Devolved Taxes in Wales

The Context

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#welshtaxes

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1. Introduction

"Taxes are unavoidable. But we can design our taxes. We are not bound to have a tax system as inefficient, complex, and unfair as our current one. To improve things, we need to see the system as a whole, we need to design the system with a clear understanding of the population and economy on which it operates, and we need to apply economic insights and evidence to the design. We also need a much more informed public debate and a much better set of political processes than the ones we currently have."

Mirrlees Review

1.1. The Wales Act 2014 gives the National Assembly for Wales powers over a range of taxes for the first time in its history. It now has the power to hold a referendum on whether it should levy a Welsh rate of income tax, and from April 2018 it will be responsible for the collection and management of Land Transaction Tax and Landfill Disposals Tax (formerly Stamp Duty Land Tax and Landfill Tax, respectively). Council tax and non-domestic (business) rates, both forms of taxation, have also both been fully devolved to the Assembly.

1.2. The Wales Act 2014 also grants the Assembly the power to introduce new taxes with the approval of the UK Parliament. This is an unprecedented opportunity. New taxes are an additional lever with which the Welsh Government can seek to improve the economy, society and environment of Wales by changing organisations' and individuals' behaviour, as well as raise much-needed revenue. There is remarkably little awareness of the potential for new Welsh taxes, yet if the UK government's intentions are realised, by 2020 devolved taxes will raise approximately a fifth of the Welsh Government's funding.[1]

1.3. The Bevan Foundation has been awarded funding by the Joseph Rowntree Charitable Trust to develop proposals for new taxes which could change the behaviour of businesses, organisations and individuals, and help to create a fairer, more prosperous and sustainable Wales. It is specifically interested in taxes which improve corporate accountability for any social, economic or environmental 'harm', and which are not regressive in their impact.

1.4. This working paper is the first output from this project. It provides key context for any new taxes that might be introduced by:

- summarising the evolution of devolved tax-raising powers;

- looking in detail at the provisions of the Wales Act 2014 in respect of new and other devolved taxes;
- considering the relationship between taxation and Welsh public finances;
- looking at the principles that should underpin any taxation system; and
- highlighting the issues that any new taxes in Wales will need to address.

Future outputs from the project will recommend new taxes that could be introduced.

2. The development of devolved taxation

2.1. How public services in Wales are financed has been hotly contested for many years. The Barnett formula was introduced to determine Wales' (and Scotland and Northern Ireland's) block grant in the late 1970s, but as devolution has developed questions have been increasingly asked about the fairness, accountability and transparency of Welsh public finances. While much attention has focused on the fairness of the Barnett formula, there has also been consideration of whether the National Assembly for Wales should have tax-raising powers – finally granted in the Wales Act 2014. Wales is by no means alone in securing tax-raising powers. Across the UK, devolved nations and English cities are either gaining or seeking their own taxation powers, resulting in a patchwork quilt of different arrangements.

2.2. This section traces the devolution of tax powers in the UK, focusing on Wales but with a round-up of tax powers elsewhere, as context for the possible introduction of new taxes.

Devolved taxation to Wales

2.3. Given the cautious approach taken to devolution in 1997, it is unsurprising that the Government of Wales Act 1998, which established the Welsh Assembly, did not give it tax-raising powers. A Welsh Office press release about the Act stated:

> *"**Does this mean that the Assembly could acquire … tax-raising powers?** No. The white paper did not suggest this and the Bill does not provide for it."*[2]

2.4. There was nevertheless some support for the devolution of tax-raising powers at that time. The Liberal Democrats' 1997 Manifesto called for the introduction of 'Home Rule for Wales', which would involve the "creation of a Welsh Senedd, elected by proportional representation, and able to raise and reduce income tax."[3] Some Labour MPs also called for tax powers to be put forward in the 1997 referendum,[4] and asked why the then UK Labour government had proposed tax-raising powers for Scotland but not Wales.

2.5. Five years after the Assembly was established, the Richard Commission concluded that tax-varying powers, similar to those granted to the Scottish Government in 1998, were a 'desirable', though not essential, complement to

primary legislative powers.[5] The UK Government did not act on this recommendation, and there was therefore no provision for taxation powers in the Government of Wales Act 2006.

2.6. In 2010, the Holtham Commission was established to consider the adequacy of the arrangements for funding devolved public services. The Commission's remit included not only the Barnett formula but also the scope for the Welsh Assembly Government to have tax-varying powers. The Commission ruled out the devolution of a relatively long list of taxes, but concluded that further consideration should be given to the devolution of:

- Income tax (excluding income tax on savings and dividend income);
- Corporation tax;
- Taxes on property and land;
- Minor taxes with a relatively immobile base and which may be of value as policy levers (Landfill Tax, Aggregates Levy and Air Passenger Duty); and
- New taxes on goods or activities that are currently untaxed at the UK level, such as tourism or the depletion of natural resources.

2.7. In 2011, the Silk Commission was tasked by the UK government to look at, amongst other things, increasing Wales' financial accountability. Its recommendations on taxation, published in November 2012, echoed those of the Holtham Commission, with the following taxes proposed to be devolved:

- Stamp Duty Land Tax;
- Landfill Tax;
- Aggregates Levy;
- Air Passenger Duty;
- Non-domestic rates; and
- Income tax (partial).

The exception was corporation tax, where "the costs would outweigh the benefits" of devolution. However, should corporation tax be devolved to Scotland and Northern Ireland, the Commission recommended its devolution would need to be offered to Wales.[6]

2.8. On new taxes, the Silk Commission recommended that when the UK Government introduced new taxes in devolved areas, "there should be a presumption in favour of devolving powers over the tax to the Welsh Government."[7] It also recommended that the National Assembly for Wales should be given the power to introduce new taxes and associated tax credits,

with the agreement of the UK government.

2.9. The Welsh Government welcomed the Silk Commission's report. In its evidence to the Commission it had stated that it was 'open minded' to tax devolution, particularly in policy areas which were already devolved, but would reconsider this stance if a funding floor and borrowing powers could not be agreed.[8] Hence it was 'particularly pleased' with the recommendation to devolve borrowing powers and described powers over taxes such as stamp duty as a 'new lever to support economic growth.'[9] The recommendation for a referendum on partial devolution of income tax was also embraced.

