Chartered Institute of Taxation

30 Monck Street
London SW1P 2AP
T: +44 (0)20 7340 0550
E:post@ciot.org.uk

The Finance Committee of the National Assembly for Wales

Inquiry: Impact of variations in national and sub-national income tax

Joint Response by the Chartered Institute of Taxation (CIOT) and the Low Incomes Tax Reform Group (LITRG)

1 Introduction

1.1 The Chartered Institute of Taxation and the Low Incomes Tax Reform Group (LITRG) sets out below its joint response to the Finance Committee of the National Assembly for Wales' inquiry[1] on the 'Impact of variations in national and sub-national income tax'.

1.2 The inquiry, published on 14 October 2019 and closing on 15 January 2020, raises questions in respect of the possible impact of different income tax rates across the Wales-England border. The terms of reference of the inquiry are:

- To examine the effects of sub-national income tax variations in international tax systems on the behaviour of low, medium and high income earners, particularly migration and tax avoidance.
- To understand how low, medium and high income earners may respond to income tax rate divergence for each tax band between Wales and England.
- To understand the level of divergence in income tax rates that could trigger a behavioural change in low, medium and high income earners in Wales and England.
- To assess the monetary impact on WRIT revenue with varying levels of tax rate divergence.

1.3 In our response we concentrate on income tax, but it should be noted that there are many other factors that will affect where an individual, and their family, live, which we touch on below. We

[1] http://senedd.assembly.wales/mgIssueHistoryHome.aspx?IId=26476

suspect, for the vast majority of individuals, variations in income tax are unlikely to affect their behaviour (unless those variations are very significant).

1.4 Our response also draws on our experience of the variations in income tax rates and bands in Scotland.

2 About us

2.1 The Chartered Institute of Taxation (CIOT) 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 (LITRG) 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 & Customs (HMRC) 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 Overview

3.1 It is not possible in the time available to respond to this consultation to undertake the research we believe should be undertaken to ascertain awareness of the devolution of income tax powers to Wales amongst those living in Wales (and close to Wales) and what these powers mean to Welsh taxpayers both in respect of paying tax to Wales and in respect of what those taxes pay for (the 'social contract'). For example, in Scotland the social contract has been a strong supporting narrative which resonates well. A document has been published on the role of income tax in Scotland's budget: https://www.gov.scot/publications/role-income-tax-scotlands-budget/.

3.2 We think that it will be important to undertake further work and research looking at different types of taxpayer and their attitude to paying more or less tax in return for greater or less social funding. For example, to what extent free education, free prescriptions, free social care, increased local authority funding etc could affect willingness (or otherwise) to pay or accept paying more income tax.

3.3 The research should also consider geographical differences, such as proximity to work, ease of travel across the Wales-England border, effect of house prices, rental costs and cost of living generally on individual choices as regards where they live and work, and to what extent changes in tax rates may influence decisions (as compared to other factors).

3.4 Another aspect to consider is whether income tax rates divergence might encourage or discourage migration to or from Wales and what effect that may have on house prices and rental costs in Wales (and whether that effect would be short or long term). For example, if a decrease in income tax rates were to encourage migration to Wales, would that in turn increase housing costs affecting the flow of migration?

3.5 Additionally, we think the research should look at how much increases in income tax rates would actually increase the tax take (because the increase in revenue from taxpayers who remain in Wales and continue to report high incomes is offset for example, by more Welsh taxpayers migrating to England to work because of the higher Welsh rates). It is even possible that such behavioural effects could exceed the direct increase from raising the rate, which although an extreme possibility, does highlight the importance of such research. (For similar reasons, it should not be assumed that reductions in the rate would reduce revenue pro rata.) One of the difficulties to be addressed is that researchers tend (and are maybe constrained) to aggregate behavioural effects to produce a single composite estimate of the sensitivity of reported income to the tax rate, though in real life its different components call for very different responses: for example, increased under-reporting can be addressed by enforcement action, other types of behavioural response such as tax-driven incorporation of businesses – see para 5.10 below - (or potentially in the future, migrating from Wales to escape a social care levy and migrating back later in life to benefit from better social care) can potentially be addressed by design features of the system. It is also possible that individuals will choose to extract more income that is not liable to the Welsh rates of income tax (such as investment income) or realise capital gains to meet their 'income' needs – see further below. In addition, reactions to increased tax rates can be emotional as well as practical and this may be influenced by a perception of what the extra money is spent on and whether that commands support.

