

## VAT Assignment

### Roundtable session with the Scottish Parliament's Finance and Public Administration Committee

#### Response by the Chartered Institute of Taxation

## 1 Executive Summary

- 1.1 The assignment of a proportion of UK VAT revenues raised in Scotland to the Scottish budget was recommended by the Smith Commission and legislated for in the Scotland Act 2016. Despite this, a number of concerns have been raised about how VAT assignment will work in practice. Many of these issues, first considered by the committee's predecessor, the Finance and Constitution Committee, persist. These include: the lack of a suitable model for identifying and assigning VAT revenues raised in Scotland, the lack of policy autonomy that would be afforded to the Scottish Government from a policy of 'assignment', and the introduction of additional risks to the Scottish budget.
- 1.2 'Assignment' means apportioning some of the UK VAT revenues to the Scottish budget – it is an allocation model. By contrast, 'devolution' means responsibility for the tax being given to the Scottish Parliament, such as with the full devolution of taxes on land transactions or partial devolution of the rates of tax (as with Scottish income tax).
- 1.3 The idea of VAT devolution is theoretically possible but would not be straightforward, adding complexities for businesses to comply with their tax obligations. It could introduce opportunities for distortive behaviours such as tax avoidance.
- 1.4 Our view to date has been that it is not practical or desirable for businesses to keep separate records of VAT receipts raised in Scotland, which would be necessary for a devolved VAT.

## 2 About us

- 2.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the UK for advisers dealing with all aspects of taxation. We are a charity and our primary purpose is to promote education in taxation with a key aim of achieving a more efficient and less complex tax system for all. We draw on the experience of our 19,000 members, and extensive volunteer network, in providing our evidence.

- 2.2 The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 2.3 The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties, UK and devolved taxes. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.
- 2.4 The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries.
- 2.5 Our members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.
- 2.6 Our stated objectives for the tax system include:
- A legislative process that translates policy intentions into statute accurately and effectively, without unintended consequences.
  - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
  - Greater certainty, so businesses and individuals can plan ahead with confidence.
  - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).
  - Responsive and competent tax administration, with a minimum of bureaucracy.

### 3 Introduction

- 3.1 In August 2023, The Scottish and UK governments agreed an [updated Fiscal Framework](https://www.gov.scot/publications/fiscal-framework-agreement-between-scottish-uk-governments/)<sup>1</sup>. In relation to VAT, the Framework notes that: "It was agreed in the 2016 Fiscal Framework agreement that the full details of the VAT assignment methodology will be jointly developed and agreed by both HMRC and Scottish Government officials. Once completed and agreed by officials, the assignment methodology and operating arrangements will be presented for joint ministerial sign-off at a future meeting of the Joint Exchequer Committee."
- 3.2 The Finance and Public Administration Committee has agreed to hold a one-off roundtable evidence session on VAT assignment in Scotland. The Committee is keen to explore whether the previous issues with assigning VAT persist (as highlighted [by the previous Committee in 2019](https://archive2021.parliament.scot/parliamentarybusiness/CurrentCommittees/111059.aspx)<sup>2</sup>). The Committee also wishes to discuss whether any new issues and/or solutions have arisen since then and what issues require to be resolved in order for VAT assignment to be implemented.
- 3.3 The following questions have been posed:
1. Do the previous issues with assigning VAT persist?

<sup>1</sup> <https://www.gov.scot/publications/fiscal-framework-agreement-between-scottish-uk-governments/>

<sup>2</sup> <https://archive2021.parliament.scot/parliamentarybusiness/CurrentCommittees/111059.aspx>

2. Have any new issues/solutions arisen since 2019 (when the Finance & Constitution Committee (F&CC) last considered this topic)?
3. What issues require to be resolved in order for VAT assignment to commence?