2.10. A year later, in November 2013, the UK Government accepted most of the Silk Commission's recommendations, either in part or full.[10] It envisaged the National Assembly for Wales having two income streams: the first to continue to be a block grant allocated via the Barnett formula and the second to be from taxation. The devolved taxes were to be Stamp Duty Land Tax, Landfill Tax, non-domestic rates, partially-devolved Income tax and the ability to introduce new taxes. However the UK Government did not accept the recommendation on the devolution of Air Passenger Duty, and said it would review the case for devolving Aggregates Levy. It also stated that the devolution of income tax would include a requirement that any variations in tax rates must be applied to all tax bands (the so-called 'lock-step'). The Wales Bill, published in December 2013, provided the legislative basis to take forward the UK Government's intentions.

2.11. The Bill attracted a great deal of controversy. Critics were concerned that the 'lock-step' made the income tax powers far less likely to be used, whereas the UK Government said it maintained parity with Scotland and ensured the progressivity of the current income tax system was sustained.[11] However, the controversy surrounding the plans coupled with the proposed changes in respect of non-savings, non-dividend income tax in the Scotland Bill resulted in the UK Government amending the Wales Bill to allow different rates to apply to different bands.[12, 13] The other provisions of the Bill, and in particular the ability of the National Assembly for Wales to introduce new devolved taxes, attracted very little attention indeed. The Bill received Royal Assent on 17th December 2014.[14]

2.12. In February 2015, the UK Government's St David's Day Agreement[15 16] included three further commitments in respect of Wales' finances:

- a further review the potential for devolving Air Passenger Duty, with a discussion paper promised by Summer 2015;
- to examine the Smith Commission's recommendations for Scotland which are relevant to Wales (not least the assignment of a proportion of VAT revenues);
- to introduce a funding floor, to be agreed in the next Spending Review (autumn 2015).

2.13. The St David's Day agreement was made in the expectation that the Welsh Government will call a referendum on income tax powers in the 2015-2020 Parliament. The Agreement made clear that funding arrangements after 2020 will take "full account of the Welsh Government's new powers and responsibilities, given the significant impact that tax devolution could have on its funding."

2.14. Another Wales Bill to take forward the St. David's Day commitments was announced in the Queen's Speech on 27th May 2015[17] and its publication is awaited.

2.15. The Welsh Government has broadly welcomed the devolution of smaller taxes (Stamp Duty and Landfill Tax) and is making arrangements for their introduction from April 2018. However it has argued until there is a fair funding settlement it is not in the best interests of Wales to devolve any element of Income tax, as the block grant will still account for 80 per cent of funding. Precisely what constitutes 'fair funding' is less clear, but agreement over a funding floor would be an important first step:

> *"If we can secure satisfactory delivery of that clear commitment to a funding floor – and I have learned by now that the devil of course will be in the detail – one of my fundamental concerns about the devolution of income tax will have been largely addressed."*[18]

2.16. In the longer term, the First Minister has called for a fundamental reform of the arrangements for funding devolved nations, suggesting that a new system should comprise revenues retained from devolved taxes combined with resources raised from pan-UK 'solidarity taxes' allocated according to an independent, needs-based assessment.

Scotland

2.17. Scotland has led the way on devolved taxation. Arguably evidence of a greater appetite for devolution, Scotland's 1997 referendum did not only ask if voters agreed that there should be a Scottish Parliament (74.29% of those who voted did), it also asked if they agreed that the Scottish Parliament should have tax-varying powers, and 63.48% did.[19] Despite taxation being identified as a reserved power, the Scotland Act 1998 permitted the Scottish Government to vary the UK rate of income tax by +/- three pence in the pound. These powers were never used, and in 2009 the Commission on Scottish Devolution (the Calman Commission) recommended a devolved Scottish rate of income tax to replace the Scottish Variable Rate.

2.18. The Calman Commission proposed deducting 10 pence from all bands of UK tax rates (and a consequential reduction in the block grant), which could then be replaced with a new Scottish rate of income tax, operating on the basis of a 'lock-step'. Although it advised that the tax on income from savings and distributions should not be devolved, it recommended that half of what was raised in Scotland should be allocated to the Scottish Government.[20] It also recommended devolving Stamp Duty Land Tax, Aggregates Levy, Landfill Tax and Air Passenger Duty, and giving the Scottish Parliament the power to introduce new taxes in Scotland with consent from the UK Parliament.[21]

2.19. The Scotland Act 2012 implemented many of Calman's recommendations, including the devolution of Land Transaction Tax and Landfill Tax from April 2015, powers to introduce a Scottish Rate of income tax from April 2016 and the power to introduce new taxes.[22]

2.20. This settlement did not hold for long. In the lead up to the 2014 Scottish independence referendum, the main political parties supporting a 'no' vote promised a much more comprehensive devolution package, which included a number of new or enhanced fiscal powers.[23] Post-referendum, the Smith Commission was established by the UK Government to make recommendations for further devolution.[24]

2.21. The Smith Commission agreed that the Scottish Parliament should be able to set the rates and thresholds for income tax on non-savings, non-dividend income. It also recommended the full devolution of Air Passenger Duty, Aggregates Levy and receipts from the first 10 percentage points of the

standard rate of VAT raised in Scotland. The UK Government committed to implementing these recommendations in full in May 2015, and the Scotland Bill 2015-16 was published.[25] The only significant difference to the Smith Commission's recommendations was the proposal to devolve 2.5 percentage points of the reduced rate of VAT raised in Scotland, in addition to the 10 percentage points of revenue from standard rate VAT. Overall, the provisions will result in the Scottish Government raising approximately 50% of its annual budget from its own tax revenues. The Barnett formula will continue to be used to determine Scotland's block grant, although it will be significantly adjusted to take account of tax revenues.

Northern Ireland

2.22. The devolution of tax powers to Northern Ireland has taken a different path to Wales and Scotland, in part because of its land border with the Republic of Ireland. The long haul rate of Air Passenger Duty has been devolved,[26] there have been exemptions to increases in certain environmental charges such as the Climate Change Levy.,[27] and alternative arrangements for the Aggregates Levy (including an 80% levy credit) have been permitted.[28] The Northern Ireland Assembly also has the power to introduce new taxes, although it has not pursued this option yet.

2.23. More recently, the UK Government has passed legislation to allow for the devolution of corporation tax, not least so that it can take account of the rate applied in the Republic of Ireland (currently 12.5% compared to the UK rate of 20%). The Corporation Tax (Northern Ireland) Act 2015 gives the Northern Ireland Assembly powers to set the rate of tax (expected to be from April 2017) for all the trading profits of small and medium-sized enterprises if their employee time and costs are predominately incurred in Northern Ireland. It will also apply to the profits attributed to trading activities in Northern Ireland by large enterprises. Rental and investment income will continue to be covered by the UK rate.

Cities and Regions

2.24. Calls for greater tax powers have been made by large cities, and the evolution of City Deals throughout the UK has seen some interesting tax arrangements emerge.

