



House of Commons  
Scottish Affairs Committee

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# The Scotland Bill

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Fourth Report of Session 2010–11

## *Volume I*

*Report, together with formal minutes*

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## The Scottish Affairs Committee

The Scottish Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Scotland Office (including (i) relations with the Scottish Parliament and (ii) administration and expenditure of the offices of the Advocate General for Scotland (but excluding individual cases and advice given within government by the Advocate General)).

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The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at [www.parliament.uk/scotaffcom](http://www.parliament.uk/scotaffcom).

### Committee staff

The current staff of the Committee are Dr Rebecca Davies (Clerk), Duma Langton (Inquiry Manager), James Bowman (Senior Committee Assistant), Gabrielle Henderson (Committee Assistant), Karen Watling (Committee Assistant) and Ravi Abhayaratne (Committee Support Assistant)

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## Summary

On 30 November 2010, the Government introduced the Scotland Bill in the House of Commons, and published an accompanying Command Paper, *Strengthening Scotland's Future*.<sup>1</sup> We focused our scrutiny on the Government's financial provisions.

### Support

We support the provisions of the Scotland Bill, while believing that there is some work to be done in particular areas.

### Transparency

We believe there is a need for transparency of figures used to calculate all parts of the financial arrangements in the Scotland Bill, not only to diminish the scope for manufactured grievance but also to enhance decision making. We want to keep this area under review and want regular reports to this Committee on the progress being made on opening up figures for scrutiny.

### Evolution

The constitution of the UK continues to evolve, as does devolution. However, an overemphasis on the formal division of responsibilities has diverted attention away from the need for co-operative working and for the best use to be made of powers already devolved. We believe that this is an area that requires further examination and we intend to evaluate the progress made in various policy areas, comparing devolved Scotland to other jurisdictions. As part of an evolving constitution we also see further decentralisation of both reserved and devolved powers to be both popular and desirable. Progress should not be measured solely by the extent by which powers are sucked into Edinburgh and we will wish to look at how reserved responsibilities can be exercised closer to the people they serve.

### Money

We recognise that, since devolution, the Scottish Parliament has had virtually complete discretion over how to spend an enormously increased resource budget up from £13.2 billion in 1999-00 to £24.1 billion in 2008-09.<sup>2</sup> It is not clear that an ever larger flow of free money has resulted in better or more efficient spending since there has been little pressure to pursue either objective. The transfer of responsibility for raising part of the money that is spent, particularly in a time of economic difficulty following the collapse of major Scottish banks, is intended to help the maturation of the Scottish Parliament and to enhance the level of political discourse in Scotland.

As pointed out elsewhere, we are supportive of the Government's position in relation to the

1 Bill 115 2010-11 and CM 7973

2 Scotland Office and Office of the Advocate General for Scotland, Annual Report 2005, Annex 1; Scotland Office Tables 2009-10, Annex 1, Departmental Expenditure Limit – Scotland Office and Scottish Government

taxation powers to be devolved. We find particularly exciting the capacity to develop new taxes, which, when taken together with the advice we received about the attraction of taxes on non-mobile assets, particularly land, opens up an avenue for our colleagues in the Scottish Parliament to undertake interesting work.

#### Powers

Those who, as a matter of principle, wish the Scottish Parliament to have more powers usually find an argument to suit. This debate has been no exception and some attention has focused on the need for more powers to influence economic development. We have been struck, during our oral evidence sessions, by the strength of the consensus that it is the use made of powers, rather than the holding of powers themselves, that makes the difference. We have not been convinced that the Scottish Government is making the best use of the powers it has available at present. In particular we are concerned by the points raised by employers about the lack of readiness for the world of work shown by many, predominately young, Scots.

#### Responsibility

There is a strong element of both a grievance and a dependency culture in Scottish politics. This package of measures, taken together, give the Scottish Parliament greater ability to make their own decisions and be judged by them, while at the same time providing a secure economic and social framework within which Scotland and its people can thrive.

#### Scrutiny

As many of the measures proposed in the Bill and *Strengthening Scotland's Future* will require considerable preparatory work, we see merit in continuing our scrutiny as the proposals are implemented. In particular, we will closely monitor the roles of the UK Government, HMRC and the Office for Budget Responsibility.

# 1 Introduction

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1. On 30 November 2010, the Government introduced the Scotland Bill in the House of Commons, and published an accompanying Command Paper, *Strengthening Scotland's Future*.<sup>3</sup> The Bill and Command Paper set out the Government's proposals for implementation of the findings of the *Commission on Scottish Devolution (the Calman Commission)*, which published its Report in June 2009.<sup>4</sup> The Bill received its Second Reading in the House of Commons on 28 January 2011, and its Committee stage was taken on the floor of the House on 7, 14 and 15 of March 2011.<sup>5</sup>

2. Our predecessor Committee published its Report on the *Commission on Scottish Devolution* on 3 March 2010.<sup>6</sup> That Report focused on the Calman Commission's recommendations concerning relations between the House of Commons and the Scottish Parliament. We endorse the findings of our predecessor Committee. The findings of the Calman Commission, and other issues relating to the devolution settlement in Scotland, were also the subject of parliamentary scrutiny by other Committees in the previous Parliament. For example, the House of Commons Justice Committee published its Report *Devolution: a decade on*, in May 2009.<sup>7</sup> The House of Lords Select Committee on the Barnett Formula published its Report in July 2009.<sup>8</sup>

## Our Inquiry

3. We launched our inquiry on 6 January 2011, with a view to publishing our Report in time for the Third Reading of the Bill. The purpose of our inquiry was to specifically examine the provisions and proposals set out in the Scotland Bill and the Command Paper, and to consider how those proposals sought to implement the recommendations of the Calman Commission. We sought evidence on the following questions:

- Which of the recommendations of the Calman Commission on Scottish Devolution are not implemented by the Bill, and why?
- What provisions are made in the Bill, which were not recommended or considered by the Commission on Scottish Devolution?
- What are the fiscal and financial implications of the provisions in the Bill for Scotland?
- What further provisions could/should be included in the Bill in order to further amend and develop the Scotland Act 1998?

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3 Bill 115 2010-11 and CM 7973

4 Commission on Scottish Devolution, *Serving Scotland Better: Scotland and the United Kingdom in the 21<sup>st</sup> century*. June 2009

5 HC Deb 27 January 2011, col 467; HC Deb 7 March col 665; HC Deb 14 March, col 49; HC Deb 15 March, col 169

6 Scottish Affairs Committee, *Commission on Scottish Devolution*, Third Report of Session 2009-10, HC 255

7 Justice Committee, *Devolution: a decade on*, Fifth Report of Session 2008-09, HC 529. 24 May 2009

8 House of Lord Select Committee on the Barnett Formula, *First Report*, Session 2008-09, HL 139. 17 July 2009

4. We took oral evidence from a number of academics, journalists, economists and voluntary sector and trade union representatives. We also heard evidence from Sir Kenneth Calman, the Chairman of the Commission on Scottish Devolution, Fiona Hyslop MSP, Minister for Culture and External Affairs, Scottish Government,<sup>9</sup> from Rt Hon Michael Moore MP, Secretary of State for Scotland, and Rt Hon David Mundell MP, Parliamentary Under-Secretary of State for Scotland. A full list of witnesses is attached at the end of this Report. We met with Members of the Scottish Parliament Committee on the Bill in order to discuss the conclusions of its Report, published on 3 March 2011.<sup>10</sup> We received a wide range of written evidence, a full list of which is attached to this Report. We would like to thank all of those who assisted us with our inquiries, including the House of Commons Scrutiny Unit and the House of Commons Library.

5. The main focus of our scrutiny has been on the financial and fiscal provisions of the Bill, for a number of reasons. First, as noted above, much of the subject matter of the Bill has already been the focus of detailed parliamentary scrutiny, including by our own predecessor Committee. Second, the Government considers the financial provisions to be the most important component of its proposals. The Scotland Office noted that of the areas covered in the Bill, “the most significant are the proposals to devolve a number of tax powers and to increase the financial accountability of the Scottish Parliament”.<sup>11</sup> In focusing our scrutiny in this area, we sought to evaluate the Government’s proposals on the basis of the Government stated aim for the Bill—of increasing the financial accountability of the Scottish Parliament.

6. While some of the Government’s proposals are included in the Bill, many of the fiscal proposals do not require legislation, and are set out in the Command Paper, *Strengthening Scotland’s Future*. While we make some recommendations in relation to amendments required on the face of the Bill, most of our recommendations are focused on improving the implementation of the proposals, should the Bill be enacted. We reserve our comments to the more controversial aspects of the proposals and seek to identify mechanisms to improve the deliverability and workability of the proposals, in particular in the areas of cooperation and transparency, in order to strengthen the devolution settlement for the benefit of the people of Scotland.

## The purpose of the Bill

7. Two important principles have underpinned our scrutiny of this Bill. First, the late John Smith, former leader of the Labour Party, once described devolution as “the settled will” of the Scottish people. The former Secretary of State for Wales, Ron Davies, also described devolution as “a process not an event”.<sup>12</sup> While the present Scottish Government—as a matter of principle—opposes reservation of responsibilities currently within the competence of the Scottish Parliament,<sup>13</sup> we believe this view is over simplistic. **We believe**

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9 The formal term at the time of writing is “Scottish Executive,” but the Bill would formalise the common usage of referring to the Executive as the “Scottish Government”.

10 Scotland Bill Committee, *Report on the Scotland Bill and relevant legislative consent memoranda*, SP Paper 608, Session 3, 2011, available at [www.scotland.gov.uk](http://www.scotland.gov.uk)

11 Ev 14

12 Ron Davies, *Devolution: A process not an Event*, Cardiff, Institute of Welsh Affairs, 1999.

13 Q 694



that the evolution of the constitution is a process which requires powers to move in whichever direction is in the interest of the people and their better governance. We therefore see devolution as a multi-directional process, with powers moving in different ways. This process should lead to further decentralisation within Scotland, to local authorities and communities, and not simply to a gathering in of authority in Edinburgh. We note that many of our witnesses identified this Bill as a step, rather than an end point. We agree with this view and believe that further changes should be based on experience.

8. Second, the main focus of criticism of the Bill has been from those who see the Bill as a missed opportunity to provide the Scottish Parliament with levers for economic growth. However, we believe this criticism is based on a deliberate misunderstanding of the purposes and objectives of the Bill. The Scottish Parliament Committee on the Bill noted that the Scotland Bill was about “good government [...] intended to improve how Scotland is governed and align decisions on spending and taxation more closely so that the Scottish Parliament will be more accountable, and, in the long run, take better decisions”.<sup>14</sup>

9. Rt Hon Michael Moore MP, Secretary of State for Scotland said:

Primarily, this is a constitutional Bill. It’s about giving the Scottish Parliament more accountability, ensuring that we tweak the balance of devolved and reserved powers, and improving some of the procedural aspects of Parliament and of inter-parliamentary and intergovernmental relations.<sup>15</sup>

10. The implementation of the proposals and the enactment of legislation will impact on the daily reality of the lives of the people of Scotland. It is important therefore, that the Government get this right. Professor Jim Gallagher, Secretary to the Calman Commission and former Director General for Devolution, UK Government, noted that: “constitutions are a framework within which governments operate. This is seeking to create the right framework, with proper incentives, including financial incentives, within which the Scottish Parliament—the Scottish Government—working with other institutions in the UK, can do the best it can for the Scottish people”.<sup>16</sup> **We welcome the opportunity afforded by the Scotland Bill and *Strengthening Scotland’s Future* to improve the constitutional framework within which devolution operates in Scotland. We particularly welcome the Government’s stated aim of improving the accountability of the Scottish Parliament, which we believe will be to the benefit of the people of Scotland.**

## Timing and process

11. The Secretary of State for Scotland told us that his intention from the outset was to secure Third Reading of the Bill in this House, “before the Scottish Parliament went into its election dissolution period so that the electorate and the parties in Scotland had a strong indication of where the Bill was headed and to demonstrate that it had secured

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14 Scotland Bill Committee, SP Paper 608, para 39

15 Q 595

16 Q 51

parliamentary support”.<sup>17</sup> He emphasised the delicate nature of the timing, “if not choreography” of the process.<sup>18</sup>

12. This choreography was necessary because the Bill is subject to the Sewel Convention, which states the Government’s expectation that the UK Parliament will not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament.<sup>19</sup> However, since “the United Kingdom Parliament retains authority to legislate on any issue, whether devolved or not [and] it is ultimately for Parliament to decide what use to make of that power”.<sup>20</sup> A more precise articulation might be that the UK Government would not normally invite the UK Parliament to legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament.<sup>21</sup> The present position was made clear by the Secretary of State when he said that:

ultimately, we are responsible and accountable for taking the legislation through. We have not offered a guarantee that we will change everything in our Bill and in the processes attached to it—in the Command Paper—as a result of this process. What we’ve undertaken to do is reflect very carefully indeed.<sup>22</sup>

13. The Scotland Bill was debated in the Scottish Parliament on 9 December 2010, when the majority of the Parliament voted in support of the general principles of the Bill.<sup>23</sup> A Committee of the Scottish Parliament was established in order to scrutinise the provisions in the Bill more closely. Its work has overlapped with our scrutiny of the Bill. As noted above, the Committee, under the convenorship of Wendy Alexander MSP, published its Report on the Bill on 3 March 2011. While the Committee recommended that the Scottish Parliament should support the Scotland Bill, it also identified a “number of areas” where changes to the Bill and associated policy were needed. It therefore recommended that a further Legislative Consent Motion (LCM) would be required during the next session of the Scottish Parliament to consider the amendments to the Bill before it receives Royal Assent.<sup>24</sup>

14. The Scottish Parliament Committee’s Report and the draft Legislative Consent Motion was debated in a plenary session of the Scottish Parliament on Thursday 10 March 2011.<sup>25</sup> The Motion was as follows:

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17 Q 561. The Scottish Parliament will be dissolved on 23 March 2011

18 Ibid

19 Further detail on the Sewel Convention is available in House of Commons Library Standard Note 2084, *The “Sewel Convention”*, 25 November 2005, in the *Memorandum of Understanding and Supplementary Agreements between the United Kingdom Government, the Scottish Ministers, the Welsh Ministers, and the Northern Ireland Executive Committee*, Cm 7864, March 2010, and in *Devolution Guidance Note 10*.

20 *Memorandum of Understanding and Supplementary Agreements between the United Kingdom Government, the Scottish Ministers, the Welsh Ministers, and the Northern Ireland Executive Committee*, Cm 7864, March 2010, para 14.

21 Cabinet Office, *The Cabinet Manual – Draft*, December 2010, para 286, p 101. See also House of Commons Library Paper, *Scotland Bill*, Research Paper 11/06, 18 January 2011, p 9

22 Q 655

23 Minutes of Proceedings of the Scottish Parliament, 9 December 2010, vol 4, no 40, session 3.

24 Scotland Bill Committee, *Report on the Scotland Bill and relevant legislative consent memoranda*, SP Paper 608, Session 3, 2011, paras 4 and 5

25 The motion was passed by 121 votes to 3.

That the Parliament agrees that, further to motion S3M-7550 passed on 9 December 2010 supporting the general principles of the Scotland Bill as introduced in the House of Commons on 30 November 2010, the Bill be considered by the UK Parliament; invites the UK Government and the UK Parliament to consider the amendments and proposals made in the report of the Scotland Bill Committee, and looks forward to considering any amendments made to the Bill with a view to debating them in a further legislative consent motion before the Bill is passed for Royal Assent.<sup>26</sup>

15. Fiona Hyslop MSP, Minister for Culture and External Affairs, Scottish Government, identified the fact that the first day of the Committee stage of the Bill took place before the Scottish Parliament was able to debate the Scottish Parliament Committee's Report and its proposed Legislative Consent Motion on the Bill, as an issue of "real concern". She explained that this time scale had not allowed the Scottish Parliament to indicate its consent before the amendments "on the non-financial aspects will be tabled, debated and voted on".<sup>27</sup> Mr Moore said there should be an opportunity, after the LCM has been passed in the Scottish Parliament, "to get an amending stage here in this House", and that the Government would therefore "certainly satisfy that [the Sewel] principle".<sup>28</sup> Ms Hyslop indicated that it would be very helpful if there were an opportunity for issues of real concern to be considered by the Scottish Parliament "after the House of Commons Committee stage".<sup>29</sup>

**16. We agree that the UK Parliament should respect the well established principle that it should not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament. We appreciate the delicate choreography performed by the Scotland Office in seeking to bring forward a timetable which sought to balance the right of the Scottish Parliament to scrutinise the legislation, while at the same time allowing the House of Commons to complete its stages before the Scottish Parliament elections.**

**17. While we regret that the first day of Committee stage in this House took place before the Scottish Parliament debate on its Legislative Consent Motion, we welcome the fact that the Scottish Parliament indicated its consent before the second and third days of Committee stage.**

**18. We note that the Scottish Parliament Committee on the Bill recommended some significant amendments to the Bill. We also note the amendments made to the Bill during its Committee stage in this House. We have some sympathy therefore with the Scottish Parliament Committee's view that a further Legislative Consent Motion would be required in the next session of the Scottish Parliament, in order to consider the Bill, as amended, before the Bill receives Royal Assent. We believe that it would be appropriate to seek the views of the Scottish Parliament on the final version of the Bill.**

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26 [www.scottish.parliament.uk/apps2/business/orsearch/ReportView.aspx?r=6175&mode=html](http://www.scottish.parliament.uk/apps2/business/orsearch/ReportView.aspx?r=6175&mode=html)

27 Q 684

28 Q 568

29 Q 684

## Other areas for inquiry

### *The Crown Estate in Scotland*

19. During the course of our inquiry, we received a high number of submissions commenting on the proposals in the Bill relating to the Crown Estate Commissioners and the Crown Estate in Scotland.<sup>30</sup> We did not have sufficient time during the course of this inquiry to consider that material in detail. On 16 February 2011, we therefore announced a separate inquiry into the Work of the Crown Estate in Scotland.<sup>31</sup> This was welcomed by the Secretary of State for Scotland, who said that he was “happy to keep the operation of the Crown Estate under active review”,<sup>32</sup> and expressed his “complete and utter” enthusiasm to come back to the issue at a future stage.<sup>33</sup> The Scottish Parliament Committee on the Scotland Bill also welcomed this inquiry as an “important development”.<sup>34</sup>

### *Devolution issues and acts of the Lord Advocate*

20. As the Scottish Parliament Committee noted, during the passage of the Bill, the Advocate General for Scotland brought forward proposals to deal with devolution issues and acts of the Lord Advocate.<sup>35</sup> However, the Scottish Parliament Bill Committee did not feel that there had been adequate time for all interested to scrutinise what was being proposed.<sup>36</sup> It subsequently recommended that following further work on these proposals, the Scottish and UK Governments and Law Officers should report back to the Scottish Parliament in the new session, and that a further Legislative Consent Motion, on this particular issue, be considered then.<sup>37</sup> **We agree with the Scottish Parliament Committee that there has not been sufficient time to adequately scrutinise devolution issues and the acts of the Lord Advocate. We agree that this should be the subject of a further Legislative Consent Motion to be considered by the Scottish Parliament in the new session.**

### *The Electoral System*

21. We also received a submission in relation to the electoral system for the Scottish Parliament. This is an issue to which we may wish to return in due course.

