The Smith Commission

Written Submission by Scottish Chambers of Commerce

INTRODUCTION

Scottish Chambers of Commerce represents a network of 26 Chambers of Commerce across Scotland, which in turn have around 11,000 business members. These are businesses of all sizes and across all sectors and together they employ half of Scotland's private sector workforce.

When we surveyed our members earlier this year, some 68% of businesses responded that they would like to see the Scottish Parliament have more powers. The question, of course, is which powers these should be. Each of the political parties which campaigned for a 'No' vote in the referendum published its proposals for further devolved powers, whilst the Scottish Government has published its own preferences for the further devolution of powers to Scotland, in the wake of the referendum.

Scottish Chambers of Commerce believes that the focus for Scotland, its leadership and its institutions must be:

- to grow our economy
- to ensure that its people have ample opportunity to participate in and benefit from this growth, and
- to recognise that businesses are the principal drivers of growth.

This critical point in the development of Scotland's constitutional status also provides an opportunity to consider the Scottish Parliament's wider role and functions, including how it could respond better to the needs and objectives of Scotland's businesses.

Politicians must take this opportunity to ensure that the devolved settlement for Scotland is considered and appropriate. It is more important to get it right than to do it quickly or without due consideration. The critical issue is that any changes to the devolved settlement must deliver a benefit to business and our economy.

SUMMARY OF RECOMMENDATIONS

1. **Scottish Chambers of Commerce recommends that Air Passenger Duty should be devolved to the Scottish Parliament**

2. **Scottish Chambers of Commerce takes a neutral view on the devolution of further powers on Income Tax.**

3. **Scottish Chambers of Commerce takes a neutral view on the devolution of further powers on Corporation Tax.**

4. **Scottish Chambers of Commerce believes that there would be little risk attached to devolving the Aggregates Levy**

5. **Scottish Chambers of Commerce would argue that the Scottish Government ought to have greater power to identify and target specific Scottish skills needs through the immigration system. In particular, we would argue for the devolution of rules for student visas in order to take full advantage of the interest in Scotland's world class universities shown by talented, high potential individuals from across the world.**

6. **Scottish Chambers of Commerce recommends that the effectiveness of the Scottish Parliament Committee system is reviewed with a view to developing a clear route map towards improved performance**

7. **Scottish Chambers of Commerce recommends that the Scottish Government and the UK Government work more closely together to ensure joined up and coherent delivery of policies with a welfare dimension in Scotland**

8. **Scottish Chambers of Commerce recommends that employment regulation and legislation should remain as consistent as possible throughout the United Kingdom**

9. **Scottish Chambers of Commerce is neutral on the need for any additional borrowing powers.**

TAXATION

We believe that there has been too much focus on Scottish Government spending in Scotland and not enough consideration given to how revenues are raised to pay for this. We are therefore supportive of the concept of extending the revenue raising powers of the Scottish Parliament, provided such powers enable Scotland's politicians to create a more competitive business environment in Scotland.

The process of extending the fiscal powers of the Scottish Parliament has already begun. The Scotland Act 2012 delivered new powers to Scotland, including the Land and Buildings Transaction Tax and the Landfill Tax, which have now been set for 2015-16, and over Income Tax, which is due to take effect in 2016-17. These taxes supplement the existing fiscal powers of the Scottish Parliament in terms of Income Tax (the Scottish variable rate of +/-3%, which has never been used) and Business Rates. The Council Tax is also administered locally in Scotland by local authorities, though this has been frozen for the past 7 years as a result of a deal between councils and the Scottish Government.

Prior to the Scotland Act 2012, the Labour, Conservative and Liberal Democrat Parties in Scotland created the Commission on Scottish Devolution, chaired by Sir Kenneth Calman, to develop proposals to extend the devolution settlement in Scotland. In addition to the proposals enacted by the 2012 Act, the Commission also proposed that Air Passenger Duty and the Aggregates Tax be devolved to the Scottish Parliament.

The present Scottish Government has also long proposed the devolution of Corporation Tax to Scotland, with a view to reducing the rate by 3% relative to the overall UK headline rate, having published a discussion paper[1] on the subject within a devolved context and developing this in their White Paper on independence[2].

The basket of taxes that is available to the Scottish Parliament is important, not only in terms of the new powers available to it but also in respect of the manoeuvring room this creates to allow policy makers to better utilise existing powers. For example, gaining new powers might make the Parliament more likely to vary Business Rates.

In considering our response, it is worth considering each of these taxes in turn.