2.25. As part of the first wave of City Deals in 2012, Greater Manchester's City Deal included an 'Earn Back Model' in which the authorities receive a larger proportion of income generated from business rates if they successfully boost the local economy.[29] Although the scheme has not given the Greater Manchester Combined Authority tax raising powers, it gives it more control over tax revenues raised in the city and financial incentives to boost economic growth. The 2012 City Deals also gave Newcastle, Sheffield and Nottingham access to finance through New Development Deals, which allow borrowing against future income from non-domestic rates.[30]

2.26. Tax raising powers for cities and regions have also been considered. In 2013 the London Finance Commission recommended that the starting point for greater fiscal autonomy should be the five property taxes:

- Non-domestic rates;
- Council tax;
- Stamp Duty Land Tax;
- Annual Tax On Enveloped Dwellings; and
- Capital Gains Property Disposal Tax.

2.27. The Commission proposed that responsibility for the taxes should be devolved entirely, which included setting tax rates, revaluation, banding and discounts, and that the yields of these taxes should be offset by reducing the grant a London government received from the UK Government. It also recommended that the benefits of new taxes should be evaluated. The Commission did not see the devolution of income tax as a priority, but suggested it should be revisited after the full devolution of property taxes and when other policy areas – such as health and welfare – were considered for devolution.[31]

2.28. More recently, Phillip Blond and Mark Morrin have recommended the same property taxes should be devolved to Greater Manchester, and that it should begin a dialogue with the UK Government to consider devolving the management and retention of income tax. They have also recommended that Greater Manchester should have further tax-raising powers by 2020. [32]

2.29. These ideas have been echoed in Blond's and Morrin's reports for the Core Cities[33] and Key Cities[34] groups, on the basis that devolution of tax powers will enable cities to create the local conditions necessary for economic growth. The UK Parliament Communities and Local Government Select Committee recommended a devolution framework which included the partial devolution of business rates, devolution of stamp duty and powers to introduce new taxes. It

also suggested that local authorities and the UK Government should consider proposals to apportion the VAT and income tax raised within an area to groups of local authorities.[35]

2.30. The UK Government has been piloting schemes to allow local authorities to retain additional non-domestic rates growth,[36, 37] and the Chancellor has stated that all local authorities will be able to keep the proceeds raised from business rates by 2020, although limited information is available about this at this time.[38] The UK Government has also confirmed it will publish a discussion paper on devolving Air Passenger Duty to English regions. Further devolution of fiscal powers was hinted at by the Chancellor speaking about developing the 'Northern Powerhouse'.[39]

Conclusion

2.31. The devolution of taxes to Wales is not a new idea but it has followed a tortuous process. It will have taken two Commissions and eight years from the time devolution of taxes on land transactions and waste disposed to landfill were mooted to their implementation. The prospect of partial income tax devolution has been even more convoluted with shifts in legislation and several hurdles to be overcome before a Welsh rate of income tax could be a reality.

2.32. The slow progress in Wales contrasts with that elsewhere in the UK, where innovative revenue-retention schemes are already in place and powers to devolve some taxes and introduce new taxes are under active consideration, not only for devolved governments but for city regions as well.

3. The devolved taxes

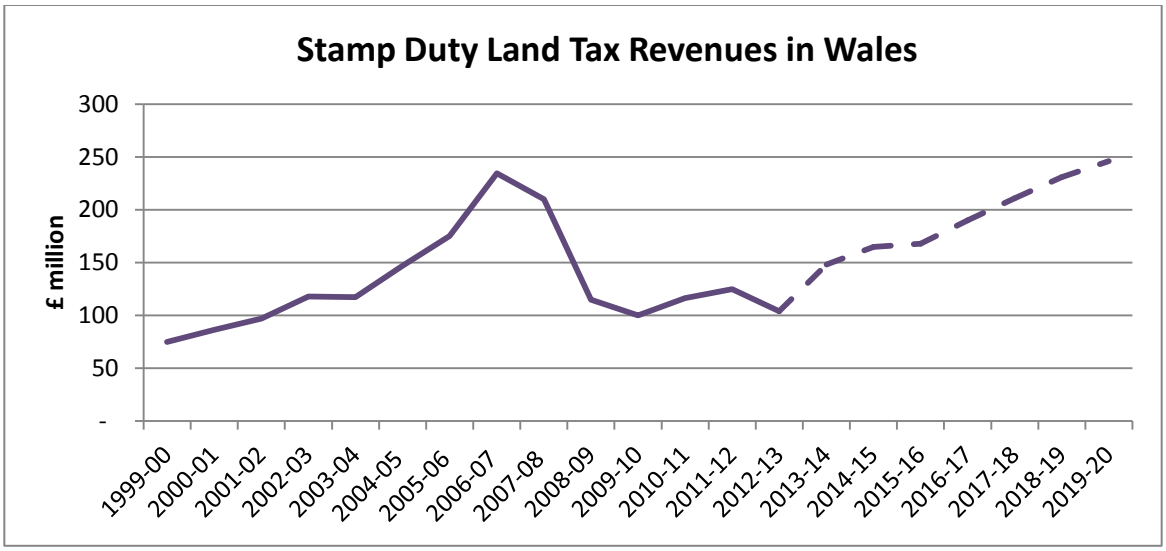
3.1. The Wales Act 2014 devolved modest tax raising powers to the Welsh Assembly, almost a decade after it was recommended by the Richard Commission. The Welsh Government has already consulted on the approach it should take for the collection and management of taxes and a draft bill is now before the Assembly. It has also consulted on the devolved taxes on land transactions and waste disposed to landfill.

3.2. This section looks in more detail at the taxes that have been devolved in the Wales Act 2014, at the role of taxes in Welsh public finances and at their potential as new policy levers.

Tax on transactions on land

3.3. The Wales Act 2014 (clauses 15-17) dis-applies Stamp Duty Land Tax and enables the National Assembly for Wales to establish its own tax on land transactions. The Welsh Government has recently consulted on the arrangements for new tax on land transactions – the Land Transaction Tax.[40] Much of the detail, e.g. on rates and bands, remains to be determined and as such it is impossible to forecast the revenue that the new tax might generate.

3.4. The revenue generated by Stamp Duty Land Tax has varied from year to year, reflecting the cycle of the property market. It reached a high of £235 million in 2006/07, falling £100 million during the credit crunch before recovering to £145 million in 2013/14.[41] Looking ahead, the Office for Budget Responsibility[42] forecast that receipts will increase by 70% over the next five years.