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30 See the list of written submissions received at the end of this Report.

31 Terms of reference for this inquiry will be issued in due course.

32 Q 667

33 Qq 670 and 671

34 Scotland Bill Committee, para 165

35 See Elish Angiolini QC’s evidence to the Scottish Parliament Bill Committee on 8 February, available at [www.scottish.parliament.uk/s3/committees/scotBill/mop-11/sbmop11-0208.htm](http://www.scottish.parliament.uk/s3/committees/scotBill/mop-11/sbmop11-0208.htm)

36 Scotland Bill Committee, para 204

37 Scotland Bill Committee, para 205

## 2 Background

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### Commission on Scottish Devolution

22. The Commission on Scottish Devolution, known as, and hitherto referred to as ‘the Calman Commission’, was set up in 2008 by the UK Government in response to a motion passed by the Scottish Parliament, which called for an independent commission to review devolution in Scotland. This motion was supported by the opposition parties at Holyrood: Labour, the Conservatives and the Liberal Democrats. It was explicitly designed as an attempt to secure the position of Scotland within the UK, and was a counter-proposal to the *National Conversation* established by the SNP Administration, which included consideration of independence for Scotland as a policy option.<sup>38</sup>

23. The terms of reference of the Calman Commission were as follows:

To review the provisions of the Scotland Act 1998 in the light of experience and to recommend any changes to the present constitutional arrangements that would enable the Scottish Parliament to serve the people of Scotland better, that would improve the financial accountability of the Scottish Parliament and that would continue to secure the position of Scotland within the United Kingdom.<sup>39</sup>

24. The Commission published its final report in June 2009.<sup>40</sup> It concluded that devolution had been “a real success” which worked well in practice, and that “the Scottish Parliament had embedded itself in both the constitution of the United Kingdom and the consciousness of Scottish people. It is here to stay”.<sup>41</sup> The report included 63 recommendations on how devolution should be developed, and these were grouped under four headings: i) strengthening devolution, ii) strengthening cooperation, iii) strengthening the Scottish Parliament, and iv) strengthening financial accountability. The central conclusion of the Commission was that while devolution had established a Parliament that could be held to account for spending choices, that Parliament lacked accountability for raising revenue.<sup>42</sup> A series of recommendations were made to address this, including the devolution of a flat rate of income tax and some other smaller taxes.<sup>43</sup>

25. The previous Government welcomed the Calman Commission’s Report and conclusions,<sup>44</sup> and established a steering group, comprising Labour, Conservative and Liberal Democrat representatives, in order to consider the implementation of its recommendations. It published a White Paper, *Scotland’s future in the United Kingdom: building on ten years of Scottish devolution*, on 25 November 2009.<sup>45</sup> This included an

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38 House of Commons Library, *Scotland Bill*, Research Paper 11/06, 18 January 2011

39 HC Deb 25 March 2008, cc7-8WS.

40 Commission on Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21<sup>st</sup> century*, June 2009.

41 Cm 7973, p 5.

42 Ev 14

43 See text box on page 15.

44 HC Deb 15 June 2009, cols 5-7WS

45 Cm 7738

intention to introduce legislation to take forward the proposals, and detailed responses to the Commission's recommendations.

26. The Scottish Government also published a *Scottish Government response to the Commission on Scottish Devolution*, on 9 November 2009. It supported some recommendations of the Commission, rejected others, and felt that many required further consideration.<sup>46</sup> However, it also complained that “the remit of the Commission was too narrow,” so that “from the outset [...] it was clear that the Commission would not be able to consider the proposition that Scotland should be an independent country. Federalism was also outwith the Commission's remit”.<sup>47</sup> While the Scottish Government had reservations about a number of proposals, it was most concerned about the Commission's recommendations on income tax:

In the crucial area of finance and taxation the Commission's report represents a missed opportunity particularly to offer real and effective fiscal and economic levers for Scotland. The Commission's proposals would deliver less transparency, less accountability and would expose the Scottish Government's budget to significant risks without adequate levers to offset these risks.<sup>48</sup>

## The Scotland Bill 2010-11

27. Following the 2010 general election, the new Government immediately committed itself to “implement the proposals of the Calman Commission”,<sup>49</sup> and stated its intention to legislate in this area in the Queen's Speech on 25 May 2010.<sup>50</sup> The Bill was introduced in the Commons on 30 November. At the same time, the Government published a Command Paper, *Strengthening Scotland's Future*, which outlined how each of the recommendations of the Calman Commission would be taken forward.<sup>51</sup> In introducing the Bill, the Secretary of State for Scotland, Rt Hon Michael Moore MP said:

The Scotland Bill demonstrates the determination of the coalition Government to ensure that the Scottish Parliament is empowered to meet the needs of the Scottish people. Both the Bill and the accompanying Command Paper set out the bold reforms the Government are taking to strengthen the Scottish Parliament and the Scottish Government. Once the measures included in the Scotland Bill and this paper are fully implemented, a historic shift in power will have been accomplished. The Scottish Parliament and Scottish Ministers will have more powers, be more accountable, and be able to be more responsive to Scotland's needs within the framework of a strong and stable United Kingdom.<sup>52</sup>

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46 According to Minister for Culture and External Affairs, Fiona Hyslop, “There are 29 recommendations that we accept and a further 20 that either need more clarification or relate to the Parliament.” SP OR 27 May 2010, c26630.

47 *Scottish Government response to the Commission on Scottish Devolution*, 9 November 2009, paras 2-3

48 *Ibid.*, Annex A.

49 HM Government, *The Coalition: our programme for government*, May 2010, p 28

50 HC Deb 25 May 2010, col 32

51 Cm 7973, November 2010.

52 HC Deb 30 November 2010, cc69-71WS.



28. Dave Moxham, Deputy General Secretary, Scottish Trade Union Congress (STUC) said that STUC members broadly supported the Calman recommendations, and that “the Scotland Bill does not do a bad job of attempting to translate that into legislation”.<sup>53</sup> Nevertheless, the Bill does not include all of Calman’s recommendations. Among those left out of the Bill are the recommendations for social security and welfare reform, reform of charities legislation, animal health, the welfare budget and food labelling. As our inquiry has focused on the financial provisions, we did not fully consider the merits or otherwise of the Government’s position on these issues. However, we did receive evidence on these issues, which is published on our website. Furthermore, we raised some of these issues during our oral evidence sessions, and took action on some of these issues. For example, we asked David Mundell MP, Parliamentary Under Secretary of State, to meet with the Scottish Federation of Housing Associations (SFHA) in order to discuss, and consider their specific concerns in relation to the provisions relating to insolvency. The Minister met with them on 24 February, and his feedback to us is printed with this Report.<sup>54</sup>

### The Scottish Government’s response

29. While we understand that the Scottish Government’s proposals have not been supported beyond a single political party and are not representative of the views of the Scottish Parliament as a whole, we nevertheless feel that we should pay some attention to these views. Fiona Hyslop MSP, Minister for Culture and External Affairs, Scottish Government, said that the Scottish Government “welcomed the transfer of power within the Scotland Bill”, but had “obvious concerns” in relation to some aspects of the Bill.<sup>55</sup> She said:

The Bill, as it stands, takes away more powers from the Scottish Parliament than it gives. The power that it gives is on airguns, but it reserves three others—so for one power given, three are taken away.<sup>56</sup>

30. In its Legislative Consent Memorandum on the Scotland Bill, published on 1 December 2010, the Scottish Government noted “its regret that the UK Government has not proposed legislative measures to secure some of the recommendations of the Calman Commission, including; to give Parliament a role in benefits policy; to devolve marine nature conservation; to provide a role for Scottish Ministers in directions to the Crown Estate Commission; and to devolve Air Passenger Duty and Aggregates Levy”.<sup>57</sup>

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53 Q 374

54 Ev 139

55 Q 694

56 Q 695

57 Scottish Government *Legislative Consent Memorandum on the Scotland Bill*, LCM (S3)30.1, 1 December 2010, p 6

## 3 Financial provisions

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### The current situation

31. The Scotland Act 1998 gave the Scottish Parliament some limited tax raising powers—most notably, the power to vary the basic rate of income tax by plus or minus 3 pence in the pound (the Scottish Variable Rate (SVR)). This power has never been used. Indeed we were astonished that it had been allowed to lapse by the present Scottish Government, apparently without the knowledge or consent of the Scottish Parliament. Scottish Ministers set non-domestic rates and can influence council tax.<sup>58</sup> The Scottish Parliament currently raises approximately 15% of its budget.<sup>59</sup>

32. The majority of the Scottish Parliament’s spending is funded by the block grant from the UK Government. The size of the block grant is determined by the non-statutory Barnett Formula. The Scottish Parliament has discretion as to how the grant currently estimated to be about £30 billion annually is spent.<sup>60</sup> The Barnett Formula, devised in the 1970s is an ongoing source of controversy and debate.<sup>61</sup> This is likely to continue, and perhaps intensify, given the recommendations of the House of Lords Committee on the Barnett Formula, the findings of the Holtham Commission, and the current context of ongoing UK Government cuts during the current spending review period.

### Calman’s proposals

33. In line with its terms of reference, the Calman Commission considered the financial arrangements for the funding of devolution in Scotland. It concluded as follows:

the very wide spending powers that the Scottish Parliament has are not matched by its taxation responsibilities. Although the Scottish Parliament controls 60% of identifiable public spending in Scotland, it is responsible in practice for deciding only 10% of the taxation levied in Scotland. Its budget is determined overwhelmingly by the block grant from Westminster. We agree with the judgment expressed in the majority of the evidence received by us that this is not the right balance. It does not allow the Scottish Parliament to be sufficiently financially accountable for its decisions. In particular it does not make it accountable effectively for taking taxation and spending decisions together and, critically, for making the choice at the margin between them.<sup>62</sup>

34. The Calman Commission therefore recommended a set of proposals designed to improve the financial accountability of the Scottish Parliament as set out in the box below.

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58 For more detail, see the House of Commons Library, *Scotland Bill*, Research Paper 11/06, 18 January 2011.

59 Cm 7973, November 2010, p 11

60 For more detail, see the House of Commons Library Paper 11/06.

61 See for example, House of Lords Select Committee on the Barnett Formula, *The Barnett Formula*, First Report of session 2008-09, HL Paper 139, 17 July 2009.

62 Commission on Scottish Devolution, *Final Report*, June 2009, para 2.34.



### *Calman Commission proposals*

A reduction in Scotland of rates of income tax by 10p in the pound with a commensurate cut in the block grant;

Replacement of the Scottish Variable Rate of income tax with a new Scottish rate of income tax. This could be set at 10p to restore the level of funding under the current arrangements. Alternatively it could be set at more or less than 10p and the Scottish Government's budget would be adjusted accordingly. These arrangements would mean that the Scottish Parliament would have to make a decision on tax;

Income tax on savings and distributions should not be devolved but half the yield assigned to Scotland with a corresponding reduction in the block grant;

The structure of income tax, including bands, allowances and thresholds, would remain the responsibility of the UK Parliament;

The following taxes should be devolved to the Scottish Parliament with a corresponding reduction in the block grant:

Aggregates levy

Landfill tax

Air passenger duty

Stamp duty land tax;

The Scottish Parliament should be given the power to legislate for new taxes in Scotland, with the agreement of the UK Parliament;

The Scottish Parliament should be granted additional borrowing powers to manage cash flow and to increase capital investment, subject to limits;

There should be a strengthening of the intergovernmental arrangements for dealing with finance; and,

The changes should be phased in to avoid unexpected variability in Scotland's public finances.<sup>63</sup>

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<sup>63</sup> See Commission on Scottish Devolution, *Final Report, June 2009, para 2.34* and House of Commons Library Paper 11/06, 18 January 2011.

### ***Scotland Bill and Strengthening Scotland's Future***

35. The Government accepted the central conclusion of the Calman Commission, and has repeatedly emphasised that the Bill and Command Paper are designed to address the Scottish Parliament's lack of financial accountability by proposing "the largest transfer of fiscal power from London since the creation of the United Kingdom".<sup>64</sup> The Bill therefore includes financial provisions which are designed to reduce Scotland's dependence on UK tax revenues and which are intended to "incentivise policies aimed at economic development and to increase accountability for spending decisions".<sup>65</sup>

36. The Bill proposes the devolution of some tax and borrowing powers, worth £12 billion, to the Scottish Parliament. It would be given increased income tax powers from 2015, setting a Scottish income tax rate each year which would apply equally to the basic, higher and additional rates. There would be a corresponding cut to the Treasury block grant, currently worth approximately £30 billion a year, as a result. The Bill also gives the Scottish Parliament power to collect "devolved taxes" to create further revenue. Landfill Tax and Stamp Duty Land Tax will be devolved (with a corresponding cut in the block grant), but two other taxes recommend by the Calman Commission—an Aggregates Levy and Aviation Tax—remain reserved, in the short term at least. The Bill does not assign tax receipts from Scottish savings, i.e. the savings of 'Scottish taxpayers'. The Bill will also see the introduction of Scottish Government capital and resource borrowing powers, worth £2.7 billion, for the first time,<sup>66</sup> the resource element of which is intended, primarily, to offset any shortfall that might occur should the revenue from the Scottish rate of income tax and the devolved taxes be less than expected at the transition.<sup>67</sup>

37. The Scotland Office has indicated that the financial changes outlined in the Bill and Command Paper will be: "introduced carefully with transitional arrangements in place to ensure there is no windfall gain or adverse shock to the Scottish budget. This new tax-raising power will be in place in 2016, in time for the Scottish Parliament elected in 2015 to take the first tax decision".<sup>68</sup> The Federation of Small Businesses welcomed this transitional period as a "safeguard in view of such significant changes".<sup>69</sup>

38. The Government has also indicated that the new funding arrangements will require dialogue between the UK and Scottish Governments. It has outlined its intention to establish an Intergovernmental Bilateral Committee on Fiscal Devolution, which will be chaired by the Exchequer Secretary to the Treasury and will also include relevant Scottish Ministers and the Secretary of State for Scotland.<sup>70</sup>

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64 Cm 7973, p 11

65 House of Commons Library Paper 11/06

66 Ibid

67 Ibid

68 Ev 15

69 Ev w22

70 House of Commons Library Paper 11/06, p 23

### *The Barnett Formula*

39. The Government made it clear that while it recognised concerns expressed in relation to the Barnett Formula, it does not have “any plans to change arrangements before the stabilisation of the public finances”.<sup>71</sup> However, Professor Gallagher added that there was nothing in the proposals in the Bill that “obliges you to keep using Barnett in the future”.<sup>72</sup> Sir Kenneth Calman told us that “the Bill makes the assumption that it continues but that there might have to be some change at some point. It seems to me that managing that process, however it is done, is going to be a key part of the next few years, which is why, if the Bill becomes an Act, it is something that needs a bit of time to be thought through”.<sup>73</sup>

### **Income Tax**

40. The main features of the Government’s proposals in relation to income tax are set out below:

#### *Income Tax proposals*

- The Scottish variable rate would be abolished;
- The basic, higher and additional tax rates on income would be reduced by 10p in the £ with a commensurate reduction in the Scottish block grant;
- The Scottish Parliament would be required to pass a resolution by December each year to levy a new Scottish income tax rate;
- The Scottish rate would apply to income from earnings and pensions but not income from savings and dividends;
- The Scottish Parliament would be able to set the Scottish rate in amounts of half pence or whole pence;
- The Scottish rate would apply to every UK resident taxpayer who is defined as a Scottish taxpayer;
- The proposals would be introduced in April 2016 with a transitional period of two to three years;
- The amount paid to the Scottish Government would be based on forecasts prepared by the Office for Budgetary Responsibility with the forecasts being reconciled with actuals up to 12 months after the end of the relevant financial year; and,
- Only HMRC would collect income tax in Scotland.<sup>74</sup>

