Finance Committee

The Scottish Rate of Income Tax

Submission from PricewaterhouseCoopers

Response

Thank you for the opportunity for PricewaterhouseCoopers LLP (PwC or We) to contribute to the Committee's deliberations on the 2016-2017 budget. PwC is the largest professional services organisation in the UK, and employs around 16,000 people, of whom 300 staff and partners are in Wales, 850 in Scotland and 1,200 in Northern Ireland. We provide advisory services to Government departments, public bodies and agencies, as well as to organisations throughout the private sector. We consider ourselves well-placed to comment constructively and independently on the issues at hand. Drawing on our experience in the business community across the Scotland, we have sought to focus our comments on the way in which the potential tax policy changes might impact on businesses and on economic growth.

Setting a Scottish Rate of Income Tax (SRIT)

Setting the rate for the new SRIT which will apply from April 2016 is, of course, a matter for the current Scottish Government who will take into account a wide range of policy objectives. As detailed below we believe there are likely to be a number of practical complications with varying the rate which may make it less desirable, bearing in mind particularly that the SRIT is likely to be a temporary measure.

The considerations that lead us to this view are as follows.

(1) Complexity

Whilst income tax has been identified as a suitable tax for devolution to Scotland (as well as to other parts of the UK), there are still significant issues of complexity which should not be underestimated. Employers are still in the process of making changes to their PAYE systems and HMRC guidelines for the identification of Scottish taxpayers have not yet been finalised. The existence of the rate-varying power, rather than its use, has prompted the changes, but administering a rate that is different to the rate prevailing in the rest of the UK (rUK rate) will add complexity and administrative costs.

The further significant tax-varying powers contained in the Scotland Bill 2015 will, if enacted as drafted, abolish the lockstep mechanism whilst maintaining the integrity of the UK income tax system. The SRIT is, therefore, anticipated to be a short term measure, and hence the added burden from a changed rate for this period may be disproportionate.

(2) Behavioural impacts

Decisions on setting the SRIT should not, in our view, ignore the potential fiscally-induced behavioural responses that Scottish and indeed rUK taxpayers may have following a change in SRIT. While tax is not the only measure that individuals take into account in their choice of residence, it can be a factor.

This point was considered by the Holtham Commission which considered, in the context of Welsh devolution, the possible inducement of migratory flows between parts of the UK, as well as behavioural responses in those who remain.[1] These concerns will apply equally to Scotland as they do in Wales (notwithstanding the differences in population density living close to the Scottish and Welsh land borders with England).

The report concluded (para. 4.13) that, whilst in general the magnitude of migratory and behavioural responses and effects are uncertain and are likely to be relatively small, it is possible that a higher propensity to migrate is likely amongst the more affluent. For example, this may be due to the availability of multiple places of residence in the UK, including Scotland.

The Financial Scrutiny Unit briefing prepared for the Scottish Parliament in 2014[2] and a report drafted by the Royal Society of Edinburgh, following a debate with a panel of experts, supports this view, pointing out that additional rate taxpayers appear more likely to react to changes in tax rates than basic and higher rate taxpayers. To put this into context, it is estimated that there are approximately 2.1 million basic rate, 370,000 higher and 18,000 additional rate taxpayers in Scotland.

In summary, any tax rate differential could influence worker migration, particularly among the more affluent, with a consequential impact on tax revenues. The extent to which SRIT can diverge from rUK rates without a distorting effect on the tax base may therefore be limited.

(3) Impact on tax revenues

It should be noted that there is not always a simple correlation between raising rates and raising revenues (or vice versa). There may be no significant increase in revenues associated with higher taxes due to the ability of high income earners to relocate within the UK. An unintended effect could be that the higher SRIT would apply to lower income households, i.e. those that are unable to relocate, while failing to collect the additional revenue from wealthier ones. Considerations as to the equity of this approach, and the potential impact of higher rates on all taxpayers should be included in any rate-setting decisions.

We have not modelled the effect of various possible rates for SRIT. However, such modelling clearly needs to be performed in some detail and regularly to assess the effect on revenues in relation to the additional complexity for individuals and employers.

Public awareness of the introduction of SRIT

[1] http://gov.wales/docs/icffw/report/100705fundingsettlementfullen.pdf
[2] http://www.scottish.parliament.uk/ResearchBriefingsAndFactsheets/S4/SB_14-14.pdf and https://www.royalsoced.org.uk/cms/files/events/reports/2014-2015/Further-powers-for-Scotland.pdf

In his report[3], Lord Smith of Kelvin noted that one of the challenges facing both the UK and Scottish Parliaments is the relatively weak understanding of the current devolution settlement.

Our Citizens' Jury research has indicated consistently that the current allocation of powers and the issues of managing the fiscal deficit are widely misunderstood, and that when citizens are better informed, their views on such matters alter significantly.

PwC has, for a number of years, engaged actively with our wide-ranging client base to raise awareness of SRIT, and to help our clients understand and assess the potential impact of its introduction. As a leading professional services firm, we engage with businesses across all sectors of the economy and our interactions with, and feedback from, our wide-ranging client base suggests that, both in a business and an individual capacity, there is a very low level of knowledge and understanding of SRIT. Indeed, a surprisingly high number of organisations had have no knowledge of SRIT at all.

The Scotland Act 2012 was enacted in April 2012. The then Secretary of State for Scotland, Michael Moore MP, described the legislation as the largest ever transfer of fiscal powers from central Government to Scotland. Despite this, and the fact that the SRIT was scheduled to be introduced regardless of the outcome of the referendum on Scotland's independence in September 2014, it was largely unnoticed, and was overshadowed by the media campaigns focused on the independence referendum.

It is, therefore, important that the Scottish and UK Governments, together with HMRC, take appropriate steps now to increase awareness levels, especially amongst taxpayers. Consideration could be given to targeted campaigns aimed at informing and educating both individuals and employers ahead of the introduction of the SRIT. This would help to raise awareness levels of Scotland's new fiscal framework, thereby providing greater transparency and financial accountability.

This could be achieved through the use of a number of social and broader media platforms, such as TV and radio advertising, social media blogs (e.g. LinkedIn, Twitter), HMRC employer bulletins, gov.uk website and the publication of a range of materials designed to raise public awareness and educate the public on the forthcoming changes.

On a further practical note, given the lack of public awareness of the changes, it is possible that individuals will turn to Revenue Scotland in the first instance when they have questions on SRIT, at least until such time as it is clear to people that the tax continues to be administered by HMRC. It would be helpful for Revenue Scotland to take pre-emptive action, for example by including links in their web page to HMRC information on income tax.

In conclusion, once a decision on the rate of Scottish income tax has been reached, we consider that this should be communicated with a higher degree of transparency

[3] Smith commission https://www.smith-commission.scot/wp-ntent/uploads/2014/11/The_Smith_Commission_Report-1.pdf

and clarity as widely as possible, and that the impact is monitored in order to demonstrate the impact on revenues and spending.

If you would wish to discuss these issues further, please do not hesitate to contact us.

Yours faithfully,

David Glen

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