THE WHITE PAPER PROJECT

A Scottish Tax System
— Imagining the Future
— Executive Summary

COMMON WEAL POLICY
Introduction

This report makes suggestions on how an independent Scotland might create a viable tax system. The report is split into four sections. The first considers the principles and foundations on which a Scottish tax system should be based.

Part two makes observations on the political and functional organisation of a Scottish tax system.

The third section looks at the interaction of the Scottish tax system with those systems from which it will need to draw data to ensure that taxes can be properly charged.

In part four there is a discussion of more detailed aspects of the tax system Scotland needs, including looking at the actual taxes required and mechanisms needed to beat tax abuse.

The principles and foundations on which a Scottish tax system should be based

*Principles*

A tax system is based upon mutual trust. An electorate has to believe that its government will impose appropriate taxes and then administer them not just legally but in accordance with the principles of social justice. A government has to trust that its electorate will pay in accordance with the spirit as well as the letter of the law of the country.

This relationship of mutual trust requires that a tax system be based on sound principles that are clearly stated so that all can understand them. While the Universal Declaration of Human Rights does not refer to taxation directly, a careful reading of the Declaration suggests a number of the principles of a Scottish tax system can be derived from the text.

It is suggested that these principles should form the basis for Scottish taxation.

*Economic Foundations*

If Scotland is to have a sound tax system then it must be based on economic reality. It is widely believed that tax is necessary to pay for government provided services. It has, however, recently been realised that this is not the case. This is because all government services can in principle be paid for either by a central bank creating new money or by quantitative easing (‘QE’) operations (which amount to much the same thing).

This understanding is critical to the design of a Scottish tax system. What it demands is that Scotland must have its own currency from the day it becomes independent. This is because of another critical consequence of the understanding of tax and money, which is that a country with its own central bank and currency cannot go bankrupt.

What should also be clear is that a Scottish currency is also essential for the creation of an effective tax policy for an independent Scotland. This is because if a country has its own currency then there is technically no limit to what a government can achieve. There are, however, two
practical constraints. The first is that the government does not try to create more economic activity than the economy can deliver. And the second is that they must tax sufficiently to cancel enough of the money that the government has created through its spending to ensure that its inflation targets are met.

The implications of this understanding are profound. First, a policy based on this understanding does not require that the Scottish Government balance its budgets. Secondly, this understanding means that the Scottish Government does not need to think itself beholden to bond markets or their interest rate whims. Third, in this scenario tax entirely ceases to be a mechanism that raises money to pay for government spending. Tax is, instead, a means of reclaiming the money that the government has spent into the economy as a result of that spending.

**The reasons to tax**

There are six reasons to tax:

i. **Reclaiming the money the government has spent into the economy.** Tax reclaims the money spent to prevent excessive inflation.

ii. **Ratifying the value of money.** The payment of tax gives a currency its value in exchange and as a result passes control of an economy to the government that charges that tax.

iii. **Reorganising the economy.** Tax is an integral part of shaping macroeconomic policy to meet social and economic goals.

iv. **Redistributing income and wealth within the economy.** This is an essential function that any Government must undertake and appropriately designed taxes are a proven and effective method for delivering this policy.

v. **Repricing goods and services.** Markets cannot always price the externalities of the goods and services they supply or reflect social priorities. Tax permits repricing of goods and services to reflect these facts.

vi. **Raising representation in democracies.** When people recognise that they pay tax they are more interested in engaging with the electoral process.

**Theory into practice**

The following statements should form the basis for tax in Scotland:

i. The tax system should deliver the macro-economic goals of the Scottish Government.

ii. The tax system should reflect the social priorities of the Scottish people.

iii. The tax system should encourage the engagement of all in Scotland in the democratic process.
iv. The Scottish tax system should be effective in:
   - Reducing economic and social stress within Scotland and between Scotland and other states;
   - Encouraging truthful, tax compliant behaviour;
   - Minimising opportunities for tax abuse.

v. Additionally the Scottish tax system should be:
   - Integrated with other law, such as that regulating companies, partnerships and trusts to help deliver tax compliant behaviour and a level playing field for all Scottish businesses;
   - Adequately resourced to achieve these objectives.

The political foundations of Scottish taxation

Some practical assumptions

An independent Scotland will transition from being part of the United Kingdom, this process will require co-operation based on the following assumptions.

First, that an independent Scottish Government will have time between the date when an independence vote and the day of independence itself to put essential measures in place.

Second, that unless decided otherwise the provisions of UK law tax will become Scottish law tax after independence.

Finally, that HM Revenue & Customs in Scotland will transition to become the Scottish tax authority and that the dual structure now in place will cease to exist.

The politics of tax

It will be necessary to create new structures to manage tax within the political landscape, in which it will play an integral part. This requires five things:

1. There should be a minister responsible for taxation.

2. There should be a ministry for tax that is independent of, but which should clearly liaise with, the Finance Ministry that would be responsible for managing the state’s spending.

