

# **Scotland Bill Committee Committee**

## **1st Report, 2011 (Session 3)**

### **Report on the Scotland Bill and relevant legislative consent memoranda**

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The Scottish Parliament  
Pàrlamaid na h-Alba

## **Scotland Bill Committee Committee**

**1st Report, 2011 (Session 3)**

### **Report on the Scotland Bill and relevant legislative consent memoranda**

**Published by the Scottish Parliament on 3 March 2011**





The Scottish Parliament  
Pàrlamaid na h-Alba

## **Scotland Bill Committee Committee**

### **Remit and membership**

#### **Remit:**

To consider the Scotland Bill and report to the Parliament on any relevant Legislative Consent Memorandum.

#### **Membership:**

Brian Adam (Deputy Convener)  
Ms Wendy Alexander (Convener)  
Robert Brown  
Tricia Marwick  
David McLetchie  
Peter Peacock

#### **Committee Clerking Team:**

##### **Clerk to the Committee**

Stephen Imrie

##### **Senior Assistant Clerk**

Mary Dinsdale

##### **Support Managers**

Stephen Fricker, Andrew Howlett and Vikki Little





The Scottish Parliament  
Pàrlamaid na h-Alba

## Scotland Bill Committee Committee

### 1st Report, 2011 (Session 3)

#### Report on the Scotland Bill and relevant legislative consent memoranda

The Committee reports to the Parliament as follows—

## CONCLUSIONS AND RECOMMENDATIONS

### Introduction

1. This report is made to the Scottish Parliament by the ad hoc Committee established to consider the Scotland Bill (the “Bill”) currently before the UK Parliament, and to recommend whether the Scottish Parliament should consent to that Bill. Consent is needed because, if enacted, the Bill will make changes to the powers and functions of the Scottish Parliament and of the Scottish Ministers.

### Legislative consent to the Scotland Bill

2. The Scotland Bill is the direct consequence of the work of the Commission on Scottish Devolution (“CSD”), which itself was established by the Scottish Parliament in 2007. The recommendations of the CSD were warmly welcomed by the Scottish Parliament in 2009. The Scotland Bill was debated in the Scottish Parliament in December 2010, with a majority in the Parliament voting to support the *general principles* of the Bill.<sup>1</sup>

3. **Having reviewed all the evidence before us, including such alternative proposals as were put to the Committee, our first and main conclusion is that the Scottish Parliament should support the Scotland Bill.**<sup>2</sup>

4. **Our key recommendation is, therefore, that the Scottish Parliament should pass a motion as outlined in paragraph 225 of this report conveying its consent to the proposed legislation. There are a number of areas where the Committee suggests that changes to the Bill and associated policy are needed, and so a further legislative consent motion will be required during**

<sup>1</sup> Minutes of meeting of the Scottish Parliament, 9 December 2010, Vol 4, No 40, Session 3.

<sup>2</sup> A proposal to delete paragraphs 3 and 4 was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

**the next session of the Scottish Parliament to consider the amendments to the Bill before it receives Royal Assent.**

5. Two members of the Committee (Brian Adam and Tricia Marwick) dissented on paragraphs 3 and 4 of this Report and proposed the following alternatives.

6. They welcome more powers for this Parliament. They support many of the non-financial aspects of this Bill that deliver more powers for the Parliament, although believe that in many cases the Bill could and should go further. The tax proposals in the Bill, particularly those related to income tax, are flawed. They should be overhauled and replaced with full financial responsibility for the Scottish Parliament.

7. They recommend, therefore, that the Parliament gives its partial consent to this legislation dependent on the UK Government amending the legislation to include full financial responsibility and extension of the non financial powers in the Bill. Further, the Bill should not be passed by the UK Parliament without the express consent on its final provisions from the Scottish Parliament via a Legislative Consent Motion. In addition, the tax proposals should not be commenced without express consent from the Scottish Parliament via a Legislative Consent Motion.

8. Their points are further developed by them in Annex A (Minority View).

**The Scotland Bill and the developing governance of Scotland**

9. The Secretary of State for Scotland, Rt. Hon Michael Moore MP, was keen to stress as he brought forward the Scotland Bill how significant a measure it was. In our view, he was right to do so. However, it is important to place the Bill in the history of how Scotland is governed has developed.

10. The establishment of the Scottish Parliament was a landmark event. The late First Minister, Rt. Hon Donald Dewar MP, said in the Scottish Parliament that—<sup>3</sup>

“We have had great powers granted to us: powers to develop a world-class education system; powers to build a modern health service; powers to unlock opportunities and to bind communities that have been torn apart by deprivation and social pressures.”

11. It was, however, neither the beginning nor the end of the process of changing the governance of our nation. Scotland has since 1707 maintained some separate governmental institutions. These evolved in the 19<sup>th</sup> and 20<sup>th</sup> centuries to include, by 1999, a very substantial department of State operating within a framework of administrative devolution. The Scotland Act 1998 was, however, a profound change. For the first time since the Act of Union, Scotland again had a Parliament of its own to give democratic accountability in Scotland to the organs of government.

**12. The Committee agrees with the CSD that this change has been hugely successful. The Scottish Parliament has firmly established itself in both the**

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<sup>3</sup> Scottish Parliament, *Official Report*, 13 May 1999, Col 25.



**regard of the Scottish people and the constitution of the UK. Its constitutional status is clear. The fact that the United Kingdom Government seeks the consent of the Scottish Parliament before legislating to extend its powers in this Bill is testament to that.**

13. However, the Scotland Act 1998 was not the end of the road for the development of devolution in Scotland. Since 1999, there have been nearly 170 orders made under the Scotland Act to alter the devolution settlement, update statute law, assign executive responsibility for functions or otherwise alter the competence of the Scottish Parliament.<sup>4</sup> A significant example was devolution of the responsibility for rail services to the Scottish Government.

14. The CSD concluded that the allocation of functions between the Scottish and the UK Parliaments was broadly right but because there were very limited tax-raising powers, there was not enough financial accountability. The Scotland Bill proposals to devolve new tax-raising powers will mean that, for the first time, spending decisions made in Scotland will have direct consequences for personal taxation in Scotland. The ability to take decisions on both spending and taxation will give the Scottish Parliament and the Scottish Government the responsibility to make policy decisions that reflect the needs of Scotland's economy and the will of the Scottish people.

15. This is a very important change for Scotland and for the UK. It is the first time that meaningful taxation powers have been decentralised from the UK Treasury, which has hitherto collected around 96% of the country's tax revenues. The Secretary of State was therefore right to emphasise the significance of the Bill.

16. A number of our witnesses referred to the view attributed to the former First Minister of Wales, Mr Ron Davies AM, that devolution was "a process, not an event".<sup>5</sup> He was, no doubt, thinking of the development of Welsh devolution, which has followed a different path from Scotland. It is, however, in any event a false dichotomy. Devolution in 1999 was a momentous event for Scotland, just as this Scotland Bill is a significant one. However, both events take their place within the wider history of the development of Scotland's place in the UK. Just as that did not stop after 1998, it will not be set in stone after the Scotland Bill is enacted.

17. This continuing development is especially important in relation to the financial powers, which are at the very heart of the Scotland Bill. They are in themselves a substantial step. They will give the Scottish Parliament control over about one-third of its revenues to complement the virtually complete spending discretion it already has. As a result, the Scottish Parliament will have a combination of spending and tax freedoms comparable to, and in some respects greater than, many sub-national European governments. As the Holtham Commission on Wales noted, "...most sub-national governments are funded to some degree by tax revenues from within their regions While three European Union member states levy sub-national taxes on corporate income, six do so on personal income".<sup>6</sup>

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<sup>4</sup> Scotland Office website. <http://www.scotlandoffice.gov.uk/scotlandoffice/37.html>

<sup>5</sup> Ron Davies, *Devolution: A Process not an Event*, Cardiff: Institute of Welsh Affairs, 1999.

<sup>6</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010, paragraph 4.2.

18. Just as the Scotland Act provided for legislative competence and Ministerial power to develop, so the Scotland Bill provides for further development in relation to taxation, through powers to devolve additional taxes and create new ones. In its financial provisions this is in essence an enabling bill providing in future for a straightforward order in council mechanism to devolve additional taxes given the consent of both Parliaments.

**19. In our view, the Scotland Bill represents a significant step forward and creates a framework for further evolution of financial powers in the enabling financial powers in the Bill. Scotland will be in a comparable position to other decentralised systems in federal or quasi-federal countries. The devolution settlement will continue to evolve rebalancing powers and responsibilities within the framework of the United Kingdom, which will be the stronger as a result.**

### **The package of financial powers in the Bill**

20. Many expert witnesses agreed that the package of taxation measures in the Bill, income tax and a basket of smaller taxes, was sensible and the right place to start any process of fiscal devolution. **The Committee agrees with this.**

21. Levying only a single rate of Scottish income tax is, as the CSD recommended, administratively the simplest way of achieving the objective of improving accountability. The balance of evidence we heard was that, in a system where most tax is collected by employers through PAYE, a single rate was the obvious way to begin fiscal decentralisation (see the section on Devolution on Income Tax in this Report). This is relatively common in other European jurisdictions.

22. There are arguments in favour of allowing the Scottish Parliament to vary the higher rates of income tax also, and to do so, would allow for additional flexibility and be a useful tool for a Scottish Government as it is in other countries. We discuss this in detail below. The system in Scotland may evolve in future, as we have seen in other countries, to allow this. At present, however, there is a balance to be struck between what might be desirable in the long-run and administrative simplicity now. There is also a balance to be struck between the flexibility in the tax power and certainty and stability in the revenues. **We agree with the CSD and much of the expert evidence we heard that the Bill strikes the right balance at this time.**

23. The evidence which the Committee received on the devolution of other taxes broadly agreed with the CSD (see paragraphs 632-659 of this Report) on the scope for devolution of other taxes. Taking first the 3 largest yielding taxes: income tax, VAT and National Insurance Contributions. On income tax there was widespread support for a shared tax base as found in many other federal and devolved nations. VAT could only be assigned to the Scottish Parliament (that is to say it could be given a share of VAT receipts in Scotland but not vary the rates). However, this would not improve the Scottish Parliament's accountability to voters. The Committee received no proposals identifying National Insurance Contributions in particular as suitable for devolution. They are linked to contributory benefit

entitlements and devolving them might create problems for people who receive benefits such as old age pensions or Job Seekers Allowance.

24. Oil revenues have been a significant contributor to the UK's public finances, and Scotland has benefited substantially from that. However, the UK taxpayer has also financed infrastructure to enable oil development and, in any event, oil revenues are volatile - ranging from £2 billion to £12 billion a year - and resources finite - production has been in decline for almost a decade. **The risks attendant on these factors are better managed, in the Committee's view, at a UK level.**

25. Aside from excise duties, the devolution of which could create significant market distortions and cross border flows, that leaves only corporation tax as a significantly high yielding tax. It is often suggested for devolution as an instrument to promote economic development. We have looked at that in detail and our views are discussed below.

26. **All of this confirms the Committee in the view that sharing income tax is the obvious and most appropriate start to give the Scottish Parliament its first significant additional tax powers. This will mean the Scottish Parliament has a basket of taxes – income tax, Non-Domestic Rates, Council Tax, Stamp Duty Land Tax (SDLT) and Landfill Tax – amounting to about one-third of its revenues. Two more taxes are to be considered with powers to add more in the future. Together with its untrammelled spending powers, this will give the Scottish Parliament very wide fiscal powers.**

27. However, as the CSD said, the story will not end here. There is scope for further development in the future. The CSD envisaged potential for greater use of assignment of tax revenues to align the Scottish Budget more closely with the performance of the Scottish economy. Witnesses drew attention to developments in, for example, Canada, where tax-sharing similar to the Scotland Bill developed over time into more complex forms with greater freedoms available to the Provinces.

28. It is not necessary at this stage to speculate on what developments might lie next or when. They will come in response to the circumstances of the time. **The Committee is clear, however, that this Bill will enable future changes to strengthen the position of Scotland within the United Kingdom further.** Devolution is a way of adjusting and balancing the powers and responsibilities of the different levels of government with the UK to meet changing needs and aspirations. The Scotland Bill will aid that process.

### **The major criticisms made of the Scotland Bill**

29. In evidence to the Committee, a number of criticisms were made of the Bill. Some of those suggested changes or amendments. Others were to the effect that the basis of the CSD's recommendations and so the structure of the financial provisions of the Bill was flawed. The Scottish Government, in particular, argued this strongly, indeed so strongly did they hold this view that even though the Scottish Parliament supported the *general principles* of the Bill, the Scottish Government did not until very late in the process make any proposals for specific

amendments to improve the tax provisions of the Bill and to ameliorate the problems which they perceived.<sup>7</sup>

30. The Committee regrets that this is the case. Although a majority of the Scottish Parliament supported the creation of the CSD, the Scottish Ministers did not, preferring to launch their “National Conversation”. **The Committee is disappointed with the refusal of the present Scottish Ministers to engage constructively in debate on the detail of how to improve the financial provisions in the Scotland Bill. We note with regret that despite promises of constructive engagement, no amendments or written suggestions for improvements to the financial provisions in the bill were received during our evidence taking and having pressed for such positive improvement, these ideas were finally were submitted on 20 February, more than 10 weeks after the publication of the bill and 20 months after the CSD report was published.** Nevertheless, their plans and the criticisms they and others make of the proposals should be properly scrutinised and considered, and the Committee has done so with some care.

*Fiscal decentralisation and economic growth*

31. The Scottish Government’s expressed view is that the taxation powers in the Bill are insufficient to improve the growth rate of the Scottish economy but that devolving the full range of taxes paid to the Scottish Government could be expected to increase economic growth above what would otherwise have been the case<sup>8</sup>.

32. This issue proved to be controversial during our deliberations and the evidence we received is reviewed in the report (see paragraphs 370-385).

33. The Scottish Ministers have made a number of claims about the effect of fiscal decentralisation on growth. The First Minister said in a speech in October 2010 that full tax powers could grow the Scottish economy by an extra 1% a year.<sup>9</sup> During our deliberations, the Scottish Government published an illustration of what the effect on revenues of such growth might be.<sup>10</sup>

34. The Cabinet Secretary for Finance and Sustainable Growth told the Committee that the Scottish Government’s assertions were based on the work of Professors Andrew Hughes Hallett and Drew Scott, who appeared as witnesses during our deliberations. The Committee heard a great deal of evidence on their work.

35. In their supplementary written evidence to the Committee<sup>11</sup>, Professors Hughes Hallett and Scott said that, in their view, fiscal decentralisation would give a one-off boost to the Scottish economy. They suggested that “a 1% increase in revenue devolution might, at the UK level of GDP/head, be expected to increase a

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<sup>7</sup> When the Committee was finalising its report on 22 February 2011, the Scottish Government submitted an amendment to devolve all taxes except VAT.

<sup>8</sup> Scottish Government, *Summary of Full Financial Responsibility & Independence*, January 2011.

<sup>9</sup> SNP website. Available at: <http://www.snp.org/node/17415>

<sup>10</sup> Scottish Government, *Summary of Full Financial Responsibility & Independence*, January 2011.

<sup>11</sup> Professors Hughes Hallett and Drew Scott, supplementary written evidence submitted to the Committee.

country's GDP/head by 0.91%. That is a figure well within our previously estimated range of 0.6% to 1.3%.”<sup>12</sup> Other economic experts were highly critical of their reasoning.<sup>13</sup>

**36. The Committee is not persuaded by the case presented by the Scottish Government and nor by that of Professors Hughes Hallett and Scott. The evidential base was, in our view, remarkably weak, and the claims made did not stand up to challenge or scrutiny. In our view, the overwhelming balance of expert economic opinion in Scotland and internationally was that the existing evidence base supports neither any clear link between fiscal decentralisation and an economy's long-run rate of growth, nor such a precise numerical link between fiscal decentralisation and an increase in GDP.**

37. In any event, the First Minister's claim – of an additional 1% growth *per year* – is an exaggerated version of what Professors Hughes Hallett and Scott have stated in their research.

38. Other witnesses who favour fiscal decentralisation have not made such claims for its effects. Mr Ben Thomson of the think tank, Reform Scotland, and the Campaign for Fiscal Responsibility agreed with the Committee that the effects on growth of fiscal and other powers depended on what use was made of them. Professor Michael Keating described the debate about autonomy and growth as asking a question that cannot be answered by statistics: the case for more fiscal autonomy for Scotland was to bring decisions on spending and taxation into line, to allow more innovation, and to improve the quality of policy debate.

39. The Scotland Bill is about good government. It is 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. Better decisions will, in the longer term, mean improvements to many aspects of Scottish public life. A Scottish Government will have a stronger incentive to promote efficiency in public services, allowing more output to be obtained for the same input of taxes, or allowing lower taxes, and to match the allocation of public resources more closely with people's preferences. All of this will be beneficial for public life in Scotland and should be good for Scotland's economy too. These reasons are in part why that the Committee supports the general principles of the Bill. It will be good for Scotland and should be good for its economy, but we make no unsubstantiated claims about the likely effect on GDP.

**40. It is our view that whilst higher growth is a desirable policy objective, more fiscal powers of themselves cannot on the basis of the evidence be shown to produce that objective.**

41. The Scottish Government, however, use this assertion to promote their policy of Full Financial Responsibility, under which all taxes in Scotland would be levied by the Scottish Parliament. No detailed plan was, however, published for this

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<sup>12</sup> Professors Hughes Hallett and Drew Scott, supplementary written evidence submitted to the Committee.

<sup>13</sup> Professor Muscatelli et al, *The Scotsman*, 31 January 2011.

scheme, although the Cabinet Secretary for Finance and Sustainable Growth told us that it was the alternative which the Scottish Government had advocated in a series of meetings with the UK Government about the Scotland Bill.

42. During the Committee's work, the Secretary of State for Scotland said that the Scottish Government had not shown detailed plans to the UK. The Scottish Government then published and gave to the Committee all the correspondence they had sent to the UK Government. It included a single side of paper which were the only written plans. The Committee asked the Scottish Government for costing and modelling of these plans, which they proposed as the alternative to the Scotland Bill. On 7 February 2011, the Cabinet Secretary published a form of modelling which showed that between 1980/81 and 2008/09 under his plans, and taking into account North Sea revenues, Scotland is estimated to have run an average annual net fiscal deficit worth 0.7% of GDP under the current framework. This compares to a UK average annual net fiscal deficit worth 2.5% of GDP over this period. The choice of the starting point of 1980/81 was not accidental. If you look at data for the most recent 7 years, the figures in GERS indicate that Scotland and the UK are comparable, assuming a 90% geographic share of North Sea oil.

43. Full Financial Responsibility was the Scottish Government's alternative to the plans in the Scotland Bill. The Committee did not examine this in detail, as there was no detail to examine. We received no costings for these plans, no material explaining the practical implications for taxpayers, employers, Scotland's financial sector or collection plans. However, we were able to come to several obvious conclusions. Firstly, as was made clear in evidence to us, fiscal systems serve constitutional ends. Full Financial Responsibility is no exception. The constitutional aim it serves, however, is not the preservation of the UK. Secondly, it is plain that under fiscal responsibility, Scotland would run a substantial deficit – even including all possible oil revenues. There is no scope for an 'oil fund', which would be the only sensible way for a small nation to manage oil wealth. Finally, it is clear that no thought has been given to the effect of these plans on the economy of the UK, to which Scotland will inevitably remain linked. Scotland would, under such plans, be part of a monetary union, but not a fiscal union – a recipe for economic instability. Recent experience has demonstrated the risks to small countries of divorcing fiscal and monetary unions as would be proposed under full fiscal autonomy. As the financial and banking crisis has demonstrated, there is benefit from membership of an economic, monetary and fiscal union, in which risks are shared.

**44. The Committee is clear that the evidence shows that full financial responsibility or autonomy is not a serious alternative to the fully worked out plans in the Scotland Bill.**

#### *Corporation tax*

45. There is one area, however, where the view that the Scotland Bill lacks economic levers could be plausible, and that relates to corporation tax. Many of those who support fiscal devolution see corporation tax as the flagship of such a policy and a symbol of a low-tax, business-friendly economy. The Committee has

considered this in detail (see paragraphs 490-513 of this report) as have other independent inquiries<sup>14</sup>.

46. The latest estimate (2008-09) of the amount of corporation tax which would be raised from businesses in Scotland is around £2.8 billion per year.<sup>15</sup> Companies account for their profits and taxation at a UK level and the GERS estimate relates to economic activity carried out in Scotland rather than which companies are headquartered or registered here. The figure excludes taxes on profits earned from the extraction of hydrocarbons from the North Sea.

47. Increasing competition to attract mobile investment or retain existing businesses has tended to drive down tax rates on corporations. The UK corporation tax rate, currently 28%, is being reduced in 1% steps in each of the next 4 years to 24% in 2014-15.<sup>16</sup>

48. Devolution of corporation tax might give the chance to set lower Scottish rates to incentivise businesses and promote investment in the Scottish economy. The Republic of Ireland, despite its present deep financial troubles, is often held up as an example of how low corporation tax rates – 12.5% compared the UK level of 28% – can be used to attract inward investment and therefore still generate tax receipts. The Republic of Ireland has kept its rates low throughout its recent period of sustained growth and does so now, even at a time of great economic hardship for the country. Many believe that this has been a significant factor for the country in attracting business to locate activity there.

49. It is natural to consider whether Scotland can do the same. There are, however, legal hurdles. EU State Aids rules constrain the extent to which corporation tax can be varied within a Member State. There are several important European Court of Justice judgments on this but, in summary, the scope exists for a devolved government to set lower rates provided certain conditions are met. Important among these is that the devolved administration must not be protected from the revenue consequences of its decisions. It is clear that reducing corporation tax rates will cut revenue, at the minimum for some years, as the evidence from the Exchequer Secretary to the Treasury showed.

50. The CSD looked at this issue in some detail and recommended against devolution of corporation tax. A number of our witnesses also argued against it. Interestingly, the business people with whom the Committee engaged typically did not press for its devolution, even though they favoured lower overall rates of taxation.

51. The main concern about the devolution of corporation tax is the potential to create economic distortions. Corporate profits are hard to pin down geographically and companies have a strong incentive to recognise their profits in the place where they will be subject to the lowest tax rate. There will be many devices to enable them to do so, such as registering a legal entity in Scotland or “brass plating”, or booking profits in Scotland through manipulation of transfer pricing.

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<sup>14</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010.

<sup>15</sup> Scottish Government Expenditure and Revenue Scotland, 2008-09 Table 4.1, p36.

<sup>16</sup> HM Treasury Budget, June 2010, Table 2.1, p40.

These are not fanciful possibilities. They happen whenever companies register in places like the Isle of Man. Similarly, many commentators have noted that a significant proportion the corporation tax paid in the Republic of Ireland relates to economic activity elsewhere in the EU.

52. A number of problems follow from this. First, it misallocates resources in an economic sense. Tax avoidance may be profitable for companies but is not a productive activity. Nor would it attract jobs and growth to Scotland. Secondly, it increases the risk of a race to the bottom in corporation tax rates (as one can see in other countries such as Switzerland) so that tax revenues are lost.<sup>17</sup> Thirdly, and perhaps most serious, if Scotland were able to cut corporation tax, the risk is that all it would attract are 'paper profits' from companies elsewhere in the UK who had the incentive to recognise in Scotland. The net effect of this would be that overall, less corporation tax was paid in the UK even though Scotland attracted more of it to support devolved spending. This is has been referred to as "cannibalising" the tax base.

53. Although a number of witnesses argued for devolving corporation tax, the Committee received no detailed evidence on how such powers might be used. There appeared to be a general assumption that the rates might be lowered, rather than increased, but no suggestion of how much, and what that might do to attract mobile investment. Corporation tax devolution would inevitably take place in a competitive environment but none of its proponents offered any view about who Scotland's competitors might be, what sort of rate cuts – and so spending reductions, as the gap could not be made up by borrowing – might be needed to be more attractive, how a race to the bottom might be avoided, and so on. Overall this suggests that many of the calls for corporation tax devolution are based on what might be theoretically attractive, but its supporters have not engaged with the realities of how it would turn out in practice.

**54. The Committee does not believe that Scotland should seek to maximise its tax income by becoming a tax haven for companies operating elsewhere in the UK. We therefore support the UK Government in not at this stage devolving corporation tax in the Scotland Bill.**

**55. The Committee notes that international experience does show some scope for differentiation of corporation tax, and that there are arguments that it can be used as an economic development tool, especially by small countries. It is therefore not something we would wish to rule out entirely for the future, especially if schemes were being developed within the UK which avoided the worst of the distortions that might be created.**

56. Additionally, the Committee understands that it is not possible simply to transfer the Republic of Ireland's experience – good or bad – to Scotland. Ireland set a low rate of corporation tax when its economic base was very weak. It was able to attract mobile investment at the price of losing only a little revenue. Scotland is not in that position and a Scottish Government would have to think very hard about cutting tax rates and income from pre-existing companies in the hope of attracting additional income from new arrivals in the future. The price in

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<sup>17</sup> Professor Lars Feld, written evidence submitted to the Committee.



terms of lost revenues and reduced services might be high. The Exchequer Secretary to the Treasury said that the UK Government planned reductions but that each 1% cut in corporation tax rate cost £700-800 million in lost revenues. He did not foresee a date when the lost revenues would be offset by increases in the tax base. Therefore, a 10% cut in corporation tax in Scotland might cost about £600 million per year for an indeterminate period.

57. There are, however, two other developments that the Committee has noted. The first was the idea in the Report of the Holtham Commission for Wales of a method that might be used to devolve corporation tax while avoiding some of the risks that we have described.<sup>18</sup> It would relate the corporation tax liability of a company in Wales or Scotland to activity or proportion of payroll there. The Welsh Commission agreed it was not in anyone's interests to have a race to the bottom and the cannibalisation of the corporate tax base. Their approach was to urge future UK wide consideration corporation tax as a potential regional economic development tool. They recommended a formula for regional corporation tax variation linked to relative regional underperformance, and sought to minimise avoidance by tying it to payroll and, as other countries have done, put the onus on companies to establish they qualify for reduced rates. The second development is the commitment by the UK Government to consider whether there is scope for reducing corporation tax in Northern Ireland, again for economic development reasons, notably bearing in mind the land border with the Republic of Ireland with its low tax rates.

**58. It is not appropriate, therefore, to simply legislate for corporation tax devolution to Scotland which could spur the undesirable effects described above but if, as anticipated, there are 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.** Given the very cool reception that Scottish business gave to the potential complexities of any such approach, it would be important that there was full discussion of the potential implementation costs to weigh against benefits before such a scheme went ahead.

**59. Neither of the ideas referred to is as yet a firm plan, but the Committee's view is that 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. Any discussions about this should involve all the devolved nations.**

*The Scotland Bill and the Scottish economy*

60. A Scottish Government criticism of the Bill is that it does not provide levers for economic growth. This is, in our view, misplaced for a number of reasons. First as we have seen, there is no direct connection between fiscal devolution and economic growth. Second, through having complete autonomy over a whole range of expenditure decisions such as education, the Scottish Parliament already has a

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<sup>18</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010.

considerable number of levers at its disposal which are important drivers of growth and the increased fiscal accountability that the Bill will provide particularly by linking spending to tax revenue under its control will sharpen the incentives on the Scottish Parliament to use these levers effectively and give it a direct financial stake in the future success of the Scottish economy. Thirdly the Bill provides substantial borrowing powers for the first time. Fourthly it gives the Scottish Parliament tax powers amounting to almost one-third of its expenditure responsibilities including the full suite of property taxation and powers to address environmental and other challenges through new taxes or service charges. Finally the enabling powers are there to devolve other taxes, although the Committee did not hear widespread demands from the business community to do so - indeed the opposite, with a desire for stability through the changes already envisaged in the Bill. What the Bill does not do is unilaterally devolve corporation tax for the reasons outlined above.

61. However, most important of all, all the evidence suggests and our witnesses - even Scottish Ministers – agree that the important question was not what powers were available but the use that was made of them. The Scottish Parliament already had unrestricted freedom over the majority of the public spending in Scotland and over the subjects which are most critical for the country's economic success – education, training, infrastructure, transport, economic development powers etc.

62. Many of the levers are already in the hands of the Scottish Government and the Scotland Bill will add to them, notably through additional borrowing powers as well as tax discretion over one-third of the budget. The challenge is to use them wisely.

*Is there a 'deflationary effect'?*

63. A major criticism by the Scottish Government of the Scotland Bill was that it would have a 'deflationary effect', that is to say that the new system would result in a smaller Scottish budget than the Barnett formula would deliver. The UK Government disagreed, and the contrasting evidence is discussed at paragraphs 407-470.

64. Under the Scotland Bill scheme, the Scottish Parliament will receive a share of income tax receipts for part of its budget. Whether this will produce more or less than the Barnett formula depends upon a number of factors including, most importantly, how the reduction in grant is determined. The UK Government has not yet made firm proposals for doing so, and we discuss the options for it below. The Scottish Government however has performed a calculation based entirely on a method (indeed the only method) that had been ruled out by the UK Ministers.

65. The Scottish Government claim assumes that the grant would have been cut by the same proportion in each year as the income tax revenues bore to spending in 1999. As our report shows, this was an untypical year, and if the average of a longer period had been chosen quite a different result is obtained, as the evidence

of the UK Government shows. In our view, the Secretary of State was therefore right to refer to the Scottish Government's claim as a 'nonsense figure'<sup>19</sup>.

66. There is, however, a further problem with the Scottish Government's claim. If the same formula was applied starting not from 1999, but 2011, it would have resulted in an *increase* to the budget of over £1 billion a year more than what current spending plans will provide (nearly £2 billion over 4 years). This is hardly a 'deflationary effect'.

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<sup>19</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 382.

**Table 1: Scottish Government Forecast DEL, Forecast DEL under Scotland Bill Proposals and Forecast Annual Difference: Cash terms** <sup>20</sup>

	Scottish Government Outturn DEL	Estimated Income Tax Receipts Assigned to Scotland	Block grant reduction	Revised Block	Estimated DEL under Scotland Bill Proposals	Difference in year
<b>2011-12</b>	27,907	4,328	15.5%	23,579	27,907	0
<b>2012-13</b>	28,262	4,657	15.5%	23,879	28,536	274
<b>2013-14</b>	28,248	5,035	15.5%	23,867	28,901	653
<b>2014-15</b>	28,484	5,437	15.5%	24,066	29,504	1,020

Source: SPICe

67. This table, however, illustrates an important point. The effect of the new system proposed by the UK Government will depend on the surrounding economic and fiscal circumstances. If it is introduced at a time when UK public spending on health and education is growing very substantially and that feeds through into Barnett consequentials, then relying on a Scottish income tax may produce less. However, if it is used when the UK is applying increased resources to other programmes, such as debt reduction or defence spending, then having direct access to some tax receipts will be advantageous.

68. **In our view, it cannot, therefore, be said that the Scotland Bill's scheme will have a 'deflationary effect' and the Scottish Government's claim about this effect is wrong and misleading.** As noted earlier in the report, income tax is not a declining tax. There was a temporary decline in its share of tax revenue over a 10-year period from the mid 1970's when, following the UK's accession to EU and the consequent need to harmonise VAT rates, VAT grew in importance as a source of tax revenue. However, that period aside, it is a buoyant tax whose revenues have more than kept pace with the growth in the economy. The actual impact of the Scotland Bill on the Scottish Budget will depend on a number of factors, notably the method chosen to calculate the reduction to be made in grant. It will also depend on the circumstances at the time, and the recent periods of record levels of high spending growth, followed by retrenchment, are each in different ways untypical. What this illustrates is that it would be unwise to argue for or against a particular formula or method of grant reduction on the basis that in recent years it had an advantageous or disadvantageous result.

### **Other significant finance issues raised in evidence**

#### *Grant reduction*

69. The essence of the Scotland Bill's scheme is that tax revenues should be substituted for some of the grant on which the Scottish Budget relies. A reduction will, therefore, have to be made to the grant. **We agree that getting this right is the most significant question the Parliament has to consider, one though on which an immediate decision is not needed.** The evidence we considered on this is at paragraphs 570-586.

<sup>20</sup> SPICe calculations

70. The CSD said only that the reduction in grant should be “commensurate”.<sup>21</sup> The Holtham Commission, however, suggested a number of options were available. In particular, they noted that the reduction that was appropriate in relation to a tax which was likely to stay steady and one that was buoyant and likely to grow in future would be different.

71. The UK Government’s Command Paper does not make specific proposals, although it does rule out the very simple system of cutting the grant by the percentage of the tax yield in the first year. Instead, it suggests that the change be negotiated with the Scottish Government. It does, however, make it clear that any changes that the UK Government makes to the income tax base will result in corresponding adjustments to grant (the “no detriment” clause).

**72. The present Scottish Government has made no proposals to the Committee for the grant reduction mechanism.** The evidence from our expert witnesses was, however, very helpful in setting out our options.

73. Grant reduction will not take place for some years. **So it was perhaps understandable that the UK Government was not able to make more detailed proposals for grant reduction at this stage, though it has made the Committee’s task more difficult. Equally, we are disappointed that the Scottish Ministers were willing only to criticise the plans and not make constructive alternative suggestions on this matter.**

74. In our view, the grant reduction mechanism for income tax should be designed to meet certain principles. These include—

- that it should insulate the Scottish Budget from decisions of the UK Government that alter the income tax base;
- that it should *not* insulate the Scottish Budget from the performance of the Scottish economy, so that the Scottish Parliament has a direct financial stake in Scotland’s economic success;
- ideally, that it should reduce any effects of cyclicity in tax receipts on the Scottish budget;
- the reduction should reflect both the amount of tax income foregone in the first year and its likely future pattern of growth;
- that it should not when introduced of itself cause a step change in the Scottish budget (up or down) in the first year; and
- it should not be designed to gain advantage in one set of fiscal circumstances or another.

**75. This suggests to the Committee that a simple percentage reduction, or even one based on several years of experience, may not be the best option.**

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<sup>21</sup> Commission for Scottish Devolution, *The future of Scottish devolution within the Union: a first report*, December 2008, para 3.179, page 104.

**The Committee is 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.**

76. The method of grant reduction to be followed requires, as the UK Government says, careful inter-governmental negotiation and the preparatory work for this must begin soon, so that the Scottish Parliament can have a clearer idea of the proposed method before the Bill is enacted. The Scottish Government should participate fully and constructively in this.

**77. Finally, the Committee suggests that there would be merit in both administrations committing to the principle of a formal review of the grant reduction mechanism after a period of around 10 years.**

**78. Our recommendations are therefore as follows—**

- **The grant reduction method should be designed to support the principles identified above;**
- **Intergovernmental discussions to analyse the options to achieve that should be undertaken and completed before the Bill is enacted; and**
- **These should consider in detail the option of indexing grant reduction to the income tax base in the rest of the UK.**

*Income tax*

79. Under the Scotland Bill, income tax will be the Scottish Parliament's largest source of tax revenue, accounting for almost 50% of total devolved tax. The Committee received a great deal of evidence on whether income tax was suitable for devolution, some criticising particular features of the income tax proposals, and whether relying on it to the extent of 15% of the total Scottish Budget was too risky in the short- and long-term.

80. The CSD identified income tax as the most suitable for devolution, as did the Holtham Commission for Wales, and our expert witnesses were virtually unanimous that it was the best place to start tax devolution. Indeed, the Committee received no evidence which argued that income tax should not be devolved. It is clear from the evidence we received relying on income tax has a number of advantages. It is paid by a large proportion of the population. It is a buoyant tax, raising sums which tend to rise over time with incomes and so economic growth.

81. Some witnesses, including the Scottish Government, argued that, from past experience, UK income tax receipts would not keep pace with expenditure over long periods of time and so there is an inherent deflationary bias involved in relying heavily on income tax, forcing the government to either raise tax rates or cut expenditure. **From the analysis that Committee has outlined at paragraphs 407-470, we conclude that this is not so. In particular the share of total taxation derived from income tax has risen over the years since devolution.**

**While there can be periods of time when expenditure grows faster than income tax receipts, over the long-run, income tax is a robust tax whose revenues more than keep pace with both expenditure and other taxes.**

82. We also heard criticism that a reliance on income tax comes with short-term risks. The risks arising from a variation in income tax receipts are small relative to total expenditure. Scottish revenues will still retain a very considerable degree of stability through the block grant. We discuss the UK Government's proposals for the short-term management of income tax and associated borrowing powers elsewhere in our Report.

#### *Access to Higher Rates*

83. A number of witnesses expressed concerns because under the Bill's proposals, a future Scottish Government would be constrained to set a single rate of tax. Concerns were expressed that (i) this was regressive; (ii) it could lead to problems associated with lower 'fiscal drag'; and (iii) the potentially greater mobility of high income taxpayers could unduly constrain decisions about setting a single rate.

84. It is clear to us that the Scottish income tax will be slightly progressive; because there is a tax free personal allowance higher income taxpayers pay a greater proportion of their income in the Scottish income tax (obviously Scottish taxpayers also pay UK income tax, which will be markedly more progressive).

85. The Committee accepts the view expressed by a number of witnesses that overall income redistribution is most effectively undertaken at the UK level using benefit as well as tax instruments. The Committee also notes that some other countries restrict sub-central governments to operate a single rate and that where sub-central governments have been given discretion to set different rates, tax competition has resulted in rather flat structures.<sup>22</sup>

86. It is clear that if the Scottish income tax covered a higher proportion of the higher rate bands, it would yield more revenue, but this would simply result in a bigger offsetting reduction to grant, and so would not affect spending power. It has, however, been suggested that because the Scottish Income tax is a flat rate it will not grow so quickly as UK income tax revenues, and so as spending needs, because of the effect of 'fiscal drag'.

87. The arguments about fiscal drag are complex and are discussed at paragraph 530. It arises under a progressive tax system when, as incomes grow, more people are drawn into paying income tax, or paying it at higher rates. Consequently, revenue from income tax may tend to rise more quickly than income causing the share of income tax revenue in GDP to rise over time.

88. Since the Scottish income tax is set at a single rate, the Scottish budget would benefit less from fiscal drag, when it occurs, than UK tax income. Some critics have suggested that this is a flaw in the system which will over time cause the Scottish Government to have to increase tax rates.

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<sup>22</sup> Professor Chris Heady, written evidence submitted to the Committee

89. However, over the long term, the governments of most advanced economies take steps to mitigate the effects of fiscal drag by indexing tax allowances and thresholds in line with GDP growth and so keep the share of tax revenue in GDP more or less constant.

90. Under these circumstances, the loss of fiscal drag over the long-term through being confined to setting a single rate is a much smaller problem than some witnesses alleged. Moreover, despite this indexation, income tax revenue has been rising slowly in relation to both GDP and public expenditure, so there should be no need to raise tax rates.

91. The effects that may occur arise more in the short-term when allowances and thresholds are not being increased and so are cyclical in nature, producing both gains and losses.

92. Nevertheless, there remains the issue that decisions over indexing allowances and thresholds are made by the UK Government, and the Scottish Government would have no control over the degree to which its tax revenues are subject to fiscal drag. Under the principles of grant reduction articulated above, the Scottish Government's budget should be compensated for consequences that arise solely as a result of decisions by the UK Government.

93. If Scotland had a flat rate structure, then UK Government decisions to index personal allowances would affect its tax income, but not changes to tax thresholds since these would have no effect on its tax revenue. This should be taken into account in the grant reduction mechanism and the operation of the 'no detriment' clause. If Scotland had a more progressive rate structure, these would have to take account of both changes in both allowances and thresholds.

94. The Committee notes the advantage of greater flexibility given the potentially high degree of mobility of high-rate taxpayers that was powerfully articulated by Professor Holtham. This, in part, reflects the evidence put forward by the Holtham Commission regarding the high concentration of potentially mobile population close to the Welsh border, whilst the concentration around the Scottish border is far lower, suggesting that this may be less of a concern.

95. The Committee also notes that the Holtham Commission accepted that in order to limit the potential costs of avoidance and 'race to the bottom competition' for high income taxpayers, it would be necessary to severely constrain the limits within which the various tax rates could be varied to no more than 3 pence from the UK rates.

96. The Committee is also mindful of the additional costs that might fall on both HMRC and employers of collecting tax with a more complex rate structure. Especially at the introduction of a new system simplicity is greatly to be valued. We are also mindful that the Scottish Government has no expertise in taxation issues, and starting with a simple flat rate carries less risk. **Revenues from the higher rates of income tax are likely to be more volatile, as payments like bonuses are more sensitive to economic conditions. The Committee's view is that there is a fine balance between the potential benefits of greater flexibility from access to the higher rates and avoiding any possible fiscal**



**drag effects, that could arise and the advantages of simplicity and avoidance of that flow from the flat rate structure.**

**97. The Committee recommends that while the flat rate structure should be adopted initially, this decision should be carefully evaluated as experience is gained of operating it.**

*Concentration of risk*

98. Under the Scotland Bill, the Scottish Budget will depend on income tax for about 15% of its resources. A number of witnesses questioned whether this was too great a concentration of risk. There are two separate aspects to this question. The first relates to the degree of risk attached to the stream of income tax revenue.

**99. We examine elsewhere in our report the risks associated with income tax under the Scotland Bill in the short-term and on the long-run, and are satisfied that, subject to some changes that we propose, these are manageable.**

100. The second issue is whether whatever risk to the Scottish budget remains could not be further reduced by having limited access to other sources of tax revenue. **We do not think so.** As one of our witnesses said, like income tax, most sources of tax revenue depend on the level of economic activity and so are correlated with income tax and so will tend to decline when income tax declines and grow when it grows. Oil revenues are a partial exception to that as they are governed by the world price of oil, but they are highly volatile. This argument neglects the fact that the largest source of income to the Scottish Budget will be the grant which is supported by all the taxes which flow to the UK Government and also by its capacity to borrow. **Therefore, we do not see this as a valid criticism of the scheme in the Bill.**

*Other taxes*

101. The Committee welcomes the comments made by the Secretary of State for Scotland on the plans for devolution of the Aggregates Tax. Given this positive approach, **we recommend that a clause should be inserted in the Bill to devolve responsibility for this tax, which can be brought into force once the relevant court case is resolved.**

102. In relation to Air Passenger Duty, we also welcome the comments made by the UK Government. As the structure of APD is currently under review, the revenues for it might change and, in particular, the revenues which would accrue in Scotland are subject to large uncertainties, as the Scottish air travel market differs from the rest of the UK in important respects. This requires inter-governmental discussion on the UK Government's plans. **We therefore agree with the UK Government that once the future of this tax is decided, it should be considered for devolution.**

*New taxes*

103. The Scotland Bill contains powers for other taxes to become devolved taxes, including new taxes created in Scotland. The powers are exercised with the

agreement of both Parliaments. This was recommended by the CSD, and it was welcomed by our witnesses.

**104. The Committee strongly supports this aspect of the Bill, as it provides a mechanism and framework for the further development of tax devolution in the future. In our view, the Scotland Bill is therefore an ‘enabling’ Bill in relation to finance, just as the Scotland Act 1998 enabled the transfer of powers and functions.** The UK Government has already indicated plans to use it to devolve Aggregates Levy and Air Passenger Duty in due course. The Command Paper sets out criteria which the UK might apply when considering whether to agree a new devolved tax.

105. One key issue raised to us is that of spillover effects. On this, Professor Holtham said—

“...you cannot entirely eliminate spillovers. If the British Government does things with its tax policy, it will affect the prosperity of France to some extent. France is a big trade partner; if we impoverish ourselves, it will suffer. The search completely to insulate your policy against a neighbour's policy is a mirage or wild goose chase. However, you should structure arrangements to minimise spillovers and to ensure that, as far as is possible, risks are allocated in the right place.”<sup>23</sup>

**106. A number of witnesses (e.g. Dr John Aldridge) drew attention to the opportunities that new tax powers, wisely exercised, offered the Scottish Parliament. We accept that the UK Government has a legitimate interest in proposals for new devolved taxes as they may have ‘spillover’ effects in the rest of the country. We also agree that any future Scottish Parliament will wish to be careful and cautious about adding to the tax burden in Scotland. Nevertheless, we agree with those of our witnesses who were concerned that the criteria set out by the UK Government were capable of being applied to rule out the creation of any new tax whatsoever. We hope that this is not the UK Government’s intention and will welcome their reassurance that agreement will not be withheld unreasonably for any new proposals from the Scottish Parliament in future. We would also suggest a close examination of the context and implications of the proposed criteria as part of the implementation process.**

*Short term borrowing and managing risk*

107. The plans set out in the Scotland Bill and the Command Paper will mean that the Scottish Budget is subject to some risks that it does not presently bear, including short-term, cash flow risks. These arise because the Scottish Budget will, in part, depend on Scottish tax revenues, and they may flow in irregularly and be higher or lower than expected. At present, the UK Government bears these risks. The CSD therefore recommended short-term borrowing powers, which the Scotland Bill includes. However, the UK Government’s plans also include other important details on how the new system will operate.

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<sup>23</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 202.

108. The Scottish Budget will continue to be supported by a grant drawn down by the Scottish Government as it needs to during the year. As we note elsewhere, short term risks relate only to about 15% of the Budget. They relate primarily to a single rate of income tax which is less volatile in yield than many other taxes such as corporation tax. The Scottish Government will have a current borrowing power to use if devolved taxes like SDLT or Landfill Tax produce less than forecast.

109. For the Scottish income tax, the plans are more complex. The Office for Budget Responsibility will forecast Scottish income tax receipts for each Spending Review period. HMRC will collect the tax and Scottish Government will be able to draw down income based on the estimates, as spending needs arise, just as with the grant. Therefore, the UK Government will carry the risks from the uneven flow of tax revenues. Within 12 months of the year end, estimates and actuals will be reconciled. If more has come in than forecast, the funds can be put into a new Scottish cash reserve. If less, the new borrowing powers may be used, subject to certain constraints as outlined below.

110. The constraints are however quite substantial. Any deviation of less than 0.5% of the Scottish resource budget (£127 million in 2014-15) is to be absorbed within the Scottish Budget. Borrowing is limited to £200 million a year (approximately 4% of devolved tax revenues). The maximum stock of short term borrowing at any one time is limited by the Bill to £500 million. Short-term loans must be repaid within 4 years, and any surplus tax receipts above forecast must first be applied to reduce any existing borrowing.

111. In evidence to the Committee, UK Ministers explained that this should give the Scottish Government similar certainty about budgets to UK Government Departments, and the idea of the UK still carrying in year revenue risk was welcomed by other witnesses. Others, including the Scottish Government, were concerned about exposure to cyclical fluctuations without, as they saw it, enough scope to mitigate them by borrowing. This would have a pro-cyclical effect exacerbating the economic cycle.

112. Witnesses generally welcomed the Scottish cash reserve, but some argued for the ability to fill it from budget savings as well as surplus tax income, though UK Ministers distinguished between these. Concerns were raised about the forecasting plans as forecasts are subject to much greater levels of error for later years.

**113. As far as the macroeconomic issues raised are concerned, the Committee accepts that the Scottish Budget may be cyclically influenced, but regards the scale of these potential effects as likely to be small given that this risk applies to just 15% of the Scottish Parliament's income and that income tax is less cyclically volatile than some other taxes and at the peak of the recent downturn it fell 7% in a year so hitting the overall Scottish Parliament budget by less than 1%. This already small risk will be further mitigated if our suggestions about grant reduction are followed.**

114. In relation to the mechanics of the system, the Committee generally welcomes the approach taken by the UK Government. There are, however, a

number of areas where the UK Government's proposals give the Committee cause for concern and where in its view some change will be needed.

**115. The Committee supports the UK Government's proposal to continue to absorb the in-year revenue risk for income tax. This makes good practical sense as HMRC are collecting the revenue and the cash flow risk is not one which the Scottish Government is well placed to manage. The Committee also welcomes the plan to base receipts on an OBR forecast and the UK Government's aim in giving the Scottish budget revenue certainty. Like a number of our witnesses, however, the Committee is not sure that sticking with these forecasts throughout the Spending Review period even as better data becomes available is the best approach and invites the UK Government to review it.**

**116. The Committee also cannot see the justification for the requirement that the first £120 million of any tax shortfall must be met by spending reductions in the year in question. There is no principled basis for the amount cited. A prudent Scottish administration may well wish to operate on a basis of that sort, but that is properly a decision for them to take. It should not be imposed on them by a Treasury rule. It might in practice be true that underspends in any one year could absorb sums of this magnitude. It is equally possible that they may not. The decision in which year to make the reduction properly belongs to the Scottish Ministers. Such a detailed rule may be appropriate in the relationship between HM Treasury and a UK Government Department. The Committee therefore recommends that the UK Government's plans should be amended to do away with this. This will encourage exactly the sort of prudent behaviour which the Bill seeks to promote.**

**117. The Committee is concerned that the proposed annual and overall limits for short-term borrowing are set to be inadequate, especially once the above change is made. These need to be recalculated on a more principled basis, and the Committee commends to the UK Government the research provided to us by Professor Bell.<sup>24</sup> In our view, the Scotland Bill should be amended to increase the overall short-term borrowing limit of £500 million, set in 1999 when the Scottish Parliament had no tax powers other than the Scottish variable rate, to a suitable larger amount. This requires to be determined but may be about twice the current proposed level.**

**118. The Committee welcomes the creation of the Scottish cash reserve and congratulates the UK Government in going further than the CSD in this respect. This will allow a prudent Scottish Government to build up savings to use in good or tough times. However, the Committee sees no distinction between savings that are made by securing efficient outcomes in spending and surplus income for this purpose. Each should be able to be added to the Scottish cash reserve, without needing Treasury agreement. This will give a Scottish Government certainty that savings can be set aside for the future, and the incentive to do so. It will end the long running anomaly that HM Treasury can exercise some detailed control at the margin over Scottish spending through**

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<sup>24</sup> Professor David Bell, University of Stirling, research provided to the Committee.

releasing End Year Flexibility in the same way as it does for a UK Government department. Once funds are voted by the Scottish Parliament to support the Scottish Budget, they should be 'owned' by that budget and not held to be released at HM Treasury discretion.

*Capital borrowing*

119. At present the Scottish Government's capital budget is contained within its overall Budget and is supported by UK Government borrowing. The CSD recommended a power to borrow for additional capital spending in any one year.

120. They are more substantial than the CSD proposed and allow commercial Treasury borrowing, though there is no power to issue bonds. Once the powers are phased in, the Scottish Ministers will be able to borrow up to 10% of the Scottish capital budget in any one year and there will be an overall statutory limit on indebtedness of £2.2 billion.

121. The new capital borrowing powers were widely welcomed in evidence. The Scottish Government said they would increase their ability to manage infrastructure investment. Witnesses generally, including the Cabinet for Finance and Sustainable Growth<sup>25</sup>, accepted the need for some controls on borrowing, but challenged the limits that are proposed. Several witnesses suggested that the Scottish Government's capacity to service borrowing from devolved tax income should be used to set the limits. Some additionally saw no reason why the Scottish Government should not be able to issue bonds.

122. The UK Government proposes that the new powers be phased in and available from 2014-15. Some of our witnesses pressed for them to be available earlier.

**123. All of the Committee members welcome the new capital borrowing power and, in particular, allowing the Scottish Government the option of borrowing commercially. The power will give the Scottish Government flexibility over the timing of investment, and the capacity to borrow commercially gives more financing options, though the terms available from the National Loans Fund are likely to be the most economic and we understand it can offer a lot of flexibility.**

**124. The Committee accepts that there will 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 proposes 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. We discuss one possible calculation at paragraph 601. These offer additional flexibility but are not so large as to imperil the UK's fiscal controls.**

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<sup>25</sup> On 21 February 2011, the Cabinet Secretary proposed in amendments submitted to the Committee that these controls should take the form of a code of practice agreed between the Scottish Government and HM Treasury, but proposed no specific limits.

125. The Committee understands UK indebtedness and that the UK Ministers will wish to be cautious about allowing new borrowing. The Committee well understands that the UK Government is seeking to reduce UK indebtedness and that allowing additional borrowing in Scotland is, therefore, difficult. **Nevertheless, it can be financed from Scottish resources and the Committee hopes that the UK Government will be prepared to phase in higher amounts than currently proposed and, in particular, the Committee sees no reason why the powers should not become available earlier in the next Scottish Parliament and invites the UK Government to consider bringing forward these borrowing powers. The Committee accepts that if the UK Government is concerned about the impact on overall UK borrowing at a time of economic difficulty, then a smaller overall limit might be agreed in the first instance.**

126. **The Committee's view is that it is unlikely that the Scottish Government will need or wish to access the bond markets in the near future. Nevertheless, it is not a possibility that should be ruled out in statute, as we do not think that the bond markets – which are highly sophisticated – are incapable of distinguishing and pricing Scottish Government bonds properly. We therefore recommend 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.**

*Implementation issues*

127. The CSD recommended that, if adopted, its proposals should be implemented in a managed way, stage by stage. They recommended that there should be intergovernmental arrangements to deal with taxation issues, a new relationship between the Scottish Government and HMRC, which will collect the Scottish income tax, and arrangements to ensure that there is a transparency in the funding system. The Command Paper sets out the UK Government's plans for taking forward these recommendations.

128. Under the UK Government's plans, the new funding system will be implemented in three phases. First when the "small" taxes are devolved and a reduction made to the block grant in respect of them. Second, when the Scottish income tax is first introduced in 2016 and in a transitional period. Third when the 'once and for all' grant reduction is to be made. This is intended to ensure that there is stability in the system when the new Scottish income tax is first introduced, and that the final grant reduction calculation is made on the basis of more experience of the yield of the Scottish income tax.

129. **The Committee agrees that it is a sensible aim to have the new tax powers available for the Scottish Parliament currently scheduled to be elected in 2015, and the income tax powers in force in April 2016. Not all of our witnesses, however, were convinced that income tax devolution needed two implementation stages and the Committee is concerned that this could mean the full system was not in place till nearly 2020. We therefore invite the**

**UK Government to review the plans to see whether it is possible to shorten the transition period, or do away with it entirely.**<sup>26</sup>

130. The major implementation challenge will be for HMRC, which will have to identify Scottish taxpayers and ensure that they are charged the right rate of tax. The Bill contains a new definition of a Scottish taxpayer and the UK Government is working with stakeholder groups on the practicalities of implementation. The Committee noted that one of the strengths of the Bill's proposals is their relative simplicity. **We agree with those involved in tax collection who said that keeping the detailed plans as simple as possible was highly desirable. We recommend that in finalising important details like pension and tax charitable reliefs, the UK Government is prepared to adopt simple solutions, such as allowing relief at the equivalent UK rate.** The Committee would welcome any simplification in the UK definition which reduced costs to taxpayers and others.

131. So far as the definition of a Scottish taxpayer is concerned, the Committee notes that this is quite complex but understands that this is because of the definition of a UK taxpayer. It was suggested that definition might be simplified in future and, if so, the Committee would welcome that, and the consequent simplification of the Scottish definition. **The Committee recommends that this definition be applied in the meantime as a matter of principle to the Scottish variable rate even though it is unlikely to be exercised.** This will give greater certainty to those involved in tax collection.

132. **The whole Committee welcomes the changing relationship between the Treasury and HMRC and the Scottish Parliament and Government. The new framework of intergovernmental machinery should be dynamic and develop with experience to meet changing needs. We welcome the proposal for a new UK-Scottish Tax Committee (we discuss its status and remit below) and agree that there needs to be a direct relationship between HMRC and the Scottish Ministers and Parliament. We welcome the appointment of an Additional Accounting Officer responsible for the Scottish income tax, but are concerned that a non-statutory memorandum of understanding, as is proposed, may be insufficient.**

133. 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.**

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<sup>26</sup> At a very late stage in the Committee's deliberations, the Scottish Government proposed amendments relating to the bringing into effect of the Bill's financial provisions. We have not had the opportunity to consider these in detail but there should be scope for the Scottish Parliament to be consulted about the implementation of the new powers, as was implied in the UK Government's plans.

134. There will be costs associated with the collection of the Scottish income tax. Some of these will fall on business and it is obviously desirable that these be kept to the minimum necessary by keeping the tax as simple as is possible. Further work is clearly needed by the UK Government on these costs, as the estimates which were produced are acknowledged to be uncertain. **All members of the Committee recommend that, as the Bill progresses in its passage, further work is done, in the new bilateral tax committee, to assess and, where possible, reduce these costs.**

135. The UK Government proposes that other costs will fall on the Scottish Budget. The Scottish Government argues that, as the Bill is UK policy, UK budgets should meet its costs. **The Committee does not agree.** The process that led to this Bill was initiated in the Scottish Parliament and will not proceed without the consent of the Parliament. We accept that the principle enunciated in 1998 was that the cost of the devolution settlement should be met from within the Scottish Budget. However it is 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.**

136. 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.**

137. This bilateral Committee will be an important new part of the inter-governmental machinery and the whole Committee recommends that it begins its work during the progress of the Scotland Bill and continues to meet regularly thereafter, if needs be at the instance of the Scottish Government, and should not confine itself to twice yearly meetings. Meetings should be able to be called by either party as a mechanism to forestall or resolve disputes, avoiding the need for top level political exchanges.

138. The whole Committee welcomes the principle of this new inter-governmental body. It will have a number of operational tasks, but will also provide a forum for dialogue between a future Scottish Government and HM Treasury and HMRC. These are likely to include such issues as the use of borrowing powers and the scope for new taxes, grant reduction formulae etc. It is important that it is clear how the work of this body relates to other inter-governmental fora such as the Finance Ministers' Quadrilateral and the Joint Ministerial Committees. Given the breadth of its likely responsibilities and significance, the Committee suggests that it be referred to as a Joint 'Exchequer' Committee, and invites the UK Government to consider whether it should have some statutory underpinning.



139. It will also be important that there is full transparency in the financial arrangements between Westminster and the Scottish Parliament. This will reduce the scope for suspicion and avoidable disputes. The CSD recommended a role for the National Audit Office in the area but the Command Paper suggests that by publishing data in relation to the grant calculation and the income tax estimates, sufficient transparency will be ensured. **This is welcome but the Committee is not wholly convinced by it. We do not doubt in the slightest the integrity of HMRC or OBR but both are answerable to the UK Government. There should be the possibility of some audit of their work in relation to, or on behalf of, the Scottish Parliament. If the National Audit Office is not appropriate, the Committee recommends that consideration be given to allowing access for the Auditor General for Scotland to examine their work so as to facilitate proper accountability to the Scottish Parliament.**

### **Non financial issues**

140. Although the Scotland Bill has at its core a series of provisions relating to financial matters, it also contains a series of significant proposals to alter the legislative powers of the Scottish Parliament and its procedures, and the competences of the Scottish Ministers. Our conclusions and recommendations on each of these are as follows.

141. **During our consideration of the relevant provisions in the Bill that seek to re-reserve particular policy areas (e.g. regulation of the health professions, insolvency), the Committee debated whether, in principle, any power currently devolved should be reserved. On a division, members voted against the presumption that powers should never be re-reserved and consider that the merits for doing so should be considered on a case-by-case basis.**<sup>27</sup>

#### *Air weapons*

142. One member of the Committee proposed that the powers to regulate all firearms should be devolved to the Scottish Parliament. This was disagreed to by division.<sup>28</sup>

143. Consequently, the Committee welcomes the intention of the UK Government to amend the Scotland Act to create a specific exception to the reservation of firearms for the regulation of air weapons, in order to give the Scottish Parliament legislative competence in this area. We note that this excludes those air rifles, air guns or air pistols which are of a type declared by rules made by the Secretary of State under section 53 of the 1968 Act to be “specially dangerous”. These particular weapons are already banned and we see no reason why this would change.

**144. We are aware of public concern in Scotland about air weapons. For these reasons, the whole Committee is content to recommend to the**

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<sup>27</sup> The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

<sup>28</sup> The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

**Scottish Parliament that it should give its legislative consent to the provisions in the Scotland Bill relating to air weapons (clause 11).**

*Insolvency*

145. The UK Government has stated that whilst it agreed with the CSD that a common approach to corporate insolvency across the UK is necessary, it would include a clause in the Scotland Bill to make amendments to Schedule 5 to the Scotland Act 1998. Therefore, responsibility for the rules on winding-up in Scotland would be re-reserved.<sup>29</sup>

146. The Committee notes that Scottish Government's view that it is not necessary to address such circumstances through reserving matters to the UK Government and Parliament and that improved inter-governmental working is preferable. However, we also note the support of bodies such as the Institute of Chartered Accountants in Scotland that re-reservation of responsibility for corporate insolvency procedure, excluding receivership, is beneficial as it will ensure consistency throughout the UK.

**147. The Committee debated the merits of re-reservation of insolvency to the UK Parliament. On a division, it favoured the principle of re-reservation.<sup>30</sup> The Committee is content with the current proposals by the UK Government in relation to the re-reservation of insolvency to the UK Parliament. However, we do have concerns in relation to the impact on Registered Social Landlords as raised by the Scottish Federation of Housing Associations and others.**

**148. To this extent, the whole Committee is content to recommend to the Scottish Parliament that it should give its legislative consent to the provisions in the Scotland Bill relating to the re-reservation of insolvency, subject to provisions being drafted which will secure capacity for devolved legislation to affect the winding-up of Registered Social Landlords (clause 12).**

*Regulation of the health professions*

149. The Scotland Act reserves the regulation of health professions that are regulated under enactments listed within the Act. This includes doctors, dentists, dental auxiliaries, opticians, pharmacists, nurses, midwives, health visitors, chiropodists and veterinary surgeons. Legislation has been passed subsequent to the Scotland Act which provides for the regulation of additional health professions not listed in the Scotland Act meaning regulation of such professions is devolved to the Scottish Parliament. Examples of these professions include dental nurses, dental technicians and pharmacy technicians.

150. The UK Government proposes that the regulation of all such health professions should be reserved. The legislative consent memorandum from the Scottish Government<sup>31</sup> makes clear that it does not support the proposed change arguing that inter-governmental working already achieves the objectives set out by

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<sup>29</sup> HM Government. *Strengthening Scotland's Future*, p57-58.

<sup>30</sup> For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

<sup>31</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

the CSD. The Scottish Government has made it clear that it does not support re-reservation of powers from Holyrood in almost any circumstances.

151. The Committee notes the variance in views between the two administrations and also between different health bodies, regulators and professional associations. We note, however, that the Scotland Act 1998 was drafted to reserve all health professions as they then existed and it appears that the devolution of professions created since then was an unintended consequence

**152. The Committee debated the merits of re-reservation of the regulation of health professions to the UK Parliament. On a division, the Committee concluded that, overall, we are content to recommend to the Scottish Parliament that it should give its legislative consent to the provisions in the Scotland Bill relating to the re-reservation of the regulation of health professions (clause 13).<sup>32</sup>**

*Antarctica*

153. Clause 14 of the Bill introduces provisions to regulate activities in Antarctica, which were not reserved under the Scotland Act 1998. The Scottish Government's view is that the creation of an entire new reservation in Schedule 5 to address this issue is unnecessary and disproportionate. Its view is that the outcome sought by both governments is merely to ensure that relevant functions can be exercised consistently by the Foreign and Commonwealth Office (FCO) on behalf of the UK as a whole, and that this can be achieved entirely satisfactorily by allowing executive functions belonging to the Scottish Ministers to be exercised by UK Ministers.

154. The Scottish Government's position is that the proposal also sets an undesirable precedent for the Scottish Parliament. As for other parts of the Bill, its view is that removing responsibilities from the Scottish Parliament should only be a last resort.

**155. The Committee's view is that it is entirely sensible for the UK Government to propose the change that it has done in the Scotland Bill. Whilst we note the Scottish Government's objection to re-reservation of any power, the Committee is content to recommend to the Scottish Parliament that it should give its legislative consent to the provisions in the Scotland Bill relating to Antarctica (clause 14).**

*BBC Trust member for Scotland and MG Alba*

156. The CSD recommended that responsibility for the appointment of the Scottish member of the BBC Trust should be exercised by Scottish Ministers, subject to the normal public appointments process.<sup>33</sup> The UK Government believes that clause 17 of the Scotland Bill, which requires a Minister of the Crown to obtain the agreement of the Scottish Ministers before making a recommendation for the appointment of the Scottish member of the BBC Trust, meets the spirit of the CSD recommendation, and is the most appropriate outcome as the appointment is

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<sup>32</sup> For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

<sup>33</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p170-171.

primarily that of a member of a UK body and broadcasting remains a reserved matter.<sup>34</sup>

157. The Scottish Government supports the recommendation of CSD but does not believe that the provisions in the Bill implement that recommendation.