71 Cm 7973, pp 22-23

72 Q 18

73 Q 17

74 Extract from SPICe – The information centre, *The Scotland Bill 2011-11*, SCO. S3.10.1.6, pp 9-13

41. Under the proposed arrangements, rates of income tax set by the UK Government for Scottish taxpayers would be reduced by 10p in the pound. The Scottish Parliament would then levy a single rate of Scottish income tax which would apply in addition to the UK rate. The Scottish Parliament could choose a 10 pence Scottish rate, which would restore the overall rate of income tax back to the levels in the rest of the UK, or could alternatively choose a rate higher or lower than 10 pence.<sup>75</sup>

42. The Scottish Parliament could only choose a single rate which will be applied to all the UK bands; it would not be able to set a different rate to apply to higher rate taxpayers, for example. All elements of the income tax structure such as thresholds, allowances, and the rates which apply in the rest of the UK remain the responsibility of the UK Government.<sup>76</sup> The Scottish Government has suggested therefore that: “the proposals on income tax do not actually devolve the tax,” as while “the Scottish Parliament has the responsibility to set a tax rate [...] the tax itself, and all its associated elements such as bands and thresholds and the administrative arrangements for collecting it, remain reserved”.<sup>77</sup>

43. Several of our witnesses argued that the tax proposals should go further. Professor Keating, University of Aberdeen, said that he would favour the devolution of the tax bands and rates “for reasons of good governance”. He explained: “I think it is a legitimate decision whether we decide to have a higher or lower marginal rate”.<sup>78</sup> He also argued that this would provide room for pursuing social and economic policy objectives.<sup>79</sup> He concluded that the Bill, in its current form would “contribute only partially to the aims of autonomy, policy innovation and accountability and that the motivation for the new 10p tax power is more the political one of forcing the Scottish Parliament to make an explicit tax decision, than to give it more autonomy”.<sup>80</sup>

44. Mr Alan Trench, Honorary Senior Research Fellow, UCL, noted:

The Bill would make the Scottish Parliament responsible for generating about a third of its own spending from tax revenues [...] Holyrood will have no control over how progressive the tax system is, and will have to accept the tax rates, bands and exemptions that apply at UK level, and simply levy its own single rate of tax on each of those bands[ ...]And as the UK Government will retain control of exemptions and reliefs, Scottish tax revenues will be subject to Westminster control—meaning that when the UK takes decisions to increase the personal allowance to £9,000 or eliminate the 50% top rate, that will affect Scottish revenues [...] The Bill doesn't create a distinct sphere of ‘devolved tax powers’, within which the Scottish Government and Parliament can indeed be held accountable for their decisions.<sup>81</sup>

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75 House of Commons Library Paper, 11/06, p 19

76 House of Commons Library Paper, 11/06, p 20

77 Scottish Government *Legislative Consent Memorandum on the Scotland Bill*, p 25

78 Q 205

79 Ibid

80 Ev 118

81 *Parliamentary Brief*, 18 January 2011. Available at [www.parliamentarybrief.com/](http://www.parliamentarybrief.com/)

45. Professor Anton Muscatelli, Chair of the independent expert group of the Calman Commission, agreed that there should be some discussion around “thresholds and different tax bands and whether this (Bill) is a staging post to a more complex discussion around those issues”.<sup>82</sup> He noted that the recommendations of the Calman Commission could have been “more precise” about the nature of tax devolution, but emphasised that “simplicity was a factor as well”.<sup>83</sup>

46. The Government’s proposals are in line with Calman’s proposals on income tax. Professor Gallagher noted that this model of a shared tax base in relation to income tax was taken from the Canadian experience. He said: “the idea of knocking 10p off the UK tax and allowing the Scottish Parliament to substitute some tax—the so-called notion of tax room—was something that happened in Canada in the 1950s, which gives one reassurance that it might work”.<sup>84</sup> He was subsequently, “strongly of the view” that this “would be the right place for Scotland to start”.<sup>85</sup> The Scottish Parliament Committee on the Bill agreed: “sharing income tax is the most obvious and most appropriate start to give the Scottish Parliament its first significant additional tax powers”.<sup>86</sup>

47. Professor Muscatelli explained that his group had proposed a 10 pence variation across all the bands is because there was an “issue of administrative simplicity”. He added that adding another “level of complexity” would lead to the need for greater co-ordination and greater administrative complexity in terms of applying PAYE.<sup>87</sup>

48. The Secretary of State for Scotland further explained the rationale for this approach:

There are three elements to this. First, this broadly maintains the redistributive nature of the tax system. Our fundamental is that we want to keep the virtues of a unified United Kingdom tax system. We are not going down the road of separate tax systems in Scotland from the rest of the UK—in the main. Clearly, on some of the smaller taxes we will be, but on this main one we will not be. We want to maintain the integrity of the most important tax in the UK. The redistributive element is the first part.

The second part is the volatility issue. In particular, when you look at the additional rate, in times of economic growth especially, it [income tax] will outperform—the yield on it might do better than the yield on the other levels of taxation. The converse is also true: when you get into a period of economic decline or recession, the yield on that [income] tax will decline more quickly. It is inherently more volatile, which increases risk, and we are determined to limit the risk in the process. The third and final part is that it obviously has the merit of simplicity.<sup>88</sup>

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82 Q 236

83 Q 236

84 Q 23

85 Q 23

86 Scotland Bill Committee, para 26

87 Q 203

88 Q 583

The Scottish Parliament Committee on the Bill concluded that while the flat rate structure “should be adopted initially”, this decision should be carefully evaluated “as experience is gained of operating it”.<sup>89</sup>

**49. We welcome the Government’s proposals for the abolition of the Scottish variable rate, and the creation of a new Scottish rate of income tax. We agree that the proposals have the merit of maintaining the integrity of UK income tax, while also allowing the Scottish Parliament to be accountable and responsible for raising some of its own tax revenues.**

**50. We also note the comments of those witnesses who suggested that the accountability of the Scottish Parliament could be further enhanced through the further devolution of tax rates and personal allowances. However, devolution is a process and, on balance, we conclude that the Government’s current proposals are appropriate at this time. We see considerable merit in closely monitoring and evaluating the implementation of these proposals before there should be any consideration or discussion of devolving further powers in relation to income tax. This entire process should be as transparent as possible, and we undertake to monitor it closely.**

## Implementation Issues

51. Many witnesses raised concerns about the implementation of the Government’s income tax proposals. These concerns focus on three key issues: i) the definition of a Scottish taxpayer; ii) the operational and administrative capability of HM Revenue and Customs (HM RC) to deliver the Government’s proposed scheme; and, iii) the potential cost and burden of the new scheme for businesses, employers and individuals in Scotland.<sup>90</sup> However, on balance David Moxham, STUC, identified that while there were “likely to be complications” and that this was “likely to be a bumpy process”, he added that the problems were not “so large” as to persuade the STUC that the “devolution of the tax in itself is a bad idea”.<sup>91</sup>

### *Defining a Scottish taxpayer*

52. The Bill provides for the Scottish Parliament to set a Scottish rate of income tax to be charged on all ‘Scottish taxpayers’. To this end, the Bill retains the definition of a Scottish taxpayer established in the *Scotland Act 1998* for the purposes of the ‘Scottish Variable Rate’ (SVR). Individuals resident in the UK for tax purposes will be liable to pay the Scottish rate if they meet one of three tests:

- if they have a “close connection” with Scotland for a given year;
- if they do not have a close connection with any part of the UK but spend “more days of that year in Scotland” than other parts of the UK; or,

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89 Scotland Bill Committee, para 97

90 CIOT press notice, *Scotland Bill: tax experts highlight important technical issues*, 30 November 2010 See also Ev w 35 from the SCDI.

91 Q 381

- if they represent a Scottish constituency in Westminster, Edinburgh or the European Parliament for any part of that year.<sup>92</sup>

53. HMRC stated that the net effect of using this definition was: “that, for the majority of people, which part of the UK they live in will determine whether or not they are a Scottish taxpayer. This means that an individual’s address will normally be a good indicator of whether or not they are a Scottish taxpayer avoiding the need for individuals to fill in complex forms”.<sup>93</sup> However, HMRC went on to acknowledge that “detailed design work” would have to be carried out to deal with “the small number of individuals whose circumstances are less straightforward”.<sup>94</sup> Mr Moore conceded, however, that the Government would have to “make assumptions” about where the tax base is resident.<sup>95</sup>

54. At a roundtable discussion in September 2010, hosted by the Chartered Institute of Taxation, concerns were raised about the practicalities of the test of a Scottish taxpayer. A report of the proceedings noted:

as the definition [of a Scottish taxpayer] currently in the Scotland Act relies on the number of days spent in Scotland in the course of the tax year, the status of a taxable person will not be able to be finalised for any year until he or she has spent the requisite number of days either inside or outside Scotland. Whether an individual should be treated as a Scottish taxpayer can, therefore, change during the year, with consequential complications in the application of PAYE.<sup>96</sup>

55. In its submission to the Scottish Parliament’s Committee on the Bill, the Institute of Chartered Accountants of Scotland (ICAS) noted that the definition of a ‘Scottish taxpayer’ used in the Bill “causes concern for the anomalies it creates”. It cited as an example, the case of an itinerant worker, who:

might have spent 101 days in Scotland, 99 days in England and 165 days working overseas but in such a case he would be UK resident and deemed to be a Scottish taxpayer despite the fact that he has spent the majority of his time outside Scotland. If there is a tax differential introduced the individual affected is not going to think the result either fair or acceptable. There is also concern that ascertaining someone’s whereabouts on a particular day is not only an invasion of their privacy but can be difficult to ascertain. Particularly in the service sector with communication by email and other means, it is often difficult to ascertain the precise location of an individual at a particular time.<sup>97</sup>

56. The Institute continued:

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92 Scotland Bill – Clause 26(3) Section 80D

93 Written evidence from HMRC to the Scotland Bill Committee, para 8

94 Ibid

95 Q 612

96 “Round and round the table”, *Tax Adviser*, November 2010.

97 Written evidence from the ICAS to the Scotland Bill Committee. See [www.icas.org.uk](http://www.icas.org.uk)



The acceptability or otherwise of taxation is a very fragile principle. If the public have a perception, no matter how misconceived that perception might be, that a tax is arbitrary in its application and unfair, that tax will be unpopular.

We understand from discussions with HMRC that they have no intention to introduce a concession to split the fiscal year to deal with movements. This is unacceptable. Unless this is remedied it is likely that unacceptable levels of error will arise from movements in and out of Scotland. Again, the likelihood of errors can be minimised if preparation for the change starts now and an obligation is imposed on people to notify promptly any change in their individual circumstances and change of residence.<sup>98</sup>

57. The Law Society of Scotland shared these concerns and highlighted examples of recent legal cases which indicate that the “residence qualification is not without controversy”.<sup>99</sup> It further noted that the relevant sections in the Bill<sup>100</sup> are “difficult to interpret for those who move between jurisdictions within the United Kingdom inasmuch as they create some uncertainty and potential problems regarding compliance”.<sup>101</sup> It concluded that: “the provisions will need some amendment to deal with changes in residence status of a number of categories of employee, including those working onboard ship, in oil rigs, in the armed forces and who are neither UK resident nor employed by non-UK employers”.<sup>102</sup>

58. The Institute of Chartered Accountants of Scotland recommended that the definition of ‘Scottish taxpayer’ in the Bill be reconsidered, and a statutory definition introduced, which would give greater certainty to all. It noted that this certainty was required in order to keep the costs of compliance as low as possible.<sup>103</sup>

59. However, Sarah Walker, Director PAYE, Self Assessment & NI Contributions, HMRC, told us that the “sort of things” which had been raised around definitions of a Scottish taxpayer were “things we can very easily address together with the representative bodies”.<sup>104</sup> She added that, despite the suggestions to the contrary, HMRC was “not expecting a lot of difficult cases”,<sup>105</sup> and that she did not think there were “loopholes”.<sup>106</sup>

**60. We note the concerns expressed to us in relation to the anomalies and difficulties which occur in defining a Scottish taxpayer. We welcome the reassurances of HMRC that these issues will be addressed. We also welcome the assurances given by the Government during Committee stage, that it will bring forward an amendment to address issues around the definition of a Scottish taxpayer, on Report. HMRC will need to undertake detailed design and implementation work in order to minimise costly**

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98 Written evidence from the Institute of Chartered Accountants of Scotland to the Scotland Bill Committee. See also HC Deb 27 January 2011 c495, c550.

99 Ev w10

100 New Section 80D, 80E and 80F

101 Ev w10

102 Ev w10

103 Ev w28

104 Q 242

105 Q 251

106 Q 256



delays and the potential for legal proceedings in relation to the definition of a Scottish taxpayer. We will seek regular detailed reports from HMRC to this effect, and will monitor its progress very closely.

61. We recognise that there will always be a minority who wish to evade, avoid or escape their tax responsibilities. Their existence is not sufficient reason to abandon this welcome change in the administration of tax.

### **HMRC – systems and resources**

62. A second area of concern related to the ability and capacity of HMRC to deliver the new system. Sarah Walker, told us however, that the proposals were “doable”.<sup>107</sup> She explained:

The basic design of the income tax<sup>108</sup> is based on the Scottish variable rate which has been in place since the relevant legislation was passed in 1998. That is built into our systems and built into employers’ systems. The differences are clearly that the new Scottish tax will apply to all the rates of income tax rather than just the basic rate and that a portion of the revenue from each of those rates will be attributed to Scotland, but that does not affect the mechanics of how it will work for employers. The other thing to say is that the expected date for implementation is 2016, which gives us five years from now to get all the arrangements in place, which is giving us plenty of time to do it. We are not going to be rushed. We are confident that we will be able to deliver.<sup>109</sup>

63. However, on 1 February, the Public Accounts Committee (PAC) published its Report *HM Revenue and Customs’ 2009-10 Accounts*.<sup>110</sup> This Report further fuelled our concerns in relation to HMRC’s capacity to deliver. The Report identified that the implementation of the New National Insurance and PAYE Service in 2009 was “flawed”, resulting in “lasting and costly losses for the Department” and causing “unacceptable uncertainty and inconvenience to the taxpayer”.<sup>111</sup>

64. While she was not in a position to comment in detail on the PAC Report, Sarah Walker agreed that HMRC had a “lesson to learn from that”. She sought to address our concerns and said that the “changes that we need to put in to implement the Scottish tax are of a much smaller magnitude than the wholesale reform on PAYE”.<sup>112</sup> She continued: “the only thing I can add in terms of assurances is that we did give the Scottish Government an indication that we would be able to run the Scottish variable rate with effect from 2013 if they wanted to operate it”.<sup>113</sup> She went on to say “that is the vast majority of the IT change that we would need in order to operate the Scottish income tax, which we are aiming

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107 Q 239

108 Scottish Rate of Income Tax

109 Q 239

110 Eighteenth Report of Session 2010-11, HC 502

111 Ibid

112 Q 263

113 Q 265

another three years beyond that to do. On that basis, if we could do most of it in two years' time but we actually have five years to do it, it seems to me a reasonable expectation that we will be able to deliver it".<sup>114</sup> The Secretary of State for Scotland added that the Government would be appointing an additional accounting officer within HMRC with specific responsibilities, who would be "absolutely named and nailed as responsible for the collection of the Scottish rate of income tax".<sup>115</sup>

65. It was also noted that a number of HMRC staff would be working on Scottish income tax. Sarah Walker said that it was too soon to say where they would be based, but as "we have call centres in Scotland. It might well make sense for those jobs to be in Scotland, but I cannot say".<sup>116</sup> Mr Moore identified these as "operational matters for HMRC" but that he was "reasonably confident" that there would be additional roles for people in Scotland as a result.<sup>117</sup>

### **Impact on business**

66. The Federation of Small Businesses noted the potential impact of the new income tax scheme on businesses in Scotland. It noted that this would have "implications on a far greater number of businesses than might originally have been envisaged, as more businesses will be required to navigate different tax codes and accompanying processes (costs of software updates etc). We are also concerned that the burden of identification may be shifted from HMRC to businesses".<sup>118</sup> The Scottish Retail Consortium also pointed out that: "retailers' operating systems (in common with other Scottish employers) will have to be modified to administer the changes, imposing IT, legal, administrative and training requirements. This could place considerable burden on head office personnel, especially at the point of first introduction, handling different taxation regimes once this is implemented".<sup>119</sup>

67. The Low Income Tax Reform Group also identified concern that any mistakes or incorrect coding would have a disproportionate effect on those with low incomes,<sup>120</sup> particularly in relation the link between tax and benefits entitlements.<sup>121</sup>

**68. HMRC must get the new Scottish tax system right. There is no room for error or delay. If the definition of a Scottish taxpayer is unclear or inadequate, the burden of identification could fall on small businesses, employers and individuals. This would be unacceptable.**

**69. Furthermore, the potential impact for small businesses and individuals in Scotland of any delay or error should not be underestimated, as it would result in an additional**

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114 Q 265

115 Q 587

116 Q 278

117 Q 651

118 Ev w22

119 Ev w31

120 Ev w25

121 Ev w27

economic and administrative burden for business. We seek further assurance from both the Government and HMRC that the cost of design and implementation of new payroll systems will be fully met by HMRC and will not be passed on.

70. We recommend that HMRC work closely with business groups in designing and implementing systems and software which is straightforward and easy to use. HMRC should also issue clear and detailed guidance for employers in a timely fashion.

71. We recognise that the new Scottish tax system will involve an additional burden for businesses throughout the UK, the scale of which is as yet unknown. We ask the Government to clarify the scale of this burden, and the level of responsibility which will fall on employers.

