Background Paper

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Wealth taxes and devolution

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WEALTH TAXES AND DEVOLUTION

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1. Introduction

The UK, traditionally a highly fiscally centralised country, is partway through an extensive programme of tax devolution to the three devolved legislatures in Scotland, Wales and Northern Ireland. This programme of tax devolution is highly asymmetric across the three devolved nations and diverse across the taxes being devolved. A number of relatively smaller taxes have been or are being 'fully devolved', whereby legacy UK taxes cease to operate in the devolved nation and the devolved government becomes wholly responsible for establishing and administering any replacement tax.

At the other end of the spectrum there are plans to assign a share of Scottish VAT revenues to the Scottish budget, giving the Scottish Government no control over VAT policy, but with the aim to link the size of the Scottish budget to the growth of VAT revenues over time. In between are arrangements for the partial devolution of income tax in Scotland and Wales. Under these arrangements, the UK Government retains responsibility for defining the broad parameters of the tax, including the definition of the base, allowances and reliefs, whilst the devolved governments have varying scope to alter rates and (in the Scottish case) thresholds.

This programme of tax devolution is motivated by objectives to improve the accountability of devolved governments for their policy decisions, and to enable policy to better reflect the preferences of the devolved nations. But tax devolution can also entail costs and risks. These may include diseconomies of scale in administering separate tax systems, additional complexity and cost for taxpayers and employers, and a range of inefficiencies through inter-jurisdictional competition and agency problems.

This paper poses the question: if the UK were to introduce a net wealth tax, to what extent would there be a case for that tax, or elements of that tax, to be devolved?

The notion of a tax being devolved in this sense can include anything on the spectrum from full devolution, to some form of tax sharing arrangement where the devolved government can vary specific aspects of the tax within their territories, to revenue assignment.

To analyse this question, the paper draws on economic theory, the practical experience of recent tax devolution in the UK and lessons from other countries that operate a wealth tax at devolved level.

The paper focuses on the case for devolution to the UK's three devolved legislatures. There is no reason in principle why the same arguments could not be applied if considering the case for tax devolution within England, and this point is picked up separately.

The paper is structured as follows. Section 2 reviews arguments from the economic literature on the case for and against tax devolution, and considers which characteristics of a tax lend it to being more or less appropriate for devolution. Section 3 sets out the changing tax responsibilities of the Scottish Parliament, Welsh Assembly and Northern Ireland Assembly. Section 4 describes how various institutional arrangements – covering grant allocation, revenue forecasting and borrowing – are evolving alongside the changing tax responsibilities, and considers some of the lessons that have emerged from the recent experience of tax devolution in the UK. Section 5 reviews arrangements for and lessons from two European countries that operate wealth taxation at a subcentral level of government – Switzerland and Spain. Section 6 brings the preceding sections together to appraise the case for devolving a UK wealth tax. Section 7 broadens the discussion to consider devolution of a wealth tax within England. Section 8 concludes.

2. Why devolve?

If the UK were to introduce a wealth tax, what would be the case for devolving some elements of the design of that tax to one or all of the devolved parliaments in Edinburgh, Cardiff and Belfast? This section considers first the arguments for and against devolving fiscal powers generally. It then goes on to consider which factors are important in deciding whether or not a particular tax is suited for devolution.

A longstanding literature in economics – fiscal federalism – argues that fiscal devolution has the potential to improve economic outcomes through several channels (Oates 1999; Oates, 2005)[1]:

(1) Devolution allows spending and taxation decisions to be better tailored to the preferences of a subnational electorate. For example, citizens of one jurisdiction may have a preference for higher progressivity, or may be more willing to trade-off lower tax rates for lower levels of public spending. In this sense, the case for devolution becomes stronger the more that preferences for public services differ across subregions.

(2) Fiscal devolution can also enhance the accountability of devolved politicians, in the sense that it strengthens the linkages between devolved policy decisions and economic outcomes.

(3) Devolution can have wider benefits at national level if it enables divergent policy to inform analysis of policy effectiveness (this is sometimes known as 'laboratory federalism').

But tax devolution can also entail costs and risks (Rodriguez-Pose and Gill, 2005). These can include:

- 'Spillover effects' where the outcomes of subnational governments acting individually are suboptimal compared to outcomes under central government provision. One example is the possibility for downward competition on tax rates to compete for mobile tax bases.

- Spatial inequalities in public good provision, if territories within the nation have differing tax-raising capacities.

- Institutional burdens, including the risk of diseconomies of scale in administering different tax regimes, or challenges for taxpayers in understanding and complying with tax policy that differs across the country (or where the authority to tax a given base is shared across different levels of government).