158. We agree with Mr Jeremy Peat, former BBC Trustee for Scotland that it is important that the appointee has the confidence of both the UK and Scottish Governments and the ability to satisfy their requirements. Mr Peat thought, given that the appointed person was both a member of a UK board, considering UK matters, and also has specific responsibility in Scotland, e.g. chairing the BBC's Audience Council Scotland, the important thing was to ensure that these two elements of the role are appropriately fulfilled.<sup>35</sup>

**159. On a division, the Committee therefore recommends to the Scottish Parliament that it should give its legislative consent to the provisions in the Scotland Bill relating to the appointment of the BBC Trust member for Scotland (clause 17).<sup>36</sup>**

**160. However, the whole Committee does have sympathy with the view that in relation to MG Alba, the Scottish Ministers should approve the appointment of MG Alba's board members given that it is difficult to argue that this is a UK body. We recommend that the UK Government reconsiders its position in relation to this particular body.**

*Scottish Crown Estate Commissioner and the wider role of the Crown Estate*

161. The Scotland Bill contains provisions that make a limited change to the functioning of the Crown Estate Commissioners in relation to Scotland. Specifically, the Bill recommends that there should be a specific Crown Estate Commissioner appointed to represent Scottish interests and that this should be someone who can demonstrate significant knowledge and understanding of interests in Scotland. In addition, the Bill contains a requirement that Scottish Ministers should be consulted formally on the appointment of the Scottish Commissioner.

162. The Scottish Government and others believe that the CSD's recommendations are modest in terms of tackling the wider issues of accountability and transparency of the Crown Estate Commission in Scotland. The Scottish Government state that although the Crown Estate Commission's activities affect policy areas that are devolved – including: rural affairs; terrestrial and marine planning; marine management and strategy; economic development; fisheries; ports and harbours and notably the development of renewable energy – the responsibility for the power of direction over the Crown Estate Commission's operations in Scotland rests with the Secretary of State for Scotland, and that the Crown Estate Commission is not accountable to Scottish Ministers or the Scottish Parliament.

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<sup>34</sup> HM Government. *Strengthening Scotland's Future*, p58-59.

<sup>35</sup> Scotland Bill Committee, *Official Report*, 1st February 2011, Col 323.

<sup>36</sup> For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

163. The debate on the wider role of the Crown Estate Commission was one where the Committee received a fair number of submissions, all calling for reform in one shape or another of the Crown Estate Commissioners and for a greater role for the Scottish Parliament and the Scottish Government in those areas of its operations of most relevance to the devolved competences of the Parliament. We also received submissions outlining options for reform ranging from full devolution to various interim proposals. Most notable of these interim measures were the submissions in the evidence from Mr Calum Macdonald, a former MP for the Na h-Eileanan Siar, which proposed governance structures based on previous reforms of the Forestry Commission.

164. The Committee welcomes the limited provisions in the Scotland Bill in relation to the appointment of a specific Crown Estate Commissioner appointed to represent Scottish interests. **However, we take the view that the process should be the same as that being followed for the BBC Trust member for Scotland. Secondly, whilst we have a great deal of sympathy for some of the more radical options being proposed for the Crown Estate Commissioners, we accept that this will require more detailed consideration between the UK Government and the devolved administrations. Given this will take time, we are favourably disposed towards consideration of some of the interim proposals for the Bill, notwithstanding the wider considerations that will continue after this Bill is enacted and we urge an early and full dialogue between the UK Government and the devolved administrations on this issue with all options on the table for the future governance of the Crown Estate Commissioners' functions in Scotland.**

165. The Committee notes with some interest that the Scottish Affairs Committee in the House of Commons will review the work of the Crown Estate Commissioners in Scotland. This is an important development. The Committee also notes the positive attitude evidenced by the Secretary of State for Scotland to this initiative. We also note the consultation currently underway by the Scottish Government.

166. **The whole Committee notes that there are clearly significant issues to be dealt with in relation to the Crown Estate and its Commissioners. Many of these go beyond the remit of our work on this Bill. Nevertheless, there are important issues which fall within the scope of the Bill. The first relates to the CSD recommendation on the appointment of a Commissioner for Scotland, on which our view is as laid out above. The second is the relationship of the Commissioners with the Scottish Parliament and the Scottish Government. This needs to be improved and made more formal, recognising the importance of the devolved matters affected by the Crown Estate Commissioners' work, notably in relation to renewables policy. We suggest that the Crown Estate Commissioners might re-instate their Scottish Operating Division; that consideration be given to the creation of the Scottish Committee with relevant stakeholders to be chaired by the Commissioner for Scotland; that the Commissioners should present a report of their work in Scotland to the Scottish Parliament; and that the Scottish Ministers should have a statutory right to be consulted on the exercise of the Secretary of State's powers of direction.**

*Misuse of drugs*

167. Clause 19 of the Scotland Bill amends the Misuse of Drugs Act 1971 (“the MDA”) in relation to the circumstances in which a doctor may prescribe controlled drugs to a person addicted to certain drugs. Section 10(2)(i) of the MDA provides for the Secretary of State to make regulations to prohibit a doctor from providing certain controlled drugs to such a person except in accordance with an “addicts licence”.

168. The Committee notes most of the evidence taken generally endorses the Bill’s provision. We also note the views of the Accountable Officer Network Scotland which highlights a number of points or questions that might need to be considered in terms of devolving responsibility for licensing.

**169. The whole Committee therefore recommends to the Scottish Parliament that it should give its legislative consent to the provisions in the Scotland Bill relating to the misuse of drugs (clause 19) and asks that the UK Government gives consideration to the points raised by the Accountable Officer Network Scotland.**

*Power to prescribe drink-driving limits*

170. Clause 20 of the Scotland Bill amends the Road Traffic Act 1988 to give Scottish Ministers powers to make regulations in relation to the prescribed alcohol limit which applies when driving in Scotland.

171. Most of the evidence received by the Committee expressed support for the proposal that the Scottish Ministers should set the alcohol limit for driving. This includes the views of the Scottish Government itself, which broadly supports the provisions on drink-driving. Some of the evidence received called, however, for a lowering of the blood/alcohol limit, in some instances from the current 80mg per 100ml blood to 20mg.

172. One of the key issues to emerge during the Committee’s consideration of this issue related less to the principle of devolution of these powers and more to whether this goes far enough. The Minister for Culture and External Affairs told the Committee that additional devolution of a more complete package of powers over drink-driving would be helpful, including limits, penalties, responsibility for random testing etc.

173. The Committee agrees that there is merit in the UK Government considering the extent of devolution currently proposed to include a more complete package of powers relating to drink-driving.

**174. The whole Committee therefore recommends to the Scottish Parliament that whilst it should give its legislative consent to the provisions in the Scotland Bill relating to drink driving limits (clause 20), the UK Government should give consideration to the case for a more extensive set of powers to be devolved (including limits, penalties and the responsibility for random testing).**

### *Speed limits*

175. Clause 21 of the Bill would allow Scottish Ministers the power to set speed limits on all Scottish roads without the need to consult with the Secretary of State, and Scottish Ministers would also be enabled to specify signs for a Scottish national speed limit. The powers would include setting the national speed limit on special roads, and setting the national speed limit on all other roads (except the 30mph limit on restricted roads), including the current 70mph on all dual carriageways and the current 60mph on all single carriageways.

176. In its evidence to the Committee, the Scottish Government welcomed the proposals in the Bill but stated that the provisions should be adjusted to devolve responsibility for the speed of all classes of vehicle, not just the maximum speed of vehicles on roads. In its view, this would provide greater clarity and accountability for this issue in Scotland.

177. The UK Government told the Committee that it was not its intention to devolve specific speed limits, partly on the basis that it was incumbent on those who drive those vehicles to know the speed limit for that vehicle and that it was more straightforward to have those limits consistent throughout the UK.

178. The Committee agrees that there is a case to be made to extend the current powers in the Scotland Bill and devolve responsibility for the speed of all classes of vehicle, not just the maximum speed of vehicles on roads, which might therefore enable the Scottish Ministers, on a pilot basis, to alter the speed limits on specific roads for other types of vehicles such as HGVs.

**179. The whole Committee therefore recommends to the Scottish Parliament that whilst it should give its legislative consent to the provisions in the Scotland Bill relating to speed limits (clause 21), the UK Government should give consideration to the case for a more extensive set of powers to be devolved, including the setting of speed limits for other classes of vehicle.**

### *Elections*

180. In its final report, the CSD stated that devolving those elements of responsibility for the administration of elections, currently vested in the Secretary of State for Scotland, would be consistent with the principle that matters should be decided at the level closest to those affected, unless there are good reasons for determining them at a UK level.<sup>37</sup> In its Command Paper, the UK Government states that it agrees with this approach.<sup>38</sup>

181. The UK Government goes on to state that it believes that there are good reasons why some elements of electoral administration should remain with the Secretary of State as they relate to reserved matters (in particular the franchise and the combining of Scottish Parliament polls with polls at other, reserved, elections) thus ensuring that issues of UK constitutional importance continue to be dealt with at UK level. The UK Government believes that the provisions in the Bill will enable Scottish Ministers to make general provision for the conduct and

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<sup>37</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p163.

<sup>38</sup> HM Government. *Strengthening Scotland's Future*, p51.

administration of elections to the Scottish Parliament, subject to necessary constraints.<sup>39</sup>

182. While, in its submission to the Committee, the Scottish Government welcomes the devolution of the administration of Scottish Parliament elections as set out in the CSD recommendation, it also points out that it has consistently argued that full legislative, as well as administrative, responsibility for the elections should be devolved<sup>40</sup>.

183. In its submission to the Committee<sup>41</sup> the Scottish Government point out that under the proposals in the Bill, there would be further fragmentation, with the Secretary of State retaining a number of responsibilities including voter registration, rules about the composition of Parliament, the procedure for filling any regional seat vacancy during the life of a Parliament and rules relating to disqualification. These areas would be covered by separate Scottish Parliament Rules to be made by the Secretary of State. However, there would be no requirement for the Secretary of State to consult Scottish Ministers about these rules (in contrast to the equivalent requirement placed on Scottish Ministers).

184. The Committee only received one further piece of written evidence, which related specifically to the clauses in the Bill dealing with elections.<sup>42</sup> In its written evidence, the Electoral Commission draws the Committee's attention to the Local Electoral Administration (Scotland) Bill, currently before the Scottish Parliament, which seeks to establish on a statutory basis the work of the Electoral Management Board in relation to local government elections in Scotland. This would include providing the Convener of the Board with a power of direction over other local government Returning Officers and Electoral Registration Officers. The Electoral Commission welcomes this Bill and supports the establishment of a statutory Electoral Management Board and a power of direction for its Convener for elections to the Scottish, UK and European Parliaments.

185. The Electoral Commission believes that, should clause 1 of the Scotland Bill be enacted, it would potentially create a vehicle by which the remit of the Electoral Management Board, and the power of direction of its Convener, could be extended to cover Scottish Parliament elections. It understands that this is the policy intention of the Scotland Office but that the Scottish Government is concerned that the intention may not be achievable as the Scotland Bill is currently drafted. The Electoral Commission, therefore, encourages the Committee to ascertain whether clause 1, as currently drafted, would allow the extension of the Board's remit to occur.<sup>43</sup>

186. In his evidence to the Committee on 3 February 2011, the Parliamentary Under-Secretary of State for Scotland, Rt. Hon David Mundell MP, reiterated the UK Government's belief that the measures set out in the bill offer the appropriate

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<sup>39</sup> HM Government. *Strengthening Scotland's Future*, p51.

<sup>40</sup> Scottish Government, letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>41</sup> Scottish Government, letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>42</sup> Electoral Commission, written evidence submitted to the Committee.

<sup>43</sup> Electoral Commission, written evidence submitted to the Committee.



balance of responsibilities between the Scottish Parliament and the UK Parliament.<sup>44</sup>

187. In addition, the Scotland Office minister agreed that the UK Government would be willing to look at how the proposed Electoral Management Board's arrangements for the Scottish Parliament elections could work best with the Scottish Parliament's statutory footing for local elections.<sup>45</sup>

188. The Committee believes that there is a case to be made for the issues of voter registration and the rules about the composition of the Scottish Parliament to be made by the UK Government. However, there may be a case that the procedure for filling any regional seat vacancy during the life of a Parliament and the rules relating to disqualification are not issues that the UK Government should have control over, and that these sit more properly with the Scottish Parliament. Furthermore, we believe that the UK Government should look again at the points raised by the Electoral Commission.

**189. The Committee therefore recommends to the Scottish Parliament that whilst it should give its legislative consent to the provisions in the Scotland Bill relating to elections (clauses 1 to 3), the UK Government should give consideration to the case for curtailing the extent of the Rules to be reserved. We consider that the issues of the procedure for filling any regional seat vacancy during the life of a Parliament and the rules relating to disqualification should be devolved to the Scottish Parliament. Furthermore, on clauses 1 and 3 in particular, the UK Government should commit to consultation with the Scottish Parliament and the Scottish Ministers prior to any future use of the powers.**

**190. Finally, the Committee recommends that the UK Government considers the points made by the Electoral Commission on the remit of the Electoral Management Board.**

*Scottish Government/Scottish Executive*

**191. The whole Committee welcomes the proposal to rename the Scottish Executive as the Scottish Government.**

#### **SPPA Committee recommendations (Clauses 4, 5, 6 and 8)**

192. These provisions in the Scotland Bill have previously been considered and recommended for approval by the SPPA Committee and endorsed by the Scottish Parliament.

**193. On that basis, the Committee therefore recommends to the Scottish Parliament that it should give its legislative consent to clauses 4, 5, 6 and 8 in the Scotland Bill.**

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<sup>44</sup> Scotland Bill Committee, *Official Report*, 3rd February 2011, Col 396.

<sup>45</sup> Scotland Bill Committee, *Official Report*, 3rd February 2011, Col 397.

## Legal and technical provisions

194. The Scotland Bill also contains a series of provisions making more legal or technical changes. The evidence we received on these matters is set out above in paragraphs 880 to 941. We conclude as follows.

### *Partial suspension of Acts subject to scrutiny by Supreme Court (clause 7)*

**195. The Committee recommends that the Scottish Parliament should give its consent to the UK Parliament to legislate on this matter and give effect to the provisions in clause 7 of the Bill. However, in doing so, the Committee recommends that any order bringing into effect the non-referred parts of a bill should be subject to the affirmative procedure.**

### *Continued effect of provisions where legislative competence conferred for limited period (clause 10)*

**196. The Committee recommends that the Scottish Parliament should give its consent to the UK Parliament to legislate on this matter and give effect to the provisions in clause 10 of the Bill.** For the avoidance of doubt, we recommend that the UK Government gives consideration to the evidence we received from the Law Society of Scotland on this matter.

### *Time limit for human rights actions against Scottish Ministers etc (clause 16)*

**197. The Committee recommends that the Scottish Parliament should give its consent to the UK Parliament to legislate on this matter and give effect to the provisions in clause 16 of the Bill.**

### *Implementation of international obligations (clause 23)*

**198. The Committee understands why the UK Government has proposed this provision, but has considerable sympathy with the view expressed by some witnesses that it is a power of potentially very wide application – and could be used for matters which are of greater moment than the examples which have prompted the suggestion. The Committee invites the UK Government to consider whether the provision is needed at all or whether it might be given a more restricted application.**

### *Maximum penalties which may be specified in subordinate legislation (clause 33)*

**199. The Committee recommends that the Scottish Parliament should give its consent to the UK Parliament to legislate on this matter and give effect to the provisions in clause 33 of the Bill.**

### *Proposed amendments to Section 57 and 98 of the Scotland Act 1998 – Devolution issues and acts of the Lord Advocate*

200. The final issue considered by the Committee were the proposals brought forward by the Advocate General for Scotland to deal with devolution issues and acts of the Lord Advocate. As outlined early, these proposals have been introduced during the passage of the Bill and were not part of the original provisions.

201. The proposals have been subject to an informal consultation launched by the UK Government in September 2010, and were also the focus of a report by an

Expert Group, chaired by Professor Sir David Edward, which reported on 11 November 2010.

202. The Advocate General stated that he supports the implementation of the Report's recommendations. Accordingly, a UK Government amendment to the Scotland Bill is to be brought forward to implement the key recommendations of the Expert Group.

203. The Committee takes note of the variance in the views expressed by the Scotland Office and the Scottish Government. The Committee believes that there is an issue that needs to be resolved in relation to devolution issues and acts of the Lord Advocate but further notes that there remain differences of opinion between the Lord Advocate and the Advocate General for Scotland on the detail of the way forward.

**204. Given that the detail of these proposals has arisen late in our consideration of the Scotland Bill, and the Bill which we are considering does not contain them, the Committee does not feel that there has been as yet adequate time for all interested to scrutinise what is being proposed. It cannot yet therefore recommend legislative consent at this stage.**

**205. The Committee does, however, recognise that there is an issue that needs to be resolved. It welcomes the principle of what is being proposed by the Advocate General for Scotland, that prosecution actions by the Lord Advocate should be removed from the devolution issues procedure under the Scotland Act. It also found persuasive the evidence that the UK Supreme Court should have scope to hear issues that arise in relation to ECHR or EU obligations in criminal cases. We would urge the Scottish and UK Governments, and their respective Law Officers, to work closely together over the coming months and to report back to the Scottish Parliament in the new session. A further legislative consent motion will be considered then. The Committee cannot at this stage recommend that the Scottish Parliament gives its consent to the UK Parliament to legislate on this matter.**

#### **Other issues not covered in the Bill**

206. Some of the evidence received by the Committee made representations on issues not currently covered by the Scotland Bill. The evidence we received on these matters is set out above in paragraphs 942 to 970. We conclude as follows.

##### *Welfare and benefits*

207. The Committee notes that the recommendations of the CSD on these matters were not on the whole taken up by the UK Government. Furthermore, we note the UK Government's reasoning for that.

208. The Committee believes that there was merit in the intentions underpinning the recommendations made by the Commission. There is an important point of principle that where powers for certain policies, such as housing, care for the elderly etc., are devolved, then consideration needs to be given interaction of the social security system with devolved responsibilities.

209. We also believe that this is an area where there needs to be further inter-governmental work covering the interface of devolved and reserved matters such as welfare, benefits, employment and skills issues. **We would urge the creation of an inter-governmental forum in this area to create a space for dialogue on these matters to take place. We are well aware of the historical problems that can arise when such dialogue is non-existent or does not reach an amicable solution.** This is particularly true at a time when the UK Government is making major changes to the benefit system and we urge that those changes should be thoroughly discussed in the intergovernmental machinery, on the basis of an agreed memorandum of understanding on the need to consider the impacts on devolved responsibilities. Just as there is scope for considering whether there should be a statutory underpinning for the finance relationships, so there may be a case for a statutory basis for intergovernmental consultation on appropriate aspects of welfare reform.

210. The CSD recommended that there should be scope for Scottish variation in Housing and Council tax benefits. **Housing benefit, we understand is to be subsumed in the new Universal Credit. But we also understand from UK Ministers that they plan to decentralise Council Tax benefit. The Committee welcomes this, on the understanding that it offers scope for Council Benefit to relating to local taxation to be altered to suit Scottish circumstances, but notes that much more detail is needed on the UK Government's plans. We would recommend that the during the passage of any related bill, the UK Government commits to consulting with devolved institutions on its plans for tax and benefit reform and the interaction with devolved competences and policies.**

#### *Marine Conservation*

211. The Committee notes that the consideration of this matter by the Commission on Scottish Devolution took place during the passage of the Marine and Coastal Access Bill, and that that the Commission did not wish to imperil the new arrangements which were being put into legislation at that time. It recommended, however, that devolution be taken forward after a review of those new arrangements. The new Marine management arrangements have now been on the statute book for some time and the Committee considers that the time must soon be right for that review to happen.

**212. The whole Committee believes that there is scope for further devolution of marine conservation issues and recommends that the UK Government begins the review as soon as possible.**

#### *Food standards and labelling*

213. This is an area where the CSD recommended that there should be a re-reservation but the new UK Government did not agree. Its view was that the law on food labelling was sufficiently constrained by EU legislation that the problem was unlikely to arise. This was welcomed by the Scottish Government.

214. Evidence received by the Committee from the Scottish Retail Consortium, however, stated that the Committee should recommend that the UK Government looks again at re-reserving the food content and labelling powers back to Westminster.

**215. The Committee recommends that the UK Government explains in more detail why it has not taken forward the recommendation agreed to by the Commission on Scottish Devolution.**

*Rail regulation*

216. The Scottish Parliament is responsible for many aspects of rail travel in Scotland following the 2005 Railways Act, such as specifying and funding investment in rail infrastructure. However, currently rail regulation is reserved to Westminster. Two members of the Committee (Brian Adam and Tricia Marwick) consider that this is an anomaly that undermines the Scottish Parliament's ability to improve Scotland's railways. Their view is that the Scotland Bill is an opportunity to end this anomaly. They recommend that consideration be given to amending the Scotland Bill to devolve rail regulation to the Scottish Parliament or this matter be devolved via another relevant legislative vehicle.

217. However, the Committee received no evidence on this proposal, which was first made by the Scottish Government on 21 February – and is not in a position to make recommendations.

**Legislative consent motion**

218. It is important to understand the significance of the legislative consent motion which we recommend should be passed and what this will mean in practice for the consideration of the Scotland Bill.

219. It is a measure of the significance of the Bill that this is the first time that the Scottish Parliament has established a special committee to consider a Westminster bill.

220. The process which led to the Scotland Bill was a co-operative one between the different levels of Government in the UK. Both have an obvious and legitimate interest in its content. The Sewel Convention is clear that changes to the powers and functions of the Scottish Parliament and the Scottish Ministers must be made with the Scottish Parliament's consent, and UK Government ministers have recognised this.

221. In a complex bill of this sort, consent is not a simple yes/no distinction. It involves a process of dialogue between the different levels of Government. This has already begun, with the Scottish Parliament passing a resolution to support the *general principles* of the Bill, which enabled the Secretary of State for Scotland to inform the UK Parliament of the Scottish Parliament's broad view when he presented the Bill for a Second Reading.

**222. This Committee recommends that the Scottish Parliament should give its consent to the Scotland Bill.**

**223. It is often the case that, for bills passed at Westminster, only one legislative consent motion is needed. In more complex bills, however, more than one legislative consent motion is needed, and this will be the case for this Bill.**

**224. We now therefore recommend that the Scottish Parliament passes a legislative consent motion, which refers to the various amendments, suggestions and proposals that the Committee has made. This will enable a further process of dialogue, so that this Parliament in its next session can consider the Bill as amended – in light of our report, and any other changes made – and decide whether it consents to the changes which have been made, before the Bill can be passed for Royal Assent.**

**225. The Committee, therefore, recommends that the Scottish Parliament passes a motion in broadly the following terms—**

“Further to the motion passed in the Parliament supporting the general principles of the Scotland Bill, as introduced in the House of Commons on 30 November 2010, the Parliament now agrees that the Bill be considered by the UK Parliament; invites HM 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.”

## BACKGROUND

### A brief history

226. On 6 December 2007, the Scottish Parliament voted by a majority<sup>46</sup> to establish an independently chaired commission to review devolution in Scotland. This became known as the Commission on Scottish Devolution (“CSD”), or the ‘Calman Commission’, after its chairman, Professor Sir Kenneth Calman.

227. The CSD was set up in March 2008 with the following remit—

“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>47</sup>

228. In addition to Sir Kenneth Calman, the CSD had 14 other members.<sup>48</sup> The CSD also established an independent expert group to advise on financial accountability matters. The expert group was chaired by Professor Anton Muscatelli, then Principal and Vice Chancellor of Heriot-Watt University, and consisted of 12 other members.<sup>49</sup>

229. The CSD published its first report, *The future of Scottish devolution within the Union: a first report*,<sup>50</sup> in December 2008 and its final report, *Serving Scotland Better: Scotland and the United Kingdom in the 21st century: final report*,<sup>51</sup> in June 2009.

230. Prior to the establishment of the CSD, the new Scottish Government, which took office in May 2007, published *Choosing Scotland's future: a national conversation: independence and responsibility in the modern world*.<sup>52</sup> The ‘National Conversation’ document contained options for constitutional change in Scotland including further powers for the Scottish Parliament. Alongside the ‘National Conversation’ document, the Scottish Government established a website for people and organisations to submit their views.<sup>53</sup>

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<sup>46</sup> Scottish Parliament, *Official Report*, 6 December 2007, Col 4268 (S3M-976, For 76, Against 46, Abstentions 3).

<sup>47</sup> <http://www.commissiononscottishdevolution.org.uk/about/index.php>

<sup>48</sup> <http://www.commissiononscottishdevolution.org.uk/about/members.php>

<sup>49</sup> <http://www.commissiononscottishdevolution.org.uk/about/index.php>

<sup>50</sup> Commission for Scottish Devolution, *The future of Scottish devolution within the Union: a first report*, December 2008. Available at:

<http://www.commissiononscottishdevolution.org.uk/uploads/2008-12-01-vol-1-final--bm.pdf>

<sup>51</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009. Available at:

<http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-12-csd-final-report-2009fbbookmarked.pdf>

<sup>52</sup> Scottish Government, *Choosing Scotland's Future: A National Conversation: Independence and Responsibility in the Modern World*, August 2007. Available at:

<http://www.scotland.gov.uk/Publications/2007/08/13103747/0>

<sup>53</sup> Available at: <http://www.scotland.gov.uk/Topics/a-national-conversation>

231. In his role as chairman of the CSD, Sir Kenneth Calman wrote to the First Minister in May 2008 inviting the Scottish Government to take part in its work. In response, the First Minister highlighted the work of the 'National Conversation' and whilst offering Scottish Government officials as a means of providing assistance on factual matters, otherwise declined to be involved in the work of the CSD.<sup>54</sup>

232. The first report of the Commission for Scottish Devolution was presented to the Scottish Parliament and the UK Government on 2 December 2008. The report outlined the main functions of the Scottish Parliament, reviewed how it was financed and was accountable to the Scottish people, and set out how the new Scottish political institutions related to the rest of the UK. At this stage in its work, the CSD's report set out its general thinking and posed a number of specific questions on how it might take forward some of the key issues. The CSD encouraged people and organisations to provide responses to the specific questions in order to inform its final report.

233. To assist in this consultation, the CSD published a paper in December 2008. This summarised the broad conclusions of the first report, identified some important principles and set out a series of 49 questions requiring further consideration in the second phase of the Commission's work.<sup>55</sup> These covered areas such as principles, powers and functions, financial accountability, relationships between parliaments and governments, other features of the Scotland Act and the operation of the Scottish Parliament.

234. In its final report, published in June 2009, the CSD made a total of 63 recommendations. The overview booklet<sup>56</sup> published alongside the final report summarises the recommendations under a number of key headings, as follows—<sup>57</sup>

*"Strengthening devolution"*

We make 24 specific recommendations, which are explained in much greater detail in the section of our Report on Strengthening Devolution, covering a wide range of areas. Examples include:

- devolving powers for the administration of Scottish elections to the Scottish Government;
- simplifying the law relating to the regulation of charities, to make life easier for those who work in that vital sector;
- devolving the regulation of airguns;

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<sup>54</sup> Letter to Sir Kenneth Calman from the First Minister, dated 22 May 2008. Available at: <http://www.commissiononscottishdevolution.org.uk/uploads/2008-08-19-response-from-first-minister-to-chair.pdf>

<sup>55</sup> Commission for Scottish Devolution, *The future of Scottish devolution within the Union: a consultation*, December 2008. Available at: <http://www.commissiononscottishdevolution.org.uk/uploads/2008-12-19-csd-a5-consult-bm.pdf>

<sup>56</sup> Available at: <http://www.commissiononscottishdevolution.org.uk/uploads/2009-06-12-csd-overview-booklet.pdf>

<sup>57</sup> Summarised in the briefing paper produced by the House of Commons' Library, *The Commission on Scottish Devolution – the Calman Commission*, Standard Note: SN/PC/04744, 4 June 2010.



- devolving power to set drink-driving limits and the level of the national speed limit;
- devolving responsibility for nature conservation at sea to the Scottish Parliament at an appropriate opportunity; and
- creating scope for the two Governments to agree changes to Housing Benefit and Council Tax Benefit in Scotland where these might be needed because of changes in devolved policy.

[...]

#### *Strengthening cooperation*

Our recommendations to develop mutual respect between Parliaments and Governments – which should be the guiding principle in all their relations – are set out in the section of our Report on Strengthening Cooperation and include:

- introducing a regular “state of Scotland” debate in the House of Commons;
- strengthening the existing mechanisms for both Parliaments to work together, and proposing new ones including a way for the Scottish Parliament to work with the UK Parliament on reserved matters; and
- re-invigorating the Joint Ministerial Committees, and making them subject to greater Parliamentary scrutiny and transparency.

[...]

#### *Strengthening the Scottish Parliament*

We believe there is scope for some improvements to the Parliament’s committee system, to its scrutiny of legislation, and to various other procedural matters. In the section of our Report dealing with Strengthening the Scottish Parliament, we set out our detailed recommendations.

[...]

#### *Strengthening financial accountability*

In the section of our Report on Strengthening Accountability in Finance we set out our detailed recommendations for achieving this. They include:

- cutting basic and higher rates of income tax levied by the UK Government in Scotland by 10 pence in the pound, with a corresponding reduction in the block grant;
- replacing the Scottish Variable Rate of income tax with a new Scottish income tax rate, applying to basic and higher rates of tax and collected as now; a 10 pence rate would replace the reduction in block grant;

- devolving Stamp Duty Land Tax, the Aggregates Levy, Landfill Tax and Air Passenger Duty (APD) to the Scottish Parliament, again with a corresponding block grant reduction;
- giving Scottish Ministers additional borrowing powers; and
- strengthening the inter-governmental relationships that deal with finance.”

235. Changes to financial accountability are at the heart of the Scotland Bill; the CSD made the following recommendations in relation to this aspect of devolved powers—

“RECOMMENDATION 3.1: Part of the Budget of the Scottish Parliament should now be found from devolved taxation under its control rather than from grant from the UK Parliament. The main means of achieving this should be by the UK and Scottish Parliaments sharing the yield of income tax.

a. Therefore the Scottish Variable Rate of income tax should be replaced by a new Scottish rate of income tax, collected by Her Majesty’s Revenue and Customs (HMRC), which should apply to the basic and higher rates of income tax.

b. To make this possible, the basic and higher rates of income tax levied by the UK Government in Scotland should be reduced by 10 pence in the pound and the block grant from the UK to the Scottish Parliament should be reduced accordingly.

c. Income tax on savings and distributions should not be devolved to the Scottish Parliament, but half of the yield should be assigned to the Scottish Parliament’s Budget, with a corresponding reduction in the block grant.

d. The structure of the income tax system, including the bands, allowances and thresholds should remain entirely the responsibility of the UK Parliament.

RECOMMENDATION 3.2: Stamp Duty Land Tax, Aggregates Levy, Landfill Tax and Air Passenger Duty should be devolved to the Scottish Parliament, again with a corresponding reduction in the block grant.

RECOMMENDATION 3.3: 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.

RECOMMENDATION 3.4: The block grant, as the means of financing most associated with equity, should continue to make up the remainder of the Scottish Parliament’s Budget but it should be justified by need. Until such times as a proper assessment of relative spending need across the UK is carried out, the Barnett formula should continue to be used as the basis for calculating the proportionately reduced block grant.

RECOMMENDATION 3.5: This system will require a strengthening of the intergovernmental arrangements to deal with finance.

- a. The present Finance Ministers' Quadrilateral Meeting should become a Joint Ministerial Committee on Finance (JMC(F)), and should meet regularly on a transparent basis to discuss not just spending but taxation and macroeconomic policy issues.
- b. HMRC should advise Scottish Ministers in relation to those devolved taxes it is tasked with collecting and their responsibilities in relation to income tax and should account to them for the operation of these Scottish taxes. Scottish Ministers should be consulted on the appointment of the Commissioners of HMRC.
- c. All the relevant spending or grant calculations done by HMRC and HM Treasury should be audited by National Audit Office (NAO) which should publish an annual report on the operation of the funding arrangements, including reporting to the new JMC(F) and to the Scottish Parliament."

236. In the UK Parliament, the then Secretary of State for Scotland, Rt. Hon Jim Murphy MP, made a written statement to the House of Commons on 15 June 2009, welcoming the Commission's final report. He announced the setting up of a steering group comprising the parties involved in the Calman process, chaired by him, to help the UK Government and the Scottish Parliament plan how to take forward the Commission's recommendations.<sup>58</sup>

237. In the Scottish Parliament, a debate was held on the CSD's final report on 25 June 2009. By a majority, the Parliament warmly welcomed the report, agreed that the Commission's report was a comprehensive response to the remit approved by the Scottish Parliament on 6 December 2007 and welcomed the establishment of the steering group. The Scottish Parliament also called on the Scottish Government to make fully available the resources of the Scottish administration to cooperate in this respect, and called on the Scottish Parliamentary Corporate Body (SPCB) to continue to allocate appropriate resources and funding to enable the Scottish Parliament to support the work of the steering group and consider the recommendations that apply to the Scottish Parliament.<sup>59</sup>

238. The Scottish Government welcomed the publication of the CSD's final report and urged the UK Government to make early progress on some of the non-financial recommendations. However, the Scottish Government expressed reservations about the financial powers recommended by CSD. Speaking at the debate, the then Minister for Culture, External Affairs and the Constitution, Mike Russell MSP said—

"Only on one area is there substantive disagreement, which needs to be listened to. Calman's recommendations may appear to give Scotland more

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<sup>58</sup> House of Commons' Library, *The Commission on Scottish Devolution – the Calman Commission*, Standard Note: SN/PC/04744, 4 June 2010

<sup>59</sup> Scottish Parliament, *Official Report*, 25 June 2009, Col 18988 (S3M-4490, For 69, Against 49, Abstentions 1).

control over its finances, but the reality is very different from the appearance. On a superficial level and a deep level, Calman offers nothing to Scotland in fiscal terms. Indeed, it could actually make things worse in our fiscal activity.”<sup>60</sup>

239. In November 2009, the Scottish Government formalised its response to the final report of the CSD when it published *The Scottish Government response to the recommendations of the Commission on Scottish devolution*. It supported certain recommendations and rejected others, most notably on taxation.<sup>61</sup>

240. The then UK Government published its Command Paper, *Scotland's future in the United Kingdom: building on ten years of Scottish devolution*, on 25 November 2009, setting out its response to the Calman Commission's recommendations.<sup>62</sup> This included an intention to introduce legislation to take forward some the proposals, and detailed responses to the Commission's recommendations.

241. The then UK Government accepted most of the CSD's recommendations, but there were differences. For example, it did not accept the Commission's recommendation that half of the yield of income tax on savings and distributions, should be assigned to the Scottish Parliament's Budget, with a corresponding reduction in block grant.<sup>63</sup> It proposed that the Scottish Government should be able to borrow for additional capital spending but only if it increased the tax rate to cover the costs.

242. Following the UK general election in May 2010, the new Conservative-Liberal Democrat coalition agreement included a commitment to implement the proposals of the CSD. The UK Government announced in the Queen's Speech that it would bring forward legislation to implement the recommendations from the final report of the CSD.

243. On 30 November 2010, the UK Government introduced the Scotland Bill<sup>64</sup> (“the Bill”) in the House of Commons, along with explanatory notes.<sup>65</sup> It also published a Command Paper (*Strengthening Scotland's Future*), setting out further detailed on its proposed policies.<sup>66</sup> Further detail on the provisions in the Scotland Bill is set out later in this report.

244. The Scotland Bill does not replicate all of the recommendations made in the CSD's final report. A number have been developed since the previous administration considered the CSD's final report, most notably an extension of the

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<sup>60</sup> Scottish Parliament, *Official Report*, 25 June 2009, Col 18841.

<sup>61</sup> Scottish Government, *Response to the Commission on Scottish Devolution*, November 2009. Available at: <http://www.scotland.gov.uk/Publications/2009/11/09152544/0>

<sup>62</sup> Cm 7738, 25 November 2009. As cited in House of Commons' Library, *The Commission on Scottish Devolution – the Calman Commission*, Standard Note

<sup>63</sup> HM Government, *Scotland's Future in the United Kingdom: Building on ten years of Scottish devolution*, November 2009, p21.

<sup>64</sup> House of Commons, Scotland Bill, Bill 115, 30 November 2010. Available at: <http://www.publications.parliament.uk/pa/cm201011/cmbills/115/111115.i-iii.html>

<sup>65</sup> House of Commons, Scotland Bill, Bill 115-EN, 30 November 2010. Available at: <http://www.publications.parliament.uk/pa/cm201011/cmbills/115/en/2011115en.htm>

<sup>66</sup> HM Government. *Strengthening Scotland's Future*. Available at: <http://www.publications.parliament.uk/pa/cm201011/cmbills/115/en/2011115en.htm>

proposed borrowing provisions. Of the recommendations not translated into the Bill, some do not require legislation, others are for parliaments and governments to consider for administrative action. The UK Government's plans for a number of these have been set out in the Command Paper. In other cases, it explains why the UK Government has decided not to bring forward legislation. Additionally, there are a number of provisions in the Bill which were not included at all in the Commission's recommendations notably in legal areas, for example, such as referrals to the Supreme Court.

245. Although the Bill was introduced in the UK Parliament by the UK Government, it contains provisions that, if enacted, would either change the law in a devolved area or change the law-making powers of the Scottish Parliament or the devolved functions of the Scottish Ministers. For these reasons, the Scotland Bill is subject to a legislative consent motion in the Scottish Parliament under what has become known as the 'Sewel Convention'.<sup>67</sup>

246. The Sewel Convention is an important aspect of the devolution settlement, and is reflected in the Memorandum of Understanding between the UK Government and the Scottish Government (formerly Scottish Executive) and in Devolution Guidance Note 10.<sup>68</sup>

247. The Guidance Note states that nothing in the Scotland Act prevents the UK Parliament from legislating on matters which are within devolved competence: section 28(7) makes that clear. However, during the passage of the Scotland Act, the UK Government announced that it "would expect a convention to be established that Westminster would not normally legislate with regard to devolved matters<sup>69</sup> in Scotland without the consent of the Scottish Parliament." This has become known as the Sewel Convention, and its purpose is to reflect and respect the devolution settlement and the role of the devolved institutions.

248. The Sewel Convention ensures that Westminster will normally legislate on devolved matters only with the express agreement of the Scottish Parliament, after proper consideration and scrutiny of the proposal in question.

249. Given its significance, the Bill was debated by the Parliament on 9 December 2010, following the introduction of the Bill in the House of Commons. By a majority, the Scottish Parliament resolved that it supported the *general principles* of the Bill and noted that it would give the Scottish Parliament substantial new

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<sup>67</sup> Note: The "Sewel Convention"—*that Westminster would not normally legislate with regard to devolved matters in Scotland without the consent of the Scottish Parliament*—is an essential feature of the devolution settlement, being reflected in the Memorandum of Understanding between the UK Government and the Devolved Administrations, as well as in the UK Government's Devolution Guidance Note (DGN) 10.

<sup>68</sup> Scottish Government, *Devolution Guidance Note 10, Post – Devolution Primary Legislation affecting Scotland*.

<sup>69</sup> In this context 'devolved matters' does not refer just to matters that are within the legislative competence of the Scottish Parliament and could, therefore, potentially be included within an Act of the Scottish Parliament. It additionally is taken to refer to matters which, although reserved, affect the breadth of the devolved institutions' powers - i.e. the legislative competence of the Scottish Parliament or the executive competence of the Scottish Ministers.

taxation, spending and other powers, and strengthen its relationship with the rest of the United Kingdom and enable it to serve the people of Scotland better.<sup>70</sup>

250. This resolution defined the Scottish Parliament's overall view of the Bill, but it did not at that stage convey the Parliament's consent to the Bill. The Parliament's Standing Orders set out the procedure for the consideration of any legislative consent motion. This involves the Parliamentary Bureau referring the matter to a lead committee, which then reports to the Parliament. The lead committee's report should normally address separately the general merits of the policy contained in the relevant provisions of the Westminster Bill, and the justification for using the legislative consent route in these circumstances. Committees may also include in their reports any comments they may have on the terms of the draft motion. Lead committee reports normally conclude with a clear recommendation to the Scottish Parliament on whether to agree the legislative consent motion. However, it is also open to a lead committee not to make a recommendation.

251. On this occasion, the Scottish Parliament agreed to establish an ad hoc committee to consider the Scotland Bill and any relevant legislative consent memoranda, two of which have been lodged to date. The Scotland Bill Committee ("the Committee") was established in December 2010, consisting of 6 members of the Scottish Parliament.<sup>71</sup> Further information on the work of the Committee is set out in later sections of this report.

252. Legislative consent memoranda are essentially explanatory, setting out the author's views on the provisions in the relevant UK bill and outlining whether or not the author recommends that the Scottish Parliament should give its legislative consent. Any member of the Scottish Parliament can lodge a memorandum though normally memoranda are lodged by the Scottish Government.

253. In relation to this Bill, to date, two legislative consent memoranda have been lodged. The first was lodged by the Scottish Government on 1 December 2010.<sup>72</sup> The second legislative consent memorandum was lodged by Iain Gray MSP, supported by Annabel Goldie MSP and Tavish Scott MSP (as leaders of the 3 main opposition parties), on 13 December 2010.<sup>73</sup> Both of these legislative consent memoranda have been referred to the Scotland Bill Committee for consideration.

254. Both of the legislative consent memoranda contain draft motions although the wording of the motion in each memorandum differs. It will be open to the Scottish Government or any other member of the Scottish Parliament to lodge a legislative consent motion now that the Committee has reported.

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<sup>70</sup> Scottish Parliament, Motion S3M-7550, agreed on 9 December 2010.

<sup>71</sup> Scottish Parliament, Motion S3M-7518, agreed on 1 December, 2010.

<sup>72</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1. Available at: <http://www.scottish.parliament.uk/business/legConMem/LCM-2010-2011/ScotlandBillLCM.pdf>

<sup>73</sup> Iain Gray MSP, legislative consent memorandum, LCM(S3) 30.2. Available at: [http://www.scottish.parliament.uk/business/legConMem/LCM-2010-2011/ScotlandBill\\_lcm.pdf](http://www.scottish.parliament.uk/business/legConMem/LCM-2010-2011/ScotlandBill_lcm.pdf)

## THE SCOTLAND BILL: AN OVERVIEW

255. The Scotland Bill, as introduced in the House of Commons, is in four parts. The first two deal with non-financial matters. Part 1 concerns the Scottish Parliament and its powers, while Part 2 concerns the Scottish Ministers and their powers. Part 3 covers the financial changes. Part 4 includes a clause on criminal penalties, plus provisions on matters such as interpretation and commencement. There are five Schedules, the majority of which cover consequential amendments.<sup>74</sup>

256. At its heart, and probably the most controversial elements, are the financial provisions, which provide the right to set a new Scottish rate of income tax, collect certain other taxes, and borrow. Consequential changes to the block grant are discussed in the Command Paper. Further sections of this report provide more detail on how the financial provisions are to work and the evidence that the Committee took in this area. It is, however, worth presenting a short overview of the financial provisions as they are at the core of the Bill and the debate on legislative consent.

### The financial provisions

257. The Scotland Act 1998 gave the Scottish Parliament the power to vary the basic rate of income tax by plus or minus 3 pence in the pound; known as the Scottish Variable Rate (SVR). According to HM Treasury, increasing the basic rate by the full 3 pence would have increased the funds available to the Scottish Government by £1.2 billion in 2011-12.<sup>75</sup> To date, the SVR power has never been used.

258. The only other tax decision taken directly by which the Scottish Ministers can raise extra revenue or reduce the tax burden directly is through varying the poundage on business rates. Business rates currently generate about £2 billion in revenue.<sup>76</sup> They are in support of local authority expenditure. Scottish Ministers also have very substantial influence over council tax through the powers which they exercise in relation to grant provided to local authorities. The present Scottish Government has exercised these powers to support a freeze on council tax in recent years. In addition, some revenue can be generated by fees and charges, for example, bridge tolls or prescription charges, but the amount currently raised by this means is modest.

259. The estimated share of Scottish Government total current spending which is funded by taxes determined in Scotland is set out in Tables 2 and 3 below.<sup>77,78</sup>

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<sup>74</sup> House of Commons, *Research paper on the Scotland Bill*, paper 11/06, 18 January 2011.

<sup>75</sup> HM Treasury Budget 2010, page 123

<sup>76</sup> Scottish Government, Scotland's Spending Plans and Draft Budget 2011-12, page 200

<sup>77</sup> Scottish Parliament, SPICe briefing for the Scotland Bill Committee, *Share of Scottish Government Total Current Spending Funded by Taxes Determined in Scotland*.

<sup>78</sup> A proposal to add 2 supplementary tables after Table 3 (removing references to Council Tax) was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

**Table 2: Estimated Spending Supported by Devolved Taxes under Different Proposals (£m Outturn prices)**

	Calman £m	Calman £m	Scotland Bill £m	Status Quo
	2006-07	2010-11	2010-11	2010-11
Income tax	4,150	4,500	4,500	
Income tax on savings and distributions	500	500		
Aggregates Levy	50	50		
Landfill Tax	75	75	75	
Stamp Duty Land Tax	555	555	555	
Air Passenger Duty	94	100		
Non-domestic rates	1,884	2,068	2,068	2,068
Council tax	1,812	1,857	1,857	1,857
Total Devolved Tax Revenue	9,120	9,705	9,055	3,925
Current Expenditure (Resource DEL +NDR+ Council Tax)	26,049	29,856	29,856	29,856

**Table 3: Estimated Share of Spending Funded by Devolved Taxes under Different Proposals**

	Calman £m	Calman £m	Scotland Bill £m	Status Quo
	2006-07	2010-11	2010-11	2010-11
Income tax	15.9%	15.1%	15.1%	
Income tax on savings and distributions	1.9%	1.7%	0.0%	
Aggregates Levy	0.2%	0.2%	0.0%	
Landfill Tax	0.3%	0.3%	0.3%	
Stamp Duty Land Tax	2.1%	1.9%	1.9%	
Air Passenger Duty	0.4%	0.3%	0.0%	
Non-domestic rates	7.2%	6.9%	6.9%	6.9%
Council tax	7.0%	6.2%	6.2%	6.2%
Total Devolved Tax Revenue	35.0%	32.5%	30.3%	13.1%

Source (both tables): SPICe

Notes: The following assumptions have been used in calculating the yield of devolved taxes if these had applied in 2010-11: (i) Scottish income tax is levied on income and pensions at 10p in the £ across all taxable income excluding interest and distributions, (ii) No aggregates levy or Air Passenger Duty at this stage, (iii) The yield from landfill tax and Stamp Duty Land Tax is assumed to be the same as Calman although given the state of the housing market the latter figure is likely to be an overestimate for the current year, and (iv) For consistency with Calman, current expenditure has been taken as Resource DEL plus Non-Domestic Rates plus Council Tax.

260. The figures show that under the Scotland Bill proposals, the share of Scottish Government total current spending that would be funded by taxes determined in Scotland would be about 30%. This compares with a figure of about 13% when the only devolved taxes are Non-Domestic Rates and Council Tax. Adding in the Aggregates Levy and Air Passenger Duty or a variant of these, would increase the figure by less than one percentage point. The percentage will also rise if, as expected in the present spending period, expenditure increases more slowly than taxes.



261. At present, the taxation decided in Scotland is Non-Domestic Rates and Council Tax, or roughly £4 billion, in £30 billion of spending. Therefore, to increase spending by 1%, Scotland would have to increase tax effort by over 7%. Conversely to cut taxes by 10%, spending need be cut by only 1.4%.

262. The Scotland Bill will change the gearing between Scottish tax effort and spending. About one-third of spending will now be supported “own resources”. Therefore, a 1% rise in spending needs a 3% increase in tax effort; or a 1% cut in spending would allow a 3% reduction in taxation. A Scottish Government could choose to load all spending changes onto local taxes or income tax only and if they did, the gearing on that tax would obviously be higher. For example, a penny either way on the Scottish income tax only corresponds to a 1.7% change in spending.

263. The Scotland Bill reduces the gearing between devolved spending and locally decided taxation but having any grant means that some level of gearing is inevitable. The local government experience suggests that the gearing effect has a particularly important impact when it is exploited by a central government seeking to reduce spending or control local tax and spending levels. There are no powers in the Scotland Bill for the UK Government to influence Scottish tax levels in the way that the UK and Scottish Governments both control local tax levels. Consequently gearing is really just an arithmetical property of the system to be borne in mind by the Scottish Government in setting its budget.

264. One of the other key changes brought about by the Bill is in relation to borrowing. The Scottish Government currently has only short-term borrowing powers limited to a maximum of £500 million, but it does not in practice have to exercise these as it has the flexibility of drawing down money as spending needs arise from the UK Treasury. This power is not a source of funds for investment nor a tool for the management of the Scottish economy. Capital expenditure is supported by the block grant from Westminster in the same way as current (except for local authority borrowing for capital spending) so in effect the UK Government’s borrowing supports Scottish Government capital investment.

#### *Strengthening Scotland’s future*

265. In the Preface to the UK Government’s Command Paper, *Strengthening Scotland’s Future*, the Prime Minister and the Deputy Prime Minister stated, “It is absolutely right that Scotland has a greater degree of fiscal autonomy....The proposals to devolve tax-raising powers mean that, for the first time, spending decisions made in Scotland will have proper consequences for taxation in Scotland”.<sup>79</sup>

266. The proposals consist of—

- A Scottish income tax to replace part of the UK income tax;
- The devolution of stamp duty land tax and landfill tax;
- The power to create or devolve other taxes to the Scottish Parliament;

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<sup>79</sup> HM Government. *Strengthening Scotland’s Future*, page 7.

- Extensive new borrowing powers;
- A Scottish cash reserve to manage fluctuations in devolved tax receipts; and
- Scottish and UK ministers to work together on a new UK-Scottish tax committee.

267. The Command Paper differs from the CSD in excluding the Aggregates Levy and Air Passenger Duty from taxes to be devolved. According to the UK Government, the Aggregates Levy is subject to legal challenge as so has not yet been devolved. The UK Government has said that it will consider devolution of the levy when court proceedings have been completed.<sup>80</sup> On Air Passenger Duty, the UK Government is considering the wider future of aviation duty and considers it would not be practical to devolve this duty before deciding how aviation should be taxed.<sup>81</sup>

#### *A Scottish income tax*

268. The main features of the income tax proposal are—

- The Scottish variable rate would be abolished;
- The basic, higher and additional tax rates on income would be reduced by 10 pence in the pound 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 tax payer who is defined as a Scottish tax payer;
- The proposals would be introduced in April 2016 with a transitional period of two to three years;
- The amount of income tax revenues paid to the Scottish Government would be based on forecasts prepared by the Office of Budgetary Responsibility with the forecasts being reconciled with actuals up to 12 months after the end of the relevant financial year; and
- Only Her Majesty's Revenue and Customs (HMRC) would collect income tax in Scotland.

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<sup>80</sup> HM Government. *Strengthening Scotland's Future*, page 32

<sup>81</sup> HM Government. *Strengthening Scotland's Future*, page 32

269. The Calman Commission estimated that a 10 pence in the pound Scottish income tax would raise £4.65 billion, of which £500 million would come from tax on savings and dividends.<sup>82</sup>

270. The Scottish Government in its response to the Calman Commission estimated that a 10 pence in the pound Scottish income tax would result in about 44% of income tax paid by Scottish tax payers accruing to the Scottish Government.<sup>83</sup> In recent years, Scottish tax payers have contributed about 7.4% of all UK income tax receipts. Therefore, initially at least, the Scottish share of all UK income tax receipts would amount to about 3.26% of total receipts.

271. The latest forecast by the Office of Budget Responsibility (OBR) is for UK income tax receipts of £156.5 billion in 2011-12. This suggests that a Scottish Income Tax rate at 10 pence in the pound applied only to earnings and pensions would raise about £4.4 billion in 2011-12.<sup>84</sup>

#### *Land Tax and Landfill Tax*

272. 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. The UK Government expects that the devolved taxes would be introduced in April 2015. In its work, the CSD estimated that in 2006-07, SDLT raised £555 million and Landfill Tax £75 million.<sup>85</sup>

#### *Other taxes*

273. The Bill would allow other taxes to be devolved by Order in Council approved by the Westminster and Scottish Parliaments.

#### *New borrowing powers*

274. The Bill would also allow Scottish Ministers to borrow for both capital and current expenditure. The main features of the borrowing power for capital expenditure are—

- Scottish Ministers would be able to borrow from the National Loans fund and private lenders such as commercial banks;
- Borrowing would be way of loan and not by issuing bonds;
- There would be a limit on the amount of outstanding debt of £2.2 billion and borrowing in any year would be limited to 10% of the Scottish capital budget;

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<sup>82</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, table 3.4.

<sup>83</sup> Scottish Government, the Scottish Government's Response to the Recommendations of the Commission on Scottish Devolution, annex B.

<sup>84</sup> Office for Budget Responsibility, *Forecasting the Public Finances*, table 1.

<sup>85</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, table 3.4.

- The annual and overall limits could be amended by order made by the Secretary of State with HM Treasury consent and the approval of the House of Commons; and
- Borrowing powers could be permitted for specific projects from April 2013 and become fully operational from April 2015.

275. The borrowing power for current expenditure is in recognition of the increased uncertainty and volatility of tax receipts compared to the block grant. The main features are—

- The power to borrow up to £200 million in any one year to finance current expenditure when receipts from devolved taxes, other than income tax, are less than predicted at the start of the year or when actual receipts from devolved taxes are less than predicted at the time of a Spending Review by more than 0.5% of the Scottish resource budget;
- Cumulative borrowing for this purpose will be limited to £500 million;
- Borrowing would be from the National Loans Fund (NLF) via the Secretary of State for Scotland at NLF rates;
- Repayment would be required within four years; and
- HM Treasury would have the power to revise the current borrowing and debt limits upwards or downwards but not down below the original £500 million.

#### *A Scottish cash reserve*

276. Recognising that uncertainty and volatility could lead to receipts being higher than expected, the Bill also proposes the creation of a Scottish cash reserve to provide the flexibility to offset good and bad years.

#### *Implementation of the new financial provisions*

277. The Scotland Bill will devolve increased taxation powers to the Scottish Parliament and give it the ability to create new, devolved taxes. The key *quid pro quo* is that the block grant will be reduced to compensate for the increased tax-raising powers of the Scottish Parliament. The UK Government has said that it will work with the Scottish Government and key stakeholders to determine how this can be achieved without negative impact on the Scottish or UK economies.<sup>86</sup> Consistent with the Commission's recommendations, the UK Government's policy is that these financial measures will be implemented in a phased way, beginning in 2013. Therefore, the Scottish Parliament currently scheduled to be elected in 2015 will be the first that is required to make substantial decisions about the levels of taxation in Scotland in order to fulfil the Scottish Government's programme. There will need to be close liaison on the commencement procedures between the 2 Governments and the 2 Parliaments.

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<sup>86</sup> HM Government, *Strengthening Scotland's Future*, p12.

278. Increased financial powers also increase the exposure to risks. According to the UK Government in its Command Paper, income from taxation is much more likely to vary than that from the established UK Government grant, introducing a degree of risk to that part of the Scottish budget. The new public spending framework therefore provides borrowing powers to help manage this risk. The UK Government's view is that this, combined with the continuance of a significant proportion of income from the block grant from central government, will allow stability and predictability of public service provision in Scotland. The new borrowing powers will, in effect, mean that a proportion of UK borrowing and debt will derive from the actions of the Scottish Parliament.<sup>87</sup>

279. The UK Government has said that the new borrowing powers will sit within the UK fiscal framework as a whole, so that the overall economic stability of the UK will be maintained and fiscal risk to the UK Exchequer will be minimised. The UK Government believes that the new system needs to be as simple and transparent as possible. The Scottish income tax base will be shared between the UK Government – which will be responsible for decisions about the thresholds and scope of the tax – and the Scottish Government, which will set part of the overall rate that Scottish taxpayers will pay.

280. Furthermore, the Command Paper states that the phased implementation will also allow the new arrangements to be introduced in a manner that reflects the Scottish Parliamentary electoral cycle and affords those affected by the changes sufficient opportunity to work closely with the UK Government to ensure this framework is implemented as efficiently as possible. The Command Paper concludes that over the next four years, the UK Government will work collaboratively with the Scottish Government and Parliament to finalise all elements of this system so that it operates effectively for each Government and for businesses and individuals across the UK.<sup>88</sup>

281. Three key phases are envisaged for the implementation of the new provisions—<sup>89</sup>

- *Phase 1* — When the smaller taxes are devolved, currently planned to be April 2015, there will be a one-off reduction, which will then be deducted from the block grant for all future years. Upon the passage of the Scotland Bill, the UK Government will engage with both the Scottish Government and the Scottish Parliament on the means of calculating the reduction in block grant associated with the devolution of SDLT and Landfill Tax. In contrast to income tax, which will in future apply to a tax base shared between the Scottish and UK Parliaments, these taxes will be completely devolved to the Scottish Parliament and hence any changes to the rates or structure of a tax by one jurisdiction will not have a direct impact on the receipts of the other.
- *Phase 2* — For income tax, the deduction from April 2016 in each year of transition will be based on an OBR annual forecast of Scottish

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<sup>87</sup> HM Government, *Strengthening Scotland's Future*, p21.

<sup>88</sup> HM Government, *Strengthening Scotland's Future*, p22.

<sup>89</sup> HM Government, *Strengthening Scotland's Future*, p34-35.

income tax receipts. During transition, the UK Government will bear the risk of any deviation of outturn from any forecast. A change made by the UK Government to the structure of income tax would not have an impact on the Scottish Government as the value of the deduction will be recalculated annually. The Scottish Budget will therefore be the same as calculated by the Barnett formula if the Scottish income tax is set at 10 pence in the pound.

- *Phase 3* — Following the transition period, there will be a one-off deduction to the block grant with the total budget derived by the Barnett formula adjusted proportionately going forward to make this deduction permanent. The transition period will have provided real outturn data for Scottish tax receipts and allowed the forecasts produced by the independent OBR to be proven, ensuring the reduction in block grant will be based on evidence and the best data available.

282. In terms of borrowing powers, the 1998 Scotland Act currently allows Scottish Ministers to borrow up to £500 million for short-term current spending, although this power has never been used. The Scotland Bill replaces this power with a more extensive one (subject, however, to the same £500 million limit) to reflect the increased financial accountability of the Scottish Parliament, and gives an additional power that allows the Scottish Government to be able to borrow for capital purposes and so add to its capital budget in any one year.

283. According to the UK Government, the extended current borrowing facility provides Scottish Ministers with the fiscal levers necessary to deal with the deviation between forecast and actual outturn receipts of the devolved taxes, and will come into operation when these taxes are devolved. Scottish Ministers will be allowed to borrow to fund capital expenditure. From 2013, this will be available for specific projects based on HM Treasury consent. From 2015, the full power will come into force, where the Scottish Government will be able to borrow up to the set limit for any capital purposes and not subject to HM Treasury consent on a project specific basis. Consequently, after 2015, borrowing to finance capital expenditure will not be subject to Treasury consent but to the controls and limits set out in the Command Paper.<sup>90</sup>

284. In summary, the Scotland Bill proposes that Scottish Ministers have powers to borrow for three purposes—

- to provide the Scottish Consolidated Fund with an appropriate cash working balance in case of temporary shortfalls between revenues and expenditure (as at present, though not exercised);
- to provide the Scottish Government with the fiscal levers necessary to deal with deviations between forecast and outturn receipts; and
- for capital purposes.

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<sup>90</sup> HM Government, *Strengthening Scotland's Future*, p37.

285. The Scotland Bill provides the powers to borrow up to £500 million for cumulative current debt and £2.2 billion for capital debt<sup>91</sup>. Switches between the capital and current limits will not be allowed, and these separate totals should not be exceeded.

286. In those years when the tax receipts are above forecast, the first call on such sums would be to pay off previous debt. However, should that not exist, additional revenues should be credited to a Scottish cash reserve, with the intention that they can be used for any potential future deficits. It would mean that when outturn receipts from taxes are lower than forecast by more than 0.5% of the Scottish resource budget, any accrued cash reserve and subsequently, borrowing, would then be drawn upon.

287. As described above, the new borrowing powers will be introduced in a phased way. Initially borrowing for capital purposes will only be available for specific purposes as agreed in advance with HM Treasury, for example, prepayments for the Forth Replacement Crossing. From 2015, the controls and limits applied to capital borrowing are the following—<sup>92</sup>

- Scottish Ministers will be allowed to borrow up to 10% of the Scottish capital budget any year to fund capital expenditure; approximately £230 million in 2014/15. The overall stock of capital borrowing cannot be above £2.2 billion;
- Scottish Ministers will not be able to borrow for capital expenditure far in advance of need, for example to build up a store of capital which is not spent for many years;
- The Scottish Government should inform the UK Government about their capital spending plans, including how they intend to fund this by borrowing, at each Spending Review or, if that is not possible, at least six months before the start of the relevant financial year;
- The Scottish Government will be able to obtain loans from the National Loans Fund via the Secretary of State for Scotland for capital expenditure. They will also be able to borrow from additional sources such as commercial banks, subject to the condition that this represents good value for money. The Scottish Government will not be able to issue its own bonds; and
- Borrowing to finance capital expenditure funded by a loan from the NLF will be for a maximum of 10 years. However, a longer timeframe may be negotiated, for example, 25 years, if this better reflects the lifespan of the associated assets.

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<sup>91</sup> HM Government, *Strengthening Scotland's Future*, p38.

<sup>92</sup> HM Government, *Strengthening Scotland's Future*, p39-40.

### **Alterations to legislative/executive competence and devolved powers**

288. According to the UK Government's Command Paper, since 1998, a number of orders have been made to provide the Scottish Parliament with extra powers or to alter the competences of the Scottish Ministers. The current Scotland Bill provides, in its view, the opportunity to develop the settlement further.<sup>93</sup> The key changes proposed are set out below.

#### *Elections*

289. The Scotland Act 1998 reserves to the UK Government responsibility for elections to the House of Commons, the European Parliament and the Scottish Parliament. The Secretary of State for Scotland is, therefore, responsible for the conduct of UK Parliamentary, Scottish Parliamentary and European Parliamentary elections in Scotland, and for the franchise at all elections (including local government elections) in Scotland. Scottish Ministers are responsible for local government elections in Scotland and legislation relating to their conduct. The Calman Commission recommended that the powers of the Secretary of State for Scotland relating to the administration of elections to the Scottish Parliament should be devolved. The Bill makes provision for the transfer of some, but not all, of the Secretary of State's powers relating to these elections.<sup>94</sup>

290. The Bill's Explanatory Notes provide further details on what is planned, namely—

- Clause 1 of the Bill makes a series of changes to Section 12 of the Scotland Act 1998 to give Scottish Ministers the powers to make provisions on the conduct of Scottish Parliament elections, the questioning of such elections and the consequences of irregularities. Scottish Ministers must, however, consult the Secretary of State for Scotland before exercising these powers. Clause 1 also inserts a new Section 12A into the 1998 Act, which gives the Secretary of State powers to make provisions about the registration of electors in Scotland.
- Clause 2 amends Section 15 of the Representation of the People Act 1985 which relates to the combination of polls. Where Scottish Parliamentary general elections are held on the same day as UK general elections or European Parliament elections, they are to be combined.
- Clause 3 requires regulations made by the Secretary of State under the new Section 12A (see above) to be laid in draft and approved by both Houses of the UK Parliament. The Scottish Ministers and the Secretary of State must consult the Electoral Commission before they exercise their powers to make subordinate legislation under the provisions of Section 12 and 12A of the 1998 Act.

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<sup>93</sup> HM Government, *Strengthening Scotland's Future*, p47.

<sup>94</sup> House of Commons, *Research paper on the Scotland Bill*, paper 11/06, 18 January 2011.



- Finally, Clause 9 provides that the responsibility for reviewing the boundaries will remain with the Boundary Commission for Scotland.

*Air weapons*

291. Firearms are currently a reserved matter. Clause 11 of the Bill would amend the Scotland Act to create a specific exception to the reservation of firearms for the regulation of air weapons, in order to give the Scottish Parliament legislative competence in this area. The proposed exception would apply to air rifles, air guns or air pistols which do not fall within section 5(1) of the Firearms Act 1968 (“the 1968 Act”) and which are not of a type declared by rules made by the Secretary of State under section 53 of the 1968 Act to be “specially dangerous”. This mirrors the definition of an air weapon that can be found at section 1(3)(b) of the 1968 Act.

292. Firearms law will remain reserved in other respects, including the power for the Secretary of State to designate “specially dangerous” air weapons, which would then fall under the reserved regime that applies to other firearms.

*Power to prescribe drink-driving limits*

293. Under the Road Traffic Act 1988, the Secretary of State for Transport has regulatory powers over the prescribing of drink-driving limits. The subject matter of the Road Traffic Act – including this power over drink-driving limits – is generally reserved by the Scotland Act 1998. Clause 20 of the Scotland Bill would give Scottish Ministers the power to prescribe a drink-driving limit for offences committed in Scotland, in line with a recommendation made by the CSD in its final report. Under the provision, any order will be subject to the affirmative procedure in the Scottish Parliament.

