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Corporation Tax Discussion Paper
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Corporation Tax Discussion Paper

1. The Scottish Council for Development and Industry (SCDI) is a broad-based business and civic membership organisation. Our aim is to influence and inspire government and key stakeholders to create sustainable economic prosperity for Scotland. We support the Scottish Government's Purpose: "To focus government and public services on creating a more successful country, with opportunities for all of Scotland to flourish, through increasing sustainable economic growth."
2. SCDI members have no single position on the devolution of fiscal powers. However, they have expressed the view that greater financial responsibility for the Scottish Parliament should be considered within the context of policies for sustainable increases in Scotland's comparatively sluggish long-term economic growth rate. The interest of SCDI is principally in whether new financial powers and accountability will further encourage and enable increasing sustainable economic growth via a competitive and stable environment for business growth and more closely aligning Scotland's economic performance with the Scottish Parliament's revenues. Corporation tax is an important lever to promote growth and investment, and we therefore welcome discussion of whether its devolution to the Scottish Parliament and reform would benefit the Scottish economy overall.
3. This discussion must be evidence-based. SCDI has found that there is mixed evidence that devolving greater powers to sub-national governments to raise and spend their own public funds is in itself enough to promote economic growth. We have called for an independent, comprehensive review of Scotland's fiscal arrangements, which should aim to identify a small number of key fiscal policy measures that would promote sustainable economic growth in Scotland and address some of the weaknesses in accountability and transparency present in the existing arrangements. We do not believe that this discussion paper provides the detailed evidence and information which businesses and civic organisations are seeking in order to engage in the discussion in an informed way. The extremely short timescale for responses to the consultation does not offer sufficient opportunity for many of them to participate and offer considered feedback, and is inappropriate for an issue of this importance to the future of Scotland. Given the time constraints, SCDI's comments, at this stage, mainly focus on some potential implications for businesses of introducing separate tax jurisdictions in the UK.

4. SCDI has previously called for economic modelling, including Scottish and UK Government facilitation for independent economic modelling, of fiscal proposals. Given the volatility of corporation tax receipts, it is necessary to understand whether any proposed reforms would support the Scottish economy and public spending through a period of economic volatility and/ or fiscal contraction. Feedback from SCDI members continues to indicate that the highest priority issues for the Scottish Parliament are still skills, infrastructure, innovation and growing exports, and the potential benefits of devolving and reforming corporation tax needs to be considered along with the risks that there will be less public funding available to support these highly important economic priorities.
5. In an operating environment of greater fiscal powers, it will be of increasing importance for Scotland to have greater independent analysis of public spending. SCDI has proposed the creation of a Scottish Office for Budgetary Responsibility to take a lead role in making an independent yet informed assessment of the public sector balance sheets, control forecasting and inform spending decisions. The National Performance Framework and Government Economic Strategy have established a number of sustainable economic growth targets for Scotland, and analysis is needed of the effectiveness of a range of levers, including fiscal and spending, in driving sustainable economic recovery and meeting all those targets.

What would be an appropriate rate of corporation tax for Scotland (balancing competitiveness on the one hand with maintaining a fair and transparent tax regime on the other)?

6. As previously stated, SCDI believes that discussion of this question would benefit from detailed economic modelling, including independent economic modelling.
7. SCDI fully recognises the potential for competitive rates of corporation tax to attract foreign direct investment and encourage entrepreneurship and business growth. Evidence from Ireland - and the vital importance which the Irish Government continues to attach to it - indicates that, in certain circumstances and in combination with a range of levers, a lower rate of corporation tax can help to attract significant globally mobile investment to a small, open economy. But it is clear that a wide range of other factors also have a strong influence and may or may not have an even stronger influence. SCDI believes that deeper analysis of the relative benefits, disbenefits and importance of differential corporation tax rates for the Scottish economy is required, including whether real economic activity would be attracted or an incentive for businesses to shift profits around tax jurisdictions would be created; in other words, whether corporation tax competition within the UK would be efficient or lead to a race to the bottom.
8. As the discussion paper notes, the UK Government has announced the phased reduction of the corporation tax to 23% by 2014, which would be the lowest headline rate of corporate tax in the G7. This suggests that the Scottish

Government would have to make very substantive reductions to current corporation tax rates in Scotland to improve the Scotland's competitiveness with the rest of the UK, which would have commensurate implications for lower revenues and, therefore, public spending and services, at least in the short-term. It can also be anticipated that other UK regions would seek to maintain their corporation tax competitiveness if the Scottish Parliament cuts the Scottish rate.