#### 4 VAT Assignment – Background

- 4.1 The [Smith Commission](#)<sup>3</sup> report, paragraph 84, noted that *'The receipts raised in Scotland by the first 10 percentage points of the standard rate of Value Added Tax (VAT) will be assigned to the Scottish Government's budget. These receipts should be calculated on a verified basis, to be agreed between the UK and Scottish Governments, with a corresponding adjustment to the block grant received.'*
- 4.2 This has been given legislative effect in [section 16 of the Scotland Act 2016](#)<sup>4</sup>. Under the proposals the first 10 percentage points of the Standard rate of VAT raised in Scotland, and the first 2.5 percentage points of the reduced rate of VAT, in other words half the amount of VAT raised in Scotland, would be directly assigned to the Scottish budget.
- 4.3 VAT is the only 'assigned' tax in the package of taxes that fund Scotland. The intention with VAT assignment is that it should be possible to allocate an amount of revenue directly to the Scottish budget without creating additional administrative burdens for traders or the tax authorities.
- 4.4 It should be noted that the Fiscal Framework is an agreement between the Scottish and UK governments and therefore does not have legal force. The [revised Fiscal Framework](#)<sup>5</sup> agreed in August 2023 sets out that the VAT assignment methodology is to be jointly developed and agreed by both HMRC and Scottish Government officials and then presented for joint ministerial sign-off at a future meeting of the Joint Exchequer Committee, the date yet to be confirmed.
- 4.5 The [assignment model](#)<sup>6</sup> discussed to date is based on the VAT Total Theoretical Liability model (VTTL Model).
- 4.6 In effect, VAT assignment is a sharing of locally generated taxes. The tax remains a UK-wide tax, with the UK Government retaining full legislative and administrative responsibility, albeit with a proportion of the revenues raised in Scotland directly allocated to its budget. It is a funding mechanism, rather than a tax power, that is designed to introduce an element of fiscal responsibility, by linking the budget more closely to the performance of the Scottish economy. Although it may represent a significant revenue raiser, the Scottish Government will have no direct tax levers to exercise in relation to its amount.
- 4.7 The estimated Scottish VAT Assignment share of UK VAT ranges from 4.24% to 4.57% from 2011 to 2021, with the exception of 2020 where VAT Assignment share fell to 4.03% due to COVID-19 impacts. This equates to £

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<sup>3</sup> <https://webarchive.nationalarchives.gov.uk/ukgwa/20151202171017/https://www.smith-commission.scot/>

<sup>4</sup> <https://www.legislation.gov.uk/ukpga/2016/11/section/16/enacted>

<sup>5</sup> <https://www.gov.scot/binaries/content/documents/govscot/publications/agreement/2023/08/fiscal-framework-agreement-between-scottish-uk-governments/documents/2023the-agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal-framework/2023the-agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal-framework/govscot%3Adocument/2023the-agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal-framework.pdf>

<sup>6</sup> [https://assets.publishing.service.gov.uk/media/5bf69c1eed915d184076bf68/VAT\\_assignment\\_model\\_publication\\_final\\_1.pdf](https://assets.publishing.service.gov.uk/media/5bf69c1eed915d184076bf68/VAT_assignment_model_publication_final_1.pdf)

5,933 million in calendar year 2021. See '[Scottish VAT assignment 2021 – experimental statistics](#)',<sup>7</sup> published on 28 September 2023 (and which has further analysis and stats).

- 4.8 Our view to date has been that it is not practical or desirable for businesses to keep separate records of VAT receipts raised in Scotland. It may also not even be feasible to arrive at a figure for the amount of VAT raised in Scotland because HMRC does not hold the data. Assignment is the lesser of two evils because it does not call upon businesses to administer 'Scottish' VAT.

## **5 Question 1: Do the previous issues with assigning VAT persist?**

- 5.1 Overall, we consider that the issues previously identified when VAT assignment was last examined by the Finance and Constitution Committee remain. They include the following issues:
- 5.2 The aim of VAT assignment is to bring greater accountability to decision making in Scotland. However, the Scottish Government will have no direct controls over VAT rates and policy. At best, the government may seek to grow the economy in order to increase the VAT tax take, but it will be difficult to connect Scottish economic decisions to the tax, and to show a clear line of accountability between the Scottish Government and the operation of the tax.
- 5.3 VAT policy making will remain a UK Government responsibility and so there may be questions over whether, and to what extent, the Scottish Government is able to input to the policy making process. As a result, there may be a lack of control or ability to influence VAT policy and the way in which it may affect wider economic policy.
- 5.4 There has been much debate about a lack of public awareness and understanding of the different tax responsibilities at different levels of government (UK, Scottish, and local). In a poll on awareness and understanding of the devolved taxes, conducted for CIOT by Diffley Partnership in January 2023, 12% of Scots surveyed said they thought powers over VAT were the responsibility of the Scottish Parliament (compared with 73% who correctly identified that it was a decision for the UK Parliament). While this 12% figure is relatively low, this is the highest number CIOT has recorded since it first polled this question in 2018. This lack of understanding will not be assisted if there is also VAT Assignment added into the mix. See '[Poll suggests growing confusion over Scottish taxes](#)'<sup>8</sup> (CIOT news release, 9 February 2023).

## **6 Question 2: Have any new issues/solutions arisen since 2019 (when the F&CC considered this)?**

### **Post Brexit**

- 6.1 Now that the UK has left the European Union, it is no longer subject to EU VAT law, opening up the potential for change. Although VAT law in the UK is still based on EU requirements, over time there is no barrier to VAT law being modified or more radically reformed. Change could happen across the single UK market, or it could potentially involve some devolution of VAT powers to the nations and regions of the UK.