Air Passenger Duty

Scottish Chambers of Commerce has long taken the view that Air Passenger Duty (APD) is a tax which impacts negatively upon Scotland's connectivity, our tourism industry and our ambitions to internationalise and grow our exports. There is a very strong case to reduce or, as many of our competitor nations have done, eliminate this tax at a UK level. However, despite intensive lobbying by Scottish Chambers of Commerce and the aviation industry for an extended period of time, the only UK Government concession on the tax came in the 2014 Budget Statement when the Chancellor announced a reduction in APD for very long haul destinations[3].

Against this background, the opportunity to devolve APD to the Scottish Parliament has a clear attraction. The Calman Commission in 2009 considered the practicality of devolving APD to the Scottish Parliament and concluded that:

"Assuming the devolution, and thus the potential application of different rates in Scotland than elsewhere in the UK, did not conflict with EU law, we think the devolution of APD would not be associated with administrative or economic inefficiencies and is therefore potentially achievable."[4]

The Silk Commission in Wales also reached a similar conclusion there.[5]

Indeed, within the UK there is already a precedent for devolving APD. The Finance Act 2012 devolved to the Northern Ireland Assembly the power to set APD rates on direct long haul flights from Northern Ireland for destinations in APD bands B, C and D.[6]

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[1] Devolving Corporation Tax in the Scotland Bill, September 2011
[2] Scotland's Future: Your Guide to an Independent Scotland, November 2013
[3] Budget 2014, HC 1104, March 2014
[4] Serving Scotland Better: Scotland and the United Kingdom in the 21st Century, Final Report, para 3.142, June 2009
[5] Empowerment and Responsibility: Financial Powers to Strengthen Wales, Recommendation 6, November 2012
[6] Finance Act 2012, s.190

Research has also shown that the imposition of APD has a negative impact on Scotland's economic performance. A study undertaken by York Aviation estimated that by 2016, the cost of APD to Scotland in terms of passenger numbers will be 2.1 million passengers per year, with £210 million per year less being spent by inbound visitors and a loss of £50 million on other tax revenues.[7] At a UK level, a report by PwC estimated that the abolition of APD could result in an immediate boost to UK GDP of 0.45% in the first year, with an ongoing positive benefit thereafter.[8] This report also estimates that abolition of APD could in fact result in a positive return for the Exchequer in terms of the effect on other revenues through improved trade links and higher levels of employment. It seems likely that Scotland could enjoy a share of these benefits if the tax was devolved and reduced or eliminated.

Devolution of Air Passenger Duty to Scotland has been proposed by the Scottish Government[9], the Scottish Conservatives[10] and the Scottish Liberal Democrats[11].

There is also a clear linkage between APD and a number of existing Scottish Government responsibilities, including tourism and economic development.

We believe that the evidence supports the proposition that devolving APD would boost Scotland's international connectivity, export potential and tourism industry. As a result, **Scottish Chambers of Commerce recommends that Air Passenger Duty should be devolved to the Scottish Parliament.**

Income Tax

Since its creation in 1999, the Scottish Parliament has had the power to raise or lower Income Tax in Scotland by up to 3%.[12] This power has never been used. The Scotland Act 2012 extends the powers of the Scottish Parliament further in respect of Income Tax, creating the Scottish Rate of Income Tax (SRIT), due to be implemented in 2016-17.[13] This will result in the basic, higher and additional rates of UK Income Tax being reduced by ten percentage points for Scottish taxpayers, with the Scottish Parliament then free to set the SRIT at any level it sees fit, which it will be required to do on an annual basis. Since then, the Scottish Government and each of the major political parties have set out a series of proposals to devolve Income Tax powers beyond this.

Awareness amongst businesses of the impending changes as a result of the 2012 Act is growing but the full implications, including how likely politicians will be to use the new powers, are not yet known.

Given that there has been no opportunity yet for the 2012 Act changes to be implemented, **Scottish Chambers of Commerce therefore takes a neutral view on the devolution of further powers on Income Tax.**

[7] The Impact of Air Passenger Duty in Scotland, York Aviation, October 2012
[8] The economic impact of Air Passenger Duty, PwC, February 2013
[9] More Powers for the Scottish Parliament: Scottish Government Proposals, October 2014
[10] Commission on the Future Governance of Scotland, May 2014
[11] Federalism: the best future for Scotland, October 2012
[12] Scotland Act 1998, s.73
[13] Scotland Act 2012, s.25

Corporation Tax

The Scottish Government has proposed the full devolution of Corporation Tax (CT)[14] but none of the other major political parties support such a move, the Scottish Liberal Democrats going furthest by suggesting that proceeds raised through CT should be assigned to the Scottish Parliament.[15]

