1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) and its Low Incomes Tax Reform Group (LITRG) set out below their joint response to the Finance Committee of the Senedd Cymru’s inquiry into the implementation of the Wales Act 2014 and the operation of the Fiscal Framework.

1.2 The terms of reference of the inquiry, published on 1 July 2020, are:

Taxation

- The Welsh Government’s tax principles, whether these have been met and whether the current tax regime and proposed new taxes align with these principles;
- How successful the administration of Welsh Taxes and the Welsh Rates of Income Tax has been;
- What possible future tax changes could look like and what scope there is for a different approach to taxation in Wales;
- How the mechanism for devolving powers for new Welsh taxes has been performing.

The Fiscal Framework

- Consider the fiscal framework processes and how funding is allocated to the Welsh block grant;
- Examine the application of the Barnett Formula and the criteria for excluding specific funding from the formula;
- Consider the block grant adjustment mechanism and the effectiveness of the adjustment model;
- Review the suitability of the budget management tools such as the Wales Reserve, and the ability to borrow;
- Evaluate the treatment of spill-over effects and the mechanism for agreeing these effects;

- Draw comparisons between Wales and other international fiscal frameworks.

The questions relating to the Fiscal Framework are largely outside our remit and therefore the focus of our response is under the Taxation heading. However, we welcome the Framework review as it is clearly important the framework remains fit for purpose as more powers over tax and social security are devolved.

1.3 Under the Wales Act 2014 and subsequent Welsh legislation, two devolved taxes are collected in Wales by the Welsh Revenue Authority (WRA) – Land Transaction Tax (LTT) and Landfill Disposals Tax (LDT).

1.4 Following the passing of the Wales Act 2017, Welsh Rates of Income Tax (WRIT) apply from 6 April 2019 but are collected by HM Revenue & Customs (HMRC). The UK Government reduced each of the three rates of income tax (basic, higher and additional rate) paid by Welsh taxpayers by ten pence. The three Welsh rates confirmed by the National Assembly are then added to the reduced UK rates. The combination of reduced UK rates plus the Welsh rates determine the overall rate of income tax paid by Welsh taxpayers. The WRIT rates in 2019-20 have been set such that the tax rate paid by Welsh taxpayers is the same as that paid by taxpayers in England and Northern Ireland. The Welsh Government has committed to not increasing Income Tax rates during this National Assembly term.

There is no power to create, amend or remove income tax bands nor amend any income tax reliefs or allowances.

2 About us

2.1 The Chartered Institute of Taxation is the leading professional body in the United Kingdom concerned solely with taxation. 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. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties.

2.2 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. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

2.3 The CIOT’s 19,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

2.4 The Low Incomes Tax Reform Group is an initiative of the Chartered Institute of Taxation to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.5 LITRG works extensively with HM Revenue and Customs and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

3 Executive summary

3.1 Both Land Transaction Tax and Landfill Disposals Tax were developed through highly collaborative processes involving extensive informal and formal consultation the results of which are reflected in their final design, successful implementation and administration.

3.2 Changes to the devolved taxes are to some extent driven by changes made by the UK government to the predecessor taxes as a consequence of the effect of such changes on the Welsh government’s tax revenues through block grant adjustments. The need to make consequential changes may impinge on both stability and the ability of the Welsh government to consider change through collaboration and involvement of stakeholders particularly where changes are announced with little notice and an immediate adjustment is required to preserve revenue.

3.3 Wales has not introduced a Disclosure of Tax Avoidance Schemes regime therefore the WRA’s awareness of potential threats to the devolved tax base due to avoidance is more dependent on robust
strategies for assessing tax risk and from exchanges of information between HMRC and the WRA.

3.4 It is too early in the development and assessment stage to evaluate whether the proposed new taxes will, if taken forward, adhere to the Welsh Government’s tax principles.

3.5 We commend the current approach of promoting a positive case for taxation by illustrating the link between taxes and spend on public services in Wales and building knowledge and awareness of Welsh taxes across Wales. However, we are concerned that, anecdotally, awareness and understanding of the Welsh Rates of Income Tax by the public in Wales remains fairly low despite efforts to engage the public via the WRIT Communications Plan. We acknowledge the difficulty in generating interest when effective rates are unchanged.

