



**National Assembly for Wales  
Finance Committee**

**Impact of variations in national and sub-national  
income tax inquiry – call for evidence**

**Evidence from ICAS**

**13 January 2020**

## Introduction

1. The ICAS Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 board and committee members.
2. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 22,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.
3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members in the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.
4. As a matter of policy, ICAS does not comment on the rates of any tax.

## General comments

5. ICAS welcomes the opportunity to respond to this inquiry, published on 14 October 2019 and closing on 15 January 2020, which we understand raises questions in respect of the possible impact of different income tax rates across the Wales-England border. We acknowledge the terms of reference of the inquiry to be:
  - To examine the effects of sub-national income tax variations in international tax systems on the behaviour of low, medium and high-income earners, particularly migration and tax avoidance.
  - To understand how low, medium and high-income earners may respond to income tax rate divergence for each tax band between Wales and England.
  - To understand the level of divergence in income tax rates that could trigger a behavioural change in low, medium and high-income earners in Wales and England.
  - To assess the monetary impact on WRIT revenue with varying levels of tax rate divergence.
6. ICAS has contributed the experience of its members and their technical expertise in the development and implementation of the devolved taxes in Scotland, both in relation to Scottish income tax and with the two Scottish devolved taxes, Land and Buildings Transaction Tax (LBTT) and Scottish Landfill Tax (SLfT), and in the establishment of the tax authority Revenue Scotland.
7. In relation to Scottish income tax, the direction of travel was set in 2018/19 with the introduction of five bands – providing a more progressive charging structure than in the rest of the UK. With this structure, the profile of Scottish income tax has been raised as the differentials between Scotland and the rest of the UK have grown across thresholds and rates, and from one year to another.
8. Our comments below are based on experience of Scottish income tax. We appreciate that the devolving of income tax powers to Wales differs from that in Scotland, in that the taxable bands cannot be changed, although within each band there is the ability to insert a Welsh rate of income tax.
9. We believe much of the experience in Scotland, and the behavioural reactions to changes in income tax rates may be informative to the Welsh analysis.
10. The key points that attract attention and where behaviour may be influenced in Scotland are for those earning above the average income where the income tax rates are progressively higher than those in the rest of the UK, leading to concerns as to whether this may affect behaviours and, if so, at what point, for
  - those in Scotland, and
  - those who may be attracted into Scotland.

11. The main areas of behavioural reaction to higher taxes are generally considered to be for those who are self-employed and at what level of profits/ growth of their business they make the decision to incorporate; IR 35 type situations; and more generally, methods for seeking to avoid higher rates. We discuss these points of behavioural response below.
12. Whilst Scotland has a lower starting rate of income tax at 19% this is within a relatively small band of income and, based on anecdotal evidence from our members, we do not believe that this influences behaviour of either taxpayers or employers.
13. In the Scottish experience, the substantial time lag between the point at which new rates (and bands, in the case of Scotland) were introduced and the point at which data to assess behavioural responses became available has led to uncertainty for both the public, professional advisers and for those involved in forecasting and spending decisions.

### **The impact on revenues from behavioural change**

14. Clearly, there is a desire that taxpayers should operate within the spirit of the law and not avoid what was intended by the legislators but there can be challenges in fully understanding the contributory factors to tax driven behaviour.
15. A taxpayer simply using the legal options available, or tax incentives offered, can impact revenues. Some of the challenges in relation to the income tax powers include:
  - Learning about the interactions of different taxes and which tax levers are devolved or reserved
  - Evaluating the levels of risk around potential behavioural reactions to tax measures.
  - Accepting that the range of possible responses depends on the level of divergence and an individual's personal circumstances.
16. Appreciating that if a tax is 'competitive' and, say, the rates are reduced relative to those in the rest of the UK, or rates increased, this introduces incentives to reduce tax liabilities in a jurisdiction. Differentials tend to encourage tax planning, but where a jurisdiction only has a small number of taxpayers, such as in Scotland or particularly in Wales, it is important to understand the higher and additional rate population demographic. Their lifestyle (i.e. pensioner, employee, entrepreneur) will impact revenues in different ways should they decide to adapt their behaviour.
17. Any taxpayer who views a tax bill as an unwanted cost may seek to minimise this cost and so divergent rates across income tax (Scottish, Welsh and UK), corporation tax and capital gains tax lend themselves to tax planning behaviours such as business incorporation by an individual who wishes to be paid in dividends rather than a salary. With a partially devolved system, it can be difficult to attribute behavioural impact entirely to a change in income tax rates as there may be other changes taking place in the non-devolved part of the taxation system, for example, with dividend taxation, capital gains tax or taxation of property income. Putting income tax advantages down as the sole reason for certain tax behaviours may be misrepresenting the individual's motivation.
18. Also, arguably, focusing on 'avoidance' misses the point that there is a category of taxpayer behaviour responding to changes in tax law that is not quite strong enough to be categorised as avoidance but can nevertheless affect revenues.
19. For those in employment, it may be difficult to quantify attempts to minimise taxable income in the higher bands. Employers may decide to reconfigure remuneration packages to enable their employees to exchange salaries/wages for items such as pensions or further holiday entitlement; or individuals may increase their pension contributions, reduce their hours or not take on overtime and hence reduce their taxable pay. Small changes for individuals, but the cumulative effect could be significant for the Government in terms of tax take and in terms of productivity with both fiscal and economic impact.