The extent to which tax devolution might yield benefits and impose costs depends on a range of economic and institutional factors. These include, for example, the economic and political context (how divergent are public preferences for redistribution or public service provision? How mobile are tax bases across regions in response to tax rate differences?), the design of institutions and rules to support that devolution (for example, to what extent are any differences in tax capacity between regions equalised through inter-governmental grant, and to what extent does this undermine some of the accountability arguments for devolution?), and the nature of the powers devolved (Eiser, 2020).

[1] The fiscal federalism literature generally talks about 'fiscal decentralisation'; fiscal devolution is a particular form of decentralisation, whereby a degree of tax (or spending) control is devolved to a semi-autonomous level of government.

But *which* taxes might be more or less suited to operation by a subnational tier of government?

Economic theory traditionally argued that taxes with a redistributive or economic stabilisation element should be the responsibility of central government, with subnational governments relying mostly on taxes levied against relatively immobile and stable (over time) bases.

In practice, tax decentralisation in many countries has extended beyond this to encompass taxes with redistributive elements on relatively mobile tax bases. This reflects the reality that, whilst few taxes meet all the possible criteria for being appropriate for operation at a subnational level, there is a view, as highlighted above, that subnational governments should be reasonably reliant on own-source revenues on grounds of accountability (Bahl and Cyan, 2011). Linked to this is a view that tax autonomy at subnational level will improve the prospects of realising an 'economic dividend' of devolution (Pike et al., 2012).

In other words, the decision of which taxes to devolve reflects a trade-off between, on the one hand, a desire to assign spending and taxation levers to appropriate levels of government, and on the other hand, the objective that subnational governments should fund themselves through their own sources of revenue as far as possible. Furthermore, the allocation of a tax between different tiers of government does not need to be (and frequently is not) binary; instead, different tiers of government can (and often do) have responsibility for different aspects of the tax structure, or share the taxation of a given base.

Which factors might we want to take into consideration when deciding whether a particular tax is more or less suitable for devolution? The key criteria are likely to include the following:

- Public preferences: the extent to which public preferences over the structure or level of a tax might vary across subnations.
- Administrative efficiency: the extent to which different tax policy can be operated economically at subnational level.
- Tax base mobility: the extent to which the tax base is transferable across jurisdictional boundaries in response to tax policy differences.
- Inter-regional inequalities: the extent to which tax decentralisation might give rise to issues of inter-regional inequities, given the distribution of the tax base.
- Tax incidence: the extent to which the burden of the tax falls on beneficiaries of subnational government expenditure programmes. The case for devolution will be stronger where a tax levied by a subnational jurisdiction falls on (a majority of) residents of that jurisdiction (e.g. a residence based income tax), rather than say a tax on corporate profits, where the incidence of a different rate of corporation tax in one jurisdiction may fall on consumers in other jurisdictions.
- Visibility: the extent to which the tax is visible to the electorate, in the sense that the electorate is aware of its tax liability with respect to the subnational government.
- Revenue volatility: The extent to which a revenue stream is volatile annually or over the economic cycle (as subnational governments tend to have limited tools to manage such volatility).

Clearly any given tax might 'score' well on some of these considerations but not others. And it is often possible to design supporting institutions to mitigate some of the potential disadvantages

that any given tax might have. For example, grant mechanisms can be designed to offset problems of unequal tax bases; borrowing powers or grant design can offset issues of volatility – although these institutions can themselves create further risks.

In general, these considerations point to property and land taxes being at the most appropriate end of the spectrum in terms of tax devolution, followed by residence-based income taxes. Corporation tax no doubt sits at the other end of the spectrum given the mobility of the base, its volatility over time, the lack of visibility, and its incidence.

In Section 6 of this paper we will consider how a wealth tax measures up against these considerations.

3. Background to tax devolution in UK

The devolved legislatures in Scotland, Wales and Northern Ireland have, since their establishment in the late 1990s, exercised significant policy autonomy in areas including health, education, justice and policing, economic development, the environment, and culture and sport. They have traditionally had relatively less responsibility over tax policy. Only council tax and non-domestic rates were determined in Scotland,. Similarly, rates (council tax) and non-domestic rates were devolved to the Northern Ireland Assembly, although only council tax was devolved in Wales.

A significant programme of tax devolution has been underway to the Scottish Parliament in particular (following the Scotland Acts 2012 and 2016), and to the Welsh Assembly to a slightly lesser extent (following the Wales Act 2014).

This programme of devolution was instigated initially by the Calman Commission, which argued that the Scottish Parliament's imbalance between spending responsibility and revenue raising responsibility was problematic. It noted: 'Funding by block grant alone means that while the Scottish Parliament is completely accountable for the spending of its budget, it is not accountable for the total of that budget or how it is raised; it has no fiscal powers that can be used as policy instruments and it does not have a direct financial stake in the performance of the Scottish economy' (Commission on Scottish Devolution, 2009, para 3.87).