*Speed limits*

294. Legislation relating to speed limits is currently reserved, although certain functions are exercised by the Scottish Ministers. The national speed limits (30mph generally in built-up areas; 60mph on single carriageway rural roads; and 70mph on dual carriageways and motorways) are set by the UK Government. Local authorities have the power to set lower speed limits on local roads in their areas on a road-by-road basis and Scottish Ministers have the power to set lower speed limits on trunk roads, also on a road-by-road basis.

295. Clauses 21 and 22 of the Scotland Bill would transfer responsibility to set certain national speed limits on roads in Scotland to the Scottish Ministers. The Bill would therefore devolve the following powers—

- to set the national speed limit on special roads, which includes changing the current 70mph on all motorways;
- to set the national speed limit on all other roads (except the 30mph limit on restricted roads), which includes the current 70mph on all dual carriageways and the current 60mph on all single carriageways; and
- to specify the traffic signage to be used for the Scottish national speed limit.

296. However, the provision does not allow the Scottish Ministers to change the national speed limit for particular classes of vehicle, such as commercial vehicles or cars towing caravans. Furthermore the powers allow Scottish Ministers to specify the signage for any new national speed limit in Scotland by regulation, but the Scottish Ministers can only make those regulations with the agreement of the Secretary of State.

*Misuse of drugs*

297. Licensing of the prescription of controlled drugs to treat addiction is currently reserved to UK Ministers. Clause 19 of the Bill would transfer to Scottish Ministers the authority for regulating licenses for doctors practising in Scotland in connection with patients being treated in Scotland.

*Re-reservation of insolvency*

298. The Calman Commission recommended that the UK Insolvency Service, with appropriate input from the relevant department of the Scottish Government, should be made responsible for laying down the rules to be applied by insolvency practitioners on both sides of the border. Corporate insolvency law is partly reserved and partly devolved. Under the Scotland Act, the general legal effect of liquidation is a reserved matter, but the process and effects of liquidation are devolved. Administration is also reserved, while receivership is devolved.

299. Clause 12 of the Bill achieves the policy aim recommended by the Commission by reserving the winding up of business associations in its entirety. The associated Schedule also includes some amendments to the Insolvency Act to harmonise procedure in Scotland with reforms which have recently been made in England and Wales.

*Re-reservation of health professions*

300. Clause 13 of the Bill would reserve the regulation of all health professions. The current position under the Scotland Act is that the regulation of the health professions which were regulated when the Scotland Act came into force is reserved to the UK Parliament. The regulation of the health professions which have been regulated since then (such as operating department practitioners, dental nurses, dental technicians, clinical dental technicians, orthodontic therapists, pharmacy technicians and practitioner psychologists) is devolved to the Scottish Parliament, as will the regulation of any health professions which are regulated in the future. This has happened because the Scotland Act listed only those professions which existed in 1998. The new clause will add a 'catch all' provision to reserve any other profession concerned (wholly or partly) with the physical or mental health of individuals.

*Antarctica*

301. One of the more obscure issues in Scotland Bill is the provisions to regulate activities in Antarctica, which were not reserved under the Scotland Act 1998. The UK Government is proposing that it should be the case and proposes such as change in clause 14 of the Bill.

*Appointments to the BBC Trust*

302. Members of the BBC Trust are appointed by the Queen in Council, on the advice of UK Ministers, following an open selection process. Clause 17 of the

Scotland Bill requires UK Ministers to act jointly with the Scottish Ministers in giving that advice in relation to the appointment of the Member for Scotland or the designation of an existing Trust member as the Member for Scotland.

*Scottish Crown Estate Commissioner*

303. Clause 18 of the Bill gives statutory effect to one of the CSD's two recommendations in relation to the Crown Estate (CE): that there should be a Scottish Crown Estate Commissioner and that the Scottish Ministers should be formally consulted prior to that Commissioner's appointment. The second was that the Secretary of State for Scotland should, in consultation with Scottish Ministers, more actively exercise his powers of direction under the Crown Estate Act 1961. This, however, does not require legislation. The UK Government's Command Paper indicates that it intends to keep the work of the CE under review, and believes that this reserve power should be used only where necessary.<sup>95</sup>

*Scottish Government*

304. The Bill makes provision (clause 15) that would replace the title "the Scottish Executive" with "the Scottish Government" in the Scotland Act.

**Procedures of the Scottish Parliament**

305. The Scotland Bill also makes a series of provisions which alter the procedures of the Scottish Parliament. Clauses 1 to 3 covering elections to the Scottish Parliament have been summarised above. In addition, the following changes are being proposed.

*Presiding Officer and deputies*

306. Clause 4 of the Bill implements the relevant recommendations in the CSD's final report. It would change the requirement that Scottish Parliament must appoint a Presiding Officer and deputies at the first meeting of a new session, and enables additional deputies to be appointed (at present only two deputies may be appointed).

*Scottish Parliamentary Corporate Body*

307. Clause 5 would amend section 21(2)(b) of the Scotland Act 1998 to require that the Scottish Parliamentary Corporate Body comprises (in addition to the Presiding Officer) at least four MSPs as opposed to the current requirement for only four MSPs to be appointed. This is designed to offer the Scottish Parliament more flexibility in its own operations.

*Bills: statements as to legislative competence*

308. Clause 6 of the Bill requires any person introducing a Bill in the Scottish Parliament to make a statement that it is (in that person's opinion) within the Scottish Parliament's legislative competence. Currently, only Ministers have to make such a statement when introducing a Bill.

*Members' Interests*

309. Clause 8 would give the Scottish Parliament greater flexibility to determine arrangements for the Members' interests arrangements.

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<sup>95</sup> HM Government, *Strengthening Scotland's Future*, p16.

*Views of the Scottish Parliament*

310. The Scottish Parliament's Standards, Procedures and Public Appointments Committee dealt with the matters outlined above in its report on the recommendations of the Commission on Scottish Devolution regarding Scottish Parliament procedures.<sup>96</sup> This was published on 24 September 2010. It approved these changes and was endorsed by the Scottish Parliament on 29 September 2010.

**Other technical and 'legal' provisions**

311. Finally, the Scotland Bill also proposes a number of more technical or 'legal' provisions, as set out below.

*Partial suspension of Acts subject to scrutiny by Supreme Court*

312. Clause 7 of the Scotland Bill is one of the provisions that did not result from a recommendation of the Commission on Scottish Devolution but is proposed by the UK Government as an improvement to the operation of the devolution settlement.

313. Under section 33 of the Scotland Act, the UK and Scottish Law Officers are able to refer a Scottish Parliament Bill to the Supreme Court for decision on whether it is within legislative competence. The Presiding Officer may not submit the Bill for Royal Assent until this has been resolved.

314. The proposed provision would amend this process to enable single provisions to be identified for Supreme Court consideration without affecting the remainder of the Bill. The Bill could be submitted for Royal Assent by the Presiding Officer, but the disputed provisions would not come into force until the Supreme Court had reached a decision. The Court has the power to prohibit the Scottish Ministers from bringing the affected provisions into force, but does not have the power to commence them itself.

*Continued effect of provisions where legislative competence conferred for a limited period*

315. Clause 10 of the Bill follows a recommendation of the CSD to create a mechanism to allow the temporary grant of legislative competence to the Scottish Parliament so as to allow, by agreement, legislation on reserved matters to be pursued at Holyrood, just as the Sewel Convention allows legislation on devolved matters to be taken at Westminster. It does this by expanding upon the existing statutory mechanism (section 30 of Scotland Act 1998) for transferring legislative competence and clarifying the effect of a time limited order made under section 30. This approach relates to the practical experience of the order made under section 30 in consequence of the *Somerville* case.<sup>97</sup>

*Time limit for human rights actions against Scottish Ministers etc*

316. This provision (clause 16) did not result from a recommendation of the CSD, but from discussion between the UK and Scottish Governments. Clause 16 would

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<sup>96</sup> Scottish Parliament, Standards, Procedures and Public Appointments Committee, 5th Report 2010: *The recommendations of the Commission on Scottish Devolution regarding Scottish Parliament procedures*, 24 September 2010.

<sup>97</sup> *Somerville & Ors v The Scottish Ministers*, 2006, CSIH 52.

replace the Convention Rights Proceedings (Amendment) (Scotland) Act 2009. That Act, which was passed in response to the *Somerville* case, creates a statutory time limit for bringing proceedings under the Scotland Act alleging a breach of Convention rights by the Scottish Ministers. This ensures that the same time limit applies regardless of whether proceedings are brought under the Scotland Act or the Human Rights Act 1998. The clause will repeal the section 30 Order and the amendment to legislative competence which enabled the Scottish Parliament to introduce the Act, and instead make equivalent provision in the Scotland Bill.

*Implementation of international obligations*

317. Clause 23 of the Bill also did not result from a recommendation of the CSD but is now being proposed by UK Ministers. Scottish Ministers are responsible for implementing European Community law and international obligations in relation to devolved areas in Scotland. UK Ministers generally cannot act where a function has been transferred to Scottish Ministers, but an exception to this allows UK Ministers to act concurrently with Scottish Ministers in relation to the implementation of European Community obligations, as there may be circumstances in which UK-wide implementation is more convenient.

318. The provisions in the Bill would broaden this exception, allowing UK Ministers to act concurrently with Scottish Ministers to implement other international obligations on a UK-wide basis. This might be used where UK-wide implementation is considered arguably to be more convenient.

*Maximum penalties which may be specified in subordinate legislation*

319. This provision (clause 33) also did not result from a recommendation of the Commission on Scottish Devolution. Currently an order under the Scotland Act can create a penalty of up to two years imprisonment for conviction on indictment, but can only allow the summary courts to impose a penalty of up to three months imprisonment (or a level 5 fine).

320. This is now inconsistent with the Criminal Proceedings etc. (Reform) (Scotland) Act 2007. The Act increased the maximum period of imprisonment for summary convictions in “either way” offences (that is, those that can be tried either summarily in the District Courts or Sheriff Courts or on indictment in the High Court of Justiciary or Sheriff Court) to twelve months.

321. Clause 33 would amend section 113(10) of the Scotland Act to allow the creation of new offences that attract sentences of up to twelve months imprisonment, thus bringing the limits for summary conviction in line with the criminal penalties established in the Criminal Proceedings etc (Reform) (Scotland) Act 2007. A power would be provided to allow such penalties to be revised in line with future changes in the standard tariff for offences in Scotland.

322. The enabling power to make further changes would be subject to affirmative procedure in the Scottish Parliament and Westminster, so it would not allow the UK Government to make unilateral changes to this aspect of Scots criminal law.

*Section 57(2) of the Scotland Act*

323. Since the Bill's introduction in the House of Commons, the Advocate General for Scotland (Lord Wallace of Tankerness) has brought forward proposals for an additional provision in the Bill. This follows the publication of a report by an expert group, chaired by Professor Sir David Edward<sup>98</sup> about a number of devolution issues relating to acts of the Lord Advocate.

324. The Advocate General is expected to table government amendments to the Scotland Bill to implement the Expert Group's key recommendations. This will, in particular—<sup>99</sup>

- Remove acts of the Lord Advocate in her capacity as head of criminal prosecutions and investigation of deaths in Scotland that are incompatible with any rights conferred by the European Convention on Human Rights that are given effect to by the Human Rights Act 1998 ("Convention rights") or Community law from the ambit of section 57(2) of the Scotland Act; and
- Create a statutory right of appeal from the High Court of Justiciary sitting as a criminal appeal court to the Supreme Court in relation to matters where it is alleged that the Lord Advocate has acted incompatibly with any such Convention right or Community law to replace the existing devolution issue procedure that currently applies in such cases. The UK Government's view is that the jurisdiction of the Supreme Court should be maintained to ensure that fundamental rights enshrined in international obligations are secured in a consistent manner for all those who claim their protection in the United Kingdom.

325. According to the Advocate General for Scotland, the proposed amendments recognise the unique position of the Lord Advocate among Scottish Ministers (which is already recognised in the Scotland Act) as being both a Scottish Minister and the independent head of the system of criminal prosecutions and investigation of deaths in Scotland. His view is that the Lord Advocate will become subject to a regime that is the same as all other prosecutors in the United Kingdom in relation to the latter role.

**Issues not currently covered by the Scotland Bill**

326. In the written evidence received by the Committee and in the Scottish Government's legislative consent memorandum, reference is made to a number of other issues, some of which were considered by the CSD, which are not currently a feature of the Scotland Bill. The main issues are outlined below.

*Welfare*

327. In its final report, the CSD made several recommendations on welfare matters. These were—

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<sup>98</sup> *Section 57(2) and schedule 6 of the Scotland Act 1998 and the role of the Lord Advocate: report of the expert group*. Available at: <http://www.oag.gov.uk/oag/225.html>

<sup>99</sup> See <http://www.oag.gov.uk/oag/223.81.html>

- Recommendation 5.19: There should be scope for Scottish Ministers, with the agreement of the Scottish Parliament, to propose changes to the Housing Benefit and Council Tax Benefit systems (as they apply in Scotland) when these are connected to devolved policy changes, and for the UK Government – if it agrees – to make those changes by suitable regulation.
- Recommendation 5.20: formal consultation role should be built into Department of Work and Pension's commissioning process for those welfare to work programmes that are based in, or extend to, Scotland so that the views of the Scottish Government on particular skills or other needs that require to be addressed in Scotland are properly taken into account.
- Recommendation 5.21: The Deprived Areas Fund should be devolved to the Scottish Parliament given the geographic nature of the help it is designed to provide and the fit with the Scottish Government's wider responsibilities.
- Recommendation 5.22: As part of its considerations as to future reform of the Social Fund, the UK Government should explore devolving the discretionary elements of the Fund to the Scottish Parliament.
- Recommendation 5.24: The interpretation provision in relation to "social security purposes" in the Scotland Act should be amended to make it clear that the reservation refers to social security purposes related to the type of provision provided by the UK Department for Work and Pensions.

328. The UK Government's view is that its welfare reform programme has generally superseded the Commission's recommendations. The UK Government has therefore elected not to take forward the recommendations in the Scotland Bill. It did not see the need for recommendation 5.24.

#### *Marine environment*

329. The CSD made the following recommendation on the marine environment—

"The effectiveness of the agreement [on marine planning] reached by the UK and Scottish Governments should be kept under review by the inter-governmental machinery, and nature conservation should be devolved to the Scottish Parliament at the earliest appropriate opportunity, taking into account the experience and evidence to be gained from the operation of the regime set out in the respective Marine Bills."<sup>100</sup>

330. The Scottish Government's view is that the Scotland Bill would have provided an opportunity to devolve legislative competence over marine nature conservation

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<sup>100</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p16.

to the Scottish Parliament. However, the UK Government has chosen not to implement this recommendation at this stage but has committed to keep the current arrangement under review, and to consider further devolution of powers to Scotland once it has assessed, in conjunction with the devolved administrations, the effectiveness of the arrangements currently in place.

#### *Aggregates Levy*

331. The Aggregates Levy is a tax on the commercial extraction of sand, rock and gravel in the UK. The CSD recommended that this tax should be devolved to the Scottish Parliament. However, at this stage, the UK Government has chosen not to propose measures to implement this recommendation. The UK Government's rationale for this decision is that it would not be practical to devolve the Aggregates Levy while the EU litigation brought by the British Aggregates Association in relation to the Levy is ongoing.

#### *Air Passenger Duty*

332. The CSD also recommended that APD should be devolved to the Scottish Parliament. As with the aggregates levy, the UK Government has chosen not to fulfil the recommendation to devolve APD. The rationale for this is that the UK Government's Coalition Agreement commits it to consider replacing APD with a per-plane tax, and that it would be impractical to devolve APD while these considerations were ongoing.

#### *Immigration*

333. The CSD recommended that, "Whilst retaining the current reservation of immigration, active consideration (supported by inter-governmental machinery) should be given to agreeing sustainable local variations to reflect the particular skills and demographic needs of Scotland."<sup>101</sup> In its Command Paper, the UK Government stated that it "... agrees with the Commission that there should be a single framework for managing immigration in the UK, with the flexibility to meet Scottish needs."<sup>102</sup>

#### *Charities*

334. The CSD also recommended that the definitions of "charity" and "charitable purpose" should be standardised across the UK (with the agreement of both parliaments), and that charities registered in one part of the UK should not have to register separately in another part in order to conduct their activities there. The UK Government in its Command Paper said that it intends to revisit the Commission's recommendations during its forthcoming review of the Charities Act 2006.<sup>103</sup>

#### *Food content and labelling*

335. The UK Government had previously indicated its intention to re-reserve food content and labelling, in line with a recommendation made by the CSD. The CSD felt that the potential for the Scottish Parliament to legislate differently on food

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<sup>101</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p16.

<sup>102</sup> HM Government, *Strengthening Scotland's Future*, p15.

<sup>103</sup> HM Government, *Strengthening Scotland's Future*, p17.



content and labelling could be problematic for the UK single market.<sup>104</sup> However, the UK Government concluded that "...it is unnecessary to legislate in this area" and that doing so "...would be to write superfluous legislation."<sup>105</sup>

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<sup>104</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p16.

<sup>105</sup> HM Government, *Strengthening Scotland's Future*, p60-61.

## AN OVERVIEW OF THE EVIDENCE TAKEN BY THE COMMITTEE

336. The Scotland Bill Committee was established on 1 December 2010, immediately following the introduction of the Scotland Bill in the UK Parliament. With the impending elections to the Scottish Parliament due in May 2011, and the dissolution due on 22 March, the workload of the Committee has been intensive.

337. Prior to the publication of this report, 11 formal meetings of the Scotland Bill Committee have been held in the period December 2010 to March 2011. Over 100 written submissions of evidence have been received, from the two governments, interest groups, trade and professional associations, trades unions, STUC, local authorities, the SCVO and private individuals.

338. In addition, the Committee has met informally on three separate occasions with a cross-section of businesses from across Scotland and business associations. Events were held with the Scottish Chambers of Commerce, PricewaterhouseCoopers, CBI Scotland, Scottish Council for Development and Industry, Institute of Directors, Federation of Small Businesses in Scotland, Scottish Financial Enterprise and the Scottish Parliament+Business Exchange.

339. The Committee felt that there was particular value in engaging more informally with representatives of the business community in order to gauge their views on the practical effects of the provisions in the Bill, mainly those on the introduction of a Scottish income tax and other financial matters. The general perception of the Bill taken by the Committee from these meetings was a desire by the business community not to comment on the more politically controversial matters and to register a very strong desire for the detail to be clearly worked out and explained to the business community prior to the commencement of any provisions. This is an issue we return to in our conclusions.

**340. The Committee is grateful to all of those who gave up their time to produce written evidence, appear before the Committee or otherwise share their expert views on the Scotland Bill and wider issues. The Committee believes that in the time available, this has enabled bodies and individuals from across Scotland to have their say and we are confident that as the legislative process in the UK Parliament continues, there will be further opportunities for consultation and dialogue.**

341. Both governments – UK and Scottish – have provided substantial amounts of information and evidence to the Committee at various stages of its work. UK Government departments (in particular the Scotland Office and HM Treasury) and other bodies such as HMRC, the Office of Budget Responsibility and the CE, have all provided evidence to the Committee. This has been valuable to the Committee in its consideration.

342. As the Secretary of State for Scotland, Rt. Hon Michael Moore MP, made clear to the Committee, the primary purpose of the engagement by the UK Government with the Committee and the Scottish Parliament as a whole is to seek its consent to legislate in devolved areas. Asked for reassurance that if the Committee were to recommend changes to the Bill and the Parliament agreed to

them in a legislative consent motion, the UK Government will implement the changes, he said—

“It would be a poor process if we did not reflect on the decisions taken by this committee and the Parliament. I look forward to the committee's consideration of the bill and to studying its findings and discussing them with colleagues.”<sup>106</sup>

343. He supplemented this statement in a letter to the Committee, which states—

“I have committed on the record in evidence sessions with your Committee to give full consideration to your Committee's Report and any recommendations that you may make, including those that impact on the current drafting of the Bill.”<sup>107</sup>

344. The Scottish Government has also provided evidence to the Committee throughout the process on both the financial and non-financial provisions in the Bill. One area of contention has been the desire by the Committee, following the undertakings made by both the First Minister<sup>108</sup> and the Cabinet Secretary for Finance and Sustainable Growth<sup>109</sup>, to receive detailed modelling of full fiscal autonomy from the Scottish Government.<sup>110</sup> In the latter stages of the Committee's work, some such information was provided.<sup>111</sup>

345. The Scottish Government is not supportive of all of the provisions contained in the Bill. This has meant additional challenges for the Committee in its work as ordinarily, legislative consent motions enjoy the support of the government.

346. The Scottish Government's legislative consent memorandum set out its initial concerns in relation to the Bill and also identified those provisions which it does support.<sup>112</sup> The Scottish Government supports a number of the proposals in the Bill and the Command Paper, such as the proposals on air weapons, drink-driving limits, and licensing to treat addiction. The Scottish Government does not, however, support the proposals to reserve matters currently devolved to the Scottish Parliament: regulation of certain health professionals (those newly regulated since the Scotland Act) and aspects of the law of insolvency.<sup>113</sup>

347. In addition to some of the issues that were in the CSD report but which are not in the Bill (e.g. welfare, immigration etc.), the Scottish Government's other main area of concern is the financial provisions. Its view is that the provisions have

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<sup>106</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 25.

<sup>107</sup> Scotland Office, letter received by the Committee, 16 February 2011. Available at: [http://www.scottish.parliament.uk/s3/committees/scotBill/documents/LetterfromtheSofS-16February2011\\_000.pdf](http://www.scottish.parliament.uk/s3/committees/scotBill/documents/LetterfromtheSofS-16February2011_000.pdf)

<sup>108</sup> Scottish Parliament, *Official Report*, 9 December 2010, Col 31360.

<sup>109</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 83.

<sup>110</sup> Scottish Government, *Full Financial Responsibility*, February 2011.

<sup>111</sup> Scottish Government, Letter from the Cabinet Secretary for Finance and Sustainable Growth and 3 annexes, 7 February 2011. Available at:

<http://www.scottish.parliament.uk/s3/committees/scotBill/currentInquiries.htm>

<sup>112</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>113</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1, paragraph 6.

the potential to impose significant cuts on Scotland's budget.<sup>114</sup> Its second concern is the cost of implementing the changes to the financial system.<sup>115</sup> Overall, the Scottish Government considers that the current proposals do not meet the ambition that the Scottish Government has for Scotland, that the Bill fails to provide Scotland with any significant new economic or financial levers and that the proposals pose a considerable risk to future Scottish budgets. Its view is that Scotland needs full financial responsibility to boost economic recovery, invest in public services and support long-term sustainable growth.<sup>116</sup>

348. Some of the other witnesses who gave evidence that contained criticisms of the Bill, and the financial provisions in particular, shared these views. Their assessment was that the Scotland Bill failed in three key areas, namely that it was—

- not a package designed to boost economic growth;
- not well designed, and;
- created greater instability.

349. The Bill's supporters, including of course the UK Government itself, do not accept this critique. They would say that growth is clearly a policy objective agreed by many, but it is not clear that any one governance structure delivers it. Strong growth is seen in countries of different sizes with different constitutional arrangements. No direct or simple link exists between fiscal decentralisation and growth. All federal and quasi federal countries use a mix of shared and devolved taxes, almost invariably sharing income tax. The Scotland Bill will increase accountability but preserve stability. Greater fiscal power may involve some increased risk and the Bill will give the Scottish Parliament access to revenues which are not simply a grant from the UK Parliament

350. The Secretary of State for Scotland said that—

“We believe that, taken together, the bill and the command paper — “Strengthening Scotland's Future” — will significantly strengthen Scotland's future. The Scotland Bill marks the second phase of devolution, one in which the Parliament will be further empowered, its accountability will be increased and its stability will be assured within a strong and effective United Kingdom.”<sup>117</sup>

His view is the Bill signifies the largest transfer of fiscal powers from central Government since the creation of the UK, most significantly through the creation of the Scottish rate of income tax, combined with substantial new borrowing powers and with the transfer of responsibility for two specific taxes: stamp duty land tax and landfill tax.<sup>118</sup> The Secretary of State also cites the transfer of new legislative powers and the addition to executive competences and states that these changes

<sup>114</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1, paragraph 12.

<sup>115</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1, paragraph 12.

<sup>116</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1, p20.

<sup>117</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Cols 24-25.

<sup>118</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 25.

are based on the experience of 10 years of devolution and are designed to ensure more effective delivery of services across the country.<sup>119</sup>

351. A number of witnesses, including many of those in favour of the Bill stress that, like devolution as a whole, the financial arrangement proposed as part of this Bill is something which will continue to evolve over time.<sup>120</sup> They point to the establishment of, for the first time in the UK, a major shared tax base and point to wider international experience, which suggests that countries embarking on the devolution of tax matters traditionally start with income tax and then add to the suite of devolved taxes over time (see later sections of this report). The view taken by some is that, whilst the Bill may not be perfect, it is a radical first step and establishes a framework for further change in the longer term.

352. One key debate that took place during the Committee's consideration of the Bill and alternatives to its key financial provisions was whether there was a causal link between the devolution of fiscal powers and economic growth. This issue is covered in more detail in subsequent sections of this report. However, it is worth recording at this stage that in its final submission to the Committee in February 2011, the Scottish Government states that—

“Quantifying behavioural changes under Full Financial Responsibility, and their effect on Scotland's economy and public finances, is almost impossible. The full effect will depend on a wide range of factors including the impact of new economic policies, accompanying changes in the cost of providing new, and existing, public services and the short term and long term impact of changes to Scotland's economic performance on tax receipts and public spending.”<sup>121</sup>

353. For the Bill's supporters, this comment is in stark contrast to the comments made by the First Minister in his speech to the SNP's conference in October 2010 in which he stated—

“We know thanks to the work of Andrew Hughes Hallett and Drew Scott that with economic powers we could grow the Scottish economy by an extra 1 per cent a year.”<sup>122</sup>

354. It is important to note at this stage, that for many who commented either mostly in favour or against certain provisions on the Bill, there were suggestions that further improvements do need to be made and that further clarity in key areas was needed, particularly the need for robust inter-governmental mechanisms in order that the transition to the new arrangements works well. We also heard calls for more detail to be provided on the grant reduction mechanism and its phasing. We return to these matters as part of our conclusions and recommendations.

355. On the non-financial side, although slightly less high profile, there were differences of view expressed in the evidence that was received by the

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<sup>119</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 25.

<sup>120</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Cols 208-209.

<sup>121</sup> Scottish Government, *Full Financial Responsibility*, February 2011, p6.

<sup>122</sup> Speech by the First Minister to the SNP's annual conference, October 2010. Available at: <http://www.snp.org/node/17415>

Committee. Some of the evidence provided suggested that the Bill could go further in respect to the transfer of certain powers (such as on the regulation of speed limits and drink-driving, air weapons, and matters relating to the BBC Trust and the Crown Estate Commissioners), and some expressed a view that other matters which the CSD had recommended should be covered by the Bill (e.g. certain aspects of welfare and immigration issues). We return to these matters in more detail in subsequent sections of the report and as part of our conclusions and recommendations.

356. Finally, the issues which we have described above as technical and 'legal matters' were also the focus of differences of opinion. The main area of debate was on the provisions that have now been proposed by the Advocate General for Scotland relating to Section 57(2) of the Scotland Act. Again, these matters are explored in subsequent sections of the report.

### **The debate between the financial provisions in the Scotland Bill and full fiscal responsibility or fiscal autonomy**

357. The Scottish Government and others have outlined their opposition to the main principles behind the financial provisions and how they might operate in practice. The Scottish Government's view at the debate on the 9 December 2010 was that whilst it supported the general principles of the Bill in conferring more powers and responsibilities on the Parliament, it expressed concern about key aspects of the new system of financing proposed by the UK Government for devolved government, which it believed would further reduce the resources available for public services in Scotland. The Scottish Government also regretted the omission from the UK Government's proposals of important recommendations from the CSD, notably on further tax powers.<sup>123</sup>

358. The Scottish Government's favoured model for the financial provisions that it would have preferred to have seen in the Bill is Full Financial Responsibility. There has been much debate on whether it was appropriate for the Committee to have considered alternative financial systems alongside looking at the merits of what is actually in the Bill itself.

359. The reason for the Committee's focus on the alternative financial models comes in direct response to the comments made by the Scottish Government's Minister for Culture and External Affairs during the debate on the Scotland Bill held on 9 December 2010. She urged the Committee to "...give full scrutiny to alternative proposals to the Scotland Bill and the provisions that have been sought in all our [the Scottish Government's] discussions with the UK Government to secure a better deal". To do so, she suggested would "...help the Parliament and give it an opportunity to consider the other option."<sup>124</sup>

360. The Scottish Government's contention is that it is currently constrained in its opportunities to influence fully the drivers of economic growth as a result of the current constitutional and financial framework.<sup>125</sup> The Cabinet Secretary for

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<sup>123</sup> Scottish Parliament, Amendment S3M-7550.1, agreed on 9 December 2010.

<sup>124</sup> Scottish Parliament, *Official Report*, 9 December 2010, Col 31390.

<sup>125</sup> Scottish Government, *Full Financial Responsibility*, February 2011, p1.

Finance and Sustainable Growth's view of the new proposals in the Scotland Bill is that it "is not about improving economic growth or providing an opportunity to make a fundamental difference to the lives of the people of Scotland". His opinion is that without real access to the levers of growth or to social policy, the Bill will simply change the accountability arrangements for Scotland's budget from the UK Government.<sup>126</sup>

361. His key criticisms of the financial provisions in the Bill were summarised in his opening remarks to the Committee during his final appearance in February 2011. He said that—

"Our evidence has highlighted the potential risks from a deflationary bias; the lack of meaningful economic powers; the inadequate borrowing provisions to manage budgetary volatility; the economic inefficiency of the income tax proposals; the modest capital borrowing powers; the lack of detail on the block grant adjustment, the no-detriment rule and the costs of set-up and continuing administration; and concern about the transparency and long-term sustainability of a system that depends on an on-going series of ad hoc technical fixes and adjustments."<sup>127</sup>

362. The alternative financial model proposed by the Scottish Government can be characterised as follows—

"...a framework of full financial responsibility would devolve to Scotland all tax revenues except VAT; allow the co-ordination of benefit and employment policy in Scotland; provide control over the levers that are crucial to business; and allow us to control the key policy instruments in Scotland. It would also transfer the levers that are required to manage that fiscal transfer by providing proper saving and borrowing powers."<sup>128</sup>

363. The Cabinet Secretary for Finance and Sustainable Growth's overall conclusion would appear to be that there are no improvements that can be made to the workings of the main financial provisions in the Bill. His preference is that Scotland "would do better to open up the whole thing"<sup>129</sup>. His view is that, "Fundamentally, the Government's perspective is that we do not believe that the arrangements in the bill provide the type of financial and economic levers that would enable Scotland to focus on growth."<sup>130</sup>

364. Until 20 February, 4 weeks after the close of written submissions, the Committee had received from the Scottish Government only criticisms of the finance clauses in the Bill and no proposals to improve them. On 21 February 2011, after the Committee had ceased to take oral evidence, the Cabinet

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<sup>126</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 415.

<sup>127</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 415.

<sup>128</sup> Scottish Government, *Full Financial Responsibility*, February 2011.

<sup>129</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 433.

<sup>130</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Cols 434-435.

Secretary for Finance and Sustainable Growth submitted proposed amendments to the Bill to remove the reservation of all taxes apart from VAT.<sup>131,132</sup>

365. Other critics of the financial provisions shared similar views on the financial provisions. In their analysis, Professor Andrew Hughes Hallett (St. Andrew's University and George Mason University) and Professor Drew Scott (University of Edinburgh) wrote in their evidence to the Committee that—

“The adverse economic consequences of the proposed funding model become all the more problematic because the Bill fails to provide for the transfer of any additional economic levers to the Scottish Government which it otherwise could utilise to improve the overall rate of economic growth (e.g. competence to improve competitiveness, corporation tax, labour market policies, etc.). As we discuss below, this in our view is the single greatest defect in the Scotland Bill, particularly given the considerable economic challenges that face Scotland at present.”<sup>133</sup>

366. Key to their critique of the Bill is that it focuses on devolving one main tax (income tax). They say that the addition of Landfill Tax and Stamp Duty Land Tax would diminish, but only very slightly, the overall risk to Scottish Government expenditure, and that—

“...it is essential that additional taxes are devolved in order further to diversify this revenue risk. There are a number of “minor” taxes that could be devolved which would not be expected to move synchronously with income tax receipts – such as fuel duty, excise duty, air passenger duty, vehicle duty etc.”<sup>134</sup>

367. Professor Michael Keating of the University of Aberdeen stated in his written evidence that he would “prefer a radical measure of fiscal autonomy, with the Scottish Parliament responsible for the bulk of taxes but paying a share to Westminster for UK services.” In his view, this “would provide greater policy autonomy and flexibility for Scotland and spread the cyclical risk of tax fluctuations, at least to some degree.”<sup>135</sup>

368. Ben Thomson of Reform Scotland said that the current devolution of taxes does not presently go far enough—

“I would like the bill to become much more of an enabling bill. In the words of Ron Davies — this applies equally to Scotland as it does to Wales— devolution should be a process, not a solution. Similarly, the present Scotland Bill should be a process, not a single solution. That can be achieved

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<sup>131</sup> Scottish Government, Letter from the Cabinet Secretary for Finance and Sustainable Growth, 21 February 2011. Available at:

<http://www.scottish.parliament.uk/s3/committees/scotBill/currentInquiries.htm>

<sup>132</sup> This paragraph was agreed to by division. For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

<sup>133</sup> Professors Hughes Hallett and Scott, written evidence submitted to the Committee, paragraph 3.

<sup>134</sup> Professors Hughes Hallett and Scott, written evidence submitted to the Committee, paragraph 42.

<sup>135</sup> Professor Michael Keating, written evidence submitted to the Committee, paragraph 2.



through an examination of the definition of devolved taxes. The proposed new clause 80A(4) of the 1998 act deals with the definition of devolved taxes. It would be good to make that definition wider so that, over time, we could devolve more and more taxes, moving towards the philosophy that we describe in our paper: that the majority, if not all, of the taxes for the money that is spent in Scotland are raised in Scotland.”<sup>136</sup>

369. Other witnesses, however, had a different view of where the appropriate balance of tax devolution should lie in the best interests of Scotland and of the United Kingdom as a whole. We deal later with the suitability or otherwise of specific taxes for devolution but, broadly, these witnesses did not accept that Full Fiscal Responsibility was a desirable outcome for Scotland, and focused on the greater sensitivity to Scottish needs arising from more accountability and the devolution of appropriate tax powers in terms of the framework provided in the Scotland Bill. The Committee, however, welcomes the detailed views provided by witnesses on the technical aspects of the tax proposals, which we discuss later.

### **Fiscal decentralisation and economic growth**

370. One of the central debates arising during the Committee’s consideration of the Scotland Bill and the merits of alternative financial models such as full financial responsibility or fiscal autonomy was that of the link between fiscal decentralisation and economic growth.

371. As the Committee has noted previously in this report, the First Minister told his party’s most recent national conference that “...thanks to the work of Andrew Hughes Hallett and Drew Scott that with economic powers we could grow the Scottish economy by an extra 1 per cent a year.”<sup>137</sup>

372. The “work” referred to by the First Minister was also cited in an official Scottish Government publication of January 2011.<sup>138</sup> In this document, the Scottish Government states that Full Financial Responsibility, either within the UK or under independence, would provide greater opportunities to promote accountability and could act as a powerful engine for growth and prosperity. More specifically, the Scottish Government stated that—

“Recent research suggests greater financial responsibility can have a significant effect on a country’s economic performance.

“Analysis by Professors Andrew Hughes Hallett and Drew Scott suggests that “a 1% point increase in fiscal devolution [the proportion of revenue and expenditure devolved] might be expected to raise GDP by 1.3% after five years above what would otherwise have been the case.”<sup>139</sup>

373. The research referred to is published in a paper by Professors Hughes Hallett and Scott. Their exact wording is—

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<sup>136</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 278.

<sup>137</sup> Speech by the First Minister to the SNP’s annual conference.

<sup>138</sup> Scottish Government, *Summary of Full Financial Responsibility & Independence*, January 2011.

<sup>139</sup> Scottish Government, *Summary of Full Financial Responsibility & Independence*, January 2011.

“If we stick with the high/middle income countries, the OECD countries with detailed results for the US, Germany and China for example, we find that a 1% point increase in fiscal devolution (share of local expenditures in total government spending for that region) generates additions of between 0.16% and 0.32% to growth rates. Translating that to Scottish data for 2007-08, and taking a mid-point estimate of 0.25%, this means a 1% point increase in fiscal devolution might be expected raise GDP by 1.3% after five years above what would otherwise have been the case.”<sup>140</sup>

374. A key difference in the two statements by the Scottish Government is the shift from a suggestion of an extra 1% annual growth of the Scottish economy towards a suggestion that increased fiscal devolution might be expected to raise GDP by 1.3% after five years. There is also a difference in what is meant by fiscal devolution between the Scottish Government [the proportion of revenue and expenditure devolved] and the words used by Hughes Hallett and Scott [share of local expenditures in total government spending for that region].

375. Members of the Committee focussed on the specific work of Professors Hughes Hallett and Scott rather than that of the Scottish Government as a direct consequence of the comments made by the Cabinet Secretary for Finance and Sustainable Growth. He said that the Scottish Government had not itself at that stage carried out any modelling of Full Financial Responsibility or fiscal autonomy but had “advanced the independent academic research of Professor Hughes Hallett and Professor Scott” in all of its discussions designed to assist the UK Government in seeing what an alternative model of fiscal responsibility would enable Scotland to achieve.<sup>141</sup>

376. The debate on the causal link, if any, between fiscal decentralisation and economic growth that ensued was a key element of the Committee’s consideration of the merits of the financial proposals advanced as an alternative to those outlined in the Scotland Bill. It is directly relevant to the Bill itself (as it proposes significant fiscal decentralisation) and also to the merits of the financial proposals advanced as an alternative to those outlined in the Bill.<sup>142</sup>

377. A critical nuance is whether there is a link between economic growth or economic performance. Writing more recently on the matter, Professors Hughes Hallett and Drew Scott stated—

“Academic research, including ours, does not assert that an increase in fiscal devolution would, in itself, lead to a systematic increase in the rate of growth in the economy without additional measures and institutional change to support it. However, what we, together with the overwhelming bulk of academic research, do claim is that an increase in fiscal devolution typically

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<sup>140</sup> Professor Andrew Hughes Hallett and Professor Drew Scott, *Scotland: A New Fiscal Settlement*, page 37.

<sup>141</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 82.

<sup>142</sup> An amendment to this paragraph was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 3 (Robert Brown, David McLetchie, Peter Peacock), Abstentions 1 (Wendy Alexander).

leads to an increase in efficiency and hence economic performance – defined as an increase in income (GDP) per head.”<sup>143,144</sup>

378. In a submission to a national newspaper, Professor Anton Muscatelli, of Glasgow University and the chair of the CSD’s Independent Expert Group, along with five other experts describe the claim that greater tax devolution would lead to economic growth, at best, as “not proven”.<sup>145</sup>

379. Subsequently, Professors Hughes Hallett and Drew Scott, along with 8 other academics and business people, wrote also to a national newspaper to put their case. They stated that “...the devolution of financial powers - where the Scottish Parliament is responsible for raising its revenues as well as spending them - will allow more tailored economic policies to be put in place to improve the Scottish economy.”<sup>146</sup>

380. One of the world’s leading experts in this area is Professor Dr Lars Feld, director of the Walter Eucken Institute in Freiburg and Professor for Economic Policy at the University of Freiburg, Germany. In written evidence to the Committee, Professor Feld concludes that, “Fiscal decentralisation does not lead to higher economic growth because economic growth is much more driven by factors other than taxes and spending, e.g., by increases in technological progress and improved human capital.”<sup>147</sup>

381. He also states that—

“Decentralised taxing powers are advantageous because financial responsibility is enhanced, political accountability regarding the relation between voters (taxpayers) and Parliaments/Governments increases. Decentralisation of taxes and spending leads to a more efficient public sector and it enhances economic performance.”<sup>148</sup>

382. The conclusion that the issue is less about the degree of decentralisation and more about what institutions do with the powers and, critically, the spending decisions taken, was one shared by many of the witnesses who gave evidence to the Committee on experience in other countries. For example, Professor François Vaillancourt of the University of Montreal, Québec, Canada, stated, “There is no evidence relating to decentralisation and economic growth that really stands the test of time.”<sup>149</sup> His view was that, “The fundamental answer is that you are not doing what you want to do for improved economic growth; you are doing it because you believe that it will give you better governance, which may lead to improved economic growth in the long term.”<sup>150</sup>

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<sup>143</sup> Professors Hughes Hallett and Drew Scott, *The Scotsman*, 4 February 2011.

<sup>144</sup> A proposal to retain paragraphs 377 to 379 was agreed to by division. For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

<sup>145</sup> Professor Muscatelli et al, *The Scotsman*, 31 January 2011.

<sup>146</sup> Professors Hughes Hallett and Scott et al, *The Scotsman*, 7 February 2010.

<sup>147</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 25.

<sup>148</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 25.

<sup>149</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 227.

<sup>150</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 227.

383. Similarly, Professor Dr Paul Bernd Spahn of the Goethe Universität in Germany said "...there is no firm relationship between fiscal autonomy and growth. It would be risky to make that case".<sup>151</sup>

384. In his final oral evidence to the Committee, the Scottish Government's Cabinet Secretary for Finance and Sustainable Growth said that the Scottish Government's position had not changed but also stated in response to question on the link between decentralisation and economic growth that "a large measure of it depends on what you do and what policies you take forward."<sup>152</sup>

385. The Chief Economic Advisor to the Scottish Government when asked about these claims said that he was obliged to give his professional advice to Ministers privately.<sup>153</sup>

### **International experience**

386. Some of those in favour of the Bill believe that the proposed decentralisation of the additional taxes outlined represents a radical shift within the history of the United Kingdom. Others have suggested, however, that compared to other countries, the proposed changes do not go far enough. One part of the Committee's scrutiny has been to consider whether, within the context of other international states or sub-state nations or regions, the provisions outlined in the Scotland Bill are all that unusual.

387. Table 4 below, summarises the devolution of income tax and/or corporation to sub-central regions or nations across a range of countries. This demonstrates the extent to which, internationally, the decentralisation of fiscal powers has occurred.

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<sup>151</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 200.

<sup>152</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 440.

<sup>153</sup> This paragraph was agreed to by division. For 3 (Wendy Alexander, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 1 (Robert Brown).

**Table 4: Decentralisation of income tax and corporation tax by state**

OECD Country	Income tax powers held by regions	Corporation tax powers held by regions
Australia		
Austria		
Belgium	<b>x</b>	
Canada	<b>x</b>	<b>x</b>
Chile		
Czech Republic		
Denmark	<b>x</b>	
Finland	<b>x</b>	
France		
Germany		<b>x</b>
Greece		
Hungary		
Iceland	<b>x</b>	
Ireland		
Italy	<b>x</b>	
Japan	<b>x</b>	<b>x</b>
Korea	<b>x</b>	<b>x</b>
Luxembourg		<b>x</b>
Mexico		
Netherlands		
New Zealand		
Norway	<b>x</b>	<b>x</b>
Poland		
Portugal		<b>x</b>
Slovak Republic		
Spain	<b>x</b>	
Sweden	<b>x</b>	
Switzerland	<b>x</b>	<b>x</b>
Turkey		
United Kingdom		
United States	<b>x</b>	<b>x</b>

Source: OECD (income tax as at 2009, corporation tax as at 2010)

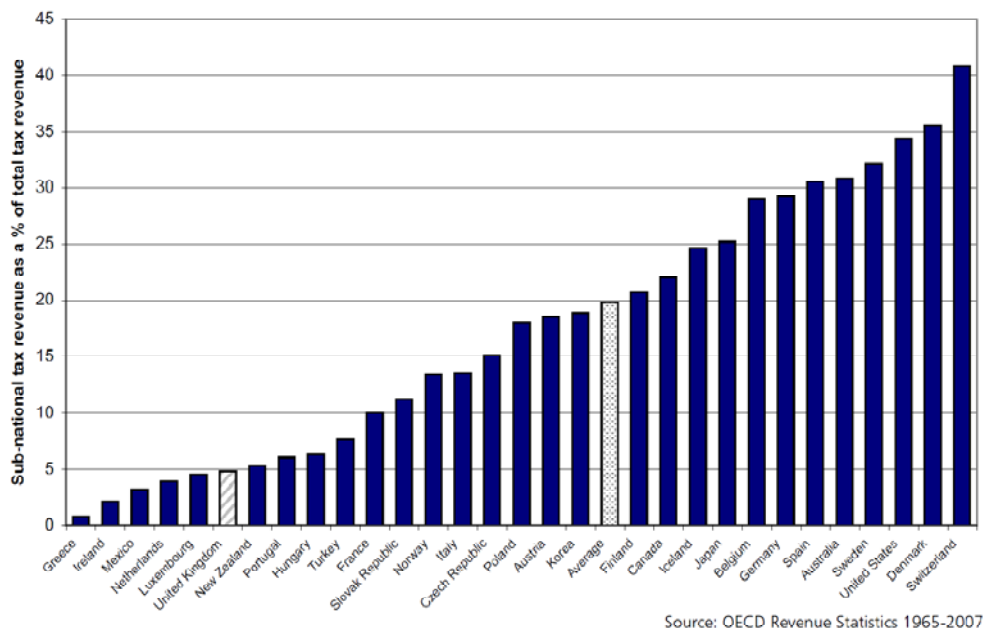
388. In his report on a possible new funding and financial settlement for Wales<sup>154</sup>, Professor Gerald Holtham states that—

“Three European Union (EU) member states levy sub-national taxes on corporate income, while six do so on personal income. Canada and the USA allow both personal and corporate income taxes to vary sub-nationally.”<sup>155</sup>

<sup>154</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010.

389. Of the 27 EU countries, 6 levy decentralised income taxes while only 3 decentralise corporation tax (4 if the partial decentralisation to only some Spanish provinces is counted). Figure 1 below, extracted from the Holtham report, shows that sub-national tax revenues tend to be highest in federal states and in countries with highly decentralised systems of public services (for example Denmark, Sweden and Spain). The UK currently has a strikingly low proportion of tax revenue collected at the sub-national level even by the standards of unitary states.

**Figure 1: Sub-national taxes as a share of total tax revenue**



Source: OECD Revenue Statistics 1965-2007, as cited in the Holtham Report  
 Note: The UK value excludes non-domestic rates.

390. In his evidence to the Committee, Alan Trench of University College London, stated that—

“The system proposed in the bill would create a system substantially less under devolved control than the taxing powers of provinces in Canada, cantons in Switzerland or states in the USA. In such countries, the lower level of government raises 60-70 per cent of its total spending from its own tax base, rather than the 30-35 per cent contemplated here. It would create greater autonomy than enjoyed by German Länder or the regions and communities in Belgium (where reform of federal finance has been central to the inability to establish a federal government since the June 2010 elections). It is debatable, given how the system of equalisation in Australia works

<sup>155</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010, paragraph 4.2.

(where states raise about 55 per cent of their spending), whether this is greater than the effective autonomy of states there.”<sup>156</sup>

391. His view is that, “Rather than representing the end of a process of reviewing and revising Scottish devolution, it will require further revisions in the coming years (possibly even before it wholly comes into effect).”<sup>157</sup>

392. However, Professors Hughes Hallett and Drew Scott told the Committee that—

“...as far as we are able to discern from our research the funding regime that is being proposed in the Scotland Bill has no parallel with any other federal or quasi-federal country. In every case that we have studies – including Canada, Spain, Belgium, the USA, Germany, Italy, Australia, and Switzerland – sub-central governments enjoy significantly greater control over taxes levied in their own jurisdiction than is being proposed in the Bill and are able to raise funds by issuing their own bonds.”<sup>158</sup>

393. In relation to these alternative viewpoints, the Committee notes there is a different of opinion regarding Belgium and Germany. We also note that the evidence is contradictory. What is clear is that Scotland already has uniquely broad spending freedoms and as a result of the Scotland Bill it will have more revenue raising discretion.

394. Reform Scotland also shares the view that the proposed reforms do not go far enough compared to other countries. It states that the proposals of the Scotland Bill are more limited than those that exist in other countries in two main ways. First, the proposed tax base is narrow and, secondly, regional governments in other countries tend to have power over the underlying law which allows more flexibility (for example, over allowances as well as tax rates).<sup>159</sup>

395. Professor Lars Feld provided the Committee with a detailed submission that reviewed the fiscal systems in the Federal Republic of Germany and also Switzerland, with its system of cantons. His overall conclusion on Germany is that “...the properties of the German fiscal constitution do not encourage the states to be fiscally responsible”. For this reason, the Federal Government passed additional legislation in 2009 to force the Länder to realise balanced budgets as of 2020.<sup>160</sup>

396. Professor Feld’s view is that Switzerland is characterised by a competitive federalism<sup>161</sup>. He also states that “...existing evidence indicates that tax competition leads to lower public expenditures in Switzerland”.<sup>162</sup>

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<sup>156</sup> Alan Trench, written evidence submitted to the Committee, paragraph 15.

<sup>157</sup> Alan Trench, written evidence submitted to the Committee, paragraph 28.

<sup>158</sup> Professors Hughes Hallett and Scott, written evidence submitted to the Committee, paragraph

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<sup>159</sup> Reform Scotland, written evidence submitted to the Committee.

<sup>160</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 8.

<sup>161</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 9.

<sup>162</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 15.

397. In light of the international experiences reviewed by Professor Feld, he concludes when looking at the provisions in the Scotland Bill by saying that “the goal of financial accountability of the Parliament and Government in Scotland will be enhanced by the proposals in the Bill and the Command Paper.”<sup>163</sup> He further concludes that—

“To my view, the advantages of substituting the revenue from taxes levied by the Scottish Parliament for some of the grant from the UK government dominate. A careful reading of the Swiss case above will clarify why I think that existing evidence rather speaks in favour of such tax decentralisation. I would however also not totally eliminate inter-governmental transfers if there were asymmetries between jurisdictions.”<sup>164</sup>

398. In his evidence to the Committee, Professor Robin Boadway of Queen’s University, Canada, also writes favourably of the Bill. He states that his overall impression of the Bill’s provisions is “highly positive”. He suggests that the financing structures “are a major step” in the devolution of financial responsibility and accountability to the Scottish Government. He also describes these, from a longer run perspective, “as interim measures”.<sup>165</sup>

399. Professor Boadway notes that the form of the financial provisions outlined by the UK Government is similar to the Canadian system in the sense that the federal government has devolved tax room to the provinces, and allowed them to choose their own tax rates. He notes that, in Canada, most provinces have their income taxes collected by the federal government as part of the Tax Collection Agreements. His view is that the procedure of tax forecasting and year-end reconciliation is very similar to what is being proposed in this Bill. He states, however, that the Canadian experience is that forecasting has in the past been imperfect, and the provinces have complained that shortfalls were not returned to them with interest.<sup>166</sup>

400. In their evidence to the Committee, various international experts gave their views on the detail of what is proposed by the UK Government in the Bill and the Command Paper and as originally proposed by the Calman Commission. Professor Vaillancourt of Montreal stated that—

“I believe that the instrument that has been chosen, personal income tax, is the best one for the purpose. Corporate income tax is difficult to administer at a personal level, because of tax shifting between various jurisdictions. Value added tax is a feasible option — it is administered at the national level in parts of Canada, for example — but it is also difficult to administer in such a way. Personal income tax allows people to see a relationship between what they pay and what they get, and it is linked to the responsibilities of the Scottish Parliament, such as education, social services, health, long-term care and so forth. It is, therefore, an appropriate tool.

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<sup>163</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 27.

<sup>164</sup> Professor Lars Feld, written evidence submitted to the Committee, paragraph 28.

<sup>165</sup> Professor Robin Boadway, written evidence submitted to the Committee, paragraph 2.

<sup>166</sup> Professor Robin Boadway, written evidence submitted to the Committee, paragraph 12.



The degree of choice that is proposed — the 10p rate — could be argued to be an acceptable first step. However, if you look at the various changes that are happening throughout the world—in Spain, Canada and so on — it is probably a minimum.”<sup>167</sup>

401. Professor Holtham said—

“...I agree with the other witnesses that income tax is the obvious place to start. There are only three or four large taxes, of which income tax is one. There are fewer difficulties with income tax than with any of the others. Certain areas of the bill have drawbacks, but I believe that in each case they are susceptible to a technical fix — improvements could be made that would solve the problems to which people have pointed. There have been some genuine and fair criticisms that can be resolved without throwing the whole thing out. The basic structure is okay, but there are areas in which the bill could be fine tuned.”<sup>168</sup>

402. Professor Muscatelli told the Committee that—

“The commission chose a point that strengthens accountability and balanced it against risk by introducing a certain amount of revenue risk for the Parliament. However, the bill does not adopt some of the more volatile taxes, such as corporation and other taxes, that would inject more risk into the Parliament's revenues. Income tax has less impact in terms of tax spillover or tax competition, so it is the obvious place to start. Not surprisingly, that is where a lot of other devolved, federal Governments choose to place themselves when it comes to sharing taxation.”<sup>169</sup>

403. In supplementary written evidence to the Committee, Professor Vaillancourt, provided further detail on how the Canadian system of devolving fiscal powers to its provinces has evolved over time, clearly demonstrating that it has been an evolutionary process in that country.

404. His evidence states that before World War II, both the Canadian federal government and the provincial governments had a role in both personal income tax and corporate income tax. During the war, this shifted far more towards the former (although Ontario and Québec did not participate in this shift). Various shifts then reversed this process, with increasing decentralisation until the present day where Canadian provinces can levy the same direct and indirect taxes as the federal government except for custom duties and excise duties. According to Professor Vaillancourt, in 2010, all of the Canadian provinces levy both personal income taxes and corporate income taxes at various rates and nine provinces levy sales taxes using a mix of VAT and retail sales taxes. Finally, some provinces levy payroll taxes and most levy capital taxes on corporations. In all cases, they are

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<sup>167</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 200.

<sup>168</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 201.

<sup>169</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 201-202.

completely free in setting the base, rates, and collection mechanisms. There are no tax harmonisation laws setting tax parameters.<sup>170</sup>

405. Closer to home, the Committee is aware of the experiences of fiscal decentralisation in Spain where central government taxes have been partially or totally ceded to Autonomous Communities (ACs). Of the partially ceded taxes (personal income tax, value added tax and excise taxes), the ACs have the power to modify only the income tax rate. Totally ceded taxes include inheritance and gift tax, wealth tax, tax on electricity and tax on gambling, amongst others. With regard to these taxes the central government sets the basic rules of taxation, but the ACs have powers to determine the final tax liabilities. In addition, ACs can create new taxes in tax fields not used by the central government.

406. According to a publication by Bosch and Duran in 2008 “for the time being, use of their legal capacity by ACs has been quite limited...After enjoying tax power for 11 years, only one AC, Madrid, and in 2007, has modified the regional tax rate schedule of the (IT) [income tax]. Regarding this tax, ACs have concentrated on introducing different tax credits...Spanish ACs have been more active in other ceded taxes, but those taxes are unimportant or imperceptible”<sup>171</sup>. Bosch and Duran also explain that “ACs have introduced a range of their own taxes mainly related to environmental issues (i.e. water, emissions and waste) and gambling (i.e. bingo) which, on average accounts for a small percentage of the revenue of ACs...More recently, a few ACs have also levied taxes on large shopping areas”<sup>172</sup>. Since then, the Spanish experience has diverged with four Autonomous Communities exercising powers to alter income tax rates.

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<sup>170</sup> François Vaillancourt and David Guimond, *Personal Income tax rate setting: evidence from Canada and comparison with the USA, 2000-2010*.

<sup>171</sup> Bosch, N. and Duran, J.M. (2008), *The Financing System of Spanish Regions: Main Features, Weak Points and Possible Reforms*, in *Fiscal Federalism and Political Decentralization: Lessons from Spain, Germany and Canada*.

<sup>172</sup> Bosch, N. and Duran, J.M. (2008), *The Financing System of Spanish Regions: Main Features, Weak Points and Possible Reforms*, in *Fiscal Federalism and Political Decentralization: Lessons from Spain, Germany and Canada*.

## IS THERE A “DEFLATIONARY EFFECT”?

407. One of the major criticisms expressed to the Committee by the Scottish Government and others is that there is a longer term, deflationary bias within the proposals that brings risks to the Scottish Government budget. In a letter to Committee, John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, explained that “this deflationary bias is driven by two simple facts – i) income tax revenues have grown by less than total public spending (as illustrated over the last ten years and by analysis from the IMF from 1965) and ii) Scotland would be in line to receive a decreasing share of the revenues from higher tax bands. This is the reality of the figures.”<sup>173</sup>

408. This section of the report looks in more detail at the claims made on the suggested deflationary effect and reviews the evidence that the Committee heard on this matter.

### **Growth of income tax relative to public spending**

409. The Committee received evidence from both the Scottish Government and some witnesses that, from past experience, UK income tax receipts would not keep pace with expenditure and so there was an inherent deflationary bias involved in relying on income tax as the main new tax to be devolved, forcing the government either to raise tax rates or cut expenditure.

410. The Scottish Government has expressed its view that—

“This discord between the growth rates of income tax and total public spending/total taxation is a long-term phenomenon. For example, the IMF report<sup>174</sup> that since 1965, total taxation as a share of UK GDP has grown by 6.2% points. However, income tax has grown by only 0.9% points.”<sup>175</sup>

411. This view was echoed by John Whiting of the Chartered Institute of Taxation in his evidence to Committee. He observed—

“The main shift across the world has been to indirect taxes — in our terms, VAT. That can be seen around Europe, where such rates are generally rising... Under European rules, VAT can go up to a maximum of 25 per cent; the Danes are there and feel that that is all right. We have a bit of a way to go in that regard. I do not think that the balance has gone totally as far as it could do.”<sup>176</sup>

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<sup>173</sup> Scottish Government, Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Available at: <http://www.scottish.parliament.uk/s3/committees/scotBill/documents/LetterfromJohnSwinney-25January2011.pdf>

<sup>174</sup> IMF. *Long term trends in public finances in the G-7 Economies*. Available at: <http://www.imf.org/external/pubs/ft/spn/2010/spn1013.pdf>

<sup>175</sup> Scottish Government, Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis. Available at: <http://www.scottish.parliament.uk/s3/committees/scotBill/documents/LetterfromJohnSwinney-AnnexC-DeflationaryBiasAnalysisforScotlandBillCommittee.pdf>

<sup>176</sup> Scotland Bill Committee, *Official Report* 25 January 2011, Col 309.

412. Professor Drew Scott also shared this concern when giving evidence to Committee, stating that—

“There is a presumption that as long as the powers are not used, they will be neutral ... In our view, they would be negative. That is based on the evidence of the rate of growth of the two variables ... Not using the powers would have a consequence. I think that they would have to be used. Our view, which I am entirely comfortable for the committee to contest, is that it would be necessary to raise taxes to maintain public spending or to reduce public spending to maintain taxes.”<sup>177</sup>

413. The piece of evidence to which both the Scottish Government and Professors Hughes Hallett and Scott refer is an International Monetary Fund (IMF) study,<sup>178</sup> which showed that over a 42 year period from 1965 to 2007, total tax revenue in the UK as a percentage of GDP rose from 30.4% to 36.6%, whilst revenue from personal income tax rose from just 10.1% to 10.9%.<sup>179</sup>

414. The full figures for the UK from the IMF study are given in the table below.

**Table 5: UK tax revenues as a percentage of GDP**

	1965	1975	1985	1995	2005	2007
PIT <sup>180</sup>	10.1	14.1	9.8	10.0	10.6	10.9
CT <sup>181</sup>	1.3	2.2	4.7	2.8	3.4	3.5
NICS <sup>182</sup>	4.7	6.2	6.7	6.1	6.8	6.8
VAT/Sales <sup>183</sup>	1.8	3.1	6.0	6.6	6.8	6.7
Other	12.5	9.7	10.4	9.1	8.8	8.8
Total Taxes	30.4	35.2	37.6	34.5	36.3	36.6

Source: IMF

415. What this table reveals is that total taxes as a percentage of GDP rose sharply over the first 20 years of the period and then flattened out, and indeed fell slightly. This broadly mirrors the experience in other OECD countries where taxes as a percentage of GDP rose sharply from 25.5% to 32.5% from 1965-1985, but then rose far more slowly from 32.5% to 34.8% from 1985-2007.<sup>184</sup>

416. The IMF study also produces figures for the share of public expenditure in GDP in the UK and other G7 countries. Figures for the UK ratio of public expenditure to GDP are given in the table below.

<sup>177</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 182.

<sup>178</sup> Cottarelli and Schaechter, “Long-term Trends in Public Expenditure in G7 Economies”, IMF Staff Position Note, SPN/10/13, 2010.

<sup>179</sup> Cottarelli and Schaechter, op.cit. Table 1 p12.

<sup>180</sup> Personal Income tax.

<sup>181</sup> Corporation Tax.

<sup>182</sup> National Insurance (Social Insurance) Contributions .

<sup>183</sup> VAT and Excise Duties.

<sup>184</sup> OECD, *Tax Revenue Statistics*, Table A.

**Table 6: UK public expenditure as a percentage of GDP<sup>185</sup>**

	1965	1975	1985	1995	2005	2007
Public Expenditure	34.1	44.9	44.0	42.2	38.9	38.6

Source: IMF

417. As the IMF study points out, across all G7 countries, there was a similar rapid growth in public expenditure as a share of GDP between 1965 to 1985 followed by a flattening out.<sup>186</sup>

418. So the picture is that in the UK, as in most advanced countries, both taxes and public expenditure rose rapidly as a share of GDP over the 1960's and 1970's, but from the 1980s onwards, governments in the UK and elsewhere have taken steps to control them and stabilise or slightly reduce their share of GDP.

419. Turning to the mix of taxes, a significant event that has to be taken into account is that in 1973, the UK joined the European Union and had to harmonise its VAT rates with those in other EU countries.

420. As can be seen from Table 6, while income tax as a percentage of GDP rose rapidly in line with total taxes up to 1975, the rebalancing of the tax system as a consequence of joining the EU meant that income tax as a percentage of total tax fell as VAT increased rapidly between 1975 and 1985.

421. The 42 year sweep of history therefore covers—

- an early period where (i) there was very rapid growth in both taxes and spending; (ii) the UK was not a member of the EU and so did not rely on VAT as a significant source of tax revenue; and
- a later period where, as now, (i) governments operate tighter control of both taxes and spending; (ii) the UK is a member of the EU operating a harmonised VAT regime.

422. To understand how robust income tax is as a means of funding expenditure it therefore makes sense to compare like-with-like and to confine attention to the more recent period from 1985 onwards.

423. Combining the previous two tables and expressing revenue from personal income tax as a fraction of both total tax revenue and of public expenditure produces the following table.

<sup>185</sup> Cottarelli and Schaechter, "Long-term Trends in Public Expenditure in G7 Economies", IMF Staff Position Note, SPN/10/13, 2010, chart 4.

<sup>186</sup> "The second fiscal trend that characterises the last decades is the increase in the size of government – measured by the ratio of spending to potential GDP. This is true for overall spending as well as primary spending – spending excluding interest payments. Most of the increase took place between 1965 and 1985, a trend which was present in all G-7 countries.", Cottarelli & Schaechter, "Long-term Trends in Public Expenditure in G7 Economies", IMF Staff Position Note, SPN/10/13, 2010, p8.

**Table 7: UK personal income tax revenue as a percentage of (a) total tax revenue and (b) public expenditure**

	1985	1995	2005	2007	2009*
Total Tax Revenue	26.1	29.0	29.2	29.8	30.4
Public Expenditure	22.3	23.7	27.2	28.2	32.9

\* Note: 2009 figures estimated by SPICe using data from the IMF and OECD Tax Revenue Statistics.

424. This table shows that over the long run, income tax receipts have grown in relation to both public expenditure and total tax revenue.

425. This is consistent with the evidence of Professor Gerald Holtham when he gave evidence to Committee saying that he did not believe the trend in income tax declining as a percentage of total taxes would continue. He explained—

“It is pretty clear that in 50 years we have moved from direct tax to indirect tax. Now, the basic rate is at 20p and VAT is at 20 per cent. How much further do you think that tendency will go? I do not think it safe to assume that the trend will continue to move in the same direction”.