3. To preserve the political independence of the tax collection function the ministry of tax would devolve such tasks to an administrative agency.

4. The Scottish Parliament should have a tax select committee.

5. There should be an Office for Tax Responsibility that should report directly to that committee.
Revenue Scotland

A Minister of Taxation must be responsible for the Scottish tax system, but an agency that is beyond political interference must be responsible for the administration of tax in the country. Revenue Scotland must fulfil that role, but must not be modelled on HM Revenue & Customs. The structure of HMRC has been rightly criticised for:

- Being too close to big business;
- Having too close a relationship with the biggest firms of tax lawyers and accountants;
- Being selectively hostile to smaller business interests;
- Being lenient on the wealthy whilst being inflexible in their approach to those on benefits.

To avoid this, the governance structure of Revenue Scotland must be robust. This would suggest that it should have a Board made up of both Revenue Scotland personnel and people representing a wide range of stakeholder groups, and not just business interests. The groups to be represented might include:

- Large business;
- Smaller companies;
- The self-employed;
- Pensioners;
- Trade unions;
- The staff of Revenue Scotland;
- Charities;
- Civil society;
- Local authorities;
- The tax profession..

A local tax office network throughout Scotland, a strong career structure with appropriate pay and restrictions on the right of senior staff to work in the private sector will also be necessary to ensure change in behaviour and culture.

Tax reporting

The government of an independent Scotland should publish information in a way that is readily accessible to, and as comprehensible as possible about, its accounts, both in total and by department, as well as about its tax system, again in total and by individual tax.

First, the government should publish its accounting data in interactive format so that a person could access information at whatever level they like. In addition, it is essential that information on outcomes against expectations be provided both in total and by department so that the ability of the government to deliver against its budgets can be checked by anyone who wants to do so.

Second, Revenue Scotland should explain not just what taxes there are, but why they exist, what they are meant to achieve, how they are meant to achieve it and what success criteria will be used for the appraisal of whether or not they actually achieve that goal. This should include the proactive monitoring of tax performance by Revenue Scotland and the Office for Tax Responsibility.
Finally, the tax gap should be measured by Revenue Scotland and the Office for Tax Responsibility, and as a tool used to improve economic management in Scotland.

**Securing the data needed to underpin Scottish taxation**

*Tax related data*

Securing the data required to deliver a robust tax system is a six-stage process:

1. **The tax base has to be robustly defined.** Scotland will need to write its tax law purposively, making it clear that whole classes of transaction and assets are within the law unless specifically excluded from being so. The opportunities for tax abuse should be reduced as a result.

2. **The tax base has to be found.** Finding the tax base requires systems that are capable of determining:
   a. Which people are in Scotland;
   b. The companies that are active in Scotland, including those doing so that are incorporated in other countries;
   c. Who is trading;
   d. Who might be importing and exporting, as well as what they are bringing into and out of the country;
   e. Which people are in employment;
   f. Who owns assets such as land and buildings, shares in companies, bank accounts and other valuable property such as patents and copyrights as well as moveable assets such as vehicles, planes and yachts if they are to be taxed. Comprehensive record keeping systems are required as a result, with verification of ownership being an essential component in all such systems.

3. **The tax base has to be counted.** This requires that accounting and valuation systems appropriate to Scotland’s needs are in existence.

4. **Assess the tax base at the right rates of tax.**

5. **Allocate the resulting revenues efficiently and to best social effect.** This requires that a government has a robust and accountable budgeting system.

6. **Report on the outcomes of taxing.**

*National income data*

Data is needed on the total levels of the following within the economy:

1. Consumption by households;
2. Investment by business;
3. Government spending;
4. Imports and exports;
5. Wages;
6. Rents;
7. Profits,
8. Production;
9. Movement in inventory levels.

If Scotland is to have a reliable and accountable tax system it is essential that it has its own system of national accounting and official statistics that is suitable for the purposes of Scottish decision making, which Government Expenditure and Revenue Scotland (GERS) has never been.

The taxes that will be needed

Introduction to this section

The Scottish tax system will have to incorporate a wide range of taxes already in operation in Scotland that are more or less universal to modern tax systems. The rest of this section will focus on where an independent Scottish Government may seek to innovate to create an integrated tax system that meets Scotland’s specific needs.