The Calman Commission recommended the partial devolution of income tax to the Scottish Parliament, alongside devolution of stamp duty land tax and landfill tax.[2] These recommendations became law through the Scotland Act 2012. The UK's stamp duty land tax and landfill tax ceased to operate in Scotland in April 2015, replaced by land and buildings transactions tax and Scottish landfill tax, both of which are administered by a new Scottish tax collection agency, Revenue Scotland.

The Calman Commission's income tax proposals were effectively superseded, before they were operationalised, by the recommendations of the Smith Commission.[3] The Smith Commission, set up following the Scottish independence referendum, recommended that:

- Non savings, non-dividend (NSND) income tax revenues raised in Scotland should be transferred to the Scottish Parliament, with the Scottish Parliament having the ability to vary income tax rates and bands in Scotland without constraint, but with the UK Government retaining authority to determine the income tax base, including the setting of allowances and reliefs.

- Air passenger duty (APD), a tax on passengers on flights from Scotland, should be devolved in full.

- A share of value added tax (VAT) revenues collected in Scotland should be assigned to the Scottish Parliament. Specifically, the first 10 pence of standard rate VAT and the first 2.5 pence of reduced rate VAT to be assigned to the Scottish Parliament.

- Aggregates levy, a tax on the extraction of aggregates, should be devolved in full.

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[2] The Calman Commission also recommended the devolution of the air passenger duty and aggregates levy, but these were not devolved until the Scotland Act 2016, following the Smith Commission.

[3] Technically a 10 pence Scottish rate of income tax operated for one year in 2016/17, but there was no budgetary impact of this in practice.

These recommendations were legislated for in the Scotland Act 2016. Scotland's new income tax powers became operational in April 2017, but implementation of the other three taxes has been delayed. In the case of VAT assignment this is because of difficulties in identifying a satisfactory methodology for estimating Scotland's share of VAT revenues. The devolution of APD and aggregates levy has been delayed by various legal and state aid issues.[4]

The Smith Commission argued that these new fiscal powers would 'strengthen the Scottish Parliament's ability to pursue its own vision, goals and objectives' and make the Scottish Parliament 'more accountable and responsible for the effects of its policy decisions and their resulting benefits or costs', ultimately making the parliament 'more responsive, durable and stable' (Smith Commission, 2014).

Once the programme of fiscal devolution is complete, devolved revenues (over which the Scottish Government can vary rates and bands) will account for around 37% of Scottish Government spending, rising to 48% once assigned VAT is included (Scottish Government, 2020).

In Wales, the Commission on Devolution in Wales (Silk Commission) was established in 2011 to review financial and constitutional arrangements. Its recommendations for tax devolution to Wales closely followed those of the Calman Commission for Scotland, and were enacted in the Wales Act 2014. As a result, the UK's stamp duty land tax and landfill tax both ceased to apply from April 2018, replaced by the land transaction tax and landfill disposals tax respectively. And from April 2019, a new Welsh rate of income tax (WRIT) was applied in Wales.

Under the WRIT, tax revenues from NSND income tax in Wales are shared between the UK and Welsh Governments. The three rates of UK income tax (basic, higher and additional) paid by Welsh taxpayers are reduced by 10 pence. The Welsh Assembly then decides on the rates that are added to this. If the Welsh rate is set to 10 pence for each band then there is no difference to the tax rates paid in Wales compared to England and Northern Ireland, for a given level of income, and the revenues from this 10 pence flat rate are transferred to the Welsh budget. The Welsh rate can differ across the three income tax bands but the Welsh Government cannot vary tax bands (in contrast to Scotland), nor any allowances or reliefs. The Welsh rate has to-date remained fixed at 10 pence, meaning that Welsh taxpayers pay the same tax rates as in England and Northern Ireland.

Echoing the Calman Commission, the Silk Commission made the case for tax devolution on the basis that 'because the budget comes largely in a grant from the UK Parliament, the Welsh Government and National Assembly for Wales are not accountable to the Welsh electorate for how revenue is raised in the same way that they are for how it is spent… changes to the existing system could deliver greater responsibility and empowerment to the Welsh Government'. (Commission on Devolution in Wales, 2012)

The WRIT brings devolved revenues as a share of devolved spending to 22% in Wales, compared to 7% before the Wales Act 2014 (Ifan, Siôn and Poole, 2019).

In principle both the Scotland Act 2012 and the Wales Act 2014 also provide the Scottish and Welsh Governments with the ability to introduce new taxes in devolved areas of competence, with the agreement of HM Treasury. In practice however, the Welsh Government has expressed

[4] Flights from the Highlands and Islands have been exempt from APD since 2001, but a continuation of this exemption under what is technically a 'new' tax would be subject to confirmation from the EU that the exemption is not in breach of State Aid rules. The aggregates levy is intended to create incentives to promote recycled aggregate by increasing the cost of first used aggregate. The British Aggregates Association (BAA) argues that some of the tax exemptions effectively create issues of State Aid.

frustration at the process, in relation to its attempts to introduce a land value tax in Wales (Welsh Government, 2020).