426. He added that—

“The block grant is structured around expenditure, which means that if the UK Government continues to switch money from direct to indirect taxes any extra expenditure will — as long as the money is spent — be reflected in the allocation via the Barnett formula. You are pointing not to an absolute squeeze on the total level of Scottish resources but to what is certainly a possibility that over time the grant will grow in importance relative to taxation”<sup>187</sup>

427. Within the Command Paper, the UK Government also does not anticipate a deflationary bias stating that—

“...the size of the Scottish budget, and variations to it, will be determined by the growth of the block grant element and the growth of income tax receipts. We would expect the relationship between these two elements to be broadly neutral over time.”<sup>188</sup>

428. When asked what would happen if the relationship changed, the Secretary of State for Scotland explained to Committee—

“Through the new mechanisms that we propose to sit alongside the new tax arrangements – through the UK-Scottish tax committee and the other ministerial contacts – that stuff will be carefully kept under review...We would not want the situation to go too far out of kilter.”<sup>189</sup>

<sup>187</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 204.

<sup>188</sup> HM Government. *Strengthening Scotland's Future*.

<sup>189</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 383.

### Scottish share of revenues from each tax band

429. The second factor which the Scottish Government believes will result in a deflationary bias relates to the decreasing share of revenues that the Scottish Government will receive from higher tax bands. John Swinney stated to Committee—

“According to the proposals that are in front of us, the Scottish Government would receive half the tax revenues from the basic rate, a quarter of the revenues from the higher rate and a fifth of the revenues from the top rate. Between 1999 and 2008, the upper-rate revenues grew by an average of 13 per cent, compared to growth in the basic rate of just 6 per cent. Although the potential for growth in higher-rate tax revenues is double the potential for growth in basic-rate tax revenues, under the proposed arrangements a diminished share of those taxes would be retained in Scotland, with the result that the opportunity to see the tax base grow and, therefore, to tackle some of our underlying concern about the deflationary implications of the Scotland Bill proposals, would be lost to Scotland.”<sup>190</sup>

430. In written evidence to Committee, the Scottish Government also said that—

“As a further example, in 2010-11, the UK Government introduced a new top rate of 50% tax on the highest earners to raise additional revenues to fund public services. Under the current Scotland Bill plans, the Scottish Budget would receive none of the additional revenues nor any of the additional benefits from natural ‘fiscal drag’ as people become richer through time and move into higher tax bands.”<sup>191</sup>

431. Professor Iain McLean of the University of Oxford agreed with the Scottish Government that it will not benefit proportionately if people move into higher tax bands, but stated—

“On the other hand, the balancing counter-effect — we will not know whether it will balance until we see some numbers or some modelling — is that if people move from zero tax to the standard rate of tax, the Scottish Parliament will get about half of that. I do not know how those two effects will measure out against each other, nor, I submit, will anybody else know, unless and until some modelling is done.”<sup>192</sup>

432. In their written evidence to Committee, Jim and Margaret Cuthbert highlighted why they were concerned about the decreasing share of revenues from higher tax bands. They wrote that—

“Under most foreseeable circumstances, a Scottish government operating under the Calman proposals would face increasing financial pressure as fiscal drag decreased the share of Scottish income tax revenues which it

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<sup>190</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 85.

<sup>191</sup> Scottish Government, Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis.

<sup>192</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 141.

received. Taken together, this means that the Scottish government would find itself under almost irresistible pressure to progressively increase the Scottish rate of tax: hence condemning the Scottish economy to increasing lack of competitiveness and ongoing decline.”<sup>193</sup>

433. Professor Holtham suggested—

“...it would be better to have a constant proportion of each tax bracket—in other words, half would be on the basic rate and half on the higher rates. If the proportion of each tax bracket devolved to Scotland is the same, your revenues will grow at the same rate as overall income tax rates and, if anything, you should expect the share of the Scottish revenue that comes from taxation rather than the grant to go up.”<sup>194</sup>

434. Giving evidence to Committee, Mr David Gauke MP, Exchequer Secretary to the Treasury in the UK Government, justified this proposed system stating that—

“It is worth making the point that the tax take from the higher and additional rates is quite volatile. The risks, if you like, from the perspective of the Scottish Government, if dependence upon those areas was too great, would increase the uncertainty that you would face. It is right that we get the balance right between providing stability for Scotland and greater accountability and flexibility. The Calman proposal of 10p for every tax band will do that and it will provide greater accountability, while protecting Scotland from the volatility that can occur with higher tax rates.”<sup>195</sup>

### **Modelling the impact that the Scotland Bill proposals would have had on Scottish Government funding since devolution**

435. A key principle of the Scotland Bill proposals is that some of the block grant is exchanged for the scope for the Scottish Parliament to levy its own taxes. During the transition period, the value of the deduction from the block grant corresponding to the reduced UK rate of income tax in Scotland will be calculated annually. After the transition period, the block grant will be permanently reduced by a certain amount that is deemed to reflect the reduced revenues to the UK Exchequer from the taxes the Scotland Bill devolves to the Scottish Parliament.

436. This is a critical issue and the Committee has been keen to understand the extent to which the proposed funding model is likely to result in a budget for Scotland that is different to that under the current Barnett framework.

437. The Scottish Government provided written evidence on this matter, outlining its concern that—

“Had these proposals been introduced at the start of devolution in 1999, our budget would have been lower than under the current framework in each and every year from 2001/02 to 2010/11. The cumulative shortfall would have

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<sup>193</sup> Jim and Margaret Cuthbert, written evidence submitted to the Committee, Paper 2.

<sup>194</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 205.

<sup>195</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 39.

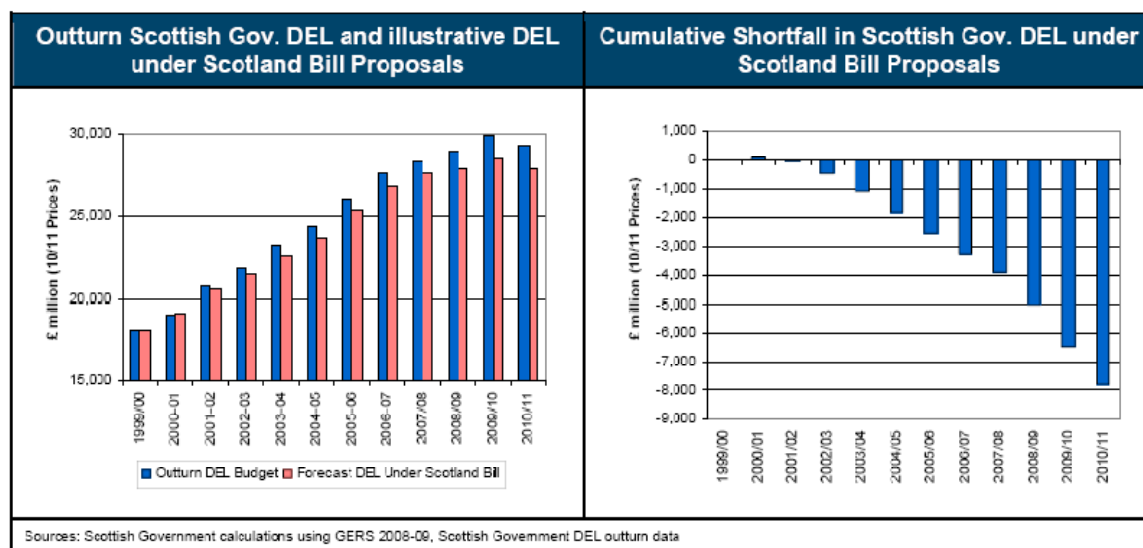


been approximately £8 billion – a significant reduction in the resources available for public services in Scotland.”<sup>196</sup>

438. The Scottish Government analysis assumes that the Scotland Bill’s income tax proposals were introduced in 1999-2000 with the block grant being permanently reduced by their estimate of the share of income tax receipts that would have been assigned to Scotland in 1999-00 had the proposals been in place. Income tax receipts assigned to the Scottish Government in 1999-2000 are estimated to be worth 19.2% of the block grant and thus the actual outturn block grant provided to the Scottish Government is reduced by this percentage each year thereafter. The income tax component changes in line with the estimated year-on-year changes in Scottish income tax revenues.

439. The Scottish Government states that, “This methodology is consistent with the example provided in the Calman Commission’s final report (page 113-114)<sup>197</sup>”. The Scottish Government’s chart reproduced below (Figure 2) on the right shows the difference between the actual outturn Scottish block grant (Scottish DEL) and their estimate of what the Scottish block grant would have been under the Scotland Bill proposals since devolution. The chart below on the left accumulates the estimated shortfall over the period, showing their estimate of what the cumulative shortfall would have been.

**Figure 2: Scottish Government modelling of the block grant and the Scotland Bill’s proposals**



Source: Scottish Government<sup>198</sup>

440. The UK Government criticises this methodology, with the Secretary of State for Scotland stating to Committee that, “The presumption in the £8bn figure, which

<sup>196</sup> Scottish Government. *Scotland Bill Financial Provisions*, November 2010.

<sup>197</sup> Scottish Government. *Scotland Bill Financial Provisions*, November 2010.

<sup>198</sup> Scottish Government. *Scotland Bill Financial Provisions*, November 2010.

I think is a nonsense figure, is that you somehow base your entire adjustment to the block grant on the worst year in the worst post-war recession.”<sup>199</sup>

441. The UK Government provided their own modelling to the Committee that illustrates that had the proposals been in place since 1999-2000 there could have been a cumulative shortfall valued at a lesser £691 million over the period. Their model is similar to that used by the Scottish Government, but instead of reducing the block grant by 19.2%, the share of income tax receipts in 1999-2000, it reduces the block grant by 17.25% -- the average of the share of income tax receipts as a percentage of the block grant in each year between 1999-2000 and 2010-11.

442. The UK Government qualified their methodology over that used by the Scottish Government saying—

“As the Command Paper sets out, the value of the adjustment to the block grant would not be priced on the basis of receipts in a single year, rather an average of receipts over a number of years. From the Calman Commission’s final report, it can be inferred that the Commission intended for the value of the adjustment to be a percentage based on the average worth of the devolved tax receipts over a number of years, not a single year.”<sup>200</sup>

443. Both examples outlined above have illustrated to the Committee the sensitivity of the level of Scottish Government funding under the Scotland Bill proposals to the level of block grant reduction selected. The UK Government stated within written evidence—

“There are a number of ways of calculating the value of the initial adjustment to the block grant, and it is very sensitive to a number of factors:

- the year in which that adjustment is made;
- whether the adjustment is based on a single year or an average of years; and
- the period of time over which the value of the reduction is calculated.”<sup>201</sup>

444. In modelling the impact of adopting the Scotland Bill, both the Scottish and UK Governments assumed that the block grant is reduced by a constant proportion in every period and this component of the block grant is replaced by the amount of income tax raised in that period. The crucial statistic behind all the different modelling exercises is the ratio of Scottish income tax to the DEL that

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<sup>199</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 382.

<sup>200</sup> Scotland Office. *A technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget*. Available at:

<http://www.scottish.parliament.uk/s3/committees/scotBill/documents/NoteforSPcommittee.pdf>

<sup>201</sup> Scotland Office. *A technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget*. Available at:

<http://www.scottish.parliament.uk/s3/committees/scotBill/documents/NoteforSPcommittee.pdf>

Scotland would have got under current block grant system. The figures for this ratio are given in the table below.<sup>202</sup>

**Table 8: Ratio of Scottish income tax to outturn/estimated DEL under current block grant system**

Year	Income Tax/DEL	
	Scottish Government Model	UK Government Model
1999/00	19.2%	18.4%
2000/01	19.7%	19.8%
2001/02	18.4%	18.7%
2002/03	17.4%	17.9%
2003/04	16.4%	16.6%
2004/05	16.3%	17.2%
2005/06	16.4%	17.5%
2006/07	16.4%	17.4%
2007/08	16.7%	17.3%
2008/09	15.1%	16.3%
2009/10	14.0%	14.6%
2010/11	14.3%	15.3%
2011/12	15.5%	16.4%
2012/13	16.5%	17.4%
2013/14	17.8%	18.9%
2014/15	19.1%	20.2%

Source: SPICe

445. As can be seen from the table, while there has been some year-to-year variation in this ratio, the broad trend has been for this ratio to fall from 1999-2000 until 2009-10 and then to start rising. This reflects a period over which expenditure (particularly on education and health) rose much faster than tax revenue, which comes to an end in 2010-11. From this table, it is possible to identify the years in which, from the modelling provided, it has become clear that—

- if the percentage by which the block grant is reduced by either the Scottish or UK Governments is **higher** than the ratio of income tax to DEL in that year, then Scotland would **lose** in that year had Scotland Bill proposals been adopted; or
- if the percentage by which the block grant is reduced by either the Scottish or UK Governments is **lower** than the ratio of income tax to DEL in that year, then Scotland would **gain** in that year had the Scotland Bill proposals been adopted.

446. This argument generates a further important implication of the different assumptions made by the Scottish Government and the UK Government regarding the calculation of the initial reduction in the block grant. If, as is assumed by the

<sup>202</sup> These are based on figures supplied by SPICe but there is no substantive difference between these numbers and those used by Scotland Office and the Scottish Government.

Scottish Government, it is the ratio of income tax to DEL in the year in which the Calman proposals are implemented that is used to make the initial grant reduction, then, in the first year, the switch to the scheme will be budget neutral. This is illustrated in Figure 2 where it can be seen that the net effect is zero in 1999/2000. However, as has been discussed, the budgetary implications for future years will be enormously sensitive to the precise fiscal conditions that prevail in the year when the scheme is implemented.

447. However if, as is assumed by the UK Government, some average ratio of income tax to DEL is used as the basis for the initial grant reduction, then there may be a positive or negative change to the Scottish Budget in the first year depending on how the ratio of income tax to DEL in the first year relates to the average. This is illustrated in Figure 3 where it can be seen that because the average used to calculate the grant reduction was lower than the ratio of income tax to DEL in 1999/2000 there was a positive gain to the Scottish Budget in that first year. However under this method for making the initial grant reduction, the budgetary implications for future years do not depend on the year in which the switch to the new funding mechanism.

448. So there is a choice to be made between budget neutrality in year 1 of implementation with its accompanying great sensitivity of future budgets to the fiscal conditions in the year in which the switch is made, and a method of grant reduction which makes future budgets far less sensitive to initial conditions, but at the cost of a non-neutral budget change in the first year.

### **Modelling the impact of the Scotland Bill proposals on Scottish Government funding from 2010 onwards**

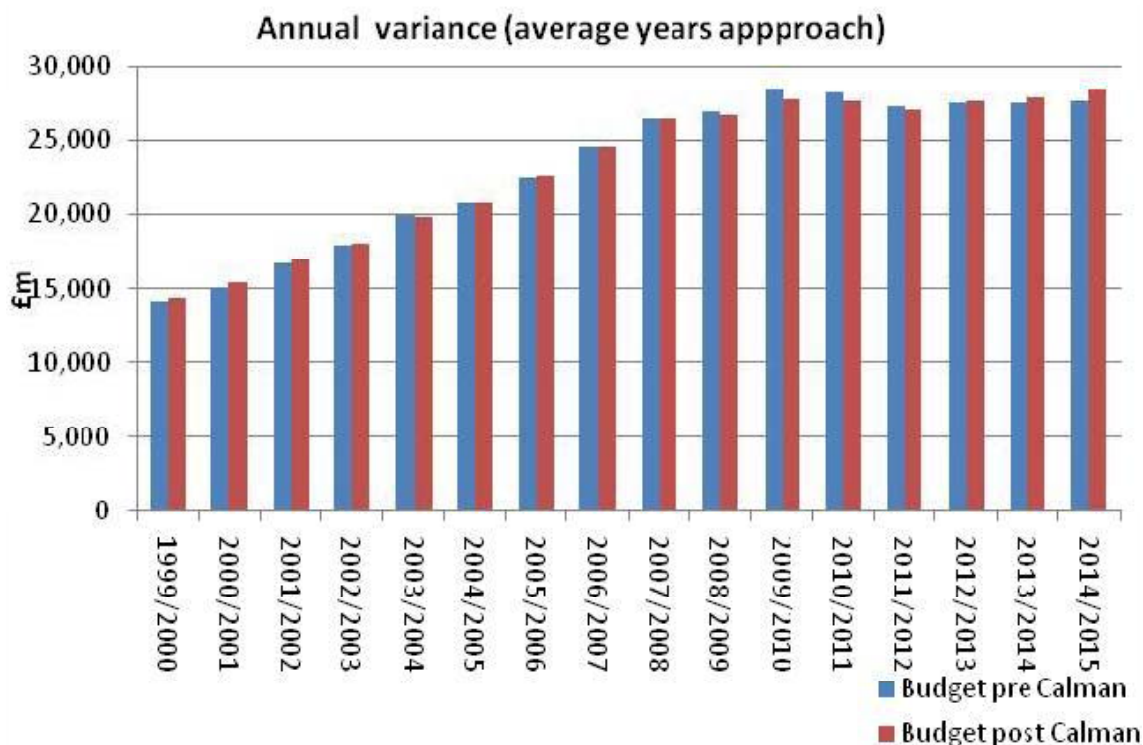
449. It was emphasised to Committee by a number of witnesses that in the period since devolution, as modelled by the Scottish and UK Governments, the UK has seen public expenditure, notably on services which are devolved, grow at a faster rate than income tax receipts. The UK Government explained to Committee in written evidence that, “Estimating what the impact of the new funding model would have been in recent years will provide a partial picture.”<sup>203</sup> The Committee was therefore interested to see the Scottish and UK Governments’ models extended to the forthcoming period of fiscal consolidation to ascertain the net impact on the Scottish budget under the proposals.

450. The UK Government provided a written submission which showed that rolling forward the previous model with a block grant reduction of 17.25% in 1999-2000 (average income tax receipts as a share of the block grant from 1999-2000 to 2010/11) resulted in a cumulative gain to the Scottish budget of £397 million over the entire period to 2014/15 – shown in the chart reproduced below (Figure 3).

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<sup>203</sup> Scotland Office. *A technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget*. Available at: <http://www.scottish.parliament.uk/s3/committees/scotBill/documents/NoteforSPcommittee.pdf>

**Figure 3: Modelling the Scottish budget under the Scotland Bill's provisions in the current spending review period (UK Government analysis)**

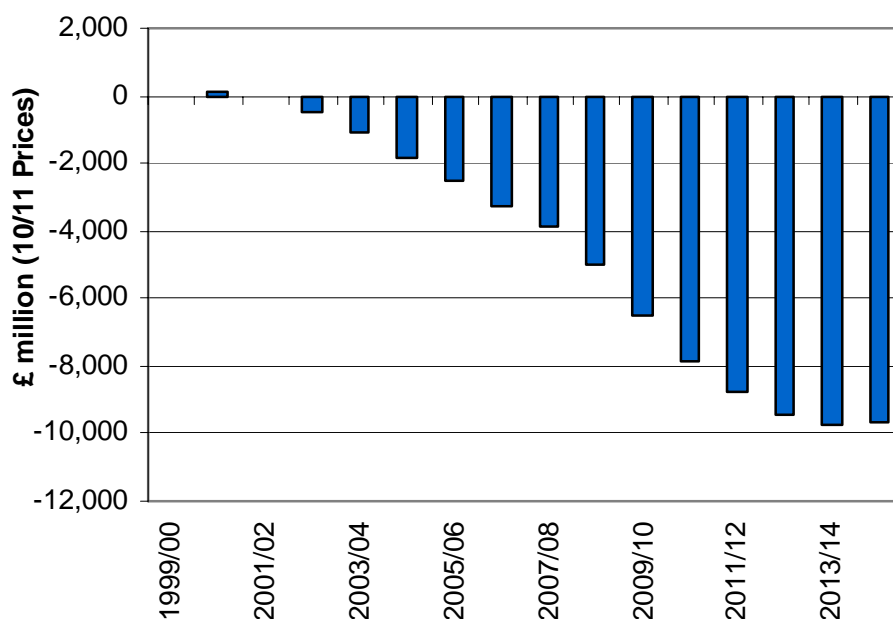


Source: Scotland Office<sup>204</sup>

451. On the other hand, the Scottish Government stated that “extending the time period to 2014-15 serves to increase the cumulative shortfall in the Scottish Government’s Budget – with a revised figure of close to £10bn obtained” as shown in their chart below (Figure 4).

<sup>204</sup> Scotland Office. *A technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget.*

**Figure 4: Modelling the Scottish budget under the Scotland Bill's provisions in the current spending review period (Scottish Government analysis)**



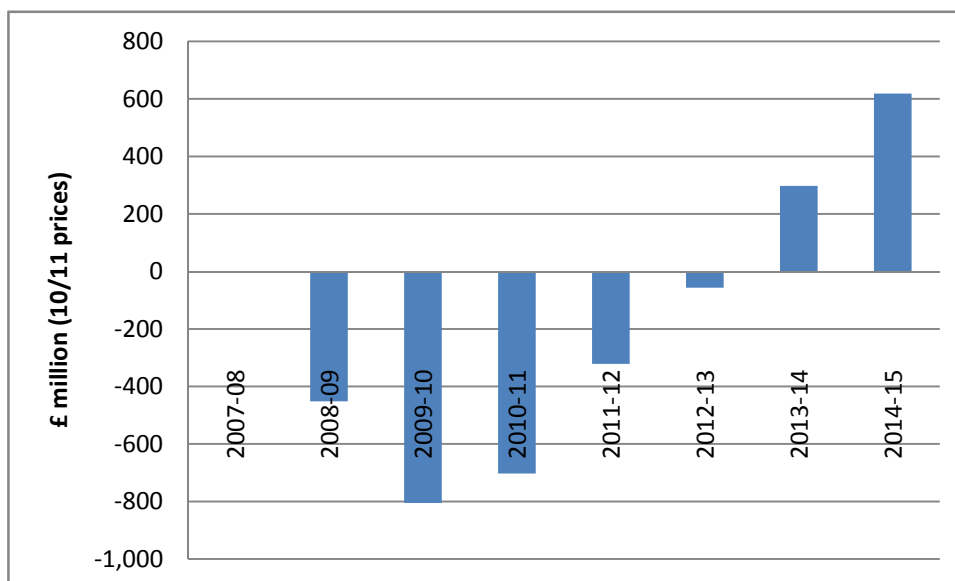
Source: Scottish Government calculations using GERS 2008-09, Scottish Government DEL outturn data. Scottish Government<sup>205</sup>

452. A further Scottish Government model provided to Committee illustrated the impact to 2014/15 of introducing the Scotland Bill proposals in 2007/08.<sup>206</sup> This model showed that under the Scotland Bill proposals in 2014/15 DEL would be over £600m above forecast actual DEL for 2014/15, as shown in Figure 5 below.

<sup>205</sup> Scottish Government. *Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis.*

<sup>206</sup> Scottish Government. *Letter from the Cabinet Secretary for Finance and Sustainable Growth - 7 February 2011. Annex B - Additional Information on Scottish Income Tax Provisions.*

**Figure 5: The annual difference between DEL under the Scotland Bill proposals and actual forecast DEL if the proposals were introduced in 2007/08.**



Source: SPICe

453. The result is that the Scottish Government's model shows the cumulative loss reducing from 2013-14 as estimated income tax revenues rise, while public spending continues to fall. The Scottish Government explained why their model forecasts DEL under the Scotland Bill proposals being higher than forecast actual DEL in these years writing that "during periods where cuts to the block grant are deep and income tax revenues are stable or growing, the Scottish Government's Budget would fare better under the Scotland Bill than under the status quo."<sup>207</sup>

454. SPICe analysis shows that if the Scottish Government model started in 2011/12, it would result in Scottish DEL being cumulatively higher than current forecasts for DEL by almost £2bn over the period 2011/12 to 2014/15 as shown in the table below.

<sup>207</sup> Scottish Government. *Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis.*

**Table 9: Scottish Government Forecast DEL, Forecast DEL under Scotland Bill Proposals and Forecast Annual Difference: £m Cash terms<sup>208</sup>**

	Scottish Government Outturn DEL	Estimated Income Tax Receipts Assigned to Scotland	Block grant reduction	Revised Block	Estimated DEL under Scotland Bill Proposals	Difference in year	Cumulative difference
<b>2011-12</b>	27,907	4,328	15.5%	23,579	27,907	0	0
<b>2012-13</b>	28,262	4,657	15.5%	23,879	28,536	274	274
<b>2013-14</b>	28,248	5,035	15.5%	23,867	28,901	653	927
<b>2014-15</b>	28,484	5,437	15.5%	24,066	29,504	1,020	1,947

Source: SPICe

455. It can be concluded that the economic circumstances at the time of the permanent reduction and over the modelling period have a significant influence over the results of the modelling. It is currently proposed in the UK Government's Command Paper<sup>209</sup> that the permanent reduction will need to be calculated two or three fiscal years after the new Scottish rate of income tax is introduced in April 2016. It is noted that there is considerable uncertainty with regard to the economic circumstances post 2014/15 and thus the likely impact of any permanent reduction cannot be forecast at this stage.

456. The Committee notes analysis by the Scottish Government Chief Economic Adviser Dr Andrew Goudie which suggests that public expenditure will not return to 2009/10 levels in real terms until 2025/26.<sup>210</sup>

### **Details relating to the proposed block grant adjustment mechanism**

457. The Scottish Government provided written evidence to Committee arguing why their modelling scenario has more validity than the UK Government modelling saying—

“The scenario provided by the UK Government is predicated upon a number of specific assumptions. For example, it would have required an ability in 1999 to correctly forecast economic growth and UK Government policy over the following ten years and foreseen the global financial crisis and subsequent recession.”<sup>211</sup>

458. They went on to say that—

“To date, the UK Government has provided no detail on how this adjustment will be made in practice. No robust modelling or assessment (including sensitivity analysis) has been provided either in public or in private to the

<sup>208</sup> SPICe calculations

<sup>209</sup> HM Government. *Strengthening Scotland's Future*, page 24-25.

<sup>210</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 422.

<sup>211</sup> Scottish Government. Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis.



Scottish Government. In addition, no analysis was provided to accompany the publication of the Bill on St Andrew's Day."<sup>212</sup>

459. The Scottish Government also pointed out that, in its view, the key unanswered questions include—<sup>213</sup>

- Will this adjustment be based on a backward looking average?
- Will it be forward looking?
- How will it account for the recent recession (and fall in income tax revenues) which serve to reduce any average?
- How will it account for the forthcoming fiscal consolidation?
- How will it account for future UK Government policy – e.g. to increase/decrease public spending or raise additional tax revenues from other sources?

460. Several witnesses have also expressed disappointment at the lack of detail in the proposals for adjusting the block grant. For example, Alan Trench wrote to the Committee stating—

“It is a matter for considerable regret that the Command paper leaves the question of how the reduction from the block grant to allow for the new tax powers to be resolved later on, despite the importance of this issue to the working of the proposed arrangements. In my view the failure to set out a proposed mechanism for this is a grave failing on the part of the advocates of the bill and Command paper, as its effect is simply unknowable at this stage.”<sup>214</sup>

461. However, the UK Government's Command Paper justifies why the mechanism for adjusting the block grant has not been specified stating—

“The Commission made no recommendation for how the reduction in the block grant exchanged for the devolved tax powers should be calculated. We infer from the examples provided in the Commission's final report that the reduction would be a percentage based on the average worth of the devolved tax receipts over a number of years, not a single year. This approach poses the question of which years to base the percentage reduction upon; for example the forthcoming period of fiscal tightening would not be a suitable base period to calculate the initial reduction. The actual outturn receipts from the Scottish income tax during the transition period will therefore be instrumental in informing the reduction in block grant associated with the new income tax power. It is also the case that a definitive knowledge

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<sup>212</sup> Scottish Government. Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis.

<sup>213</sup> Scottish Government. Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex C – Deflationary Bias Analysis

<sup>214</sup> Alan Trench, written evidence submitted to the Committee.

of the actual yield from a Scottish rate of income tax does not yet exist, although it is possible to use the Survey of Personal Incomes to derive accurate estimates of the position in past years. These circumstances make a definitive statement on the correct reduction to the block grant inappropriate at this time.”<sup>215</sup>

462. The Command Paper also states that—

“Following the transition period, there will be a one-off deduction to the block grant with the total budget derived by the Barnett formula adjusted proportionately going forward to make this deduction permanent. The transition period will have provided real outturn data for Scottish tax receipts and allowed the forecasts produced by the independent OBR to be proven, ensuring the reduction in block grant will be based on evidence and the best data available.”<sup>216</sup>

463. It has been highlighted to Committee that the economic circumstances during the transition period could have a significant impact on the permanent adjustment chosen. One particular uncertainty highlighted to Committee in relation to adjusting the block grant is the extent to which the economic circumstances at the time it is introduced will be taken into account in its calculation.

464. On this matter, the Secretary of State for Scotland assured the Committee that—

“We want a fair balance that ensures that the adjustment, which will be based on an average of the tax receipts over a period of years, is seen as a fair reflection of the Scottish economy and its capacity to generate income tax receipts. I do not know whether there could ever be a typical period of public spending, but the period on which the adjustment will be assessed will be broadly accepted as being a reasonable basis for that assessment.”<sup>217</sup>

465. At a later date, he assured Committee that, “We will not simply pick one year out of a cycle as the basis on which we will reduce the grant... A period of years will have to be used and the economic circumstances of the time will be considered.”<sup>218</sup>

466. The Command Paper provides more detail stating that—

“The UK Government will continue reviewing the system to ensure that the relative levels of public expenditure going forward remain consistent with what the Commission described as the social and economic unions between Scotland and the rest of the United Kingdom. This approach is intended to serve as a safeguard to both the Scottish and UK Parliaments once the new

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<sup>215</sup> HM Government, *Strengthening Scotland's Future*, page 35

<sup>216</sup> HM Government, *Strengthening Scotland's Future*, page 35

<sup>217</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 36.

<sup>218</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 384.

arrangements are implemented, for example by limiting the risk of an unintended transfer of resources one way or the other.”<sup>219</sup>

467. The Holtham Commission in Wales looked into different ways of designing the grant adjustment mechanism and stated, “The deduction can be managed in different ways, but all options give rise to some surprisingly complex issues concerning the incentives they create for the devolved administration and the distribution of risks among the different tiers of government.”<sup>220</sup> It goes on to argue that—

“It can surely be agreed that risks consequent on the actions of the Assembly Government should be borne by its budget and risks consequent on the action of the UK Government should be borne by UK budgets. Exogenous risks arising from elsewhere should be pooled across the union. It follows that an ideal regime should in principle shelter the Welsh budget from cyclical and UK policy risk, as those are not under the control of Welsh Ministers. However, the Welsh budget should not be protected from Welsh policy risk, i.e. changes to the tax base arising from decisions of Welsh Ministers should have their budgetary impact in Wales.”<sup>221</sup>

468. The UK Government’s Command Paper commented that—

“The Government is aware that the Independent Commission on Funding and Finance for Wales (the “Holtham” Commission) considered in some detail an alternative to a one-off deduction although practical constraints mean their recommended method could not at present be applied. Although we have set out a clear methodology for achieving the principle of ‘no detriment’, we will further analyse such alternatives and engage with the Scottish Government and the independent OBR to ensure that the optimal and most equitable model is the one ultimately adopted.”<sup>222</sup>

469. In written evidence, the Scotland Office confirmed that—

“The Government will consult with the Scottish Government on the methodology for adjusting the block grant. The Government will review the system to ensure that the relative levels of public expenditure going forward remain consistent with what the Commission described as the social and economic unions between Scotland and the rest of the United Kingdom. This approach is intended to serve as a safeguard to both the Scottish and UK Parliaments once the new arrangements are implemented, for example by

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<sup>219</sup> HM Government. *Strengthening Scotland’s Future*, page 36.

<sup>220</sup> Independent Commission on Funding and Finance for Wales. *Fairness and accountability: a new funding settlement for Wales*, page 46.

<sup>221</sup> Independent Commission on Funding and Finance for Wales. *Fairness and accountability: a new funding settlement for Wales*, page 48.

<sup>222</sup> HM Government. *Strengthening Scotland’s Future*, page 36.

limiting the risk of an unintended transfer of resources one way or the other.”<sup>223</sup>

470. The Committee’s conclusions on the “deflationary effect” and our detailed recommendations in relation to the method of grant reduction are set out later in this document.

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<sup>223</sup> Scotland Office. *A technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget*. Available at:  
<http://www.scottish.parliament.uk/s3/committees/scotBill/documents/NoteforSPcommittee.pdf>

## DEVOLUTION OF INCOME TAX

### Background

471. As it currently stands, the UK has a relatively centralised system for public spending and collecting taxes. Most taxes collected in Scotland go to the UK Treasury. According to estimates produced by SPICe, devolved taxes currently account for around 13% of the Scottish Government's budget.<sup>224</sup>

472. Whilst the Scottish Parliament currently has some tax-raising powers, these are limited, covering Non-Domestic Rates and the ability to control Council Tax. The Scottish Parliament also has the power to vary the basic rate of income tax up or down by up to 3 pence in the pound (the Scottish Variable Rate), although this has never been used.

#### *Income tax will be major own source of revenue*

473. Under the proposals in the Scotland Bill, income tax will, at least initially, become the Scottish Parliament's main own source of revenue for funding devolved expenditure. As the following table shows, had the Scotland Bill been in place in 2010-11, income tax would account for almost 50% of total devolved tax revenue.

**Table 10: Devolved taxes in Scotland**

Source of Tax	Tax Revenue 2010-11 (£m)
Income tax	4500
Landfill tax	75
Stamp Duty Land Tax	555
Non-domestic rates	2068
Council tax	1857
Total Devolved Tax Revenue	9055
% of Devolved Tax Revenue from Income Tax	49.7%

Source: SPICe<sup>225</sup>

474. As a tax base, there are a number of major advantages of relying primarily on income tax. The first is that it is a tax paid by most of the electorate. In Scotland in 2009, there were 3.9 million voters<sup>226</sup> registered to vote in elections to the Scottish Parliament and 2.6 million income taxpayers<sup>227</sup>. Therefore, two-thirds of voters will pay the tax. Accordingly, as a tax, it serves us well in terms of meeting a primary objective of increasing the accountability of the Scottish Ministers to the electorate for the taxes they raise and the use they make of this to fund expenditure.

475. A second advantage of income tax is that it is an *ad valorem* tax and so tax revenue increases automatically in line with the growth of the tax base through inflation without having to adjust the tax rate. This is in contrast with specific taxes

<sup>224</sup> Scottish Parliament, SPICe briefing for the Scotland Bill Committee, *Share of Scottish Government Total Current Spending Funded by Taxes Determined in Scotland*.

<sup>225</sup> Scottish Parliament, SPICe briefing for the Scotland Bill Committee, *Share of Scottish Government Total Current Spending Funded by Taxes Determined in Scotland*.

<sup>226</sup> General Register Office of Scotland, *Electoral Statistics 2009*, Table 1

<sup>227</sup> HMRC, *Statistics, Income Tax*, table 2.2

such as alcohol and tobacco taxes where as prices rise through inflation, the tax becomes a declining fraction of revenue unless ministers, with the approval of Parliament, decide to raise the rate of duty.

476. The Committee received very little if any evidence which argued that income tax should not be devolved. However, it did receive submissions that were critical of the proposal to rely so heavily on income tax and of particular features of the income tax proposals in the Bill.

### **The focus on income tax**

477. Both the Scottish Government and other witnesses have been highly critical of the proposals in the Bill for making income tax the only major tax to be devolved. They argue that this reduces the opportunities to both—

- enhance long Scotland's longer term economic performance (promote growth), and
- respond to short term shocks.

478. The Committee notes, however, that no detailed costed proposal has been submitted by the Scottish Government as to what additional tax powers should be devolved to Scotland.

479. The issues in relation to long-term economic performance and short-term shocks are rather different. The complaint in relation to long-term economic performance is about the lack of additional *policy instruments* at the disposal of the Scottish Parliament, and so about the lack of additional taxes over which the Scottish Parliament would have the power to determine the tax rate.

480. The issue in relation to short-term shocks is about the lack of additional taxes whose tax revenues could insulate the Scottish budget from a shock to its income tax revenue. So this is primarily a matter relating to what additional tax revenues might be assigned to the Scottish Parliament though of course in practice the ability of the grant to absorb such shocks is highly important. The recent economic shock of the banking crisis was of such a scale that the resources deployed could not have been met within the tax scope available to a Scottish Government. The NAO estimates that the total resources extended in the stabilisation effort exceeded £850 billion. SPICe estimated that £470 billion related to the Scottish institutions' stabilisation.<sup>228</sup>

### *Economic Performance*

481. On the matter of long run economic performance, in his oral evidence to the Committee, Sir Kenneth Calman<sup>229</sup> pointed out that the Scottish Government already has considerable powers to influence economic performance through its control over expenditure decisions on, for example, education, which was one of the major drivers of productivity and long-run economic performance.

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<sup>228</sup> A proposal to amend this paragraph was agreed to by division. For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

<sup>229</sup> Scotland Bill Committee. *Official Report*, 18 January 2011, Col 241.

482. In his written evidence, Professor Lars Feld argued that, “Decentralisation of taxes and spending leads to a more efficient public sector and it enhances economic performance.”<sup>230</sup> In a subsequent note provided in relation to his evidence, he confirmed that a very significant driver of this greater public sector efficiency was—

“... the devolution of some tax powers, because that changes the game that politicians confront. For if taxpayers have to fund some of the expenditure out of taxes then politicians have to convince voters that a given level of provision of services was essential and could not be provided at a lower cost, and if you want to increase provision then you have to convince taxpayers to pay extra taxes.”<sup>231</sup>

483. He added that there “was convincing empirical evidence of such effects, in particular the work on which he reports in his evidence on what had happened in Switzerland.”<sup>232</sup>

484. The enhancement of economic performance which the Bill could bring about arises, therefore, not just from the deployment of additional tax instruments but by linking tax and expenditure decisions and so improving the effectiveness with which a whole array of existing instruments are used.

485. A number of witnesses have considered the issue of whether there are additional taxes for which powers should be devolved to the Scottish Parliament to determine the tax rate, and so give the Scottish Government the additional instruments that it seeks in order to enhance Scotland’s economic performance.

486. In his written evidence, Professor Chris Heady of the University of Kent, notes that, “There are countries in which sub-central governments have very wide taxing powers, covering everything except social security (National Insurance) contributions” and goes on to add “I do not know of any OECD country with sub-central social security contributions.”<sup>233</sup>

487. Both Professors Heady and McLean – and other witnesses – recognise that VAT is a European tax whose rates cannot be controlled by the Scottish Parliament.

488. The Committee has received very little evidence that proposes that the tax rates on oil could be used as a tool to enhance Scotland’s economic performance. Oil is a natural resource, the profits from which are a valuable source of tax revenue. The structure of tax rates is set to maximise tax revenue while not distorting the decisions of companies that need to make massive investments to extract the oil. Whether the tax rates on oil can be used as a tool to enhance Scotland’s economic performance was not explored in evidence in front of the Committee.

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<sup>230</sup> Professor Lars Feld, written evidence to the Committee.

<sup>231</sup> Professor Lars Feld, note of meeting with Committee advisers (unpublished).

<sup>232</sup> Professor Lars Feld, note of meeting with Committee advisers (unpublished).

<sup>233</sup> Professor Chris Heady, written evidence to the Committee.

489. As Professor Iain McLean notes in his evidence, consideration has been given to the separate question of whether oil revenues should be assigned to Scotland<sup>234</sup>. Given the very considerable volatility of these revenues, the CSD decided that the Scottish budget should not be exposed to this volatility and consequently did not recommend that oil taxes be assigned.<sup>235</sup>

### Corporation tax

490. The only remaining major tax that could, therefore, be a candidate for rate-setting decisions to be devolved is corporation tax. However, devolving powers to set this particular tax rate is not at all straightforward because of EU law, which precludes tax systems that could be perceived to be a form of State Aid from favouring some businesses at the expense of others.

491. In his evidence to the Committee, the Cabinet Secretary for Finance and Sustainable Growth stated that—

“The Scottish Government's objective is to be enabled to use business tax powers to support economic growth in Scotland. That foundation of our thinking is about ensuring that the Parliament has a range of financial responsibilities and attributes that will enable us to deliver a higher level of economic performance. That may manifest itself in, for example, the way in which we provide tax reliefs to certain sectors of the economy; how we incentivise and encourage the development of research and development activity; and how we create an advantageous corporation tax regime on which we can establish the most competitive position in the international marketplace. Having that range of powers would enable the Scottish Government to exercise a greater degree of financial flexibility and responsibility in contributing to economic growth in Scotland.”<sup>236</sup>

492. A number of witnesses referred to the use of corporation tax as an economic lever in Ireland and the current work of the Northern Ireland Affairs Committee in its consideration of devolving corporation tax powers in Northern Ireland. For example, John Whiting of the Chartered Institute of Taxation commented that—

“I believe that corporation tax should be devolved or, at least, widely consulted on. I subscribe to a previous witness's view that it is, in a sense, a decaying tax; I do not think that there will be a race to the bottom and/or to introduce a zero rate, but it is tempting to offer cut prices. To all intents and purposes, that is what the Republic of Ireland did and it has done pretty well from the first-mover advantage it secured in dramatically cutting its rate. Northern Ireland is thinking quite hard about arguing for that power, and Scotland could, too ... Fundamentally, on the question whether you should have power over corporation tax, I find the situation odd. In one sense, you

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<sup>234</sup> Professor Iain McLean, written evidence to the Committee.

<sup>235</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, page 97.

<sup>236</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 110.



are getting the power over a large proportion of income tax, and corporation tax would seem to go along with that.”<sup>237</sup>

493. Mr Whiting’s view was that a reduction in the rate of corporation tax could be part of the overall long-term strategy to try to make the system more competitive. He suggested that a decision to do so would be based on the trade off between the reduced amounts that a government could levy from a cut in the corporation tax rate, versus the stimulation that could be achieved through the encouragement of companies to locate in Scotland. His view was that the objective was to stimulate income tax, PAYE, national insurance, VAT and generated business rates—all the other taxes—from companies and that this is where corporate investment delivers money to the exchequer.<sup>238</sup>

494. However, a number of challenges associated with the devolution of corporation tax were raised with Committee. For example, Professor Anton Muscatelli stated—

“It is probably the most volatile of all the major taxes that could be devolved. There is also the issue of tax competition. We reviewed some evidence from Switzerland that showed that, where there is competition on corporation tax, there has been a race towards matching lower rates of corporation tax and a shift from corporate taxation to personal income taxation. That perhaps flies in the face of what we are trying to achieve, which is assigning revenue to maintain some level of similar expenditure on public services.”<sup>239</sup>

495. Professor Iain McLean warned that—

“...you would get massive what I would call pretend incorporations like the massive incorporations in the state of Delaware in the United States. If those were what are at present UK incorporations, the only result would be a tax loss to the UK as a whole, and there would be no gain to the Scottish economy or the Scottish Parliament.”<sup>240</sup>

496. Iain McMillan, former commissioner at the CSD, warned the Committee about the volatility of receipts stating—

“We went by the evidence that was put before us and the advice of the expert group. In their evidence earlier this afternoon, Anton Muscatelli and others explained the volatility of corporation tax receipts. Commissioners were alive to the issue: we took advice in that regard.”<sup>241</sup>

497. He also warned about the cost to businesses highlighting that—

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<sup>237</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 307.

<sup>238</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 307.

<sup>239</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 212.

<sup>240</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 140.

<sup>241</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 239.

“Devolving corporation tax into sub-national areas does not come cheap. Companies have to keep separate accounts of taxable profits.”<sup>242</sup>

498. The UK Government reiterated these practical issues when defending its position on corporation tax to Committee. Mr Gauke MP, Exchequer Secretary at HM Treasury stated—

“I would argue that corporation tax is important for growth in the UK, but a host of practical issues would arise if responsibility for it were devolved to Scotland, which the secretary of state set out. There are concerns about businesses brass plating and there would be a compliance cost as businesses pretended to be located principally in Scotland as opposed to the rest of the UK, with the intention of benefiting from a different rate of corporation tax.”<sup>243</sup>

499. He added—

“I return to some of the practicalities of policing the proposed arrangement. How would profits be allocated between Scotland and England? The fact that Scotland has a land border with the rest of the UK makes it somewhat more difficult. The case for Northern Ireland to have control over its rate is different, because of its geographical situation... It seems to me that the administrative difficulties, from the point of view of taxpayers and of HMRC, are likely to be pretty considerable, which is why I think that Calman did not recommend Scotland having control of corporation tax.”<sup>244</sup>

500. Mr Gauke MP also said—

“The Treasury has carried out its modelling on the assumption that there would be a loss to the Exchequer from each reduction. In broad terms, each reduction by a penny, by one percentage point, would result in UK receipts falling by around £800 million.”<sup>245</sup>

501. Chapter 7 of the Report by the Holtham Commission, which looked at a new financial settlement for Wales, contains an extensive discussion of the issue and concludes that it might be possible for the power to set the corporation tax rate to be devolved to a sub-national government provided that a number of conditions are met, including the requirement that the sub-national government bears the entire revenue risks associated with this rate-setting power. Specifically, in order to avoid challenge from the EU, a sub-national government “would have to take all the cyclical and other risk associated with the tax without any grant offset.”<sup>246</sup> This would also constrain the grant reduction to be a proportionate cut. These very considerable risks would have to be offset against any potential gains as a development tool.

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<sup>242</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 241.

<sup>243</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 39.

<sup>244</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 40.

<sup>245</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 38.

<sup>246</sup> Independent Commission on Funding and Finance for Wales. Available at: [http://wales.gov.uk/docs/ieffw/report/100705\\_fundingsettlementsumen.pdf](http://wales.gov.uk/docs/ieffw/report/100705_fundingsettlementsumen.pdf).

502. The Committee notes that the Holtham Commission did not recommend immediate devolution of corporation tax to Wales but rather an ongoing discussion with the UK Government and other devolved administrations about the feasibility of devolving corporation tax and, specifically, whether it would be possible to get UK-wide agreement on limited rate changes (to avoid race to the bottom) while still complying with EU law.

503. These very considerable risks would have to be offset against any potential gains as a development tool. In his oral evidence, Professor Muscatelli of Glasgow University notes that the CSD's Independent Expert Group had always recognised that the issue of what taxes to devolve involved balancing off additional revenue risk against the potential gains of additional autonomy and accountability.<sup>247</sup>

504. A number of witnesses cast doubt on these potential gains, particularly in the light of two further risks—

- a race to the bottom as other countries/regions cut their rates of corporation tax; and
- sophisticated tax avoidance whereby corporations take advantage of the low tax rate without transferring any meaningful economic activity.

505. Thus Professor McLean writes, “Your Committee has discussed the possible devolution of Corporation Tax, as do, e.g., Hughes Hallett and Scott. That would be a terrible idea. Experience in Northern Ireland between 1920 and 1972<sup>248</sup> suggests that such devolution would give rise to massive tax avoidance: nowadays largely through firms’ transfer pricing practices.”<sup>249</sup>

506. Professor Heady notes in his evidence to the Committee that, “Several OECD countries do levy a corporate tax at the sub-central level but the experience of this has not been very positive. It is a very volatile tax and can result in a misallocation of investment.” He goes on to conclude, “So, overall, I don’t think it is practical to devolve more taxes.”<sup>250</sup>

507. In his oral evidence, Dave Moxham, Deputy General Secretary of the Scottish Trades Union Congress (STUC) spoke against the devolution of corporation tax on the grounds of concern about a race to the bottom.<sup>251</sup>

508. On the other hand, Reform Scotland argues that such devolution is necessary. It stated—

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<sup>247</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 201 - 202.

<sup>248</sup> See Richard Perren, ‘Vestey, William, first Baron Vestey (1859–1940)’, *Oxford Dictionary of National Biography*, Oxford University Press, 2004; online edition, May 2008. [<http://www.oxforddnb.com/view/article/36647>, accessed 31 Dec 2010]. Incorporation in Northern Ireland formed part of the Vestey’s tax avoidance strategy that led George V to protest against the first Baron’s ‘Lloyd George-sold’ peerage.

<sup>249</sup> Professor Iain McLean, written evidence to the Committee, paragraph 30.

<sup>250</sup> Professor Chris Heady, written evidence to the Committee.

<sup>251</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 460.

“...even if the changes proposed by the Scotland Bill were to encourage politicians to increase the focus of political debate on improving economic performance, the Bill does not provide the tools that would allow it to introduce fiscal policies to improve the economy. That would require a broader base of taxes to be devolved, including corporation tax and other business taxes.”<sup>252</sup>

509. The Committee is sensitive to the concerns about the risks associated with devolving corporation tax, notably the scope for companies to shift profits to lower tax areas without shifting economic activity, so reducing overall tax take without promoting economic development. A “race to the bottom”, as sub-national governments compete to attract highly mobile capital, is a particular concern when it is possible for companies to shift financial capital (e.g. debts) thereby lowering the effective rate of taxation on real capital.

510. There is a voluminous literature on tax competition<sup>253</sup>, and the conclusion is that while a race to the bottom can happen, a great deal depends on the nature of the system of company taxation that is in place. For example, the experience of the Canadian system has been one where over long periods of time different provinces sustain very different rates of taxation on corporate income. For example, in 1999, the tax rate in Quebec was 9.2% while that in Newfoundland, New Brunswick, Manitoba and Saskatchewan was 17%.

511. A study of the Canadian system suggested<sup>254</sup> that the explanation of this was that “In the presence of income shifting, jurisdictions’ tax rates may diverge despite tax competition, as high tax jurisdictions tax locational rents due to the firm, and real investment escapes high tax rates through income-shifting.” Translated into the UK context this suggests that it is possible that the UK Government might be able to continue to set a relatively higher tax rate because corporations are attracted to locate in London because of the advantages they get from proximity to the City with its wealth of financial and legal expertise, while lower tax rates might prevail in Northern Ireland and the other devolved administrations.

512. However some care needs to be taken in generalising from the Canadian experience, because there are a number of rather special features of their tax system. The first is that it does not consolidate income earned by corporate groups for tax purposes, so companies with separate subsidiaries in different provinces can shift income from high-tax provinces such as British Columbia to low-tax profits such as Quebec. When corporate income is consolidated, as in US, such tax shifting is much more difficult. Secondly, multi-jurisdictional consolidated companies with branches and sales offices in different provinces must allocate their income across provinces according to an allocation formula agreed by the provinces (a system which has some similarity to the ideas of the Holtham Commission for Wales).

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<sup>252</sup> Reform Scotland, written evidence submitted to the Committee.

<sup>253</sup> However much of the literature has focused on international studies - see, for example, C. Fuest, B. Huber and J. Mintz (2003) “Capital Mobility and Tax Competition: A Survey” CESifo Working Paper 956 for a survey – and there has been less of a focus on sub-national governments.

<sup>254</sup> Mintz, J. and M. Smart (2001), Income Shifting, Investment and Tax Competition: Theory and Evidence from Provincial Taxation in Canada, CESifo Working Paper No. 554.

513. The Committee's conclusions on the scope for devolving corporation are at paragraphs 45 to 59.

### **A broader basket of taxes**

514. A number of witnesses giving evidence to the Committee expressed a view that other taxes should be considered for devolution in addition to those proposed within the Scotland Bill. Their rationale is that this could provide a broader tax base which would be beneficial for the Scottish Government. For example, Professor Drew Scott explained to Committee that—

“...we are concerned that the range of taxes that are being devolved to the Scottish Administration is inadequate to insure Scottish public spending against an economic shock that weakens the Scottish employment base on which the new Scottish income tax yield depends ... If all the eggs are placed in the income tax basket, that is a higher risk.

[...]

We looked at a range of countries with devolved tax systems — Germany, Canada, the USA, Spain and Belgium — and could find no other system that places all its revenue eggs in one significant income tax basket. Tax sharing extends to corporation tax, general sales tax, VAT and so on. As far as we can find from the literature and from examples, no other jurisdiction is as significantly dependent on one tax base as Scotland would be if the bill in its current form were implemented.”<sup>255</sup>

515. The Scottish Government also expressed their desire for a broader tax base to the Committee, with John Swinney stating that—

“The answer lies in the range of financial responsibilities that would be available to the Scottish Government. Without a broad range of powers that can enable the Parliament and the Government to take account of particular circumstances and to take actions to address an inherent risk that might undermine revenue and could have a negative effect on levels of public expenditure, there has to be the ability to take action that can create greater economic activity and greater economic impact. That would be the Government's approach to the issue... the broader the range of responsibilities that any Administration carries, the greater its ability to manage any strain in one or more budget lines that arises from the tax revenues that it manages.”<sup>256</sup>

516. In a subsequent evidence session, he stated—

“You could include corporation tax and a variety of other measures. We have specified that we do not think that VAT should be part of the framework; we

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<sup>255</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 156.

<sup>256</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 86.

accept that that must remain a United Kingdom tax, but a whole range of taxes could be devolved under the concept of full financial responsibility.”<sup>257</sup>

517. Reform Scotland agreed that the existing proposals put Scotland at risk and wrote to the Committee to say—

“If you move just one tax, and not a range of taxes, it is a little bit like giving a plumber a hammer to do the job — he has only one tool in his box and he cannot even get started. The trouble with income tax is that it creates volatility. You need a range of taxes to be able to match expenditure with tax raising. There is therefore a big flaw in the proposal, in that using just one tax will create a very volatile system ... Last year, income tax fell but the overall tax take went up. Having a range of taxes enables you to overcome volatility”.

518. Ben Thompson later added “I suspect that if it were introduced, politicians would be as loth to use the 10p variation as they have been the 3p variation because of the volatility that it would create.”<sup>258</sup>

### **Other taxes for consideration**

519. Natural resource taxation, excise duties and Capital Gains Tax were among other taxes suggested for devolution to broaden the tax base. For example, Alan Trench proposed to Committee that—

“A much better set of targets to consider would be the so-called sin taxes, which generate much more revenue and relate much more directly to the devolved functions. Although the Calman commission considered that option and rejected it, the arguments in favour of it outweigh the arguments that were balanced against it, which were basically spillover arguments that related to concerns that, for example, the benefits of a higher rate of duty on alcohol or tobacco in Scotland would be undermined by people smuggling those goods in from across the border.”<sup>259</sup>

520. Other witnesses were broadly in agreement that VAT would be unsuitable for devolution. For example, Professor Holtham explained that—

“There are difficulties with VAT, for example, in that European legislation places a restriction on having different VAT rates in a given jurisdiction, but also because variations can lead to smuggling and huge trade distortions. It is all too easy to buy kit somewhere and move it somewhere else. There are big problems in that regard. If you want to have the power to alter rates, you really want to look for taxes where the base is fairly immobile. As I understand it, that is very much what you want to do. Your ability to alter VAT rates is negligible — forget it — whereas your ability to alter income tax rates, particularly basic rates, is fairly substantial.”<sup>260</sup>

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<sup>257</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 436.

<sup>258</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 287.

<sup>259</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 475.

<sup>260</sup> Scotland Bill Committee, *Official Report*, 18th January 2011, Col 210.

521. However, Professor Drew Scott expressed his view that “It is possible to share the revenue from a sales tax... to have a tax-sharing agreement.”<sup>261</sup>

522. The Committee’s detailed recommendations in relation to the devolution of other taxes and the other issues raised in this section of report are set out later in this document.

### **Short-term risks**

523. As outlined above, it can be seen that income tax revenue is likely to account for about 50% of total devolved tax revenue, which in turn is likely to account for about 30% of public expenditure. Income tax revenue will, therefore, account for approximately 15% of spending. A 5% variation in income tax revenue will represent around 0.75% of expenditure.

524. Under the Scotland Bill, the Scottish Government will receive a basket of taxes plus a block grant that will still finance the bulk of expenditure. The movement in the block grant will reflect expenditure decisions, which will respond to movements in total UK tax revenue but in a damped fashion.

525. In addition, revenues transferred to the Scottish Parliament will gain an additional element of smoothing by being related to forecasts of tax revenues over the spending review.

526. While there can be periods when revenues from different taxes move in opposite directions, for most taxes, revenues are driven by the level of economic performance and so are positively correlated. The exception is revenues from North Sea oil, which are driven by factors unrelated to UK economic activity. Movements in the oil price will affect some sectors of the economy positively and others negatively.

527. The Committee heard conflicting evidence on this matter. In his written evidence, Professor Iain McLean noted, “Tax receipts in general depend on economic activity and are therefore highly correlated with one another. The more taxes are devolved, the more Scotland is exposed to fiscal risk.”<sup>262</sup> In oral evidence, Professor Hughes Hallett pointed out that oil revenues were not necessarily positively correlated with other tax revenues and that there was still some element of risk reduction as long as taxes were not perfectly correlated.<sup>263</sup>

### **Higher bands**

528. A number of witnesses expressed concerns that under the Bill’s proposals, a future Scottish Government would be constrained to set a single rate of tax, which, if it was set at 10 pence, would represent 50% of the 20 pence band, just 25% of the 40 pence band and 20% of the 50 pence band.

529. Concerns were raised on a number of different issues.

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<sup>261</sup> Scotland Bill Committee, *Official Report*, 11th January 2011, Col 184.

<sup>262</sup> Professor Iain McLean, written evidence to the Committee.

<sup>263</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 169.

*Lower fiscal drag: analysis*

530. Fiscal drag is the process by which, under a progressive tax system, with unchanged rates, allowances and thresholds, as GDP grows over time so too does the share of tax revenue in GDP.

531. There are two sources of fiscal drag. The first arises because of the system of personal allowances whereby people are entitled to earn a certain amount of income without paying any tax, and pay tax on only their taxable income – the amount of their income above the personal allowance. If the personal allowance remains fixed then, as incomes grow, (i) more people become liable for tax as their incomes rise above this threshold, and (ii) those already liable for tax find that a higher fraction of their income is taxable. This means that for every 10% increase in GDP taxable income – the tax base - grows by more than 10%.

532. The second source of fiscal drag arises because of the presence of various tax thresholds above which the marginal rate of tax increases for individuals with higher levels of taxable income. If the tax thresholds remain fixed then, as taxable incomes grow, (i) more people end up paying tax at the higher marginal rates; (ii) for those already paying tax at the higher rates, a higher fraction of their taxable income is taxed at these rates. This implies that for every 10% increase in taxable income – the tax base – tax revenue grows by more than 10%.

533. In his evidence, Professor Dr Paul Bernd Spahn said that he had calculated that, with the structure of rates in place for the UK tax system, for every 1% increase in GDP, there is a 1.2% increase in income tax yield.<sup>264</sup> This is consistent with published evidence by Creedy and Gemmell<sup>265</sup> that suggests that for the UK the combined effect of the two sources of fiscal drag is that for every 10% increase in GDP income tax revenue increases by between 12% and 14%.

534. As Professor Spahn and many other witnesses pointed out,<sup>266</sup> confining the Scottish Government to setting just a single rate of tax means that this second component of fiscal drag would not exist, since under this arrangement, every 10% increase in taxable income results in precisely 10% more tax revenue.

535. Therefore, under the Scotland Bill proposals, while Scottish tax revenues would still benefit from the first source of fiscal drag, the second source would not exist and so, in terms of tax revenue, Scotland would not benefit so much from income growth.

536. Professor Holtham and Jim and Margaret Cuthbert proposed that a way to address this issue would be to give Scotland greater discretion to set tax rates across the bands that were closer to being proportional to the UK rates which would therefore generate similar degrees of fiscal drag as the UK tax system.

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<sup>264</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 206.

<sup>265</sup> J. Creedy and N. Gemmell (2004), "The Income Elasticity of Tax Revenue: Estimates for Income and Consumption Taxes in UK", *Fiscal Studies*, 55-77

<sup>266</sup> Jim and Margaret Cuthbert, written evidence submitted to the Committee; Professors Hughes Hallett and Scott, written evidence submitted to the Committee; Scottish Government, letter dated 25 January 2010.



537. However, all these arguments rest on the assumption that allowances and thresholds remain unchanged as incomes grow. As pointed out above, over the last 30 years, governments have taken steps to tightly control the share of GDP taken by taxation, and one way they do this is to increase allowances and thresholds as incomes grow, thus reducing the impact of fiscal drag.<sup>267</sup>

538. If personal allowances are increased exactly in line with GDP then, for every 10% increase in GDP, taxable income – the tax base - would also grow by 10% thus nullifying the first source of fiscal drag.

539. If tax thresholds are increased exactly in line with GDP, then for every 10% increase in taxable income, tax revenue will increase by 10%, thus nullifying the second source of fiscal drag. This is exactly what would happen with a single tax rate. The implication is that, *under these circumstances*, there would be no reduction in the growth of tax revenue (loss of fiscal drag) by being restricted to a single tax rate.

540. The extent to which this has been taking place can be considered in the tables above. These show that, in the UK, over the 10-year period between 1985 and 1995, GDP grew by 27.7% while income tax revenues as a fraction of GDP rose from 9.8% to 10.0%. Therefore, for every 10% growth in GDP, tax revenues grew by just 10.2%. Between 1985 and 2005, GDP grew by 71.1%<sup>268</sup> yet income tax revenues grew from just 9.8% of GDP to 10.6%. This implies that for every 10% growth in GDP tax revenues have grown by just 10.8%. Both of these figures are very much lower than the figures of 12% -14% that would be expected given the evidence given by Professor Spahn and the work of Professors Creedy and Gemmell.

541. The conclusion is that, like other governments, over the long run the UK government has taken active policy steps including the resetting of both personal allowances and tax thresholds in order to mitigate fiscal drag and limit the rise of income tax revenues and have them grow more or less in line with incomes.

542. Given this policy the potential reduction in the growth of tax revenues through being confined to set just a single tax rate will have been very much smaller than critics have argued.

543. However the decision about the rate at which thresholds and allowances are uprated in line with the growth of GDP – and hence the extent to which fiscal drag is allowed to impact on tax revenues - is a matter for the UK Parliament.

544. Under the principles of grant reduction articulated below, Scotland should get compensated for a Westminster decision to uprate allowances and so reduce the first component of fiscal drag, but, if it has a flat rate it should receive no compensation for decisions to uprate thresholds and so reduce the second

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<sup>267</sup> An amendment to this paragraph was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

<sup>268</sup> OECD Statistical Extracts 2011 (expenditure approach)

component of fiscal drag – because these would cause no loss of tax revenue to Scotland.

545. But if Scotland had a progressive rate structure then, under the principles of grant reduction articulated below, it would get compensated for decisions made by the Westminster Parliament regarding tax thresholds – along the lines proposed by the Holtham Commission<sup>269</sup>.

546. A further implication of the previous analysis is that reduced fiscal drag is more a short-term phenomenon that comes into play over periods when allowances and thresholds are not increased in line with real incomes.

547. However, over these shorter terms, taxable incomes can fall as well as rise and it is income that is subject to the higher rate taxes that tends to be more volatile as, for example, bonuses rise and fall. While being constrained to set a single tax rate and having lower fiscal drag means that Scottish tax revenue will not benefit so much from an upturn in income, neither will it lose so much from a downturn.

#### *Regressivity*

548. Professors Hughes Hallett and Scott expressed the view that by having a single tax rate “What this essentially does is to introduce an element of regressivity into the income tax system as it affects Scotland alone.” They illustrate this by supposing that the Scottish Government raised its tax rate by 1 pence and say that “a disproportionate burden of the increase in tax will fall on low income earners (a 1p tax rise constitutes a higher share of low incomes than high incomes), with the result being that at the margin the increase in income tax operates as a “flat tax” and is highly regressive.”<sup>270</sup>

549. However, this is to ignore the fact that Scottish taxpayers will continue to have a personal allowance and so will be taxed on their taxable income, which is the difference between their income and their personal allowance. The existence of the personal allowance means that (i) for any given tax rate, those on higher incomes pay a higher percentage of their income in tax than those on lower incomes; and (ii) if the tax rate is increased those on higher incomes will face a larger percentage increase in tax than those on lower incomes.<sup>271</sup>

550. In both these senses, the Scottish income tax could be argued to be *progressive* and not *regressive*. By way of example, if the personal allowance were at its current level (£6,475) and if the tax rate in Scotland were set at 10 pence, then someone on an income of £26,475 would pay £2,000 in tax, which is 7.6% of their income, while someone on an income of £56,475 would pay £5,000 in tax, which is 8.9% of their income. If the tax rate were raised to 11 pence, the

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<sup>269</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010

<sup>270</sup> Professors Andrew Hughes Hallett and Drew Scott, written evidence to the Committee.