### **Implementation costs**

72. The Impact Assessment accompanying the Scotland Bill gives an estimate of the annual costs of setting up the new Scotland Tax as £45 million, with an annual running cost of £4.2 million.<sup>122</sup> However, the Explanatory Notes to the Bill also state that “[as the] ultimate compliance and administrative costs depend either on approaches to a number of areas currently under discussion [...] it is not possible to provide detailed costings at this stage”.<sup>123</sup> Sarah Walker said that HMRC had “reasonable confidence” that the £45 million quoted in the Impact Assessment was a “good” estimate of the cost.<sup>124</sup> She explained that this estimate covered the period between “now and 2016”.<sup>125</sup> She explained that of the £45 million, “roughly £10 million is IT costs, computers costs and the remainder is the administration of setting the thing up”.<sup>126</sup>

73. Several organisations have suggested, however, that this is an underestimate of the cost. Sarah Walker said that she did not recognise the figure of £150 million quoted by the Institute of Chartered Accountants of Scotland, and could not “see any obvious way” in which figures could escalate to this degree. She said that the costs were unlikely to “go up hugely unless the system becomes much more complicated”.<sup>127</sup> However, the Secretary of State for Scotland emphasised that £45 million was a “provisional estimate in the regulatory impact assessment”, and wished to “strongly highlight the provisional nature” of that estimate.<sup>128</sup> He concluded:

A number of factors will come into play on that cost, but one of the critical ones will be what the Scottish Government decide they want on P60 documentation and other things. Until we know what the Scottish Government of the day think is the

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122 Scotland Office, *Impact Assessment of the Scotland Bill*, 30 November 2010

123 Bill 115 2010-11, Explanatory Notes

124 Q 260

125 Q 247

126 Q 247

127 Q 260

128 Q 614

appropriate information that they need from the system, the costs, I'm afraid, cannot be finalised.<sup>129</sup>

74. In relation to who pays for the HMRC costs, the UK Government has outlined that: “it is an established principle that the costs of devolution will be borne by the Scottish budget”.<sup>130</sup> However, the Scottish Government suggested that the administrative costs of the new tax system should fall on the UK Government, rather than on the Scottish budget, as proposed.<sup>131</sup> It cites paragraph 3.2.8 of the *Statement on Funding Policy*, which governs intergovernmental finance:

[...] where decisions taken by any of the devolved administrations or bodies under their jurisdiction have financial implications for departments or agencies of the United Kingdom Government or, alternatively, decisions of United Kingdom departments or agencies lead to additional costs for any of the devolved administrations, where other arrangements do not exist automatically to adjust for such extra costs, the body whose decision leads to the additional cost will meet that cost.

The Scottish Government believes that the decision of the UK Government to introduce changes to the system of funding devolved matters in Scotland would lead to additional costs falling on the Scottish Government, and consequently—consistent with the Statement of Funding Policy—these additional costs should be met by the UK Government.

75. The UK Government has cited paragraph 3.2.6 of the *Statement of Funding Policy* in support of its view:

the devolved administrations will meet all the operational and capital costs associated with devolution from within their allocated budgets.

When asked who would be responsible for paying the costs of additional staff to operate the new tax, Sarah Walker said they “would be paid for by the Scottish Government”.<sup>132</sup>

### Accountability

76. The Scottish Parliament will receive a report on Scottish income tax receipts as part of the National Audit Office’s yearly report on HMRC. Scottish Parliamentary Committees will also be able to ask HMRC Accounting Officers for evidence.<sup>133</sup> In its Report, the Scottish Parliament Committee on the Bill concluded that there needed to be a more “direct relationship between HMRC and the Scottish Ministers and Parliament”.<sup>134</sup> While it welcomed the appointment of an Additional Accounting Officer responsible for the

129 Q 615

130 Extract from SPICe – The information centre, *The Scotland Bill 2011-11*, SCO. 53.10.1.6, pp 9-13

131 *Legislative consent memorandum from the Scottish Government*, LCM (S3)30.1, 1 December 2010, pp 24-25. The UK Government’s position is set out in the Bill’s *Impact Assessment*, p 8.

132 Q 277

133 House of Commons Library Paper 11/06, p 24

134 Scotland Bill Committee, para 132

Scottish income tax, it expressed concern “that a non-statutory memorandum of understanding, as is proposed, may be insufficient.”<sup>135</sup> It concluded:

HMRC will be working for Scottish Ministers in collecting the Scottish income tax and it is important that their responsibilities and accountabilities are clear. In our view, HMRC should be obliged, as the Bill provides, to collect the tax; it should be obliged to give similar priority to collecting Scottish income tax as other taxes (so that there does not emerge a widening ‘tax gap’ between the amount due and what is actually collected); and they should be obliged to account to Scottish Ministers and the Parliament for their collection work and performance. The whole Committee recommends that these duties and accountabilities of HMRC for the Scottish Income tax should be put on a statutory footing.<sup>136</sup>

77. While the Committee accepted that the costs of the scheme should be met by the Scottish Budget, it concluded that it was not right that the Scottish Budget should “simply be obliged to pay whatever HMRC say the collection costs are. These need to be challenged and scrutinised by both the Scottish Government and the Scottish Parliament”.<sup>137</sup> It further concluded:

This will be a first task for the new bilateral tax Committee proposed by the UK Government. Detailed discussions with HMRC, HM Treasury and the Scottish Government should begin soon, to plan and cost the set up and running of the new system. At this stage, the cost estimates that the Committee has seen are acknowledged to be only rough, but firmer estimates are needed soon. These discussions should include the option that, once the costs are properly identified, the amount to be charged to the Scottish Budget should be fixed so that HMRC have the incentive to control costs tightly.<sup>138</sup>

**78. We note the Secretary of State’s admission that the figure of £45 million is only a provisional estimate of the cost. We welcome reassurances from HMRC that the costs will not escalate significantly, given that much of the detailed design and implementation work is still to be done, it is impossible to give a fully accurate estimate of the cost at this time.**

**79. While we agree with the principle that the costs of the implementation and delivery of the new Scottish tax rate should be met by the Scottish budget, the Scottish Parliament cannot be expected to issue a blank cheque to HMRC. We agree with the Scottish Parliament Committee that both the Scottish Government and Scottish Parliament should be able to challenge and scrutinise HMRC very closely.**

**80. However, for the avoidance of doubt, it should be made absolutely clear that tax collection remains a reserved responsibility. The provision of information and an ongoing dialogue with the Scottish Government should not be taken to assume any**

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135 Para 132

136 Para 131

137 Para 135

138 Para 136

degree of joint ownership or management of HMRC, which will remain directly accountable to the UK Parliament. In addition to the existing mechanisms for monitoring the general work of HMRC by the Government, we believe that the Scottish Affairs Committee should be involved in reviewing the various processes and activities of HMRC, which relate to the collection of Income Tax on behalf of the Scottish Government.

## Devolved taxes

81. The Bill would disapply the existing UK Stamp Duty Land Tax (SDLT) and Landfill Tax in Scotland and introduce the concept of a “devolved tax”. SDLT and Landfill Tax would become devolved taxes with the Scottish Parliament having power over the collection and management of these taxes. This is in line with what Calman proposed. The UK Government expected that the devolved taxes would be introduced in April 2015. Calman estimated that in 2006-07 SDLT raised £555 million, and Landfill tax £75 million, in Scotland.

82. The Government’s proposals differ from the recommendation of the Calman Commission: the proposals exclude the Aggregates Levy and Air Passenger Duty from taxes which should be devolved. Sir Kenneth Calman reminded us that the Commission recommended the devolution of these taxes because these were the ones the Commission “thought most practical and useful”.<sup>139</sup>

83. The Aggregates Levy is a tax raised on the quarrying industry, and is currently set at £2.00 per tonne.<sup>140</sup> The Secretary of State for Scotland explained that:

the main reason for not devolving the Aggregates Levy [...] is the fact that this issue is before the courts at present. It is not appropriate to devolve a tax when its very existence, or its structure, is under challenge. We have put the commitment in the Command Paper [...] that assuming an appropriate outcome from the court case, we will look to devolve that.<sup>141</sup>

The Scottish Parliament Committee welcomed the “positive approach of the Secretary of State for Scotland in relation to the devolution of the Aggregates Levy”. It therefore recommended that a clause be inserted in the Bill to devolve this tax “which can be brought into force once the relevant court case is resolved”.<sup>142</sup>

84. Mr Moore said that “on the issue of Air Passenger Duty, you will be aware that the Government are reviewing that. Once the outcome of that is known, we will take steps to devolve it as appropriate”.<sup>143</sup> Glasgow Prestwick airport noted that devolving Air Passenger Duty to Scotland would “permit an appropriate regime to be put in place for Scottish air travel recognising Scotland’s particular requirements”.<sup>144</sup> The Scottish Parliament

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139 Q 39

140 Ev w12

141 Q 590

142 Scotland Bill Committee, para 101

143 Q 590

144 Ev w3



Committee agreed with the UK Government—that this should be considered for devolution “once the future of this tax is decided”.<sup>145</sup>

85. With the exception of the British Aggregates Association, which stated that “Scotland has lost nothing by the retention of the levy by London”,<sup>146</sup> we found a broad consensus in favour of the devolution of both the Aggregates Levy and Air Passenger Duty. Professor Muscatelli was “disappointed” that all four taxes recommended by the Calman Commission had not been devolved. While he understood the Government’s reasons for delaying the decision, he argued that a “contingent decision” could have been taken.<sup>147</sup>

86. Dave Moxham, STUC, said that he was not sure that the Government’s arguments in relation to the decision not to devolve the Aggregates Levy and Air Passenger Duty “necessarily stand up”. He said “I am not sure that it is not possible for those to be devolved to the Scottish Government and then for it to take its view on whether it also needs to make changes, pursuant to court action or other considerations”.<sup>148</sup> The Scottish Government agreed, and did not consider the reasons for delay being cited by the UK Government as “substantive barriers” to devolving responsibility for these taxes in this Bill, “particularly given that the other financial provisions are not scheduled to be devolved until 2015 or 2016 at the earliest”.<sup>149</sup> The Scottish Government argued that in the event that these taxes were devolved, “it would simply be for the Scottish Government and Parliament to consider options for future reform or to address the consequences of EU judgements, as is already the case in other areas, and any other devolved policy”.<sup>150</sup>

**87. We welcome the devolution of Stamp Duty Land Tax and Landfill Tax, and share the disappointment expressed to us that the Aggregates Levy and Air Passenger Duty will not be devolved at the same time. We understand the Government’s reasons for this and we welcome the Secretary of State’s assurance that the Government’s intention is to take steps to devolve both taxes “as appropriate”. However, we note that while the Government has stated that it will look to devolve the Aggregates Levy following the conclusion of legal proceedings, it is still in the process of considering whether Air Passenger Duty is appropriate for devolution.**

**88. We appreciate the frustration expressed that there is no provision for the devolution of those taxes on the face of this Bill. Given that the Government intends that these taxes be devolved, we recommend that provision be included on the face of the Bill for an enabling power to devolve the Aggregates Levy and Air Passenger Duty following an affirmative resolution of the House of Commons, with a view to this provision coming into force as appropriate.**

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145 Para 101

146 Ev w 14

147 Q 176

148 Q 385

149 Scottish Government, *Legislative Consent Memorandum on the Scotland Bill*, p 22

150 *Ibid*, p 22

## New taxes

89. In *Strengthening Scotland's Future* the UK Government note that the Calman Commission recommended that the Scottish Parliament should be given a power to legislate, with the agreement of the UK Parliament, to introduce specified new taxes that apply across Scotland.<sup>151</sup> This was described as “an important new power for the Scottish Parliament, providing an instrument that will help deliver desired policy outcomes as well as potentially raising additional revenues”. Clause 24 of the Scotland Bill therefore enables new tax raising powers to be devolved to the Scottish Parliament, following approval by both the UK and Scottish Parliaments.

90. Scottish Financial Enterprise pointed out that this provision in the Bill, “appears quite widely drawn”.<sup>152</sup> They point out therefore that these proposals “go further” than the Calman Commission’s proposals “as generally understood”.<sup>153</sup> Mr Moore noted, however, that without this provision, the Scotland Bill would be a “smaller, less impressive Bill”,<sup>154</sup> and he highlighted that, for the first time, the UK Government were providing “the facility to allow the Scottish Parliament, with the agreement of the United Kingdom Treasury, to set new taxes”.<sup>155</sup> The Scottish Parliament Committee voiced its “strong” support for this aspect of the Bill, as it provided a mechanism and framework for the further development of tax devolution in the future. It concluded that, in this sense, the Scotland Bill was an “enabling” Bill in relation to finance.<sup>156</sup>

91. Ms Hyslop welcomed this Clause, and described it as being “helpful”,<sup>157</sup> but added that she thought it was an “excuse for not transferring some of the other taxes that Calman recommended”.<sup>158</sup> Nonetheless, she called for this provision to be as “open ended” as possible.<sup>159</sup> Professor Keating explained that similar legislation operated in both Spain and Italy, but that legislation was drafted slightly differently to the effect of meaning “you can tax something that does not duplicate an existing tax”. He said: “it has the same effect [...] as saying that it has to get Westminster approval. I would rather put it in the way that I have just put it. It seems to give more autonomy to the Scottish Government and then ultimately it would be up to the courts to decide whether this was overlapping with an existing tax”.<sup>160</sup>

92. The Government has also set out the criteria against which it will determine whether or not to devolve powers for a requested tax. It stated in *Strengthening Scotland's Future* that: “foremost will be the need to ensure that the proposed tax would not impose a disproportionate negative impact on UK macroeconomic policy or impede, to any degree,

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151 Cm 7973

152 Ev w45

153 Ev w46

154 Q 590

155 Q 590

156 Para 104

157 Q 789

158 Q 787

159 Q 790

160 Q 210



the single UK market. The Scottish Parliament will be expected to provide supporting evidence confirming a proposed new tax complies with these criteria”.<sup>161</sup> Mr Moore explained that the main purpose of the criteria was to make sure that new taxes did not lead to “unbalancing the arrangements between Scotland and the rest of the UK”.<sup>162</sup>

93. Mr Moore described how he thought this process might work in practice. He said that it would be a “process of discussion and negotiation with the Treasury”,<sup>163</sup> and explained that how the Treasury and the UK Government responded would depend on the specific proposals and their compliance with the criteria”.<sup>164</sup> He said: “like much of the rest of the taxation proposals, there is a lot of work that will have to be done after Royal Assent to work through the new mechanisms”.<sup>165</sup>

**94. We welcome the provisions in the Scotland Bill which will enable the devolution of other taxes in the future, and that for the first time, with the agreement of the UK Government, the Scottish Parliament will be able to set its own taxes. We welcome the criteria which is outlined in *Strengthening Scotland’s Future*, and recognise the need for such criteria in order to avoid the risk of duplicate taxation.**

**95. We accept that it would not be appropriate for the Secretary of State to speculate on future taxation policy. However, we were disappointed that, when pressed, the Secretary of State could not give us examples of the type of tax which could potentially be acceptable, nor tell us whether two taxes mooted (on strongly caffeinated alcoholic drinks or a universal land tax), would meet the criteria and consequently be considered for devolution. We are also concerned by the absence of any clear process or mechanism by which the criteria will be applied, and ask the Government to provide a more thorough and detailed explanation of how this process would work, during the passage of the Bill through this House. We also wish to consider detailed proposals of how this process would work, before the first request for consideration of a new tax is received from the Scottish Parliament.**

**96. We agree with the Secretary of State for Scotland when he said that without this provision, the Scotland Bill overall would be less impressive. However, the success of such a provision depends upon the use which is made of it. There will need to be goodwill and co-operation on the part of both administrations to ensure that this provision is used in the spirit intended.**

### ***Tax on savings***

97. The Calman Commission recommended that income tax on savings should not be devolved to the Scottish Parliament, but that half of the yield should be assigned to the Scottish Parliament’s Budget, with a corresponding reduction in the block grant. Professor Gallagher noted that the reason the Government decided not to adopt this

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161 The criteria are outlined in *Strengthening Scotland’s Future*, Cm 7973, pp 32-33.