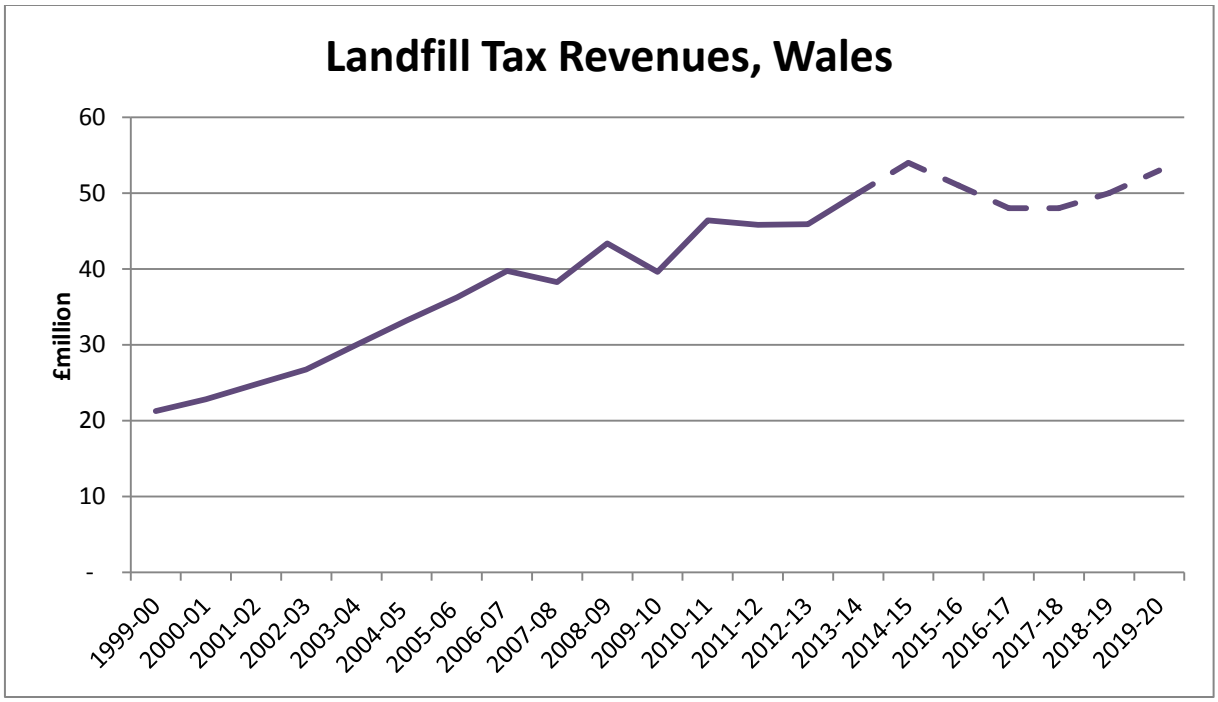


Source: Office for Budget Responsibility, Devolved Taxes Forecast (July 2015)

Tax on waste disposed to landfill

3.5. The Wales Act 2014 (sections 18-19) dis-applies Landfill Tax and enables the National Assembly for Wales to establish its own tax on waste disposed to landfill. The Welsh Government has recently consulted on proposals for a new tax, which will be introduced on 1 April 2018.[43] The scope to make substantial changes is relatively limited, both by the need to maintain revenue and by the mobility of waste which could be transferred into or out of Wales to reduce waste operators' tax liabilities.

3.6. Despite the intention that Landfill Tax will divert waste to other methods of disposal, revenues have risen to peak at £50 million in Wales in 2013/14. The forecast to 2019/20 is that the revenue raised will be broadly static.[44]



Source: Office for Budget Responsibility, Devolved Taxes Forecast (July 2015)

Non-domestic rates

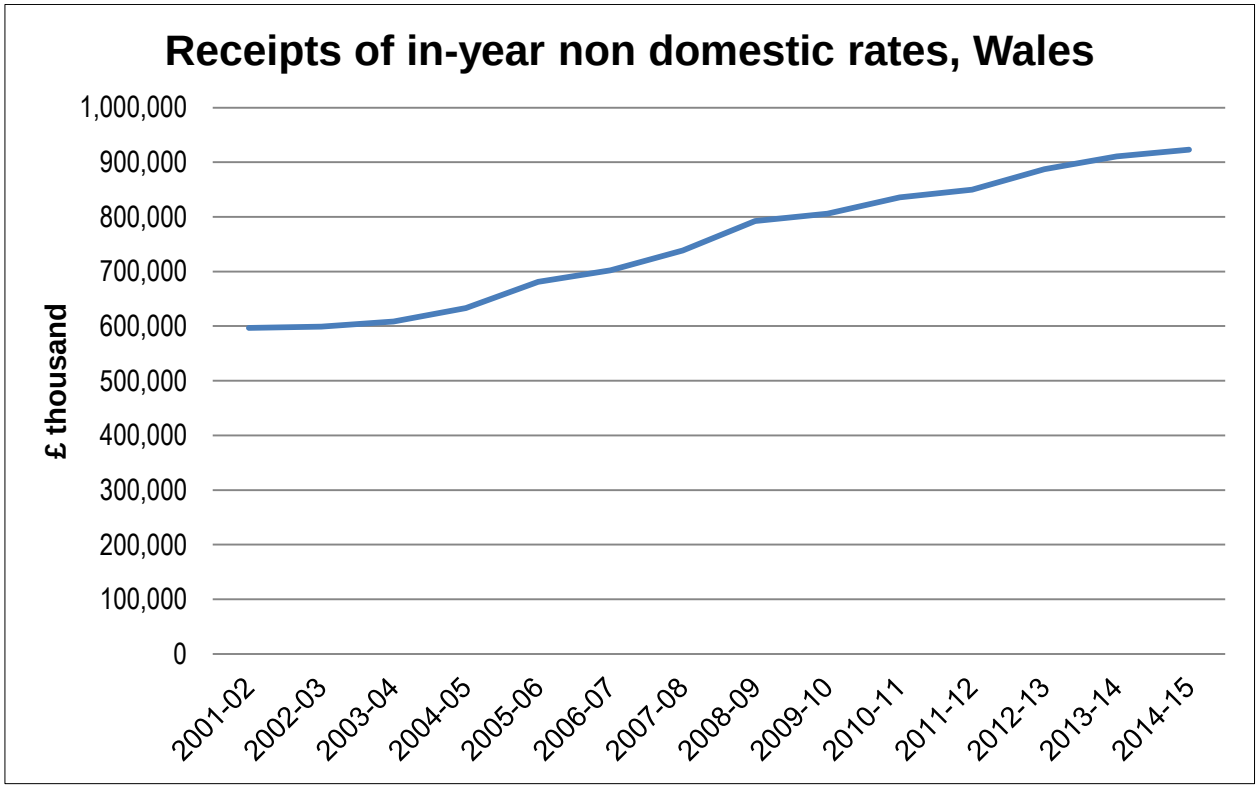
3.7. Non-Domestic Rates (business rates) were fully devolved to Wales in April 2015. Since 2011 the Minister for Economy, Science and Transport has been responsible for business rate policy, with power over operations being held by the Minister for Public Services. The devolution of business rates is the responsibility of the Finance Minister.[45] A revaluation of non-domestic rates in Wales was conducted in 2008 (with the next revaluation having been delayed to 2017), and the Welsh Government has used the tax as a policy lever, such as in the Wales Retail Relief scheme which offers a discount on business rates to qualifying retailers.[46]