3.6 We note that an additional rate of income tax of 50 per cent for incomes over £150,000 was introduced in the UK in April 2010. The additional rate was subsequently reduced to 45 per cent with effect from April 2013. HMRC's report in March 2012 'The Exchequer effect of the 50 per cent additional rate of income tax'[2] concluded that there was a considerable behavioural response to the rate change, including a substantial amount of short term forestalling: around £16 billion to £18 billion of income was estimated to have been brought forward to 2009-10 to avoid the

[2] https://webarchive.nationalarchives.gov.uk/20140206181159/http://www.hmrc.gov.uk/budget2012/excheq-income-tax-2042.pdf

introduction of the additional rate of tax. However, the report indicated that determining the true (longer term) underlying behavioural response to the additional rate was more challenging. The conclusion drawn from the 2010/11 Self-Assessment data was that the underlying yield from the additional rate was much lower than originally forecast, and that it was quite possible that it could be negative. The report points to difficulties in quantifying the longer term effect of the additional rate because of the perception that it was a temporary increase[3]. This issue remains politically and academically controversial – see for example https://fullfact.org/economy/did-cutting-50p-rate-tax-raise-8-billion/ - but one clear point is short-term effects including forestalling and more enduring effects can be very different in both their scale and nature.

3.7 It is also worth noting that the power to vary income tax rates in Wales applies only to non-savings and non-dividend income,[4] i.e. 'earned' income which leaves Wales particularly exposed to potential increases in tax-motivated incorporation. Variations in income tax rates internationally and in most sub-national systems (for example, the United States of America) apply to all income and not solely earned income. Additionally, in many international and sub-national systems, the 'states' are significantly larger than the four United Kingdom 'states'. The Swiss cantons are probably closer to the size of Wales than the average American state. A comparison of the federal with the cantonal systems in Switzerland might therefore repay study[5].

3.8 Direct comparisons with other international and sub-national tax systems may be limited given that (i) the sources of income subject to tax in those systems will be different and (ii) the proximity of the Wales-England border to a large number of the populace of Wales may be more significant than in other systems.[6]

3.9 This said, there can be variations in the rates of state and local income tax rates in the USA which are understood to affect behaviour. For example, residents of New York City may pay substantial state and city tax, but, we understand, commuters from Connecticut may pay much more modest levels. Similarly, many high earning Americans retire to Florida which does not impose personal income tax. The USA's states all have their own residence rules, and US citizens have to file tax returns, so day-counting is required, as well as identifying other factors which are used to determine residence – some of which may be considered manipulable (such as changing of driving licence details). At the extreme, this could lead to claims of residence in income-tax-free states on the basis of residences that might be considered holiday homes. We would expect some research to have been undertaken by the Congressional Business Office (CBO) or equivalent State-level bodies around these issues, which may provide the Finance Committee with some reasonable studies, albeit of a very different tax system.

[3] The increase was really only in place for one potentially unaffected year (2011/12) as 2010/11 was the first year of the increase making evaluation difficult for that year, while 2012/13 was affected by the announcement the new rate would end.
[4] Non-savings and non-dividend income includes employment income, self-employment profits, rental profits and pension income (including the state pension).
[5] Recent research on cantons levy wealth taxes at different rates is at https://www.cesifo.org/en/publikationen/2019/working-paper/behavioral-responses-wealth-taxes-evidence-switzerland
[6] It should be noted that Scotland and Wales are significantly different both in terms of the length of border relative to the size of the country and density of population along either side of the border.

3.10 It may be worth looking at variations in Ireland between taxation in the Republic of Ireland and Northern Ireland and the effect of living in an area of lower cost of living in Northern Ireland but working in say, Dublin where wages are generally higher. In particular, it is more beneficial for higher earners to be working in the UK compared to Ireland largely due to the Universal Social Charge (USC) in Ireland which is not payable in the UK.

3.11 As the Committee may be aware, a useful study has already been published by the Wales Centre for Public Policy[7]. This sets out some information in relation to demographics and geography, and looks at the implications for setting income tax rates. This may therefore provide a basis for further research.

3.12 With income tax only partially devolved, and the allowances, base and reliefs all being decided at a UK level, there is always the potential for unforeseen consequences or interactions – some will be administrative, others will be behavioural. Devolution in this partial manner, which is also the case for Scotland, creates considerable complexity, for example, many Scottish taxpayers cannot easily work out their own tax liability now.