162 Q 590

163 Q 597

164 Q 602

165 Q 602

recommendation was because it would “produce variability in the tax year without increasing accountability”.<sup>166</sup>

98. Furthermore, Professor Muscatelli said that recommendation had not been adopted because it would require “major amendment in terms of the administrative arrangements for tax collection in the UK”, and that “it was difficult to attribute without additional administrative requirements, for example, on banks and building societies”.<sup>167</sup> He added that assigning this revenue would not “add significantly to accountability”.<sup>168</sup> However, Professor Keating would have liked to have seen this recommendation being implemented. He said that other countries go beyond the Calman recommendation and devolve the tax on savings rather than just assigning the rights. He concluded therefore that “technically, that seems to be possible”.<sup>169</sup>

**99. We agree that the assignment of tax receipts from savings would not increase the accountability of the Scottish Parliament, so the decision not to assign these revenues does not undermine the Government’s stated aim for the Bill. However, we do not object to the assignment of such revenues in principle. We therefore recommend that further work should be done to evaluate whether the assignment of tax receipts could be achieved without creating a disproportionate financial and administrative burden, and whether the potential advantages of assigning the receipts outweigh the potential disadvantages in this context.**

### **Corporation Tax**

100. Neither the Calman Commission nor the Bill proposed the devolution of Corporation Tax. However, this subject was the source of considerable debate during our inquiry. Professor Muscatelli stressed that tax competition was “the main reason why our group recommended that Corporation Tax should not be devolved”. He explained that “evidence from other countries, including Switzerland” suggested that it would be:

very likely, if Corporation Tax had been devolved and, say, the Scottish Parliament had decided to marginally lower Corporation Tax, that it would have put pressure on the rest of the UK to follow suit. What is happening in other countries like Switzerland is that you sometimes find that, overall, the rate of Corporation Tax is lowered and the burden then falls on personal income taxation because something has to pay for the taxation hole. That was the reason why we decided not to.<sup>170</sup>

101. Professor Gallagher agreed. He said: “if there is a declining tax, it is Corporation Tax”.<sup>171</sup> He explained: “the devolution of Corporation Tax within the UK would be a way of ensuring that we cannibalised our own tax revenue. If it is devolved to Scotland and Scotland takes, for the sake of argument, 10p off the Corporation Tax, there is a strong

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166 Q 3

167 Q 176

168 Q 177

169 Q 177

170 Q 182

171 Q 23

incentive for companies not to change their actual economic behaviour but to change their corporate structures so that they book their profits in Edinburgh and pay less tax. The net effect of that is that the UK as a whole gets less tax and we have simply cannibalised our own tax income”.<sup>172</sup>

102. However, Professor Keating pointed to the experience of countries other than Switzerland. He said:

I think Corporation Tax could have been devolved. There are huge economic constraints on variation and it probably would not have varied very much because of the loss of competitiveness if you put it too high and the loss of revenues if you put it too low. The tax competition is a fact. This indeed would have meant, as we find in other federal countries, that there is not a huge amount of variation, but it does give the opportunity for the fine tuning I was talking about earlier on and the use of that in pursuit of specific industrial policy objectives. If Scotland had its own priorities, it could use the tax power in order to further them.<sup>173</sup>

Professor Muscatelli agreed that in most countries where Corporation Tax is varied for economic development reasons, that needs to be as part of a concordat at national level to specify exactly what the aims are of that measure. He said “it is not simply the Basque country saying, ‘we are going to create a tax haven and all businesses are going to come to us.’ It requires quite close co-ordination”.<sup>174</sup>

103. The Secretary of State said:

Corporation Tax is obviously the most significant of those taxes that might have been devolved. Again, that was looked at by the Commission. The Report—whether it is of the independent experts or of the commission itself—spells out that one of the main reasons for that is to maintain the integrity of the United Kingdom taxation system, maintain its simplicity and minimise the compliance costs for businesses, and also not set up the overt possibility of tax competition for corporations, which might be tempted, if the rate were higher or lower—depending on whether they were north or south of the border—to relocate their headquarters. The underlying factories or businesses might stay where they were, but the brass plate on the door of the headquarters might be moved around simply according to the Corporation Tax provisions within the United Kingdom. We do not think that that is sensible, so for that reason Corporation Tax was excluded.<sup>175</sup>

104. Ms Hyslop supported the devolution of Corporation Tax as it would give the Scottish Government the “flexibility to have a competitive environment for key sectors”.<sup>176</sup> However, the Scottish Parliament Committee supported the Government’s decision not to devolve Corporation Tax to Scotland at “this stage” but said that “international experience does show some scope for differentiation of Corporation Tax”. The Committee concluded

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172 Q 23

173 Q 179

174 Q 182

175 Q 589

176 Q 743

therefore that the devolution of Corporation Tax was “not something we would wish to rule out entirely for the future”.<sup>177</sup>

105. We note that in the discussion on Corporation Tax there seemed to be an assumption that any variation would be downwards. We did not encounter any witnesses who were in favour of the Scottish Parliament being given responsibility over Corporation Tax in order to increase it. We further note that if the Scottish Parliament had responsibility for varying Corporation Tax, there would be a commensurate reduction in the block grant to match the amount of tax revenue foregone by HM Treasury. At no time has it been made clear to us, by any of those who argued for a Corporation Tax variation and reduction, as to how the inevitable short term drop in revenue would be compensated for.

**106. We agree with many of our witnesses, as well as the Government, that there are risks in devolving Corporation Tax, not least in that this could lead to competition which could result in the “cannibalisation” of the UK’s tax base. We recognise that this is not necessarily a concern for those who wish to consider the financial position of Scotland in isolation. However, we are interested in the economic welfare of the UK as a whole, and are not persuaded that the benefits of devolving Corporation Tax outweigh the risks.**

### Block grant reduction

107. At the heart of the Government’s proposals are the provisions to give the Scottish Parliament the powers to raise a single rate of Scottish income tax, and to reduce the block grant accordingly. Indeed, the Government noted in *Strengthening Scotland’s Future* that the methodology for calculating reductions in the block grant was fundamental to the future success of the new financing arrangements. Despite this, the Command Paper is very vague about how the eventual deduction from the block grant will be made. The Government stated that the present economic circumstances “make a definitive statement on the correct reduction to the block grant inappropriate at this time”.<sup>178</sup>

108. The UK Government has undertaken to consult the Scottish Government on this issue, and while the Scottish Government has welcomed this commitment, it emphasised that it was “crucial that the options for adjustment are properly understood before the legislation proceeds”.<sup>179</sup> Ms Hyslop said, that there was a “kind of feeling of don’t worry [...] the Treasury will see you all right”. This is inadequate. Ms Hyslop described that situation as “quite worrying”, as agreeing to a reduction in the block grant, which as yet, does not have a clearly defined process, basis or formula upon which that calculation would be made, was “like issuing a blank cheque”.<sup>180</sup> Professor Keating noted that a much clearer statement of exactly how that would work, was required.<sup>181</sup>

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177 Scotland Bill Committee, paras 54 and 55

178 Scottish Government, *Legislative Consent Memorandum on the Scotland Bill*, pp 35-36

179 Ibid ,p 24

180 Q 712

181 Q 175

109. It is currently estimated that Scottish income tax receipts would amount to approximately 35% of the Scottish Government's budget, so the reduction in the block grant would be somewhere of this order of magnitude. However, there is some dispute of this figure, for example, Reform Scotland claimed that income tax receipts would be closer to 26% of the total budget. When pressed on how the figure of 35% had been calculated, the Secretary of State conceded that the Government had not analysed this figure itself, but that the figure was cited directly from the Calman Commission. The Secretary of State noted that he was "broadly comfortable" with that assessment.<sup>182</sup>

**110. We are concerned that the estimate of the proportion of Scottish tax revenues of the Scottish budget given by the Secretary of State differs from the Government's own model. The Government's figures should be robust, and its calculations transparent.**

111. In evidence to us Mr Moore explained that, from financial year 2012, the Office for Budget Responsibility (OBR) would begin to calculate forecasts of Scottish tax receipts. It would therefore "build up the body of evidence" upon which the reduction in the block grant would be calculated.<sup>183</sup> During the transition period, the income received by Scotland from the level of income tax it sets and the deduction from the block grant would both be based on these forecasts, with no subsequent reconciliation to the actual tax received.<sup>184</sup> Professor Muscatelli explained that "completely insulates the Scottish Government from any fluctuation in the block grant".<sup>185</sup> He continued, "after the transition period and there is the definitive adjustment in the block grant, the revenues to the Parliament will fluctuate with tax revenues so they will no longer be as predictable as a proportion of UK expenditure in devolved areas".<sup>186</sup>

112. Mr Moore said: "we will want to make that adjustment, based on a period of years, and ensure that the judgment we are making is consistent both for historic figures and expectations going forward. If we get that number significantly out, it makes a big difference to that permanent adjustment".<sup>187</sup> The Government's intention was to "build a body of evidence that will allow us to say "the Scottish tax take is x% of the grant" and therefore "we reduce by that amount." The final adjustment would be made in 2018 or 2019, but the Government would "make sure that we kept that under review, so that there are not massive divergences after that adjustment is made".<sup>188</sup>

113. The absence of a clear method and process by which the block grant would be calculated was described by Mr Trench as "one of the most glaring failings of the Bill".<sup>189</sup> He added that the omission was "hugely disappointing", given that "the UK Government

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182 Q 621

183 See paras 121- 129 of this Report.

184 Cm 7973, November 2010 p 25, and pp 34-35.

185 Q 190

186 Q 173

187 Q 604

188 Qq 604, 609 and 610

189 Q 445

has had 18 months to decide how to respond to the Calman Commission's recommendations".<sup>190</sup>

114. Professor Muscatelli explained that the proposals suggested a transition period in which the Scottish Government would be totally insulated so there would be no impact. There would then be a once-and-for-all deduction in the grant. The UK Government has based this on the principle of "no detriment", which means that any policy changes to the UK tax base that impact (either positively or negatively) upon the Scottish budget will be compensated by an appropriate adjustment to the block grant".<sup>191</sup> However, Professor Muscatelli explained that he would "much rather see a mechanism that is clear and transparent and which does not insulate the Scottish Government from its own actions, because, after all, that is what accountability is about, but insulates the Scottish Government from actions taken by the Westminster Parliament on taxation because it would be unfair to see that reflected on the Scottish devolved resources".<sup>192</sup>

115. Professor Muscatelli further identified the need to "pin down how the grant reduction formula is going to work so that it does not become a political issue for conflict between the two countries [...] it is important that the grant formula should be embedded in such a way that it is understood by all parties".<sup>193</sup> Professor Gallagher agreed and noted that if the Calman Commission had had another six months, it would have considered the "next phase" of "how we calculate the balance between the stream of income tax revenue that the Scottish Parliament will have under the proposals in this Bill and the grant that it gets from the UK Government".<sup>194</sup> Sir Kenneth Calman agreed that, with hindsight, he would have considered "whether that [the reduction in the block grant] could be indexed in a different way".<sup>195</sup>

116. Professor Gallagher highlighted that the most important question to be addressed was "what is a commensurate reduction for access to this stream of revenue".<sup>196</sup> He said:

How you calculate that in the end will have a very important influence on the total spending power available for the Scottish Parliament [...] The key is to find the right way to do it so that whether Scotland has more or less depends on the tax decisions the Scottish Parliament takes and how successful the Scottish Parliament is in growing the Scottish economy. That is the policy objective one should set [...] The important question now is to get the balance between the income tax powers that will be available and the grant that will continue to be still the majority support for devolved public spending in Scotland.<sup>197</sup>

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190 Ev 134

191 Cm 7973, November 2010, pp 25-26.

192 Q 193

193 Q 235

194 Q 5

195 Q 4

196 Q 5

197 Q 5



117. Professor Muscatelli proposed that a “straightforward” formula which indexed the grant to the UK income tax base (based on the Holtham Commissions’ research) would address this issue.<sup>198</sup> He added that rather than a one off adjustment, that adjustment should be “varied every year on the basis of what is happening to the UK income tax base”.<sup>199</sup> He therefore recommended a formula adjustment which indexed the grant adjustment to the UK income tax base”.<sup>200</sup> Professor Gallagher also endorsed the Holtham Commission as the “best work” which had been done on the analysis of that question, from both the economic and political perspective,<sup>201</sup> while Mr Trench highlighted the “careful and thoughtful discussion of this issue in the report of the Holtham Commission in Wales; the same principles apply to Scotland as to Wales”.<sup>202</sup>

118. The Scottish Parliament Committee on the Bill concluded that it was “attracted to the analysis of the Holtham Commission” and “by the suggestion that the reduction in grant might be indexed to changes in the income tax base for the rest of the UK” as this “might achieve many of the objectives alone”.<sup>203</sup> The Scottish Parliament Committee therefore recommended that the option of indexing grant reduction to the income tax base in the rest of the UK should be considered in detail.<sup>204</sup>

**119. The major omission of the Government’s proposals is that neither the Bill nor the Command Paper provide an adequate explanation as to how the balance between income tax and the reduction to the block grant will be calculated. The Government itself has noted the central importance of this mechanism to its proposals. While we would not expect a definitive statement on the actual amount by which the grant will be reduced at this stage, we would expect the Government to have put forward a considered proposal on the principles and methodology of this system. We recommend that detailed consideration should be given to how the reduction in the block grant will be calculated as matter of urgency.**

**120. We are persuaded that a straightforward formula which indexes the grant to the UK income tax base merits close consideration. We draw the Government’s attention to the detailed work of the Holtham Commission in Wales on this issue.**

### **Office for Budget Responsibility**

121. The proposal in the Command Paper is that the calculations for the reduction in the block grant, will be based on the new Office for Budget Responsibility’s (OBR) forecast of tax revenues.<sup>205</sup> Many of our witnesses expressed concerns about this, first in relation to

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198 Q 195. The Independent Commission on Funding and Finance for Wales, known as the ‘Holtham Commission’ was set up to look into the pros and cons of the current approach of distribution of public expenditure to the Welsh Assembly Government and to consider alternatives, including tax varying powers and greater powers to borrow. <http://wales.gov.uk/icffw/home/?lang=en>

199 Q 196

200 Q 236

201 Q 5

202 Ev 136

203 Para 75

204 Para 78

205 For more information on the Office for Budgetary Responsibility see House of Commons Library note *The Office for Budgetary Responsibility*, 15 November 2010, SN/EP/5657

the expertise of the OBR in relation to the technicalities of forecasting tax receipts, and second, in terms of the accountability and transparency of that organisation.

122. Making such forecasts, even at a UK level, is not straightforward. As the OBR noted in its November 2010 forecast, “public sector receipts are highly dependent on the path of the economy and so projections are subject to [...] risks and uncertainties”.<sup>206</sup> The actual level of receipts can differ from the level forecast even at the beginning of the financial year. For example, the April 2009 Budget forecast income tax receipts (gross of tax credits) of £140.5 billion.<sup>207</sup> The latest estimate is that income tax yielded £144.9 billion—over 3% higher than forecast at the beginning of the financial year.<sup>208</sup> The further ahead tax receipts are forecast, the greater scope for their eventual outturn to differ from the forecast value. Professor Gallagher described the OBR as a “new beast”, adding that “we don’t know what it is like because we haven’t seen it do anything yet [...] they have never estimated a Scottish tax revenue before, so I don’t know whether they will be over-optimistic or under-optimistic”.<sup>209</sup>

123. At the moment, there are no official forecasts of Scottish income tax revenues, although estimates of past receipts are published by the Scottish Government and HMRC. The Secretary of State explained that at present there were no “good forecasting arrangements for income tax receipts. We do not have all the data that we will require”.<sup>210</sup> In addition, Mr Moore also pointed out that discussions between the UK Government and the OBR will “only start once the Bill gets Royal Assent”.<sup>211</sup> He emphasised that there were a “number of years work ahead” which meant that there was “plenty of time to consider all the different issues”.<sup>212</sup>

124. Witnesses expressed some concern about the OBR having this role. Mr Trench identified that “the problem, however, that the Treasury and the OBR have is that they are part of the UK Government, and they cannot be expected to be impartial actors or determiners of finances”.<sup>213</sup> He noted that “even if it is independent in relation to HM Treasury it cannot be said to be impartial in relation to the Scottish Government as it is part of the UK Government”.<sup>214</sup> The Scottish Parliament Committee on the Bill concluded that while it did not doubt “in the slightest” the integrity of the OBR, it was answerable to the UK Government. It concluded that there should be the possibility of some audit of its work in relation to, or on behalf of, the Scottish Parliament.<sup>215</sup> Ms Hyslop noted that the proposed Joint Fiscal Committee would allow these issues to be more transparent and more accountable, and that this would particularly help in relation to issues relating to

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206 Office for Budget Responsibility, *Economic and fiscal outlook*, Cm 7979, November 2010, para 4.9.

207 HM Treasury, *Budget 2009*, HC 307 April 2009 p 231 (Table C6).

208 Office for Budget Responsibility, *Economic and fiscal outlook*, Cm 7979, *Fiscal supplementary tables*, Table 1.1

209 Qq 20 and 15

210 Q 604

211 Q 636

212 *Ibid*

213 Q 458

214 Ev 134

215 Scotland Bill Committee, para 139



OBR and forecasting.<sup>216</sup> Ms Hyslop concluded that both Governments needed to “get into space of working together”.<sup>217</sup>

125. The Secretary of State pointed out that when the OBR start forecasting in 2012, its data would be an “open book” in order to “compare how accurate the forecasts will be compared to out-turn.”<sup>218</sup> He added that the “reconciliation (between forecasts and receipts) would be publicly notified and would be available for “scrutiny and independent audit as Parliament or Government see fit”,<sup>219</sup> and that the OBR would be accountable to this Committee.<sup>220</sup>

126. The Scottish Council for Development and Industry (SCDI) proposed that a Scottish Office for Budgetary Responsibility be established, which “could take a lead role in making an independent yet informed assessment of the public sector balance sheets, have control over forecasting and inform spending decisions”.<sup>221</sup> Professor Gallagher agreed that the body would require “a substantial corpus of expertise”.<sup>222</sup> However, Professor Muscatelli said that he was “comfortable” with the OBR undertaking this work. He said: “to create yet another body would be administrative overkill, but if the OBR had that responsibility, and if the whole system had oversight from the National Audit Office, I would have thought that would be sufficient”.<sup>223</sup>

**127. The Office for Budgetary Responsibility (OBR) is a relatively new body, and its task of forecasting Scottish income tax receipts is a new task. This will require a body of expertise. We seek assurances from the Government that the OBR will be adequately equipped and resourced to undertake this work, the scale and complexity of which should not be underestimated.**

**128. We note the assertion of some of our witnesses, who have cast doubt on the ability of the OBR to be impartial in relation to the Scottish Government as it is part of the UK Government. We do not accept this. However, the Government has an opportunity from the outset to operate the principles and practices which are necessary in order to make sure premature concerns about impartiality do not become a reality. We note three key principles:**

**First, the work of the OBR should be transparent. We welcome the Minister’s assurance that its calculations would be an “open book”.**

**Second, the Minister noted that discussions with the OBR would not begin until the Bill had received Royal Assent. We therefore recommend that there be close co-ordination between the UK and Scottish Governments and the OBR from the outset.**

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216 Qq 702 and 704

217 Q 709

218 Q 622

219 Q 588

220 Q 638

221 Ev w35

222 Q 20

223 Q 214

**Finally, we welcome the Minister’s assurance that the work of the OBR will be subject to scrutiny by this Committee. We will closely monitor the work of the OBR in its role of forecasting Scottish tax receipts, and will liaise closely with our colleagues in the Scottish Parliament on this matter.**

