Taxing an independent Scotland

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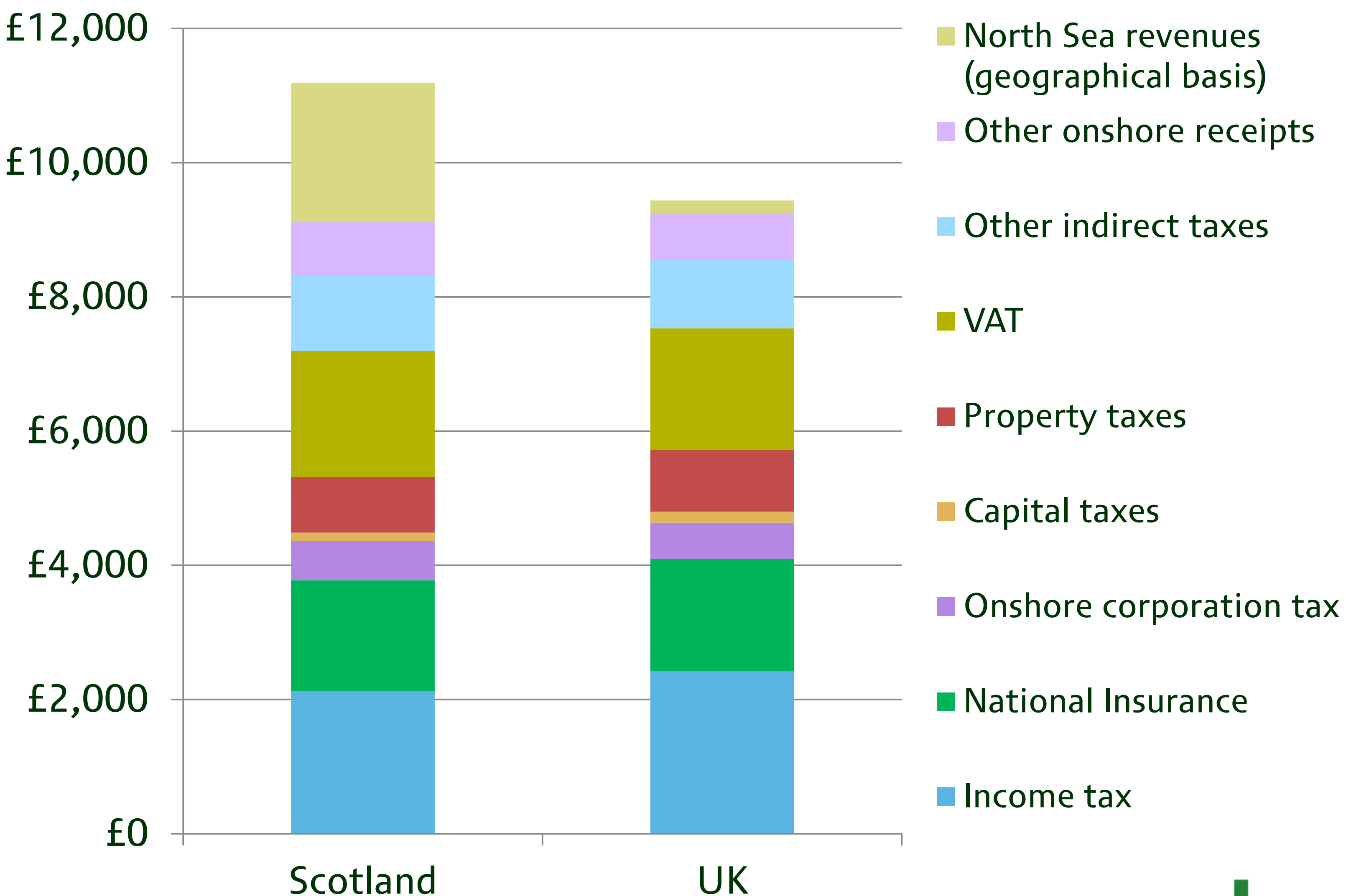
For full report see *www.ifs.org.uk/publications/6912*

Revenue per person, 2011-12

2013-14 prices



Source: Authors' calculations using GERS 2011-12

Options for raising more revenue

Reform	Revenue raised
Income tax: increase basic rate by 1ppt	£365m
Income tax: increase higher rate by 1ppt	£60m
Income tax: reduce personal allowance by £500 p.a.	£280m
VAT: increase main rate by 1ppt	£430m
VAT: increase reduced rate by 1ppt	£35m
VAT: increase zero rate by 1ppt	£165m
Increase alcohol and specific tobacco duties by 10%	£120m
Increase fuel duties by 10%	£215m
Increase council tax rates by 10%	£175m
Abolish single occupants' council tax discount	£140m

Note: Full-year (2014-15) effects of reforms introduced in 2013-14.