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<sup>7</sup> <https://www.gov.uk/government/statistics/scottish-vat-assignment-experimental-statistics/scottish-vat-assignment-experimental-statistics-2020>

<sup>8</sup> <https://www.tax.org.uk/poll-suggests-growing-confusion-over-scottish-taxes>

- 6.2 The Scottish Government has previously called for the devolution of VAT powers to the Scottish Parliament. We think more analysis and understanding of the impacts and options is required before advocating the devolution of either, or both, VAT rates or policy. VAT is not designed for ease of use over borders as it is designed to operate in a single market without variation in rates (i.e. one Standard Rate (SR), one Reduced Rate (RR), and Zero Rate (ZR)), thresholds or exempt transactions).
- 6.3 Also, variations in taxes (rates, incidence, thresholds) can lend themselves to tax planning. VAT is a very expensive tax for taxpayers and businesses because it is based on turnover on all taxable sales at 20% (accepting that some items may have a reduced or zero rate applied to them). There is a great deal at stake, either in pricing (the cases of, say, Jaffa cakes, tea cakes or Pringles illustrate the competitive issues of whether an item is standard or zero rated), or fraud. For example, the basic Missing Trader Intra Community (MTIC) fraud model involves organised, sophisticated activities that seek to exploit cross-border differences in how VAT is treated in different EU Member States and could also apply within domestic borders if the rates varied.

### **Making Tax Digital (MTD) for VAT**

- 6.4 Making Tax Digital, MTD, is part of HMRC's tax administration programme with a focus on the digitalisation of the tax system. MTD for VAT has been implemented in stages since April 2019 and is a reporting mechanism whereby traders record their transactions – and the associated VAT – online, and then submit their tax returns online to HMRC. The aim is to lessen the scope for mistakes.
- 6.5 However, MTD for VAT has simply taken existing processes online and does not assist in identifying the jurisdiction of any transaction so in its current form would not assist HMRC in analysing receipts received in Scotland.
- 6.6 Although digital systems could assist in years to come, this is a long way off in terms of system design. 'Digital' is not an immediate solution to providing a mechanism for identifying Scottish VAT.

### **Ongoing analysis and modelling**

- 6.7 As part of the UK official statistics, VAT assignment has been forecast and calculated each year, but with no direct impact on the Scottish Government's budget. The aim of these forecasts has been to allow for the development and testing of the methodology for calculating Scotland's aggregated share of VAT liabilities. See '[Scottish VAT assignment 2021 – experimental statistics](#)'<sup>9</sup>, published on 28 September 2023.
- 6.8 This work shows that the assignment based on the VTTL model can be done, but it does not address the underlying concerns that were expressed in 2019 and that remain today.
- 6.9 The revised [Fiscal Framework](#)<sup>10</sup> notes that: 'The methodology for apportioning VAT revenues to Scotland will be used to estimate receipts in the year immediately prior to assignment. This will be reconciled to outturn using the same methodology once the relevant data is available'. However – there is no true outturn – it can only ever be compared with a rerun of the model.

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<sup>9</sup> <https://www.gov.uk/government/statistics/scottish-vat-assignment-experimental-statistics/scottish-vat-assignment-experimental-statistics-2020>

<sup>10</sup> <https://www.gov.scot/binaries/content/documents/govscot/publications/agreement/2023/08/fiscal-framework-agreement-between-scottish-uk-governments/documents/2023the-agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal-framework/2023the-agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal-framework/govscot%3Adocument/2023the-agreement-between-scottish-government-united-kingdom-government-scottish-governments-fiscal-framework.pdf>

- 6.10 The following caveat has been included alongside the recently published statistics: 'It is not possible to directly measure VAT raised in Scotland as the information collected from businesses through VAT returns does not specify the UK region of consumption. The share has been estimated using the Scottish VA model, jointly developed by officials from UK government and Scottish Government.' This therefore suggests that a degree of uncertainty remains in the ability to accurately identify VAT receipts raised directly in Scotland using the jointly developed assignment methodology.

### **Reports on devolved taxes**

- 6.11 A number of studies have been undertaken across the United Kingdom relating to devolved taxes, which include consideration of the issue of VAT devolution and assignment.
- 6.12 The final report of the Independent Fiscal Commission for Northern Ireland, [\*More fiscal devolution for Northern Ireland?\*](#)<sup>11</sup>, issued in May 2022, said: 'We also do not consider pure tax assignment as a desirable way forward. That brings risks without the policy levers gained from additional powers. Tax assignment occurs when the devolved government's budget depends on the revenues raised from within its territory, but the devolved government has no ability to vary tax policy (which is set by the central government). In principle this could create the right incentives to improve economic policy so as to increase incomes and hence revenues. In practice, economic performance, and hence tax receipts, will vary for many reasons outside of the control of the devolved administration.'
- 6.13 It concluded that 'There is a case, in principle, for devolution of VAT to Northern Ireland. However, the uncertainty regarding the significant additional compliance and administration burdens relative to income tax are sufficient that, in our view, further work at this stage should prioritise consideration of options for devolving income tax, rather than VAT. At this stage, therefore, we will not be carrying this tax forward for consideration as part of the second phase of our work.'
- 6.14 The [\*Poverty and Inequality Commission\*](#)<sup>12</sup> set up to advise the Scottish Government on its anti-poverty agenda has also examined how tax policy can be used in Scotland to support this agenda. The report of its Tax Working Group said: 'While the assignment of VAT to Scotland has been a long-standing topic of discussion between the Scottish and UK governments, there appears to the Commission to be little prospect of a viable methodology to allow this to be further developed, and the Commission believes the Scottish Government should focus its efforts on other areas.'