<sup>271</sup> A proposal to delete paragraphs 549 to 550 was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

first taxpayer would pay an additional £200 in tax – 0.76 % of their income - while the second taxpayer would pay an extra £500 in tax – 0.89% of their income.<sup>272</sup>

551. Professor Boadway recognised that, because of personal allowances, the Scottish tax system would in itself be progressive. However, he also expressed a different concern, which related to the progressivity of the total amount of income tax being paid by taxpayers in Scotland. If the Scottish tax rate is 10 pence, then the overall tax system in Scotland is just as progressive as that in the rest of the UK. However, if the Scottish tax rate were greater than 10 pence, then “superimposing a linear progressive tax on a more progressive UK tax reduces the progressivity of the system overall.”<sup>273</sup> He goes on, however, to argue that, “The effect is not very large since the incremental Scottish tax only applies if Scotland chooses a rate greater than 10p. So, at this point of time, it is probably not worth worrying about.”<sup>274</sup>

552. The question of whether sub-central governments *should* have greater control over the degree of progressivity was addressed by a number of witnesses. In previously published research, Professors Hughes Hallett and Scott have argued that income redistribution is a matter for the UK Government.<sup>275</sup>

553. Professor Heady gave evidence that there was broad consensus that “cautions against sub-central control of tax progressivity, partly because regions with more progressive taxes will lose high income individuals by out-migration and gain low-income individuals by in-migration”.<sup>276</sup> He pointed out that Nordic countries restrict sub-central governments to a single rate.

554. Professor Holtham argued strongly that he and his colleagues on the Holtham Commission had seen precisely this same concern about the possible loss of high-income individuals through outward migration as a reason for retaining some limited flexibility to set different rates on different bands. They had in mind the possibility that a government seeking to raise more tax revenue to finance beneficial expenditure programmes might be deterred from doing so if, by being restricted to a single rate, they were forced to raise the rate on high-income taxpayers and suffer a significant loss of such taxpayers. Given the concentration of people living near the Welsh border this was seen as a serious risk.<sup>277</sup>

555. The Holtham Commission recognised that if the same number of pence in the pound were devolved, but discretion was given to set different rates on different bands, then concern about raising rates on high earners could potentially result in a regressive structure whereby the basic rate was raised to 11 pence but higher rates kept at 10 pence<sup>278</sup> and that this would be politically difficult to justify.

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<sup>272</sup> If there were no personal allowance, then the claim of regressivity by Professors Hughes Hallett and Scott would still be wrong for if the Scottish tax rate were raised by 1p this would result in the same proportionate increase in tax for all taxpayers irrespective of income.

<sup>273</sup> Correspondence between Professor David Ulph and Professor Robin Boadway (unpublished)

<sup>274</sup> Correspondence between Professor David Ulph and Professor Robin Boadway (unpublished)

<sup>275</sup> A. Hughes Hallett and D. Scott, *Scotland: A New Fiscal Settlement*, Ch 5(b).

<sup>276</sup> Professor Chris Heady, written evidence to the Committee.

<sup>277</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability: a new funding settlement for Wales*, Final Report, July 2010, paragraph 4.14, page 36.

<sup>278</sup> Independent Commission on Funding and Finance for Wales, *Fairness and accountability:*

556. Accordingly, in order to retain a progressive structure and also limit the degree of tax competition, the Holtham Commission recommended that a constant proportion of the tax at each band be devolved but that the devolved government be constrained to vary rates by less than 3% from the UK structure.

557. Professor Boadway points out that experience in Canada where provinces can choose their own rate structure has shown that this “has led to less progression at the provincial level than at the federal level.”<sup>279</sup> In other words, provinces tend to end up with much flatter taxes than the federal tax.

*Vertical fiscal externalities*

558. The Committee received evidence from Jim and Margaret Cuthbert about what they saw as a flaw in the Calman proposals.<sup>280</sup> Their arguments were supported by Professors Hughes Hallett and Scott.<sup>281</sup>

559. The “flaw” identified by Jim and Margaret Cuthbert is they say it is possible that, if the Scottish Government were to cut the tax rate, total income tax revenues raised in Scotland could rise, but, because only a proportion of those revenues come to the Scottish Government, with the rest accruing to the UK government, income tax receipts accruing to the Scottish Government could fall. They provide some calculations that show how this could arise.

560. The term *vertical fiscal externalities* is used to describe the issue at the heart of this argument since it refers to a situation where a national and sub-national government share a tax base, and a decision on the tax rate – by whichever level of government – has implications for the tax revenue received by the other level of government.

561. The starting point of the argument that has been proposed is the assumption that a cut in the rate of income tax in Scotland leads to an increase in total tax revenues raised on Scottish incomes.

562. If a government in a particular country cuts the rate of income tax, then it is in principle possible that, through a variety of routes, the total amount of taxable income in that country will increase. However, there is no guarantee that total tax revenue raised from that taxable income will increase. For that to happen it has to be the case that the expansion in the amount of taxable income is sufficient to offset the reduced rate of tax levied on that income.

563. While there are conditions under which this might happen, no evidence was provided to the Committee to demonstrate that these conditions apply in Scotland.

<sup>282</sup> Professor McLean told the Committee that—

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*a new funding settlement for Wales*, Final Report, July 2010, paragraph 6.45, page 70.

<sup>279</sup> Professor Robin Boadway, written evidence to the Committee.

<sup>280</sup> Jim and Margaret Cuthbert, written evidence to the Committee.

<sup>281</sup> Professors Hughes Hallett and Scott, written evidence submitted to the Committee, page 2.

<sup>282</sup> For the conditions hypothesised by Jim and Margaret Cuthbert to arise, an economy would have to be on the downward-sloping part of what is known as the ‘Laffer curve’. This curve relates to the total of revenue raised by income tax to the tax rate. It is generally supposed to take the form of an

"It is theoretically possible, but I think that the likelihood of its occurring is infinitesimally small and that the seriousness of the issue is therefore infinitesimally small. I am sorry to be a tax bore: the proposition depends on Scotland's being on the right-hand side of what tax experts call the Laffer curve, whereby existing rates are so high that they defeat the point of doing the taxed activity to the extent that people do not do it, so if you reduce the rates, you increase the yield. There is no empirical evidence in any of Jim and Margaret Cuthbert's papers to suggest that Scotland is on the right of the Laffer curve, and I have many reasons for suspecting that it is not."<sup>283</sup>

564. If what Professor McLean says is correct, then this means that were the Scottish Government to cut its tax rate then, even if there were indeed some expansion in taxable income, total tax revenues raised on Scottish incomes would actually fall.

565. Nevertheless, there is more general point arising from the evidence supplied to the Committee by Jim and Margaret Cuthbert that applies in this more plausible scenario. For if the taxable income in Scotland does indeed increase were the Scottish Government to cut its tax rate, then tax revenue accruing to the UK Government would increase since, by assumption, the tax rate applied by the UK Government is unchanged. This implies that tax revenue accruing to the Scottish Government would fall by more than the fall in the total tax revenue raised on Scottish incomes.

566. This is because the Scottish Government bears all the revenue loss from the cut in the rate, but gets only a proportion of the revenue gain from the higher tax base, since that has to be shared with the Westminster.

567. But equally if the Scottish Government raises its tax rate then its tax revenue goes up by more than the overall increase in taxes raised on Scottish incomes, since it gets all the gain from the higher tax rate but suffers only a fraction of the cost of the reduced tax base, the remaining proportion being borne by the UK Government.<sup>284</sup>

568. The conclusion from the above is that it is by no means clear that the points raised in the evidence to the Committee can be considered a flaw. The tax decisions by one government are bound to have some effect on the revenues of the other. This is simply a feature of a system with a shared tax base. There is no evidence to suggest that the particular effects envisaged by the Cuthberts are at all likely to happen. Whether or not they do arise, it is not clear what implications for tax policy flow from this interaction between tax revenues, since tax rates are set for reasons other than raising revenue.<sup>285</sup>

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inverse U, since tax revenue will naturally be zero when the tax rate is zero, and tax revenue may also be zero when the tax rate is 100% since there is no incentive to earn any income. Most economists believe that economies are typically on the upward sloping part of the Laffer curve where any cut in the tax rate results in a reduction in tax revenue.

<sup>283</sup> Scotland Bill Committee, *Official Report*, 14 January 2011, Cols 150-151.

<sup>284</sup> In the language referred to in the previous footnote, the Laffer curve is steeper.

<sup>285</sup> A proposal to delete this paragraph was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

569. The Committee's detailed recommendations in relation to the reliance on income tax, fiscal drag and the other issues raised in this section of report are set out elsewhere in this document.

## THE GRANT REDUCTION MECHANISM AND CAPITAL BORROWING

### Grant reduction mechanism

#### *Background*

570. The essence of the proposals in the CSD report and the Scotland Bill is that access to tax revenues should be substituted for some of the grant on which the Scottish Budget relies. A reduction will therefore have to be made to the grant which the Scottish Government presently receives from Westminster.

571. The Committee agrees with a number of our expert witnesses (Professors Vaillancourt, Spahn, Holtham and Muscatelli) who said that the determination of what reduction is necessary is the most significant question that the Scottish Parliament has to consider as part of its consideration of the Scotland Bill. It is not, however, a decision that needs to be made immediately.

572. It should be noted that the CSD made only the broadest of recommendations in this area and said that the reduction in block grant should be “commensurate”, although it illustrated a reduction of the grant based on the ratio of grant to tax income in the first year of the new system.

573. The matter was considered in more detail in the report of the Holtham Commission for Wales, which suggested that the approach illustrated in the CSD Report was only one and perhaps the simplest of the options available.

574. The UK Government’s Command Paper discussed the issue of grant reduction in general terms and noted that the simplest approach might not be the best, as it gave too much weight to the ratio of tax to grant in the start year, and suggested that the ratio over a number of years, and not just one, should be considered.<sup>286</sup> The UK Government has, therefore, not proposed a specific grant reduction mechanism, but rather an implementation strategy that means a final decision does not need to be taken until after some years, during which there will be discussion with the Scottish Government to agree the best way to determine the reduction.

575. The UK Government’s plans do, however, contain some specific proposals. First that during the transitional period, grant will be calculated so that together with the yield at a Scottish rate of income tax of 10 pence, it produces a budget equal to the outcome of the Barnett formula. This is similar to the arrangement which would operate at present under the Scottish Variable Rate (SVR) of income tax. It means that the Scottish Budget will only differ if the Scottish Parliament sets a rate of income tax different from the rest of the UK. During this transitional phase, therefore, the Scottish Budget will not be affected by changes in the Scottish tax base. The Committee discusses the case for such a transitional period elsewhere in this report, but we note here that it has the advantage that it allows a period during which the size of the Scottish income tax base can be assessed more certainly as it is actually collected. This is broadly as recommended by the CSD.

576. The second specific element is that the UK Government has made clear that as it is responsible for the income tax base, it should bear the effects of any changes to that base on the Scottish Budget.<sup>287</sup> So, for example, if a change in personal allowances of the sort which was announced in the UK Budget in 2010 reduces the income tax yield in Scotland, then the grant to Scotland would be increased to make it up. This is referred to as a 'no detriment' clause, though it could course operate in either direction.

577. Finally it should be noted that there will need to be grant reductions calculated by reference to the smaller taxes. The tax bases will not be shared between Parliaments and any changes by one jurisdiction will not directly impact receipts of the other giving no need for subsequent adjustments to the block grant. As a result, a simple one-off reduction to the baseline in April 2015 is proposed in the Command Paper.<sup>288</sup>

*Views expressed to the Committee*

578. The Scottish Government submitted evidence to the Committee on what they called the deflationary bias in the proposals. This is discussed in detail earlier in our report. It should be noted that the Scottish Government has not provided the Committee with alternative proposals for grant reduction or any argumentation on the details of the issue or principles to underlie the methodology. However, their criticism illustrates how important the issue is, and how the choice of grant reduction method can have a significant impact on the Scottish Budget.

579. Our expert witnesses all agreed on the critical importance of this issue and a number of suggestions were made as to the appropriate method of grant adjustment. In his written submission to the Committee, Professor Robin Boadway, a distinguished Canadian scholar of fiscal federalism, suggested that the grant should be reduced in each year by the exact value of the yield of 10 pence of income tax.<sup>289</sup> If that were done, the Scottish budget would only differ from what Barnett would have produced if the Scottish Parliament set a tax rate which was greater or less than 10 pence.

580. This suggestion is very similar to what would operate under the SVR of income tax and is in essence what the UK Government proposes for the transition period of implementation in the Command Paper. It too illustrates a number of important issues. First, it achieves the result of insulating the Scottish Budget from changes in income tax base made by the UK Government, provided that the tax rate set by the Scottish Parliament is set at 10 pence. However, if the Scottish Parliament sets a different rate, the difference operates on the changed tax base and so the yield (or reduction in yield) from the tax decision will be greater or lesser because of the UK's decision on allowances, reliefs etc. This is also what would happen under the SVR.

581. This proposed methodology would also substantially insulate the Scottish Budget from other changes in the tax base, notably those which result from economic growth. If the yield of 10 pence of income tax in Scotland increased as a

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<sup>287</sup> HM Government, *Strengthening Scotland's Future*, page 36.

<sup>288</sup> HM Government, *Strengthening Scotland's Future*, page 34.

<sup>289</sup> Professor Robin Boadway, written evidence to the Committee.



result, say, of successful economic development policies pursued by the Scottish Government, none of the benefit of that would accrue to the Scottish Budget. Of course the obverse also applies: the budget would be protected from the effects of economic decline. The only revenues which would be affected by change in the tax base would be those generated or forgone by any difference from 10 pence. The Scottish Parliament's budget would therefore have no real connection with the fortunes of the Scottish economy.

582. It was a desire to ensure that the Scottish budget had a connection to growth in the Scottish economy that led the CSD to recommend a 'once and for all' reduction in grant (See chapter 3 of the CSD report, scenario 3). The UK Government in its Command Paper accepts this argument, but points out that a simple percentage reduction based on one year is very sensitive to which year is chosen, as can be seen from the evidence submitted also by the Scottish Government.

583. Some of the witnesses providing evidence on this point saw some potential disadvantages in a simple percentage reduction approach, even if the proportion represented the average of a number of years. Professor Gerald Holtham and Professor Dr Bernd Spahn drew attention to the analysis of this issue in their Commission's report for the Welsh Assembly Government. This report recommends a funding system for Wales very similar to that envisaged in the Scotland Bill. The Welsh Assembly is presently grant funded but would have access to a stream of income tax revenue. The commensurate reduction in grant should be thought of as the price to be paid for access to this revenue. Such a "price" would be a combination of the offset to the block grant that takes place at the time of devolution, and the way in which subsequent adjustments that offset are made. They considered a number of ways this could be calculated, and the choice between them should be made on the basis of which of the risks affecting that revenue stream should be borne by each level of government.

584. The first was what the Professors Holtham and Bernd Spahn called an 'Own Base' deduction, as also suggested to the Scotland Bill Committee by Professor Boadway. It protects the devolved budget from a number of risks, including the economic effects of devolved policy decisions. The proportionate deduction exemplified in the CSD report, they thought, exposed the devolved budget fully to economic risks, but would require ad hoc adjustments to compensate for UK policy decisions on the tax base. A fixed deduction, or one indexed to prices, the Holtham Commission had thought might be appropriate for some small taxes.

585. In evidence to the Committee, Professor Holtham emphasised the case for a deduction which was indexed to changes in the tax base of the equivalent taxes in England. This would, in his view, insulate the devolved budget from policy changes which affected the tax base, but not from the relative performance of the Scottish economy.

586. The Committee's detailed recommendations in relation to the grant reduction mechanism are set out later in this document.

## Capital borrowing

### *Background*

587. The Scottish Budget contains both “resource” – essentially current – expenditure and capital spending. These are identified separately in the HM Treasury Departmental Expenditure Limit, which sets the Budget. The capital spending, like the resource spending, is directly financed by the grant from the UK Government so, in effect, the UK Government borrows to finance devolved capital spending. This amounts to about £3 billion a year. An exception to this is local authority capital spending which, though included in the Scottish Budget, can be financed by borrowing by councils. The Scottish Government can add to the capital budget by reducing resource spending but not *vice versa*. It has, therefore, no capital borrowing powers.

588. The CSD recommended that the Scottish Government should have power to borrow to finance additional capital spending so that it had discretion over the total of capital as well as current spending in any one year. The CSD recommended that the borrowing should be from the Treasury, which should be able to set conditions and limits. The Scotland Bill contains in clause 32 new powers for the Scottish Ministers to borrow to finance capital spending. The Command Paper sets out how the Government proposes that such powers can be exercised.

589. As noted previously in this report, the powers in the Bill are in some respects more substantial than those originally recommended by the CSD. In particular, the Bill will allow the Scottish Ministers to borrow from commercial lenders as well as the National Loans Fund, though not to issue bonds. Borrowing will be subject to HM Treasury controls: once the powers are phased in after 2015, the Scottish Ministers will be able to borrow up to 10% of the Scottish capital budget in any one year and there will be an overall statutory limit on indebtedness of £2.2 billion. It should be noted that this amount will be able to be increased but not decreased by order.

### *Views expressed to the Committee*

590. The principle of new capital borrowing powers was widely welcomed in the evidence that the Committee received. The Scottish Government said that such powers would increase their ability to manage the infrastructure investment programme.<sup>290</sup>

591. Similarly, the Scottish Council for Development and Industry and the Scottish Building Federation amongst others broadly supported these powers.

592. The restrictions on the borrowing powers were, however, challenged by a number of witnesses. The Scottish Government described them as significantly more restrictive than the borrowing permitted by local authorities and other public bodies such as Transport for London (TfL).<sup>291</sup>

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<sup>290</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 98.

<sup>291</sup> Scottish Government. Letter dated 25 January 2011 from the Cabinet Secretary for Finance and Sustainable Growth, Annexe A.

593. Witnesses, including the Scottish Government and Professor Keating, saw that there was a case for overall controls. Reform Scotland welcomed the additional borrowing powers but considered the proposed borrowing powers modest relative to the size of tax receipts and the Scottish Budget.<sup>292</sup>

594. Several witnesses also saw no reason why the Scottish Government should not be able to raise finance by issuing bonds as other sub-national governments do. For example, Professor McLean of Oxford University and Professor Boadway from Queen's University in Canada both noted that capital markets provided effective discipline on sub-national borrowing in other federations.<sup>293</sup>

595. The UK Government's Command Paper proposes that the new powers be phased in and available from 2014-15. Some of our witnesses, notably the Scottish Government, pressed for them to be available earlier.

596. In his evidence, John Swinney said that—

“The fact that the borrowing powers are not scheduled to become operative until 2015 is a further limitation. I do not see any reason why that could not happen earlier, although there are some signs in the command paper that there might be technical ways in which to advance it.”<sup>294</sup>

*Limits on borrowing and indebtedness*

597. The Committee accepts that there will be constraints on the amount of borrowing set by HM Treasury. Given its responsibility for macroeconomic management in the UK, it has a proper interest in the flow of borrowing and the total indebtedness of the UK public sector. As the Cabinet Secretary for Finance and Sustainable Growth said to the Committee on 8 February 2010, in “a system in which there is financial responsibility within the United Kingdom due account and due respect must be given to the macroeconomic framework of the United Kingdom”.<sup>295</sup>

598. There is, however, perhaps less justification for the specific limitations proposed. Some of those providing evidence to the Committee suggested that the annual limit of 10% of the Scottish capital budget had no evidential basis and the overall indebtedness limit at £2.2 billion looks similarly arbitrary.

599. The basis for the calculation of these amounts was not clear to witnesses who appeared before the Committee. The Exchequer Secretary to the Treasury described the total borrowing number as an attempt to balance the two objectives of flexibility for the Scottish Government and the need to maintain fiscal discipline, but acknowledged that it might be revised upwards in future years. However, in response to a request for more information on this matter, the Secretary of State informed the Committee that—

“Capital borrowing limits have been set at £2.2 billion which is based on a 10% annual capital DEL limit (equivalent to £230 million in 2014-15) over a

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<sup>292</sup> *Reform Scotland*, Written evidence submitted to the Committee p5

<sup>293</sup> Professor Robin Boadway, written evidence submitted to the Committee, paragraph 11.

<sup>294</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Co I97.

<sup>295</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 437.

10 year repayment period. This was considered an acceptable level of risk for the UK finances by the Chancellor who is responsible for setting the UK's fiscal framework and managing the UK's borrowing and debt. I would also emphasise that the capital spending capacity associated with this new borrowing power will be additional to the allocated capital Departmental Expenditure limit determined by the Barnett formula.”

600. We regret that this clarification from the UK Government was provided in a letter on 25 February 2011. It would have been helpful to the Committee's consideration if this had been received earlier.

601. A number of our witnesses suggested that the relationship between taxation and borrowing powers might form a more principled basis for setting a total level of indebtedness. The Committee noted the suggestion of Professor Holtham that the total indebtedness should be such that servicing it was unlikely to consume more than 5% of the total tax revenues available to the Scottish Parliament.<sup>296</sup> As those revenues are approximately £5 billion per annum, this would suggest that no more than £250 million per annum should then ever be devoted to debt servicing and repayment and if a servicing cost of 5% were assumed, that would suggest an overall limit of £5 billion rather than £2.2 billion.

602. A move towards the introduction of figures along these lines would require consideration to be given to the balance between a more significant degree of flexibility for the Scottish Parliament than the current proposed limits allow for versus the need to ensure that the limits are not so large so as to imperil the UK's fiscal controls.

603. In his evidence, John Swinney said that—

“There are two distinct areas of borrowing: borrowing for revenue volatility and long-term capital borrowing. On the borrowing for revenue volatility, the cumulative limit of £500 million strikes me as being too low to deal with the volatility within a cycle. What would the number ideally be? I suspect that the number might more safely be between £1 billion and £1.5 billion.”<sup>297</sup>

604. On this matter, the Secretary of State informed the Committee that—

“OBR evidence to the Committee provided data on one-year ahead forecast errors for UK income tax since 2001-02, i.e. forecasts in the Budget for the forthcoming financial year).

Extrapolating the Scottish position from this data suggests that average one-year ahead forecast errors for Scottish income tax in the period 2001-02 to 2007-08 was £16m. Even if the exceptional period in 2008-09 and 2009-10 is included the average one-year ahead forecast errors for Scottish income tax increases to £19m. Whilst acknowledging the fact that forecast errors usually increase with the forecast horizon, our internal analysis suggests that a £200m borrowing limit will be sufficient in normal times.”

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<sup>296</sup> Scotland Bill Committee, *Official Report*, 18 January 2011, Col 222.

<sup>297</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 436.

*Phasing in*

605. The Command Paper proposes that the new borrowing power should be available in full in 2014-15 and that, before then, the power should only be available for specific purposes as agreed with HM Treasury, such prepayments for a new Forth Crossing. The Exchequer Secretary explained to the Committee that it was not the intention that the Treasury should become involved in micro-managing Scottish capital projects. The Committee agrees, as to do so would run wholly contrary to the principles of the devolution settlement.

*Access to the bond markets*

606. Under the new provisions, the Scottish Government will be able to borrow from the National Loans Fund, and also from commercial sources, but not to borrow by way of bonds. The UK Government explained that they were concerned that bonds issued by a devolved administration might confuse the debt markets.<sup>298</sup> The Committee was not convinced by the force of this argument.

607. It should be noted that bonds may at present be issued by local authorities, and by TfL, which is a transport authority. In practice, local authorities in recent years have found it more advantageous to borrow from the Public Works Loan Board (i.e. the UK Government) but TfL has issued bonds directly to the market, which it is able to service from its fare revenue. It does, however, pay a higher rate of interest than central government (about 0.4% more in its most recent – 2006 – issue).<sup>299</sup>

608. Some of those giving evidence to the Committee explained that it was almost inevitable that a Scottish Government bond would pay a higher rate of interest than a central Government one. This phenomenon was seen in Canada, for example, and the USA. The issue is whether there is any good reason why issuing of bonds should not be a policy tool open to a Scottish Government.

609. The evidence received suggests that sub-national bonds will be more expensive than national ones. This is consistent with the evidence that commercial borrowing will be more expensive than borrowing from the Treasury, as the national government is always likely to have a higher credit rating than the sub-national. It is not, however, an argument against bond issue as a method of accessing commercial funding, which may be a more efficient method of borrowing from the market than negotiating with single commercial lenders.

610. Several witnesses drew attention to the discipline that access to the bond markets might exercise on fiscal policy, as was seen in Canada and elsewhere. Others however pointed out that the markets would price in assumptions about central government support as well as views on the devolved government's prudence, and that experience showed that markets could react with unpredictable swiftness.

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<sup>298</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 43.

<sup>299</sup> Transport for London website. Available at <http://www.tfl.gov.uk/static/corporate/media/newscentre/archive/3660.html>

611. In its legislative consent memorandum, the Scottish Government states that, “The lack of opportunities to issue bonds severely constrains the flexibility and options for responsible and cost-effective borrowing”.<sup>300</sup>

612. The Committee’s recommendations in relation to borrowing and the other issues raised in this section of report (e.g. bonds) are set out later in this document

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<sup>300</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1, p22.

## MANAGING RISKS AND THE PROPOSALS FOR ENHANCED BORROWING POWERS

### **Background**

613. The plans set out in the Scotland Bill and in the UK Government's Command Paper will mean that the Scottish Budget is subject to some risks that it does not presently bear. We discuss earlier in this report some of the major risks identified by some witnesses in the new system. The risk that depending in part on tax revenues might over the long run be less advantageous for the Scottish budget than sticking with the Barnett formula is discussed in the section of the report focusing on 'deflationary bias'. In this section, the Committee has also reviewed the risks involved in linking the Scottish Budget in part to the performance of the Scottish economy, including any cyclical variations in growth as well as long term trends. The risks that may arise in the long-run from depending on income tax for part of the Scottish Budget are discussed in the section covering the reliance on income tax. Those sections also deal with the risks of so called policy spillovers, where the actions of one government affect the other which shares the income tax base.

614. There are, however, other risks to be managed in the new system. These arise because the Scottish Budget will be, in part, dependent on Scottish tax revenues, which may flow irregularly and be higher or lower than expected. At present, devolved spending is wholly supported by a grant (apart from the share of council spending which is supported by local taxes) and so the UK Government bears the risk that taxes may be lower or higher than expected, or that they may flow irregularly.

615. This issue was recognised by the CSD, and it recommended that the Scottish Government should have short term borrowing powers to deal with the uncertainties involved. The Command Paper sets out the UK Government's plans for managing these risks. They include new short term borrowing powers in the Scotland Bill, but also other elements, and important details of how the Government expects the new system to operate.

616. The plans set out in the Scotland Bill and the Command Paper will mean that the Scottish Budget is subject to some risks that it does not presently bear. We discuss earlier in this report some of the major risks identified by some witnesses in the new system. The risk that depending in part on tax revenues might over the long run be less advantageous for the Scottish budget than sticking with the Barnett formula is discussed in preceding sections, where we consider the evidence related to the Scottish Government's view that the new system would have a deflationary bias.

617. The UK Government's plans are as follows—

- The Scottish Budget will continue to be supported by grant which will continue to be drawn down by the Scottish Government as necessary to meet spending requirements during the course of the year. The risks that are being managed therefore relate to the 15% or so of the Scottish Budget which depends on the new devolved taxes (The

revenue risks of the existing devolved local taxes are already managed by local authorities and through the Non-Domestic Rates Pool).

- The Scottish Government will have a power to borrow to meet current expenditure if this is required because devolved taxes have produced less revenue than forecast.
- For the wholly devolved taxes (Stamp Duty Land Tax and Landfill Tax) this will be entirely the responsibility of the Scottish Government.

618. More elaborate arrangements are proposed for the Scottish income tax, as it will be collected by HMRC, and the tax base is shared with the UK Government, namely—

- At the beginning of each Spending Review period (which might be a period of three or four years) the Office for Budget Responsibility will make a forecast of Scottish income tax receipts for that period.
- HMRC will collect the tax as now and remit it to the (UK) Consolidated Fund, but the Scottish Government will be able to draw down income based on the estimates as the spending needs arise, just as they do with grant. Thus the UK Government will carry, as it does now, the risks which arise from the uneven flow of tax revenues during the course of a year, and the fact that not all the tax revenues which relate to a particular year come in during that year: a good proportion come in after the year end, and a small amount even later. Whenever the money actually comes in the Scottish Government will be guaranteed an income equal to the estimate during the year in question.
- There will be a reconciliation of the estimate of tax income and the actual amount received within 12 months of the year end, when nearly all the receipts are known. In its Command Paper, the UK Government notes that over 99% of income tax will be collected by this point.
- If the income is greater than the estimate the surplus will go to the Scottish Government, which will have the option of retaining it in a new Scottish cash reserve. If it is less it will create a need to borrow (or reduce spending).

619. The short term borrowing powers are subject to a number of constraints—

- The Scottish Government will be expected to absorb any deviation from forecast which is less than 0.5% of the Scottish resource budget (£127 million in 2014-15).
- Borrowing for short term purposes will be limited to £200 million in any one year. This is approximately 4% of devolved tax revenues. The maximum stock of short term borrowing at any one time is limited by Statute to £500 million.



- Short-term loans must be repaid within 4 years, and any tax receipts above forecast must first be applied to reduce any existing borrowing.

620. This issue featured in much of the evidence received on the financial aspects of the Scotland Bill, including from critics of the proposals. Much of the criticism related to the potential economic effects of the plans. The Scottish Government raised the concern that the proposals exposed the Scottish budget to cyclical fluctuations in income tax but did not give it the opportunity to mitigate such volatility by borrowing, as borrowing was to be allowed only to deal with inaccuracies in forecasts. So if a downturn in revenue was forecast, the Scottish Government would have no borrowing power to offset this effect on spending.

621. Professors Hughes Hallett and Scott saw this as having a pro-cyclical effect, so that in a time of downturn the reductions in revenue would lead to a reduction in spending which would reduce incomes and so tax revenues and so on in a vicious circle. Thus the proposed arrangements would exacerbate Scotland's economic cycle. Professor Holtham was more concerned with differential cyclical risk (as he saw UK cyclical risk better dealt with via indexation of the grant reduction) and he thought that borrowing powers should be available for this purpose.

622. So far as the mechanics of the system were concerned Professor Spahn was attracted by the idea that the UK Treasury managed the in-year revenue risk. He noted that this was the practice in some Scandinavian countries where local income taxes were levied. UK Ministers explained that this was intended to give the Scottish Government certainty and stability in its spending plans, in the same way as at present where the Scottish Government had the same degree of certainty as a UK spending department with DEL limit fixed for the Spending Review Period.

623. To help understand this issue in more detail, the Committee is grateful for the research produced by Professor David Bell of Stirling University on tax forecasting and short-term borrowing needs. He analysed the accuracy of previous HM Treasury forecasts of income tax receipts for the UK. He found that HM Treasury forecasts had tended to be over-optimistic, but only slightly so for one year ahead. The average error, however, increased markedly when forecasting more than one year ahead, and the largest errors – such as those which occurred during the recent recession, were markedly larger than the average. This was one of the factors leading to the creation of the OBR. The Secretary of State's observations on the position were mentioned at paragraph 604 but in relation to one year forecasts only.

624. The OBR has, of course, no track record on forecasting as it has only recently been created but Professor Bell's report concludes that on the basis of the HM Treasury's forecasting record, the proposed borrowing powers are unlikely to be sufficiently large. Even if the Scottish Budget is required to absorb the first £120 million of any income shortfall, it is not more likely than comparable English budgets to be subject to unplanned reductions during the Spending Review period as a result of forecasting errors. In oral evidence to the Committee, the Cabinet Secretary for Finance and Sustainable Growth suggested that the overall limit might need to be as much as £1 billion or higher.

625. Some other expert witnesses also raised questions about the forecasting plans, notably the intention to guarantee revenue levels through the Spending Review period, when forecasts are subject to much greater levels of error for later years.

626. A number of those giving evidence to the Committee welcomed the creation of a Scottish cash reserve, but could see no reason for the distinction between filling that reserve from surplus revenue receipts and from savings on budgets. In their view, money was fungible and a reserve could be made up from either source; indeed a prudent Scottish Government might wish to set aside savings made one year against the possibility that there was likely to be a shortfall in tax receipts in later years. Indeed, if the ability to carry forward surplus revenue receipts remains at the discretion of HM Treasury, then there is less incentive to accumulate them.

627. In his evidence to the Committee, the Exchequer Secretary to the Treasury saw a distinction between underspends against planned budget and tax revenues above forecast. In his view, the former should be dealt with through the existing End Year Flexibility (EYF) arrangements, under which HM Treasury was able to exercise some control over access to the funds, though he noted that the EYF system was under review. The latter should be dealt with via the Scottish cash reserve and borrowing.

628. These are very important practical aspects of the implementation of the Scotland Bill proposals. However, because of implementation timetable proposed by the UK Government and the planned transition period, they do not have to be determined as yet. It is nevertheless important to get them right, especially where they impact on the drafting of the legislation, such as in relation to the overall short term borrowing limit.

629. First of all, on the macroeconomic issues, the Committee accepts that to the extent that the Scottish Budget depends on income tax revenues that are cyclically influenced, there is a risk that the Scottish Budget will grow or reduce in a procyclical way. First of all, however, the scale of these potential effects needs to be taken into account. If income tax receipts in Scotland were (forecast) to drop by as much as 5% from one year to the next (equivalent to a serious economic downturn), total public spending in Scotland would decrease by less than 1% as a result, and that decrease would be more than offset by the automatic stabilisers of social security payments increasing. Secondly, this does, however, in part depend on the method chosen for grant reduction. If that involves an indexation similar to that proposed by Professor Holtham and discussed by the Committee a preceding section of the report, then any such effect will be markedly reduced and indeed only relate to cyclical changes to the Scottish economy which are peculiar to Scotland.

630. So far as the mechanics of the system are concerned, the Committee welcomes a great deal of the approach taken by the UK Government. There are, however, a number of areas where the UK Government's proposals give the Committee cause for concern and where in its view some change will be needed. These are discussed in our conclusions and recommendations.

## THE DEVOLUTION OF OTHER TAXES

### Background: devolved taxes

631. Clause 24 of the Scotland Bill outlines proposals to give the Scottish Government the power to create new “devolved taxes”. Mr Gauke MP, the UK Government’s Exchequer Secretary to the Treasury explained to the Committee that—

“It is largely for the Scottish Parliament to come up with proposals for new taxes that it would like to introduce. It will be expected to provide evidence that the new tax complies with particular criteria: it must not impose a disproportionate negative impact on the UK macroeconomic policy and it must not impede the single UK market to any degree. Those points are very important.

We would also consider the potential for the new tax to create incentives or economic distortions and arbitrage in the UK, the potential that the new tax might be used to create tax avoidance across the UK, the impact of the proposed tax on compliance burdens across the UK, and its compatibility with EU legislation, such as legislation covering state aid—which can be sensitive—the single market and human rights. Those are some of the restrictions that would apply, but we would look to the Scottish Government to come forward with its proposals.”<sup>301</sup>

632. At present, the UK Government plans to use the Bill to devolve Stamp Duty Land Tax (SDLT) and the Landfill Tax. In contrast to Scottish income tax, these would be devolved to the Scottish Parliament, and become “devolved taxes” in the terms of the Bill. Devolution would include collection and management, providing flexibility on how to administer these taxes (for example, to enter into an agency arrangement with HMRC or to look at other ways to collect the taxes).

633. SDLT would be devolved in broad terms, allowing flexibility for Scotland to consider reform of the tax on land transactions. Similar flexibility would be provided for tax on disposals to landfill but there is no flexibility to look at the taxation of waste disposal more generally.

634. The Bill would disapply the existing UK SDLT and Landfill Tax regimes in Scotland. It would be crucial that a workable transitional regime is put in place to avoid the risk of a gap where no tax is levied on these activities in Scotland.

635. As noted above, the Bill would further introduce the concept of a “devolved tax” with SDLT and Landfill Tax being the first devolved taxes. Provisions in the Bill would allow more taxes to be made “devolved taxes” by Order in Council approved by both the UK and Scottish Parliaments.

636. As indicated previously in the introductory sections of this report, the Bill would not devolve Air Passenger Duty and the Aggregates Levy, as recommended by the CSD.

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<sup>301</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 48.

## Views expressed to the Committee

637. These powers were broadly welcomed by many of the witnesses who provided evidence to the Committee. For example, John Aldridge, former Finance Director of the Scottish Executive, stated—

“I note that the bill has a power to further devolve existing taxes. That is another important power in the bill. I am delighted to see it there. It has the potential to increase the flexibility and options that are available to the Scottish Government and Scottish Parliament to rearrange a basket of taxation to create new incentives. I welcome that.”<sup>302</sup>

638. Reform Scotland concurred, stating—

“Reform Scotland particularly welcomes the power to create new devolved taxes. This enabling power presents an opportunity to deliver the kind of change advocated by Reform Scotland.”<sup>303</sup>

639. RSPB Scotland outlined their view in written evidence that—

“Implementation of Clause 24 could present the Scottish Government with a sizeable opportunity to develop and implement a comprehensive ‘green tax policy’ to drive forward its environmental objectives, which would complement the devolution of other green taxes such as Landfill, and we see great potential for future Scottish Governments to use these powers.”<sup>304</sup>

640. However, there were mixed views with regard to the proposal that new taxes would need to be approved at the UK level. Some argued that it was a valid proposal, for example, John Aldridge stated—

“It is absolutely right that there should be a need for consultation with the UK Government on new taxes. That is needed just in case the tax has cross-border effects”.

641. However, he added that—

“I would have liked to see some kind of greater presumption in the bill that any new tax would be approved unless there were very good reasons not to do so....There is a risk that the Treasury could use the current criteria to turn down any proposal—after all, some excuse can always be found to do so—but, in my experience, I honestly do not think that it would do that. Nevertheless, the risk exists so it might be worth trying to get the criteria tightened up as time goes on.”<sup>305</sup>

642. Professors Hughes Hallett and Scott also expressed their concerns saying—

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<sup>302</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 303.

<sup>303</sup> Reform Scotland, written evidence submitted to the Committee.

<sup>304</sup> RSPB Scotland, written evidence submitted to the Committee.

<sup>305</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 304.

“It is also worth noting that very tight restrictions are to accompany the competence to introduce a new tax in Scotland, and that this will require the consent of the UK Parliament. Moreover any such proposal will need to be comprehensively justified, and a range of potential economic effects must be examined. Somewhat ironically perhaps the economic and financial tests that a proposed new tax must be subject to are considerably more sophisticated than those to which the new Bill’s tax proposals have been subjected.”<sup>306</sup>

*Stamp Duty Land Tax and Landfill Tax*

643. The Bill provides for the devolution of two other taxes – SDLT and Landfill Tax with a corresponding adjustment to the block grant. The UK Government envisages that these UK taxes will cease to apply in Scotland from April 2015 and be replaced by taxes legislated for by the Scottish Parliament.

644. A number of organisations and individuals expressed views welcoming the devolution of Stamp Duty Land Tax and Landfill Tax including Professor Iain McLean who wrote, “I support the devolution of land transaction and landfill taxes. The IEG and the Calman Commission reasoned that the most appropriate taxes to devolve are taxes on bases that don’t move.”<sup>307</sup>

645. The Scottish Government also supported the devolution of these taxes stating, “The Scottish Government welcomes the devolution of Landfill Tax and Stamp Duty Land Tax, and the introduction of the legislative concept of “devolved taxes” (which can be added to by agreement of the two Parliaments).”<sup>308</sup>

646. Those submissions which refer to these two taxes generally welcome the proposal to devolve them recognising the merit in devolving “taxes on bases that don’t move.”<sup>309</sup> The Scottish Property Federation<sup>310</sup> acknowledged the merit in devolving SDLT to the Scottish Parliament as property and land law is already devolved. However, with the value of commercial property sales in 2009-10 down by over 60% on 2006-07, they express concern that volatility in the number of property transactions will lead to volatility in tax yield.

647. One issue in particular that was raised in relation to Landfill Tax was that of the prospects for a continuation of a Landfill Communities Fund similar to that in the existing UK Landfill Tax legislation. This was supported by bodies such as the Scottish Landfill Communities Fund Forum, the Fife Environment Trust and others. On the other hand, Binn Eco Farm Ltd stated that it recommended that the Committee should call for a detailed assessment of the value in continuing the Landfill Tax Fund in Scotland. It also called for re-introduction of a funding classification within a Scottish Landfill tax Scheme that was included in the original UK regulations but since repealed to enable spending from the fund in relation to specific waste related projects.<sup>311</sup>

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<sup>306</sup> Professors Hughes Hallett and Drew Scott, written evidence submitted to the Committee.

<sup>307</sup> Professor Iain McLean FBA, written evidence submitted to the Committee.

<sup>308</sup> Scottish Government, Legislative Consent Memorandum LCM(S3) 30.1.

<sup>309</sup> Professor Iain McLean FBA, written evidence submitted to the Committee, p3.

<sup>310</sup> Scottish Property Federation, written evidence submitted to the Committee, p2.

<sup>311</sup> Binn Eco Park Ltd, written evidence submitted to the Committee.

648. The Impact Assessment<sup>312</sup> states that the direct, administrative and compliance costs of these taxes are wholly unquantifiable as the rates of tax and the administrative arrangements will be determined by the Scottish Parliament. The Command Paper<sup>313</sup> takes the view that there should be little or no change in the administrative burden or cost of compliance while recognising that these will depend on the design of the devolved tax.

#### *Aggregates Levy*

649. Although the devolution of the Aggregates Levy was recommended by the CSD, the Scotland Bill proposals do not yet provide for this. The Secretary of State for Scotland explained to Committee that “with the aggregates levy, there is a court case in Europe at present that affects those provisions<sup>314</sup>”. He went on to say—

“We take the view — rightly, I believe — that the United Kingdom should see that particular court case through. As I understand it, there is to be an oral session before the court at some point in the new year. We hope that the case will come to a resolution before too long. We might take different views about when to make the changes and how and where the risks should be borne, but the important point is that, for both those taxes, we have taken a particular view because of the unique circumstances, but with the clear intent to devolve in due course.”<sup>315</sup>

650. He also told the Committee that—

“If a decision comes through during the passage of the bill, there will be an opportunity to update and amend the bill as it goes through Westminster. However, we are introducing a new power in relation to additional taxes for Scotland that will provide a route to allow taxes that have not been devolved to be devolved, with the agreement of the Scottish Parliament and Westminster. That would be one such area that we would be able to explore”<sup>316</sup>.

651. The British Aggregates Association provided more insight into the situation in its written evidence, stating that—

“In 2002 the BAA made a legal challenge to the Levy as it involves illegal State Aid and distorts the market. The case is currently before the European General Court with judgment likely by the middle of this year. We also issued a legal challenge to the derogation in Northern Ireland. This was successful and the N.I. derogation was withdrawn on the 1st of December 2010. In short the Levy is almost certain to be found unlawful in the near future, the Treasury is aware of this and we suspect that is precisely why it has not been devolved.”<sup>317</sup>

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<sup>312</sup> HM Government, *Impact Assessment of the Scotland Bill*, p9.

<sup>313</sup> HM Government, *Strengthening Scotland's Future*, p30.

<sup>314</sup> Scotland Bill Committee, *Official Report*, 14 December 2010. Col 28.

<sup>315</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 28.

<sup>316</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 29.

<sup>317</sup> British Aggregates Association, written evidence submitted to the Committee.

652. Despite this situation, the Scottish Government felt “disappointed at the failure to devolve aggregates levy”<sup>318</sup> and stated—

“The Scottish Government does not consider these to be 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. If 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. The UK Government states that it will consider devolving both taxes in the future but provides no timeline for doing so.”<sup>319</sup>

653. Some witnesses expressed similar views. In oral evidence, to the Committee Professor Iain McLean stated—

“With all respect to the UK Government, it seems to me that its excuse is rather threadbare. It cites current litigation but, first, that litigation has been going on for a long time, and secondly, if the Scottish Parliament wishes to take any revenue risk arising from that litigation going badly from the point of view of the taxpayer—I mean the general taxpayer, rather than the particular interests that are bringing the litigation—it should be allowed to do that. My second point on the aggregates levy is that it is part of a neat package. If there is a tax on digging holes in the ground, namely the aggregates levy, and another tax on filling them, namely landfill duty, it seems to me right that both of those should be under the control of the same Parliament. Furthermore, land does not move, and it seems to me to be a basic principle that stuff that does not move should be taxed by the lowest appropriate level of government, which in this case is the Scottish Parliament. There is also a connection between both of those, which are in a sense land taxes, and stamp duty land tax, which is proposed for devolution.”<sup>320</sup>

654. The Chartered Institute of Taxation supported the immediate devolution of both the Aggregates Levy and, for that matter, the APD.<sup>321</sup>

#### *Air Passenger Duty*

655. Air Passenger Duty is another tax which was recommended by the CSD for devolution but which is not being taken forward at this time within the Scotland Bill. Under the previous UK Government, the Scotland Office wrote that—

“The Government’s assessment is that state aid rules, competition considerations and international aviation agreements restrict its ability to devolve air passenger duty. The Government does not therefore attach priority to the implementation of this recommendation although it will keep the position under review.”<sup>322</sup>

<sup>318</sup> Scotland Bill Committee, *Official Report*, 21 December 2010, Col 79.

<sup>319</sup> Scottish Government, Legislative Consent Memorandum LCM(S3) 30.1.

<sup>320</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 142.

<sup>321</sup> *Chartered Institute of Taxation*, supplementary written evidence submitted to the Committee.

<sup>322</sup> Scotland Office. *Scotland’s Future in the United Kingdom*.

656. However, most of the evidence provided to Committee is still broadly in favour of its devolution. For example, Infratil Airports wrote that—

“Air Passenger Duty (APD) requires to be devolved to the Scottish Government for two principal reasons:-

1. The dithering of the UK Government over the future of APD has introduced uncertainties in the aviation industry and its view of the UK market.
2. The Scottish market is quite different from the main (London) UK market and a “one size fits all” solution is, in the case of Scotland, no solution at all.”<sup>323</sup>

657. The company continued by stating that—

“Recent history demonstrates the success of the Route Development Fund (RDF) when Scotland was able to offer relatively modest financial incentives to airlines to operate new routes to/from Scotland; the economic benefits far outweighed the level of public investment. By being able to selectively tax (or not) certain and potential routes to maximise the benefits to the Scottish economy, the Scottish Government would be able to influence routes and frequencies offered by airlines.”<sup>324</sup>

658. Professor Iain McLean supported these views explaining—

“It is obvious to us all that air transport to and from the Highlands and Islands is in a different category from air transport between, say, London and Edinburgh. I anticipate that any Government would want to consider a different rate for air passenger tax in cases where air transport is, if you will, a social service as much as a transport service. There therefore seems to be a powerful case for saying that it should be the Scottish Parliament, not the UK Parliament, that decides on those matters in relation to airports in Scotland.”<sup>325</sup>

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<sup>323</sup> *Infratil Airports*, written evidence submitted to the Committee.

<sup>324</sup> *Infratil Airports*, written evidence submitted to the Committee.

<sup>325</sup> Scotland Bill Committee, *Official Report*, 11 January 2011, Col 143.



## THE CHALLENGES OF IMPLEMENTATION OF THE FINANCIAL PROVISIONS

659. To ensure stability and predictability, the UK Government intends to phase the introduction of devolved taxes and other measures, using transitional arrangements until the systems operate smoothly. For the Scottish income tax in particular, the arrangements proposed are protracted and complex and a number of concerns have been expressed about the implementation and operation of such a tax.

660. These concerns are succinctly put in the written evidence from the Institute of Chartered Accountants of Scotland—

“This legislation is complex. It has the potential to affect a large number of people beyond Scottish taxpayers. Those affected would include the payers of annuities, employers, charities, pension funds and of course the Scottish Government which will rely on the income stream created by this legislation. It is important that the Scottish Government is able to identify and obtain its fair share of the tax revenues. To achieve this in a cost efficient manner, to keep the cost of compliance as low as possible, it is important that steps start now to educate taxpayers, to put in place processes and tests to ensure that the register of Scottish taxpayers can be viewed with confidence and to bring certainty to those who will be affected directly or indirectly by the Scottish Income Tax Act.”<sup>326</sup>

661. In the interest of clarity the proposed timetable is restated below.

### **Timetable for introducing a Scottish income tax**

662. From April 2012, the Office of Budget Responsibility will provide annual forecasts of income tax receipts from a tax rate of 10 pence in the pound applied to all the taxable income of Scottish income tax payers arising from employment and pensions. For the first four years, i.e. to March 2016, there will be a notional assignment of Scottish income tax receipts to the Scottish Government with a matching notional reduction in the Scottish block grant.

663. Following the Scottish Parliament elections currently scheduled for May 2015, the Scottish Parliament will set the Scottish income tax rate for the Financial Year beginning in April 2016. This will require a decision by the Parliament on what the rate should be even if it remains at 10 pence in the pound. The 10 pence rate will not apply by default. For a transitional period, currently expected to be two or three fiscal years after March 2016, the Scottish block grant will be reduced by the forecast receipts from a Scottish tax rate of 10 pence in the pound and the forecast receipts from the Scottish income tax will be paid to the Scottish Consolidated Fund.

664. If the Scottish Parliament chooses to set the Scottish income tax rate at 10 pence in the pound these amounts will be identical. If the Scottish Parliament sets a rate which is different from 10 pence in the pound then it will receive the amount the OBR forecasts will be generated by that tax rate.

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<sup>326</sup> *Institute of Chartered Accountants of Scotland*, written evidence submitted to the Committee, p6

665. Once there is clear evidence that the arrangements for forecasting Scottish income tax receipts and for their collection are operating effectively, the transitional arrangements will be terminated. The block grant will then be reduced by a percentage corresponding to the expected yield from a Scottish income tax rate of 10 pence in the pound. This percentage reduction will be applied to the block thereafter but, in keeping with the “no detriment” principle, will be subject to any annual revisions to reflect policy changes to the UK tax structure or personal allowances.

666. In order that the transitional arrangements provide reliable information on the actual tax yield, the systems will need to be functioning by the start of the transitional period i.e. April 2016.

667. The new Scottish income tax will be collected by Her Majesty’s Revenue and Customs using the existing PAYE and Self Assessment tax systems. The Scottish rate will apply to UK resident taxpayers who are defined as Scottish taxpayers. To ensure compliance and efficient collection the Scottish rate will have to be set by the end of December in the preceding calendar year.

668. Income tax receipts vary from month to month and year to year and significant amounts due are not received until well into the following tax year. To ensure continuing stability and predictability of Scottish funding the UK Government will continue to make payments to the Scottish Consolidated Fund based on a forecast of Scottish income tax receipts made by the OBR. These forecasts will cover the period of a Spending Review. An adjustment will be made to the amount paid into the Scottish Consolidated Fund before the end of the following financial year to reflect actual Scottish income tax receipts as calculated by HMRC. If receipts exceed forecast then the Scottish Government will be able to pay this into a Scottish cash reserve. If the receipts are less than forecast and there is no cash reserve then the Scottish Government will have to make reductions to the budget (if less than 0.5% of the total resource budget) or make up the shortfall by borrowing (if more than 0.5% of the total resource budget).

### **Implementation concerns**

669. In written and oral evidence, concerns were expressed about—

- Defining and identifying a Scottish taxpayer;
- The cost of implementation;
- Operation of tax reliefs for pensions, other savings products and Gift Aid;
- Impact on businesses and tax payers;
- Institutional arrangements;
- Interest on underestimated tax receipts; and

- Use of end year flexibility.

### **Defining and identifying Scottish taxpayers**

670. The Command Paper states—

“The Scotland Bill refines [the definition of a Scottish tax payer used in the Scotland Act] whilst simplifying their presentation to make it clear that a Scottish taxpayer is a UK taxpayer either resident in Scotland or whose closest connection is with Scotland. HMRC are working closely with the members of technical groups convened to consider the implementation of the Scottish rate of income tax and to ensure the definition of a Scottish tax payer can be applied efficiently.”<sup>327</sup>

671. The Bill defines a Scottish taxpayer as an individual who is resident in the UK for income tax purposes and who also meet at least one of the following conditions—

- has a close connection with Scotland;
- does not have a close connection with any part of the UK other than Scotland and spends more of the tax year in Scotland than any other part of the UK; and
- represents a Scottish constituency in the Scottish, Westminster or European Parliament.

672. The Bill defines a close connection with a part of the UK as either having one place of residence in the UK and for at least part of the year lives at that place or, if having two or more places of residence, their main place of residence is in that part of the UK.

673. In their written evidence the Law Society of Scotland states—

“The residence qualification is not without controversy as recent cases (Gaines-Cooper v HMRC and Tucza v HMRC) confirm.

“New Section 80D (when combined with new Section 80E and 80F) 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.

“For example the definition of “close connection” contained within new Section 80E, creates difficulties of interpretation. Furthermore, what does “place of residence” mean? It appears to be different from “residence” as understood in other areas of tax law such as Capital Gains Tax. Does “place of residence” imply ownership when juxtaposed against “main place of residence” in new Section 80E(3)(b) and (c).

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<sup>327</sup> HM Government, *Strengthening Scotland's Future*, p29.

“Place of residence” and “main place of residence” are not defined in new Section 80E and therefore create potential problems for interpretation by those who may live in Scotland yet work in England or vice versa, including those living on the Scottish/English border, commuters from Glasgow/Edinburgh to London and a variety of public officeholders who may have a “place of residence” in Scotland yet work considerable periods in England and Wales such as members of the House of Lords (who are not included in new Section 80D(4) or UK Supreme Court judges.

“New Section 80E also highlights the issue of split year residences. HMRC currently applies, in extra statutory concession A11 split year treatment to individuals who spend only part of the tax year resident in the United Kingdom. The concession means that for example an employee who comes to the UK for a secondment beginning on 1 June would be regarded as non UK resident and therefore not taxable in the UK on his or her general earnings from the same employment for the period from 6 April to 31 May of that tax year.”<sup>328</sup>

674. The Society questioned—

“...whether setting up the provisions of new Section 80D, E and F will require the creation of a similar extra statutory concession. It would seem more sensible to create a robust system which does not rely on extra statutory concessions in order to make it work, but rather that the fundamental architecture takes account of movement of people within the United Kingdom (and therefore within different tax zones) within the one tax year.

“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>329</sup>

675. ICAS argue that—

“Without a sound foundation defining who is a Scottish taxpayer, the cost of compliance could be unacceptably high. We therefore recommend that the definition of the Scottish taxpayer be reconsidered and a statutory definition introduced which will give greater certainty to all.”<sup>330</sup>

676. SCDI sought—

“...further assurance that the rules for designation as a Scottish tax-payer do not underestimate the number of tax-payers in Scotland, and are sufficiently robust to ensure individuals are not easily able to switch their home for income tax purposes should the rate of income tax in Scotland vary from the rest of the UK. This issue has received considerable attention on the High

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<sup>328</sup> Law Society of Scotland, written evidence submitted to the Committee, p19.

<sup>329</sup> Law Society of Scotland, written evidence submitted to the Committee, p20.

<sup>330</sup> Institute of Chartered Accountants of Scotland, written evidence submitted to the Committee, p7.

Level Implementation Committee and we continue to seek assurances that the Scottish budget would not be adversely impacted by the Scotland Bill.

“The designation of individuals as a Scottish/Rest of UK tax-payer should be a matter for HMRC and the Government, not a matter for individuals or employers.”<sup>331</sup>

677. ICAS noted that in other jurisdictions with differential state taxation there is—

“...a reporting mechanism whereby every taxpayer is required to report annually. In Scotland we have a selective self-assessment regime and we do not have the same information-gathering powers.

“We suggest that the building base should be the definition of residence. There is quite a lot of evidence from the courts — such as *Gaines Cooper v HMRC* and the *Davies* case — that the UK definition of residence is creaking at the seams. It has relied on concessionary treatment, but that treatment has changed. In December 2010, HMRC published 86 pages of updated guidance in the form of HMRC6, and it is already a complicated area. We suggest that, if we begin now, we can create a statutory definition of residence that will give taxpayers greater certainty and help to define who is a Scottish taxpayer, because that is the next step up on the building blocks. We should do that with a view to creating a mechanism that will keep the costs down and create more certainty.”<sup>332</sup>

678. The Law Society of Scotland stated that—

“...the definition in the Bill would be complicated for an ordinary person to understand. It would be much better if there was a simpler definition that anybody could pick up and read. That would be a first for tax legislation, obviously, but it would be a good thing to aspire to. There is already a leaning towards a statutory definition of residence in UK taxation, so perhaps the two things could go hand in hand.”<sup>333</sup>

679. In response to a question from the Convenor, the Exchequer Secretary to the Treasury stated that even though there was not currently a UK statutory definition involving a statutory residence test the issue was under active consideration.<sup>334</sup>

680. The importance of ensuring that the definition of a Scottish taxpayer is carefully thought through as well as how the new system will work in practice was covered in extensive evidence from the Chartered Institute of Taxation.<sup>335</sup>

## Tax reliefs

681. The Association of British Insurers (ABI) had a number of detailed points covering the operation of income tax relief on pension contributions, the difficulty in

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<sup>331</sup> Scottish Council Development and Industry, written evidence to the Committee.

<sup>332</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 261.

<sup>333</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 263.

<sup>334</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 395.

<sup>335</sup> Chartered Institute of Taxation, written evidence submitted to the Committee.

grossing up contributions and the deduction of tax from annuities all of which could add to their members' administrative burden.<sup>336</sup> Income tax relief is available for pension contributions and other savings products and Gift Aid allows charities to claim from the UK Government the tax paid by the donor at the basic rate. Income tax relief on pension contributions is given at an individual's marginal rate so if UK and Scottish rates diverge, the marginal rates will diverge. HMRC has therefore set up a Pensions Technical Group, including representatives of pension providers and insurance companies north and south of the border, to explore with them the issues that could affect different types of registered pension schemes and quantify the impact on both HMRC and those involved in administering pension schemes. The Group has begun to discuss issues common to all pension schemes and with particular emphasis on the relief at source method of claiming tax relief.

682. HMRC reports that—

“Ministers will consider later in 2011 whether tax relief for members of registered pension schemes who are Scottish taxpayers should be at the Scottish or UK rate and how any administrative burdens could be minimised. The evidence and findings provided by members of the Pensions Technical Group will feed into this decision making process. However, HMRC is aware of the complexity affecting the net pay arrangements should tax relief instead be given (potentially) at a different rate to that at which an individual is liable to pay tax on their income, and this will also have to be taken into account.”<sup>337</sup>

683. The Scottish Council for Voluntary Organisations (SCVO) pointed out that changes to Scottish income tax rates will affect all charities who receive donated income from Scottish taxpayers.<sup>338</sup>

### **Impact on businesses and tax payers**

684. The Impact Assessment stated that “marginal compliance costs [for employers and businesses] will depend on the design of Scottish tax.”<sup>339</sup>

685. ICAS stated—

“It is believed that most employers who use commercial payroll software have within that software the functionality to deal with divergent tax rates and a different treatment for Scottish taxpayers. However this has not been tested.”<sup>340</sup>

686. The importance of implementation to the business community and ideas for how this can be improved were covered in extensive evidence from the Chartered Institute of Taxation.<sup>341</sup>

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<sup>336</sup> Association of British Insurers, written evidence to the Committee, page 2.

<sup>337</sup> HMRC, Pensions Scheme Newsletter 45, 11 February 2011, page 1.

<sup>338</sup> Scottish Council for Voluntary Organisations, written evidence to the Committee, page 3.

<sup>339</sup> HM Government *Impact Assessment of the Scotland Bill* page 1.

<sup>340</sup> Institute Chartered of Accountants of Scotland, written evidence to the Committee, page 4.

<sup>341</sup> Chartered Institute of Taxation, written evidence submitted to the Committee.

## **Institutional arrangements**

687. Under the proposed arrangements responsibility for forecasting, collecting and auditing the amounts generated by the Scottish Income tax lie with OBR, HMRC and the National Audit Office (NAO) respectively.

688. To collect the Scottish income tax, HMRC will need to compile and maintain a database of Scottish taxpayers. HMRC has advised us that they will be working closely with stakeholders to ensure a smooth implementation and a minimum administrative burden on employers and individuals. As well as a High Level Implementation Group jointly chaired by the Secretary of State for Scotland and the Exchequer Secretary, HMRC has established a number of technical bodies to ensure that the impacts on both are understood.<sup>342</sup>

689. The relationship between HMRC and the Scottish Government on income tax will be set out in a Memorandum of Understanding which will be published in advance of implementation of the Scottish rate of income tax.

690. The Committee heard from Alan Trench that these arrangements present problems. The OBR is independent from the Treasury but may not be impartial between the Scottish Government and the UK Government; the Scottish Government has no direct control over HMRC and cannot ensure that HMRC serves its interests; and it is not for the UK Government to confer functions on the NAO. He suggests it may be appropriate for Audit Scotland to be involved in the task of auditing Scottish tax receipts and that at least one member of the HMRC Board be appointed by the Scottish Government.<sup>343</sup>

691. In its Command Paper, the UK Government stated that the new funding arrangements for Scotland, including greater tax responsibilities and a shared tax base, do require bilateral discussions between the UK Government and Scottish Government which will not be relevant to the other Devolved Administrations. Therefore, the UK Government will establish a new UK-Scottish tax committee – the Intergovernmental Bilateral Committee on Fiscal Devolution – which will discuss the shared interest in taxation and macroeconomic policy. The committee will be chaired by the Exchequer Secretary, as Minister for HMRC and, in addition to the relevant Scottish Government Ministers, will also include the Secretary of State for Scotland. It is envisaged that the Committee will meet twice a year following the OBR's bi-annual forecasts. The UK Government intends for the Committee to begin to meet from enactment of the Scotland Bill, to support the development and implementation of the Scottish rate of income tax and devolved taxes. Terms of reference for the Committee will be published in due course.<sup>344</sup>

## **Interest on underestimated tax receipts**

692. HMRC currently pays interest on tax overpayments and charges interest and penalties on late payments, late filing and incorrect returns. As the Scottish Government will be able to draw down forecast receipts, the impact of late paid or

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<sup>342</sup> Her Majesty's Revenue and Customs, written evidence submitted to the Committee, page1.

<sup>343</sup> Alan Trench, written evidence submitted to the Committee, page1.

<sup>344</sup> HM Government, *Strengthening Scotland's Future*, page 40.

overpaid tax will be on the UK Exchequer rather than the Scottish Government. Neither interest payments received nor the cost of interest paid will be passed on to the Scottish Government.<sup>345</sup>

693. This simplifies administration. However, Professor Boadway, who served on the CSD's Independent Expert Group on Finance, suggested that interest should be paid on any funds paid late as a result of tax receipts being underestimated.<sup>346</sup>

### **Cost of implementation**

694. The Impact Assessment of the Scotland Bill<sup>347</sup> estimates a one-off cost of £45 million with annual costs thereafter of £4.2 million. These estimates are qualified as the cost will depend on decisions still to be taken including some by the Scottish Parliament, for example, on whether Scottish and UK income taxes are separately identified on taxpayers pay slips or end year tax summary (P60).

695. The costs of implementation will be incurred by HMRC which will in turn be reimbursed by the Scottish Government.

696. The Law Society of Scotland stated that it—

“... is concerned that only a partial regulatory impact assessment has been completed in relation to the Bill and that in the explanatory notes at paragraph 232<sup>348</sup>, the financial effects and the effects on public sector manpower are not detailed.

“The Society is of the view that collecting the Scottish rate for Scottish taxpayers will be a considerable administrative effort. More information is needed about how the Scottish rate will be administered and the costs for taxpayers, employers and the Scottish Government.

“The Society notes that these costs would be incurred even where the rate set by the Scottish Government is the same as the UK rate. In particular, the Society is concerned that payroll standards written before the Scottish rate of income tax comes into effect will take some time to test in order to confirm their capability. A considerable amount of underlying administrative work requires to be undertaken in order to ensure the proper administration of the tax in a fair and equitable way so as to give certainty to PAYE taxpayers that the tax deducted from their salary is correct and to avoid underpayments or overpayments.”<sup>349</sup>

697. ICAS stated that—

“Estimates for how expensive it will be to create a register of Scottish taxpayers vary from between £45 million and £150 million. The better the

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<sup>345</sup> HM Government, *Strengthening Scotland's Future*, page 29.

<sup>346</sup> Professor Boadway, written evidence submitted to the Committee, page 3.

<sup>347</sup> HM Government *Impact Assessment of the Scotland Bill* p3

<sup>348</sup> HM Government, *Scotland Bill Explanatory Notes*, p32.

<sup>349</sup> Law Society of Scotland, written evidence submitted to the Committee, p17.



definition of a Scottish taxpayer, the likelihood of the costs being to the lower end is increased.

“Conversely, if the definition of a Scottish taxpayer is viewed as vague, liable to dispute and litigation and difficult to define, then costs will be significantly higher and would probably exceed by a considerable margin, the figure of £150 million. Once created, the maintenance of a register of Scottish taxpayers should not prove too expensive provided that a reporting mechanism is in place imposing an obligation for individuals to notify changes in circumstances immediately.”<sup>350</sup>

698. In his evidence to the Committee, John Swinney said—

“In my humble opinion, signing up to a proposition without a definitive specification and a guaranteed cost is a place we have been before—we are currently sitting in it. I caution the committee about that question, particularly in dealing with HMRC.”<sup>351</sup>

699. However, in his evidence, Michael Moore said—

“I will hand over to David Gauke shortly. We do not recognise the £150 million figure. I point out that the £45 million figure—David will say a little bit more about the basis on which we arrived at it—is provisional and is heavily caveated in the regulatory impact assessment. I hope that you have already seen that.

