% and the taxable income and profits grow by 5%, the Scottish Government would receive £2,835 million – down by £165 million, while the UK Government Westminster would receive £3,150 million – up by £150 million.

Furthermore, this example only takes into account basic rate Income Tax – the UK Government would also receive the benefits of increased higher rate and 'super tax' Income Tax, increased National Insurance and increased Corporation Tax.

Question 3

You asked:
What is your view of the proposal in the Scotland Bill for a Scottish rate of income tax levied on all income tax bands, and the reduction of UK income tax in Scotland by 10p in the pound accordingly? How would this work, are the proposals effective and are the proposed inter- Governmental mechanisms adequate?

As the first step on the route to financial accountability, **Strengthening Scotland's Future** starts the journey. However, in terms of being an effective stimulus for the Scottish Economy, we have reservations as outlined above.

If the intention of the Scotland Bill is to seek an effective devolved Government, these proposals fall short, as they have no effective ability to set an independent fiscal policy.

The Scottish Government would need powers to vary personal allowances and tax bands (e.g. to increase or reduce the basic rate band) and control over other key taxes including Corporation Tax and National Insurance to allow enhanced financial accountability to the people of Scotland.

Question 4

You asked:
How would the framework have performed over the recent downturn, particularly in the light of the significant shocks to tax revenues? Is the system robust to cope with such challenging periods and return Scotland to economic growth – if not, what frameworks are in place to address this?

Since the tax band is directed at only individual earnings, employed and self-employed, the former affected by unemployment levels, the latter more directly affected by the economic downturn, the framework would have failed in the recent downturn. It is inadequate for coping with major economic fluctuations.

No tax framework seeking to raise revenues is able react as quickly as the recent economy changed. The only redress to a sharp decline in tax revenues would be a retrospective increase in tax rates, which is unprecedented in European fiscal history and would, in any event, prove likely to be a further dampener on economic recovery.

Question 5

You asked:
What is your opinion of the proposals to create devolved taxes, Stamp Duty Land Tax and Landfill Tax, and the power to create new devolved taxes?

These are modest measures which nevertheless give the Scottish Government some opportunities for affecting behavior in areas such as waste disposal.

As for new devolved taxes, this power is of limited use if the Scottish Government is unable to vary other taxes to positively affect business decision-making. If Scotland can only introduce new taxes without reducing existing taxes such as Corporation Tax and National Insurance, it can only lead to higher taxation in Scotland than the rest of the UK. This situation is unlikely to be beneficial for the economy and should be avoided.

Question 6

You asked:
Do you have a view on the proposed new borrowing powers set out in the Scotland Bill?

We have questions and concerns over the proposed new borrowing powers.

Prudent financial management would be crucial in balancing repayment requirements – we must remember that spending in one year has to be balanced out with reductions in subsequent years.

For significant capital projects, potentially the maximum sums to be borrowed in the Scotland Bill could be inadequate.

ICAEW Scotland contributed to a Finance Committee inquiry into the funding of capital investment projects in 2007, as well as, in 2008, to a Scottish Government consultation on the role of the Scottish Futures Trust. In these two documents we outline advantages and disadvantages of the PFI approach to funding as well as the potential of using the Scottish Futures Trust to depoliticise funding decisions and make use of the very best finance experts and advice available with the aim of achieving best value for all of Scotland’s capital investment projects. The issues discussed in our responses to these consultations, and those of other respondents, could be of relevance when considering the borrowing arrangements set out in the Scotland Bill.

Question 7

You asked: What is your assessment of the plans for the implementation of this new financial system and the risks and costs associated with that and have the UK Government adequately quantified these? How would the proposals to revise the system of funding work in practice? Is there sufficient information provided yet to enable a full assessment of the proposed funding arrangements? What key decisions remain to be taken?

With increased fiscal responsibility comes increased financial risk. There is no way of avoiding the risk. An important lesson learnt from recent years would be to control spending when the tax revenues unexpectedly increase, so that correcting expenditure when they decrease would be manageable by the Scottish Government.

Another potential issue is in the timing between when the Block Grant payment is made and tax revenues are calculated. With the volatile characteristics of our economy, this timing gap could cause shortfalls and budgeting problems for the Scottish Government.

There is a long way to go on these issues. We do not feel there is yet enough information and practical detail in the proposals and the publication of the Scotland Bill should be the start of a much more detailed inquiry and process. In terms of forecasting tax 'takes', we know that the information process is not yet in place, however the plans to involve the independent Office for Budget Responsibility in forecasting as early as next year seem well-founded.

In our view, the key decision yet to be made will be whether the Scottish Government has an appetite to take on an element of potential fiscal stimulation within its powers countered by the potential risk of revenues falling and its potential inability to counter this, as outlined in our answers to the questions above.

Obviously, every Government has to deal with unexpected fluctuations in its tax revenues but, in our view, the Scotland Bill does not provide the powers needed to combat these problems – specifically, the borrowing powers are inadequate and the tax-raising powers are too restricted.

Question 11

You asked:
Do you have an opinion on the re-reserving of issues such as insolvency, the regulation of health professions etc? Would the proposals be effective in their intentions, what would be the consequences and could they be adjusted to improve their effects?

In terms of the re-reserving of insolvency, we agree with recommendation 5.23 of the Scotland Bill. Standardisation of treatment for all businesses in UK will add certainty for suppliers and employees. We see no merit in parallel sets of regulations.

Question 13

You asked:
What further changes to the powers for the Scottish Parliament not currently in the Scotland Bill would, in your view, further help to achieve the purposes of the Bill and should be considered by the UK Government for inclusion?

As we've stated in our answers above, we feel that the proposals set out in the Scotland Bill should be reconsidered in terms of both tax-raising and borrowing powers. Proper financial accountability in Scotland cannot be achieved without increasing both the tax and borrowing powers available to the Scottish Government. Ideally, further financial powers would also allow Scotland to benefit from current and future taxation of its national resources including oil, gas and renewable energy.