3.13 The CIOT has carried out work to examine the consequences and interactions that arise as a result of the partial devolution of income tax to Scotland. In conjunction with the Institute of Chartered Accountants of Scotland, we formed the Scottish Taxes Policy Forum. This published the paper *Devolving Taxes across the UK: Learning from the Scottish Experience* in October 2018, alongside the results of a poll of Scottish adults commissioned by the CIOT.[8] The CIOT also commissioned a further poll in 2019,[9] which again focused on the public's understanding and awareness. We think the Committee could usefully examine the paper and the results of the two polls as part of this inquiry.

4 Response to the consultation - To examine the effects of sub-national income tax variations in international tax systems on the behaviour of low, medium and high income earners, particularly migration and tax avoidance.

4.1 For the majority of people non-tax factors such as family ties and responsibilities, cost of housing (buying or renting), availability of work (and travel links to work), cost of living, schools and social services are likely to be greater influences on where the individual lives than small variations in income tax. However, tax changes may have an impact at the margin, especially for high earners, influencing longer term decisions about whether or not to move in the context of 'a life event 'when say, a taxpayer changes jobs or downsizes. It is important to disentangle the effects of different taxes, for example Land Transaction Tax.

4.2 To the extent that variations in income tax rates affect behaviour we would suggest that the effect would be largely focussed on higher earners. Although whether small variations in income tax rates

[7] *The Welsh Tax Base: Risks and Opportunities after Fiscal Devolution* – Dr EG Poole, G Ifan (2 July 2018): https://www.wcpp.org.uk/publication/the-welsh-tax-base-risks-and-opportunities-after-fiscal-devolution/
[8] https://www.tax.org.uk/media-centre/press-releases/press-release-new-poll-discovers-more-four-fifths-scots-lack
[9] https://www.tax.org.uk/media-centre/press-releases/press-release-poll-scots-still-failing-understand-devolved-taxes-support

alone would cause a person to leave a location to which they are intrinsically linked is questionable, for those individuals that are ‘mobile’ as regards to choosing where they live and work, it is a factor that may be taken into account (amongst many others). Lower earners are often less likely to be ‘mobile’ in relation to these options.

4.3 Furthermore, while we would not expect to see tax avoidance schemes arising from small variations in income tax rates, differing rates across Wales, Scotland and the rest of the UK do present a compliance burden. That burden falls not just on the individuals but also on their employers, pension providers and HM Revenue & Customs (HMRC).

4.4 Individuals need to establish whether they are resident in Wales, Scotland or the rest of the UK for income tax purposes. Section 116E of the Government of Wales Act 2006 defines who is a Welsh taxpayer, the key elements being:

> **116E Welsh taxpayers**
>
> (1)For any tax year, a Welsh taxpayer is an individual (T)—
>
> > (a) who is resident in the UK for income tax purposes for that year (see Schedule 45 to the Finance Act 2013), and
> >
> > (b) who, for that year, meets condition A, B or C.
>
> (2)T meets condition A if T has a close connection with Wales (see section 116G).
>
> (3)T meets condition B if—
>
> > (a) T does not have a close connection with England, Scotland or Northern Ireland (see section 116G), and
> >
> > (b) T spends more days of that year in Wales than in any other part of the UK (see section 116H).
>
> (4)T meets condition C if, for the whole or any part of the year, T is—
>
> > (a) a member of Parliament for a constituency in Wales,
> >
> > (b) a member of the European Parliament for Wales, or
> >
> > (c) an Assembly member.

4.5 The provisions for determining who is a Scottish taxpayer are set out in section 80D of the Scotland Act 1998 and operate in an equivalent manner to the Welsh provisions. It is, in theory, impossible therefore for a UK resident individual to be considered (say) both a Welsh and an English taxpayer, or indeed neither. This is because the rules first require the individual to be a UK taxpayer (UK resident), and then move that person from the UK rules into the Welsh or Scottish rules (where that individual has earned income).