3.8. Local authorities are responsible for collecting business rates and they are then pooled together by the Welsh Government. This pool – worth almost £1 billion a year - is then allocated to local authorities as part of their annual settlement through a formula based on their spending needs.

3.9. As this needs-based formula is used to redistribute business rates by the Welsh Government, critics have raised concerns that local authorities do not directly benefit from the business rates they collect. It has been suggested that the Welsh Government should look at the Business Rates Retention Scheme operating in England which allow local authorities to borrow against future

business rates revenue, and consider introducing a business rates retention scheme in Wales.[47]

3.10. Receipts from non-domestic rates have increased steadily since 2001, and in-year receipts in 2014/15 totalled £922,745,000 in Wales. However, this figure does mask the regional differences in business rate receipts. For example, in-year receipts for 2014/5 in Cardiff and Swansea were £181,990,000 and £72,572,000 respectively, while much lower receipts were collected in other areas such as Ceredigion (£16,737,000) and Torfaen (£21,366,000).[48]



Source: StatsWales (2015), Collection of non-domestic rates, by year (£ thousand)

Income tax

3.11. The Wales Act 2014 (clauses 8-10) allows the National Assembly for Wales to determine a Welsh rate of income tax on non-savings, non-dividend income, if this is agreed in a referendum. If introduced, the UK rates of non-savings, non-dividend income tax would be reduced by 10 percentage points, and separate Welsh rates for each of basic, higher and additional tax payers would be added to the reduced UK rate. It would be for the Assembly to decide whether the

Welsh rate of income tax would be lower, equal to or higher than 10 per cent in each tax band. The Assembly would not decide tax allowances or reliefs. [49]

3.12. Total income tax receipts from Wales in 2013/14 were £4.785 billion.[50] The Office for Budget Responsibility has estimated that a 10 pence rate of Income tax on non-savings, non-dividend income in Wales would have generated £1.846 billion in 2013/14, rising to £2.515 billion by 2019/20.[51]

New taxes

3.13. The Wales Act 2014 amends the Government of Wales Act 2006, by inserting clause 116c to allow the National Assembly for Wales to introduce new devolved taxes. The same clause also allows the UK Government to devolve any new UK taxes to the National Assembly for Wales. It is important to note that the Wales Act does not give the National Assembly for Wales fiscal responsibility – any new taxes would be subject to the approval of the Assembly and of both Houses of Parliament through an Order in Council. This is a significant limit to the Assembly's powers.

3.14. The Wales Bill Command Paper makes clear the requirements that any new taxes would need to meet. Proposals for new taxes will be assessed against a range of criteria, including the extent to which the new tax:

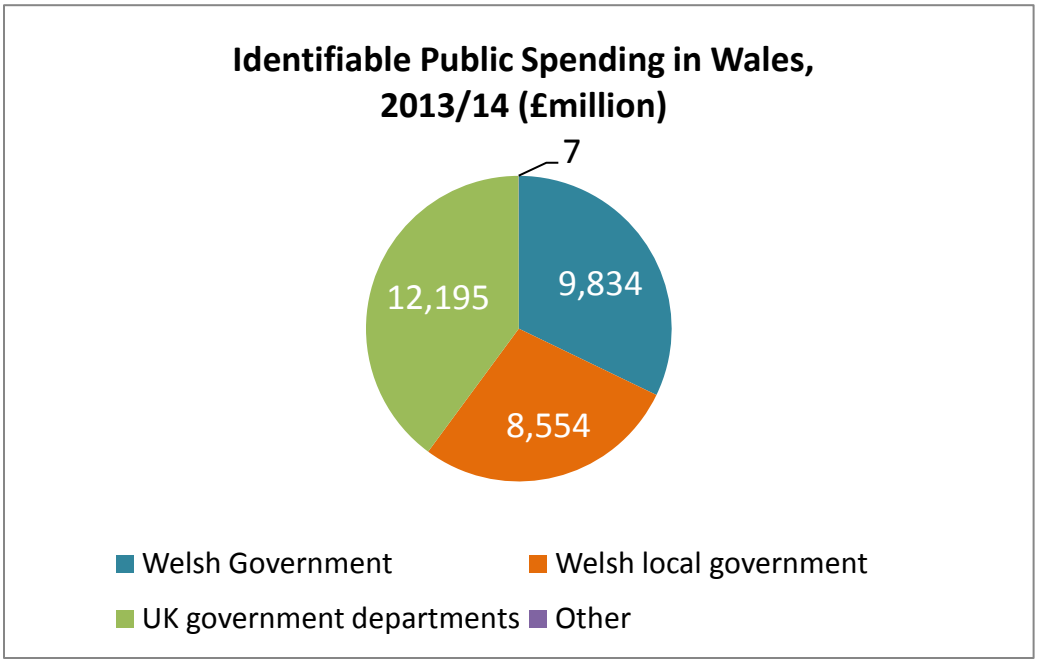
- affects UK macro-economic or fiscal policy and/or the single market;
- compliance with EU legislation;
- increases tax avoidance risks; or creates additional compliance burdens for businesses and/or individuals;
- is aligned with devolved responsibilities.[52]

3.15. It will also need to include details of the tax base, the estimated revenue and economic impact, the estimated impact on UK revenue or interaction with UK-wide taxes, the impact on businesses and individuals, and assessments against all relevant legislation and directives. There are, as some have pointed out, some significant gaps in the information available, not least the tax base.[53] While the requirements are demanding, they are by no means insurmountable.

Taxation and Public Finances in Wales

3.16. Devolved taxes are an integral part of the wider financing of public spending in Wales. In 2013/14, total identifiable public expenditure in Wales – including UK government spending on pensions, benefits and Welsh Government

expenditure was £30.590 billion. Of this, just under 40% was expenditure by UK government departments, with almost all the rest being expenditure by the Welsh Government or Welsh local government.



