Scottish Chambers of Commerce
The Ultimate Business Network

Devolution of Corporation Tax in Scotland: A position paper from the Scottish Chambers of Commerce, September 2011

About this paper

Scottish Chambers of Commerce (SCC) has conducted extensive research among its network of members on the issue of devolution of Corporation Tax to Scotland. This and our desk-based research are continuing; this paper sets out the position we have reached so far. We welcome further input on this issue from both the business community and experts in the field.

Corporation Tax is a business tax, and the voice of business has so far not been adequately heard in this public debate. It is imperative that constitutional decisions are not taken in an ivory tower of political belief, but take into account real-world experiences, and the practical implications of any decisions made.

A consultation paper outlining the Corporation Tax devolution issue and the public debate so far was circulated around the Chamber network, and Chambers and their members were invited to respond. We received submissions from businesses across Scotland. In addition, facilitated focus group sessions were held with local Chambers' staff and members to explore the issues in depth. The Scottish Chambers of Commerce is the most comprehensive, representative network of business in Scotland, so this process has provided a real insight into the views and concerns of Scottish business – a crucial stakeholder in any business tax debate.

Alongside this primary research process, SCC has thoroughly reviewed the expert submissions to this debate from academics, public officials and tax practitioners, both those discussing Scotland specifically and those discussing the issue more widely, including the economic impact of low Corporation Tax in the Republic of Ireland and the resultant policy choices that must be made in/for Northern Ireland.

This paper uses the primary and the desk-based research described above to present the position of Scottish business in the debate over the possible devolution of Corporation Tax to

Scotland. Scottish Chambers of Commerce is pursuing no political agenda here, in support of one constitutional position or another. We seek only to inform decision makers of the issues that occur in this debate, for the Scottish business community. Any policy making should ensure that these issues are addressed, in order that the business tax regime in Scotland enables maximum economic growth.

Introduction

The Scottish Chambers of Commerce has conducted extensive, detailed consultation throughout its comprehensive network of businesses on the issue of devolution of corporation tax, the issue of the moment among those politicians and commentators concerning themselves with Scotland's constitutional future. The findings are clear; while Scottish business people have opinions, often firmly held, on either side of this debate, the debate so far is about politics, not Scotland's economy.

Business needs to see the debate move on and key economic questions answered. The Scottish Government proposes several options for reform, but businesses are concerned about the assumptions made. What will the Scottish Corporation Tax base look like? Each of the Scottish and UK governments already has economic levers at their disposal – which government has the levers sufficient to ensure that Scottish companies are successful enough to pay Corporation Tax? The business for this debate is recognition of the entire cost of doing business in Scotland, of which Corporation Tax is just one element.

Revenue stability/volatility

A stated aim of the Scotland Bill is to inject a greater sense of accountability into Government spending in Scotland, by making it responsible for raising a proportion of its own revenue. The Bill proposes to do this by cutting the amount of income tax the UK Government levies in Scotland by 10 pence in the pound, and enabling the Scottish Government to levy income tax beyond this reduced rate.

Several of those who argue in favour of devolving Corporation Tax do so on the basis of revenue stability. They are concerned that the current proposals do not give the Scottish Government the flexibility it requires to respond to changing economic condition due to over-reliance on a single tax – income tax. It is argued that having control over a more substantial 'basket' of taxes, including Corporation Tax as a key fiscal lever, is necessary.

The counter-argument to this position is that Corporation Tax is a very volatile revenue raiser. The latest GERS figures available point to revenues excluding those from the North Sea fluctuating within a £1 billion range over the last five years, including, of course, a big decrease when the recession began in 2008. In the same period, North Sea tax revenues leap nearly threefold as the price of oil has risen sharply. This demonstrates the susceptibility of Corporation Tax revenues to factors outwith a government's control, and so difficult to plan for. Were Corporation Tax to be devolved to Scotland along with a proportion of Income Tax through an amended Scotland Bill, it would play a significant role in the Scottish Government's fiscal armoury, and its potential for uncontrollable volatility would need to be taken into account.

Small businesses

SCC's member research threw up concerns among small business members that the predominance of SMEs within Scotland's business community not liable for Corporation Tax would compound the budgetary problems created by the revenue volatility described above.

While GERS assesses what proportion of the UK's Corporation Tax revenues are raised in Scotland, this does not equate to the amount that the Scottish Government would receive were the tax to be devolved, as the GERS figure includes taxes that would accrue to the UK rather than the Scottish Government in the event of devolution[1]. An HMRC assessment put the figure at £2.6 billion[2] but this figure is disputed by the Scottish Government's economists[3]. When balancing all the available evidence, the safest conclusion is that the calculation of the impact of Corporation Tax on the Scottish budget is a difficult one to make under the current regime.

