



Scottish Parliament

Finance and Constitution Committee

Inquiry - Pre Budget scrutiny - 2021/22

Evidence from ICAS

5 August 2020

Introduction

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.
2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions relevant to Chartered Accountants.
3. We welcome the opportunity to give evidence to this inquiry.

General comments

4. The overall background against which the 2021/22 Budget is set will be the need for funds to support the economy to rebuild and to provide public services. At the same time, sources of revenues are likely to be reduced and fragile. The Budget in 2021/22 will need to manage the tensions arising from a desire to spend, but less revenue with which to do so. And where any burdens fall (say, less spending and/or any tax increases) needs to be agreed and supported by the citizens of Scotland. It will also be set against the UK backdrop.
5. Revenues for the Scottish Budget come predominantly from the block grant, taxation and the impact of block grant adjustments. The fiscal framework is due for re-negotiation in 2021. The negotiations may, or may not, be brought forward but the Scottish Budget constraints are not unique; in broad terms they also apply to the rest of the UK. What is unique is the number of moving components that make up the Scottish Budget and the need to manage these in the round. They are not easy to understand making accountability and public understanding more challenging.
6. A policy of openness and transparency alongside ensuring effective challenge and scrutiny exists, is critical in building trust in government, meeting stewardship duties and demonstrating accountability for decisions.
7. The purpose of the Scotland Act 2016 was to make the Scottish Parliament more accountable to the public, but this purpose is undermined if its policies are not understood. We believe that more could be done to improve wider understandability and explain decisions.
8. The pandemic has illustrated the importance of clear and prompt (ideally synchronised) communication of the differences around application of initiatives/ lockdown easing measures for businesses in devolved jurisdictions to minimise confusion. This will remain relevant in relation to Budget 2021/22. It has also demonstrated increased interest in, and challenge of, devolved decisions. Full details of how the Barnett Consequentials are applied both in terms of devolved priorities and the finances (particularly where subject to a different devolved policy decision) would help to strengthen transparency and promote understanding, trust and accountability.
9. We suggest that there needs to be a greater level of public debate, public understanding and engagement on public finances and tax, including increasing transparency about the link between raising tax revenues and paying for improved public services. Media reporting tends to concentrate on the need for taxes to be paid by large businesses and wealthy individuals, but the public debate should also cover how, and to what extent, everyone should contribute.
10. The Scottish Government (and the UK Government) plus those involved in developing and implementing the measures introduced to ease the economic impact of coronavirus, have instigated closer and stronger collaboration with the professional bodies and the accountancy profession. We hope this will continue as the focus shifts to rebuilding the economy because we believe it has been beneficial.
11. The recovery from Covid-19 is subject to considerable uncertainties; it is likely to be lengthy and troublesome for business and the economy - and remains highly dependent on the duration of restrictions, any recurrence of the virus and the effectiveness of the Government response (both UK and Scottish). Further information on the ranges of possible outcomes will be needed.

12. As Chartered Accountants, our submission focuses on our areas of expertise: governance, accountability, scrutiny and taxation.

Specific questions

Question 1: What should be the priorities in Budget 2021/22 in addressing the impact of Covid-19?

13. A key priority is to support the economy; the private sector economy needs to be as robust as possible to provide employment and wealth creation. Without this, there are limited sources of taxation revenues to provide government funds.
14. A number of elements may be needed in order to support the economy; there needs to be a balance between:
- any 'kneejerk' reaction to raise taxes to fund the extra borrowing arising from Covid-19,
 - raising taxes to fund the inflationary element of existing public services, and
 - the need to keep the tax burden manageable over 2021/22 to support the economy in order to get people back into employment and through Brexit.

Taxation needs to both collect funds and support the economy or, at the very least, not create economic disincentives or distort behaviour.

15. Businesses and employment are needed to provide structure, a sense of purpose, and vitality within our communities. There should be a broad policy of engagement with businesses and citizens across Scotland in securing a short-term financial strategy, which has public support. There may also be a need to weigh up whether sector specific support is needed¹.
16. For the public sector, the funding of local government needs to be revisited with a need for longer term budget planning, including an inquiry to look at the evidence around social care needs, funding and working with the NHS. Covid-19 exposed the lack of a holistic approach to care homes to date. As a result, their needs and the risks posed by Covid-19 were not identified. The significant and growing cost of social care is an 'elephant in the room', which has been put off for years. Now would be a good time to review the evidence and set out a plan.
17. A further priority in relation to social care costs is to try and encourage better understanding across the four nations of the UK about the devolved settlements. For instance, it may not be helpful to increase NIC to fund social care, as some commentators have proposed; NIC is a reserved source of funds, but social care is a devolved responsibility.

Question 2 - How should Budget 2021-22 address the unprecedented levels of uncertainty and volatility in the public finances arising from the public health emergency in such a way that allows public bodies some certainty in planning and managing their own budgets?