We are not capping the cost at £45 million, nor are we suggesting that it needs to be as much as £45 million. We are saying that that is what we think it will be, on the basis of the best evidence that is available. I am sure that you will have noticed that we said in the impact assessment that much will depend on what the Scottish Government wants in the way of detail, P60 documentation and so on. As the UK Government, we could just say, “Here it is—impose it,” but we will not do that. We will discuss and work through it.”<sup>352</sup>

700. The Committee’s detailed recommendations in relation to the challenges of implementation are set out later in this document.

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<sup>350</sup> Institute of Chartered Accountants of Scotland, written evidence submitted to the Committee, p5.

<sup>351</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 431.

<sup>352</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 394-395.

## CHANGES TO THE LEGISLATIVE POWERS OF THE SCOTTISH PARLIAMENT

### Background

701. As outlined in the section on the Scotland Bill, the UK Government proposes to make a series of changes that affect the legislative powers of the Scottish Parliament. In this section, the Committee reviews the evidence taken in relation to—

- Air weapons;
- Insolvency;
- Regulation of the health professions; and
- Antarctica

702. The Committee's conclusions and recommendations on these areas can be found in the final section of this report.

### Air weapons

703. Clause 11 of the Bill would amend the Scotland Act to provide that the regulation of air weapons, within the terms of section 1(3)(b) of the Firearms Act 1968, would fall within the legislative competence of the Scottish Parliament. However, the power to make rules and orders in relation to “specially dangerous weapons” would remain a reserved power. The UK Government has indicated that the reason for proposing this partial devolution of air weapons regulation is that—

“These [specially dangerous weapons] are weapons that have been the subject of particular licensing regimes or, in the case of air pistols, banned from use. They are a category of weapon that the Home Secretary has determined is particularly dangerous and which is already the subject of significant regulation or, indeed, a ban across the UK.

The Calman proposal was to devolve competence to the Scottish Parliament in relation to air weapons other than those particularly dangerous ones so that, in theory, the Scottish Parliament could make provision for airguns because of specific concerns that had been raised here in Scotland. The proposal was to give an additional power to the Scottish Parliament on airguns to meet a legitimate concern that you and others have raised about issues in Scotland that might not be addressed on a United Kingdom basis.”<sup>353</sup>

704. Written evidence to the Committee was received from a range of bodies, including: Association of Chief Police Offices in Scotland (ACPOS), British Association for Shooting and Conservation (BASC) Scotland, Gregg Corbett, Law Society of Scotland, Scottish Air Rifle and Pistol Association (SARPA), Stephen Maxwell, the Scottish Government and UNISON Scotland.

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<sup>353</sup> Scotland Bill Committee. *Official Report*, 14 December 2010, Cols 63-64.

*Devolved and reserved responsibilities for regulation of air weapons*

705. The evidence received by the Committee highlighted the potentially problematic nature of having a split in the responsibilities for regulation of air weapons. The Scottish Government's view was set out in written evidence from the Minister for Culture and External Affairs—

“Exercise of this power would thus effectively adjust the boundary of reserved and devolved competence. Normally such adjustments are made under the Scotland Act, or by primary legislation subject to the Sewel Convention. In this case, the power would lie with UK Government Ministers and would not be subject to any procedure in the Parliament. The Scottish Government has therefore proposed that the relevant power should be only be exercised with the consent of the Scottish Parliament...

An alternative approach to avoid this complication would be to devolve legislative competence for all air weapons to the Scottish Parliament.”<sup>354</sup>

706. The Scottish Government's submission to the Committee included a specific amendment to the Bill to give effect to the changes that it believes should be made to the Scotland Bill.<sup>355</sup>

707. The British Association for Shooting and Conservation stated—

“Transferring authority over one group of firearms (air-weapons) from Westminster to Holyrood but reserving all others will inevitably cause confusion and uncertainty. In addition, having responsibility for one group of firearms but not the rest will lead to disproportionate restrictions.”<sup>356</sup>

708. This view was echoed by the Scottish Air Rifle and Pistol Association.<sup>357</sup> BASC also commented that one of the reasons for their not supporting the proposed partial devolution of regulation was that no clear indication had been given as to what Scottish Ministers or MSPs intend to do with such powers if they were devolved.

709. ACPOS was also of the view that—

“The best estimate is that there may be as many as 500,000 air weapons in Scotland. At the moment, those weapons — apart from the most dangerous, which are classed as section 1 firearms under the Firearms Act 1968 — are unregulated. ACPOS's position is that, in an ideal world, to avoid confusion, one set of legislation would be the best option for licensing. However, if the Scottish Parliament decided that it wished to license air weapons, we would be happy to be involved in consultation on the issue.

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<sup>354</sup> Scottish Government, Letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>355</sup> Scottish Government. Letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011

<sup>356</sup> British Association for Shooting and Conservation, written evidence submitted to the Committee.

<sup>357</sup> Scottish Air Rifle and Pistol Association, written evidence submitted to the Committee.

Licensing air weapons is a complex issue. Ideally, we would prefer them to come under the 1968 act, so that we did not have two sets of rules. Given the number of such weapons, cost and resources would have a definitive impact on licensing them from a policing perspective.”<sup>358</sup>

710. This was supplemented in its written evidence which stated—

“It has long been the view of ACPOS that Firearms Legislations is unnecessarily complex and difficult for the general public, Police and Licensing Authorities to understand and apply in a fair and proportionate manner. Therefore any decision to introduce legislation, which would apply only to Air Weapons, would need to be considered extremely carefully to ensure that the aims of the legislation were constructed to achieve specific, reasonable objectives.”<sup>359</sup>

711. During their evidence to the Committee, UK ministers said that they were sympathetic to the devolution of powers over the regulation of most air weapons to the Scottish Parliament. The Parliamentary Under of Secretary of State at the Scotland Office, Rt. Hon David Mundell MP, also stated on the issue of “specially dangerous weapons”—

“It is clear that if the seriously dangerous air guns are banned throughout the United Kingdom, it would not be the Government's intention to change regulation or devolution in that regard. As I said earlier, if the bill proceeds as set out, it will be a matter entirely for the Scottish Parliament whether to make changes.”<sup>360</sup>

*Scale of the problem associated with air weapons in Scotland*

712. Many witnesses in both oral and written evidence referred to the possible misperception of the scale of air-gun crime in Scotland as being a driver behind the proposed devolution of some air weapon regulation to Scottish Ministers.

713. BASC, in written evidence provided some background to the issue—

“After the death of Andrew Morton there were many calls for all air-weapons to be banned, followed by discussion over a possible licensing system. Such a system was rejected by ACPOS at the First Minister's Firearms Summit in May 2008 and was criticised by BASC as well, on the grounds that there may be as many as 500,000 air-weapons in Scotland and that it would be impossible or prohibitively expensive to try to licence them all. This could directly affect responsible users of air-weapons but have no effect upon existing law-breakers.

One of the commonly-quoted reasons for the proposed changes to air-weapons in Scotland was the misunderstanding that crimes and offences involving firearms were increasing and that Scotland had a “particular problem” with air-gun crime.

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<sup>358</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Cols 329-330.

<sup>359</sup> Association of Chief Police Offices in Scotland, written evidence submitted to the Committee.

<sup>360</sup> Scotland Bill Committee. *Official Report*, 3 February 2011, Col 399.

The regularly produced “Recorded Crimes and Offences Involving Firearms in Scotland” reports from the Scottish Government clearly show the true picture. In 2009-10 the number of recorded crimes and offences involving firearms in Scotland was “the lowest reported total for the ten year period covered by this bulletin”. There were 839 crime and offences reported, 12% lower than the previous year, which itself was 17% lower than the year before. Consequently, firearms offences in Scotland are decreasing, not increasing.”<sup>361</sup>

714. In oral evidence to the Committee, Temporary Assistant Chief Constable Tom Ewing, representing ACPOS, stated—

“Statistics for 2009 showed that there were 92 injuries from air weapons, of which 15 were serious. That is in the context of there being some 500,000 [air] guns.”<sup>362</sup>

715. ACPOS was also asked whether the figures being provided suggested that there is a distinct problem in Scotland. In response, ACPOS indicated that—

“You could argue both ways with regard to firearms offences: for example, you could say that there is less of a section 1 firearms issue in Scotland than there is in England and Wales – it is a probably open for analysis.”<sup>363</sup>

#### *Cross-border issues*

716. In the evidence taken by the Committee, there were mixed views as to whether devolving these powers could lead to cross border complications, with SARPA suggesting that—

“If some form of Licence control was brought about this could lead to cross border issues for those who shoot nationwide impacting many national events and may by default criminalise the legitimate user.”<sup>364</sup>

717. On the other hand, the Law Society of Scotland did not “envisage any practical cross border difficulties which could not be accommodated in subsequent legislation, which would clearly require provide for reciprocity with regard to licensing regimes should the Scottish Parliament, in terms of Clause 11 of the Bill, decide to regulate air weapons”<sup>365</sup>.

718. The Committee’s detailed recommendations in relation to air weapons are set out later in this document.

#### **Insolvency**

719. Corporate insolvency law is currently partly reserved and partly devolved. Under the Scotland Act, the general legal effect of liquidation is a reserved matter,

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<sup>361</sup> British Association for Shooting and Conservation, written evidence submitted to the Committee.

<sup>362</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Col 332.

<sup>363</sup> Scotland Bill Committee. *Official Report*, 14 December 2010, Col 334.

<sup>364</sup> Scottish Air Rifle and Pistol Association, written evidence submitted to the Committee.

<sup>365</sup> Law Society of Scotland, written evidence submitted to the Committee.

but the process and effects of liquidation are devolved. Administration is also reserved, while receivership is devolved.

720. The final report of the Commission on Scottish Devolution recommended that the UK Insolvency Service, with appropriate input from the relevant department of the Scottish Government, should be made responsible for laying down the rules to be applied by insolvency practitioners on both sides of the border. The Commission concluded that this might be achieved without altering devolved legislative competence through UK legislation with consent from Scottish Parliament under the Sewel Convention.<sup>366</sup>

721. In its Command Paper, however, the UK Government, stated that whilst it agreed that a common approach across the UK is necessary, it would include a clause in the Scotland Bill to make amendments to Schedule 5 to the Scotland Act 1998. Therefore, responsibility for the rules on winding-up in Scotland would be reserved.<sup>367</sup>

722. The UK Government argued that this will enable the rules on winding-up to remain properly aligned throughout Great Britain. It stated that windings-up in Scotland will remain subject to supervision where necessary by Scottish Courts. Matters which are the subject of common law, such as set off and disclaiming onerous property, will not be affected, with Scottish law still applying.

723. The Scottish Government's view is that improved inter-governmental working is the correct way to address circumstances in which devolved and reserved competences impact on one another. It believes that it is wrong as a matter of principle to address such circumstances through reserving matters to the UK Government and Parliament.<sup>368</sup>

724. The Scottish Government believes that the arguments for reserving this specific competence are weak. It argues that as these matters are so integrated into court procedures and Scottish private law, especially diligence, it is better that they are dealt with on a devolved basis. The Scottish Government considers that the programme of modernisation already underway within the Government, with appropriate dialogue with the UK Insolvency Service would result in a satisfactory outcome without disturbing the current devolved responsibilities. This would allow a position that brought about a consistency of approach, yet recognised the important differences in the legal framework of Scotland.<sup>369</sup>

725. In their evidence to the Committee, the Institute of Chartered Accountants in Scotland (ICAS) stated that it believed that "the re-reservation of responsibility for corporate insolvency procedure, excluding receivership, is beneficial as it will ensure consistency throughout the UK." ICAS argues that "Scotland will also

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<sup>366</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009.

<sup>367</sup> HM Government. *Strengthening Scotland's Future*, p57-58.

<sup>368</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>369</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

benefit from legislative change being introduced at the same pace as the rest of the UK.”<sup>370</sup>

726. ICAS state that there are cross applications among the different corporate insolvency processes which make them complex. For example, it cites the split in the corporate insolvency regime which has meant that procedures relating to insolvent companies and Limited Liability Partnerships under the jurisdiction of Scots Law were governed by Rules which were partly the responsibility of Westminster and partly that of the Scottish Government. Its view is that this gave rise to complications as the same Rule, for example regarding the convening of and attendance at meetings of creditors, might be subject to review and amendment by both authorities.<sup>371</sup>

727. In short, ICAS notes that there are now significant differences between the English and the Scottish Rules which result in additional costs in Scotland in winding-up procedures, which have a detrimental effect on the return to creditors. This places Scotland at a disadvantage in its view.<sup>372</sup>

728. Similarly, the Institute of Chartered Accountants in England and Wales Members in Scotland shares these views. Its submission states that “standardisation of treatment for all businesses in UK will add certainty for suppliers and employees” and that it sees no merit in parallel sets of regulations.<sup>373</sup>

729. The Law Society of Scotland also endorses these points, describing the current situation as confusing, with significant risks and to that extent unsatisfactory in principle.<sup>374</sup>

730. In his evidence, David Bennett of R3 (a trade association representing business recovery specialists) and of the Law Society said—

“The current situation, whereby the rules are divided into rules for which the Scottish Government has responsibility — the Accountant in Bankruptcy is the relevant official — rules for which the Insolvency Service and Westminster have responsibility, and rules for which both Governments have responsibility and at which they poke away without apparently or necessarily consulting each other, is a recipe for confusion and expense and we would like it to end.”<sup>375</sup>

731. However, he also stated that resolution of the issue—

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<sup>370</sup> Institute of Chartered Accountants in Scotland, written evidence submitted to the Committee.

<sup>371</sup> Institute of Chartered Accountants in Scotland, written evidence submitted to the Committee.

<sup>372</sup> Institute of Chartered Accountants in Scotland, written evidence submitted to the Committee.

<sup>373</sup> Institute of Chartered Accountants in England and Wales Members in Scotland, written evidence submitted to the Committee.

<sup>374</sup> Law Society of Scotland, written evidence submitted to the Committee.

<sup>375</sup> Scotland Bill Committee. *Official Report*, 25 January 2011, Col 258.

“... does not necessarily require re-reservation, provided that the Accountant in Bankruptcy is given instructions to work with the Insolvency Service and the resources to do so. We are talking about no more than technicalities.”<sup>376</sup>

*Registered Social Landlords*

732. On the detail of the provisions, the Scottish Government notes that the provisions would reserve responsibility for insolvency procedures relating to Registered Social Landlords (RSLs), for which the Scottish Parliament had particular responsibility, recently exercised in the Housing (Scotland) Bill 2010.<sup>377</sup>

733. This is an area where the limited amount of evidence that the Committee received was overwhelming negative. For example, the Scottish Federation of Housing Associations (SFHA) wrote that it was “opposed in the strongest possible terms to the provision contained within clause 12 of the Scotland Bill which serves to re-reserve to Westminster responsibility for legislation relating to the insolvency of social landlords in Scotland.”<sup>378</sup>

734. SHFA argues that since housing is a devolved matter the UK Government should not be using the Scotland Bill to affect the Scottish Parliament’s ability to legislate on all aspects of housing policy, such as land, tenancies, leases and regulation, including regulation of social housing (an integral part of which is the regulatory regime for addressing the risk of insolvency among RSLs).<sup>379</sup>

735. SFHA’s view is that it is of “paramount importance that the power to legislate over any changes to the existing powers of the SHR [Scottish Housing Regulator], including that relating to the winding up of RSLs, should remain with the Scottish Parliament.” The SFHA wants the existing exemption for the winding up of RSLs to be confirmed in the forthcoming Scotland Act, or for proposals to reserve the powers to do so to be removed from the Scotland Bill.<sup>380</sup>

736. The SHFA’s view was supported in the evidence provided by others, including the Chartered Institute of Housing Scotland and the Glasgow and West of Scotland Forum of Housing Associations.

737. In her evidence to the Committee, the Minister for Culture and External Affairs stated that—

“Right up until the bill was published, we were told that RSLs would not be covered in that way. We need to bear in mind that the Scottish Parliament has just passed the Housing (Scotland) Act 2010, which gives real powers to the Scottish housing regulator that can be used even for companies that get into difficulties. There is a real conflict in this proposal. Alex Neil has written to the Secretary of State for Scotland to set out all the issues.”<sup>381</sup>

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<sup>376</sup> Scotland Bill Committee. *Official Report*, 25 January 2011, Col 259.

<sup>377</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>378</sup> Scottish Federation of Housing Associations, written evidence submitted to the Committee.

<sup>379</sup> Scottish Federation of Housing Associations, written evidence submitted to the Committee.

<sup>380</sup> Scottish Federation of Housing Associations, written evidence submitted to the Committee.

<sup>381</sup> Scotland Bill Committee. *Official Report*, 21 December 2010, Col 119.



738. In response, the Scotland Office ministers told the Committee that<sup>382</sup>—

“We followed the recommendation of the commission that there was confusion about responsibilities in relation to insolvency matters.

[..]

We considered the housing associations issue, but we would get into a complicated legal area if some legal entities were to be excluded from the provisions or treated differently from others. That is why there is no specific proposal to exclude housing associations from the provisions.”

739. The Committee’s detailed recommendations in relation to insolvency and RSLs are set out later in this document.

### **Regulation of the health professions**

740. The Scotland Act reserves the regulation of health professions that are regulated under enactments listed within the Act. This includes doctors, dentists, dental auxiliaries, opticians, pharmacists, nurses, midwives, health visitors, chiropodists and veterinary surgeons. Legislation has been passed subsequent to the Scotland Act which provides for the regulation of additional health professions is not listed in the Scotland Act meaning regulation of such professions is devolved to the Scottish Parliament. Examples of these professions include dental nurses, dental technicians and pharmacy technicians.

741. Where the UK Government Department of Health seeks to place requirements on these new professions, this requires an order under section 60 of the Health Act 1999 and which must, to have effect, be ratified by the Scottish Parliament, as well as the UK Parliament.

742. The CSD’s report stated that the section 60 process can be “cumbersome and time consuming”. It concludes that—

“...it is important that there should be a common approach to regulation of the health professions to ensure that there is clarity for patients as well as an assurance of common standards irrespective of the location in which they find themselves in need of care or advice. Similarly, for practitioners, a consistent approach to regulation helps to ensure that mobility within Great Britain is straightforward and that relevant continuing professional development is recognised...The Commission therefore recommends that regulation of the health professions is reserved without exception...”<sup>383</sup>

743. Clause 13 of the Scotland Bill seeks to give effect to this recommendation. It also makes a number of consequential amendments to the legislation relating to the health professions that are regulated by the Health Professions Council, the

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<sup>382</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Cols 60-61.

<sup>383</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p186.

General Dental Council, and the General Pharmaceutical Council (the regulators that regulate the few devolved professions).<sup>384</sup>

744. The legislative consent memorandum from the Scottish Government<sup>385</sup> makes clear that it does not support the proposed change arguing that inter-governmental working already achieves the objectives set out by the Commission. The memorandum then provides a number of examples to demonstrate that such relationships and lines of communication are already in place. It also argues that since health is almost entirely devolved, “any proposal to remove responsibility for a health matter from Scotland, and transfer it to the United Kingdom Government, is anomalous.” Finally, it cites the UK Department of Health’s (DH) evidence to the CSD which concluded “DH is not seeking any changes to the reservation of the health professions in the Scotland Act 1998. In practice, both the Government and the devolved administration have always sought to apply a UK-wide framework...To seek total reservation in this area would be unnecessary, when pragmatic, shared solutions are available.”<sup>386</sup>

745. A number of organisations reflected on the pros and cons of re-reserving certain professions without providing an overall position on this issue. The Health Professions Council suggested in written evidence that the key objective is to ensure that a common framework of regulation for health professionals exists across the UK. It stated—

“We observe that there is widespread consensus that a consistent UK-wide approach to the regulation of health professions is both appropriate and beneficial to professionals and the public. If effective and flexible regulatory approaches are in place then this will be achieved regardless of whether the issue is reserved or not.”<sup>387</sup>

746. NHS Highland stated that—

“Whilst health professions health care regulation is reserved at present, it is not perfect in some ways as it arguably limits our ability to be more creative within Scotland. Timelines for change are long, but on the other hand it ensures consistency and makes best use of resources.”<sup>388</sup>

747. The General Dental Council’s submission notes that the need to lay section 60 orders before both the UK Parliament and the Scottish Parliament “has not presented any issues.” However it also acknowledges that “Looking ahead, we note the potential increase in cost and complexity of regulation should statutory requirements diverge between Scotland and other parts of the UK.” It concludes that, “Based on the GDC’s experience to date, there are no pronounced advantages or disadvantages to the devolved model.”<sup>389</sup>

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<sup>384</sup> Scotland Bill Explanatory Notes.

<sup>385</sup> *Scottish Government*, legislative consent memorandum, LCM(S3) 30.1.

<sup>386</sup> Department of Health, written submission to the Calman Commission.

<sup>387</sup> Health Professions Council, written evidence submitted to the Committee.

<sup>388</sup> NHS Highland, written evidence submitted to the Committee.

<sup>389</sup> General Dental Council, written evidence submitted to the Committee.

748. In oral evidence witnesses from the General Pharmaceutical Council<sup>390</sup>, and the General Dental Council<sup>391</sup> made clear that, as regulators, they must remain apolitical and therefore do not take a view on how to proceed. Similarly, Marc Seale of the Health Professions Council (HPC), added that—

“Looking to the future, if the legislation changes, the HPC and how we engage in Scotland and other home countries will remain the same. Our role as a regulator is to work with the different systems however they are run and in whichever country.”<sup>392</sup>

749. NHS Ayrshire and Arran supported the centralisation of all health professions stating that—

“We can only see benefits in UK-wide centralisation. In particular we consider decentralisation a dis-benefit in that it adds bureaucracy to the movement of staff. In addition, we consider that it would result in inefficiencies and discrepancies through duplication of multiple systems and standards.”<sup>393</sup>

750. The Royal College of Physicians of Edinburgh argues that—

“...as healthcare professionals work closely in multi-disciplinary teams it would seem logical to ensure that regulation is handled consistently. This reflects the mobility of professionals and patients around the UK and their expectations. All regulated healthcare professionals should function to standards that are UK-wide and governed by a single UK regulator.”<sup>394</sup>

751. The Academy of Medical Royal Colleges and Faculties in Scotland shares the view that there should be one regulatory authority in the UK and that regulation should not be devolved.<sup>395</sup>

752. On the other hand, NHS Education for Scotland's written submission states that—

“Our consensus view is to retain Scotland's devolved powers for regulation of new health professional groups and we would not wish to see these powers being re-reserved to Westminster...to relinquish existing powers which at the very least provide Scotland with a well tested insurance policy at a time of imminent change in Westminster policy for health and regulation seems unwise”.<sup>396</sup>

753. NHS Education for Scotland provides seven arguments to substantiate this position including: the efficiency of linking devolved health professions' regulation to the implementation of health policies in Scotland; that devolved regulation allows it to be more flexible to the specific needs of Scotland, for example the

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<sup>390</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 270.

<sup>391</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 270.

<sup>392</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 271.

<sup>393</sup> NHS Ayrshire and Arran, written evidence submitted to the Committee.

<sup>394</sup> Royal College of Physicians of Edinburgh, written evidence submitted to the Committee.

<sup>395</sup> Academy of Medical Royal Colleges and Faculties in Scotland, written evidence submitted to the Committee.

<sup>396</sup> NHS Education for Scotland, written evidence submitted to the Committee.

potential requirements for prescribing by Physician's Assistants in remote and rural areas; and development of "robust models of regulation and assurance which take account of devolved structures, enabled through the leverage conferred by statutory power."<sup>397</sup>

754. The Scottish Forum for Healthcare Science supports this position stating—

"From our own perspective as healthcare scientists we would urge that regulation remains within the legislative competence of the Scottish Parliament and is not re-reserved to Westminster. This appears to us to be the only way in which we can ensure that the model of education and training to meet the standards required for regulation suits the needs of NHS Scotland. We are also concerned that while a number of other professions within healthcare had, as long ago as 2004, been recognised by HPC [Health Professions Council] as being candidates for regulation, the decision to take this forward has been delayed by the Department of Health for England."<sup>398</sup>

755. In oral evidence, Joseph McIntyre said that those representatives of technicians and the Dental Laboratories Association that responded to his request for a view—

"...said overwhelmingly that they want things to stay in Scotland. If we were going to look further, there would have to be a much bigger scoping exercise."<sup>399</sup>

756. Finally, although not suggested in the Bill, a number of organisations, such as Independent Healthcare Advisory Services, offered up the view in evidence that they would not wish to see regulation for all healthcare professions devolved. NHS Highland supported this view stating that "If regulation was to become a devolved matter, the cost and administration of regulation for a country the size of Scotland could be significant."<sup>400</sup>

757. During the UK Government's evidence to the Committee, Rt. Hon David Mundell MP said that—

"My understanding is that contrary evidence was given to the Calman commission in the sense that there was a view that there would be a benefit in re-reserving the regulation of the health professions. There would also be a benefit going forward in that new, emerging health professions would not have to be defined. As we have seen over the period of devolution, new professional groups have emerged. The Government is still of the view that re-reservation is the preferred way forward."<sup>401</sup>

758. The Committee's detailed recommendations in relation to the re-reservation of the health professions are set out later in this document.

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<sup>397</sup> *NHS Education for Scotland*, written evidence submitted to the Committee.

<sup>398</sup> *Scottish Forum for Healthcare Science*, written evidence submitted to the Committee

<sup>399</sup> Scotland Bill Committee, *Official Report*, 25 January 2011, Col 271.

<sup>400</sup> *NHS Highland*, written evidence submitted to the Committee.

<sup>401</sup> Scotland Bill Committee. *Official Report*, 3 February 2011, Col 398.

## Antarctica

759. Clause 14 of the Bill introduces provisions to regulate activities in Antarctica, which was not reserved under the Scotland Act 1998. The Scottish Government's view is that the "creation of an entire new reservation in Schedule 5 to address this issue is unnecessary and disproportionate".<sup>402</sup> Its view is that the outcome sought by both governments is merely to ensure that relevant functions can be exercised consistently by the Foreign and Commonwealth Office (FCO) on behalf of the UK as a whole, and that this can be achieved entirely satisfactorily by allowing executive functions belonging to the Scottish Ministers to be exercised by UK Ministers, in a manner consistent with section 108 of the Scotland Act.

760. The Scottish Government's position is that the proposal also sets an undesirable precedent for the Scottish Parliament. As for other parts of the Bill, its view is that "removing responsibilities from the Scottish Parliament should only be a last resort".<sup>403</sup> Once reserved, its opinion is that the Scottish Parliament would lose all influence over the policy to be pursued, and there would be no foreseeable prospect of the Parliament regaining its responsibilities from Westminster.

761. The alternative proposed by the Scottish Government is to use the vehicle of a Legislative Consent Motion in connection with the proposed Antarctic Bill. This would suggest that the relevant executive functions under the existing 1994 Act should be exercisable by the FCO, with retrospective effect. New functions arising would be treated on an analogous basis and would also be exercisable by the FCO. The net result would be to enable the FCO to undertake the regulation of existing and new activities for both reserved and devolved matters, but without altering the legislative competence of the Scottish Parliament in relation to environmental protection or other devolved matters.<sup>404</sup>

762. The Committee's detailed recommendations in relation to Antarctica are set out later in this document.

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<sup>402</sup> *Scottish Government*, written evidence submitted to the Committee.

<sup>403</sup> *Scottish Government*, written evidence submitted to the Committee.

<sup>404</sup> *Scottish Government*, written evidence submitted to the Committee.

## CHANGES TO MINISTERIAL COMPETENCES

### Background

763. As outlined above, the UK Government proposes to make a series of changes which affect the competences of the Scottish Ministers. In this section, the Committee reviews the evidence taken in relation to—

- BBC Trust member for Scotland;
- Scottish Crown Estate Commissioner;
- Misuse of drugs;
- Power to prescribe drink-driving limits; and
- Speed limits.

764. The Committee's conclusions and recommendations on these areas can be found in the final section of this report.

### BBC Trust member for Scotland

765. The CSD recommended that responsibility for the appointment of the Scottish member of the BBC Trust should be exercised by Scottish Ministers, subject to the normal public appointments process<sup>405</sup>.

766. The UK Government believes that clause 17 of the Scotland Bill, which requires a Minister of the Crown to obtain the agreement of the Scottish Ministers before making a recommendation for the appointment of the Scottish member of the BBC Trust, meets the spirit of the CSD recommendation, and is the most appropriate outcome as the appointment is primarily that of a member of a UK body and broadcasting remains a reserved matter<sup>406</sup>.

767. Members of the BBC Trust are currently appointed by the Queen in Council, on the advice of UK Ministers, following an open selection process. The UK Government's stated intention is that Scottish Ministers will be involved in all steps in the appointment process: deciding selection criteria and advertising; short-listing for interview; interviewing and deciding on a preferred candidate. UK Ministers will retain oversight of the process. However, no decisions would be made in the process without the agreement of the Scottish Ministers.

768. The Scottish Government supports the CSD's recommendation but does not believe that the provisions in the Bill implement that recommendation<sup>407</sup>. It also does not agree with the UK Government's argument that it is essential for all members of UK bodies to be appointed by UK Government Ministers. It believes

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<sup>405</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p170-171.

<sup>406</sup> HM Government. *Strengthening Scotland's Future*, p58-59.

<sup>407</sup> Scottish Government, written evidence submitted to the Committee.

that it should be possible for UK bodies to operate effectively, and with a common purpose, when members are appointed by ministers from different jurisdictions.

769. In its legislative consent memorandum, the Scottish Government invites the Parliament to consider recommending further involvement of devolved Scottish institutions in broadcasting in Scotland.<sup>408</sup>

770. In his oral evidence to the Committee, the former national BBC Trustee for Scotland, Jeremy Peat, told the Committee that, when he was interviewed for the post, the interviewing committee had included representatives of both the Scottish Executive and the Department for Culture, Media and Sport.<sup>409</sup>

771. Mr Peat agreed that if the provisions in the Clause meant that the UK Ministers made the actual decision on the appointment, then this did not fully meet the terms of the CSD recommendation. However, Mr Peat went on to tell the Committee that, in his opinion, what really mattered was that the Member for Scotland has the confidence of both the UK and Scottish Governments and ability to satisfy their requirements. Mr Peat thought, given that the appointed person is both a member of a UK board, considering UK matters, and also has specific responsibility in Scotland, e.g. chairing the BBC's Audience Council Scotland, the important thing is to ensure that these two elements of the role are appropriately fulfilled.<sup>410</sup>

772. The Committee only received one piece of written evidence which dealt in part with the clause relating to the BBC Trust. In its submission, Consumer Focus Scotland indicated it supported the provision in the Bill which would require UK Ministers to reach agreement with Scottish Ministers before making a recommendation.<sup>411</sup>

773. During their evidence to the Committee, the UK Government said that—

“We have followed the spirit of what Calman suggested. Indeed, we are doing that now, even before the measures are progressed, because, as I think members will be aware, a new BBC trustee for Scotland appointment process is currently under way. Although there is no obligation to involve the Scottish Government, we have sought to do that in order that it will have an input on who will be the new BBC trustee for Scotland. We very much accept the spirit of Calman's suggested process for that. Our view was that the BBC trust is a United Kingdom body and therefore appointments to it need to be made on a United Kingdom basis. However, in effect, the Scottish ministers will have a significant input into the appointment process.”<sup>412</sup>

#### *MG Alba*

774. One related issue that arose during the consideration of the Bill relates to MG Alba. The Scottish Government is of the view that it would be desirable to use the Scotland Bill to implement the recommendation made by the Scottish

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<sup>408</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>409</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 322-325.

<sup>410</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 323.

<sup>411</sup> Consumer Focus Scotland, written evidence submitted to the Committee.

<sup>412</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 61-62.

Broadcasting Commission that Scottish Ministers approve the appointment of MG Alba's board members<sup>413</sup>.

775. The Scottish Government argue that it would be difficult to characterise MG Alba as a UK body, as it is funded by Scottish Ministers. Therefore, the Scottish Government believes that the objection raised by the UK Government, in relation to changing the accountability arrangements for BBC Trust appointments, would not apply.

776. On 11 January 2011, the Scottish Minister for Culture and External Affairs, Fiona Hyslop MSP, wrote to the UK Minister for Culture, Communication and Creative Industries, Ed Vaizey MP<sup>414</sup>. In that letter, Ms Hyslop asked Mr Vaizey to consider transferring responsibility to Scottish Ministers for the appointment of the MG Alba Board.

777. Mr Peat, in response to a question on the responsibility for the appointment of the board of MG Alba, said that, as the funding for MG Alba came from the Scottish Government, it was logical that the board of MG Alba should be appointed by the Scottish Government rather than by the UK Government.<sup>415</sup>

778. During one of his appearances at the Committee, the Parliamentary Under-Secretary of State for Scotland, Rt. Hon David Mundell MP, told the Committee that, as the question of the appointment of the MG Alba board has now been raised by the Scottish Government, the matter will be looked at by the UK Government.<sup>416</sup>

779. The Committee's detailed recommendations in relation to the BBC Trust and to MG Alba are set out later in this document.

### **Scottish Crown Estate Commissioner and the wider role of the Crown Estate**

780. The final report of the CSD recommended that the Secretary of State for Scotland should, in consultation with Scottish Ministers, more actively exercise his powers of direction under the Crown Estate Act 1961 ("the 1961 Act") and, having consulted Scottish Ministers, should give consideration to whether such direction is required immediately. It also recommended that the appointment of a Scottish Crown Estate Commissioner should be made following formal consultation with Scottish Ministers.<sup>417</sup>

781. In its response to the Calman Commission's report, the previous UK Labour Government noted the measures taken recently by the Crown Estate Commissioners to better engage with its stakeholders in Scotland. It cited, as an example, the Scottish Liaison Group, which the Crown Estate Commissioners

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<sup>413</sup> Scottish Broadcasting Commission, *Platform For Success - final report of the Scottish Broadcasting Commission*, p35.

<sup>414</sup> Scottish Government, Correspondence between the Scottish Government and UK Government about the Scotland Bill, copies provided as written evidence submitted to the Committee.

<sup>415</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 324.

<sup>416</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 398.

<sup>417</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, pages179-181.



(CEC) had established in order to improve its understanding of the views of stakeholders across the whole of its interests in Scotland<sup>418</sup>.

782. The previous UK Government's response also recognised the case for proactive engagement with the Crown Estate Commissioners in Scotland proposed in the Calman Commission's recommendations, and promised to continue to engage on important issues when they arise. The then UK Government stated its belief that the statutory power of direction provided by the 1961 Act<sup>419</sup>, a power for use in extreme circumstances and never used, should remain a sanction of last resort.

783. In the Command Paper, the present UK Government accepted the Commission recommendation that there should be a specific Crown Estate Commissioner appointed to represent Scottish interests and that this should be someone who can demonstrate significant knowledge and understanding of interests in Scotland<sup>420</sup>. The Scotland Bill, therefore, includes a clause to establish, on a statutory basis, a Scottish Commissioner, in contrast with the current arrangements under which there is simply an understanding that Scottish interests will be represented in the composition of the Crown Estate Commissioners. In addition, the Bill contains a requirement that Scottish Ministers should be consulted formally on the appointment of the Scottish Commissioner.

784. In response to the CSD's recommendation that the Secretary of State for Scotland should actively use his power to issue a direction to the Crown Estate Commissioners, the UK Government states that it is working with the Crown Estate Commissioners to improve transparency in relation to its Scottish operations, and that the Government will keep the work of the Crown Estate Commissioners under review and use its power of direction only where necessary<sup>421</sup>.

785. In its written submission to the Committee, the Scottish Government states that it believes that the CSD's recommendations are modest in terms of tackling the wider issues of accountability and transparency of the Crown Estate Commissioners in Scotland<sup>422</sup>. The Scottish Government also highlights what it believes is an anomaly. It points out that, although the CEC's activities involve policy areas that are devolved – including: rural affairs; terrestrial and marine planning; marine management and strategy; economic development; fisheries; ports and harbours – the responsibility for the power of direction over the CECs' operations in Scotland rests with the Secretary of State for Scotland, and that the CEC is not accountable to Scottish Ministers or the Scottish Parliament.

786. In addition, the Scottish Government raises concerns that the Crown Estate Commissioners' focus is to manage the Estate on a commercial basis in order to optimise financial returns. The Scottish Government, therefore, argues that the

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<sup>418</sup> HM Government, *Scotland's Future in the United Kingdom: Building on ten years of Scottish devolution*, November 2009, pages 15-16.

<sup>419</sup> The Crown Estate Act 1961.

<sup>420</sup> HM Government. *Strengthening Scotland's Future*, pages 63.

<sup>421</sup> HM Government. *Strengthening Scotland's Future*, page 6.

<sup>422</sup> Scottish Government. Letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011

limited extent to which the CEC supports other public policy objectives, or wider public interests, is a key issue which needs to be addressed. The Scottish Government point out that this issue was also highlighted by the Treasury Select Committee's review, which was published in March 2010<sup>423</sup>. That report stated that the extent of the Scottish Government's powers and responsibilities, including those over Scotland's marine environment and renewable energy development, mean that it is essential for there to be a close and constructive working relationship between the CEC and the Scottish Government<sup>424</sup>.

787. In its submission to the Committee, the Scottish Government also argues that the impact of the Bill's provision with regard to the CEC will be negligible and will not solve the fundamental anomaly of Scotland's national assets, including seabed and cultural sites, being managed by a remote and unaccountable body. The Scottish Government describes the Crown Estate Commissioners as acting as a collegiate board with the Scottish Commissioner having no specific remit or power within that board. It points out that the CEC has no separate operating division and accounting unit for the Scottish Commissioner to relate to or manage, so it believes that the UK Government cannot argue that the appointment will deliver strengthened management arrangements in Scotland or ensure CEC take greater account of Scottish interests.

788. In a letter to the Secretary of State for Scotland (a copy of which was provided to the Committee), the Cabinet Secretary for Rural Affairs and the Environment, Richard Lochhead MSP, set out his views on the Crown Estate Commissioners. The letter<sup>425</sup> informed the Secretary of State that the Scottish Government had issued its consultation paper, *'Securing the Benefits of Scotland's Next Energy Revolution'*<sup>426</sup>. The consultation sets out proposals to maximise community benefit from renewable projects. In addition, the consultation raises the question on the role of the CEC in the development of offshore low carbon projects and, more broadly, as an administrator of public assets.

789. In his letter, the Cabinet Secretary also promised to share with the Secretary of State a specific paper on the role of the CEC in Scotland and the action the Scottish Government would like to see taken in order to address its concerns. This paper does not appear to be in the public domain.

790. The Committee received 25 written submissions which wholly, or in part, dealt with the clause in the Bill relating to the Crown Estate Commissioner. Only the submissions from the Crown Estate Commissioners do not call for changes in the clause relating to the CEC.

791. Six submissions indicated support for the evidence submitted by Andy Wightman<sup>427</sup> or for the amendment to the Crown Estate Act 1961<sup>428</sup> suggested in

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<sup>423</sup> House of Commons, Treasury Committee, *The Management of the Crown Estate*, Vol 1.

<sup>424</sup> House of Commons, Treasury Committee, *The Management of the Crown Estate*, page 50.

<sup>425</sup> Scottish Government, Correspondence between the Scottish Government and UK Government about the Scotland Bill, copies provided as written evidence submitted to the Committee.

<sup>426</sup> Scottish Government, *Securing the Benefits of Scotland's Next Energy Revolution*.

<sup>427</sup> Written submissions from Andy Wightman, Chrissie Bannerman, James Hunter, Local People Leading and Rt. Hon. Brian Wilson.

<sup>428</sup> Written submissions from Mary Mackenzie and from the Scottish Islands Federation.

his submission. The written evidence from Mr Wightman stated that, if it is really the UK Government's intent that the Bill further empowers the Scottish Parliament,<sup>429</sup> the proposal contained in clause 18 is lamentable and scarcely credible. Mr Wightman pointed out that there would be no requirement for the Scottish Crown Estate Commissioner, who would be appointed under the terms laid down in the Bill, to represent the interests of Scotland or of the Scottish Parliament when fulfilling his or her role. Mr Wightman argued that this would mean that the Scottish Commissioner could wield more power over the public lands comprising the Crown lands of Scotland than the democratically-elected First Minister of Scotland or the Scottish Parliament which has legislative jurisdiction over them<sup>430</sup>.

792. Mr Wightman also asks why the power of direction, which exists to enable the Secretary of State for Scotland to direct the Crown Estate Commissioners over matters in Scotland, should continue to lie with the Secretary of State, especially since the Secretary of State has little to do with the day to day governance of Crown rights and has very limited staff capacity to take a view on how such a power should be deployed, and to what end, over the scale and range of the Crown Estate Commissioners operations in Scotland<sup>431</sup>.

793. Mr Wightman stated that he is unable to understand why the Bill cannot be used to bring the responsibility for the management and revenues of all Scotland's Crown property rights together in one place under the full jurisdiction of the Scottish Parliament. He concluded his submission with the proposal that clause 18 is removed and replaced with a provision which would amend the Crown Estate Act 1961, by inserting after Section 1(7) of that Act a new section:

“Section 1(8) This Act does not apply to Scotland.”

794. The written submission from Highland Council draws the Committee's attention the work of the Crown Estate Review Working Group (CERWG) which consisted of the six local authorities covering the Highlands and Islands, Highlands & Islands Enterprise (HIE) and the Convention of Scottish Local Authorities (COSLA). The CERWG produced a report<sup>432</sup> which was published on 21 February 2007. The main recommendation from this review was that—

“The Secretary of State for Scotland and Scottish Ministers should, given the changed circumstances of devolution, implement an appropriately constituted review to ensure that the property, rights and interests which make up the Crown Estate in Scotland contribute more fully to the delivery of Scottish Executive policies and well being of the people of Scotland.

795. The submission from Calum MacDonald<sup>433</sup>, formerly MP for Na h-Eileanan Siar, offers a different option for dealing with what he describes as a lack of

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<sup>429</sup> HM Government. *Strengthening Scotland's Future*, p11.

<sup>430</sup> Andy Wightman, written evidence submitted to the Committee, p3.

<sup>431</sup> Andy Wightman, written evidence submitted to the Committee, p2.

<sup>432</sup> Crown Estate Review Working Group, *The Crown Estate in Scotland: New Opportunities for Public Benefits*, 2006.

<sup>433</sup> Calum MacDonald, written evidence submitted to the Committee.

practical and effective accountability exacerbated by developments since devolution.

796. Mr MacDonald provides a potential model for how the Crown Estate Commissioners could operate in Scotland; one he has a working experience of, namely the Forestry Commission (FC). Mr MacDonald explained that, since devolution, there had been three key innovations in the FC, namely—

- two Forestry Commissioners for Scotland were to be appointed by the Secretary of State in Westminster after consultation with Scottish Ministers – a provision similar to clause 18 of the Bill;
- the two Scottish Commissioners were to be supported by a National Committee for Scotland whose members would be appointed by Scottish Ministers and which would be chaired by one of the Scottish Commissioners; and
- the funding of most of the FC's operations in Scotland would be via the block grant allocated to the Scottish Parliament.

797. Mr MacDonald suggests that the second of these innovations would go a significant way towards addressing the current lack of accountability of the Crown Estate Commissioners in Scotland while retaining the reserved status of the Crown Estate Commissioners, as recommended by the CSD.

798. In his submission, Mr MacDonald also supplies an option to enable the CSD's Recommendation 5.8 to be added to the Bill. He suggests the following provisions be included in the Bill so that—

- a) the Secretary of State will exercise his powers of direction after consultation with Scottish Ministers;
- b) the Secretary of State will appoint a National Committee of Scotland in consultation with Scottish Ministers to advise on the exercise of these powers;
- c) the Scottish Commissioner will chair the National Committee of Scotland.

799. Mr MacDonald contends that his proposal would have only a small financial implication for Scotland. He suggests that the costs of three appointed members of the National Committee attending five or six meetings a year should total less than £25,000 per annum. This cost could be shared between the Crown Estate Commissioners and the Scottish Ministers, as should the task of providing the secretariat for the National Committee.

800. In its written submission<sup>434</sup>, received after they provided oral evidence to the Committee, the Crown Estate Commissioners, for the first time, told the Committee about the Memorandum of Understanding (MoU) it is developing with the Scottish Government. The Scottish Government did not mention this MoU in either its written submissions or oral evidence.

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<sup>434</sup> Crown Estate, supplementary information submitted to the Committee.

801. In addition, the Crown Estate Commissioners explained that it is also developing a MoU with the Highland and Islands councils. The intention of this MoU is to provide a structure for dialogue and to help ensure that the work of the Crown Estate, local authorities and other partners are aligned in order to deliver value to coastal communities, thereby maximising economic benefits.

802. In this supplementary information, the Crown Estate also lists the other measures which it has in place and which it believes makes it more responsive to Scottish policy and stakeholders. These include—

- A separate annual Scottish report on activities with financial information about the Crown Estate in Scotland;
- A Scottish Liaison Group engaging with key stakeholders;
- Scheduled meetings with the Scottish Government, including the offer of formal meetings with relevant Scottish Ministers and committees of the Scottish Parliament; and
- A substantial increase in number of Scottish based staff to 34 and an enhancement of the Scottish Leadership team.

803. In his oral evidence to the Committee, Roger Bright, Chief Executive of the Crown Estate Commissioners, stated that the Crown Estate Commissioners would have no difficulty in working with both the Scottish Parliament and the Scottish Government<sup>435</sup>. However, Mr Bright found it difficult to hypothesise about what the more formal arrangements would be and how they work in practice.<sup>436</sup>

804. The Committee also questioned the Secretary of State on the various options which could be used to generate greater accountability for the work of the Crown Estate Commissioners in Scotland. In his response, Rt. Hon Michael Moore MP spoke about the increased number of formal meetings which he has had with the Crown Estate Commissioners since he became Secretary of State.<sup>437</sup> He told the Committee that the UK Government was open to the idea of more transparency and accountability. However, he went on to say that, although he was not currently minded to change the provisions in the Bill, he was not trying to dissuade the Committee from putting forward a case to amend the Bill's provisions.<sup>438</sup>

805. Mr Moore concluded that it was the intention of the Scotland Office and HM Treasury to develop their own engagement with the Crown Estate Commissioners, but that this should not be seen as putting any barriers in the way of the Crown Estate Commissioners also engaging properly with the Scottish Government.<sup>439</sup> Mr Bright followed up this comment to tell the Committee that the Crown Estate Commissioners has formally offered to appear before Scottish Parliament committees and before the Scottish Government Ministers in order to explain and

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<sup>435</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Cols 400-405.

<sup>436</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Cols 401.

<sup>437</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Cols 402.

<sup>438</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Cols 402

<sup>439</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Cols 402.

discuss its strategies and plans, and to better understand the Scottish Governments objectives.<sup>440</sup>

806. The Scottish Government's position is that greater engagement, whilst welcome, is not sufficient. In the last of her appearances before the Committee, Fiona Hyslop MSP, the Minister for Culture and External Affairs, confirmed that the Scottish Government was arguing for full devolution of the Crown Estate.<sup>441</sup> She went on to explain that the Scottish Government was especially concerned about the lack of policy influence for the Scottish Government under the present situation.<sup>442</sup>

807. The Minister also pointed that, as the Crown Estate Commissioners' statutory duty as laid out in the Crown Estate Act 1961 is to raise revenue, the Scottish Government believes that this often means that the decision-making in relation to the stewardship and management in areas, which are of vital importance to Scotland, can be flawed.<sup>443</sup>

808. In her evidence, Lucy Parsons, Project Manager for Marine Renewable Energy at Orkney Islands Council, told the Committee that, currently, the Council's interests are generally aligned with those of the Crown Estate, because the value of its sea bed is enhanced by the success of the industry in which the Council has a major interest. However, the question which could cause the Council problems is what happens when these interests are not aligned.<sup>444</sup>

809. For Mr Wightman, the main issue which needs to be addressed is the governance of Crown Estate Commissioners and its effective public administration and accountability.<sup>445</sup> When asked his opinion of the suggestion put forward by Calum MacDonald in his submission, Mr Wightman told the Committee that anything that improves the accountability and the ability of the Scottish Government and Scottish Parliament to make policy over these Crown rights, is to be welcomed.<sup>446</sup>

810. In his evidence, Mr Wightman put forward his understanding of the relationship between the devolved and reserved aspects of the CE and its property rights as laid out in the Scotland Act 1998.<sup>447</sup> He also drew the Committee's attention to the Scottish Law Commission's Report on Law of the Foreshore and Sea Bed<sup>448</sup>.

811. The Committee's detailed recommendations in relation to the Crown Estate Commissioners and wider matters are set out later in this document.

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<sup>440</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 403.

<sup>441</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 448.

<sup>442</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 448.

<sup>443</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 449.

<sup>444</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 461.

<sup>445</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 462.

<sup>446</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 462.

<sup>447</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 465.

<sup>448</sup> Scottish Law Commission, *Report on Law of the Foreshore and Sea Bed*, 2003.

## **Misuse of drugs**

812. Clause 19 of the Scotland Bill amends the Misuse of Drugs Act 1971 (“the MDA”) in relation to the circumstances in which a doctor may prescribe controlled drugs to a person addicted to certain drugs. Section 10((2)(i) of the MDA provides for the Secretary of State to make regulations to prohibit a doctor from providing certain controlled drugs to such a person except in accordance with an “addicts licence”.

813. The Bill proposes amending the MDA—

- to give Scottish Ministers powers to issue addicts licences to doctors acting in Scotland and to set terms and conditions and modify or revoke existing licences;
- to give Scottish Ministers (instead of the Secretary of State) a power of direction to any doctor who has contravened certain provisions of the MDA, where the contravention relates to activities which took place in Scotland; and
- to give Scottish Ministers (instead of the Secretary of State) the power to refer cases about directions to a tribunal or advisory board.

814. Evidence on this clause was provided to the Committee by a number of bodies, including: the Accountable Officer Network Scotland; the Independent Healthcare Advisory Services (including the Scottish Independent Hospitals Association (SIHA) and the Scottish Independent Nurse Association (SINA)), the Law Society of Scotland and the Scottish Government.

815. Most of the evidence taken generally endorses the Bill’s provision, including that from the Scottish Government which “broadly supports the provisions on licensing to treat addiction”.<sup>449</sup> However, the Accountable Officer Network Scotland highlighted a number of points or questions which might need to be considered in terms of devolving responsibility for licensing. These related to the choice of body for licensing, governance issues, how monitoring and management of licensing would be undertaken and the need to review the current responsibility of Accountable Officers.<sup>450</sup>

## **Drink-driving limits**

816. Clause 20 of the Scotland Bill amends the Road Traffic Act 1988 to give Scottish Ministers powers to make regulations in relation to the prescribed alcohol limit which applies when driving in Scotland. The Road Traffic Act includes two offences when the limit has been exceeded: causing death by careless driving when under the influence of alcohol and driving a vehicle with an alcohol level about the prescribed limit.

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<sup>449</sup> Scottish Government. Letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>450</sup> Accountable Officer Network Scotland, written evidence submitted to the Committee, paragraph 4.

817. Evidence on this clause was provided to the Committee by a number of bodies, including: ACPOS, Brake, Law Society of Scotland, Road Haulage Association Ltd, Royal College of Physicians of Edinburgh, Royal Society for the Prevention of Accidents (RoSPA), UNISON Scotland and the Scottish Government.

818. Most of the evidence received expressed support for the proposal that the Scottish Ministers should set the alcohol limit for driving. This includes the Scottish Government itself, which “broadly supports the provisions on drink driving”.<sup>451</sup>

819. In its written evidence, Brake (a road safety charity) highlighted that currently the drink drive limit in Scotland, England, Northern Ireland and Wales is 80mg per 100ml alcohol. This was the highest limit in Europe, shared only with Malta. Brake stated that—

“In 2008, 40 people were killed in Scotland by drivers who were over the legal alcohol limit. 170 people were severely injured which means that they suffered injuries such as brain damage, paralysis and loss of limbs.”<sup>452</sup>

820. Brake believes that lowering the drink drive limit to 20mg per 100ml of blood would help to reduce this toll as well as reducing the number of deaths and injuries that are caused by drink drivers who are below the current legal limit. Brake’s priority is that the drink drive limit in the UK is lowered as widely as possible.<sup>453</sup>

821. In further evidence to the Committee, Brake provided international comparisons, showing that—

“European countries have reduced their drink drive limits, however Great Britain has not yet committed to doing so. Most EU countries have a drink drive limit of 50mg/100ml, but in Sweden, Poland, Estonia, the Czech Republic, Slovakia and Hungary it has been lowered to 20mg/100ml or less. The European Commission adopted a recommendation in January 2001 which proposed harmonisation of the BAC level at 50mg or below.”<sup>454</sup>

822. RoSPA stated that the current drink drive limit of 80mg per 100ml of blood should be lowered to 50mg per 100ml of blood and that this level should be applied across the UK.<sup>455</sup>

823. One of the key issues to emerge during the Committee’s consideration of this issue related less to the principle of devolution of these powers and more to whether this goes far enough. The Minister for Culture and External Affairs told the Committee that additional devolution of a more complete package of powers over drink-driving would be helpful. She said—

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<sup>451</sup> Scottish Government. Letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>452</sup> Brake, written evidence submitted to the Committee.

<sup>453</sup> Brake, written evidence submitted to the Committee.

<sup>454</sup> Brake, written evidence submitted to the Committee.

<sup>455</sup> The Royal Society for the Prevention of Accidents, written evidence submitted to the Committee.



“In terms of policy implementation, that would be in the interests of the police as it would give them the powers on random breath testing and penalties that they would need to make an impact. There is no reason why it cannot be devolved and members on all sides of the chamber have called for that for a number of years. There is no strong reason for it to be retained; the case for that has still to be argued.”<sup>456</sup>

824. This view was also illustrated by the Road Haulage Association Ltd—

“The proposed transfer of a few powers relating to transport are helpful but the split between reserved and devolved matters remains unnecessarily complicated. It would seem far better constitutionally, and practically, to start from the presumption that all transport issues should be devolved unless there is an exceptional reason for not doing so.”<sup>457</sup>

825. Neil Greig of the Institute of Advanced Motorists also supported transfer of additional powers. He said “... for road safety, it does not really make sense to have just the power to alter the drink-driving limit without having the powers over penalties and without considering the impact on the police, which is also a devolved matter.”<sup>458</sup>

826. During their evidence to the Committee, UK ministers said that—

“The first important point, particularly given how some of the evidence to the committee is reported, is that devolving powers over certain matters under the Scotland Bill will not automatically lead to change on those matters. Whether the Scottish Parliament makes changes to, for example, drink-driving limits, speed limits or the regulation of air guns will be entirely a matter for it to determine.

On the specific point about the range of drink-driving powers, that issue was considered in detail by the Calman commission, which concluded — and the Government shares this view — that responsibility for the other powers should rest with the UK Government. That was to ensure certainty of provision throughout the UK while allowing the Scottish Parliament and Government to influence issues in relation to alcohol consumption and crime in Scotland.”<sup>459</sup>

827. The Committee’s detailed recommendations in relation to drink driving are set out later in this document.

## **Speed limits**

828. Clause 21 of the Bill would allow Scottish Ministers the power to set speed limits on all Scottish roads without the need to consult with the Secretary of State, and Scottish Ministers would also be enabled to specify signs for a Scottish national speed limit. The powers would include setting the national speed limit on

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<sup>456</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 433.

<sup>457</sup> Road Haulage Association, written evidence submitted to the Committee.

<sup>458</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 340.

<sup>459</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 397.

special roads, and setting the national speed limit on all other roads (except the 30mph limit on restricted roads), including the current 70mph on all dual carriageways and the current 60mph on all single carriageways.

829. In its evidence to the Committee, the Scottish Government set out the current position—

“Legislation relating to speed limits is currently reserved, although certain functions are delegated to Scottish Ministers. The national speed limits (30mph generally in built-up areas; 60mph on single carriageway rural roads; and 70mph on dual carriageways and motorways) are set by the UK Government. Local authorities have the power to set lower speed limits on local roads in their areas on a road by road basis and Scottish Ministers have the power to set lower speed limits on trunk roads, also on a road by road basis.”<sup>460</sup>

830. Evidence was received from a wide range of bodies including Brake, the Law Society of Scotland, the Road Haulage Association Ltd, RoSPA, UNISON Scotland, WWF Scotland and private individuals. The key issues highlighted in the evidence included—

- the case for devolving all powers relating to setting speed limits;
- whether the powers should allow for an increase as well as a reduction in speed limits;
- restricting powers to setting the speed limit to cars only or including other classes of vehicle;
- the reasons for reducing the speed limit (including road safety and environmental grounds);
- the case for increasing the limit for freight vehicles; and
- whether the different speed limits north and south of the border could lead to confusion.

*The case for devolving all powers on speed limits to Scottish Ministers*

831. Some of those providing evidence to the Committee suggested that one of the reasons for supporting the case for devolving all powers associated with setting speed limits to Scottish Ministers was that there was a difference in Scottish roads and a local knowledge which was best recognised by those in Scotland. For example, the Scottish Government felt that—

“As with national speed limits, we would not want to be subject to any changes which the UK Government may decide to make to vehicle speeds. Scotland’s roads, by their very nature, may need different solutions for

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<sup>460</sup> *Scottish Government*, letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

vehicle speeds than those of England. Any decisions on the speed of vehicles on Scottish roads should therefore be for the Scottish Ministers.”<sup>461</sup>

832. Similarly, the Road Haulage Association Ltd stated that—

“We think that speed limits in Scotland should be set in Scotland, because of the differences in the roads. The vast majority of roads in Scotland are rural roads. Local knowledge of how safe those roads are, and of the volumes of traffic concerned, means that there would be a benefit from speed limits in Scotland being dealt with in Scotland, rather than at Westminster, where the majority of people have probably never been in Scotland or seen the roads here. There are differences, and we believe that the Scottish Parliament is best placed to make the decisions for the roads here.”<sup>462</sup>

*Restricting the speed limit to cars only*

833. At present, the Bill’s current provisions are restricted to cars only. When they appeared before the Committee, UK ministers were questioned on why this was the case. In response, Rt. Hon David Mundell MP, Under Secretary of State for Scotland, told the Committee—

“There is a range of speed limits for specific vehicles. It is not the intention to devolve specific speed limits, partly on the basis that it is incumbent on those who drive those vehicles to know the speed limit for that vehicle and that it is more straightforward to have those limits consistent throughout the UK. However, the speed limit for cars – which make up the vast majority of vehicles in Scotland and the UK – is a national speed limit. That is the speed limit that was to be devolved.”<sup>463</sup>

*Case for including other classes of vehicle*

834. In the evidence heard by the Committee, there was a reasonable degree of support for the inclusion of vehicles such as HGVs, buses and cars towing caravans to be included in the power to set a national speed limit. The Scottish Government argued that—

“The omission of the ability to set the maximum speed limits for different classes of vehicle seems anomalous, particularly as the main evidence given to the Commission on this subject was from the Road Haulage Association Scotland. *There was no indication in the Commission’s report that it intended its recommendation to be restricted in this way.* The clause therefore leaves in place the current complex patchwork of responsibility for speed limits in Scotland, depending on the type of road and vehicle, which the Bill could otherwise have rationalised through a more comprehensive package of Scottish powers.

It is the Scottish Government’s view that the provisions should be adjusted to devolve responsibility for the speed of all classes of vehicle, not just the

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<sup>461</sup> Scottish Government. Letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>462</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Cols 341-342.

<sup>463</sup> Scotland Bill Committee. *Official Report*, 14 December 2010, Col 66.

maximum speed of vehicles on roads. This would provide greater clarity and accountability for this issue in Scotland.”<sup>464</sup>

835. This view was echoed by the Road Haulage Association which felt that “the split between reserved and devolved matters remains unnecessarily complicated” and recommended that all transport issues should be devolved<sup>465</sup> and WWF Scotland also supported “a more comprehensive devolution of powers over national speed limits”<sup>466</sup>.

836. Conversely, Neil Greig of the Institute of Advanced Motorists believed that it was right that other vehicles were not included in the devolved power, stating that if they were included it would add an extra layer of complication.<sup>467</sup>

*Reducing speed limits - safety and environmental grounds*

837. Evidence supporting a reduction in speed limits covered a range of different angles. Brake believed that the default urban limit should be lowered to 20mph and that the national speed limit should be lowered from 60mph to 50mph, with lower limits where risks are higher. They cited statistics to support this—

“International academic evidence shows that 20mph limits and zones in residential areas and around community facilities are effective in improving road safety ... Evidence also suggests that the national speed limit is inappropriately high for many rural roads and that lowering the limit on rural roads would help reduce casualties and the disproportionately high number of deaths that happen on rural roads. In Great Britain, 61% of road deaths happened on rural roads in 2009 despite only 33% of crashes occurring there.”<sup>468</sup>

838. Similarly, RoSPA was of the view that “The more speed, the greater the danger, so we would advocate reducing speeds”<sup>469</sup>. WWF Scotland, on the other hand, advocated environmental reasons as the basis of its case for reducing speed limits—

“The optimum speed for fuel efficiency and carbon emissions of the average car is around 40-55mph. Cutting the national speed limit will also increase engine and tyre life, reducing costs of maintenance and repair, and could cut the number of deaths and serious injuries on Scotland’s roads. A report commissioned by the Scottish Government in August 2009 states that lower speed limits and smoother traffic flow ‘will have the effect of improving vehicle efficiency and reducing CO2 emissions’.”<sup>470</sup>

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<sup>464</sup> Scottish Government, letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011

<sup>465</sup> Road Haulage Association, written evidence submitted to the Committee.

<sup>466</sup> WWF Scotland, written evidence submitted to the Committee.

<sup>467</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Col 345.

<sup>468</sup> Brake, written evidence submitted to the Committee.

<sup>469</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Col 344.

<sup>470</sup> WWF Scotland, written evidence submitted to the Committee.

*Increasing speed limits for freight vehicles*

839. The Committee heard arguments in favour of increasing the national speed limit in certain circumstances and locations for freight vehicles (a power which is not currently in the Bill). The Road Haulage Association Ltd referred to the economic case, with Scotland having “many strategic single carriageway roads which are the lifeblood of the Scottish economy in being able to move goods efficiently across the country”. Its representative, Phil Flanders, cited a parliamentary committee’s inquiry into freight transport, which recommended a trial on increased speed limits<sup>471</sup>. He also stated that—

“With regard to many roads, and the A9 in particular, the Scottish Parliaments inquiry into freight in 2005 or 2006 recommended that we trial an increased speed limit to see how it would work. There are arguments for and against that, but in the long term, as far as the safety element is concerned, people would see that such a change would not increase the rate of accidents. We have evidence from studies that were carried out by Transport Scotland that shows that if trucks were allowed to do 50mph, and if that limit were rigorously enforced, and if cars stuck to a limit of 60mph, and that was also rigorously enforced, the number of accidents on the A9 would reduce by 18 per cent.

[...]

We can argue all we want, but if we do not have a trial to see what happens we will never know. We have a chance to do that up here, and to lead the UK yet again.”<sup>472</sup>

840. Neil Greig was also supported of the A9 trial, emphasising that “the key point for us is that it would be very welcome if the devolution of the power provided flexibility to deal with local issues”<sup>473</sup>

841. During his initial evidence to the Committee, David Mundell MP said that—

“It is not the intention to devolve specific speed limits, partly on the basis that it is incumbent on those who drive those vehicles to know the speed limit for that vehicle, and that it is more straightforward to have those limits consistent throughout the United Kingdom. However, the speed limit for cars — which make up the vast majority of vehicles in Scotland and the UK — is a national speed limit. That is the speed limit that was to be devolved.”<sup>474</sup>

842. However, on the specific issue of the flexibility to set limits of certain roads, the UK Minister stated that he would consider the matter to write to the Committee.<sup>475</sup>

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<sup>471</sup> Scottish Parliament, Local Government and Transport Committee. 10<sup>th</sup> Report 2006, *Report on Inquiry into Freight Transport in Scotland*.

<sup>472</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Col 342.

<sup>473</sup> Scotland Bill Committee. *Official Report*, 1 February 2011, Col 343.

<sup>474</sup> Scotland Bill Committee. *Official Report*, 1 December 2010, Col 66.

<sup>475</sup> Scotland Bill Committee. *Official Report*, 3 February 2011, Col 399.