## A shared tax base

129. Professor Muscatelli noted that, should the Bill be enacted, the Scottish and UK Governments will share a tax base. Professor Gallagher explained that the Government’s proposals would lead to a “vertical fiscal externality” which means that “when you have two levels of Government that share access to the same tax base [...] the decision of one Government will have an impact on the other”.<sup>224</sup> Professor Muscatelli illustrated, for example, that “what the UK Government does with personal income taxation would have an impact on the Scottish Government’s revenues”.<sup>225</sup>

130. Mr Trench explained that:

The Command Paper avoids setting out the way that issues of UK-level tax policy affecting devolved taxes will be handled. These could be significant; changes in allowances and reliefs, in the rates of tax and in the tax banding structure, will affect the overall revenue from the devolved tax powers. When the UK Government makes such changes, there will be an obvious issue of working out how to compensate Scotland for the revenue foregone as a result, in accordance with the ‘no detriment’ principle stated in the Command Paper. But, in addition to that, there needs to be some mechanism for the Scottish Government to be involved actively and at an early stage in such decisions.<sup>226</sup>

Sir Kenneth Calman noted that a key part of the Commission’s Report and the Bill was about the ‘respect’ agenda. He said “we need to talk to each other and to do that openly to be able to discuss issues”.<sup>227</sup> Professor Muscatelli agreed that the shared tax base resulted in the need for “some sort of co-ordination.”<sup>228</sup>

131. The Command Paper makes provision for the creation of new ‘Intergovernmental Bilateral Committee on Fiscal Devolution’ to be created as a forum to discuss shared UK-Scottish interests in fiscal and economic policy.<sup>229</sup> However, Mr Trench argued that there “should be a more formal framework set to the structure within which good will and individual relationships can function much more effectively”,<sup>230</sup> and that this would be in the UK Government’s “best interest”. He concluded: “if you accept the principle that underlies Calman of delivering a measure of fiscal accountability to the Scottish Parliament

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224 Q 6

225 Q 192

226 Ev 134

227 Q 8

228 Q 210

229 Cm 7973, para 4

230 Q 448

and Government to match their accountability through the ballot box, then you have to ensure that accountability is real”.<sup>231</sup>

## Transparency and accountability

132. The key to achieving the cultural and attitudinal shift outlined above is to make sure the new regime is based on full and proper accountability and transparency. Professor Gallagher said that the UK’s public finances were “relatively un-transparent by international standards”.<sup>232</sup> He said:

One of the weaknesses of our system, which I don’t think this Bill will wholly cure, is that the central Treasury, for whom I have a very high regard, nevertheless sometimes tends to think of the devolved Administrations as just another Government Department and treats them in that way [...] One of the things that we will have to do as time goes on is to have a greater openness about all these financial calculations.<sup>233</sup>

133. Professor Muscatelli said “we are talking about lots of slippery numbers here and this is why indeed we need a lot more transparency from the Treasury. It is so that we can actually find out what has been going on and what is going on”.<sup>234</sup>

**134. The fact that the proposals will result in a shared income tax base needs to be both recognised by, and reflected in, the structures, culture and accountability and oversight mechanisms of the bodies and organisations responsible for their delivery and implementation. The Government must outline in detail how the organisational structures and oversight mechanisms of HMRC, the OBR and HM Treasury will reflect this new reality, and we look forward to receiving this information in the Government’s response to this Report.**

**135. We welcome the Government’s proposals to create a Bilateral Committee on Fiscal Devolution. This is an appropriate forum for the discussion and co-ordination of the implementation of the Government’s proposals. We note that the success of these arrangements will depend as much on goodwill and cooperation, as on systems and structures. The far reaching changes which will be brought about following the enactment of the legislation need to be accompanied by an equally far reaching cultural and attitudinal shift.**

136. We recognise that much of Scottish politics has been, and is based upon a persecution and dependency culture. While increased openness will not, in itself, reduce the perpetual grrn nor the search for grievance, they have the potential to help transform political discourse in Scotland by focusing attention less on “how much are we getting” to “what can we do with it”. Transparency can help us to stop blaming someone else.

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231 Q 450

232 Q 8

233 Q 8

234 Q 191

## Borrowing powers

137. The 1998 Act allows Scottish Ministers to borrow for short term current spending, with a limit of £500 million. This power has not been used and would be replaced by extended borrowing powers in the Bill.<sup>235</sup> The Bill allows borrowing to fund current expenditure, subject to certain limits and controls. Scottish Ministers will be permitted to borrow up to a total of £500 million to fund current spending with a limit of £200 million in any one year (from 2015).<sup>236</sup> Clause 32 of the Bill re-enacts the parts of the 1998 Act which allows borrowing to provide a working balance for the Scottish Consolidated Fund and to manage in-year volatility of receipts. It extends the power to allow borrowing across years to meet current expenditure where receipts are lower than their forecast value, subject to rules determined by the Treasury.<sup>237</sup> The Bill also sets a cap on borrowing for capital spending to the effect that “aggregates outstanding” must not be more than £2.2 billion (from 2013).<sup>238</sup>

138. Many of our witnesses identified that the limits proposed in the Bill, for both revenue and capital borrowing, were too low. Professor Keating described the Bill as being “too cautious” in this respect.<sup>239</sup>

## Revenue

139. In terms of borrowing for current revenue purposes, Mr Moore noted that the figure of £500 million “was determined by colleagues in the Treasury based on their estimations of what the fluctuations might be in the tax receipts that would need to be covered in any given year”.<sup>240</sup> He added that this limit may be varied “from time to time”, but that it would “not be reduced”.<sup>241</sup> The Scottish Government pointed out that this cap is unchanged from the in year borrowing limit permitted in the Scotland Act, despite the increase in volatility the Scottish Government would be exposed to.<sup>242</sup> Professor Drew Scott, University of Edinburgh, noted that under the new system:

[...] we have real concerns because of the £200 million limit—£200 million is about 5% of the Scottish tax take. If the forecasts are more than 5% over, in the sense that it needs to claw back after 12 months, £200 million won’t be enough. The OBR’s evidence from the nine years from 2001 to 2009 suggests that in three of those nine years it over-forecast by 5% or more. The average forecasting error was 2% over—we’re back into the use of history here—and that implies that Scotland will always be borrowing to repay an excess forecast, which is a problem. We call it a dynamic instability, because eventually you will come to the limit of your borrowing, which is

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235 House of Commons Library Paper 11/06, p 22

236 Scotland Bill – Clause 32

237 House of Commons Library Paper 11/06, p 32

238 House of Commons Library Paper 11/06, p 33

239 Q 220

240 Q 623

241 Q 623

242 Scottish Government, *Legislative Consent Memorandum on the Scotland Bill*, pp 22-23

£500 million, and you can't do anything else now except cut spending or raise taxes.<sup>243</sup>

140. Many of our witnesses agreed. Mr Trench described the borrowing limits as “seriously low” and Reform Scotland described them as “modest in the context of the scale of tax receipts”.<sup>244</sup> Professor Muscatelli concluded:

The £500 million overall limit does not cover the potential fluctuations. If you look at the difference in personal income taxation and receipts accruing to Scotland—this is the total as opposed to the bit that would be devolved under Calman—between 2007-08 and 2008-09 there was a fall of about £500 million in income tax receipts which were attributable to Scotland [...] Over time, if you wanted to protect Scotland from fluctuations in tax receipts or allow them to smooth the total resources available, you might want to look at whether £500 million is sufficient.<sup>245</sup>

In this sense, Professors Andrew Hughes Hallett, George Mason University, and Drew Scott, University of Edinburgh, consider that borrowing provisions for non-capital spending to be “both dynamically unstable and inadequate”.<sup>246</sup>

141. While there was a general consensus that the borrowing limits were too low, there was disagreement as to how, or at what level, limits should be set—if at all. Professor Muscatelli said that “doubling that limit would not be exaggerated in terms of prudence and in terms of giving the Scottish Parliament a bit more room for manoeuvre”.<sup>247</sup> He added “I would go for a limit but I would not have that limit of £500 million”.<sup>248</sup> Mr Trench agreed that this limit should be “much higher”, but should be set by the UK Government.<sup>249</sup>

## Capital

142. The Secretary of State said that, in relation to capital borrowing limits, “the judgement is about providing sufficient powers to enable the Government in Scotland to get on with major infrastructure projects”.<sup>250</sup> He added, however, that provision for this “major capital borrowing power” was not included in the Calman Commission. He made it clear that this was a baseline figure, and while it would not be a “free for all” that would be extended massively at any given point in time, it could be increased with Treasury consent and within the overall United Kingdom borrowing.<sup>251</sup>

143. SCDI believed that borrowing limits should be sufficient for the Scottish Government to manage its capital investment programme effectively and flexibly, and fluctuations in

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243 Q 543

244 Ev w18

245 Q 215

246 Ev 120

247 Q 216

248 Q 219

249 Qq 550-551

250 Q 623

251 Q 625

revenue arising from the substitution of a portion of the block grant with income tax revenues, within acceptable UK debt levels”.<sup>252</sup> Professor Muscatelli said that it was not clear that “the “£2 billion limit is the right limit”.<sup>253</sup> Dave Moxham indicated that the STUC would, “generally looking for those borrowing limits in relation to capital spend from the loans fund to be up a bit”.<sup>254</sup> Professor Muscatelli suggested that “one way to fix that would be in terms of what is prudential serviceability out of the income tax share of the total departmental expenditure limit for Scotland”.<sup>255</sup>

144. The Scottish Government welcomed the principle the introduction of a specific power to borrow for capital investment purposes and the flexibility to seek borrowing from the market. However, it noted that the regime as proposed is limited and highly controlled by HM Treasury, and argued that “as with other elements of the financial package, a greater formal role for Scottish Ministers and the Scottish Parliament in the regime, especially adjustments to the debt limit, would be desirable”.<sup>256</sup>

145. The Scottish Parliament Committee described the short-term borrowing limits as “inadequate”, and suggested that the limits should be “recalculated on a more principled basis”.<sup>257</sup> The Committee accepted that there would “be constraints on the amount of borrowing set by HM Treasury but is concerned that there is no principled basis for the particular limits proposed”. It proposed that the “total limit should be set by reference to the capacity of the Scottish Government prudently to finance it from devolved tax revenue. The precise amount may be subject to further work, but this is likely to be substantially more than £2.2 billion”.<sup>258</sup> It also recommended that the UK Government consider bringing forward these borrowing powers.<sup>259</sup>

**146. We welcome the provisions in the Bill for both capital and revenue borrowing powers to be given to the Scottish Parliament. We note the concerns of many witnesses that the limits the Bill places on these powers are too low.**

**147. We agree that there should be a limit, which should be set by the UK Government and be within the framework of the UK’s overall borrowing limits. We recommend that the Government re-consider the proposed limits, based on more thorough analysis, and in close consultation with the Scottish Parliament and with this Committee.**

**148. We believe a suitable starting point for discussion would be one billion with a limit of £500 million in any one year. We would also look favourably upon changing the date when such borrowing would be accessible to the Scottish Government and ask the Government to consider this further.**

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252 Ev w35

253 Q 236

254 Q 378

255 Q 236

256 Scottish Government, *Legislative Consent Memorandum on the Scotland Bill*, p 22

257 Scotland Bill Committee, para 117

258 Para 124

259 Para 125

## Bonds

149. In his written submission, Professor Iain McLean, Nuffield College Oxford, suggested that the Scottish Government should be allowed to issue bonds:

subject to an upper level to be determined, for the four governments of the UK in aggregate, by HM Treasury and the Debt Management Office. The UK Government’s arguments against this seem weak to me. The Exchequer Secretary of the Treasury told the Holyrood Scotland Bill Committee on December 14 that there would be ‘risks to do with confusion in the gilts market.’ If market players become confused, that is their problem. However, I think that money market professionals are capable of distinguishing between a Scottish local authority, the Scottish Government, and the UK Government.<sup>260</sup>

The STUC also “favour the ability of the Scottish Government to raise bonds”,<sup>261</sup> and expressed disappointment that provision for this had not been included.<sup>262</sup> Dave Moxham explained that: “Local authorities will still be able to run bond issues as potential borrowing [the] mechanism that is available in Scotland to other Scottish bodies should also be available to the Scottish Parliament”.<sup>263</sup>

150. While the Scottish Parliament Committee on the Bill thought it unlikely that the Scottish Government would need or wish to access the bond markets in the near future, it concluded that this possibility “should not be ruled out in statute”. It therefore recommended that the Bill be amended to permit this, subject to agreement from HM Treasury to conditions for bond issues”.<sup>264</sup>

**151. It appears strange to us, in principle, that the Scottish Parliament should not be permitted to have access to the bond market, while Local Authorities in Scotland are permitted to access this source of revenue. We endorse the view of the Scottish Parliament Committee on the Bill on this issue.**

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260 Ev 127

261 Q 375

262 Q 391

263 Q 393

264 Scotland Bill Committee, para 126



## 4 Implications for the Scottish economy

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### Magic bullet theory

152. Much of the external discussion of the Bill has focused on its potential implications for the Scottish economy. The SCDI argued that: “greater financial responsibility for the Scottish Parliament should be considered within the context of policies for sustainable increases in Scotland’s comparatively sluggish long-term economic growth rate”.<sup>265</sup> Reform Scotland noted that the “Bill does not provide the tools that would allow it to introduce fiscal policies to improve the economy”. It continued:

The Scotland Bill recognises the shortcomings of the current financial arrangements and the benefits of greater financial accountability and responsibility. However, having identified the problem with lack of financial accountability, the Scotland Bill does not provide an adequate solution. It is not reasonable to argue that increasing the proportion of the Scottish Budget that is raised from devolved taxes from 11% to 26% delivers financial accountability.<sup>266</sup>

153. The question of whether or not the Bill provides the Scottish Parliament with levers for economic growth has been the subject of some heated debate in the Scottish Parliament’s Committee on the Scotland Bill and in the Scottish media.<sup>267</sup> Much of this debate has focused on a claim made in an academic research paper written by Professors Hughes Hallett and Scott, that a “1% point increase in fiscal devolution [...] generates additions of between 0.16% and 0.32% to growth rates”.<sup>268</sup> In particular, Scottish Ministers have claimed that the act of the devolution of financial powers, in and of itself has an immediate, if small, impact on economic growth.

154. Professors Hughes Hallett and Scott told us that “the Bill provides no new economic policy levers to Scotland’s Government at a time when, in our view, the Scottish economy is facing unprecedented challenges.”<sup>269</sup> However, when questioned on the relationship between the devolution of fiscal powers and economic growth, Professor Hughes Hallett said that: “the empirical evidence is inconclusive on the question of whether it does or doesn’t lead to an increase in the growth rate systematically. Some studies say yes, and some studies say no”.<sup>270</sup> Professor Scott stated clearly, however, that “the actual act of giving power does not in itself create a bonus”.<sup>271</sup>

155. Professor McLean explained that Ministers at Holyrood had possibly misunderstood the points made in Professors Hughes Hallett and Scott’s paper:

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265 Ev w 34

266 Ev w16

267 Scotland on Sunday, *Row heats up over SNP claims fiscal autonomy will drive growth*, 16 January 2011

268 Andrew Hughes Hallett and Drew Scott, *Scotland: a New Fiscal Settlement*, 3 June 2010

269 Ev 120

270 Q 481

271 Q 484

I think the cause of the confusion here is that the evidence that they are drawing on is cross-sectional evidence—that is, jurisdictions that have higher devolution tend to be richer, or possibly have higher growth rates, than jurisdictions that have lower devolution. That does not in itself generate any prediction as to what happens if a jurisdiction moves from a lower to a higher level of devolution.<sup>272</sup>

156. Terry Murden, Business Editor, *The Scotsman* and *Scotland on Sunday*, agreed that the acceleration of the process, and the transfer of powers, will not in itself result in a magical increase in GDP and “general happiness and prosperity”. He continued:

As far as I can see, there is no evidence to support one argument or the other. Clearly, there are two camps here. One tries to claim that greater fiscal autonomy and lower taxes, which they assume may flow from that, would lead to higher growth, but there is another school of thought that says there is no evidence of that happening. Even in countries like the US, which has cut taxes, there is no hard evidence that it has increased GDP.<sup>273</sup>

157. When asked to answer the criticism that the devolution of the tax powers proposed in the Bill was a blunt instrument that does not give the Scottish sufficient levers to stimulate economic growth in Scotland, the Secretary of State for Scotland said that:

[...] as far as economic growth is concerned, my view is that the greater scrutiny and accountability that will be inherent as a result of the need to set a tax rate will really focus the mind on what impact that tax rate will have on people and businesses in Scotland. It will also renew the scrutiny of how Scotland spends its other Government expenditure and whether that is focused on economic growth. Separate to that, we are introducing, through the Bill, significant new capital powers. They could be used in a way that would not generate economic growth, but I would be surprised if that was the case.<sup>274</sup>

158. Professor Gallagher supported the view that “the key is to find the right way to do it so that whether Scotland has more or less depends on the tax decisions the Scottish Parliament takes and how successful the Scottish Parliament is in growing the Scottish economy”.<sup>275</sup> He added that “a lot of nonsense has been talked” about the relationship between the devolution of fiscal powers and growth in the private sector.<sup>276</sup> Professor Keating noted the “somewhat ill-informed debate” in Scotland about economic growth and development. He said:

What is important from the experience of other jurisdictions is that when you devolve taxation powers, it is important exactly how you use those powers and what incentives you put in place [...] That has to be a policy choice by Governments, but we need to allow them to make those policy choices.<sup>277</sup> If you look at jurisdictions

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272 Q 538

273 Q 315

274 Q 595

275 Q 5

276 Q 5

277 Q 178

across the world “there is no association between tax levels and economic growth. It depends what you are spending the money on and how you are raising it”.<sup>278</sup>

159. It is clear, from the evidence that we have received, that there is a consensus that simply transferring taxation powers will not automatically result in economic growth. We regret that this truth has been distorted by overenthusiastic interpreters of the evidence.