The vast majority of Scotland's businesses are SMEs. Depending on the business model, they may not be subject to corporation tax at all, but to other business taxes instead, such as income tax or capital gains tax. Many others don't pay the tax because their profits are not high enough. These businesses will experience no change in their circumstances or their potential whether corporation tax is devolved or not. Even for the businesses that do pay corporation tax, the location of the government to which they pay it is not relevant. A decreased rate would be welcomed by businesses that would like to retain more of their profits, but whether that rate is decreased by the UK Treasury or the Scottish Government Finance Department has no impact on the books.

There is a concern among some small businesses, though, that the Scottish government's need to finance its budget plans would lead to a lowering of the liability thresholds for corporation tax in Scotland, were it to be devolved. This is a particular concern among those who are pessimistic about how much impact a reduction in corporation tax would be in attracting increased levels of business investment to Scotland.

However, small businesses are also aware of the competitive advantage that a low level of corporation tax gives their rivals in Ireland. Lower corporation tax is one advantage which enables Irish companies to bid for contacts at a lower price than their Scottish counterparts.

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[1]Detailed Revenue Methodology Paper, Government Expenditure and Revenue Scotland 2009 – 10, Scottish Government.

[2] http://www.scotlandoffice.gov.uk/scotlandoffice/15622.html

[3] http://www.scotland.gov.uk/Resource/Doc/919/0120242.pdf

Ireland

Ireland combined its low Corporation Tax with generous Regional Development Assistance grants funded by the EU, and an aggressive marketing strategy to attract the famed levels of Foreign Direct Investment, particularly from parts of the USA with historic ties to Ireland, that drove its 1990's/2000s economic boom. Low corporation tax was undoubtedly a significant factor in Ireland's previous economic growth – and is seen by many in the country as holding the key to its economic recovery – but it has been used as one element of a basket of fiscal levers.

Ireland also benefitted then from a young population, a high proportion of whom were graduates in STEM subjects compared to other OECD countries. Optimisation of the attractiveness of Scotland's skills base to investors is an important economic lever over which the Scottish Government does already have broad control.

The lesson we must learn from Ireland is not only that alone, corporation tax will not kick-start an economic growth revolution, but also low level of corporation tax in no panacea for a country's economic ills.

Businesses' response to the devolution proposal

It is important to be clear in this debate that the proposal to devolve corporation tax to Scotland does not equate to a proposal to reduce corporation tax in Scotland. Scottish Chambers of Commerce warmly welcome the current Scottish Government's stated intention to do this, to provide an improved business environment in Scotland and a competitive advantage for Scottish companies. We also note and welcome the steps being taken by the current UK Government to incrementally reduce the headline corporation tax rate.

However, we would warn that the decision that must be made about Corporation Tax devolution can not be predicated on the current government's stated policy. The decision must be taken in full awareness of the risk that Scottish voters may elect a government in future that does not share this administration's benign intentions towards the business community and recognition of business's integral role in achieving economic growth[4].

Assumptions of a tax decrease

SCC are concerned that discussion of this constitutional reality has been lacking from the public debate on this issue so far. The debate in parliamentary committees, consultation papers and the media has been based on an assumption that devolution of corporation tax to the Scottish Government would lead to a reduction in Corporation Tax. However, not all

[4] Sir David Varney, Review of Tax Policy in Northern Ireland, December 2007

future Scottish governments may choose to do this. Indeed, the macro-economic circumstances might arise in future when Scotland's economy needs a Corporation Tax hike in order to maintain government revenues, when the rest of the UK does not.

It is therefore crucial that a thorough assessment is made of the current and future scope for such problems arising in Scotland, to properly assess the risks of devolution of this tax power.

Conclusion

To operate successfully and contribute to Scotland's economic growth, businesses require a tax regime that supports expansion and development. Lower taxation on businesses will always mean they have more scope to grow, to invest and to create jobs. Any potential reduction in Corporation Tax liability will therefore be welcomed. Businesses welcomed the current UK Government programme of Corporation Tax reduction over the coming years. A move to give Scottish businesses a competitive advantage over their rivals in the rest of the UK – and beyond – would also enable the acceleration of growth.

However, businesses also require stability and certainty. Devolution carries economic risks, and the longer the uncertainty over Corporation Tax regimes, the longer businesses feel they must put off long term investment decisions, including job creation.

Scottish Chambers of Commerce look forward to the UK and Scottish governments working productively together and engaging with business to ensure that the eventual solution to the Corporation Tax de ate is the one which works best for Scotland's businesses and economy.

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