## **The self employed**

20. Across the UK, the self-employed have always had the choice of operating as a sole trader or partnership (liable to income tax) or via a company (liable to corporation tax, whilst the owner may reward themselves by way of salary and/or dividends liable to income tax). A number of factors can influence this choice, including limited liability, tax and pension provision.
21. Using 2019/20 rates, the tax differential for the Scottish taxpayer may be up to around £4,000 depending on the level of profits up to £100,000 and how funds are extracted from the company. For the smaller business, the interaction between Scottish and UK tax regimes may encourage incorporation by Scottish taxpayers at an earlier stage in the business's evolution than compared to those in the rest of the UK.
22. This decision around the form of trading entity adopted not only influences the amount of tax payable by the trader but also determines which jurisdiction receives the taxes paid. Corporation tax is payable to the UK Exchequer, as is income tax on dividends. Scotland will only directly receive funds from Scottish income tax levied on non-savings, non-dividend income (earnings).
23. For the individual Scottish taxpayer, Scottish income tax rates, determined by the Scottish Government, will be factors to consider; as will the UK corporation tax rate at 19%, determined by Westminster.

## **IR35 – the use of personal companies**

24. Under existing rules, HMRC does not have sufficient resource to police all one-man companies; however incoming 'IR35' rules put the onus on the 'employing' company, which may lead to more conservative decisions, and lead to more contractors being within payroll. This would benefit the Exchequer and would help prevent incorporations of disguised employees.

## **Identification of Welsh taxpayers is key**

25. The identification of [Scottish and] Welsh taxpayers is essential if public funding derived from devolved taxes is to be optimised in each devolved jurisdiction. The Welsh Government should not assume that the data is correct and people have been correctly identified to the lowest possible margin of error. HMRC is ultimately responsible for ensuring that all Welsh taxpayers are correctly identified.

## **Migration**

26. There are tensions and challenges arising from the size, shape and potential mobility of the Scottish income tax base, or the Welsh income tax base, which need to be factored in when developing tax policy, particularly if there is increasing divergence from the rest of the UK.
27. The tensions inherent in a more progressive tax system may be potentially twofold: the desire to encourage inward migration and discourage outward migration.
28. In the main, tax is seen as a cost by both businesses and individuals in any evaluation of whether somewhere is deemed an attractive location. To inform taxpayers' decision making there should be clear explanations of how the various taxes work and how they link to public expenditure as well as other factors tied to locating in that jurisdiction. There is also a need to consider the cumulative effect on individuals and businesses of the different taxes, such as income tax, council tax, business rates and land taxes.
29. It is important that existing Welsh taxpayers understand and support their contribution to public finances.

## Better data

30. There have clearly been issues around aspects of the forecasting of Scottish income tax, as discussed in the November 2018 Scottish Parliament's Finance and Constitution Committee report '[Pre-budget scrutiny report](#)' (a 2019 report is awaited). There seems to be a lack of sound data, as revealed by the differences between the forecast and actual numbers of higher and additional rate taxpayers in Scotland (paragraph 73, page 17 of the report).
31. We would encourage the development of better data than is currently available in order to assist with analysis of taxpayers and their behaviour. HMRC's identification of Scottish and Welsh taxpayers is a basic example of an area where accurate and comprehensive information flow is essential to the Scottish and Welsh governments. Clearly, the information flow should be barrier-free and mutually recognised as beneficial, to ensure that tax revenues on both sides can be optimised and any potential loopholes identified and resolved expeditiously.
32. Easy access to high quality, transparent, complete and understandable information is an essential tool to enhance accountability, scrutiny and to support effective decision making on public finances. This is increasingly important in the context of devolved powers and increasing volatility of revenue.
33. Finally, ICAS has been working with the Chartered Institute of Taxation, under the banner of 'The Scottish Taxes Policy Forum', and published a paper "[Devolution Taxes across the UK: Learning from the Scottish Experience](#)". In that paper, we made a number of observations regarding the impact of variations in national and sub national income tax in the context of the Scottish experience however, the points are also pertinent to the interaction of income tax policy across Wales and the rest of the UK.