18. Evidently, we are experiencing significant volatility and uncertainty. Normally, the Finance and Constitution Committee may be presented with a Budget of set amounts, which would be considered, and questions asked about those amounts. We suggest that the Committee needs more information about the ranges of possible outcomes and spending so that the Committee can get a feel for how optimistic, realistic or pessimistic the Government is being and assess the level of preparation/ ability to meet expected challenges. This is particularly important for those areas where the Government cannot control the outcome in the short term, such as tax receipts and demand led spending such as social security.

Question 3 - Given the ongoing uncertainty and volatility, what changes to the budget process both within government and parliament may be required to ensure sufficient transparency and Ministerial accountability in a rapidly changing fiscal environment?

19. As raised in paragraph 6, a policy of openness and transparency, supported by effective challenge and scrutiny is critical in building trust in government, meeting stewardship duties and demonstrating accountability for decisions.

¹ See also [ICAS response to Advisory Group on Economic Recovery](#)

Process around taxation

20. In terms of tax policy making we would like to see the Parliament continuing to evolve from being mainly a spending institution to one in which equal weight and deliberation is given to raising the taxes to fund the spending. To support this the Scottish Parliament should institute a Tax Committee or a Tax sub-Committee of the F&CC Committee. This would ensure that time would be set aside for scrutiny of tax policy and committee members would be able to further develop their tax expertise.
21. There is at present no regular process for bringing forward and considering tax legislative changes, but it would be helpful if there was. We are therefore supportive of the Devolved Taxes Legislation Working Group completing its analysis of this and hope their work will not be deprioritised due to additional demands arising from the pandemic.
22. Something which has been innovative in Scotland is the Scottish Government's policy-making approach to taxation. A new, and in our view, successful process was used in November 2017 when the Scottish Government issued '[The role of Income tax In Scotland's Budget](#)', prior to the Scottish Budget. This set out a number of options for exercising income tax powers and was followed by a series of round table discussions. This was a most constructive and helpful exercise, which helped to pave the way for the introduction of the new structure for Scottish income tax, with the five rates and bands. By contrast, the unexpected late amendments to last year's Budget relating to the new tourist tax and the workplace parking levy (which were added without prior consultation), were unfavourably received. We caution against the use of late amendments to introduce new tax measures.
23. The Scottish Government has also been carrying out work to improve communications about tax with the general public, which we welcome. As noted in paragraph 9, we believe that there needs to be public debate and a raising of public understanding and engagement on public finances and tax. With greater awareness comes more understanding and this should help to generate taxpayer support.
24. In our view, the pandemic has not created a need for new tax policy and legislative processes in Scotland – this need already existed. It would be disappointing if the Covid-19 crisis delayed work in progress. The current strands of work (on tax policy making, the legislative process and communications about tax) should lead to a more robust tax system with greater transparency and trust.

Question 4 - What are the risks to the Scottish Budget arising from Covid-19 having a differential impact in Scotland both in terms of the impact on the Scottish economy relative to the rest of the UK and the impact on public expenditure including devolved social security benefits relative to the rest of the UK?

25. The Scottish Budget comprises the block grant, block grant adjustments, tax receipts and spending commitments. There are many moving parts, each of which may have Covid-19 related risks attaching to it. There is also concern about how the cumulative effect of these risks may impact on the Budget.
26. The risks include that there may be a need for different spending priorities, for instance, if there is higher unemployment than the rest of the UK or if there is longer lasting damage to particular sectors which are more prevalent in Scotland. Will support for these be reflected in the block grant?
27. There is also the risk that policies may seem disjointed, or may not be understood by the public and, hence, will lack public support. Central to the overall recovery will be the interaction and coordination of roles and relationships between institutions across Scotland. Success will depend on more collegiate politics across the UK, Scotland, regional partnerships and local authorities. Full recognition should also be given to regional variation and circumstances, with the roles of communities and volunteers harnessed for a more participative democracy. People should be fully engaged in the national effort to revive and restore the economy.
28. Citizens' and businesses' trust in government will be vital in the recovery and vice versa. This will require ongoing understanding of the evolving change. Required will be a continuous

engagement with business organisations in designing and delivering recovery and greater data sharing between business and government.

Question 5 - What are the implications for the Scottish Government's existing taxation policy arising from Covid-19 and what changes, if any, should be considered?

29. This is a time of economic fragility so businesses value stability, certainty of the longer-term picture and prompt communication to support their planning and encourage investment.