In Northern Ireland, air passenger duty on direct long-haul flights from Northern Ireland has been devolved (and zero-rated) since 2013.

Beyond this, discussions around tax devolution have focussed on the possibility of devolving corporation tax to the Assembly. The motivation reflects the perceived disadvantage to the Northern Ireland economy of sharing a land border with the Republic of Ireland, which has a very low headline rate of corporation tax of 12.5%. The Corporation Tax (Northern Ireland) Act 2015 provides for the Northern Ireland Assembly to have the power to set the main rate of corporation tax in respect of certain (non-financial sector) trading profits. Initially the expectation was that the power would be devolved in 2018, and the Northern Ireland Executive had stated its intention to introduce a 12.5% rate on that date. However the suspension of the Assembly between January 2017 and January 2020, and the emergence of the twin crises of Brexit and COVID-19, caused an indefinite delay to these plans, and the current administration has announced that it is no longer pursuing the idea of cutting corporation tax.

Whether corporation tax ever happens now looks very doubtful. Instead, the current Executive has announced an aspiration to establish a fiscal commission that will look at the idea of additional economic and revenue-raising powers for the Executive.

Table 1 summarises devolved taxation arrangements in Scotland, Wales and Northern Ireland.

TABLE 1: DEVOLVED AND ASSIGNED REVENUES IN SCOTLAND, WALES AND NORTHERN IRELAND

Tax	Date of transfer/ devolution	Forecast revenues raised 2020/21 (£m)	Collection authority	Degree of control by devolved legislature
Scotland				
council tax	1999	£2,100	Local authorities	Fully devolved; complete autonomy
non-domestic rates	1999	£2,749	Local authorities	Fully devolved; complete autonomy
land and business transactions tax (LBTT)	2015	£641	Revenue Scotland	Fully devolved; complete autonomy
landfill tax	2015	£116	Revenue Scotland	Fully devolved; complete autonomy
income tax	2017	£12,365	HMRC	Scottish Government sets rates and bands; reliefs/ allowances set by UKG
air passenger duty (renamed air departure tax)	tbc	£297	Revenue Scotland	Fully devolved; complete autonomy
VAT	tbc	£5,727	HMRC	Assigned revenues; no autonomy
aggregates levy	tbc	£57	Revenue Scotland	Fully devolved; complete autonomy
Wales				
council tax	1999	£1,673	Local authorities	Fully devolved; complete autonomy
non-domestic rates	2015	£1,136	Local authorities	Fully devolved; complete autonomy
land transactions tax	2018	£250	Welsh Revenue Authority	Fully devolved; complete autonomy.
landfill disposals tax	2018	£36	Welsh Revenue Authority	Fully devolved; complete autonomy
income tax	2019	£2,200	HMRC	Tax-sharing, see text
Northern Ireland				
rates (council tax)	1999	£1,340*	Land and Property Services	Fully devolved; complete autonomy
non-domestic rates	1999	N/A	Land and Property Services	Fully devolved; complete autonomy
APD on direct long-haul flights	2013	£2.3**	HMRC	
corporation tax	tbc	N/A	HMRC	Ability to vary headline rate

Notes:
* This figure of £1.34bn is the sum of forecast domestic and non-domestic rates revenues for both the district councils and the NI Executive (rates revenues are shared across both tiers of government).
** This is the cost of the policy decision to zero-rate long haul flights in 2020/21, which is reimbursed to HM Treasury from the NI Executive.

4. Institutional architecture to support tax devolution: grants, forecasting and borrowing

Going alongside the recent tax devolution to Scotland and Wales are new rules around: arrangements for the determination of the block grant from the UK Government; arrangements for tax forecasting; borrowing and other tools to manage forecast error; and principles for inter-governmental data-sharing, coordination and dispute resolution. These rules are set out in the fiscal frameworks for Scotland and Wales respectively (HM Treasury, 2016a and 2016b). It is important to sketch out some of these arrangements, as they indicate the context in which a devolved wealth tax would operate.

Consider first arrangements for the block grant. The respective governments agreed that, post tax devolution, the block grant from the UK to the devolved governments should continue to be determined by the Barnett formula.[5]

The challenge was to agree on how to make a deduction from the block grant each year which would reflect the revenues foregone by the UK government as a result of transferring a given revenue stream to Scotland/Wales – whilst simultaneously enabling the devolved governments to capture the revenue effects of any policy decisions it might make.

The process for adjusting the block grant also had to reflect various 'principles' that had been established by the Smith Commission (fiscal devolution to Scotland came before that for Wales, and the approach for Wales largely follows the Scottish approach). These principles included that:

- There should be 'no detriment' to the devolved budget from 'the decision to devolve'. In practice this means protecting the devolved governments from the effects of their relatively weaker tax bases (i.e. the fact that they raise relatively less tax revenues per capita from a given tax policy) at the point when tax devolution occurs.