160. We believe that the Scottish Government already has extensive powers to influence economic growth and had drawn to our attention by several witnesses the inadequate capacities to cope with the world of work shown by many, particularly young, Scots.

### Achieving accountability

161. Sir Kenneth Calman said that “right at the heart of all of this—was that if you want to have better governance in whatever system it is, then the financial component [...] is what your policies are and not necessarily the amount of money. If you have the wrong policies, you won’t get economic growth”.<sup>279</sup> He described fiscal accountability as “the hallmark” of the Calman Commission,<sup>280</sup> and this was also the Government’s stated aim for the Bill. Mr Trench said that “on the macro-economic level, the Bill is not giving the fiscal levers to improve economic growth, but it is not designed to do that”.<sup>281</sup>

162. Professor Muscatelli concluded that the Scotland Bill represented “a genuine advance”. He said:

I think it will require the Scottish Parliament to have a genuine debate about resources, taxation and the source of those resources and not simply how to allocate a block grant. I think there is an advance. Is it the final step? That is another issue. What we have in front of us here today does involve a significant increase in accountability.<sup>282</sup>

**163. We agree with the conclusion of our witnesses that the actual act of devolving financial powers does not, in and of itself, create an immediate bonus or boost to economic growth. It is how those powers are subsequently used which is important. We regret that much of the debate has focused on this issue, which has served as a distraction from thorough debate of the proposals in the Bill.**

**164. On the basis of our scrutiny of the financial proposals in the Bill, we conclude that the Bill does achieve its stated purpose of increasing the financial accountability of the Scottish Parliament. However, as always, the devil is in the detail, and we will continue to closely monitor the implementation and delivery of the provisions in the Bill, should it receive Royal Assent, and in *Strengthening Scotland’s Future*. We look forward to the Government’s detailed response in addressing the concerns we have raised, and recommendations we have made, in this Report, so, that in a spirit of co-operation, we**

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278 Q 181

279 Q 4

280 Ibid

281 Q 549

282 Q 199

**can work together to deliver the proposals in a robust, timely, efficient and transparent manner, for the benefit of the people of Scotland.**

## Conclusions and recommendations

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### *The purpose of the Bill*

1. We believe that the evolution of the constitution is a process which requires powers to move in whichever direction is in the interest of the people and their better governance. We therefore see devolution as a multi-directional process, with powers moving in different ways. This process should lead to further decentralisation within Scotland, to local authorities and communities, and not simply to a gathering in of authority in Edinburgh. We note that many of our witnesses identified this Bill as a step, rather than an end point. We agree with this view and believe that further changes should be based on experience. (Paragraph 7)
2. We welcome the opportunity afforded by the Scotland Bill and *Strengthening Scotland's Future* to improve the constitutional framework within which devolution operates in Scotland. We particularly welcome the Government's stated aim of improving the accountability of the Scottish Parliament, which we believe will be to the benefit of the people of Scotland. (Paragraph 10)

### *Timing and process*

3. We agree that the UK Parliament should respect the well established principle that it should not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament. We appreciate the delicate choreography performed by the Scotland Office in seeking to bring forward a timetable which sought to balance the right of the Scottish Parliament to scrutinise the legislation, while at the same time allowing the House of Commons to complete its stages before the Scottish Parliament elections. (Paragraph 16)
4. While we regret that the first day of Committee stage in this House took place before the Scottish Parliament debate on its Legislative Consent Motion, we welcome the fact that the Scottish Parliament indicated its consent before the second and third days of Committee stage. (Paragraph 17)
5. We note that the Scottish Parliament Committee on the Bill recommended some significant amendments to the Bill. We also note the amendments made to the Bill during its Committee stage in this House. We have some sympathy therefore with the Scottish Parliament Committee's view that a further Legislative Consent Motion would be required in the next session of the Scottish Parliament, in order to consider the Bill, as amended, before the Bill receives Royal Assent. We believe that it would be appropriate to seek the views of the Scottish Parliament on the final version of the Bill. (Paragraph 18)

### *Devolution issues and acts of the Lord Advocate*

6. We agree with the Scottish Parliament Committee that there has not been sufficient time to adequately scrutinise devolution issues and the acts of the Lord Advocate.

We agree that this should be the subject of a further Legislative Consent Motion to be considered by the Scottish Parliament in the new session. (Paragraph 20)

### *Income Tax*

7. We welcome the Government's proposals for the abolition of the Scottish variable rate, and the creation of a new Scottish rate of income tax. We agree that the proposals have the merit of maintaining the integrity of UK income tax, while also allowing the Scottish Parliament to be accountable and responsible for raising some of its own tax revenues. (Paragraph 49)
8. We also note the comments of those witnesses who suggested that the accountability of the Scottish Parliament could be further enhanced through the further devolution of tax rates and personal allowances. However, devolution is a process and, on balance, we conclude that the Government's current proposals are appropriate at this time. We see considerable merit in closely monitoring and evaluating the implementation of these proposals before there should be any consideration or discussion of devolving further powers in relation to income tax. This entire process should be as transparent as possible, and we undertake to monitor it closely. (Paragraph 50)

### *Defining a Scottish taxpayer*

9. We note the concerns expressed to us in relation to the anomalies and difficulties which occur in defining a Scottish taxpayer. We welcome the reassurances of HMRC that these issues will be addressed. We also welcome the assurances given by the Government during Committee stage, that it will bring forward an amendment to address issues around the definition of a Scottish taxpayer, on Report. HMRC will need to undertake detailed design and implementation work in order to minimise costly delays and the potential for legal proceedings in relation to the definition of a Scottish taxpayer. We will seek regular detailed reports from HMRC to this effect, and will monitor its progress very closely. (Paragraph 60)
10. We recognise that there will always be a minority who wish to evade, avoid or escape their tax responsibilities. Their existence is not sufficient reason to abandon this welcome change in the administration of tax. (Paragraph 61)

### *Impact on business*

11. HMRC must get the new Scottish tax system right. There is no room for error or delay. If the definition of a Scottish taxpayer is unclear or inadequate, the burden of identification could fall on small businesses, employers and individuals. This would be unacceptable. (Paragraph 68)
12. Furthermore, the potential impact for small businesses and individuals in Scotland of any delay or error should not be underestimated, as it would result in an additional economic and administrative burden for business. We seek further assurance from both the Government and HMRC that the cost of design and implementation of new payroll systems will be fully met by HMRC and will not be passed on. (Paragraph 69)

13. We recommend that HMRC work closely with business groups in designing and implementing systems and software which is straightforward and easy to use. HMRC should also issue clear and detailed guidance for employers in a timely fashion. (Paragraph 70)
14. We recognise the new Scottish tax system will involve an additional burden for businesses throughout the UK, the scale of which is as yet unknown. We ask the Government to clarify the scale of this burden, and the level of responsibility which will fall on employers. (Paragraph 71)

### *Implementation costs*

15. We note the Secretary of State's admission that the figure of £45 million is only a provisional estimate of the cost. We welcome reassurances from HMRC that the costs will not escalate significantly, given that much of the detailed design and implementation work is still to be done, it is impossible to give a fully accurate estimate of the cost at this time. (Paragraph 78)
16. While we agree with the principle that the costs of the implementation and delivery of the new Scottish tax rate should be met by the Scottish budget, the Scottish Parliament cannot be expected to issue a blank cheque to HMRC. We agree with the Scottish Parliament Committee that both the Scottish Government and Scottish Parliament should be able to challenge and scrutinise HMRC very closely. (Paragraph 79)
17. However, for the avoidance of doubt, it should be made absolutely clear that tax collection remains a reserved responsibility. The provision of information and an ongoing dialogue with the Scottish Government should not be taken to assume any degree of joint ownership or management of HMRC, which will remain directly accountable to the UK Parliament. In addition to the existing mechanisms for monitoring the general work of HMRC by the Government, we believe that the Scottish Affairs Committee should be involved in reviewing the various processes and activities of HMRC, which relate to the collection of Income Tax on behalf of the Scottish Government. (Paragraph 80)

### *Devolved taxes*

18. We welcome the devolution of Stamp Duty Land Tax and Landfill Tax, and share the disappointment expressed to us that the Aggregates Levy and Air Passenger Duty will not be devolved at the same time. We understand the Government's reasons for this and we welcome the Secretary of State's assurance that the Government's intention is to take steps to devolve both taxes "as appropriate". However, we note that while the Government has stated that it will look to devolve the Aggregates Levy following the conclusion of legal proceedings, it is still in the process of considering whether Air Passenger Duty is appropriate for devolution. (Paragraph 87)
19. We appreciate the frustration expressed that there is no provision for the devolution of those taxes on the face of this Bill. Given that the Government intends that these taxes be devolved, we recommend that provision be included on the face of the Bill



for an enabling power to devolve the Aggregates Levy and Air Passenger Duty following an affirmative resolution of the House of Commons, with a view to this provision coming into force as appropriate. (Paragraph 88)

### *New taxes*

20. We welcome the provisions in the Scotland Bill which will enable the devolution of other taxes in the future, and that for the first time, with the agreement of the UK Government, the Scottish Parliament will be able to set its own taxes. We welcome the criteria which is outlined in *Strengthening Scotland's Future*, and recognise the need for such criteria in order to avoid the risk of duplicate taxation. (Paragraph 94)
21. We accept that it would not be appropriate for the Secretary of State to speculate on future taxation policy. However, we were disappointed that, when pressed, the Secretary of State could not give us examples of the type of tax which could potentially be acceptable, nor tell us whether two taxes mooted (on strongly caffeinated alcoholic drinks or a universal land tax), would meet the criteria and consequently be considered for devolution. We are also concerned by the absence of any clear process or mechanism by which the criteria will be applied, and ask the Government to provide a more thorough and detailed explanation of how this process would work, during the passage of the Bill through this House. We also wish to consider detailed proposals of how this process would work, before the first request for consideration of a new tax is received from the Scottish Parliament. (Paragraph 95)
22. We agree with the Secretary of State for Scotland when he said that without this provision, the Scotland Bill overall would be less impressive. However, the success of such a provision depends upon the use which is made of it. There will need to be goodwill and co-operation on the part of both administrations to ensure that this provision is used in the spirit intended. (Paragraph 96)

### *Tax on savings*

23. We agree that the assignment of tax receipts from savings would not increase the accountability of the Scottish Parliament, so the decision not to assign these revenues does not undermine the Government's stated aim for the Bill. However, we do not object to the assignment of such revenues in principle. We therefore recommend that further work should be done to evaluate whether the assignment of tax receipts could be achieved without creating a disproportionate financial and administrative burden, and whether the potential advantages of assigning the receipts outweigh the potential disadvantages in this context. (Paragraph 99)

### *Corporation Tax*

24. We agree with many of our witnesses, as well as the Government, that there are risks in devolving Corporation Tax, not least in that this could lead to competition which could result in the "cannibalisation" of the UK's tax base. We recognise that this is not necessarily a concern for those who wish to consider the financial position of Scotland in isolation. However, we are interested in the economic welfare of the UK

as a whole, and are not persuaded that the benefits of devolving Corporation Tax outweigh the risks. (Paragraph 106)

25. We are concerned that the estimate of the proportion of Scottish tax revenues of the Scottish budget given by the Secretary of State differs from the Government's own model. The Government's figures should be robust, and its calculations transparent. (Paragraph 110)
26. The major omission of the Government's proposals is that neither the Bill nor the Command Paper provide an adequate explanation as to how the balance between income tax and the reduction to the block grant will be calculated. The Government itself has noted the central importance of this mechanism to its proposals. While we would not expect a definitive statement on the actual amount by which the grant will be reduced at this stage, we would expect the Government to have put forward a considered proposal on the principles and methodology of this system. We recommend that detailed consideration should be given to how the reduction in the block grant will be calculated as matter of urgency. (Paragraph 119)
27. We are persuaded that a straightforward formula which indexes the grant to the UK income tax base merits close consideration. We draw the Government's attention to the detailed work of the Holtham Commission in Wales on this issue. (Paragraph 120)

### *Office for Budgetary Responsibility*

28. The Office for Budgetary Responsibility (OBR) is a relatively new body, and its task of forecasting Scottish income tax receipts is a new task. This will require a body of expertise. We seek assurances from the Government that the OBR will be adequately equipped and resourced to undertake this work, the scale and complexity of which should not be underestimated. (Paragraph 127)
29. We note the assertion of some of our witnesses, who have cast doubt on the ability of the OBR to be impartial in relation to the Scottish Government as it is part of the UK Government. We do not accept this. However, the Government has an opportunity from the outset to operate the principles and practices which are necessary in order to make sure premature concerns about impartiality do not become a reality. We note three key principles:

First, the work of the OBR should be transparent. We welcome the Minister's assurance that its calculations would be an "open book".

Second, the Minister noted that discussions with the OBR would not begin until the Bill had received Royal Assent. We therefore recommend that there be close co-ordination between the UK and Scottish Governments and the OBR from the outset.

Finally, we welcome the Minister's assurance that the work of the OBR will be subject to scrutiny by this Committee. We will closely monitor the work of the OBR in its role of forecasting Scottish tax receipts, and will liaise closely with our colleagues in the Scottish Parliament on this matter. (Paragraph 128)

### *A shared tax base*

30. The fact that the proposals will result in a shared income tax base needs to be both recognised by, and reflected in, the structures, culture and accountability and oversight mechanisms of the bodies and organisations responsible for their delivery and implementation. The Government must outline in detail how the organisational structures and oversight mechanisms of HMRC, the OBR and HM Treasury will reflect this new reality, and we look forward to receiving this information in the Government's response to this Report. (Paragraph 134)
31. We welcome the Government's proposals to create a Bilateral Committee on Fiscal Devolution. This is an appropriate forum for the discussion and co-ordination of the implementation of the Government's proposals. We note that the success of these arrangements will depend as much on goodwill and cooperation, as on systems and structures. The far reaching changes which will be brought about following the enactment of the legislation need to be accompanied by an equally far reaching cultural and attitudinal shift. (Paragraph 135)

### *Borrowing powers*

32. We welcome the provisions in the Bill for both capital and revenue borrowing powers to be given to the Scottish Parliament. We note the concerns of many witnesses that the limits the Bill places on these powers are too low. (Paragraph 146)
33. We agree that there should be a limit, which should be set by the UK Government and be within the framework of the UK's overall borrowing limits. We recommend that the Government re-consider the proposed limits, based on more thorough analysis, and in close consultation with the Scottish Parliament and with this Committee. (Paragraph 147)
34. We believe a suitable starting point for discussion would be one billion with a limit of £500 million in any one year. We would also look favourably upon changing the date when such borrowing would be accessible to the Scottish Government and ask the Government to consider this further. (Paragraph 148)
35. It appears strange to us, in principle, that the Scottish Parliament should not be permitted to have access to the bond market, while Local Authorities in Scotland are permitted to access this source of revenue. We endorse the view of the Scottish Parliament Committee on the Bill on this issue. (Paragraph 151)

### *Implications for the Scottish economy*

36. We agree with the conclusion of our witnesses that the actual act of devolving financial powers does not, in and of itself, create an immediate bonus or boost to economic growth. It is how those powers are subsequently used which is important. We regret that much of the debate has focused on this issue, which has served as a distraction from thorough debate of the proposals in the Bill. (Paragraph 163)
37. On the basis of our scrutiny of the financial proposals in the Bill, we conclude that the Bill does achieve its stated purpose of increasing the financial accountability of

the Scottish Parliament. However, as always, the devil is in the detail, and we will continue to closely monitor the implementation and delivery of the provisions in the Bill, should it receive Royal Assent, and in *Strengthening Scotland's Future*. We look forward to the Government's detailed response in addressing the concerns we have raised, and recommendations we have made, in this Report, so, that in a spirit of co-operation, we can work together to deliver the proposals in a robust, timely, efficient and transparent manner, for the benefit of the people of Scotland. (Paragraph 164)

# Formal Minutes

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**Tuesday 15 March 2011**

Members present:

Mr Ian Davidson, in the Chair

Fiona Bruce

Cathy Jamieson

David Mowat

Fiona O'Donnell

Mr Alan Reid

Lindsay Roy

Dr Eilidh Whiteford

Draft Report (*The Scotland Bill*), proposed by the Chair, brought up and read.

Draft Report (*The Scotland Bill*), proposed by Dr Eilidh Whiteford, brought up and read as follows:

1. The UK Government introduced the Scotland Bill in the House of Commons on 30<sup>th</sup> November 2010 with an accompanying Command Paper, *Strengthening Scotland's Future*. The Scotland Bill seeks to implement 35 of the 63 recommendations of the Commission on Scottish Devolution (the 'Calman Commission') established by the Scottish Parliament in 2007, and aims to '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 Government' (Command Paper, Foreword).

2. While the objectives of further empowering the Scottish Parliament and increasing its accountability are entirely laudable, the Scotland Bill makes only modest progress in the direction of those objectives. In this respect, the passage of the Scotland Bill is a missed opportunity to enhance devolution more significantly by delivering to Scotland the levers to promote economic growth and create employment. In the aftermath of a bruising global recession, when restoring the health of the economy through sustainable growth and job creation ought to be the top priority of Governments, the Scotland Bill ducks the challenge of devolving greater fiscal responsibility to the Scottish Parliament and Government that would equip them with powers to strengthen and improve economic and social policy in Scotland, while significantly enhancing their financial accountability.