Income tax

30. There are risks that there will be less tax collected in 2021/22. In 2020/21 the budget estimates were that there were 2.6 million income taxpayers in Scotland and the average annual salary was estimated to be £25,200. Furthermore, in 2020/21 only 9% of Scottish adults (387,000 in absolute numbers) were expected to pay higher rate tax and 17,000 adults (0.4%) the top 46p rate. These are small numbers, and there is the risk that they may be smaller if the economy is restricted and unemployment grows.
31. At the same time there may be calls to collect more tax. Whilst many believe in a more progressive income tax system there are tensions and challenges arising from the size, shape and potential mobility of the Scottish income tax base, which need to be factored in when developing the Scottish Budget income tax rates for 2021/22. This may be more so, depending on what may be proposed in the UK Budget for 2021/22, if this leads to any greater divergence.
32. Key to the longer-term ability to generate more Scottish income tax is growing the economy and hence the taxpaying base – in both absolute numbers and higher incomes. It would also be desirable to attract more higher rate and additional rate jobs and job holders to Scotland.

VAT

33. The aim of the Smith Commission was to align a source of tax revenues with the performance of the Scottish economy but, despite much negotiation, a satisfactory methodology for VAT assignment has yet to be identified. As things stand, it cannot be clearly linked to the Scottish Government's economic policy – and it is a moot point whether VAT assignment brings any benefits to either government (UK or Scottish). We suggest that this be kept on hold at present. It would make more sense to revisit the fundamentals of this as part of the forthcoming fiscal framework discussions.

Land and Buildings Transaction Tax (LBTT)

34. There have already been two temporary changes to LBTT policy as a result of the Covid-19 pandemic. Firstly, to change the eligibility conditions for claiming a repayment of the Land and Buildings Transaction Tax Additional Dwelling Supplement, which was legislated for in the Coronavirus (Scotland) (No. 2) Act 2020; there is flexibility within this, so it is possible to further extend the two periods designated, if needed. Secondly, from 15 July, SSI 2020/215 will raise the threshold for paying LBTT until 31 March 2021. This may set expectations for 2021/22.

New taxes

35. There is scope to introduce new devolved taxes; so far, there is to be a Scottish wide framework to provide for a tourist levy and workplace parking, which each local authority can then choose to implement (or not). Other suggestions have been put forward including a vacant land tax and a charge on disposable cups.
36. Such suggestions need robust public consultation before proceeding, to ensure the broadest possible public support for any new taxes. Also, new taxes proposed to date are unlikely to raise significant sums and lend themselves to being set and administered at a local level by the local councils. If new taxes are to be proposed these should be subject to a robust consultative process governed by the principles discussed in our response to question 3.

Council tax and business rates

37. Council tax and business rates are areas where the Scottish Government has much more autonomy and policy has been less fettered by interaction with other UK taxes. In the longer term, updating valuations more frequently, reflecting the widening range, and revisiting these taxes could allow policies to evolve that have stronger civic and business support and more effective accountability. Please refer to our [response to the local taxation inquiry](#) for further comment.

Question 6 - Whether there needs to be temporary adjustments to the Fiscal Framework in response to the economic and fiscal impact of Covid-19 and, if so, what are the priorities and what are the risks?

38. We have no comments on the priorities and risks in relation to a need for temporary adjustments to the fiscal framework for the 2021/22 Budget; however, there may be points learnt from the Covid-19 crisis that can be taken into the fiscal framework discussion next year.

Question 7 - Whether there are any additional budget risks arising from the end of the transitional period following Brexit including having a differential impact on the Scottish economy relative to the rest of the UK and if so how should these risks be addressed in Budget 2021-22?

39. Additional budget risks arise from the ending of the Brexit transition period if it makes businesses uncertain and restrains spending.
40. A hard Brexit may also negate the positive impact of any measures put in place by the government to support the country through the forecast recession. It would also mean businesses have to focus scarce resources on the short-term challenges that would arise which would mean losing focus on the long-term growth prospects. This is what Covid-19 did for most businesses in the spring of 2020.
41. Government can help to give confidence not only to businesses considering investment but also to consumers to encourage spending. Ideally, the Scottish Budget will help to reinforce and support confidence. The risk is that fear keeps people at home even when the lockdown is lifted, creating a mismatch between supply and demand and delaying economic recovery.
42. The other budget risk that may arise is if energies and time are diverted towards constitutional matters and the arrangements around Brexit. This can best be managed by collegiate work across the four nations.

Question 8 - How should the Scottish Government's MTFS when it is published, address the uncertainties arising from the on-going health emergency.

43. The high level of uncertainty associated with the pandemic compounds the challenges of longer-term financial planning. One approach is to include scenarios (most likely, best and worst case). The intention is not to predict the financial position – it is about providing a basis for debate about the longer-term impact of Covid-19 on public finances. This approach would promote informed discussion about possible policy options/choices for income and expenditure, and the related impact on public finances, services and outcomes. It would also support openness and transparency, by providing a wider and deeper public understanding about the longer-term financial position and the back-drop to the tough decisions the Scottish Parliament faces.