4.6 However, whilst there should be little scope for manipulation of the rules (at least without significant change to living – and therefore in most cases, working – patterns), there can be significant compliance effects. For individuals in employment HMRC has to notify the individual and their employer where they assess the individual to be resident. The employer then has to deduct income tax at differing rates and amounts depending on where the individual is resident (and not where the employer is resident or where the employee works). In theory, employers simply have to operate the tax code that applies, so in terms of everyday processing of pay, the different rates arising from sub-national regimes is not an issue. Although the responsibility for identification of an individual's residence status is that of HMRC, and it is up to the taxpayer to question HMRC's decision if they disagree (so the employers' role is simply to operate the PAYE code they are given), in practice, we find that employers (and payroll operators) are contacting HMRC and employees in relation to Scottish taxpayer status issues, for example if they think an employee should have an S or C code, but they do not. For individuals, it is important that they have sufficient awareness and understanding about their PAYE code such that they realise it is their responsibility to contact HMRC if it is incorrect.

4.7 Dealing with different tax rates and regimes can lead to errors and complications, which in turn creates additional burdens on all parties. For example, if employers process PAYE Settlement Agreements (PSA), they have to calculate the appropriate tax depending on taxpayer status – UK / Scottish / Welsh. In relation to childcare voucher schemes, however, they have to apply the UK thresholds to all taxpayers. Although that means some aspects are simple, there is the complexity and burden of having to learn and remember or work out when they need to separate out taxpayers of different residence status and when they can treat them all the same.

4.8 Complexity arising from income tax rates (and, in particular, tax bands) divergence is a real concern for many. While it may be tempting to think that 'software' will work it all out, our experience of the Scottish income tax variations is that it is now more difficult to work out a Scottish resident's tax liability and be sure that it is correct than before Scotland varied its income tax rates and bands. Also, not everyone has access to software and it is generally accepted that taxpayers should not have to pay for software to work out their sub-national income taxes.

4.9 There are also many situations where even HMRC's software is unable to correctly compute the tax due without manual intervention. For example, we were originally told that there would be no exclusions from Self-Assessment online filing that arise purely because a taxpayer has Scottish status. However, there is now a long list of exclusions that apply to Scottish taxpayers[10] and we are not convinced that the current exclusions list captures all the instances in which HMRC's software does not calculate correctly income tax liabilities for Scottish taxpayers. Some of the exclusions seem to be connected with the interaction of Scottish rates and bands for earnings, and UK rates and bands for savings income. So, part of the issue is definitely related to the UK personal savings allowance (and also dividend allowance). This suggests that Self-Assessment is not able to cope with the partial devolution of income tax at present, particularly with all the other current inherent complexities in the income tax system.

4.10 This said, in terms of PAYE and different rates and bands, we understand HMRC's system can cope with hundreds of different rates and bands, so this should not be a problem of itself, although we understand there were difficulties with inserting Scotland's 19% starting rate between the personal allowance and the basic rate band.

[10] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/761697/2017-18-exc-indi-v3.0.pdf

4.11 In terms of compliance with Scottish taxpayer status, we think this is yet to be tested, because divergence has not yet been significant enough to drive artificial behaviour in terms of trying to demonstrate residence in England rather than Scotland (for example, if you have two properties). An increase in such artificial behaviour would demand a rise in compliance activity from HMRC, placing a burden on resource.

4.12 Also, creating differing sub-national income tax systems causes problems not just for tax authorities in identifying where a taxpayer is resident but also for 'mobile' individuals. For example, is a university student resident at their university living space or their parental home living space (counting days of residence will result in very different outcomes for different students)?

4.13 Establishing the residence status of each individual, even where there is no income tax divergence, will be extremely important for the UK and Welsh governments, as it determines the allocation of tax receipts.

5 Response to the consultation - To understand how low, medium and high income earners may respond to income tax rate divergence for each tax band between Wales and England.

5.1 We note that research undertaken by the Institute of Fiscal Studies (IFS) found that fewer than twenty of Scotland's richest top earners would have to switch their main residence to England for Scotland to lose out on £20m of tax revenue. The IFS's research[11] also indicates that higher income individuals can be particularly responsive to tax increases. Variations in tax rates in the main affect high earners who are also mobile. It should be remembered that not only is this a question of high earners leaving the country, but also of high earners choosing not to come to the country. We understand that there are only four thousand additional rate taxpayers in Wales, with 85 per cent of taxpayers paying the basic rate. Wales only has control over 10p within each band with no powers over thresholds. So, for example, if Wales were to introduce a 1p reduction in the additional rate, it would not have much of an impact on that small tax base and would not encourage much by way of behavioural change in terms of its effects on Welsh revenues.