3. Provisions in the Scotland Bill are nevertheless to be welcomed as far as they go, and in as much as they can improve governance in Scotland and deliver genuine benefits for its people. A number of witnesses identified this Bill as a step in a process of devolution rather than an end point, echoing the oft-cited observation of former Welsh Secretary of State Ron Davies that 'devolution is a process, not an event'. While there are diverse views in Scotland on the extent, the pace, and the objectives of further devolution, there is an overwhelming consensus on the benefits of improving and strengthening the existing devolution settlement for the good of the country.

4. The principle that the UK Parliament should not normally legislate with regard to devolved matters without the consent of the Scottish Parliament is an important one. In this respect, the timetable of the Scotland Bill has provided less than optimum opportunity for the Scottish Parliament to scrutinise the legislation before its progress in the House of Commons, or to consult adequately with wider civil society in Scotland. In particular, it is regrettable that the first day of Committee Stage debate in the House of Commons took place before the Scottish Parliament had an opportunity to debate its Legislative Consent Motion. The Report of the Scottish Parliament's Scotland Bill Committee and the Minority Report submitted alongside it make numerous suggestions to strengthen the Scotland Bill. It is also regrettable that the UK Government has had such a very short timescale within which to consider and digest these proposals; however, the UK Government is urged to consider those recommendations and table amendments to the Bill in time for its final stages.

5. A motion passed by the Scottish Parliament on 10<sup>th</sup> March 2011 (Motion S3M-8114) by a vote of 121 to 3 with 1 abstention demonstrates the breadth of cross-party consensus in the Scottish Parliament on the need for a further Legislative Consent Motion before the Bill is given Royal Assent. The views of the next Scottish Parliament should therefore be sought on the amended Bill through a Legislative Consent Motion before it receives Royal Assent.

6. The Committee sought evidence on those recommendations of the Calman Commission not implemented in the Bill; those provisions in the Bill that were not recommended or considered by the Calman Commission; the Bill's fiscal and financial implications for Scotland; further provisions that might be included in the Bill in order to amend or develop the Scotland Act 1998.

7. The Committee's deliberations have centred mainly on the financial provisions of the Scotland Bill, as these have been the focus of considerable public debate and the source of greatest variation in views. However, the non-financial provisions of the Bill are also worthy of attention, and the Committee received numerous written submissions in response to its call for evidence from a wide range of stakeholders and individuals. Particular policy areas where proposals of the Calman Commission for further devolution have been omitted from, or only partially included in the Scotland Bill include a role for the Scottish in welfare benefits policy, marine nature conservation, and in relation to the Crown Estate. It is particularly to be welcomed that this Committee has decided to give further consideration to the problems associated with the operation of the Crown Estate in Scotland in a separate enquiry given the strength of the evidence received as part of this present enquiry.

8. While the Scotland Bill proposes the transfer of a share of income tax, stamp duty land tax and landfill tax to the Scottish Parliament, along with limited borrowing powers, taxes such as Corporation Tax, 'green' taxes, fuel duty, North Sea revenues and excise duties remain reserved. Under the Scotland Bill proposals, Westminster will continue to be responsible for raising eighty five per cent of the public money spent in Scotland. This observation may help put in perspective the extent and limitations of the Bill's proposals



for further devolution, highlight the relative fiscal responsibilities of the devolved and reserved institutions, and suggest the relative degree of accountability appropriate to each.

9. Insofar as eighty five per cent of Scottish revenues will continue to flow to the UK Government, the Bill preserves a highly centralised fiscal system. During evidence sessions, witnesses made the Committee aware of a diverse range of advanced economies in Europe and elsewhere where less centralised fiscal arrangements work effectively (in particular see the oral evidence of Professors Keating and Muscatelli, 8<sup>th</sup> February 2011).

10. In terms of improving accountability for the Scottish Budget, the UK Government's Command Paper estimates that the Scotland Bill's provisions would increase the proportion of the Scottish Budget funded from devolved taxes to around 35%. In its written evidence to the Committee, think tank Reform Scotland took issue with the UK Government's assessment of the proportion of the Scottish Budget that would be funded from devolved taxes should the Bill be enacted. Based on GERS figures for 2008-09 (the latest available) Reform Scotland estimated that the taxation provisions in the Scotland Bill would instead increase the proportion of the Scottish Budget funded from devolved taxes from 11% to around 26%, some 9% lower than the 35% cited by the UK Government. Giving oral evidence on 9<sup>th</sup> February 2011, Dave Moxham of the STUC indicated that their own calculations accorded closely with those of Reform Scotland. It would appear that the figure of 35% has been drawn directly from the Calman Commission's calculations which are based on the proposals in their own original Report, not on the actual proposals brought forward by the Government in the Scotland Bill which are different in some significant respects. Given that improving the financial accountability of the devolved institutions has been cited as a prime objective of the Scotland Bill, it is regrettable that the UK Government did not undertake robust, independent, and transparent calculations of the Bill's impact. There is no small irony in this omission given the emphasis it places on the importance of financial accountability.

11. The proposals to boost accountability through a partial devolution of income tax have stimulated extensive debate and have proved to be among the most controversial aspect of the Bill's proposals. The Committee heard contrasting views on the extent to which proposals in the Scotland Bill have the potential to embed a long-term deflationary bias within the Scottish Budget. While Fiona Hyslop on behalf of the Scottish Government argued that had the Scotland Bill's proposed model been implemented in 1999 it would have resulted in a cumulative budget shortfall in the region of £8 billion, Secretary of State Michael Moore, using a different baseline, has argued that the shortfall would be lower, at £700 million. Academic economists from whom the Committee took evidence expressed a range of views on 'fiscal drag', from Professors Scott and Hughes-Hallett, who see the deflationary bias as a major flaw, to Professor Gallagher who does not see it as a problem due to Scotland's shared tax base with the rest of the UK and continued dependence on adjustable block grant revenue.

12. In relation to the income tax proposals, the Scottish Government and others have expressed concern regarding the over-reliance on a single tax (in this case, one which has been decreasing as a proportion of public spending over the last forty years) rather than on



a basket of taxes. As income tax has grown at a slower rate than public spending across OECD countries in the last four decades, the Scotland Bill potentially introduces risks to the Scottish Budget. These risks could be partially mitigated by access to other economic levers, but the existing proposals of the Scotland Bill offer few such provisions. This problem is compounded by the fact that revenue from higher rate tax bands tends to grow faster than revenue from the basic rate band, yet the Bill devolves half of basic rate income tax revenue, but only a quarter of higher, and a fifth of top rate tax revenues respectively, thereby potentially exposing the Scottish Budget to unnecessary volatility, especially in times of economic downturn. During recession, lower revenue from income tax would be likely to lead to a decline in the Scottish Budget at a time when demands on it would be increasing and there would be merit in increasing public spending to stimulate the economy.

13. The devolution of Corporation Tax has been considered in the written and oral evidence of a number of respondents and witnesses. Although the Calman Commission did not advocate the devolution of Corporation Tax, proponents in business and academic communities, and the Scottish Government argue that it is a useful fiscal lever used successfully in other devolved and federal legislatures around the world that could and should be at the disposal of Scottish Ministers. The UK Government would seem to accept the argument that lower Corporation Tax can be an effective lever to boost economic growth, yet has rejected the devolution of Corporation Tax to the Scottish Parliament at this time. Those who argue in favour of devolving Corporation Tax allude to ‘flexibility to have a competitive environment for key sectors’ (Fiona Hyslop, oral evidence 1<sup>st</sup> March 2011) and the ability to help Scottish businesses mitigate some of the structural disadvantages associated with geographical location and distance from markets. Critics of the proposal cite the potential ‘cannibalisation’ of tax revenue as the key objection (Professor Gallagher). Professor Keating’s oral evidence nuanced this debate by highlighting ‘huge economic constraints on variation . . . the loss of competitiveness if you put it too high and the loss of revenues if you put it too low. The tax competition is a fact. . . as we find in other federal countries, [that] there is not a huge amount of variation, but it does give the opportunity for the fine tuning I was talking about earlier on, and the use of that in pursuit of specific industrial policy objectives. If Scotland had its own priorities, it could use the tax power in order to further them.’

14. This debate takes place in the context of lively discussions in other devolved territories about the merits of devolving Corporation Tax, most notably in Northern Ireland. Should Northern Ireland be granted the power to vary Corporation Tax, this would have implications for the Scottish economy, something recognised by the Scotland Bill Committee of the Scottish Parliament who recommended, ‘if a scheme to vary Corporation Tax were to be available in some of the devolved countries of the UK as a tool of the UK Government’s regional economic policy, it should be available as an option for a Scottish Government to use also.’ The Scottish Parliament Scotland Bill Committee also recommended that should there be ‘discussions between the Treasury and the devolved administrations about a framework that could see limited Corporation Tax variation become part of a regional development strategy, then it is important that Scotland is at the heart of any such discussions about a future UK framework’. The UK Government should

reconsider its decision not to include the devolution of Corporation Tax in the Scotland Bill and instead consider how such provision could be used by the Scottish Parliament and Government to strengthen the Scottish economy, create jobs and boost sustainable growth.

15. Although the Bill is intended to improve the financial accountability of the Scottish Parliament, there is a distinct lack of clarity around the process and mechanisms by which the Scottish block grant will be calculated on implementation of the Bill. The absence of any firm proposals to date for reducing the block grant has prevented the Committee from giving proper scrutiny to this crucial element of the Bill. This omission was noted by a number of witnesses, who highlighted various options for consideration, including drawing on the work of the Holtham Commission in Wales. The Scottish Parliament's Scotland Bill Committee also expressed concerns about this shortcoming in the Bill's proposals. If increased accountability is a desirable goal for the Scottish devolved institutions, it should also be a desirable goal for the UK Government, which, relatively, has greater responsibilities.

16. The Committee has also heard wildly different assessments of the costs associated with implementation of the Scotland Bill, and different assessments of the logistical and technical challenges it poses. While the UK Government estimates that costs of implementing the tax proposals will be in the region of £45 million, others have estimated the costs at over three times as much. More troubling is the prospect of the Scottish Parliament being expected to write a 'blank cheque' whereby the costs, as yet unquantified, will be met through the Scottish Budget should the Bill proceed in its present form, with no guarantee that costs will not be significantly higher than the estimated provisional estimate of £45 million. Sarah Walker of HMRC told the Committee that HMRC 'have reasonable confidence that that is a good estimate of the cost, but it will depend.' In the absence of detailed proposals that can be properly assessed and scrutinised, there is a need for HMRC to develop its plans in a fully transparent way that is accountable to both the Scottish and Westminster Parliaments.

17. The provisions in the Bill devolving Stamp Duty Land Tax and Landfill Tax are to be welcomed, but it is disappointing that the proposals of the Calman Commission to devolve Aggregates Levy and Air Passenger Duty have been dropped. . The Committee received evidence from Professor McLean pointing out that both have 'bases that don't move' and that the Aggregates Levy is complementary to landfill tax. This suggests that it is inconsistent to devolve one and not the other. Moreover, these taxes already operate in a differentiated way in Northern Ireland. Notwithstanding the legal proceedings ongoing in relation to the Aggregates Levy, this should be devolved in line with the Calman Proposals, a move that would not only strengthen financial accountability in Scotland, but also improve environmental accountability.

18. The Committee has also received evidence on and considered the capital and revenue borrowing provisions contained in the Bill, which would allow annual borrowing of up to £200 million in any one year, with a maximum limit of £500 million to finance current expenditure where there are differences between the forecasts and the actualities of Scottish tax revenue under the Bill's income tax proposals. Most of the expert witnesses from whom

we took evidence identified these limits as too low in the context of the introduction of the proposed new income tax raising powers, and the attendant increased volatility these are likely to bring. The Scottish Parliament's Scotland Bill Committee also examined this issue, concluding that the powers are 'inadequate' as proposed, recommending that the limit on borrowing be 'set by reference to the capacity of the Scottish Government prudently to finance it from devolved tax revenue.' That Committee also invited 'the UK Government to consider bringing forward these borrowing powers' while recognising the UK Government's wish to constrain borrowing in the present economic climate. The Scottish Parliament's Scotland Bill Committee also considered the issue of bonds, concluding that the ability of the Scottish Government to access the bond markets 'is not a possibility that should be ruled out in statute' and recommending 'that the Bill be amended to permit this, subject, if the UK Government thinks it necessary, to the agreement from HM Treasury to conditions for bond issues'. The Bill should therefore be amended in accordance with these eminently sensible recommendations which will strengthen the proposals in the Bill and enable more effective governance in Scotland.

Motion made, and Question proposed, That the Chair's draft Report be read a second time, paragraph by paragraph. - (*The Chair.*)

Amendment proposed, to leave out "Chair's draft Report" and insert "draft Report proposed by Dr Eilidh Whiteford". - (*Dr Eilidh Whiteford*)

Question put, That the Amendment be made.

The Committee divided.

Ayes, 1

Dr Eilidh Whiteford

Noes 6

Fiona Bruce  
Cathy Jamieson  
David Mowat  
Fiona O'Donnell  
Mr Alan Reid  
Lindsay Roy

Main Question put and agreed to.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 164 read and agreed to.

Summary agreed to.

*Resolved*, That the Report be the Fourth Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

Written evidence was ordered to be reported to the House for printing with the Report, together with written evidence reported and ordered to be published on 2 and 8 February.

[Adjourned to a day and time to be fixed by the Chair.]

# Witnesses

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## Wednesday 2 February 2011

Page

**Professor Sir Kenneth Calman** and **Professor Jim Gallagher**

Ev 1

**Ruchir Shah**, Head of Policy and Research Department, Scottish Council for Voluntary Organisations and **David Griffiths**, Chief Executive Ecas, and member of the Scottish Council for Voluntary Organisations Policy Committee

Ev 12

## Tuesday 8 February 2011

**Professor Anton Muscatelli**, Principal, Glasgow University and **Professor Michael Keating**, University of Aberdeen

Ev 26

**Sarah Walker**, Director of PSN, Her Majesty's Revenue and Customs and **Pamela Mulholland**, Head of Devolved Taxation, Her Majesty's Revenue and Customs

Ev 39

## Wednesday 9 February 2011

**Terry Murden**, Business Editor, The Scotsman and Scotland on Sunday and **Bill Jamieson**, Executive Editor, The Scotsman

Ev 47

**Dave Moxham**, Deputy General Secretary, Scottish Trades Union Congress and **Andy Wightman**

Ev 57

## Wednesday 16 February 2011

**Alan Trench**, Honorary Senior Research Fellow, The Constitution Unit, University College London, **Professor Iain McLean**, Nuffield College, Oxford University, **Professor Drew Scott**, Edinburgh University, **Professor Andrew Hughes Hallet**, George Mason University

Ev 68

**Rt Hon Michael Moore MP**, Secretary of State for Scotland, **Rt Hon David Mundell MP**, Parliamentary Under-Secretary of State, **Chris Flatt**, Deputy Director, Corporate and Constitution Division and **Laura Crawford**, Head of Scotland Bill Team, Scotland Office

Ev 84

## Tuesday 1 March 2011

**Gerald Byrne**, International and Constitution Directorate, Scottish Government, **Fiona Hyslop MSP**, Minister for Culture and External Affairs, Scottish Government and **Graeme Roy**, Office of the Chief Economic Adviser, Scottish Government

Ev 100

## List of printed written evidence

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(published in Volume II)

1	Scottish Council for Voluntary Organisations	Ev 116
2	Supplementary written evidence submitted by the Scottish Council for Voluntary Organisations	Ev 117
3	Professor Michael Keating, University of Aberdeen	Ev 118
4	Professor Andrew Hughes Hallett and Professor Drew Scott	Ev 120
5	Andy Wightman	Ev 124
6	Professor Iain McLean	Ev 126
7	The Scotland Office	Ev 129
8	Alan Trench	Ev 134
9	Additional written evidence submitted by Professor Michael Keating, University of Aberdeen	Ev 139
10	Rt Hon David Mundell MP, Parliamentary Under Secretary of State	Ev 139

## List of additional written evidence

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(published in Volume III on the Committee's website [www.parliament.uk/scotaffcom](http://www.parliament.uk/scotaffcom))

1	The Scottish Wildlife Trust	Ev w1
2	Lesley Riddoch	Ev w2
3	Glasgow Prestwick Airport	Ev w3
4	Law Society of Scotland	Ev w3
5	British Aggregates Association	Ev w12
6	Community Land Scotland	Ev w14
7	Councillor Donald Macdonald	Ev w14
8	Church and Society Council of the Church of Scotland	Ev w15
9	Reform Scotland	Ev w16
10	Scottish Community Alliance	Ev w19
11	United Free Church of Scotland	Ev w20
12	The Highland Council	Ev w21
13	Federation of Small Businesses	Ev w22
14	Association of British Insurers	Ev w22
15	Low Incomes Tax Reform Group	Ev w25
16	The Institute of Chartered Accountants of Scotland	Ev w27
17	Scottish Retail Consortium	Ev w29
18	Scottish Council for Development and Industry	Ev w33
19	Scottish Property Federation	Ev w36
20	Consumer Focus Scotland	Ev w38
21	Royal Society for the Protection of Birds	Ev w41
22	Brian Wilson	Ev w43
23	Scottish Islands Federation	Ev w44

24	Scottish Financial Enterprise	Ev w45
25	Scottish Federation of Housing Associations	Ev w46
26	Calum MacDonald	Ev w47
27	Rail & Maritime Transport Union (RMT)	Ev w49

## List of Reports from the Committee during the current Parliament

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

### Session 2010–11

First Report	Postal Services in Scotland	HC 669
Second Report	Video Games Industry in Scotland	HC 500
Third Report	UK Border Agency and Glasgow City Council	HC 733