Source: HM Treasury, UK Public Expenditure Country and Regional Analysis (November 2014)

3.17. The bulk of the Welsh Government's expenditure is funded by a block grant from the UK government, determined by the Barnett formula. This arrangement has been widely criticised for being both unfair (because it takes no account of needs in Wales) and lacking accountability (because the Welsh Government is not held responsible for raising revenues). UK and Welsh Governments agreed in 2012 that there has been a convergence in funding in recent years (the so-called Barnett Squeeze), and negotiations are underway to establish a mechanism to halt convergence when public expenditure increases.

3.18. One of the aims of the Wales Act 2014 is to increase financial accountability by ensuring that a proportion of Welsh expenditure is funded by taxes that are the direct responsibility of the Welsh Government.

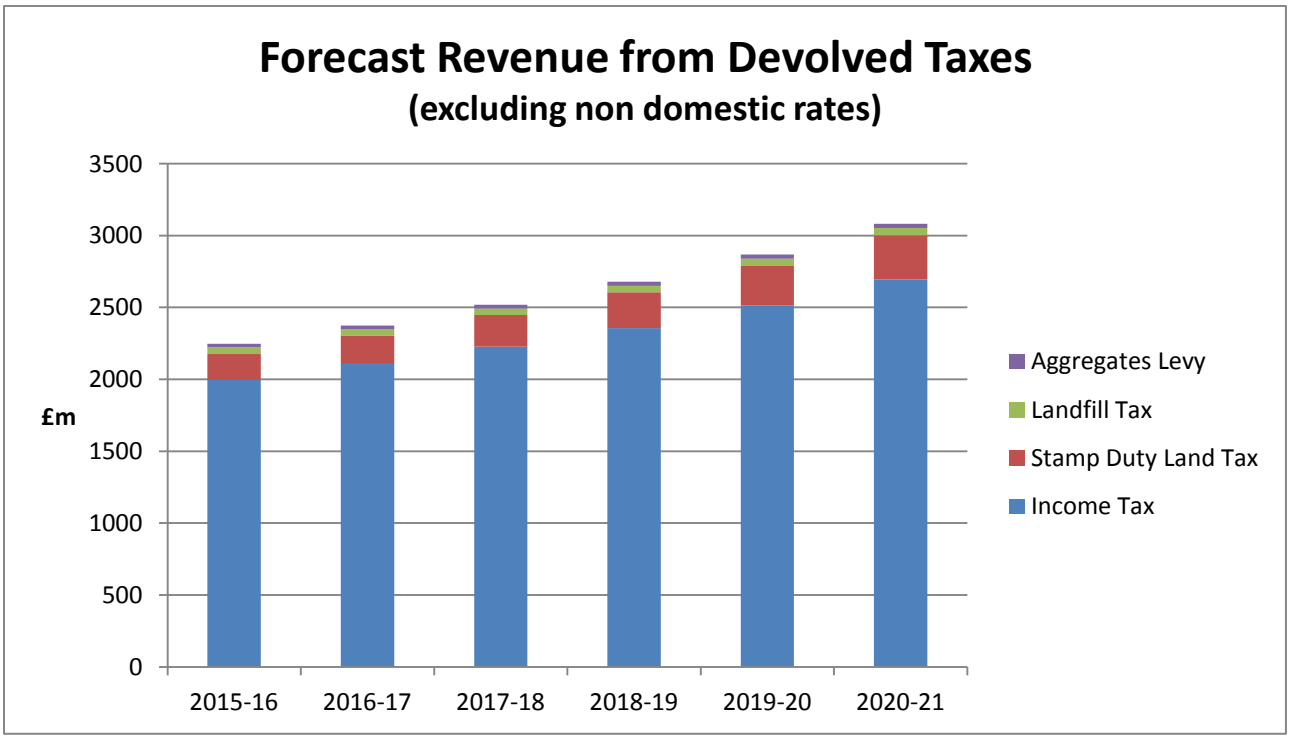
3.19. The revenue generated from taxes in Wales is substantial. In 2013/14 total receipts raised by HMRC from Wales' population were £16.789 billion. A further £1.2 billion is estimated to be raised from council tax,[54] £960 million from non-domestic rates as well as unspecified revenues from taxes such as

Vehicle Excise Duty, bringing the total tax income to approximately £19 billion.

3.20. The revenue generated through taxation exceeds the Welsh block grant but falls short of total public expenditure. Wales is by no means unique in having this sort of deficit (which is not comparable with the UK deficit): as Holtham noted in 2011, only London and the south east of England are in fiscal surplus.

3.21. Wales has a slightly different tax profile to the UK as a whole (see Appendix 1). Of the taxes raised in Wales, the 'big three' of income tax, national insurance and VAT together account for 76% of all tax revenues – a total of £12.8 billion. Of the many smaller taxes, only fuel duties raise more than £1 billion, and several taxes generated less than £100 million a year.

3.22. The Office for Budget Responsibility forecasts that the devolution of an element of Income tax, Stamp Duty Land Tax, Landfill Tax and in, due course, Aggregates Levy would result in £2.175 billion in tax revenues in 2014/15 and £2.836 billion by 2019/20. Even without the devolution of Income tax, the UK Government estimates that devolved taxes plus Non-Domestic Rates could account for 10% of the Welsh Government's budget. If there is a 'yes' vote in a referendum on income tax, the Welsh Government could raise as much as a fifth of its budget from devolved taxes.



Source: Office for Budget Responsibility, Devolved Taxes Forecast (July 2015)

3.23. The Wales Act 2014 provides for adjustments to be made to the Welsh block grant when taxes are devolved to reflect the new revenue-generating capacity of the Welsh Government. A key issue is therefore the nature of the adjustment, which will need to take account of economic factors, such as the expected tax yield, forecast growth rate and tax volatility, and also fairly apportion the risks to the UK and Welsh Governments.[55] Work is ongoing to overcome the difficulties involved:[56] the devil will almost certainly be in the detail, and the prospect of reductions to an already-inadequate block grant has not been warmly received.

3.24. The financial arrangements in respect of new taxes are different. As the Wales Bill white paper explained:

'The impact on the Welsh Government's block grant would be expected to be limited to the application of a 'no detriment' principle. Under this principle, the Government would apply a block grant adjustment only if a new tax in Wales was expected to reduce revenues to the Exchequer.'[57]

It would seem that if there is no detriment to UK revenues, the Welsh Government would retain any revenues it raises.