3.6 The fact that income tax is only partially devolved with allowances, base and reliefs all decided at a UK level means that the scope for a fundamentally different approach to taxation and future tax changes has some limitations.

3.7 We consider that robust research is needed to establish Welsh taxpayer attitude to paying more or less tax in return for greater or less social funding, and how much increases in income tax rates would in fact increase the tax take taking into account behavioural effects such as migration across the porous Wales/England border.

4 Taxation: the Welsh Government’s tax principles, whether these have been met and whether the current tax regime and proposed new taxes align with these principles.

4.1 The Welsh Government’s tax principles, as set out in The Tax Policy Framework (published in June 2017 and re-affirmed in recent Tax Policy work plans) indicate that Welsh taxes should:

- Raise revenue to fund public services as fairly as possible.
- Deliver Welsh Government policy objectives, in particular supporting jobs and growth.
- Be clear, stable and simple.
- Be developed through collaboration and involvement.
- Contribute directly to the Well-Being of Future Generations Act goal of creating a more equal Wales.

4.2 Both Land Transaction Tax and Landfill Disposals Tax were developed through highly collaborative processes involving extensive informal
and formal consultation the results of which are reflected in their final design and successful implementation.

4.3 A key message resulting from the consultations was that LTT should be consistent, wherever possible, with Stamp Duty Land Tax (SDLT) legislation such that business and practitioners would be familiar with the concepts and operation of the new tax thereby promoting stability and clarity. SDLT, and therefore, LTT have elements of complexity, particularly the partnership provisions and the sections dealing with pre-completion transactions and freestanding transfers. However, these provisions, although complex, are now reasonably well-understood by professional practitioners who advise and operate LTT on behalf of their clients and therefore consistency with SDLT aligns with the principles.

4.4 Changes to the devolved taxes are to some extent driven by changes made by the UK Government to the predecessor taxes as a consequence of the effect of such changes on the Welsh Government’s tax revenues through block grant adjustments. The need to make consequential changes\(^1\) may impinge on both stability and the ability of the Welsh government to consider change through collaboration and involvement of stakeholders particularly where changes are announced with little notice and an immediate adjustment is required to preserve revenue.

4.5 Raising revenue to fund public services implicitly requires the Welsh Government to monitor threats to the tax base through evasion and avoidance. The Land Transaction Tax and Anti-Avoidance of Devolved Taxes (Wales) Act 2017 includes a targeted anti-avoidance rule (TAAR) that applies to any relief which can be claimed in relation to LTT. A general anti-avoidance rule (GAAR) in The Tax Collection and Management (Wales) Act 2016 applies to both LTT and LDT. Wales has not introduced a Disclosure of Tax Avoidance Schemes regime therefore the WRA’s awareness of potential loss of devolved taxes through avoidance is more dependent on robust strategies for assessing tax risk and from exchanges of information between HMRC and the WRA.\(^2\) We are aware that the WRA attends the quarterly meetings of the SDLT Working Together Steering Group as part of their extensive liaison with HMRC. Although it is too early in the lifecycles of the devolved taxes to assess levels of avoidance or evasion that may

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threaten the devolved tax base, it will be necessary to evaluate emerging data in the context of the WRA’s specific Welsh approach to delivering the devolved tax system in Wales (‘Our Approach’ enshrined in the Charter) that involves working in partnership with taxpayers, their representatives and the public.

4.6 The Welsh government is exploring four new taxes; a vacant land tax, a social care levy, a disposable plastics tax and a tourism tax. Two of these taxes address local issues and aim broadly to contribute to local development (vacant land tax and a tourism tax), one is to influence consumer behaviour (single use plastic) whilst a social care levy would need to link to the taxpayer’s status and eligibility to claim benefits. The Welsh government is seeking new tax powers for a potential vacant land tax under the Wales Act mechanism by which new tax powers can be devolved. Once the powers have been devolved, it is understood that consultation with stakeholders will form part of the work to be undertaken.

It is too early in the development and assessment stage to evaluate whether the proposed new taxes will, if taken forward, adhere to the Welsh government’s tax principles. Given the different policy intent underpinning the proposed new taxes, it will be necessary to evaluate them not only as individual taxes as they are developed but also holistically, whether overall the devolved tax system adheres to the tax principles.