- The UK government should continue to manage economic shocks and budgetary risks that effect the whole UK, given that the devolved governments do not have major borrowing powers or other tools to manage major cyclical tax revenue risks.

- But nonetheless that the devolved budget should 'benefit in full' from policy decisions by the devolved government that increase revenues (and conversely bear the costs in full of policy decisions that reduce revenues or increase expenditures).

[5] The Barnett formula has been used to determine grant allocations to the devolved institutions of Scotland, Wales and Northern Ireland since their establishment in 1999, and prior to that had been used to allocate to the Scottish, Welsh and Northern Ireland departments of the UK government since the late 1970s. The formula determines the change in the block grant by allocating the devolved budgets a population share of the change in 'comparable' spending by the UK government in England. For example, if the UK government increased spending on health in England by £1 billion, then the budgets of the Scottish, Welsh and Northern Ireland executives would increase by approximately £99 million, £57 million and £34 million respectively, since health is a devolved issue. The grant is not ring-fenced in any way. The Barnett formula is recognised as creating an outcome that is relatively generous to Scotland and Northern Ireland, but not to Wales, as a result of the starting baseline, perversities in how the formula has been applied, and population growth.

To operationalise these principles, a so-called block grant adjustment (BGA) is calculated for each devolved tax separately, and consists of two elements: an initial deduction and an indexation mechanism (Bell, Eiser and Phillips, 2016).

The initial deduction is equal to the tax revenues collected in Scotland/Wales in the year immediately prior to the devolution of the tax power. For example, if income tax is devolved in 2017–18, the initial deduction is equal to income tax receipts in Scotland in 2016–17.

The indexation mechanism provides a measure of the rate at which 'comparable revenues' have grown in the rest of the UK[6] (rUK) between the date of the initial deduction and any subsequent year. The BGA thus provides an estimate of a counterfactual: what level of tax revenue would have been raised in Scotland/Wales in any given year, had tax policy been the same in Scotland/Wales as in rUK, and had the tax base grown at the same rate in Scotland or Wales as in rUK over the period since the tax was devolved?

The key implication of the BGA arrangement is that, if the sum of the revenues raised from the devolved taxes is greater than the sum of the BGAs, then the Scottish/Welsh budget is better off than it would have been without tax devolution. This could happen under two circumstances: if the tax base grows relatively more quickly in Scotland/Wales than in rUK; or if tax rates in Scotland/Wales increase relative to those in rUK. Of course, the opposite is possible: the sum of revenues raised could be less than the sum of the BGAs, if the devolved tax base grows relatively more slowly or devolved tax rates are cut.

The arrangements for adjusting the devolved government's block grant thus include elements of equalisation and elements of incentivisation. The existence of the 'initial deduction' ensures that the devolved governments' relative spending power is not affected by the initial revenue transfer (no detriment from the decision to devolve). But once a revenue stream is transferred, the devolved budget is exposed in full to any differential growth in revenues relative to rUK revenues.[7]

These arrangements ensure that the devolved budgets benefit in full from policy decisions by the devolved governments that increase revenues, and conversely bear the costs in full of policy decisions that reduce revenues or increase expenditures; and that the UK government manages economic shocks and budgetary risks that affect the whole UK. If a major UK-wide shock (such as COVID) causes devolved revenues to fall, then as long as rUK revenues fall in a similar proportion, the devolved budget is protected by the corresponding fall in the BGA. However, the devolved governments bear the risk that their tax base might grow relatively less quickly over time compared to the equivalent rUK tax base, regardless of what might cause that.

Forecasts of devolved taxes in Wales are made by the Office for Budget Responsibility; for Scotland they are made by the Scottish Fiscal Commission, an independent fiscal forecaster established in 2018. The Scottish and Welsh governments can address forecast errors through access to limited borrowing powers and a 'reserve' which can be built up over time to smooth the effect of forecast error.

[6] In practice, rUK means England and Northern Ireland for the purposes of calculating the block grant adjustments for Scotland and Wales.
[7] Note that there is a slight but important difference in the way that the BGAs are calculated for Scotland compared to Wales. Note also that the same broad approach to adjusting Northern Ireland's block grant has been mooted for when corporation tax revenues are devolved, with an important exception – the UK Government has committed to adjust Northern Ireland's block grant to account for any rUK corporation tax revenues that are lost due to migration of the rUK tax base to Northern Ireland as a result of Northern Ireland's lower headline rate. In practice it is not yet clear how this calculation would be undertaken.