Taxation as a policy lever

3.25. Taxes are about more than revenue – they are also a new, and potentially very powerful, policy lever. Taxation can change the behaviour of individuals, households and organisations, as people or organisations seek to avoid or reduce their tax liabilities. The scope for new taxes to, for example, stimulate economic growth, reduce harmful health behaviours or protect the environment is significant indeed.

3.26. There are many ways in which individuals and organisations seek to avoid or reduce the tax they pay. One of particular relevance to Wales is relocation. As Holtham pointed out, 48 per cent of the population of Wales live within 25 miles of the border with England, and 2.7 million people (90 per cent of the total population) live within 50 miles of the border. Altogether over 16 million people in Wales and England live within 50 miles of the border between the two countries, compared with three million living within 50 miles of the England - Scotland border.[58] This challenge has already been recognised in proposals for the new Landfill Disposals Tax where avoiding 'waste tourism' is a real

concern, as is the proximity of Bristol Airport (and to a lesser extent Liverpool) should Air Passenger Duty be devolved.

3.27. Sometimes the changes in behaviour to avoid tax are precisely what policymakers want: such as to reduce smoking, fuel consumption or waste disposed to landfill. Similarly, taxes (including tax credits) can be used to stimulate other forms of behaviour, such as investment in the economy. Taxes are often used where prices do not reflect negative externalities such as environmental damage or benefits such as investment in research and design. Wales has its own good example, with the levy on single use carrier bags, which was introduced prior to the Welsh Government having taxation powers, being estimated to have reduced single use carrier bag use by 71%.[59]

Conclusion

3.28. Although the devolution of Stamp Duty Land Tax and Landfill Tax are modest in terms of revenue, it is a landmark moment in the history of devolution as it finally grants the Welsh Assembly tax raising powers. The power to vary the rate of Income tax offers the potential to raise much larger revenues, although this presents a much greater risk to the Welsh Government.

3.29. The potential to introduce new taxes are slightly different. Although they are an opportunity to increase the Welsh Government's budget (as long as they are not detrimental to the UK Exchequer), new taxes can also been used as a policy lever to shape the behaviour of individuals and organisations.

4. Towards a new tax system

4.1. The Welsh Government is in a unique position to design and develop a tax system that works for Wales. For the specific taxes that are devolved, it can determine who should pay (for example the purchaser or vendor of a property), the rates of tax (which could be zero, flat rate or progressive) and tax bands, as well as exemptions and tax credits. It can name the tax, decide on the timing and method of payment, and on penalties for evasion or late payment. For new taxes, it can determine all this as well as the goods or activity to be taxed.

4.2. This section looks at the principles that we suggest should underpin a Welsh taxation system and the arrangements for tax collection, and outlines how they might be applied to develop new taxes.

Taxation Principles

4.3. The question of establishing a good tax system has concerned economists and politicians for centuries, not least because getting the system right is critical. Adam Smith's 1776 'Wealth of Nations' set out four canons of taxation, about which there is still near universal consensus. These are:

- The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities.
- The tax which the individual is bound to pay ought to be certain and not arbitrary.
- Every tax ought to be levied at the time, or in the manner, in which it is most likely to be convenient for the contributor to pay it.
- Every tax ought to be so contrived as to take out of the pockets as little as possible, over and above that which it brings into the public treasury of the state.

4.4. Adam Smith's principles clearly informed the conclusions of the Holtham Commission, which recommended that Wales' funding settlement should be based on efficiency, equity, simplicity and transparency, along with accountability and autonomy.[60] The Silk Commission added additional principles to Holtham's list, namely co-operation between governments, fiscal discipline, empowerment, economic incentivisation, stability and sustainability, to produce 11 principles.[61] The White Paper preceding the 2014 Wales Bill did

not comment on these principles nor set out its own, and nor are there any in the Wales Act 2014.[62]

4.5. The Scottish Government's principles for taxation are explicitly based on Adam Smith's four canons, namely that taxes should be:

- proportionate to the ability to pay;
- certain (in relation to the taxes that must be paid);
- convenient (a simple system that does not present administrative burdens);
- efficient.

It adds that Scottish taxes should:

- meet the distinctive needs of Scotland; and
- support sustainable economic growth. [63]

4.6. The Welsh Government's taxation principles are set out in the 'Collection and management of devolved taxes in Wales' White Paper.[64] This states that Welsh tax policy and legislation should:

- be applied fairly to those who pay taxes, including businesses;
- be simple, with any new rules clearly communicated to avoid compliance issues;
- support the Welsh Government's wider agenda to encourage growth and jobs, which will consequently help to tackle poverty; and
- provide stability and certainty for taxpayers.

4.7. Interestingly, some of the principles adopted by others - notably efficiency and transparency - are absent from the proposed Welsh principles, while the reference to meeting needs is much narrower than in Scotland. This is particularly surprising given one of the main criticisms of the Barnett formula is that it fails to take into account Wales' particular circumstances and needs.

4.8. The principles of funding and taxation are important, particularly when the Welsh Government is designing its tax system from scratch. It has not had the opportunity before to consider how it wants to be funded, who should contribute what and how they want to use tax powers. The principles should provide the framework for Wales' new funding regime in general, and for its new and devolved taxes in particular, and they should be correct and demand widespread support.

Tax collection

4.9. In order to collect devolved and new Welsh taxes, the Wales Act 2014 gives the National Assembly for Wales the power to establish a Welsh Revenue Authority (WRA). The Collection and Management of Devolved Taxes in Wales White Paper was issued in late 2014, and was put to a public consultation. Most respondents said that it was important that a WRA was a non-ministerial department. They also identified the need for expertise and there was interest in how the WRA would be scrutinised. Concerns were raised about the effectiveness of the proposed tax charter, especially if it were not enshrined in law. Respondents were keen for the WRA's powers to mirror those currently held by HMRC, and emphasised the need for simplicity. Additionally, there were calls for a fairer penalty system which takes into account intent.

4.10. The Welsh Assembly's Finance Committee's inquiry into the collection and management of devolved taxes[65] recommended that the Welsh Government should take a phased approach to the collection of taxes to ensure consistency across Wales, and that the system should not differ from the UK's approach unless necessary.

4.11. The Tax Collection and Management (Wales) Bill was published in July 2015 and establishes a WRA to be responsible for the collection of devolved taxes, either directly or by outsourcing to a third party. The Bill also outlines the governance framework as well as the various duties, rights of appeal, assessments and enquiries necessary for the WRA and taxpayers. This includes civil investigation and enforcement powers, and the option of penalties and interest in cases of non-compliance, effectively bringing the WRA into line with the powers already held by HMRC. It is intended that the Bill will complete its Committee stage (Stage 2) by 5 February 2016, after which there will be a further consideration in Plenary before a final vote and Royal Assent.