CT is a business tax and it is essential that any decisions on the future of this tax take into account the practical implications for businesses in Scotland and, indeed, across the UK. Since the Scottish Government published its first proposition on the devolution of CT in 2011, the tax landscape in the UK has altered considerably, with the main rate of CT having fallen from 26% in 2011-12 to 21% in 2014-15 and due to fall further to 20% in 2015-16.[16]

Corporation Tax is one element of the landscape of doing business in Scotland and, whilst it is often used as an example of the kind of policy that could be used by the Scottish Government to attract foreign direct investment into Scotland, this is true within the context of a range of material considerations, such as the availability of skilled workers, transport and digital connectivity, the planning system and the availability of finance to support the development of a new venture in Scotland. Of course, many of these powers are already devolved to the Scottish Parliament.

CT is also a potentially volatile tax in terms of revenues and, of course, many smaller businesses are not subject to the tax at all, instead being subject to Income Tax and/or Capital Gains Tax. That said, it is likely that the reduction of the rate of CT in Scotland could be a very useful tool in establishing Scotland as an attractive and competitive place to do business.

It is important to remember that in surveys undertaken by SCC in terms of the comparative importance of taxes to members businesses, Corporation Tax routinely features behind other business taxes such as Business Rates.

There are potential risks and opportunities in devolving Corporation Tax to Scotland and businesses have conflicting views on how attractive such a move would be. Under the circumstances, **Scottish Chambers of Commerce takes a neutral view on the devolution of further powers on Corporation Tax.**

Business Rates

Non-Domestic Rates, or Business Rates, have been devolved to the Scottish Parliament since its creation in 1999, yet it remains a tax which businesses ranked of amongst the highest importance during the recent referendum campaign.[17] Despite the fact that this tax is devolved, the Scottish Government has since 2007 chosen to mirror the Business Rates poundage set for England, though it has applied reliefs and supplements to Business Rates that vary from those used south of the border.

This reluctance to pursue a different path in terms of an already devolved tax is interesting but perhaps understandable due to the fact that this, until the Land and Buildings Transaction Tax and Landfill Tax come into force in April 2015, is the only revenue raising tool currently utilised by the Scottish Government. At a time when the Scottish block grant has been reducing in real terms, there is therefore a high degree of pressure upon the Scottish Government to expand the revenues raised

[14] More Powers for the Scottish Parliament: Scottish Government Proposals, October 2014
[15] Federalism: the best future for Scotland, October 2012
[16] HMRC Guidance – Rates and allowances: Corporation Tax, April 2013
[17] Business attitudes to Constitutional Change, Professor David Bell, May 2014

from this tax, which have increased by 28% since the time of the last revaluation in 2010 and is projected to raise almost £2.8 billion in 2015-16.[18]

Our contention is that by developing the widening basket of taxes on the revenue side of the Scottish Budget, this will create more room for the Scottish Government to address a tax which is of paramount importance to many Scottish businesses.

There is also an opportunity to consider how the process of further devolution could be used to empower not only the Scottish Parliament but also local authorities. The Scottish Government is legislating to enable local authorities to introduce local Business Rates rebates[19] but the effectiveness of such a measure will be contingent upon councils deriving some potential financial benefit from encouraging new or enhanced economic activity in their area. This would require the Scottish Government to enhance the offering to local authorities in this regard, currently delivered through the Business Rates Incentivisation Scheme[20] – a scheme which has experienced some initial difficulties.

Aggregates Levy

The Aggregates Levy has previously been highlighted as a tax which raises a modest amount of revenue but would be relatively easy to devolve. This was highlighted by both the Calman Commission[21] and the Silk Commission[22], in respect of Scotland and Wales respectively. The Silk Commission noted that those businesses which paid the Aggregates Levy often felt closer to the devolved Government than the UK Government and that this was one factor which may make the devolution of this tax more attractive. In 2012-13, this tax raised £45 million in Scotland.[23]

Devolution of this tax has been proposed by the Scottish Government[24], the Scottish Liberal Democrats[25] and by the Scottish Labour Party[26]. On balance, **Scottish Chambers of Commerce believes that there would be little risk attached to devolving the Aggregates Levy**.