Failings of the existing UK tax system

Almost all UK taxes have serious failings that need to be addressed in an independent Scottish Government’s tax system:

- **Income tax**: Generous allowances, savings and reliefs that are predominantly advantageous to the wealthy and unnecessarily increase complexity
- **Corporation tax**: Low rate and poorly policed/monitored
- **Capital Gains Tax**: Rates lower than income tax reduce yield and encourage tax avoidance
- **Inheritance Tax**: Poorly designed, easy to avoid and discriminates in favour of the wealthy
- **National Insurance**: Designed for a different era when unemployment was low, almost everyone worked only one job and self-employment was rare – not fit for purpose
- **VAT**: Regressive and with a high rate of tax evasion
- **Stamp Duty**: Too narrow in scope on financial transactions and easily avoided
- **Specific taxes**: Can be arbitrary and require explanation for effectiveness
- **Customs duties**: Effective but utilising old IT systems

There is also a range of other weaknesses in the design and administration of the UK’s tax system, including:

- No wealth tax
- No tax aimed at reducing excessive consumption
- HMRC report of activities is poor
- The UK tax gap remains high
- The UK tax office closure programme threatens to withdraw HMRC from most communities in the country
- Many think that planned staff cuts at HMRC will leave it critically short of tax specialists
- Programmes such as ‘Making Tax Digital’ are likely to reduce voluntary tax compliance
- The tax system as a whole is largely flat in its overall application, excluding those in the bottom decile of the income range for whom it is regressive.
Improvements required to create an effective Scottish tax system

There is room for considerable scope for reform to the UK tax system when adapted for use in Scotland:

Income tax
Reduce the Personal Allowance; more bands; a 50p rate; a ‘base rate’ of income tax; end higher rate reliefs beyond Personal Allowance; Investment income subject to a surcharge in excess of £3,000; reconsider tax incentives for savings; enhanced resources for identifying income of self-employed; withdraw notes of more than £10 to discourage cash economy.

Corporation tax
All companies should submit a corporation tax return; no company incorporated without proof of identity of shareholders owning more than 10% of the capital and all Directors; All shareholders owning more than 10% and Directors should become personally liable for its tax liabilities if the company fails to file a tax return within 90 days of request; Banks operating a bank account on behalf of a company should be required to report annually who they think the directors and persons owning in excess of 10% are; the rate of Corporation tax should be increased – at least 5% higher than the basic rate of income tax for small companies and 10% for big companies; all dividends should be subject to a tax equivalent to the basic rate of income tax; a strong commitment to corporation tax has to be made clear.

Capital gains tax
Taxed as if income at income tax rates; annual capital gains tax allowance reduced to maximum £2,000; abuse of transfers between spouses and civil partners must be curtailed; abolish Capital Gains Tax entrepreneur’s and reinvestment reliefs; capital gains tax should be applied to the sum realised on death on disposal of a former principal private residence taking into account all such properties owned during life.

Wealth Taxation
Inheritance tax abolished; Capital Gains Tax charged on death; a lifetime gift receipts tax created; an annual wealth tax created – a lower rate on all personal wealth exceeding £2 million and a higher rate on property of all trusts without identifiable settlors and with discretionary benefits.

National insurance
NI thresholds above income tax thresholds; The pension credit now earned by making a NI contribution should instead arise from having taxable employment income sufficient to give rise to an income tax liability; upper threshold for NI abolished (but compensated for with 30p income tax rate over an extended income range); eventual replacement with carbon usage tax (more below).

VAT
VAT exemption abolished on financial services and for-profit health and education; VAT relief introduced to encourage renovation of existing properties; VAT zero rating on installation of more energy efficiency products; Charities allowed to reclaim VAT; VAT returns adapted to be basis of digital recordings for tax purposes.
A Financial Transactions Tax
The finance sector is not subject to VAT and thus has a competitive advantage; the financial sector should be taxed in order to modify its tendency towards reckless behaviour that destabilises the economy; Stamp Duty is already a tax on trading transactions and it should be extended to share related financial derivatives in the form of a FTT; this should also be on other forms of financial trading including foreign exchange trading, where most trades are speculative; the rates charged will be tiny – the effect will be to reduce incentives for speculative risk; the FTT should be increased rapidly at times of high financial trading volatility; the FTT would reduce inequality, level the playing field and reduce market shocks.

A Carbon Usage Tax
The UK’s indirect taxes and specific tax charges are regressive in impact; a CUT would be a progressive indirect tax which would eventually replace National Insurance; The CUT will be charged on the flow of funds through a person’s bank account, will be levied by the bank and will be progressive - for most people the rate will be set at 0%; those without a bank account or who cannot explain their low bank account usage will be assessed on their income; the tax is a levy on higher rates of consumption and as such is a green tax.

Beating tax abuse

It is vital that Scotland builds a robust system to beat tax abuse within its tax system. The following is recommended:

Scottish tax law should be principles based
Tax abuse should be defined as seeking to circumvent the intention as well as the letter of the law and be backed up by a tough General Anti-Avoidance Principle built into the tax code.

International tax abuse
Scotland should seek to adopt double tax treaties based on the United Nations principles and not those of the OECD and commit to full public country-by-country reporting for all companies.

Beating domestic tax abuse
Any bank trading in Scotland must be required to provide full details to the Scottish authorities of any account that they maintain anywhere for any Scottish resident person or company on an annual basis, including the total sum deposited in the account each year.

Investing in tax
This requires adequately resourcing a Scottish tax administration, additionally tax should be taught in schools and universities, tax research sponsored, career progression in tax should be available and there should be maximum transparency in the workings of the tax system.
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