Conclusion

4.12. The principles underpinning Wales' taxation regime need to reflect the particular circumstances and needs of Wales' population and future generations. They should not be considered in isolation; devolved taxes are inextricably linked to Wales' funding arrangements and present opportunities for other policy areas such as resource management, the environment and health.

4.13. The National Assembly for Wales has a unique opportunity to develop devolved and new taxes that accord with sound principles and also meet Wales' needs and circumstances. While there are several statements of principles that could be adopted, it is important that there is a visible and robust set of principles which have strong, cross-party support, to inform Wales' new tax regime.

5. What new taxes should there be?

5.1. The next phase of this project, due for completion in late 2015, will develop proposals for new taxes that could be introduced in Wales. Provided they are in areas within the Assembly's competence, virtually anything could be taxed – there is no shortage of strange examples of taxes elsewhere in the world, on everything from playing cards (Alabama) and smart phones (France) to tethered hot air balloons in Kansas, as well as better-known taxes such as those on sugary foods or tourism.

Principles for new taxes

5.2. Any new Welsh taxes will need to be based on sound taxation principles. Not only will they need to reflect Adam Smith's 'four canons' of fairness, certainty, simplicity and efficiency, they also need to reflect the specific needs and circumstances of Wales. This includes recognising Wales' very porous borders and its somewhat different tax base compared to other devolved nations, cities and the UK as a whole.

5.3. Second, any new taxes will need popular and political support. The length of time it has taken to devolve even the most modest of taxes is an indication of the scepticism, from a variety of quarters and for a variety of reasons, about the benefits of the Welsh Assembly having such powers. The requirement for both the Assembly and the UK Parliament to approve any new tax proposals means that they will need to command cross-party support in both chambers, and will also need widespread stakeholder and public support to help to drive them through. Public and business support (or at least, minimum opposition) is also important to help with compliance and any behaviour change sought.

5.4. Third, any new taxes will need to have regard to the wider tax regime. Taxes should not only be appraised individually but as part of a bigger system, so new Welsh taxes will need to take account of other Welsh taxes (for example any new property taxes would need to complement Land Transaction Tax and council tax, for example) as well as UK taxes and those being devolved elsewhere in the UK.

5.5. Last but not least any new taxes will need to sit within wider Welsh public finances. While revenues raised by new taxes will be retained by the Welsh Government provided there is no detriment to the UK Exchequer, quite how

detriment will be assessed and accounted for remains to be seen.

Identifying potential new taxes

5.6. Any new Welsh taxes should accord with the principles outlined above, and should have a clear rationale. We are particularly interested in taxes that not only generate revenue but also address an economic, social or environmental problem in Wales. There is particular potential for taxes where an organisation or individual generates some sort of 'harm' that is not reflected in their costs – a sort of 'polluter pays' principle, that would apply to the environment and to other fields such as health and the economy.

5.7. **By way of example only**, new taxes could include:

- **Environmental taxes:**
  - taxes on exploitation of certain natural resources (e.g. coal, water);
  - taxes on waste or litter-producing activities (e.g. non-recyclable packaging).
- **Health taxes:**
  - taxes on unhealthy foods and drinks (e.g. sugary drinks);
  - taxes on unhealthy activities (e.g. smoking paraphernalia);
  - taxes on addictive gambling (e.g. fixed odds betting terminals).
- **Economic taxes:**
  - taxes on overnight visitor accommodation;
  - tax credits for investment in research & development.

We will be exploring and developing these and other ideas in the coming months.

Conclusion

5.8. It has taken a very long time for the idea that the National Assembly for Wales should be able to levy its own taxes to become a reality, albeit with strings attached. The Wales Act 2014 brings an unprecedented opportunity for the Welsh Government to use taxes to change the Welsh economy, society and environment for the better as well as to raise revenue. Introducing new devolved taxes will be no small challenge. There are significant political, legislative and fiscal hurdles to overcome, as well as public and stakeholder opinion to win over. The next phase of this project will identify some options for new taxes and how they might be introduced.

Annex 1 HMRC Receipts from taxation (2013/14)

£ million	Total HMRC receipts (Geographic)	Income tax	VAT	Capital Gains Tax	NICs	Corporation Tax (Onshore)	Bank Levy	Stamp Duty Land Tax	Landfill Tax	Fuel duties	Tobacco duties	Spirits duties	Beer duties	Wines duties	Cider duties	Betting & Gaming	Air Passenger Duty	Climate Change Levy
UK	489,850	156,898	104,718	3,908	107,690	35,718	2,200	9,273	1,189	26,881	9,531	3,056	3,346	3,713	340	2,098	3,013	1,068
Wales	16,564	4,785	4,214	66	3,850	893	41	148	50	1,320	367	113	170	144	23	86	10	58
England	420,809	137,898	88,858	3,565	92,691	31,753	1,984	8,698	1,003	22,394	7,564	2,413	2,839	3,143	281	1,766	2,666	887
Scotland	41,894	11,516	8,654	243	8,865	2,607	148	389	106	2,258	1,117	403	237	337	29	190	254	98
N. Ireland	10,536	2,683	2,992	34	2,285	429	27	37	30	909	483	4.2%	100	89	7	56	83	25
Percentage of UK total																		
UK	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100	100
Wales	3.4	3.1	4.0	1.7	3.6	2.5	1.9	1.6	4.2	4.9	3.9	3.7	5.1	3.9	6.8	4.1	0.3	5.4
England	85.9	87.9	84.9	91.2	86.1	88.9	90.2	93.8	84.4	83.3	79.4	79.0	84.8	84.6	82.6	84.1	88.5	83.0
Scotland	8.6	7.3	8.3	6.2	8.2	7.3	6.7	4.2	8.9	8.4	11.7	13.2	7.1	9.1	8.5	9.1	8.4	9.2
N. Ireland	2.5	1.7	2.9	0.9	2.1	1.2	1.2	0.4	2.6	3.4	5.1	4.2	3.0	2.4	2.1	2.7	2.8	2.4

Source: HM Revenue and Customs (2014), Disaggregated tax and NICs receipts: statistics table 2013/14

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About the Bevan Foundation

The Bevan Foundation develops ideas to make Wales a fairer, prosperous and sustainable place. We are independent of government or any political party, and are funded by membership subscriptions, donations, grants from charitable trusts and foundations and commissions.

We have made every effort to ensure this report is accurate but responsibility for any errors, and for the views in the report, are those of the Bevan Foundation.

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