Newly established tax authorities (Revenue Scotland and the Welsh Revenue Authority) administer and collect revenues from the so-called 'fully devolved' taxes (i.e. taxes on property transactions and landfill). But HMRC continues to administer and collect income tax, using new rules to identify Scottish and Welsh taxpayers (discussed below).

What has the recent experience of tax devolution to Scotland and Wales taught us that might be relevant when it comes to thinking about the potential devolution of a wealth tax?

The first point to note is that the new powers have been used. Scotland has established a distinct five-band structure of income tax that sees Scottish taxpayers pay an average tax rate that implies an average tax rate up to three percentage points higher than an equivalent rUK taxpayer. Both Scotland and Wales have adopted different rate and band structures for land and property transactions taxes than apply in England. These differences bely the concerns of those who feared that political factors would constrain variation of tax policy and undermine the purpose of tax devolution.

But tax devolution has brought a number of challenges, some of which have been resolved more easily than others (Eiser, 2020). For example:

- There have been challenges in appropriately identifying who is a 'Scottish' or 'Welsh' taxpayer.[8] This was particularly the case in Scotland, where HMRC's automated processes for identifying Scottish taxpayers initially failed to identify 400,000 Scottish taxpayers. HMRC argues that these issues have been resolved, although the identification of Scottish and Welsh taxpayers is not simply a one-off exercise, but will require monitoring on a perpetual basis, given significant annual cross border relocation.

- Some unanticipated issues arose in relation to income tax reliefs provided at UK level when the Scottish Government introduced its five band income tax policy in April 2018. The narrowing of the basic rate of income tax in Scotland raised questions about the eligibility of Scottish taxpayers for the marriage allowance which is paid to certain 'basic rate' taxpayers. A change in UK legislation was required to extend the allowance to Scottish basic and intermediate rates[9] (Scottish Taxes Policy Forum, 2018).

- VAT assignment to Scotland has been repeatedly delayed because the UK and Scottish governments cannot find a satisfactorily robust way to estimate Scotland's share of VAT revenues. The two governments agree that asking businesses to report the locations of their input purchases and/or sales would be unnecessarily complex and onerous; but estimating the VAT share through annual survey data exposes the budget to significant volatility through survey error.

5. Devolution of wealth taxes in other countries

Two European countries operate a wealth tax at a subnational level – Switzerland and Spain. This section provides an overview of the 'devolved' aspects of wealth taxation in these two countries.

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[8] A Scottish (Welsh) taxpayer is one whose main place of residence, for most of the year, was Scotland (Wales).

[9] https://www.parliament.scot/S5_Finance/General%20Documents/20180220SFC_CO.pdf

In Switzerland, all 26 cantons levy a wealth tax. The Swiss Confederation has some role in ensuring broad harmonisation across Switzerland regarding the definition of the tax base and various procedural issues, but plays no role in harmonising tax rates. There is no Confederate level wealth tax.

The Swiss wealth tax is levied by the canton in which the taxpayer is resident or, in the case of property, in the canton where the property is located. All asset classes are subject to wealth taxation except elements of pensions. Exemption levels vary by canton but are always low in international comparison. In 2015, they ranged from 25,000 to 200,000 Swiss francs (£21,000 to £170,000). The wealth tax thus affects much of the middle class in addition to the wealthiest families (Brülhart et al., 2020).

Interestingly, the federal harmonisation rules only provide broad guidelines concerning valuation. As a result, different property valuation rules are applied by different cantons, for example in terms of capitalisation rates that are used to value investment properties, and the extent to which valuations rely on expert panels as opposed to formulaic approaches (Barmes, Eckert and Aebi, 2020).

Cantons can set wealth tax rates fully autonomously. Furthermore, in most cantons the municipalities within those cantons also levy a wealth tax (typically as a multiplier of the cantonal wealth tax), which is usually assessed and collected together with the cantonal wealth tax.

As a result, wealth tax rates vary significantly between the cantons and even between different municipalities within a canton. The maximum wealth tax rate, including the supplementary cantonal wealth tax and the municipal wealth tax, is approx. 1% in the canton of Geneva, 0.7% in Zurich and closer to 0.1% in Nidwalden. The progressivity also varies significantly across cantons. 1 million Swiss francs (£843,000) of assets would attract a tax liability of 1,328 francs, 2,126 francs, and 5,455 francs (£1,119, £1,790 and £4,600) respectively in Nidwalden, Zurich and Geneva (Barmes, Eckert and Aebi, 2020).

Additionally, cantons have some scope to vary tax rates on specific forms of wealth, for example some cantons levy higher/lower rates on certain types of property or certain types of business shareholdings.

There is some evidence of downward competition on tax rates in recent years, although this has arguably been fairly marginal. The absence of clear evidence of tax competition may reflect both an acceptance of wealth taxation – which has been in place for longer than income tax – and significant heterogeneity between cantons in relation to language and culture (Sandbu, 2019).