5.2 While genuine cross-border migration is costly, it is likely to be easier for those with multiple residences to change their tax residence within the UK. It is also notable that commuting for work (either way) between Scotland and England is likely to be more difficult than commuting between Wales and England. Thus, a divergence in income tax rates between Wales and England may have a greater marginal effect, particularly amongst middle and higher earners, than that between Scotland and England. This is an aspect that would need further research.

[11] https://www.ifs.org.uk/publications/12903

5.3 It is also worth considering to what extent people would actually notice and understand a small change in income tax rates? For example, the 2019 poll of Scottish public understanding and awareness of devolved taxes[12] referred to above (see section 3) is quite illustrative. This found:

- 91 per cent said they had little or no understanding of the definition of a Scottish taxpayer, an increase of 7 percentage points compared to 2018 – This may be because little was done to publicise Scottish taxpayer status since the original notification letters from HMRC in December 2015.

- 86 per cent think they need better information about how taxes are decided in Scotland. While this figure was broadly similar with the 84 per cent who gave a similar response in 2018, there was a net drop of six percentage points in the number of Scots who said that the relationship between Scottish and UK taxes was 'easy to understand'

- There has been a decline in the number of people who can correctly identify that responsibility for income tax was shared between Holyrood and Westminster, down from 34 per cent in 2018 to 26 per cent this year. Nearly half of Scots (48%, up from 41% in 2018) now think income tax is set wholly by the Scottish Parliament

5.4 Similarly, research published in September by Deloitte found a lack of awareness on issues related to tax across the UK (see https://www2.deloitte.com/uk/en/pages/tax/articles/tax-education-gap.html for details). In addition to this lack of awareness, there is also a proportion of individuals who do not support any devolution of tax at all (see for examples response to question 6 of the CIOT poll) and if, due to complexity, that proportion grows, one (unforeseen) consequence of devolution might be lower compliance and less buy-in to the tax system generally.

5.5 Key to acceptance of Welsh taxpayer status and any divergence in income tax rates will, we think, be based around how well the changes are publicised, how accessible clear guidance is, and how well-targeted any communications are. It will be essential that people actually notice the communications.

5.6 The experience from Scotland is that to date there is no clear evidence of significant behavioural effects in terms of migration (note since April 2018 there have been 5 rates and bands in Scotland (19%/20%/21%/41%/46%)) - although whether this is because of a lack of awareness of income tax in Scotland is another matter.

5.7 Another aspect that needs to be considered is how the self-employed (sole traders and partners in partnerships) could respond to a divergence in income tax rates. With earned income being liable to sub-national variations but dividend income (and corporation tax) being liable to UK national income tax rates, a variation in income tax rates between Wales and England could lead to some self-employed individuals incorporating their business to change the basis of taxation on themselves and their earnings (i.e. so that they pay corporation tax on the profits and dividend savings income tax on the withdrawal of profits from the business rather than Welsh income tax on

[12] The polling was commissioned by the CIOT and undertaken by Mark Diffley Consulting & Research using the ScotPulse survey. 1,122 adults were interviewed between 24 and 26 September 2019. An analysis of the findings and comparison with the survey undertaken in 2018 can be found at https://www.tax.org.uk/file/chartered-institute-taxation-2019-topline-71019docx

the profits of a self-employed business). Of course, other factors will influence whether incorporation of a business is the 'right' thing to do; tax is just one of many factors. A further feature is that some of these people (self-employed / partnerships) will be employers. Incorporation should not change the number of employees, but if the business were to move to England, that could reduce employment in Wales.

5.8 Other behavioural effects are likely to include: making more pension contributions / Gift Aid donations (both of these extend the basic rate band so giving relief from higher / additional rate tax); choosing not to take a pay rise /a promotion / increase work hours. These are more likely to affect middle or high earners. We expect these behaviours are more likely to be occurring in Scotland already, because they are easier than moving house, but research would be required to determine to what degree they are happening. There is not the data at present to enable this to be determined. In all cases other factors, such as those described above, would play a role too.

5.9 Although those on lower incomes are less likely to be able to respond to income tax divergence, they may nevertheless be affected. This may particularly be the case for individuals who pay income tax and who are also in receipt of welfare benefits, such as Universal Credit. For example, in theory, when the Scottish starter rate of 19% was introduced in April 2018, this was stated to mean that all those Scottish taxpayers with incomes up to £24,000 would pay £20 less tax over the course of the tax year than taxpayers living in the rest of the UK on the same level of income. However, Scottish taxpayers who were also in receipt of a means-tested benefit such as Universal Credit that depends on net income after tax, found that their benefit was reduced, cancelling out all or part of the tax reduction.[13]

6 Response to the consultation - To understand the level of divergence in income tax rates that could trigger a behavioural change in low, medium and high income earners in Wales and England.