ADDITIONAL POWERS

Immigration

Scotland has distinct skills needs from the rest of the United Kingdom. As a nation, we have particular reliance upon a number of key sectors, including oil and gas and financial services. We also have a large, internationally recognised higher education sector that is competing to attract high quality staff and students from across the globe. Add to this the needs of an economy returning to growth after an extended period of recession and the skills shortages this has created in areas as diverse as digital, the hospitality sector and construction. The result is a compelling need for Scotland to have a more

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[18] Scottish Budget – Draft Budget 2015-16, October 2014
[19] Community Empowerment (Scotland) Bill, SP Bill 52, Session 4 (2014)
[20] Announcement of Business Rates Incentivisation Scheme, Scottish Government, 8 December 2011
[21] Serving Scotland Better: Scotland and the United Kingdom in the 21st Century, Final Report, para 3.157, June 2009
[22] Empowerment and Responsibility: Financial Powers to Strengthen Wales, Recommendation 5, November 2012
[23] Government Expenditure and Revenue Scotland 2012-13, Scottish Government, March 2014
[24] More Powers for the Scottish Parliament: Scottish Government Proposals, October 2014
[25] Federalism: the best future for Scotland, October 2012
[26] Powers for a Purpose – Strengthening Accountability and Empowering People, March 2014

distinct set of powers to target and attract people with the right skillsets to Scotland to complement the development of our indigenous skills.

There are international precedents for devolved administrations having the power to set immigration criteria which vary from national rules, most notably in Quebec.[27] **Scottish Chambers of Commerce would argue that the Scottish Government ought to have greater power to identify and target specific Scottish skills needs through the immigration system. In particular, we would argue for the devolution of rules for student visas in order to take full advantage of the interest in Scotland's world class universities shown by talented, high potential individuals from across the world.**

The Scottish Parliament

Since the Scottish Parliament was created in 1999, it has changed the way in which business has engaged with Scotland's political decision makers. Many of the key decisions which affect businesses in Scotland are now taken in the Scottish Parliament or by the Scottish Government and there are ample opportunities for businesses to engage with these institutions both directly and through representative organisations. Any review of the powers of the Scottish Parliament or of Scottish Ministers opens up the opportunity to ensure that the mechanisms the Parliament uses to engage with businesses are of the highest standard.

One of the most important linkages between business and the Scottish Parliament is its Committee system. Holyrood has been very successful in utilising its Committees to harness the views of Scotland's business community in terms of both formal and informal evidence taking processes. What we have not yet seen are many examples of the Committees taking on a challenging role in terms of their interaction with Government, similar to that which is often evident in UK Parliament Select Committees. This may yet emerge as Scotland's backbench and opposition politicians develop their confidence. In the meantime, **Scottish Chambers of Commerce recommends that the effectiveness of the Scottish Parliament Committee system is reviewed with a view to developing a clear route map towards improved performance**.

Welfare

Many of the powers over welfare and social security currently reserved to the UK Parliament have obvious links to achieving policy objectives in terms of devolved powers. This is particularly true in terms of skills and social justice. Parliaments in Edinburgh and London are working to build and operate coherent systems of skills provision, employment policy and social security that deliver for people but the division of powers in these areas can result in unnecessary complexity, potential confusion and unintended consequences. Of course, centring powers on a particular Parliament will not in itself eliminate these problems, for example, though many aspects of skills policy are devolved to Scotland, businesses can still be confused as to where to go to receive support with specific skills needs.

We remain unconvinced that the devolution of additional powers over the welfare state would enable the Scottish Parliament to better exercise its promotion of economic growth in Scotland. Instead, **Scottish Chambers of Commerce recommends that the Scottish Government and the UK Government work more closely together to ensure joined up and coherent delivery of policies with a welfare dimension in Scotland.**

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[27] Immigrating to Quebec, Government of Quebec

Employment Law

Much of the source of legislation and regulation regarding employment law has its source in the European Union and is applied across the UK. This is also an area which is rapidly evolving. Many businesses operate and employ staff throughout the United Kingdom. In March 2013 – the most recent figures available – 35.2% of private sector employment in Scotland was with enterprises with ultimate ownership outside of Scotland.[28] Of this number, 18.7% of Scottish private sector employment was in enterprises with ultimate ownership in the RUK with the remaining 16.5% of employment in enterprises with ultimate ownership outside of the UK. This employment benefits from a single market within the UK in terms of employment regulation and legislation and **Scottish Chambers of Commerce recommends that employment regulation and legislation should remain as consistent as possible throughout the United Kingdom**.

Borrowing Powers

As a result of the Scotland Act 2012, the Scottish Parliament will be given borrowing powers from 2015 onwards. These powers comprise capital borrowing to a cumulative maximum of £2.2 billion and revenue borrowing to a maximum of £500 million[29], though the latter power is intended to smooth out fluctuations that result from variations in tax receipts.

Scottish Chambers of Commerce is neutral on the need for any additional borrowing powers.

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[28] Businesses in Scotland 2013, Scottish Government, November 2013
[29] Scottish Government First Annual Report on the Implementation and Operation of Part 3 (Financial Provisions) of the Scotland Act 2012, April 2013