Given the significant variation in wealth tax rates across Switzerland, an obvious question that arises is the extent to which these heterogenous rates trigger a behavioural response (the relevant question for this paper is not whether taxpayers respond to wealth taxation generally, but specifically whether subnational variation in tax policy triggers particularly types of response, notably migration).

Recent research by Brülhart et al. (2020) exploiting cross-cantonal changes in tax rates over time finds that reported wealth holdings are highly sensitive to wealth taxation. The authors consider the impacts of a large and quasi-random tax cut in Lucerne in 2009 relative to the response to the smaller tax cut in neighbouring Bern. They find that the response of reported wealth is large. By 2015, the cumulative post-reform growth of total wealth was 40.6 percentage points larger in Lucerne than in Bern. The authors find that, of the 40.6% aggregate difference, 17 percentage points can be attributed to internal migration and a further 8

percentage points can be attributed to higher property values (which are directly related to migration). In sum (and as discussed further in Advani and Tarrant, 2020), this implies that 34% of the response to differences in wealth tax is induced by intra-national mobility.

In Spain, a wealth tax was introduced in 1977 and was retained until 2008 when it was abolished, only to be reintroduced again in 2011. The central government defines some of the broad parameters for the tax, including the definition of the assets that are subject to tax. The Spanish wealth tax is levied on individuals rather than families and is applied to net wealth on most types of asset, including property and financial assets held in Spain or abroad (Ramallo, 2020).

The Spanish government also sets national rules in relation to the exempt amount (personal allowance), tax rates, and tax exemptions – which include certain types of business, art, and primary residences. However, the autonomous communities (ACs) are not obligated to follow the national policy and have substantial autonomy to set their own rules. Of Spain's seventeen ACs, ten have set their own rules, with five following the national rules (the remaining two, Basque Country and Navarre, are fully fiscally autonomous).

As a result of this policy autonomy, the approach to taxing wealth differs significantly across ACs. Whilst the national legislation allows for a personal tax-free allowance of €700,000, some regions have set a lower personal allowance (in Cataluña for example it is €500,000). There is variation in rates too. The national level tax rates start at 0.2% and increase to 2.5%. The Balearic islands have established consistently higher rates, ranging from 0.28% to 3.45%, although the highest top rate is Extremadura's 3.75%. On the other hand, Madrid has established a 100% tax deduction, reducing effective tax rate to zero, whilst La Rioja is contemplating a 75% deduction (Ramallo, 2020).

Recent research finds that taxpayers' response to the reintroduction of the wealth tax was significant. Looking at the response in Cataluña specifically, Durán-Cabré, Esteller-Moré and Mas-Montserrat (2019) find that a 0.1 percentage point increase in the average wealth tax rate leads to a reduction in taxable wealth of 3.24% over four years. This response is found to largely reflect avoidance – and in particular changing asset and income composition to take advantage of (mainly business related) tax exemptions – rather than real responses.

Agrawal, Foremny and Martinez-Toledano (2020) find evidence for significant migratory responses to different rates of wealth tax across ACs. This effect is almost entirely driven by Madrid, which as noted above has a 0% top tax rate; there is limited evidence that individuals respond to smaller variation in rates across jurisdictions.

Both Spain and Switzerland therefore are characterised by significant subnational heterogeneity in the design of wealth taxation, and this heterogeneity does seem to create tangible behavioural impacts. But both countries have long been accepting of fairly competitive fiscally federal systems, with less emphasis on the pooling and sharing principles that have been a feature of the UK union.

6. Devolving a UK wealth tax? Appraising the issues

To what extent is there a case for devolving a wealth tax, or elements of a wealth tax, to the devolved institutions in Scotland, Wales and Northern Ireland? This section appraises a wealth tax in relation to the criteria discussed in Section 2 (public preferences; administrative efficiency; tax-base mobility; subnational variation in tax capacity; visibility; incidence; and stability).

Public preferences

As discussed in Section 2, the case for tax devolution is stronger where preferences over redistribution, or over the tax and spending mix more generally, differ over jurisdictions.

First of all, it is worth noting that survey evidence regularly shows that Scottish and Welsh taxpayers would rather pay additional taxes to their respective devolved governments than to the UK government. Most recently for example, in response to the question 'in general, if you have to pay more tax, would you prefer it went to the UK government or the Scottish/Welsh government', 61% of Scottish respondents and 59% of Welsh respondents said they would rather pay more to their respective devolved government, with 24% in both cases saying they would prefer to pay more to the UK government (Glover and Seaford, 2020).

This reflects greater levels of trust in the devolved governments relative to the UK government, and mirrors previous research for Scotland (Bell and Eiser, 2015). It does not in itself provide evidence that preferences over tax design differ. Indeed, Bell and Eiser (2015) found that even where Scots expressed a strong preference for a tax to be determined by the Scottish Government rather than the UK government, that was explicitly not in order for tax policy to be set differently in Scotland, but was purely a preference for the level of government that should be responsible. However, this observation in itself supports the argument that a new wealth tax might receive greater public support in the devolved nations if it was in some way the responsibility of the devolved governments.