6.1 We believe that research will be needed to understand what may trigger behavioural changes.

6.2 Factors that would need to be considered would be the age of the individuals (new to work, retiring), their family status (single, in a relationship, children), whether the divergence is a short term proposal or is supported by all political parties as a long term measure (locating in one state or another for a one or two year tax 'boost' is unlikely to affect the behaviour of many).

6.3 For example, short term divergences could easily trigger increased pension contributions or Gift Aid donations, but are less likely to drive behaviour that is more long term. Equally, a short term divergence (provided the public knew it was short term) might not cause, for example, someone to incorporate a business or refuse a promotion. In our opinion, divergences would probably have to be significant and long-term to result in migration out of a state. Migration into a state may be affected differently.

[13] The taper rate for Universal Credit was 63% in 2018/19, so for every £1 increase in net income due to the lower Scottish starter rate, a Scottish Universal Credit claimant saw a reduction of 63p in their Universal Credit award, meaning they would only see £7.40 of the £20 tax reduction in net terms over the course of the tax year. (Note that this is a simplified example).

6.4 The Scottish Fiscal Commission have included modelling for their forecasts, see http://www.fiscalcommission.scot/publications/occasional-papers/how-we-forecast-behavioural-responses-to-income-tax-policy-march-2018/, but it is very difficult to forecast what level of divergence may trigger behaviour changes.

6.5 Consideration needs to be given as to whose behaviour is changing, how it will be changed and the proportion of revenue they bring in. For example, if all the additional rate taxpayers in Wales left for England that would make a significant dent in Wales' revenue. Equally, if all higher rate taxpayers upped their pension contributions that would also have a significant impact, but their basic rate of Welsh income tax would still be received by Wales.

6.6 Anecdotally, we think that a 5% to 10% long term variation in income tax rates may be needed to have any significant effect on people's choices of residence. But, as noted above, we recommend further research in this area.

7 Response to the consultation - To assess the monetary impact on WRIT revenue with varying levels of tax rate divergence

7.1 We are not best placed to answer this question. We think that further research on this aspect will be needed. It is not simply a case of a decrease in income tax rates will result in less revenue for Wales, as a decrease (coupled with other factors) may result in more taxpayers residing in Wales. Similarly, an increase in income tax rates will not necessarily lead to an increase in revenue for Wales as it could lead to more people, particularly higher earners, deciding to reside elsewhere.

7.2 Equally, the timing of a policy change may affect when a behavioural change takes place. For example, an announcement of a change that is to have almost immediate effect is unlikely to have an immediate behavioural effect (except, perhaps, on someone who was in the process of deciding whether to relocate to or from Wales) but could have a longer term behavioural effect. Equally, a policy change that is announced significantly in advance of being implemented could result in behaviour changes to mitigate the effects of that policy change but, equally, adverse effects could be costed and mitigated (eg by promoting the benefits of the policy change). Overall, we think it is difficult to predict behavioural changes following a policy change and extremely difficult to cost future policy options.

7.3 The agreement between the Welsh Government and the United Kingdom Government on the Welsh Government's fiscal framework (December 2016) provides for behavioural effects to be accounted for in exceptional circumstances, where the effects are material and demonstrable, and only where both governments agree that it is appropriate to do so.

7.4 It is also worth noting that while Wales gains or loses from the full mechanical effect of changes in income tax, it only bears the behavioural effects on its proportion of the income tax rate. Hence, if the Welsh Government increases the top rate from 10% to 15%, it would retain the extra revenue raised from the additional 5% whereas in terms of behavioural response, the Welsh Government would only bear (in the absence of any inter-governmental agreement) the effect of that response on its share of the income tax rates (now 10%, 10% and 15%). The impacts on revenues from the rest of income tax (10%, 30%, 35%) and other taxes such as NICs would be felt by the UK government. This means the revenue losses (or gains) as a result of behavioural change following increases (decreases) in tax rates are smaller in Wales than if income tax and other taxes were devolved.

8 Acknowledgement of submission

8.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the inquiry is published.

The Chartered Institute of Taxation and The Low Incomes Tax Reform Group

14 January 2020