An opportunity to improve on the UK tax system

Mirrlees Review (*www.ifs.org.uk/mirrleesReview*) identified many flaws in need of attention, including:

- Council tax is still based on 1991 property values
- Corporation tax favours debt finance over equity
- Zero and reduced rates of VAT are an inefficient way to redistribute
- Inconsistent carbon prices makes cutting emissions unnecessarily costly
- Fuel duties not well targeted at congestion
- Business rates discourage property-intensive forms of production
- Stamp duty means properties not owned by people who value them most

Tax design for an independent Scotland

Scots might have different priorities

- Put more/less value on reducing inequality, paying for public services, etc.

Two other reasons Scotland's optimal tax system differs from UK's

1. Scotland has different characteristics from the UK as a whole

2. Scotland and rUK having different tax systems
   - Hassle for people/firms with cross-border affairs
   - International mobility and tax competition
   - ➢ Inter-governmental co-operation would be valuable, both for enforcement and to limit tax competition

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Scotland has different characteristics

- Slightly more equal income distribution → less need for redistribution
  - Though may also have stronger/weaker preference for redistribution
  - Or more/less responsive population

- Lower congestion → motoring taxes should raise less
  - Congestion, not emissions, is the biggest cost imposed by driving
  - Driving 1km causes congestion worth 6.3p in Scotland *vs.* 12.3p in England & Wales

➢ *NB these are differences relative to optimal, not current, UK policy*

- Oil and gas are a bigger part of the economy (if split geographically)
  - Optimal tax policy the same: high, stable rate on cash-flow base
  - But getting it right is more important in Scotland

Cross-border issues: direct personal taxes

- Hassle for people with cross-border affairs
  - Understand system, deal with two tax authorities, fill in tax return,…
- And potential tax competition
  - Insofar as people can move to / work in / save in lower-tax country
- ➢ Extent of both of these would depend on detailed rules adopted
  - Replicate UK system or choose something different?

Cross-border issues: corporation tax

- Would need to calculate how much profit earned in each location
  - Big challenge if Scotland and rUK choose different rates
- SNP propose a rate 3ppts below rUK rate
  - Would encourage investment in Scotland and profit-shifting to Scotland
  - Size of these responses difficult to quantify
- Independence also strengthens rUK incentive to cut rate: competition

Cross-border issues: VAT and excise duties

- ‘Destination basis’ of VAT mostly avoids problems of corporation tax
  - Location of consumption easier to identify than location of production

- But still some cross-border concerns
  - Cost and hassle of trading across borders
  - Greater scope for fraud
  - Cross-border shopping (especially excise tax competition?)

Mobility of tax bases

- Clearly highest for corporation tax (mobile investment, profit-shifting)
- And lowest for property taxes (land and existing buildings can’t move)
- Personal taxes (moving/working/saving abroad) and indirect taxes (cross-border shopping) somewhere in between

➢ Shift to greater reliance on less mobile tax bases, especially property?
  – Opposite of recent trend

Conclusions

- Scotland raises similar onshore revenue to UK as a whole
  - Less from income tax and from wealth and property taxes
  - But more from VAT and duties on alcohol and tobacco
- Geographical share of oil revenue means higher overall – for now
- Independence would give opportunity to design tax system differently
  - Remove some of inefficiencies in current UK system
  - Reflect different preferences and different economic circumstances
- But independence also brings challenges
  - Cross-border shopping and tax competition: rely more on property taxes?
- Economic differences and tax competition both point towards lower optimal tax rates in Scotland than in UK
- Yet dealing with budget deficit points towards higher taxes