843. The Committee's detailed recommendations in relation to speed limits are set out later in this document.

## OTHER CHANGES PROPOSED TO THE SCOTLAND ACT

### Background

844. In addition to other changes to the legislative powers of the Scottish Parliament and the executive competences of the Scottish Ministers, the UK Government proposes to make a series of additional changes to the Scotland Act 1998. In this section, the Committee reviews the evidence taken in relation to—

- Administration of elections to the Scottish Parliament (Clauses 1-3);
- Appointment of the Presiding Officer and deputies (Clause 4);
- Appointment of the Scottish Parliamentary Corporate Body (SPCB) (Clause 5);
- Statements of legislative competence (Clause 6); and
- Members' interests (Clause 8).

845. The Committee's conclusions and recommendations on these areas can be found in the final section of this report.

### Elections

846. In its final report, the CSD recommended that the powers of the Secretary of State for Scotland relating to the administration of elections to the Scottish Parliament should be devolved<sup>476</sup>. In its response to the recommendation, the previous UK Government agreed to consider carefully how certain aspects of executive responsibility for putting in place the framework for the administration of the Scottish Parliament elections might be devolved, whilst ensuring the efficient and effective conduct of elections<sup>477</sup>.

847. In the current UK Government's Command Paper<sup>478</sup> which it published to accompany the Scotland Bill, it refers to the work of the Arbuthnott Commission, which in its 2006 report<sup>479</sup> stated that there should be a review of the electoral system after the 2011 elections to the Scottish Parliament. The Government have agreed to consider this recommendation, taking into account the views of the new Scottish Parliament, following the May 2011 elections.

848. The Command Paper also discusses the 2007 Gould Report<sup>480</sup> which had considered the devolution of responsibility for elections in Scotland, following problems encountered during the combined local government and Scottish

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<sup>476</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, pages 162-163.

<sup>477</sup> HM Government, *Scotland's Future in the United Kingdom: Building on ten years of Scottish devolution*, November 2009, page 27.

<sup>478</sup> HM Government, *Strengthening Scotland's Future*, page 51.

<sup>479</sup> Commission on Boundary Differences and Voting Systems, *Putting Citizens First: Boundaries, Voting and Representation in Scotland*, 2006.

<sup>480</sup> Electoral Commission, *Independent Review of the Scottish Parliamentary and Local Government Elections*, 2007.

Parliamentary elections of 2007. The independent review led by Mr Gould had recommended that exploratory discussions should take place with a view to assigning responsibility for both elections to one jurisdictional entity. In its view, the Scottish Government would be the logical institution<sup>481</sup>.

849. In its report, the CSD stated that devolving those elements of responsibility for the administration of elections, currently vested in the Secretary of State for Scotland, would be consistent with the principle that matters should be decided at the level closest to those affected, unless there are good reasons for determining them at a UK level<sup>482</sup>. In its Command Paper, the UK Government states that it agrees with this approach<sup>483</sup>.

850. The UK Government goes on to state that it believes that there are good reasons why some elements of electoral administration should remain with the Secretary of State as they relate to reserved matters (in particular the franchise and the combining of Scottish Parliament polls with polls at other reserved elections), thus ensuring that issues of UK constitutional importance continue to be dealt with at UK level. The UK Government believes that the provisions in the Bill will enable Scottish Ministers to make general provision for the conduct and administration of elections to Holyrood, subject to necessary constraints<sup>484</sup>. The Command Paper does not indicate what these constraints are.

851. While, in its submission to the Committee, the Scottish Government welcomes the devolution of the administration of Scottish Parliament elections as set out in the CSD recommendation, it also points out that it has consistently argued that full legislative, as well as administrative, responsibility for the elections should be devolved<sup>485</sup>. The Scottish Government believes that the Gould report could be seen to support this view<sup>486</sup>. On 10 January 2008, the Scottish Parliament welcomed the Gould Report and endorsed its recommendation calling for “full devolution of executive and legislative powers to the Scottish Government and Parliament for the administration of its own elections”<sup>487</sup>.

852. The Scottish Government accepts that the provisions in the Scotland Bill would result in an improvement to the current position, devolving certain (but not all) administrative arrangements. The Scottish Government believes that the Bill’s provisions offer Scottish Ministers the opportunity to make rules of conduct for elections, but that they would need to approach the UK Government if primary legislation was required, for example, in relation to the date of elections or the voting system used. The Scottish Government also believes that the Scottish Parliament’s role would be limited to approving or disapproving the rules made by

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<sup>481</sup> Electoral Commission, *Independent Review of the Scottish Parliamentary and Local Government Elections*, 2007, page 111.

<sup>482</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, page 163.

<sup>483</sup> HM Government. *Strengthening Scotland’s Future*, page 51.

<sup>484</sup> HM Government. *Strengthening Scotland’s Future*, page 51.

<sup>485</sup> Scottish Government, letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>486</sup> Electoral Commission, *Independent Review of the Scottish Parliamentary and Local Government Elections*, 2007, page 111.

<sup>487</sup> Scottish Parliament, *Official Report*, 10 January 2008, Cols 5020-5021.



Scottish Ministers; with the Parliament having no opportunity to shape the parameters for those rules through its own primary legislation. The Bill also requires that Scottish Ministers must consult the Secretary of State before making the rules.

853. The Gould Report had indicated that fragmentation of responsibility was a key issue in the problems highlighted in the 2007 elections. In its submission to the Committee<sup>488</sup> the Scottish Government point out that under the proposals in the Bill, there would be further fragmentation, with the Secretary of State retaining a number of responsibilities including voter registration, rules about the composition of Parliament, the procedure for filling any regional seat vacancy during the life of a Parliament and rules relating to disqualification. These areas would be covered by separate Scottish Parliament Rules to be made by the Secretary of State. However, there would be no requirement for the Secretary of State to consult Scottish Ministers about these rules (in contrast to the equivalent requirement placed on Scottish Ministers).

854. The Scottish Government believes that full devolution of the administration of elections would reflect the spirit of the Gould Report and would allow the Scottish Parliament and Scottish Ministers to work with electoral professionals in Scotland to ensure that the problems highlighted by the Gould Report do not happen again.

855. In its legislative consent memorandum<sup>489</sup> the Scottish Government welcomes the suggestion that the UK Government will consider a review of the electoral system after the 2011 elections to the Scottish Parliament, taking into account the views of the new Scottish Parliament, as suggested by the report of the Arbuthnott Commission.

856. The Scottish Government does not consider that the UK Government's current policy for a simple transfer of Ministerial powers addresses the position satisfactorily. The Scottish Government, therefore, invites the Parliament to consider the case for devolution of legislative competence over the administration of elections, and to examine the detail of the proposed division of responsibilities between Scottish and UK Ministers.

857. In its submission to the Committee the Scottish Government provides its own draft amendment to the Bill, which it believes would devolve to the Scottish Parliament full responsibility for elections.

858. The Committee only received one piece of written evidence which related specifically to the clauses in the Bill dealing with elections<sup>490</sup>. In its written evidence, the Electoral Commission draws the Committee's attention to the Local Electoral Administration (Scotland) Bill, currently before the Scottish Parliament, which seeks to establish on a statutory basis the work of the Electoral Management Board in relation to local government elections in Scotland. This would include providing the Convener of the Board with a power of direction over other local government Returning Officers and Electoral Registration Officers. The

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<sup>488</sup> Scottish Government, letter from the Minister for Culture and External Affairs to the Convener of the Scotland Bill Committee, dated 31 January 2011.

<sup>489</sup> Scottish Government, Legislative Consent Memorandum: Scotland Bill, LCM(S3)30.1.

<sup>490</sup> Electoral Commission, written evidence submitted to the Committee.

Electoral Commission welcomes this Bill and supports the establishment of a statutory Electoral Management Board and a power of direction for its Convener for elections to the Scottish, UK and European Parliaments.

859. The Electoral Commission believes that, should clause 1 of the Scotland Bill be enacted, it would potentially create a vehicle by which the remit of the Electoral Management Board, and the power of direction of its Convener, could be extended to cover Scottish Parliament elections. It understands that this is the policy intention of the Scotland Office but that the Scottish Government is concerned that the intention may not be achievable as the Scotland Bill is currently drafted. The Electoral Commission, therefore, encourages the Committee to ascertain whether clause 1, as currently drafted, would allow the extension of the Board's remit to occur.<sup>491</sup>

860. In her evidence to the Committee, Mary Pitcaithly, chair of the Interim Electoral Management Board told the Committee that the Board would welcome the potential for its remit to be extended to cover elections beyond its existing remit of local government elections, including Scottish Parliament elections<sup>492</sup>.

861. Ms Pitcaithly also stated that, as returning officers in Scotland deal with various pieces of legislation when running an election, there would always be potential for confusion, but they were confident that returning officers would know which rules they should be following for the various elections held in Scotland. However, she further commented that she did not believe that any potential confusion would be affected by responsibilities for such rules being entirely reserved or devolved. When pressed on this topic, she pointed out that their role is simply to implement whatever government policies are decided on by others.<sup>493</sup>

862. The witnesses from the Interim Electoral Management Board agreed that it was not unreasonable for the Bill to specifically call for consultation between the Secretary of State and the Scottish Ministers on any proposed changes to the rules dealing only with rules relating to the Scottish Parliament. In addition the witnesses also considered that a requirement for consultation with the practitioners should also form part of the Bill's provisions.

863. In his evidence to the Committee on 3 February 2011, the Parliamentary Under-Secretary of State for Scotland, Rt. Hon David Mundell MP, reiterated the UK Government's belief that the measures set out in the bill offer the appropriate balance of responsibilities between the Scottish Parliament and the Westminster Parliament.<sup>494</sup>

864. In addition, the Scotland Office minister agreed that the UK Government would be willing to look at how the proposed Electoral Management Board's arrangements for the Scottish Parliament elections could work best with the Scottish Parliament's statutory footing for local elections<sup>495</sup>.

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<sup>491</sup> Electoral Commission, written evidence submitted to the Committee.

<sup>492</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 326.

<sup>493</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 328.

<sup>494</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 396.

<sup>495</sup> Scotland Bill Committee, *Official Report*, 3 February 2011, Col 397.

865. The Committee's detailed recommendations in relation to elections are set out later in this document.

**SPPA Committee recommendations (Clauses 4, 5, 6 and 8)**

866. In relation to the Scotland Bill's provisions which accorded with the recommendations provided by the Standards, Procedures and Public Appointments ("SPPA"), the Committee has agreed at the outset that there is little to be gained in considering matters that the SPPA Committee has already debated and approved. Its view is that these procedures have already been scrutinised by the Parliament.<sup>496</sup>

867. The SPPA Committee's recommended changes to the Scotland Act were based on its consideration of a number of the procedural issues raised in a CSD report in 2010<sup>497</sup>. It should be noted that the Scottish Parliament has already endorsed the findings and recommendations in the SPPA Committee's report<sup>498</sup>. These recommendations, which are reflected in the Bill, are summarised below.

**868. On all of the provisions in the Bill relating to the areas previously covered by the SPPA Committee, this Committee is content and would recommend that the Scottish Parliament gives its legislative consent to the UK Parliament to legislate in this respect.**

*Presiding Officer and Deputy Presiding Officers (clause 4)*

869. The SPPA Committee supported the CSD's recommended changes to section 19 of the Scotland Act in relation to the election of the Presiding Officer and two deputy Presiding Officers. The proposed changes related to—

- loosening the current requirement that the elections for the Presiding Officer and deputies must take place at the first meeting following a general election. Clause 14 replaces this with a requirement that the elections must take place within 14 days of the election and before any other proceedings (other than the oath taking); and
- giving the Scottish Parliament power to appoint additional temporary deputies to mitigate against any additional pressures being placed on the existing office holders in circumstances, such as a period of illness, where the Presiding Officer or one of the existing deputies is unable to carry out the functions of the office.

870. The Law Society of Scotland was of the view that "this is a sensible provision which the Society endorses".<sup>499</sup>

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<sup>496</sup> Scotland Bill Committee. *Official Report*, 7 December 2010, Col 9.

<sup>497</sup> Standards, Procedures and Public Appointments Committee, 5<sup>th</sup> Report 2010, *The recommendations of the Commission on Scottish Devolution regarding Scottish Parliament procedures*.

<sup>498</sup> Scottish Parliament, *Official Report*, 29 September 2010, Col 29066.

<sup>499</sup> Law Society of Scotland, written evidence submitted to the Committee.

*Composition of the Scottish Parliamentary Corporate Body (clause 5)*

871. The CSD also suggested (without making firm recommendations) a number of procedural aspects of the Scotland Act that might merit review. The SPPA Committee made one recommendation in this context, namely that section 21 of the Scotland Act could be amended to provide greater flexibility over the composition of the SPCB.

872. The SPPA Committee noted that the current membership of the Presiding Officer and four other members reflected the current situation of four major political parties forming most of the Scottish Parliament's membership, but this might not always be the case. The Bill proposes, therefore, that that this section of the Act be amended so that membership of the SPCB is no longer fixed at four, but must have *at least* four members and any increase in the number would be implemented by the Scottish Parliament through a change to Standing Orders.

873. In its evidence, the Law Society of Scotland agrees with the proposal, which would "help to take account of minority political interests".<sup>500</sup>

*Statements on legislative competence (clause 6)*

874. The SPPA Committee also agreed with the CSD's recommendation that section 31 of the Scotland Act should be amended to require that any person introducing a Bill should make a statement that the Bill is within the legislative competence of the Parliament. At present this requirement applies only to a Minister who is introducing a Bill.

875. The Law Society for Scotland in its written evidence agreed that any person introducing a Bill should certify the legislative competence of the measure and was also of the view that "the explanatory notes published with the Bill should give a general account of the main considerations that informed the statement on legislative competence under section 31(1) [of the Scotland Act]".<sup>501</sup>

*Members' interests (clause 8)*

876. In its report, the CSD was of the view that "it is important that the Parliament's own standards regime is able to evolve and adapt to changing circumstances" and therefore suggested that the Scottish Parliament be invited to make proposals to allow for greater discretion in this area.

877. The Scotland Act (section 39) currently requires the Scottish Parliament to make provision which proscribes certain conduct (failure to register or declare certain interests, and undertaking paid advocacy) and makes contravention of those provisions a criminal offence (incurring a penalty, on summary conviction, of a fine not exceeding level 5 on the standard scale). The Scottish Parliament is also enabled to apply its own sanctions for contravention of these provisions.

878. The SPPA Committee agreed with the Calman Commission that the current provisions of the Scotland Act are too prescriptive and therefore recommended that section 39 should be amended to give the Scottish Parliament greater discretion in the implementation its members' interests regime. Clause 8 of the Bill

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<sup>500</sup> Law Society of Scotland, written evidence submitted to the Committee.

<sup>501</sup> Law Society of Scotland, written evidence submitted to the Committee.

would allow the Scottish Parliament to make its own provision in relation to criminal offences in this area (rather than prescribing the offences in the Scotland Act) and would give greater flexibility about the circumstances in which sanctions were to be imposed on members. Any changes to the current arrangements would be implemented by an Act of the Scottish Parliament replacing the current Interests of Members of the Scottish Parliament Act 2006 and in the meantime, the Scotland Bill contains transitional provisions to continue the 2006 Act.

## LEGAL AND TECHNICAL PROVISIONS

879. The final set of proposals suggested by the UK Government as part of the Bill or Command Paper that were considered by the Committee are the legal and technical provisions. In this section, the Committee reviews the evidence taken in relation to:

- Partial suspension of Acts subject to scrutiny by Supreme Court (Clause 7);
- Continued effect of provisions where legislative competence conferred for limited period (Clause 10);
- Time limit for human rights actions against Scottish Ministers etc (Clause 16);
- Implementation of international obligations (Clause 23);
- Maximum penalties which may be specified in subordinate legislation (Clause 33); and
- Proposed amendments to Section 57 and 98 of the Scotland Act 1998 – Devolution issues and acts of the Lord Advocate.

880. The Committee's conclusions and recommendations on these areas can be found in the final section of this report.

### **Partial suspension of Acts subject to scrutiny by Supreme Court**

881. Section 33 of the Scotland Act 1998 allows the Advocate General, The Lord Advocate or the Attorney General to refer a Bill directly to the UK Supreme Court on the basis that the Bill, or any provision of it, is not within the competence of the Scottish Parliament. The power must be exercised within 4 weeks of the Bill being passed by the Scottish Parliament. This power has not been exercised to date.

882. Clause 7 of the Scotland Bill introduces a new section 33A into the Scotland Act. In essence it allows for part, or parts of a Bill, to be referred to the Supreme Court whilst allowing the rest of the Bill to be brought into force. This is referred to as a "limited reference" whereas a reference of the whole Bill is referred to as a "general reference". The limited reference provision is new.

883. Section 33A(8) allows the UK Supreme Court to make certain orders to ensure the provisions which have been referred cannot be brought into force before the Court has considered the case and has thereafter issued an order following its consideration.

884. In any event it is for Scottish Ministers to commence the provisions after such time as the Court says that it is appropriate to do so using the negative resolution procedure. If, however, the Court considers the provisions are beyond competence then the Court may prohibit Ministers from bringing them into force.

885. In his evidence to the Committee, Richard Keen QC, the Dean of the Faculty of Advocates expressed concern that the ability to bring into force certain provisions of an Bill whilst others remain suspended may be contrary to the will of Parliament which may have passed a Bill due to the “checks and balances” between parts of the Bill i.e. Parliament would not have legislated in respect of one part of an Bill without the benefit of the check or balance that exists elsewhere in the same Bill.<sup>502</sup> He suggested that one way of resolving the issue would be for the order bringing into force the non-referred parts of the Bill to be subject to the affirmative procedure. This would provide the Scottish Parliament with the opportunity to decide whether the non-referred parts of the Bill should come into force independently of the referred parts. In practice this would mean that the Parliament would have a second opportunity to debate the non-referred parts of the Bill. This would have the disadvantage of potentially opening up the scope of the Bill again.

886. The Law Society of Scotland in its written evidence found the concept of a “limited reference” attractive.<sup>503</sup> The Society considers that it addresses the concern that the impact of a reference has, in the past, caused the Law Officers not to make a reference. However, it too pointed out that it may prove difficult in practice to separate parts of a Bill.

887. The Scottish Government’s view of Clause 7 was set out in its legislative consent memorandum. It concludes that “there are strong arguments against it”.<sup>504</sup>

888. The Committee’s detailed recommendations in relation to the legal and technical provisions in the Scotland Bill are set out later in this document.

### **Continued effect of provisions where legislative competence conferred for limited period**

889. Clause 10 of the Bill has been referred to by some as a ‘reverse Sewel’ provision. Its effect is that when an Order in Council has been made under section 30 of the Scotland Act, then that change can be time limited. The amendment would cease to have effect at the end of the set period and the provision would return to its previous effect. Anything done using the amended provision will, however, continue to have effect.

890. Despite being referred to as a ‘reverse Sewel’ it is more like a “sunset clause”. It would mean that only one order would be required to achieve the same effect rather than one to make the change and another to remove it. Any order under section 30 requires the approval of both Houses at Westminster and of the Scottish Parliament.

891. The Scottish Government’s view is that whilst the proposal would address some of the difficulties that arose recently through the *Somerville* case, it would generally be preferable for orders made under section 30 of the Scotland Act 1998 to transfer legislative competence to the Parliament on a permanent basis.

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<sup>502</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col364.

<sup>503</sup> *Law Society of Scotland*, written evidence submitted to the Committee.

<sup>504</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

892. The view of the Law Society of Scotland is that it “does not see the necessity for this clause and would welcome further explanation of the need for it”.<sup>505</sup> Christine O'Neill of the Law Society explained—

“[...] If an order confers temporary competence but does not include the provision for the act to live beyond that temporary competence, is it the UK Government's view that when temporary competence ends, any act made under it disappears? If so, that is quite contrary to our understanding of the validity of acts of the Scottish Parliament.

If it is the Government's position that the act disappears when the competence power disappears, there is nothing special about temporary competence that makes it different from ordinary competence.”<sup>506</sup>

893. The Committee's detailed recommendations in relation to the legal and technical provisions in the Scotland Bill are set out later in this document.

### **Time limit for human rights actions against Scottish Ministers etc**

894. Clause 16 of the Scotland Bill substitutes the provisions of the Convention Rights Proceedings (Amendment) (Scotland) Act 2009 to insert a time limit of one year for actions against the Scottish Ministers under the Scotland Act 1998 where it is claimed that they have acted incompatibly with Convention rights. It was understood that the 2009 Act should be a temporary measure, to deal with the outcome of the *Somerville* case. The opportunity is taken here to amend the relevant provisions in the Scotland Act and repeal the 2009 Act.

895. In its evidence to the Committee, the Law Society of Scotland refers to the lack of consultation on the introduction of a one year time bar in the 2009 Act. In its opinion, this will have the effect of limiting the capacity of many people, who may have had their human rights infringed by the Scottish Ministers, from taking appropriate action to vindicate their human rights. Nevertheless, the Society agrees that there should be consistency between the time bar period for devolution issues under the Scotland Act and other devolution legislation and the time bar period under the Human Rights Act 1998. It questions, however, whether one year is the correct period.<sup>507</sup>

896. The Faculty of Advocates points out that the logic of the one year period is that it is consistent with the provision applying to claims brought against any other public authority under the Human Rights Act 1998.<sup>508</sup> The European Court of Human Rights itself applies a six month time limit to claims.

897. The Law Society of Scotland also takes issue as to the point at which the year begins to run. The Bill provides that the period begins “with the date on which the act complained against took place”. The Society points out that whilst this may conform with the Human Rights Act 1998, it is at odds with other

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<sup>505</sup> Law Society of Scotland, written evidence submitted to the Committee.

<sup>506</sup> Scotland Bill Committee, Official Report, 1 February 2011, Col 365.

<sup>507</sup> Law Society of Scotland, written evidence submitted to the Committee.

<sup>508</sup> Scotland Bill Committee, Official Report, 1 February 2011, Col 366.



limitation periods in Scots law such as the three year period under the Prescription and Limitation (Scotland) Act 1973 which runs from the earliest date on which the person seeking to bring the action was aware of the basis of the action.<sup>509</sup>

898. The Faculty of Advocates answered this point in its evidence to the Committee. Clause 16(6) introduces a new section 100(3B) into the Scotland Act. Subsection (b) allows the court to allow a claim to proceed even if it has been brought after the end of the one year period where the court considers it would be “equitable” to do so. Where a claimant is justifiably ignorant of his or her claim the court could be invited to exercise its discretion and allow the time to start running from the point that the claimant becomes so aware.<sup>510</sup>

899. Mr James Wolffe QC of the Faculty of Advocates explained—

“Ignorance is not the only circumstance that might justify a time extension. If an applicant was not ignorant of the basis of a claim, but was induced to refrain from making a claim because of the way that correspondence had been progressing between the applicant and the public body, the nature of that correspondence might justify their asking the court to allow the claim to be brought out of time. Therefore, the Law Society’s approach, if it is hanging its hat on awareness—that is the critical starting point — is not sufficient. One would want to look at a whole range of possible alternatives. Leaving it to the court to make the judgment is the most sensible approach in the circumstances.”<sup>511</sup>

900. Although the Scottish Government highlights a number of concerns with this provision, overall it does not oppose the proposal, which implements the terms of an understanding reached between them and the previous UK Government.<sup>512</sup>

901. The Committee’s detailed recommendations in relation to the legal and technical provisions in the Scotland Bill are set out later in this document.

### **Implementation of international obligations**

902. Clause 23 inserts a new section 57A into the Scotland Act to allow UK Ministers, concurrently with Scottish Ministers, to implement international obligations in relation to matters within devolved competence.

903. The UK Government suggested in its Command Paper that the rationale for this clause is to allow UK Ministers to implement international obligations on a UK basis where it would be more convenient to take action on a UK basis, rather than Scotland separately having to implement the obligations.<sup>513</sup>

904. The Scottish Government is not in favour of this Clause. Its legislative consent memorandum states that it has “significant doubts about the wider practical use or relevance of the new powers”. It suggest that the UK Government

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<sup>509</sup> Law Society of Scotland, written evidence submitted to the Committee.

<sup>510</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 366.

<sup>511</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 367.

<sup>512</sup> *Scottish Government*, legislative consent memorandum, LCM(S3) 30.1.

<sup>513</sup> HM Government. *Strengthening Scotland’s Future*, page 68.

already has powers, under sections 35 and 58 of the Scotland Act, to enforce compliance with international obligations and that the approach in the Bill would effectively provide UK Ministers with a substantial area of executive authority over devolved matters which would be exercisable without reference to or approval of the Scottish Parliament.<sup>514</sup>

905. Professor Sir David Edward QC in his evidence to the Committee explained that his understanding is that the purpose of the provision is to put the making of statutory instruments in the same position as the making of statutes. He stated—

“Under the Scotland Act 1998, the United Kingdom Parliament has the power to pass a statute even if it relates to a devolved matter, but the United Kingdom Government does not have the power to make a statutory instrument where competence lies with the Scottish ministers. Although there is not much explanation in the explanatory notes, I understand the problem to be that many international conventions are highly technical. It is highly desirable that the implementation of such conventions should be uniform throughout the United Kingdom. The provision is simply a means of ensuring that a single statutory instrument has effect throughout the United Kingdom. It seems to me that some form of Sewel convention is needed in relation to the use of the power.”<sup>515</sup>

906. Lord Wallace, the Advocate General for Scotland in the UK Government explained that in his view—

“...it is important for the United Kingdom to fulfil our international obligations, and it is not right that there is a separate regime for immunities north and south of the border. The change in that regard will not take any powers away from the Scottish ministers; rather, it will restore a power to UK ministers. I am sure that between the two Administrations we will work out the best way of doing that timeously.”<sup>516</sup>

907. In his written evidence to the Committee, Alan Trench said that this clause creates no requirement for agreement on the proposed action between the two sets of Ministers, nor even any requirement for consultation with Scottish Ministers about proposed UK action. In his view this therefore amounts to a substantial restoration to UK control of any matter that is the subject of an international agreement, whether or not the UK Parliament has legislated about it.

908. No such requirement for seeking the approval of the Scottish Parliament or the consent of Scottish Ministers exists under section 57 of the Scotland Act 1998 which allows UK Ministers, concurrently with Scottish Ministers, to implement Community law obligations in relation to matters within devolved competence. The rationale for this is to allow UK Ministers to implement Community law obligations through a single set of regulations having effect across the whole of the UK, rather than having separate regulations for Scotland. Before proceeding with a single set of regulations the matter is agreed between the Scottish Government

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<sup>514</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>515</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 368.

<sup>516</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Cols 54-55.

and UK Ministers. It seems likely therefore that agreement would be reached between the two Administrations prior to the implementation of international obligations in a devolved area by a single set of UK Regulations.

909. The Committee's detailed recommendations in relation to the legal and technical provisions in the Scotland Bill are set out later in this document.

### **Maximum penalties which may be specified in subordinate legislation**

910. Currently an order under the Scotland Act can create a penalty of up to two years imprisonment for conviction on indictment, but can only allow the summary courts to impose a penalty of up to three months imprisonment (or a level 5 fine).

911. This is now inconsistent with the Criminal Proceedings etc. (Reform) (Scotland) Act 2007. The Act increased the maximum period of imprisonment for summary convictions in "either way" offences (that is, those that can be tried either summarily in the District Courts or Sheriff Courts or on indictment in the High Court of Justiciary or Sheriff Court) to twelve months.

912. Clause 33 of the Scotland Bill would amend section 113(10) of the Scotland Act to allow the creation of new offences which attract sentences of up to twelve months imprisonment, thus bringing the limits for summary conviction in line with the criminal penalties established in the Criminal Proceedings etc (Reform) (Scotland) Act. A power would be provided to allow such penalties to be revised in line with future changes in the standard tariff for offences in Scotland.

913. The enabling power to make further changes would be subject to affirmative procedure in the Scottish Parliament and Westminster, so it would not allow the UK Government to make unilateral changes to this aspect of Scots criminal law.

914. The Scottish Government supports this provision stating that it is mostly a technical but nonetheless worthwhile adjustment to the provisions of the existing Scotland Act.<sup>517</sup>

915. The Committee's detailed recommendations in relation to the legal and technical provisions in the Scotland Bill are set out later in this document.

### **Devolution issues and acts of the Lord Advocate: Proposed amendments to Section 57 and 98 of the Scotland Act 1998**

#### *Background*

916. The final issue considered by the Committee are the proposals brought forward by the Advocate General for Scotland to deal with devolution issues and acts of the Lord Advocate. As outlined earlier, these proposals have been introduced during the passage of the Bill and were not part of the original provisions.

917. The Advocate General announced an informal consultation on 24 September 2010 in relation to the way in which acts of the Lord Advocate, in her capacity as head of the system of criminal prosecution, might give rise to devolution issues

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<sup>517</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

under the Scotland Act. He also appointed an Expert Group to consider the issue with Professor Sir David Edward as Chairman. The Expert Group submitted their Report on 11 November 2010.<sup>518</sup>

918. The Advocate General stated that he supports the implementation of the Report's recommendations. Accordingly, a UK Government amendment to the Scotland Bill is to be brought forward to implement the key recommendations and will, in particular—

- Remove acts of the Lord Advocate in her capacity as head of criminal prosecutions and investigation of deaths in Scotland that are incompatible with any rights conferred by the European Convention on Human Rights that are given effect to by the Human Rights Act 1998 ("Convention rights") or Community law from the ambit of section 57(2) of the Scotland Act; and
- Create a statutory right of appeal from the High Court of Justiciary sitting as a criminal appeal court to the Supreme Court in relation to matters where it is alleged that the Lord Advocate has acted incompatibly with any such Convention right or Community law to replace the existing devolution issue procedure that currently applies in such cases [The right could be exercised only with leave from the High Court or the Supreme Court itself]. The jurisdiction of the Supreme Court should be maintained both for reasons of constitutional propriety and, more importantly, to ensure that fundamental rights enshrined in international obligations are secured in a consistent manner for all those who claim their protection in the United Kingdom.

*Views expressed to the Committee*

919. Professor Sir David Edward in his evidence to the Committee advised that the UK Supreme Court's jurisdiction to consider issues concerning compatibility with Convention rights and EU law has become fairly extensive. In his view, this has meant that prosecutors find themselves facing a very large number of devolution minutes claiming that aspects of criminal cases are contrary to Convention rights. In addition, devolution minutes must be intimated not only to the Lord Advocate, but to the Advocate General for Scotland.<sup>519</sup>

920. He advised that there is also a concern among the judges of the High Court of Justiciary, who are required to consider, looking at the case as a whole, whether there has been a miscarriage of justice, whereas the Supreme Court is not so required. There is some dissatisfaction with the decisions of the Supreme Court in that respect.<sup>520</sup>

921. In addition, he said that there is dissatisfaction with the fact that the Supreme Court, by a process of interpretation, has acquired a jurisdiction to consider

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<sup>518</sup> *Section 57(2) and schedule 6 of the Scotland Act 1998 and the role of the Lord Advocate: report of the expert group.*

<sup>519</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 349.

<sup>520</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 349.

convention rights in circumstances in which the High Court had said that it is too late for the appellant to raise the matter. This means that a matter could come before the Supreme Court after having been rejected by the High Court.<sup>521</sup>

922. Professor Sir David Edward informed the Committee that the Expert Group had made various recommendations, the essence of which is that it is wrong to consider acts of the Lord Advocate, as head of the system of criminal prosecution and investigation, as being acts of the Lord Advocate as a devolved Scottish Minister. In reality those functions are retained functions, which the Lord Advocate has had since time immemorial and have nothing to do with the devolution settlement.

923. He advised that there is a considerable body of evidence that the system of treating such matters as devolution issues has caused considerable complications for the Scottish criminal prosecution system, not only for the prosecutors but for victims of crime and potential witnesses, because any delay in the process of prosecution that is caused by the system of devolution minutes causes delay, uncertainty and upset for witnesses and victims.<sup>522</sup>

924. Consequently, the Expert Group concluded that, in the first place, the Lord Advocate, acting in this capacity, should be removed from the system of devolution, simply by deleting the final words of section 57(3).

925. The Expert Group also concluded that once the High Court of Justiciary has determined an appeal there should, within limits and with leave, be a right of appeal to the Supreme Court, the limits being that there has been a breach of a Convention right or of EU law. There should be two additional requirements: that there should be a clear statement of the limit of the Supreme Court's jurisdiction in relation to Scottish criminal questions and that, before quashing any conviction, the Supreme Court should be required to apply the test applied by the High Court of Justiciary, namely that there had been a miscarriage of justice.

926. Richard Keen QC, the Dean of the Faculty of Advocates, in his evidence to the Committee agreed that there is a certain logic in the suggestion that a party in Scotland can have a Convention issue brought before the Supreme Court rather than having to go directly from the High Court of Justiciary in Scotland to the European Court of Human Rights in Strasbourg. It would not be open to the European Court of Human Rights to quash a criminal conviction; what it could do is impose a fine or order compensation. It would impose that on the United Kingdom Government for an act of a Minister of the Scottish Government.<sup>523</sup>

927. In his opinion, the Advocate General has come up with a “rather neat solution”, which is to recognise the role of the Lord Advocate as it has always been in the context of criminal prosecution but to allow for what has emerged over the past 10 years as an important facility for those subject to criminal prosecution, which is the right to raise a Convention issue, ultimately in the Supreme Court,

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<sup>521</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 349.

<sup>522</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 350.

<sup>523</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 352

where appropriate orders can be made in respect of the individual case, including, for example, the ultimate quashing of a conviction.<sup>524</sup>

928. The Law Society of Scotland takes the view that it is not appropriate to remove the Lord Advocate from the ambit of section 57(2). It did, however, ask for more time to consider the matter and to look at the proposed amendments. The Society did say that it would not welcome any restriction on the ability of the Supreme Court to be the final arbiter of Convention rights issues in the United Kingdom.<sup>525</sup>

929. One line of questioning explored by some members of the Committee was whether it made more sense to remove the Lord Advocate from her position as a member of the Scottish Government rather than bring in the proposals suggested by the Advocate General for Scotland. It was suggested by the Dean of the Faculty of Advocates that this would have major constitutional and political implications and would have to be the subject of vigorous and detailed analysis.<sup>526</sup>

930. In his evidence, Professor Sir David Edward confirmed that there are currently two Scottish judges, who are both former Lord Justice Generals, in the Supreme Court. There are no Scottish judges in the European Court of Human Rights.<sup>527</sup>

931. When asked why it was not sufficient for the European Court of Human Rights to be the final arbiter, the Law Society of Scotland pointed out that considerable expense and delay are involved in taking a case there. Its view is that the Supreme Court would act as a sift – many claims would be determined by the Supreme Court without further recourse to the European Court of Human Rights. In addition, Convention rights should be interpreted and applied consistently across the state by a single court.<sup>528</sup>

932. The Advocate General in his evidence to the Committee said that the Expert Group made a compelling case for having access to the Supreme Court in determining citizens' rights.<sup>529</sup>

933. The Scottish Government does not necessarily share this view. The Minister for Culture and External Affairs when giving evidence to the Committee advised that the Scottish Government have serious concerns about the Advocate General's proposals relating to the Supreme Court. She requested that the issue come back to the Parliament after the dissolution period.<sup>530</sup>

934. The Lord Advocate herself welcomed the position of the Expert Group and the Advocate General in recognising the problems and in their recognition of the inept way in which prosecution issues are characterised as being constitutional in the context of the Scotland Act 1998. Her concern is that the Expert Group did not

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<sup>524</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 352.

<sup>525</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 353.

<sup>526</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 357.

<sup>527</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 360.

<sup>528</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 363.

<sup>529</sup> Scotland Bill Committee, *Official Report*, 1 February 2011, Col 406.

<sup>530</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 451.

recognise the need for a specific threshold at which to identify when a matter is considered to be of constitutional importance, except in so far as it referred to leave of the court. In her opinion, if such leave were to lie from the High Court, the threshold should be sufficiently robust to deter vexatious, flippant or less serious matters going before the Supreme Court, so that only matters which were of genuine constitutional significance were to be heard there.<sup>531</sup>

935. She agreed that the UK Supreme Court has the role of reconciling issues regarding the competence of Ministers as well as the role of assessing the parameters of devolution. However, in relation to criminal proceedings, the position is uneven across the devolved administrations by virtue of the fact that the Lord Advocate is also a Scottish Minister. Her view is that the removal of the Lord Advocate from section 57(2) does not remove the Lord Advocate from her obligation to act compatibly with the Convention rights as set out under the Human Rights Act 1998.<sup>532</sup>

936. The Lord Advocate expressed concerns that because of the Supreme Court's approach, there is a real danger that we will have not just harmonisation of the interpretation of Convention rights, criminal procedure and evidence but, indeed, a complete loss of identity for Scots criminal law, unless the Supreme Court process is genuinely rarely exercised and takes place in the context of a matter that is of substantial constitutional significance across the United Kingdom or where there is a very new piece of jurisprudence that is clearly ambiguous. Her view is that it could be left to the courts to develop their own jurisprudence. The test of a breach of human rights that leads to a miscarriage of justice is a very wide proposition.<sup>533</sup>

937. The Lord Advocate emphasised that she is not suggesting that she should somehow have a limited susceptibility to Convention rights challenges. She acknowledged that it is absolutely imperative that the Human Rights Act 1998 applies to her in the same way as it applies to other public authorities. What she is concerned about is the route by which, and the level at which, all those issues are determined by the courts. In her opinion the Expert Group and the Advocate General are attempting to limit those two truly constitutional issues and that the draft provisions do not achieve that. In her opinion substantial work is required in order to ensure that they deliver what the Expert Group and the Advocate General wish to achieve.<sup>534</sup>

938. As stated above, the provisions in relation to devolution issues and acts of the Lord Advocate were only brought forward after the Bill was introduced in the UK Parliament. This has meant that the Scotland Bill Committee and indeed external organisations have had a limited time to consider the matter in the run up to the completion of this report.

939. The Committee did issue an open call for views on the matter in an attempt to gauge opinion once it became clearer what the Advocate General for Scotland was proposing. Only one submission was received in the time available.<sup>535</sup> This

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<sup>531</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 477.

<sup>532</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 478.

<sup>533</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Cols 479 - 480.

<sup>534</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Col 484.

<sup>535</sup> *Justice*, written evidence submitted to the Committee.

concluded that there was no need for the reforms along the lines being proposed by the Advocate General.

940. The Committee's detailed recommendations in relation to the legal and technical provisions in the Scotland Bill are set out later in this document.



## OTHER ISSUES NOT COVERED IN THE SCOTLAND BILL

### Background

941. During the course of the Committee's work, a number of other issues which are not currently part of the Scotland Bill or the UK Government's Command Paper were a feature of the evidence taken. These include—

- Welfare and benefits;
- Marine conservation; and
- Food standards and labelling.

942. Where applicable, the Committee's conclusions and recommendations on these areas can be found in the final section of this report.

### Welfare and benefits

943. In its final report, the CSD made a series of recommendations relating to welfare and benefits<sup>536</sup>. The details of these have been outlined in preceding sections of this report. These would, to a greater or lesser extent, have given a role for the Scottish Government in a number of matters relating to welfare and benefits.

944. In its legislative consent memorandum, the Scottish Government states that it welcomed these recommendations (with the exception of 5.24). However, it notes that the UK Government's view is that its welfare reform programme has generally superseded the CSD's recommendations and the UK Government has therefore elected not to take forward the recommendations in the Scotland Bill.<sup>537</sup>

945. The Scottish Government argues that a formal role for the Scottish Government in the decision-making within the UK's Department for Work and Pensions would help maximise the potential of DWP funding in Scotland, as DWP programmes increasingly impact on a wide variety of services funded by the Scottish Government – including skills/training, health-related services, regeneration and childcare. The Scottish Government believes the principle of a formally enshrined consultation role to be extremely important, and invites the Parliament to consider how this might be implemented, including the possibility of legislation in the Scotland Bill.

946. It also argues that devolution of the Deprived Areas Fund would have enabled Scottish cities to plan in a more strategic fashion, thus helping more people into work in Scotland in this difficult economic climate. In its view, devolution of discretionary aspects of the Social Fund would enable this funding to be better aligned with Scottish priorities.

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<sup>536</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, recommendations 5.19, 5.20, 5.21, 5.23 and 5.24.

<sup>537</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1

947. The recommendation that Scottish Ministers, with the agreement of the Scottish Parliament, could propose changes to the Housing Benefit system as it applies to Scotland could, in the view of the Scottish Government, have provided a useful mechanism to recognise Scottish interests in Housing Benefit, and take account of particular Scottish housing circumstances.

948. Similarly, the CSD's recommendation that Scottish Ministers – again, with the agreement of the Scottish Parliament – could have proposed changes to the Council Tax Benefits system as it applies to Scotland was welcomed by the Scottish Government.

949. Finally, while the Scottish Government welcomes the prospect of devolution of Council Tax Benefit and discretionary elements of the Social Fund, it is concerned at the UK Government's plans for the CSD's other recommendations: in particular there is no specific commitment to a formal role for the Scottish Government in the Work Programme; and no proposals for a formal role for either the Scottish Government or the Scottish Parliament in developing DWP benefits policy to recognise the link with devolved policy.

950. In their evidence to the Committee, UK Ministers argued that the UK Government's view was that “several of Calman's proposals had been overtaken by events” and by the proposals that are outlined in the Command Paper and are likely to be the subject of a forthcoming bill. The Parliamentary Secretary of State at the Scotland Office did state, however, that several of the CSD's proposals accord with the principle of the proposed bill. He informed the Committee that, for example, the UK Government wanted to move Council Tax Benefit closer to the control of local authorities and he also wanted to proceed on the same basis here in Scotland by working with Scottish local authorities in relation to Council Tax Benefit.<sup>538</sup>

951. In relation to the Social Fund, the Parliamentary Secretary of State at the Scotland Office indicated that the areas that will continue to operate separately and will be devolved to local government in England will also be devolved to the Scottish Government for administration. He told the Committee that the UK Government was working closely with the Scottish Government and was committed to continuing to do so in relation to various elements of the implementation of this work programme.<sup>539</sup>

952. Finally, Rt. Hon David Mundell MP stated that, in relation to Housing Benefit, it will be part of the new universal credit and that the “arrangements for housing benefit should not, therefore, be devolved”.<sup>540</sup>

953. In its evidence to the Committee, the Church of Scotland's Church and Society Council concluded as follows—

“We welcome the broad principles contained in the Scotland Bill as progress towards a more accountable system. However, we are disappointed by the

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<sup>538</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 65.

<sup>539</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 65.

<sup>540</sup> Scotland Bill Committee, *Official Report*, 14 December 2010, Col 65.

emphasis on the economic processes contained in the Scotland Bill without a corresponding emphasis on social justice. The absence of proposals to further devolve welfare provisions is in our view a serious omission.”<sup>541</sup>

954. It also stated that it was “concerned that by devolving part of the tax system without a corresponding change to the benefits system the Scotland Bill weakens the necessary relationship between tax and benefits” and that, in its view, there should be additional powers for the Scottish Parliament on the social security structure.<sup>542</sup>

955. In its evidence to the Committee, the Scottish Council for Development and Industry highlighted its publication – *Blueprint for Scotland* – in which it called for a more localised approach to support people claiming out-of-work benefits into work and employment. This included a call for local devolution of responsibility for delivery of New Deal for the disabled, and greater cross-parliament work to develop benefit and student support mechanisms that work together to take full account of the differing student support systems in use across the UK.<sup>543</sup>

956. The Scottish Council for Voluntary Organisations stated in its written evidence that a single UK benefits system is no longer able to articulate with free personal care, and other devolved policy around education, health and transport. It is also said that UK Government’s Programme for Government sits uncomfortably alongside other services provided by the Scottish Government (through Skills Development Scotland), local government and other funders such as the European Social Fund. At the very least, in SCVO’s view, options such as devolving responsibility for JobCentrePlus operations to the Scottish Parliament or making the Scottish Parliament responsible for the operation of the Work Programme ought to have been considered.<sup>544</sup>

957. Finally, Dave Moxham of the STUC told the Committee that—

“We have yet to hear a single good reason why council tax has been devolved but council tax benefit has not. In addition, there have been mechanisms in the history of the Parliament in which changes in council tax were reflected in changes to the block grant, and we certainly feel that in that respect certain wider welfare matters could be examined. The future jobs fund is a good example, because one could quite easily come to the view that a specific responsibility of the DWP has been removed as a result of easily identifiable expenditure from the Scottish skills or health budget. It seems to me to be not beyond the wit of legislation to deal with such a situation progressively. We are looking for that to be included, certainly in the committee's recommendations.”<sup>545</sup>

958. The Committee’s detailed recommendations in relation to the issues of welfare and benefits are set out later in this document.

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<sup>541</sup> Church and Society Council, written evidence submitted to the Committee.

<sup>542</sup> Church and Society Council, written evidence submitted to the Committee.

<sup>543</sup> Scottish Council for Development and Industry, written evidence submitted to the Committee.

<sup>544</sup> Scottish Council for Voluntary *Organisations*, written evidence submitted to the Committee.

<sup>545</sup> Scotland Bill Committee, *Official Report*, 8 February 2011, Cols 458-459.

## Marine Conservation

959. In its final report, the CSD noted that the responsibility for the management of the marine environment around Scotland involves a complex series of interactions and both reserved and devolved matters. This relates to issues surround to the development of new energy technologies, fishing and marine conservation more generally.

960. During the work of the CSD, the two governments successfully concluded discussions on the then Marine and Coastal Access Bill, which provides a new strategic framework for marine planning. The CSD concluded that the agreement on the UK Marine Bill between the UK Government and devolved administrations announced in November 2008 represented an effective approach to the complex and overlapping issues and responsibilities governing the management of the marine environment, providing that the goodwill continues to exist to make it work. It stated that the effectiveness of the agreement reached by the UK and Scottish Governments should be kept under review by the inter-governmental machinery, and nature conservation should be devolved to the Scottish Parliament at the earliest appropriate opportunity, taking into account the experience and evidence to be gained from the operation of the regime set out in the respective Marine Bills.<sup>546</sup>

961. The Scottish Government's view is that there is a strong case for devolution of marine nature conservation in the Bill, which was not taken forward by the UK Government in the Scotland Bill.<sup>547</sup>

962. The Committee's detailed recommendations in relation marine conservation are set out later in this document.

## Food standards and labelling

963. In its final report, the CSD recommended that—

“The Scottish Parliament should not have the power to legislate on food content and labelling in so far as that legislation would cause a breach of the single market in the UK by placing a burden on the manufacturing, distribution and supply of foodstuffs to consumers, and Schedule 5 to the Scotland Act should be amended accordingly.”<sup>548</sup>

964. The CSD stated that it would not want to see any diminution of the ability of the Scottish Parliament and Government to encourage and support the promotion of Scottish food or to see the Scottish food industry placed at a disadvantage. The CSD also considered that the Scottish authorities must have appropriate powers to deal with dangers to public health at a national or local level. In the opinion of the CSD what matters, however, is that divergence in policy and practice in this area should not produce incoherent results and should not affect the functioning of the

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<sup>546</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, page197.

<sup>547</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>548</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, page16.

UK by creating a situation which would breach the single market or create a burden on the manufacturing, distribution and supply of foodstuffs to consumers.<sup>549</sup>

965. The current UK Government chose not to take forward this particularly recommendation which its predecessor indicated that it favoured. Its view was that the law on food labelling was sufficiently constrained by EU legislation that the problem was unlikely to arise.<sup>550</sup>

966. The Scottish Government welcomed the decision not to reserve food content and labelling stating that it had consistently voiced its opposition, which would, in its view, be unnecessary, and inappropriate given the links to health policy, which is an almost entirely devolved matter.<sup>551</sup>

967. In evidence to the Committee, however, the Scottish Retail Consortium stated that it was “disappointed that the re-reservation of ‘food content and labelling’ is not included in the Bill”. It indicated that it had welcomed the recommendation by the CSD to re-reserve these powers as it believed that this would provide welcome clarity over competence in this area of policy.<sup>552</sup>

968. In subsequent more detailed evidence, the Scottish Retail Consortium argues that there are challenges which the current settlement could bring about, where ‘public health’ is not a relevant issue. It states that there is the potential for Scottish labelling proposals on other areas to come forward (e.g. mandatory environmental labelling) where Europe has yet to legislate and that these could be problematic for retailers.<sup>553</sup> It estimated that a single change to the labels of one product costs approximately £1,200. It concludes by stating that “the Scotland Bill Committee should recommend the UK Government looks again at re-reserving the food content and labelling powers back to Westminster.”<sup>554</sup>

969. The Committee’s detailed recommendations in relation to food standards and labelling are set out later in this document.

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<sup>549</sup> Commission for Scottish Devolution, *Serving Scotland better: Scotland and the United Kingdom in the 21st century: final report*, June 2009, p184.

<sup>550</sup> HM Government. *Strengthening Scotland’s Future*, p16.

<sup>551</sup> Scottish Government, legislative consent memorandum, LCM(S3) 30.1.

<sup>552</sup> Scottish Retail Consortium, written evidence submitted to the Committee.

<sup>553</sup> Scottish Retail Consortium, supplementary written evidence submitted to the Committee.

<sup>554</sup> Scottish Retail Consortium, supplementary written evidence submitted to the Committee.

## VIEWS OF THE SUBORDINATE LEGISLATION COMMITTEE

970. At its meetings on 25 January and 8 February 2011, the Subordinate Legislation Committee (SLC) considered the provisions in the Bill which confer on the Scottish Ministers powers to make subordinate legislation. The SLC reported to the Scotland Bill Committee in its 10<sup>th</sup> Report 2011, a copy of which is attached at Annexe B.

971. The SLC was content with the delegated powers contained in clauses 1, 19 and 20 and determined that it did not need to draw the attention of the Parliament to any of those powers.

972. However, the SLC made comments specifically on three of the clauses: clause 796 – effect of limited reference to the Supreme Court; clause 21 – speed limits; and clause 36 – transitional provision for Scottish statutory instruments) and these are detailed below.

### **Clause 7(6): (new section 33A) Effect of limited reference to the Supreme Court**

973. This clause introduces a new mechanism which would allow for the reference of a bill passed by the Scottish Parliament to the Supreme Court for a ruling on whether it is within the Scottish Parliament's legislative competence to be restricted to specified provisions in the bill. At present, if the Law Officers wish a ruling on the competence of any part of the Bill, it must be referred in its entirety. This prevents those parts of the Bill with which there is no *vires* concern from proceeding to Royal Assent and coming into force.

974. Section 32 is amended to permit the Presiding Officer to submit a bill which is the subject of a limited reference for Royal Assent. Section 33 is amended to require the Presiding Officer to be notified of references. New section 33A then makes provision for the treatment of limited references.

975. A bill which is the subject of a limited reference will therefore receive Royal Assent and become an Act. However, those provisions which have been specified in the reference are prohibited from coming into force in accordance with the provisions made in the Act. The provisions which are not specified are not affected. The specified provisions can only be brought into force in the event that the Court finds they are within competence and in accordance with the terms of the Court ruling.

976. A new power is created in section 33A(6) which gives the Scottish Ministers power to then bring the specified (but competent) provisions into force which is subject to negative procedure. As currently framed this power would only permit the Scottish Ministers to appoint a date or dates for commencement.

977. The SLC stated that it can envisage situations where the delay in commencement of the specified provisions may require further provision to be made to enable the Act to function as the Parliament intended. Similarly, in the event of any of the provisions being found to be outside the Parliament's legislative competence, some consequential modifications may be required as a

result. In the event that a suitable power is not available in the Act itself, it may be appropriate to provide a power in section 33A to cater for such circumstances. **The SLC recommended that further consideration is given to conferring such powers.**

978. The SLC considers that in these unusual circumstances it is appropriate for the commencement power to be subject to negative procedure. **As regards the further powers proposed, the SLC recommended that if the powers are used to modify any enactment they should be subject to affirmative procedure. Otherwise they should be subject to negative procedure.**

979. **The Committee agrees with the Subordinate Legislation Committee and recommends that the UK Government takes this into account during the passage of the Bill.**

### **Clause 21: Speed limits**

980. There are three distinct powers to be conferred on the Scottish Ministers under the Road Traffic Regulation Act 1984 relating to speed limits. The power to make provision under section 17 for regulating the speed of vehicles on special roads in Scotland in general is to be transferred to the Scottish Ministers.

981. Section 64 of the 1984 Act makes provision for prescribing the form of traffic signs and is being amended to provide that the Scottish Ministers also have the function of making regulations specifying signs for a Scottish national speed limit but only with the agreement of the Secretary of State. The power to make traffic signs regulations is subject to negative procedure and the Scottish Ministers must consult such representative organisations as they think fit.

982. Clause 21 modifies section 88 of the 1984 Act to confer the function of making orders in relation to roads in Scotland under section 88(1) and (4) on the Scottish Ministers permanently.

983. The SLC considers that it is important that the effect of the order is notified to the public and that the legal basis for the change to the speed limit is transparent and clearly identifiable since failure to observe the speed limit is a criminal offence.

984. The SLC recognises that the power to regulate signage may address the first issue – since it is primarily through road signage that the public are informed of the speed limits in force on any road from time to time. However, the 1984 Act will not require the function under section 88(1) to be exercised by SSI therefore there are no prescribed requirements as to the form of an order or for its publication. Whether such an order was made will therefore be a matter subject to the normal rules of proof of evidence. The SLC considers this unsatisfactory.

985. The SLC reported—

- that the absence of a requirement that the function in section 88(1) is to be exercised by SSI could (i) result in a lack of transparency in the legislative process, (ii) fail to give adequate public notice of the

exercise of the function and (iii) raise questions of the manner of proof of its exercise in any related criminal proceedings; and

- that in its view it would be more helpful in securing public notice and proof of exercise of the function for it to be exercised by SSI which would be subject to the procedure set out in section 30 of the Interpretation and Legislative Reform (Scotland) Act 2010 (laid only).

**986. The Committee notes the comments made by the Subordinate Legislation Committee and recommends that the UK Government takes these into account during the passage of the Bill.**

### **Clause 36: Transitional provision for Scottish statutory instruments**

987. The SLC understands that this clause is included because at the time of drafting it was not clear whether the Scotland Bill would be in force prior to the commencement of Part 2 of the Interpretation and Legislative Reform (Scotland) Act 2010, which makes changes to the procedures for scrutiny of subordinate legislation in the Scottish Parliament. This clause therefore seeks to cover any potential gap which may arise between the commencement of the Bill (and any consequential extension of executive powers to the Scottish Ministers) and the commencement of Part 2 of the 2010 Act on 6 April 2011.

988. This raises a very technical issue: once the 2010 Act procedures are fully commenced the Scottish Ministers' powers to make subordinate legislation will be exercised by a new type of instrument. This new 2010 Act SSI is independent of the Westminster statutory instrument regime. Old pre-2010 Act SSIs were a sub-category of statutory instrument.

989. This is of relevance when considering the legal requirements for numbering, publication and printing of SSIs. The 2010 Act and the publication requirements made under it only apply to the new independent form of SSI. The 2010 Act regime will only begin to operate on 6 April 2011. The 1999 Transitional SI Order<sup>555</sup> makes provision for the publication etc of the old form of SSIs which are a sub-category of statutory instrument.

990. This clause makes any new function of the Scottish Ministers conferred by the Bill and which is to be exercised before 6 April, is exercisable by the new form of independent SSI. This means that there will be no publication scheme operating for such SSIs since section 42 of the 2010 Act and the Scottish Statutory Instruments Regulations 2011 to be made under that section only comes into force on 6 April 2011 (subject to the approval of the Scottish Parliament). **The SLC reported that in the event that clause 36 is required to make provision for the Scotland Bill coming into force before 6 April 2011 then the SLC considered that provision must be made for the publication etc provisions in the 1999 Transitional SI Order to apply to the exercise of these powers prior to 6 April 2011.**

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<sup>555</sup> SI 1999/1096



**991. The Committee notes the comments made by the Subordinate Legislation Committee and recommends that the UK Government takes these into account during the passage of the Bill.**

## **ANNEXE A: MINORITY VIEW**

***Disclaimer – the text in this Annex contains the views of two members of the Committee (Brian Adam and Tricia Marwick) alone. This sets out their alternative conclusions and recommendations on the parts of the conclusions and recommendations section in main report where they do not agree with the rest of the Committee.***

### **Rejection of tax proposals**

Two members of this Committee, Tricia Marwick and Brian Adam, disagree in the strongest possible terms with the conclusions and recommendations of the Committee regarding the tax provisions of the Scotland Bill as contained in paragraphs 20 to 100. The two members also utterly refute the analysis of the evidence the Committee heard and the accompanying narrative contained in paragraphs 20 to 100.

This Committee has been hijacked for political purposes, especially with regard to the tax aspects of the Bill. This has been evident throughout, from the appointment of advisers directly involved with the Calman Commission to the treatment of expert witnesses whose views did not match the preferred political narrative. In sum, the conduct of this Committee has brought the previously highly regarded Committee system into disrepute and damaged the reputation of this Parliament. The conclusions and recommendations relating to the tax provisions that flowed from this process are therefore entirely compromised and utterly unreliable.

Paragraphs 20 to 100 are blatantly and unashamedly politically motivated. They are characterised by bias and distortion. At no point do they properly address the very real flaws in the tax provisions highlighted during the evidence sessions, most notably the lack of powers to grow the Scottish economy and create jobs and the danger to the Scottish budget inherent in the income tax proposals.

The Parliament should reject the flawed tax proposals in the Scotland Bill and recommend that the UK Government amends the Scotland Bill to provide full financial responsibility for Scotland to give the Scottish Government and Parliament the powers it needs to grow the economy and create jobs.

### **Individual minority views**

- **Merits of the Scotland Bill versus full fiscal responsibility**

The biggest challenge currently facing Scotland is returning the economy to sustainable economic growth and creating jobs in the aftermath of the UK recession. The Scotland Bill, however, utterly fails to provide the Scottish Government and Parliament with control over the economic levers that are required to address this challenge – such as full control over income tax, including bands and thresholds; corporation tax and control over Scotland's vast natural resources. The Bill as it stands poses risks to Scottish revenue while not providing the tools to mitigate that risk. It does so by devolving only on a proportion of one declining tax, income tax, while not providing access to other taxes that would allow Scotland to spread economic risk.

Moreover, the Bill falls short of its stated aim of achieving tax accountability, as the vast majority – 85% - of money spent in Scotland will continue to be determined and raised at Westminster. The UK Government's statement in the Command Paper that the Bill will give Scotland control over 35% of what it spends was utterly inaccurate and misleading - the Scottish Parliament will in fact only raise 25% of what it spends. This is far short of many other sub-state legislatures - such as Cantons in Switzerland, states in the USA or provinces in Canada.

The omission of key economic levers and the failure to deliver tax accountability is a huge missed opportunity and amounts to a fundamentally flawed piece of legislation.

Full fiscal responsibility, in stark contrast, would provide the Scottish Government and Parliament with access to the fiscal levers that are required to deliver economic growth and create jobs. With real tax powers – where the Government and Parliament is responsible for both raising its revenue and spending it – Scotland would be in a position to promote economic growth; improve Scotland's long-term competitiveness ; generate the revenue required to invest in public services and deliver genuine tax accountability.

We recommend that the Bill be amended to replace the tax proposals with full financial responsibility so that the Scottish Government and Parliament are genuinely financially accountable and have access to the key economic levers required to boost economic growth and create jobs.

- **The debate on fiscal decentralisation and economic growth**

There is a substantial body of evidence to support the position that decentralised fiscal powers, used properly, could lead to improved economic performance in Scotland. In written evidence, leading expert Professor Feld states: "Decentralisation of taxes and spending leads to a more efficient public sector and it enhances economic performance." (paragraph 25). He also stated that according to his research "Revenue decentralisation has the expected positive effect on productivity, and is consistently highly significant."

The reason behind this improvement is essentially two fold. Firstly, fiscal decentralisation leads to greater efficiencies within Government and the public sector which, in turn, enhances economic performance. Second, decentralising fiscal powers would provide the Scottish Government and Parliament with the ability to tailor economic policies to suit the particular needs and aspirations of Scotland and so increase competitiveness and growth. It is beyond doubt that without genuine fiscal powers Scotland will continue to lack the complete set of tax powers required to create growth and jobs in the Scottish economy.

Finally, with regard to the public dispute over this issue, it must be noted that Drew Scott and Andrew Hughes-Hallett have publicly stated that the Scottish Government did not misrepresent their work.

We recommend that the Bill should be amended to give Scotland full financial responsibility so that Scotland can benefit from the economic opportunities presented by fiscal decentralisation.

- **Devolution of corporation tax**

A major failing of the Scotland Bill is that it does not devolve control over corporation tax, one of the most important economic levers available to a Government pursuing economic growth. In many countries corporation tax has been the key component of a strategy to increase competitiveness and improve growth. Without this power, however, Scotland is

missing out on the opportunity to give itself with a competitive edge over the rest of the UK. This situation could soon be worsened by the UK Treasury's consideration of devolving corporation tax to Northern Ireland. The CBI Northern Ireland has stated that cutting corporation tax in Northern Ireland would have a 'transformational' impact on the Northern Irish economy – giving an *immediate* boost to the profits of businesses and generating 90,000 jobs. With control over corporation tax Scotland would be in a position to deliver a similar boost to our economy and job market. The very fact that the UK Government is cutting corporation tax itself is a clear indication that it subscribes to the argument that doing so will have a beneficial impact on the economy.

Creating a competitive corporation tax regime could play a vital part in attracting new companies to Scotland; boosting business start ups in Scotland and encouraging existing businesses to grow. That is why a growing number of leading Scottish business people have supported the devolution of corporation tax in order to improve Scotland's competitiveness. Those in favour of devolving corporation tax include: Jim McColl, founder of Clyde Blowers; Sir Tom Hunter; Tom Farmer; Sir Peter Burt; former governor and chief executive of the Bank of Scotland and David Watt of the Institute of Directors. The Committee heard plentiful evidence during its deliberations in favour of devolving corporation tax, including from Andrew Hughes-Hallett, Drew Scott and John Whiting of the Chartered Institute of Taxation.

There are various examples of corporation tax being controlled by sub state legislatures around the globe – including Canada, the USA and Germany amongst many others. There is no reason that the UK could not replicate these countries and devolve corporation tax.

We recommend that the Bill be amended to include the devolution of corporation tax so that a competitive rate of corporation tax can be set in Scotland to increase our competitiveness, attract business and create jobs.

- **The deflationary effect**

A central flaw in the income tax provisions of the Scotland Bill is that they will create a deflationary bias that places the Scottish budget at considerable risk. By basing the tax proposals on a proportion of a single tax – income tax – that has steadily decreased as a share of public spending over the last four decades, the Bill leaves the Scottish budget overly reliant on a declining revenue stream. This is a long term phenomenon in developed countries. IMF data shows that, in OECD countries, public spending has been higher than growth in income tax revenue in every decade since 1965.

According to modelling carried out by the Scottish Government – the methodology of which was consistent with that used in the final report of the Calman Commission – this deflationary bias would have resulted in the Scottish Budget being £8bn lower between 1999/2000 and 2010/11 than it actually was. The reason for this is that the Scottish Budget has increased at a far greater rate than income tax revenue over this time - the average real growth in the Scottish Budget was 4.5% while the average real growth in total Scottish income tax receipts was 1.8%. Even the UK Government has admitted that, over the same period, the Scotland Bill would have reduced the Scottish budget by £700 million.

This problem is compounded by the fact that the Bill will give Scotland less access to revenue from the higher rate of income tax than the lower rate. The Scotland Bill proposes that the Scottish Government will receive half of tax revenues at the basic rate, but only a quarter of revenues at the higher rate and just a fifth of revenues from the top

rate. Between 1999 and 2008 higher rate income tax revenues grew faster than the basic rate – meaning a greater proportion of any growth would have flown to the UK rather than the Scottish Government. Under the current Scotland Bill plans, the Scottish Budget would receive none of the additional benefits from natural “fiscal drag” as people become richer through time and move into higher tax bands.

By taking into account the threats to the Scottish Budget inherent in the Bills proposals to give Scotland a declining share of revenue from each income tax band, the deflationary bias over the period 1999-2000 to 2010-11 increases to £11bn.

The argument that the period that the Scottish Government chose for its analysis was atypical is incorrect. In fact, the atypical period in terms of public spending is the period that we are now entering, where public spending will be slashed. As the IMF data clearly shows, the long term trend is for income tax to grow at a slower rate than public spending. As a result, the Bill will likely lead to a smaller Scottish Budget, and thus less money to spend on public services and supporting business than would otherwise have been the case. This problem is compounded by the absence of other economic levers that could be used to off-set this decline.

We recommend that the flawed tax proposals in the Bill be rejected on the grounds that they would introduce a deflationary bias in the Scottish budget that would result in lower public spending.