## **7 Question 3: What issues require to be resolved in order for VAT assignment to commence?**

### **A preliminary point**

- 7.1 As previously noted in this paper, it is businesses who are the collectors of VAT. They are unlikely to welcome any further administrative burdens that further complicate their ability to comply with their tax obligations, such as having to identify 'Scottish VAT'.

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<sup>11</sup> <https://www.fiscalcommissionni.org/files/fiscalcommissionni/documents/2022-05/web-version-executive-summary-may-2022-accessible.pdf>

<sup>12</sup> [https://povertyinequality.scot/wp-content/uploads/2023/10/How\\_better\\_tax\\_policy\\_can\\_reduce\\_poverty\\_and\\_inequality\\_October2023.pdf](https://povertyinequality.scot/wp-content/uploads/2023/10/How_better_tax_policy_can_reduce_poverty_and_inequality_October2023.pdf)

- 7.2 If half the receipts of VAT received in Scotland are to be allocated to the Scottish budget, then assignment needs to be based on some form of allocation model, which, as set out above, is not an easily resolvable requirement.

### **The principles of VAT Assignment need to be met**

- 7.3 The principles of VAT Assignment should be robust and properly represent 'Scottish VAT'. Further discussions around the prospects for VAT assignment must include consideration of:
- **Transparency** - will it be clear to those with an interest in the policy (such as the Scottish and UK governments, politicians, taxpayers, and the wider public) about understanding the connections between the amounts allocated under VAT assignment and the performance of the Scottish economy?
  - **Accountability** – can the actions of the Scottish Government be clearly linked to the taxes raised?
  - **Robust data** - where does the data come from? Is it reliable? And is it robust? It should also be noted that businesses do not want additional burdens so robust data has to come from government sources and should not impose any further requirements on business.

### **Risk**

- 7.4 VAT Assignment will introduce further risk into the Scottish budget. This is the point of tax devolution, alongside increased accountability, but it needs to be risk that is within the Scottish Government's control i.e., properly tied to the economy in Scotland and to actions that the Scottish Government can take.
- 7.5 There are a number of risks that we believe may be outside the Scottish Government's control. The proposed model, based on the VAT total theoretical liability referenced above, is the total value of VAT that could be theoretically collected from the tax base across various sectors. The proposed methodology relies heavily upon survey data, particularly the Living Costs and Food Survey. In 2019, the proposed sample was small, 360 households in Scotland, and it was not known if this was representative across the income spectrum.
- 7.6 There may be areas where the underlying economy in Scotland differs from the rest of the UK, such as:
- **Household spending models** – for instance, is there a higher proportion of low-income households and hence those who tend to have expenditure predominantly on zero rated items such as food?
  - **Impact of tourism/hospitality sector** – and it is notable in the experimental Scottish VAT assignment statistics the level of impact tourism had on VAT receipts during covid.
  - **Impact of financial services sector**, which is a significant part of the Scottish economy with many services exempt from VAT.
- 7.7 There will be no available outturn data as the model is based on theoretical, not actual, data. If the model does not properly reflect 'Scottish VAT' there is no means of checking this. With this type of model one cannot produce actual outturn data.

### **Potential unintended consequences**

- 7.8 There may also be unintended consequences to consider as a result of VAT assignment. For example, the proposed model is tied to spending, rather than the performance of the economy, meaning that VAT calculations will include the impact of imports into the country. Therefore, it may not be a useful indicator in determining the performance of the domestic economy.

- 7.9 If the VAT assignment model is properly linked to the performance of the Scottish economy, then it could lead to policies designed to favour the generation of VAT receipts. In principle this is understandable, but it might also come at the expense of other areas of the Scottish economy that may not generate significant amounts of VAT. For example, two key sectors to the Scottish economy are tourism and food and drink. The former is a sector that will generate largely standard rated VAT receipts while the latter, although an important driver of the economy, produces products that will be largely zero rated for social policy reasons or due to being exported. Awareness of these behavioural drivers is needed.

The Chartered Institute of Taxation

2 November 2023