4.7 Preliminary work has been undertaken in relation to a vacant land tax with research on stalled sites in Wales. The broad objective is to increase the cost of holding vacant land to encourage the building of new homes and increase commercial development. At this early stage, we note only the practical challenges in implementing a vacant land tax in a way that is both clear and simple. Definitional issues include defining the target sites that are not being developed including land that potentially straddles different planning authorities or the Welsh/English border, and what is meant by a ‘vacant’ site. The basis of the charge is likely to require a valuation process that may prove challenging to both the taxpayer and the taxing authority. Stability may be affected by potential unintended consequences such as adversely influencing developers to choose to develop sites outside Wales because of the imposition of vacant land tax. The introduction of exemptions or reliefs (eg for public sector held land) would inevitably compromise simplicity to some degree.

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3 https://gov.wales/developing-new-welsh-taxes
4.8 Although a vacant land tax is likely to be behavioural rather than primarily revenue raising, an effective and efficient system of collection and compliance comes at a cost (again, to both the taxpayer and the taxing authority), that cost recovery will need to be built into the vacant land tax charging scheme.

5 **Taxation: How successful the administration of Welsh taxes and the Welsh Rates of Income Tax has been**

5.1 Welsh rates of income tax are paid through PAYE for employees, or are deducted by the pension provider in respect of pensions. HMRC add a ‘C’ to the start of tax codes to identify a Welsh taxpayer. In theory Welsh taxpayers will have therefore noticed little change in how HMRC collects their income tax, other than to their tax code which should now begin with a ‘C’. Welsh taxpayers generally have not needed to take any action unless they need to advise HMRC of a change of address. However, it is important that individual taxpayers have sufficient awareness and understanding about their PAYE code such that they realise it is their responsibility to contact HMRC if it is incorrect. Although at present while rates remain aligned correct coding has little practical effect for an individual taxpayer, it does affect the Welsh Government’s revenue stream. We are concerned that, anecdotally, awareness and understanding of the WRIT by the public in Wales remains fairly low despite efforts to engage the public via the WRIT Communications Plan. We acknowledge the difficulty in generating interest when effective rates are unchanged.

5.2 In terms of employers, in practice, we have seen some evidence of employers (and payroll operators) contacting HMRC and employees in relation to Welsh taxpayer status issues, for example if they think an employee should have a C code, but they do not. We also note that as part of the preparation of the 2019/20 PAYE Settlement Agreement (PSA) calculations, employers have had to prepare a separate calculation in respect of employees who are Welsh taxpayers for the first time. The method for doing this relies on identifying those Welsh taxpayers using their PAYE tax code (those with a C prefix). Employers and advisers have placed reliance on the accuracy of the tax codes that have been supplied to them by HMRC in preparing these computations and apportioning out amounts that relate to Welsh tax payers. If the Welsh income tax rates or bands are changed, then employers will likely continue to rely on the accuracy of the tax codes they hold for

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4 Section 116E of the Government of Wales Act 2006 defines who is a Welsh taxpayer
5 A PAYE Settlement Agreement (PSA) allows employers to make one annual payment to cover all the tax and National Insurance due on minor, irregular or impracticable expenses or benefits for employees.
each employee in order to correctly calculate their PSA liabilities in future tax years (as they have been in similar circumstances for Scottish tax payers this year).

5.3 Our members indicate the administration of LTT and LDT is robust and successful. The WRA has developed effective guidance and digital systems. The WRA’s guidance is well-developed with regular updates and includes meaningful examples and illustrations. The CIOT has recently commented on the WRA’s guidance building on an earlier submission⁶. Members report the LTT tax opinion service is working well to provide certainty of tax treatment for practitioners.

5.4 Systems and processes for the administration of devolved taxes have proved resilient in the face of unexpected disruption. As the WRA’s IT systems are fully cloud-based, administration appears to have been largely unaffected by both the recent flooding of the WRA offices and by the coronavirus pandemic forcing staff to work from home - subject to their internet connection.

6 Taxation: What possible future tax changes could look like and what scope there is for a different approach to taxation in Wales.

6.1 We do not provide views on the future required level of taxation, nor do we offer comment on where the burden of taxation should fall as these outside our remit. We commend the current approach of promoting a positive case for taxation by illustrating the link between taxes and spend on public services in Wales and building knowledge and awareness of Welsh taxes across Wales.