- **Reliance on income tax**

The Bill, as it stands, would make Scotland overly dependent on a single, decreasing and blunt tax. There is an inherent risk in a large proportion of the Scottish budget being reliant on the revenue of a single tax. Were this tax to decline the Scottish Government and Parliament would not be able to take steps to raise revenue elsewhere to fill the gap in the budget and maintain public spending. This risk is particularly strong in times of recession, as experienced recently, when declining income tax revenue would lead to a sharp drop in the Scottish budget at exactly the time when public spending should be maintained to fight the downturn and protect vital services, thus plunging the Scottish economy into a downward spiral.

In the longer term, as income tax is declining as a proportion of public spending and total tax revenue, creating a deflationary bias and posing a long term risk to the Scottish budget. Finally, the Bill's failure to grant equal access to the higher income tax bands as it does to the lower band means that even this very limited tax power is further blunted in terms of increasing revenue. Any growth in income tax revenue that does occur is generally based on growth in the higher income tax band, yet the Bill dictates that Scotland will only receive a quarter of revenues from the higher rate and a mere fifth of revenue from the top rate. This means that even if income tax revenue from the higher bands increases, Scotland will not see the full benefit.

We recommend that the income tax proposals in the Bill be rejected and the Bill be amended to give Scotland full financial responsibility in order that risk can be effectively managed; both long and short term changes in economic performance be adapted to; and give Scotland access to economic levers that can be effectively used to grow the economy and increase government revenue.

- **Concentration of risk**

The Committee heard substantial evidence that the income tax proposals will create risk in the Scottish economy and budget. For instance, Reform Scotland stated in its written evidence: *The main risk associated with the proposed system is the narrow tax base on which the Scottish Budget will become increasingly reliant. (p5)*. As explained earlier the Bill creates an inherent risk to the Scottish Budget because it places far too much reliance on one single tax revenue. In situations where that revenue falls the Scottish Government and Parliament lack the facility to plug the gap in public finances through other taxes. Put simply, the Bill will force Scotland to put all its eggs in one basket – a recipe for disaster.

The measures the majority of the Committee propose will not mitigate that risk as they fail to recognise that the risk inherent in this Bill is a fundamental and systemic issue that cannot be managed away with minor alterations. The only way to mitigate the risk inherent in the tax proposals is to spread that risk by giving Scotland access to the full set of economic levers.

- **Aggregates Levy and APD**

The rationale given by the UK Government as to why it has chosen not to devolve Aggregates Levy and Air Passenger Duty, as recommended by the Calman Commission, are not convincing. With regard to the former, the UK Govt. argues that since the Aggregate Levy is subject to challenges at the EU level, it cannot be devolved at present. However, the Levy has been subject to challenge at EU level since 2006, so the situation has not changed since the Calman recommendation. It is perfectly plausible for the Scottish Parliament to simply take into account any European decision related to the Levy and react accordingly. With regard to APD, the UK Govt. argues that it is under review and so it is inappropriate to devolve for now. However, this would seem to contradict the principle of devolving such taxes – it should be for the Scottish Government and Parliament to consider any changes to APD. Certainly, the Committee received considerable evidence in favour of devolving this tax.

We recommend that the Bill be amended to include APD and Aggregates Levy in accordance with the Calman Commission.

- **New taxes**

While we welcome the principle of the Scottish Parliament being able to create new taxes, the provision in the Bill on this matter is very weak. First, the Scottish Parliament is not able to create new taxes without the express permission of the UK Government – which effectively means it is not a new power at all, as the final say will continue to lie with Westminster. Second, the Bill does not allow Scotland to replace or reform existing taxes – meaning any new taxes will add to the overall tax burden on the Scottish people and Scottish business.

- **Implementation issues**

There are a number of very serious concerns related to implementation of the Scotland Bill, in particular the tax proposals. The UK Government's insistence that the costs of implementation would fall on the Scottish Parliament contradicts the UK Treasury's own Statement of Funding Policy. Also, the UK Government's estimate that the cost of implementing the tax proposals would be a one off payment of £45m plus £4.2m appears

to be highly doubtful. The Committee heard evidence that the costs could actually exceed £150m. The UK Government could not explain to the Committee how the £45m figure was arrived at and refused to agree that the £45m figure should be a ceiling. In addition to the costs of implementation, we are very concerned at the lack of detail provided by the UK Government in relation to how the tax proposals will be implemented, particularly the grant reduction mechanism.

We recommend that the Bill be amended so that the costs of implementation are borne by the UK Government in line with the UK Treasury's Statement of Funding Policy. Given the lack of detail provided regarding the implementation of tax proposals, the Bill should be amended to the effect that the tax proposals cannot commence without the express consent of the Scottish Parliament.

- **Re-reservation**

We are against the Bill's proposals to 're-reserve' powers in certain areas, most notably in regulation of health professionals, corporate insolvency and implementation of international obligations. In practical terms, the Committee heard evidence from health professional bodies that cast doubt on whether there was any need to re-reserve powers and also that there was little desire amongst the sector itself for this move. With regard to corporate insolvency, there are very serious concerns that this move will have a detrimental impact on Registered Social Landlords and the overwhelming evidence from the social housing sector was against this move. The changes to give UK Ministers to implement international obligations without the consent or even knowledge of the Scottish Government and Parliament are unnecessary and impractical. It will create confusion over what Ministers are responsible for particular matters and will not provide any significant benefits. More generally, the proposals to 're-reserve' powers are fundamentally against the spirit of devolution and should be rejected.

We recommend that the Bill be amended to remove the 're-reserving' of certain powers, particularly those related to corporate insolvency, regulation of health professionals and implementation of international obligations.

- **Late submissions etc**

We regret that there have been a number of factors that have prevented this Committee from carrying out its responsibilities in scrutinising this legislation effectively. One is the large volume of late submissions the Committee has received from all parties during this process. This has made effective and thorough scrutiny more difficult than it should have been. A second is the short time frame this Committee has had to consider what is extremely important and complex legislation. While there are valid reasons for this situation, it has nevertheless presented the Committee with great difficulties. Finally, and most importantly, the failure of the UK Government to submit detailed information on many aspects of this Bill is highly regrettable. Most notably, there has been an utter lack of detail on the implementation of the tax proposals of this Bill, particularly relating to the grant reduction mechanism, which is unacceptable given the importance of these proposals. The failure of the UK Government to provide such detail has seriously inhibited the work of this Committee.

- **Overall Conclusion – to follow para 224**

We welcome more powers for this Parliament. We support many of the non-financial aspects of this Bill that deliver more powers for the Parliament. Specifically, we support the provisions relating to air guns, drink driving and speed limits. The Bill should go

further, however, to include competence over setting penalties for drink driving and random breath tests; and control of speed limits for all vehicles. The Bill should also be extended to include full powers over elections; the Crown Estate Commissioners and appointment of the Scottish Member of the BBC Trust. The Bill should be extended to include powers over immigration and welfare, as recommended by the Calman Commission, as well as rail regulation. The legal aspects of the Bill, particularly those relating to section 57(2) of the Scotland Act, have not been given due scrutiny and consideration and cannot be supported at this time. The re-reservation of corporate insolvency; the regulation of health professionals and implementation of international obligations should be reversed.

In terms of the financial provisions, we believe that the Scottish Government and Parliament requires full economic powers in order to grow the Scottish economy in a sustainable way; create high quality jobs and deliver financial accountability. However, the tax provisions in the Bill fail on each of these counts. The proposals over income tax are flawed. The proposals will put the Scottish budget at risk and fail to provide access to the wide range of fiscal levers required to improve economic performance. These proposals should be removed and replaced with provisions that deliver full financial responsibility to Scotland. We welcome the devolution of Stamp Duty Landfill Tax and Landfill Tax, but the decision to omit Aggregates Levy and Air Passenger Duty should be reversed. We welcome in principal the devolution of capital and revenue borrowing powers, but note that the specific proposals in the Bill are inadequate and overly restrictive and should be significantly enhanced.

We recommend that the Parliament uses the Legislative Consent Motion to demand that the UK Government amend the Scotland Bill so that the Bill provides the Scottish Government and Parliament the full financial responsibility that is required to deliver sustainable economic growth; create jobs and provide financial accountability.

- **Amendments re. further consent**

The Legislative Consent Motion relating to the Scotland Bill should contain the following conditions:

The Scotland Bill cannot be passed by the UK Parliament without the express consent on its final provisions from the Scottish Parliament via a Legislative Consent Motion.

The financial proposals in the Scotland Bill cannot be commenced without express consent from the Scottish Parliament.



## **ANNEXE B: EXTRACTS FROM MINUTES**

### **1st Meeting, 2010 (Session 3) Tuesday 7 December 2010**

**Declaration of interests:** Members of the Committee were invited to declare any relevant interests.

**Choice of Convener:** The Committee chose Wendy Alexander as Convener.

**Choice of Deputy Convener:** The Committee chose Brian Adam as Deputy Convener.

**Work programme:** The Committee held an initial discussion on its approach to developing a work programme, key issues and processes, and consideration on the need to appoint an adviser.

**Decision on taking business in private:** The Committee agreed to take items 6 and 7 in private.

**Work programme (in private):** The Committee considered the detail of a work programme.

**Scotland Bill - appointment of adviser (in private):** A motion to approve two named advisers was proposed by Peter Peacock and the Convener asked for endorsement. A further motion to approve two alternative named advisers was proposed by Brian Adam. The Committee moved to a division and the motion proposed by Peter Peacock was approved by four votes (Ms Wendy Alexander; Robert Brown; David McLetchie; Peter Peacock) to two votes (Brian Adam; Tricia Marwick). The motion by Brian Adam was therefore disagreed to without a division being held. The Committee agreed to seek the approval of the Parliamentary Bureau for the appointment of the advisers agreed by a majority of the Committee.

### **2nd Meeting, 2010 (Session 3) Tuesday 7 December 2010**

**Scotland Bill (UK Parliament legislation):** The Committee took evidence from—

The Rt. Hon Michael Moore MP, Secretary of State for Scotland, Alisdair McIntosh, Director, Robin Haynes, Senior Economist, David Mundell MP, Parliamentary Under Secretary of State, The Rt. Hon Lord Wallace of Tankerness QC PC, Advocate General for Scotland, Jim Logie, Head of the Office of the Advocate General for Scotland, Scotland Office;

David Gauke MP, Exchequer Secretary, Paul Doyle, Devolved Countries Unit, HM Treasury.

**Correspondence:** The Committee agreed to consider in private the terms of its response to the letter from the Minister for Culture and External Affairs following the Minister's evidence at the Committee's next meeting. The Committee also agreed to consider its work programme in private at its next meeting.

### **3rd Meeting, 2010 (Session 3) Tuesday 21 December 2010**

**Scotland Bill (UK Parliament legislation):** The Committee heard evidence from—

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, Fiona Hyslop MSP, Minister for Culture and External Affairs, Gary Gillespie, Deputy Director, Office of the Chief Economic Adviser, Graeme Roy, Team Leader, Office of the Chief Economic Adviser, David Rogers, Deputy Director, Constitution Directorate, and Gerald Byrne, Team Leader, Constitution Directorate, Scottish Government.

### **1st Meeting, 2011 (Session 3) Tuesday 11 January 2011**

**Scotland Bill (UK Parliament legislation):** The Committee heard evidence from—

Professor Iain McLean, Official Fellow in Politics, University of Oxford;  
Professor Drew Scott, Professor of European Union Studies, University of Edinburgh;  
Professor Andrew Hughes Hallett, Professor of Economics, University of St Andrews and George Mason University.

**Work programme (in private):** The Committee reviewed its work programme. The Committee agreed to invite Scottish and UK Ministers to appear at a future meeting of the Committee. The Committee also agreed to ask the advisers and SPICe to produce further research and briefing.

### **2nd Meeting, 2011 (Session 3) Tuesday 18 January 2011**

**Scotland Bill (UK Parliament legislation):** The Committee took evidence, in a roundtable format, from—

Professor Francois Vaillancourt, Professeur titulaire, sciences économiques, Université de Montréal;  
Professor Gerald Holtham, Visiting Professor, Cardiff University;  
Professor Dr. Paul Bernd Spahn, Goethe Universität;  
Professor Anton Muscatelli, Principal, Glasgow University;

Professor Sir Kenneth Calman, Former Chairman, and Iain McMillan CBE, Former member, Commission on Scottish Devolution.

**Work programme (in private):** The Committee considered correspondence received from the Presiding Officer and two draft letters from Robert Brown, which he suggested be sent on behalf of the Committee, to Professors Andrew Hughes-Hallett and Andrew Scott, and to John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth. Tricia Marwick proposed that the letters should not be sent. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against (Ms Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock). Thereafter, a number of changes to the terms of the draft letter to Professors Hughes-Hallett and Scott were agreed to.

It was also agreed that a separate letter should be sent by the Convener, on behalf of the Committee, to Professors Hughes-Hallett and Scott inviting them to meet with the Clerks to discuss the administrative processes for dealing with written evidence from witnesses.

The Committee considered the terms of an email from Brian Adam to members of the Committee. It was agreed that the Convener write, on behalf of the Committee, to Alan Trench, inviting him to submit views on the meeting's roundtable session, and re-iterating the invitation to attend a future meeting of the Committee.

Brian Adam proposed that the Committee agree to the offer from Professors Andrew Hughes-Hallett and Andrew Scott to hold a seminar on fiscal autonomy for the Committee members. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Ms Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock).

Furthermore, Brian Adam proposed that the Committee issue a public apology to Professors Hughes-Hallett and Scott. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Ms Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock).

### **3rd Meeting, 2011 (Session 3) Tuesday 25 January 2011**

**Scotland Bill (UK Parliament legislation):** The Committee took evidence from—  
Derek Allen, Director of Taxation, and Bruce Cartwright, Convener of Technical Policy Board, Institute of Chartered Accountants of Scotland;  
Mr David Bennett, Consultant, Gillespie Macandrew, a member of the Company Law and Insolvency Committee of the Law Society of Scotland and representing the R3 Association of Business Recovery Professionals;  
Evlynne Gilvarry, Chief Executive and Registrar, General Dental Council;  
Joseph McIntyre, Director of Dental Technology Training, NHS Education for Scotland;  
Marc Seale, Chief Executive, Health Professions Council;  
Duncan Rudkin, Chief Executive and Registrar, General Pharmaceutical Council;  
Isobel D'Inverno, Director of Corporate Tax, Brodies, Convener of the Tax Law Sub-Committee of the Law Society of Scotland;

Ben Thomson, Chairman, Reform Scotland;  
John Aldridge, Former Finance Director of the Scottish Executive;  
John Whiting, Tax Policy Director, Chartered Institute of Taxation;  
Deborah Lovell, Partner, Anderson Strathern and member of the Conveyancing Committee of the Law Society of Scotland.

**Work programme:** The Committee considered its work programme and noted the revisions made.

The Committee agreed to ask the Clerk to discuss with Professor Alan Trench the invitation to appear at a future meeting.

The Committee also agreed to write to the UK Government for further information.

#### **4th Meeting, 2011 (Session 3) Tuesday 1 February 2011**

**Scotland Bill (UK Parliament legislation):** The Committee took evidence from—  
Jeremy Peat, former BBC Trustee for Scotland;  
Mary Pitcaithly, Chair, and Chris Highcock, Secretary, Interim Electoral Management Board;  
Dr Colin Shedden, Director, BASC Scotland;  
Tom Ewing, Temporary Assistant Chief Constable, Fife Constabulary, representing ACPOS;  
Neil Greig, Director of Policy and Research, Institute of Advanced Motorists;  
Kathleen Braidwood, Road Safety Officer, RoSPA Scotland;  
Phil Flanders, Director, Scotland and Northern Ireland, Road Haulage Association;  
Professor Sir David Edward, KCMG, QC, FRSE, Emeritus Professor of Law, University of Edinburgh;  
Mr Richard Keen Q.C, Dean of Faculty, and Mr James Wolffe Q.C, Faculty of Advocates;  
Christine O'Neill, Partner, Brodies and Convener of the Constitutional Law Sub-Committee of the Law Society of Scotland;  
Michael Clancy, Director of Law Reform, Law Society of Scotland.

**Work programme:** The Committee considered its work programme and noted the revisions made.

The Committee agreed that the Convener, on behalf of the Committee, write to the Secretary of State for Scotland seeking information on the timetabling for consideration of the Bill and Legislative Consent Memoranda.

The Committee also agreed that the Convener, on behalf of the Committee, write to the Scottish Government and UK Government asking that any outstanding information previously requested be provided as soon as possible.

**5th Meeting, 2011 (Session 3) Thursday 3 February 2011**

**Scotland Bill (UK Parliament Legislation)** The Committee took evidence from—

The Rt. Hon Michael Moore MP, Secretary of State for Scotland, The Rt. Hon Lord Wallace of Tankerness QC PC, Advocate General for Scotland, and The Rt. Hon David Mundell MP, Parliamentary Under Secretary of State, Scotland Office; David Gauke MP, Exchequer Secretary, HM Treasury; Laura Crawforth, Scotland Bill Manager, and Robin Haynes, Senior Economist, Scotland Office; Jim Logie, Head of Division, Office of the Solicitor to the Advocate General; Rosalind Turner, Budget Strategy and Tax team, HM Treasury; Roger Bright, Chief Executive, and Tom Mallows, Consents and External Relations Manager, The Crown Estate.

**6th Meeting, 2011 (Session 3) Tuesday 8 February 2011**

**Decision on taking business in private:** The Committee agreed to take item 3 in private and to consider its draft report in private at future meetings.

**Scotland Bill (UK Parliament legislation)** The Committee took evidence from:—

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth, Fiona Hyslop MSP, Minister for Culture and External Affairs, Dr Andrew Goudie, Chief Economic Adviser, Dr Gary Gillespie, Deputy Director, Office of the Chief Economic Adviser, and Gerald Byrne, Team Leader, Constitution Directorate, Scottish Government; Martin Sime, Chief Executive, SCVO; Dave Moxham, Deputy General Secretary, STUC; Lucy Parsons, Project Manager for Marine Renewable Energy, Orkney Islands Council; Andy Wightman; Alan Trench, Honorary Senior Research Fellow, The Constitution Unit, University College London and author of the blog "Devolution Matters"; The Rt. Hon Elish Angiolini QC, Lord Advocate, Colin Troup, Legal Secretary to the Lord Advocate, Scottish Government and Fraser Gibson, Head of Appeals Unit, Crown Office and Procurator Fiscal Service.

**Work programme (in private):** The Committee reviewed its work programme and agreed its approach to its consideration of a final report. The Committee also agreed to write to the Scottish Government's Chief Economic Adviser to seek further information on a number of financial matters.

**7<sup>th</sup> Meeting 2011 (Session 3) Tuesday 22 February 2011**

**Scotland Bill (UK Parliament legislation) (in private):** The Committee considered its draft report and various changes were agreed, some by division.

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Note of divisions in private:

Brian Adam proposed that the relevant provisions of the Bill which seek to re-reserve any policy areas which were currently devolved should not be re-reserved in principle (paragraph 141). The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

Brian Adam proposed that the powers to regulate all firearms be devolved to the Scottish Parliament (paragraph 142). The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

Wendy Alexander proposed that the principle of re-reservation of insolvency to the UK Parliament be supported (paragraph 147). The proposal was agreed to by division. For 4 (Wendy Alexander, Robert Brown, Robert McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick).

Wendy Alexander proposed that the Committee recommends to the Scottish Parliament that it give its legislative consent to the provisions in the Bill relating to the appointment of the BBC Trust member for Scotland (paragraph 159). The proposal was agreed to by division. For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

Brian Adam proposed that the regulation of health professions regulated under enactments listed within the Scotland Act remain devolved (paragraph 152). The proposal was disagreed to by division. For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

**8<sup>th</sup> Meeting (Session 3) Tuesday 1 March 2011**

**Scotland Bill (UK Parliament legislation) (in private):** The Committee considered its draft report and various changes were agreed, some by division. The Committee agreed to publish its final report.

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Note of divisions in private:

Brian Adam proposed that paragraphs 3 and 4 be deleted. The proposal was disagreed to by division: The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

Tricia Marwick proposed that two supplementary tables be inserted after table 3 (paragraph 259) which did not include references to the Council Tax. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

**Table X: Estimated Spending Supported by Devolved Taxes under Different Proposals excluding Council Tax**  
**£m Outturn prices**

	Calman £m	Calman £m	Scotland Bill £m	Status Quo
	2006-07	2010-11	2010-11	2010-11
Income tax	4,150	4,500	4,500	
Income tax on savings and distributions	500	500		
Aggregates Levy	50	50		
Landfill Tax	75	75	75	
Stamp Duty Land Tax	555	555	555	
Air Passenger Duty	94	100		
Non-domestic rates	1,884	2,068	2,068	2,068
Total Devolved Tax Revenue	7,308	7,848	7,198	2,068
Current Expenditure (Resource DEL +NDR)	24,237	27,999	27,999	27,999

SOURCE: SPICe

**Table Y: Estimated Share of Spending Funded by Devolved Taxes under Different Proposals excluding Council Tax**

	Calman £m	Calman £m	Scotland Bill £m	Status Quo
	2006-07	2010-11	2010-11	2010-11
Income tax	17.1%	16.1%	16.1%	
Income tax on savings and distributions	2.1%	1.8%		
Aggregates Levy	0.2%	0.2%		
Landfill Tax	0.3%	0.3%	0.3%	
Stamp Duty Land Tax	2.3%	2.0%	2.0%	
Air Passenger Duty	0.4%	0.4%		
Non-domestic rates	7.8%	7.4%	7.4%	7.4%
Total Devolved Tax Revenue as % of Current Expenditure	30.2%	28.0%	25.7%	7.4%

SOURCE: SPICe

Wendy Alexander proposed an amendment to paragraph 364 to insert: “Until 20 February 2011, 4 weeks after the close of written submissions, the Committee had received from the Scottish Government only criticisms of the finance clauses in the Bill and no proposals to improve them”. The proposal was agreed to by division: For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

Tricia Marwick proposed an amendment to paragraph 376 to insert “some of” to read: The debate on the causal link, if any between fiscal decentralisation and economic growth that ensued was a key element of some of the Committee’s consideration of the merits of the financial proposals advanced as an alternative to those outlined in the Scotland Bill”. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 1 (Wendy Alexander).

Wendy Alexander proposed that paragraphs 377 to 379 be retained. The proposal was agreed to by division: For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

Wendy Alexander proposed that a new paragraph 385 be added. The proposal was agreed to by division: For 4 (Wendy Alexander, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 1 (Robert Brown).

Wendy Alexander proposed an amendment to paragraph 480 to insert: “...though of course in practice the ability of the grant to absorb such shocks is highly important. The recent economic shock of the banking crisis was of such a scale that the resources deployed could not have been met within the tax scope available to a Scottish Government. The NAO estimates that the total resources extended in the stabilisation effort exceeded £850 billion. SPICe estimated that £470 billion related to the Scottish institutions’ stabilisation.” The proposal was



agreed to by division. For 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Against 2 (Brian Adam, Tricia Marwick), Abstentions 0.

Tricia Marwick proposed an amendment to paragraph 537 to insert at the end of the paragraph: “No contrary evidence was given to the Committee”. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

Brian Adam proposed that paragraphs 549 to 550 be deleted. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

Brian Adam proposed that paragraph 568 be deleted. The proposal was disagreed to by division: For 2 (Brian Adam, Tricia Marwick), Against 4 (Wendy Alexander, Robert Brown, David McLetchie, Peter Peacock), Abstentions 0.

## **ANNEXE C: REPORT BY THE SUBORDINATE LEGISLATION COMMITTEE ON THE SCOTLAND BILL**

### **Subordinate Legislation Committee**

#### **10th Report, 2011 (Session 3)**

#### **Legislative Consent Memorandum on the Scotland Bill**

The Committee reports to the Parliament as follows—

1. At its meetings on 25 January and 8 February 2011, the Committee considered those provisions in the Scotland Bill (“the Bill”) which confer on the Scottish Ministers powers to make subordinate legislation. The Committee submits this report to the Scotland Bill Committee under Rule 9B.3.6 of Standing Orders.

2. The Scottish Government provided the Parliament with a legislative consent memorandum<sup>556</sup> (“LCM”). A separate legislative consent memorandum has also been lodged by Iain Gray MSP<sup>557</sup>.

3. The Committee was content with regard to the delegated powers contained in clauses 1, 19 and 20 and determined that it did not need to draw the attention of the Parliament to any of those powers.

#### **Delegated Powers Provisions**

#### **Clause 7(6): (new section 33A) Effect of limited reference to the Supreme Court**

<b>Power conferred on:</b>	<b>the Scottish Ministers</b>
<b>Exercised by:</b>	<b>order made by SI</b>
<b>Procedure:</b>	<b>negative</b>

4. This clause introduces a new mechanism which would allow for the reference of a Bill which had been passed by the Scottish Parliament to the Supreme Court for a ruling on whether it is within the Parliament’s legislative competence to be restricted to specified provisions in the Bill. At present if the Law Officers wish a ruling on the competence of any part of the Bill it must be referred in its entirety. This prevents those parts of the Bill with which there is no vires concern from proceeding to Royal Assent and coming into force.

5. Section 32 is amended to permit the Presiding Officer to submit a Bill which is the subject of a limited reference for Royal Assent. Section 33 is amended to require the Presiding Officer to be notified of references. New section 33A then makes provision for the treatment of limited references.

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<sup>556</sup> Legislative Consent Memorandum

<sup>557</sup> Legislative Consent Memorandum (Iain Gray)

6. A bill which is the subject of a limited reference will therefore receive Royal Assent and become an Act. However, those provisions which have been specified in the reference are prohibited from coming into force in accordance with the provisions made in the Act. The provisions which are not specified are not affected. The specified provisions can only be brought into force in the event that the Court finds they are within competence and in accordance with the terms of the Court ruling.

7. A new power is created in section 33A(6) which gives the Scottish Ministers power to then bring the specified (but competent) provisions into force which is subject to negative procedure. As currently framed this power would only permit the Scottish Ministers to appoint a date or dates for commencement. The Committee can envisage situations where the delay in commencement of the specified provisions may require further provision to be made to enable the Act to function as the Parliament intended. Similarly, in the event of any of the provisions being found to be outside the Parliament's legislative competence, some consequential modifications may be required as a result. In the event that a suitable power is not available in the Act itself, it may be appropriate to provide a power in section 33A to cater for such circumstances. **The Committee recommends that further consideration is given to conferring such powers.**

8. The Committee considers that in these unusual circumstances it is appropriate for the commencement power to be subject to negative procedure. **As regards the further powers proposed, the Committee recommends that if the powers are used to modify any enactment they should be subject to affirmative procedure. Otherwise they should be subject to negative procedure.**

#### Clause 21: Speed limits

Power conferred on:

Exercised by:

Procedure:

the Scottish Ministers

regulations or orders by SSI  
(except for a temporary order  
which is not by SSI)

negative (except first order  
under section 88(1)(b) which is  
affirmative)

9. There are three distinct powers to be conferred on the Scottish Ministers under the Road Traffic Regulation Act 1984 relating to speed limits. The power to make provision under section 17 for regulating the speed of vehicles on special roads in Scotland in general is to be transferred to the Scottish Ministers. (The power under section 17(2) to make regulations in relation to any *particular* special road in Scotland was executively devolved to the Scottish Ministers by virtue of SI 1999/1750). All other powers within section 17 remain with the Secretary of State, however, those retained powers can only be exercised in relation to Scotland after consultation with the Scottish Ministers.

10. Section 64 of the 1984 Act makes provision for prescribing the form of traffic signs. While it is not clear on the face of the section, functions under section 64(1)(b) and (2) are already executively devolved to the Scottish Ministers by

virtue of SI 1999/1750. Section 64 is being amended to provide that the Scottish Ministers also have the function of making regulations under section 64(1)(a) specifying signs for a Scottish national speed limit but only with the agreement of the Secretary of State. A “Scottish national speed limit” is a speed limit which the Scottish Ministers have the power to set under section 17 (special roads) or section 88 (temporary speed limits). The power to make traffic signs regulations is subject to negative procedure and the Scottish Ministers must consult such representative organisations as they think fit. These mirror the requirements placed on the Secretary of State when exercising these powers as regards England and Wales.

11. Section 88(1) of the 1984 Act currently gives the Secretary of State the power to set temporary speed limits by order (not subject to parliamentary procedure) for a period not exceeding 18 months and section 88(4) allows the Secretary of State to continue a temporary order either indefinitely or for a specified period by way of negative procedure order. These functions can be exercised by the Scottish Ministers in respect of specified roads in Scotland by virtue of the executive devolution order SI 2000/1563. (The functions cannot presently be used by the Scottish Ministers to modify speed limits generally across the whole of Scotland.)

12. Clause 21 modifies section 88 of the 1984 Act to confer the function of making orders in relation to roads in Scotland under section 88(1) and (4) on the Scottish Ministers permanently. The procedure applied mirrors that relating to the Secretary of State. Temporary orders are not subject to procedure and are not made by statutory instrument. Orders under section 88(4) confirming temporary orders are subject to negative procedure. Temporary restriction orders which apply generally are subject to the requirement to consult with such representative organisations as the Scottish Ministers think fit.

13. The procedures which are currently applicable to the exercise of these functions and which are to be replicated for the purposes of their transfer to the Scottish Ministers appear to the Committee to be in order with one exception. The Committee accepts that it may not be necessary for the Parliament to have the power to annul or be required to approve an order making a temporary speed limit, since the order is by its nature temporary in effect. The power is likely to be used based on operational advice about road safety matters. However, the Committee considers that it is important that the effect of the order is notified to the public and that the legal basis for the change to the speed limit is transparent and clearly identifiable since failure to observe the speed limit is a criminal offence.

14. The Committee recognises that the power to regulate signage may address the first issue – since it is primarily through road signage that the public are informed of the speed limits in force on any road from time to time. However the 1984 Act will not require the function under section 88(1) to be exercised by SSI therefore there are no prescribed requirements as to the form of an order or for its publication. Whether such an order was made will therefore be a matter subject to the normal rules of proof of evidence. The Committee considers this unsatisfactory.

15. **The Committee reports:—**

- **that the absence of a requirement that the function in section 88(1) is to be exercised by SSI could (i) result in a lack of transparency in the legislative process, (ii) fail to give adequate public notice of the exercise of the function and (iii) raise questions of the manner of proof of its exercise in any related criminal proceedings; and**
- **that in its view it would be more helpful in securing public notice and proof of exercise of the function for it to be exercised by SSI which would be subject to the procedure set out in section 30 of the Interpretation and Legislative Reform (Scotland) Act 2010 (laid only).**

### **Clause 36: Transitional provision for Scottish statutory instruments**

16. The Committee understands that this clause is included because at the time of drafting it was not clear whether the Scotland Bill would be in force prior to the commencement of Part 2 of the Interpretation and Legislative Reform (Scotland) Act 2010. Part 2 of the 2010 Act makes changes to the procedures for scrutiny of subordinate legislation in the Scottish Parliament. This clause therefore seeks to cover any potential gap which may arise between the commencement of the Scotland Bill (and any consequential extension of executive powers to the Scottish Ministers) and the commencement of Part 2 of the 2010 Act on 6 April 2011.

17. This raises a very technical issue which came to the Committee's attention during consideration of the commencement order for the 2010 Act. Once the 2010 Act procedures are fully commenced the Scottish Ministers' powers to make subordinate legislation will be exercised by a new type of instrument. This new 2010 Act SSI is independent of the Westminster statutory instrument regime. Old pre-2010 Act SSIs were a sub-category of statutory instrument.

18. This is of relevance when considering the legal requirements for numbering, publication and printing of SSIs. The 2010 Act and the publication requirements made under it only apply to the new independent form of SSI. The 2010 Act regime will only begin to operate on 6 April 2011. The 1999 Transitional SI Order (SI 1999/1096) makes provision for the publication etc of the old form of SSIs which are a sub-category of statutory instrument.

19. This clause makes any new function of the Scottish Ministers conferred by the Bill and which is to be exercised before 6 April exercisable by the new form of independent SSI. This means that there will be no publication scheme operating for such SSIs since section 42 of the 2010 Act and the Scottish Statutory Instruments Regulations 2011 to be made under that section only come into force on 6 April 2011 (subject to the approval of the Scottish Parliament). **The Committee reports that in the event that clause 36 is required to make provision for the Scotland Bill coming into force before 6 April 2011 then the Committee considers that provision must be made for the publication etc. provisions in the 1999 Transitional SI Order to apply to the exercise of these powers prior to 6 April 2011.**

**ANNEXE D: LIST OF BODIES AND INDIVIDUALS THAT PROVIDED WRITTEN EVIDENCE TO THE COMMITTEE**

**1<sup>st</sup> Meeting 7 December 2010**

[Oral evidence](#)

**2<sup>nd</sup> Meeting 14 December 2010**

[Oral evidence](#)

The Rt. Hon Michael Moore MP, Secretary of State for Scotland  
The Rt. Hon David Mundell MP, Parliamentary Under Secretary of State, Scotland Office  
The Rt. Hon Lord Wallace of Tankerness QC PC, Advocate General for Scotland  
David Gauke MP, Exchequer Secretary, HM Treasury

**3<sup>rd</sup> Meeting 21 December 2010**

[Oral evidence](#)

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth  
Fiona Hyslop MSP, Minister for Culture and External Affairs  
Gary Gillespie, Deputy Director, Office of the Chief Economic Adviser  
Graeme Roy, Team Leader, Office of the Chief Economic Adviser David Rogers, Deputy Director, Constitution Directorate  
Gerald Byrne, Team Leader, Constitution Directorate, Scottish Government.

**1<sup>st</sup> Meeting 11 January 2011**

**Written evidence**

[Professor Robin Boadway](#)  
[Professor Iain McLean FBA](#)  
[Professors Drew Scott and Andrew Hughes Hallett](#)

[Oral evidence](#)

Professor Iain McLean  
Professor Drew Scott  
Professor Andrew Hughes Hallett

## **2<sup>nd</sup> Meeting 18 January 2011**

### **Written evidence**

[Gerald Holtham](#)

[Professor Chris Heady](#)

[Professor Robin Boadway](#) (PREVIOUSLY CIRCULATED ON 11.1.11)

[Professor Iain McLean FBA](#) (PREVIOUSLY CIRCULATED ON 11.1.11)

### **Oral Evidence**

Professor Francois Vaillancourt  
Professor Gerald Holtham  
Professor Dr. Paul Bernd Spahn  
Professor Anton Muscatelli  
Professor Sir Kenneth Calman  
Iain McMillan CBE

## **3<sup>rd</sup> Meeting 25 January 2011**

### **Written evidence**

[Institute of Chartered Accountants of Scotland \(ICAS\)](#)

[NHS Education for Scotland](#)

[Health Professions Council](#)

[General Dental Council](#)

[Reform Scotland](#)

### **Oral Evidence**

Derek Allen, Director of Taxation, and Bruce Cartwright, Convener of Technical Policy Board, Institute of Chartered Accountants of Scotland  
Mr David Bennett, Consultant, Gillespie Macandrew, a member of the Company Law and Insolvency Committee of the Law Society of Scotland and representing the R3 Association of Business Recovery Professionals;  
Evelynne Gilvary, Chief Executive and Registrar, General Dental Council; Joseph McIntyre, Director of Dental Technology Training, NHS Education for Scotland; Marc Seale, Chief Executive, Health Professions Council  
Duncan Rudkin, Chief Executive and Registrar, General Pharmaceutical Council  
Isobel D'Inverno, Director of Corporate Tax, Brodies, Convener of the Tax Law Sub-Committee of the Law Society of Scotland  
Ben Thomson, Chairman, Reform Scotland  
John Aldridge, Former Head of Finance, Scottish Executive Health Department;  
John Whiting, Tax Policy Director, Chartered Institute of Taxation;  
Deborah Lovell, Partner, Anderson Strathern and member of the Conveyancing Committee of the Law Society of Scotland.

#### **4<sup>th</sup> Meeting 1 February 2011**

##### **Written evidence**

[British Association for Shooting and Conservation, Scotland \(BASC\)](#)

[The Royal Society for the Prevention of Accidents \(ROSPA\)](#)

[Road Haulage Association Ltd \(RHA\)](#)

[The Law Society of Scotland](#)

##### **Oral Evidence**

Jeremy Peat, former BBC Trustee for Scotland;

Sir John Arbuthnott, former Chair of the Arbuthnott Commission on Boundary Differences and Voting;

Mary Pitcaithly, Chair, and Chris Highcock, Secretary, Interim Electoral Management Board;

Dr Colin Shedden, Director, BASC Scotland;

Tom Ewing, Temporary Assistant Chief Constable, Fife Constabulary, representing ACPOS;

Neil Greig, Director of Policy and Research, Institute of Advanced Motorists;

Kathleen Braidwood, Road Safety Officer, RoSPA Scotland;

Phil Flanders, Director, Scotland and Northern Ireland, Road Haulage Association;

Professor Sir David Edward, KCMG, QC, FRSE, Emeritus Professor of Law, University of Edinburgh;

Mr Richard Keen Q.C, Dean of Faculty, and Mr James Wolffe Q.C, Faculty of Advocates;

Christine O'Neill, Partner, Brodies and Convener of the Constitutional Law Sub-Committee of the Law Society of Scotland;

Michael Clancy, Director of Law Reform, Law Society of Scotland.

#### **5<sup>th</sup> Meeting 3 February 2011**

##### **Written evidence**

[HMRC](#)

[The Crown Estate](#)

[HMG – Department Of Health](#)

[HM Treasury](#)

##### **Oral Evidence**

The Rt. Hon Michael Moore MP, Secretary of State for Scotland

The Rt. Hon Lord Wallace of Tankerness QC PC, Advocate General for Scotland

The Rt. Hon David Mundell MP, Parliamentary Under Secretary of State, Scotland Office;

David Gauke MP, Exchequer Secretary, HM Treasury;

Laura Crawforth, Scotland Bill Manager, and Robin Haynes, Senior Economist, Scotland Office;



Jim Logie, Head of Division, Office of the Solicitor to the Advocate General;  
Rosalind Turner, Budget Strategy and Tax team, HM Treasury;  
Roger Bright, Chief Executive, and Tom Mallows, Consents and External  
Relations Manager, The Crown Estate.

### **Supplementary written evidence**

[The Crown Estate](#)

### **6<sup>th</sup> Meeting 8 February 2011**

#### **Written evidence**

[Scottish Council for Voluntary Organisations \(SCVO\)](#)

[Orkney Islands Council](#)

[Andy Wightman](#)

[Alan Trench](#)

#### **Oral Evidence**

John Swinney MSP, Cabinet Secretary for Finance and Sustainable Growth  
Fiona Hyslop MSP, Minister for Culture and External Affairs  
Dr Andrew Goudie, Chief Economic Adviser, Dr Gary Gillespie, Deputy Director,  
Office of the Chief Economic Adviser, and Gerald Byrne, Team Leader,  
Constitution Directorate, Scottish Government;  
Martin Sime, Chief Executive, SCVO;  
Dave Moxham, Deputy General Secretary, STUC;  
Lucy Parsons, Project Manager for Marine Renewable Energy, Orkney Islands  
Council;  
Andy Wightman;  
Alan Trench, Honorary Senior Research Fellow, The Constitution Unit, University  
College London and author of the blog "Devolution Matters";  
The Rt. Hon Elish Angiolini QC, Lord Advocate, Colin Troup, Legal Secretary to  
The Lord Advocate, Scottish Government and Fraser Gibson, Head of Appeals  
Unit, Crown Office and Procurator Fiscal Service.

#### **Supplementary written evidence**

[Alan Trench](#)

[Scottish Retail Consortium](#)

**Other Written evidence**

Other written evidence submitted to the Committee can be viewed online at:-  
<http://www.scottish.parliament.uk/s3/committees/scotBill/ScotlandBill.htm>

**Other correspondence, research etc**

Items of correspondence and other documents, research etc relating to the Scotland Bill can be viewed online at:  
<http://www.scottish.parliament.uk/s3/committees/scotBill/currentInquiries.htm>

## ANNEXE E: OTHER DOCUMENTS PRODUCED FOR THE COMMITTEE BY SPICE

### SPICe Paper

#### Analysis of Scottish Government's £8bn Model

A key principle of the Scotland Bill proposals is that some of the block grant is exchanged for the scope for the Scottish Parliament to levy its own taxes. During the transition period, the value of the deduction from the block grant corresponding to the reduced UK rate of income tax in Scotland will be calculated annually. After the transition period the block grant will be permanently reduced by a certain percentage which is deemed to reflect the reduced revenues to the UK Exchequer from the taxes the Scotland Bill devolves to the Scottish Parliament.

To illustrate the impact of the proposals the Scottish Government provided a hypothetical analysis of what they estimate would have been the cumulative difference between the Scottish Government's outturn Department Expenditure Limit (DEL) and the Scottish Government's DEL under the Scotland Bill proposals over the period since devolution<sup>558</sup>. They concluded "Had these proposals been introduced at the start of devolution in 1999, our budget would have been lower than under the current framework in each and every year from 2001/02 to 2010/11. The cumulative shortfall would have been approximately £8 billion – a significant reduction in the resources available for public services in Scotland<sup>559</sup>".

The UK Government, on the other hand, provided an alternative model<sup>560</sup> that estimates that had the proposals been in place since 1999/00 there could have been a cumulative shortfall valued at a lesser £691m over the period to 2010/11. It should be noted at the outset that the Scottish Government's model is in real terms and the UK Government's model is in cash terms. If the UK Government's model is converted into real terms then the cumulative shortfall is reduced to £481m to 2010/11.

This paper looks at the variables underlying these hypothetical models and uses SPICe replications of the Scottish and UK Government models to ascertain the degree of influence using a different estimate has on the overall results<sup>561</sup>.

**It should be noted that it is not necessarily appropriate to use certain combinations of variables within these models, e.g., UK Government DEL estimates may not be calculated on a compatible basis with Scottish Government income tax estimates. The alternative scenarios are not intended to present more accurate modelling, but to illustrate the sensitivities of the models to the variables being altered.**

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<sup>558</sup> Scottish Government. *Scottish Government – a note on the estimated impact of the Scotland Bill Income Tax Proposal on the Scottish DEL Budget from 1999/00 to 2010/11*. Available at: <http://scottish-parliament.cc/s3/committees/scotBill/documents/ScotlandBillAnalysissince1999.pdf>

<sup>559</sup> Scottish Government. *Letter from the Cabinet Secretary for Finance and Sustainable Growth - 25 January 2011. Annex A: Financial Provisions*. Available at: <http://www.scotland.gov.uk/Resource/Doc/1069/0108858.pdf>

<sup>560</sup> Scotland Office. *Scotland Office - a technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget*. Available at: [http://scottish-parliament.cc/s3/committees/scotBill/documents/NoteforSPcommittee\\_000.pdf](http://scottish-parliament.cc/s3/committees/scotBill/documents/NoteforSPcommittee_000.pdf)

<sup>561</sup> Note that the SPICe Scottish Government model may not exactly match the figures presented to Committee by the Scottish Government due to rounding.

## Elements to the model

To undertake the modelling, estimates of the following variables are needed:

- Outturn Department Expenditure Limit (DEL)
- The value of income tax receipts which would be assigned to Scotland under the Scotland Bill proposals (10p at each rate)
- The percentage reduction in the block grant

A time period for the modelling also needs to be selected.

An analysis of the Scottish Government's and UK Government's approach to each of these variables is provided below.

### **Outturn DEL**

The estimates of Outturn DEL in cash terms by each Government are shown in Table 1. It can be seen that the Scottish Government's DEL figures tend to be lower than the UK Government's in the first 5 years of devolution, but higher thereafter.

**Table 1 – Estimates of Outturn DEL by the Scottish and UK Government's (£m cash terms)**

Year	Estimated Outturn DEL (cash terms)		Difference
	Scottish Government	UK Government	
1999/00	13,807	14,147	-340
2000/01	14,705	15,023	-318
2001/02	16,396	16,740	-344
2002/03	17,807	17,929	-122
2003/04	19,507	19,915	-408
2004/05	21,033	20,741	292
2005/06	22,862	22,465	397
2006/07	24,906	24,537	369
2007/08	26,326	26,485	-159
2008/09	27,625	26,915	710
2009/10	29,079	28,534	545
2010/11	29,243	28,200	1,043
2011/12	27,907	27,300	607
2012/13	28,262	27,600	662
2013/14	28,248	27,500	748
2014/15	28,484	27,700	784
<b>Source:</b>	Scottish Government: budget documents with adjustments to reflect consequentials	HM Treasury: Public Expenditure Statistical Analyses (PESA)	Key difference is that SG estimates are based on actual flows of money. Non cash items have been removed.

There are many sources from which Scottish DEL figures could be sourced including HM Treasury's annual PESA publication, the Scottish Government's Consolidated Accounts or the Scottish Government's budget documents. Each source inevitably uses a different

definition of DEL, however estimates do not usually vary substantially from each other. The Scottish Government have argued that “While using different data sources for expenditure will not change the underlying results, applying Scottish DEL figures other than the figures employed in the Scottish Government analysis would not be robust - particularly for comparisons over time”. This is because “From 2011/12 onwards, the DEL budget of the Scottish Government and all Whitehall departments, are reported excluding non cash transactions such as cost of capital”. The Scottish Government has used figures which strip out the cost of capital (non-cash) across the whole time period to enable comparisons with DEL in earlier years.

#### **The impact on the model of using different DEL estimates**

If the UK Government’s DEL figures are imputed into the Scottish Government model then the cumulative shortfall reduces slightly from £7.8bn to £7.6bn in real terms by 2010/11. If the Scottish Government DEL figures are imputed into the Scotland Office model then the cumulative shortfall is increased from £481m to £730m in real terms by 2010/11.

**It can thus be seen that the DEL figures modelled by the Scottish Government produce a higher cumulative shortfall relative to the same model with UK Government DEL. However, the degree of difference between the DEL figures used is small enough that this has not had a substantial impact on the overall results.**

#### ***Income tax receipts***

The estimates of the value of income tax receipts which would be assigned to Scotland under the Scotland Bill proposals (10p at each rate) in cash terms by each Government are provided in Table 2 below. It can be seen that the Scottish Government’s income tax figures tend to be lower than the UK Government’s over the time frame modelled.

**Table 2 – Estimates of income tax receipts by the Scottish and UK Government's (£m in cash terms)**

Year	Estimated Value of 10p Tax Receipts		Difference
	Scottish Government	UK Government	
1999/00	2,651	2,600	51
2000/01	2,898	2,980	-82
2001/02	3,018	3,130	-112
2002/03	3,099	3,210	-111
2003/04	3,207	3,310	-103
2004/05	3,427	3,570	-143
2005/06	3,746	3,930	-184
2006/07	4,073	4,260	-187
2007/08	4,394	4,570	-176
2008/09	4,180	4,400	-221
2009/10	4,072	4,174	-102
2010/11	4,178	4,306	-128
2011/12	4,328	4,481	-152
2012/13	4,657	4,805	-147
2013/14	5,035	5,200	-166
2014/15	5,437	5,596	-158
<b>Source:</b>	GERS and Office of Budget Responsibility (OBR) forecasts post 08/09	HMRC estimates and OBR forecasts post 07/08	SG estimates assume the value of 10p tax receipts are 39% of annual receipts reported in GERS or 39% of annual receipts estimated using OBR's forecasts of UK receipts – based on calculating revenues associated with 10p at each rate in 2008/09 – the most recent year for which data is available. UK estimates are obtained by calculating Scottish receipts as an appropriate proportion of total receipts modelled by HMRC, taking into account the income tax rates that applied each year. Post 2007-08 Scottish receipts are calculated as 2.87% of OBR's forecasts of UK receipts – the average % 10p receipts are as a % of total UK tax receipts over the period 1999-2008.

Note: Income tax receipts calculated using OBR forecasts are estimated by SPICe using methodologies outlined by the Scottish and UK Government's.

### **The impact on the model of using different income tax estimates**

If the UK Government income tax figures are imputed into the Scottish Government model then the cumulative shortfall reduces slightly from £7.8bn to £6.2bn in real terms to 2010/11. If the Scottish Government income tax figures are imputed into the UK Government model then the cumulative shortfall is increased from £481m to £2.2bn in real terms to 2010/11. **It can be seen that the income tax estimates used by the Scottish Government produce a higher cumulative shortfall relative to the same model with**

the UK income tax estimates. The use of different income tax estimates has had a moderate impact on the overall results.

***The percentage reduction in the block grant***

A certain percentage of the outturn DEL is exchanged for income tax receipts in each model. The Scottish Government and the UK Government have modelled different percentage reductions, as outlined below:

Government	% Reduction	Rationale
Scottish	19.2 to 2005/06, 18.9 thereafter	Income tax receipts as a % of DEL in 1999/00 (changes after 2005/06 due to an accounting adjustment).
UK	17.25	Average % income tax is as a % of DEL over period 1999/00 to 2009/10.

How the % reduction chosen compares to income tax as a % of DEL over the period bears a large influence on the size of the cumulative shortfall. Table 3 shows that in general over the time period income tax as a % of DEL is lower in the Scottish Government model than it is in the UK Government model. Thus, the % reduction in the block grant will need to be lower than that in the UK model to show the same results.

**Table 3 – Income tax as a % of DEL in each model**

Year	Income Tax/DEL		Difference
	Scottish Gov	UK Gov	
1999/00	19.2%	18.4%	0.8%
2000/01	19.7%	19.8%	-0.1%
2001/02	18.4%	18.7%	-0.3%
2002/03	17.4%	17.9%	-0.5%
2003/04	16.4%	16.6%	-0.2%
2004/05	16.3%	17.2%	-0.9%
2005/06	16.4%	17.5%	-1.1%
2006/07	16.4%	17.4%	-1.0%
2007/08	16.7%	17.3%	-0.6%
2008/09	15.1%	16.3%	-1.2%
2009/10	14.0%	14.6%	-0.6%
2010/11	14.3%	15.3%	-1.0%
2011/12	15.5%	16.4%	-0.9%
2012/13	16.5%	17.4%	-0.9%
2013/14	17.8%	18.9%	-1.1%
2014/15	19.1%	20.2%	-1.1%

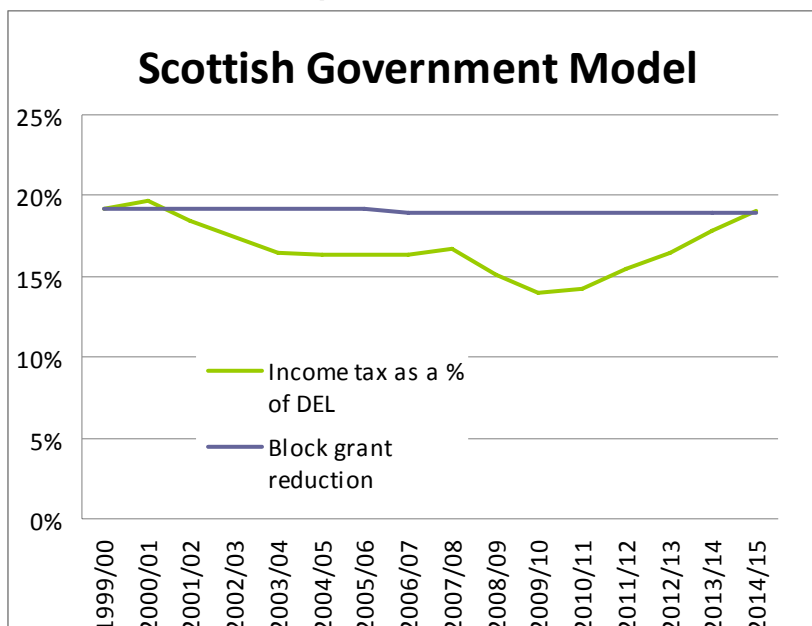
Source: SPICe

Although the exact mechanism for making the initial adjustment to the block grant has not yet been determined The UK Government's Command Paper outlines that the value of the adjustment to the block grant would not be priced on the basis of receipts in a single year, rather an average of receipts over a number of years. The principal is that it will be based on the average worth of the devolved tax receipts<sup>562</sup>. Chart 1 shows that the % reduction selected by the Scottish Government in the model is higher than income tax as a % of DEL in all years except 2000/01 and 2014/15. The result is that income tax receipts are

<sup>562</sup> HM Government. *Strengthening Scotland's Future*. Page 35.

not high enough to make up the reduction in the block grant in the intervening period and a large cumulative shortfall in DEL is created.

**Chart 1 – the Scottish Government’s % reduction in the block grant compared to income tax as a % of DEL over the period**

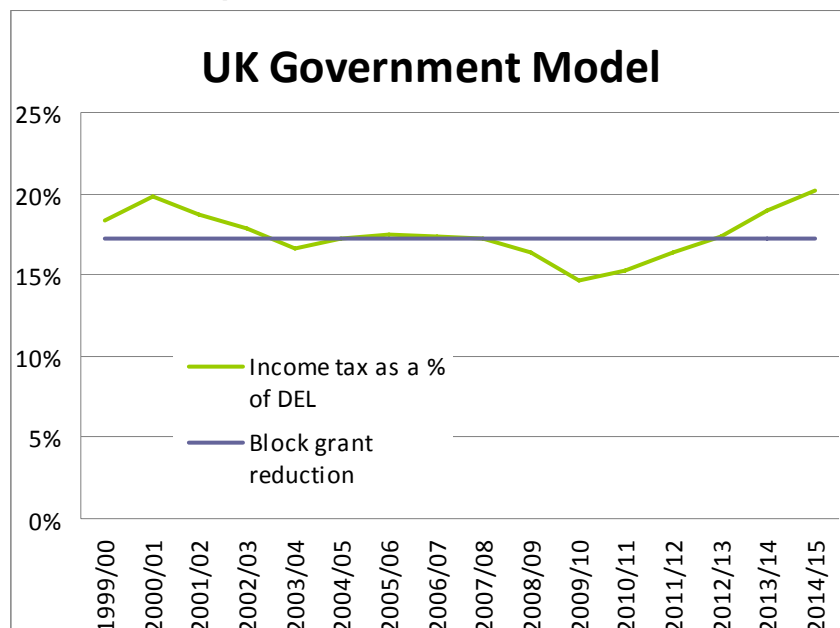


Source: SPICe

The UK Government block grant reduction is based on an average over the time period 1999/00 to 2010/11 – which represents a number of economic cycles. As a result, Chart 2 shows that the % reduction modelled by the UK Government is around the middle of the range shown for income tax as a % of DEL over the period. When income tax as a % of DEL is higher than the % reduction in the block grant the cumulative shortfall is reduced. In the years when income tax as a % of DEL is lower than the % reduction in the block grant the cumulative shortfall is built up. As the % reduction is around the middle, the result is more neutral over the time period shown.



**Chart 2 – the UK Government’s % reduction in the block grant compared to income tax as a % of DEL over the period**



Source: SPICe

### **The impact on the model of using a different % reduction in the block grant**

Were the Scottish Government to model the block grant reduction using the same rationale as the UK Government then the reduction would be 16.7% - the average income tax as a % of DEL over the period 1999/00 to 2010/11 in the Scottish Government model – and the cumulative shortfall would reduce from £7.8bn in real terms over the period to 2010/11 to £768m. Were the UK Government to model the block grant reduction using the same rationale as the Scottish Government then the reduction would be 18.4% - income tax as a % of DEL in 1999/00 in the UK Government model – and the cumulative shortfall would increase from £481m in real terms over the period to 2010/11 to £3.9bn.

**It can be seen that the higher the % reduction in the block grant relative to income tax receipts as a % of DEL, then the higher the cumulative shortfall. The Scottish Government model uses a % reduction that is higher than income tax as a % of DEL in all but two years, thus producing a substantially larger cumulative shortfall than had it modelled a % reduction around the middle of the range shown for income tax as a % of DEL over the period 1999/00 to 2010/11 – the UK Government method.**

**The UK Government model uses a % reduction that is around the middle of the range shown for income tax as a % of DEL over the period, thus producing a substantially lower cumulative shortfall to 2010/11 than had it modelled a % reduction based on income tax as a % of DEL in 1999/00 – the Scottish Government method. The use of different % block grant reductions by each Government has had a substantial impact on the overall results.**

## Summary of scenarios

Tables 4 and 5 show how the results from each model would change if a variable from the other model was substituted.

**Table 4: the Scottish Government model and alternative variables**

Scenario	Cumulative difference 1999/00 to 2010/11 (£m in real terms)	Cumulative difference 1999/00 to 2014/15 (£m in real terms)
As presented by Scot Gov*	-7,842	-9,684
With UK DEL estimates	-7,572	-8,916
With UK income tax estimates	-6,163	-7,419
With UK block grant reduction**	-768	-241

\* Figures in this table have been calculated by SPICe. They do not exactly match the figures presented to Committee by the Scottish Government due to rounding.

\*\*Based on the average income tax as a % of DEL 1999/00 to 2010/11.

**Table 5: the UK Government model and alternative variables**

Scenario	Cumulative difference 1999/00 to 2010/11 (£m in real terms)	Cumulative difference 1999/00 to 2014/15 (£m in real terms)
As presented by UK Gov	-481	502
With SG DEL estimates	-730	-201
With SG income tax estimates	-2,160	-1,764
With SG block grant reduction*	-3,895	-4,104

\* Based on income tax as a % of DEL in 1999/00.

**As written earlier, it should be noted that it is not necessarily appropriate to use certain combinations of variables within these models, e.g., UK Government DEL estimates may not be calculated on a compatible basis with Scottish Government income tax estimates. The alternative scenarios are not intended to present more accurate modelling, but to illustrate the sensitivities of the models to the variables being altered.**

## Time period of the modelling

The year chosen for the permanent reduction, its point in the economic cycle and the economic conditions in the subsequent years (which influence the relative levels and growth rates of public expenditure and income tax revenues) also influence the results of the modelling.

## Modelling from 2007/08

For example the Scottish Government has provided a second model<sup>563</sup> which estimates the results of an initial block grant reduction in 2007/08 and projects it forward to 2014/15 - the end of the next spending review period. The block grant reduction is a lesser 16.7% and the cumulative budget shortfall by 2014/15 is -£1.4bn in real terms (compared to -£6.4bn over the same period using the original model). The shortfall is lesser than the original model as a result of:

<sup>563</sup> Scottish Government. *Letter from the Cabinet Secretary for Finance and Sustainable Growth - 7 February 2011. Annex B - Additional Information on Scottish Income Tax Provisions.* Available at: <http://scottish-parliament.cc/s3/committees/scotBill/documents/LetterfromJohnSwinneytotheCommittee-AnnexBincometaxproposals-7February2011.pdf>

- A different start year, in which income tax as a % of DEL is lower than it was in the start year of the original model, lessening the percentage reduction in the block grant in all years.
- The economic conditions during the time period over which the cumulative shortfall is calculated, where it is estimated that there will be a decline in public expenditure but moderate growth in income tax receipts.

If the UK Government's model is adapted, like the Scottish Government's model, to include only the period from 2007/08 then it is estimated to lead to a cumulative budget shortfall by 2014/15 of £611m in real terms (compared to a shortfall of £600m over the same period using the original model). These results are largely on par with each other as the UK Government % reduction in the original model is very similar to that in the new model.

### **Modelling from 2010/11**

The UK Government has also provided a second model<sup>564</sup> which estimates the results of an initial block grant reduction in 2011/12 and projects it forward to the end of the next spending review period – 2014/15. This would mean a 16.4% reduction and the modelling sets out that the Scottish budget could be up to £2.2bn larger in cash terms than it would otherwise have been by 2014/15<sup>565</sup>. The surplus is generated as a result of:

- A start year in which income tax as a % of DEL is lower still than it was in the start year of the original model, lessening even further the permanent reduction in the block grant in all years.
- Large scale fiscal consolidation over the time period modelled where public expenditure is estimated to reduce by 5% in real terms and income tax receipts are estimated to increase by 17%.

If the Scottish Government's model is adapted, like the UK Government's model, to include only the upcoming Spending Review period, during which time it is estimated that there will be a decline in public expenditure but strong growth in income tax receipts, then it will similarly lead to a £1.8bn cumulative surplus in real terms.

Table 6 outlines the results of changing the time period being modelled using the Scottish Government and UK Government models.

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<sup>564</sup> Scotland Office. *Scotland Office - a technical note on modelling the potential impact of the Scotland Bill income tax measures on the Scottish budget*. Available at: [http://scottish-parliament.cc/s3/committees/scotBill/documents/NoteforSPcommittee\\_000.pdf](http://scottish-parliament.cc/s3/committees/scotBill/documents/NoteforSPcommittee_000.pdf)

<sup>565</sup> SPICE has been unable to reconcile this figure with the Scotland Office model, and gets a figure of £2bn.

**Table 6 – The results of the Scottish Government and UK Government models using different start years (£m in real terms)**

Year	Scottish Government Model			UK Government Model*		
	Start Year			Start Year		
	1999/00	2007/08	2011/12	1999/00	2007/08	2011/12
1999/00	0			210		
2000/01	97			505		
2001/02	-166			308		
2002/03	-395			144		
2003/04	-645			-150		
2004/05	-713			-9		
2005/06	-738			63		
2006/07	-711			30		
2007/08	-635	0		1	0	
2008/09	-1,100	-452		-254	-256	
2009/10	-1,477	-805		-771	-773	
2010/11	-1,358	-703		-559	-560	
2011/12	-931	-321	0	-223	-224	0
2012/13	-661	-57	262	42	40	262
2013/14	-291	297	607	424	423	638
2014/15	41	619	923	740	739	950
<b>Cumulative shortfall/surplus</b>	<b>-9,684</b>	<b>-1,422</b>	<b>1,792</b>	<b>502</b>	<b>-611</b>	<b>1,850</b>

\* Note: the modelling of a reduction in 2007-08 and 2011-12 are based on one-off adjustments, as per the 2011-12 example provided in the Scotland Office technical note. This is inconsistent with their modelling of the 1999-00 start-year which uses an adjustment based on average tax receipts over the period.

**It can be seen that the economic circumstances at the time of the permanent reduction and over the modelling period have a significant influence over the results of the modelling.**

**During periods where, after the reduction, public expenditure grows at a faster rate than tax revenues - as was the case over the first ten years of devolution - a cumulative budget shortfall is created as income tax receipts are not maintained at a high enough level to compensate for the initial budget reduction.**

**During periods where, after the reduction, public expenditure grows at a lesser rate than tax revenues – as is anticipated to be the case over the next spending review period – a cumulative budget surplus is created as income tax receipts exceed the level needed to compensate for the initial budget reduction.**

## Key points

- The Scottish Government model is in real terms, whereas the UK Government model is in cash terms. Presenting the UK Government model in real terms has the impact of reducing the cumulative shortfall, whereas presenting it in cash terms will increase it. It does not substantially impact the results. Revisions to HM Treasury deflators will have a modest impact on the results.
- The Scottish Government uses DEL figures which have non-cash items removed and measure actual flows of money. They argue that these are most robust for the model given variations in accounting for non-cash over time. The DEL figures used by the Scottish Government produce a higher cumulative shortfall relative to the same model with UK Government DEL figures. However, the degree of difference between the DEL figures used is small enough that this has not had a substantial impact on the overall cumulative difference.
- The Scottish Government uses income tax figures which are estimated as being a constant percentage of Scottish income tax receipts (39%). The income tax estimates used by the Scottish Government produce a higher cumulative shortfall relative to the same model with the UK income tax estimates. The use of different income tax estimates has had a moderate impact on the overall cumulative difference.
- As a result of the specific DEL and income tax figures used within the Scottish Government model income tax as a % of DEL is in general lower than it is in the UK Government model. Thus it would take a smaller reduction in the block grant (relative to the UK Government model) to yield the same overall cumulative difference as the UK Government model.
- The UK Government Command Paper outlines that the value of the adjustment to the block grant would not be priced on the basis of receipts in a single year, rather receipts over a number of years. It should also be noted that basing the block grant reduction on one year's tax receipts that is not representative of the average % that income tax is as a proportion of DEL over the period has the potential to skew the results according to specific economic circumstances during that year.
- The Scottish Government model uses a % reduction that is higher than income tax as a % of DEL in all but two years over the period 1999/00 to 2014/15, thus producing a substantially larger cumulative shortfall than had it modelled a % reduction around the middle of the range shown for income tax as a % of DEL over the period as per the UK Government model. The use of different block grant reductions by each Government has had a substantial impact on the overall results.
- These factors compound together with the consequence being that the two models produce considerably different results from each other.
- The time period being modelled also has a significant influence on the results as year one tax receipts will determine the level of the permanent reduction in the Scottish Government model and the economic conditions in the subsequent years influence the relative growth rates of public expenditure and income tax receipts. Periods of high growth in public expenditure relative to tax receipts are more likely to generate a higher cumulative shortfall whereas periods of fiscal consolidation where tax receipts grow faster than public expenditure are more likely to generate a cumulative surplus.