Should greater support be given for small and medium sized companies from the corporation tax regime? What form should this increased support take?

9. Proposals to vary the tax base, in addition to introducing differing tax rates in the UK, should be careful not to introduce further complexity and compliance costs.
10. SCDI would want to understand the detail of this proposal. We would be concerned if greater support for small and medium sized companies from the corporation tax regime was to be funded by higher tax rates on larger companies.

Should particular areas of business activity receive greater support from the corporation tax system and what form should such support take?

11. SCDI has previously suggested that, to encourage the rebalancing of the economy and increase exports, the rate of corporation tax levied on SMEs that export over 40% of their turnover should be lowered from the current small companies' rate.

Should particular parts of Scotland, such as Enterprise Zones, receive capital allowances in order to support economic development?

12. No comment.

What approach to submitting tax returns for businesses would be the most efficient under a system where corporation tax was devolved to the Scottish Parliament?

13. The discussion paper notes that there are rules to allocate profits to genuine economic activity and suggests that businesses are used to these rules and can easily develop systems to comply. Where different tax jurisdictions have always existed, businesses can indeed plan to put appropriate processes into place when they expand into new markets, although it should be pointed out that the appropriate attribution of overseas profits is an ongoing challenge for UK tax legislation and businesses. However, the creation of differing tax jurisdictions in an existing single market is quite different. Many Scottish businesses, and businesses based elsewhere in the UK, have grown organically over many years and their activities in Scotland and England are heavily intertwined. Some of these will have had no experience of operating in differing corporation tax jurisdictions. Those businesses which do operate internationally will have to calculate and attribute within the UK profits made overseas. The discussion paper understates the complexities and costs for businesses of separating out their

- existing activities and creating and maintaining distinct compliance processes. There are numerous layers to the tax system, and many practical questions for businesses which remain unanswered. It needs to be considered whether there is the potential that these resources would be utilised more productively elsewhere.
14. The discussion paper does not identify the risk that some non-Scottish UK businesses which at present have small, marginally profitable operations in Scotland may decide to withdraw from the Scottish market rather than deal with these new complexities and costs, or the risk that other non-Scottish UK businesses considering expansion into Scotland may regard them as a barrier, which could reduce investment, and diversity and choice for Scottish consumers.
 15. The discussion paper highlights Canada as an example where at least part of corporation tax is devolved below the national government level. However, it does not reference that there is some evidence to suggest that the greater complexities in compliance which this entails are viewed negatively by businesses. According to a PricewaterhouseCoopers report in 2008, 60% of Chief Executives surveyed said that the tax regime was their first priority for government action, compared to 38% in the UK. Businesses would expect that the Scottish Government should seek to understand and explain the reasons for these findings, and take cognisance of them in discussing options for reform in the UK.
 16. While HM Treasury has not yet provided an estimate of the administration costs associated with devolving corporation tax in Northern Ireland from which a comparison could be made and the Scottish Government's stated commitment to a tax collection system which provides value for money is noted, it seems certain that the start-up, ongoing and anti-avoidance costs of a separate regime will be significant, particularly in a prolonged period of spending constraints. The attribution of profits for corporation tax is a technically demanding subject even in countries with long histories as independent tax jurisdictions, and the scope for inefficiencies in a new system will be significant. The Scotland Bill acknowledges that it will be far from straightforward to administer accurately a dual income tax regime for individuals. It will be more difficult to do so for corporations. HM Treasury and the Scottish Government should work together to provide estimates for the extra costs in Scotland following HM Treasury's work in Northern Ireland.
 17. The Scottish Government should consider the greater resources, expertise, and timely and comprehensive data that it would need to use these powers effectively.

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