6.2 The fact that income tax is only partially devolved with allowances, base and reliefs all decided at a UK level means that the scope for a fundamentally different approach to taxation and future tax changes has some limitations. For example the power to vary income tax rates in Wales applies only to non-savings and non-dividend income,⁷ ie ‘earned’ income, leaving Wales particularly exposed to behavioural effects such as potential increases in tax-motivated incorporation or choosing to extract more income that is not liable to WRIT such as investment income or realising capital gains to meet their ‘income’ needs. Partial devolution also presents challenges in design of new taxes such as the social care levy.

⁶ https://www.tax.org.uk/sites/default/files/200417%20Welsh%20Revenue%20Authority%20guidance%20-%20CIOT%20comments.pdf
⁷ Non-savings and non-dividend income includes employment income, self-employment profits, rental profits and pension income (including the state pension).
6.3 Devolution in this partial manner, which is also the case for Scotland, creates considerable complexity and compliance burdens not just on the individuals but also on their employers and pension providers. In terms of complexity it is notable that many Scottish taxpayers cannot easily work out their own tax liability as a result of the Scottish income tax rates.

6.4 As we noted in our response\(^8\) to the Finance Committee's Inquiry into the impact of variations in national and sub-national income tax, we consider that research is needed to establish Welsh taxpayer attitudes to paying more or less tax in return for greater or less social funding, and how much increases in income tax rates would in fact increase the tax take taking into account behavioural effects such as migration across the porous Wales/England border to escape a future social care levy and migrating back to benefit from better social care in later life.

6.5 As reflected in the 2019 Welsh Tax Policy Report a programme of work is in train to review and reform the local government finance system, including one of its key component parts - non-domestic rates. One of the alternative approaches being explored is the idea of a local land value tax as a potential replacement to council tax (residential property) and non-domestic rates (non-residential property). We recognise that policy development is at a relatively early stage and largely focused on research. However, we make some observations on the features of council tax/ non-domestic rates and a land tax below at 6.6 and 6.7.

6.6 Council tax tends to be unpopular in part because it is a ‘dry’ tax charge, that is, it is levied when no monies are generated with which to meet the liability, and in part because of its visibility; it is administered by regular demands for payment in contrast to less obtrusive income or national insurance taxes. The same would be to some extent true of a local land tax although there may be alternative means of collection for both council tax or a local land tax that could be considered, such as the approach in Ireland of providing an option to have local property tax withheld from pay or pensions.\(^9\)

6.7 Non-domestic rates are distinguishable from a land value tax (which is widely promoted by economists and others as an intrinsically sounder system) by certain key features that include the following:

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• there are exemptions from non-domestic rates, notably for agricultural land and in the case of occupiers who are charities (whereas the arguments on which land value tax are based would tend to suggest there should be few if any exemptions),

• Non-domestic rates are based on rateable values, its annual rental value, so any building or improvement which increases the rent-earning capacity of the property is penalised by leading to a higher rateable value. In contrast the base for calculation of land value tax is the notional value of the land alone. There is however the practical issue of identifying the unimproved site value of land separately from non-land elements of value.

• Non-domestic rates are charged on the occupier rather than the landowner. This last feature is of considerable importance, but maybe not as much as first appears. Whenever a business takes a lease of a property on which it will pay rent, the non-domestic rate cost that will also be taken on in consequence, is known within a much greater range of certainty than many other costs and benefits of taking out the lease of that property in that location. It seems reasonable to suppose that there is a strong inverse relationship between rental and non-domestic rates levels, such that much of the effective economic cost falls on the landowner. This is often forgotten in calls by hard pressed business sectors for non-domestic rates relief.

Alternative approaches to taxing non-residential property that have the advantage of removing distortions in economic behaviour also present clear political challenges in design to avoid perceived inequities and practical matters, such as the way in which values would be assessed. The technical difficulty of how to value unimproved land, while not insurmountable, is generally regarded as one of the more significant challenges.

6.8 Finally, it is also worth noting that the coronavirus pandemic has highlighted the fact that in order to ensure the tax system and the devolution settlement are as effective as they can be in terms of future changes, there needs to be proactive co-operation between the Welsh and UK governments.

7 Acknowledgement of submission

7.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation and
the Low Incomes Tax Reform Group are included in the List of Respondents when any outcome of the consultation is published.