What about public preferences over the design of taxation more specifically?

Preferences over tax and spend have typically been argued to be not significantly different in Scotland from elsewhere in the UK (Curtice and Ormston, 2012; Bell and Eiser, 2015; Henderson, 2014). More recent data is perhaps tentatively suggestive of a growing heterogeneity of preferences for redistribution of income. British and Scottish social attitudes surveys indicate that Scots have been consistently more likely to agree with the statement that the 'government should redistribute more' than those in England since 2009, with the gap widening in recent years; by 2017, 41% of respondents in England agreed with this statement compared to 56% of respondents in Scotland (Curtice, 2019). The British Social Attitudes Survey of 2016 found that 62% of Scots agreed with the statement that the government should tax and spend more, compared to 46–50% in English regions and 43% in Wales (Dunatchik and Smith, 2018).

Unfortunately, we are not aware of any evidence on the extent to which preferences over wealth taxation specifically differ across the UK nations.

In summary, whilst preferences over tax and spend, and tax progressivity are typically argued not to differ substantially across the UK nations, there is tentative evidence that more of a divergence is opening up in Scotland. But regardless of the structure of taxation, both Scottish and Welsh voters express a strong preference for additional tax liabilities to be paid to the devolved rather than the UK government, supporting the 'accountability' arguments for tax devolution described previously.

Administrative efficiency

How straightforward would it be to identify the taxpayers (and assets) whose liabilities would be paid to the devolved governments rather than the UK government, and how straightforward would it be to operationalise different wealth taxation policy at the devolved level?

The lessons so far from the Scottish income tax experience have been that identifying 'Scottish' taxpayers is not entirely problem free; but on the other hand that it has been relatively straightforward for HMRC to operationalise a different system of rates and bands in Scotland. HMRC currently estimates the costs of implementing the Scottish income tax arrangements (excluding the operational costs of policy change) at £24 million in total; 'operating costs' – which include the costs of managing the devolved system and the variation in tax policy – will cost just under £1 million in 2018/19 and just over £1 million in 2019/20 (UK government, 2020). These costs are charged to the Scottish Government.

Assuming the tax unit for the wealth tax was the individual (as opposed to family), then HMRC's existing rules for identifying Scottish and Welsh taxpayers for income tax purposes could be used to determine taxpayer status for a devolved wealth tax, and adopted for Northern Ireland as required. Under the rules for income tax, a UK taxpayer is defined as a Scottish/Welsh taxpayer if her main place of residence in any given year is in Scotland/ Wales. HMRC's existing technical guidance includes detailed consideration of the factors that determine whether a UK taxpayer's 'main place of residence' is Scotland or Wales – including cases where taxpayers have more than one residence during the year (either because they move during the year, or where they have more than one place of residence throughout the year).

A complicating factor in the case of a wealth tax is the treatment of land and property. It may make sense to tax land and property wealth on the basis of the physical location of the asset, rather than the location of residence of the owner. This would be consistent with the proposed design of a UK wealth tax more generally, where UK-based property held by non-domiciled residents would be subject to the tax. This is also how wealth taxation works in Switzerland and Spain.

Why might there be a case for taxing land/property on the basis of the physical location of the asset, rather than the residence of the taxpayer who owns the property? If a wealth tax were devolved and Scotland adopted different rates from England, then the fact that two identical properties in Edinburgh may face different tax rates by virtue of being owned by Scottish and non-Scottish taxpayers respectively, may be perceived as unfair and undermine trust in the tax (the counter argument of course is that if liability is based on physical location, then two identical Scottish taxpayers may face different tax rates by virtue of the location of their assets). More importantly, if the tax is levied on the physical location of property, then it becomes more difficult to avoid tax simply by seeking to change taxpayer status; in effect, defining liability on the basis of the physical location of land/property makes the tax base less mobile. Furthermore, to the extent that demand for property in a given territory may reflect the outcomes of devolved government policy-making, then there is a case for basing liability on the physical location of assets on grounds of accountability and incentivisation.

However, if tax liability depends on the physical location of land and property assets, this is likely to add further complexity to self-assessment taxpayer returns, and to HMRC systems (assuming for the moment that HMRC retains responsibility for collecting devolved revenues), even if the tax unit is the individual.

If the tax unit is the family rather than the individual, then existing criterion to determine Scottish/Welsh taxpayer status will need to be adapted. Defining Scottish/Welsh taxpayer status at a household level is likely to be more contentious than defining it an individual level, given the scope for different individuals within a household to have a variety of different circumstances within a given year. The challenge would not be insurmountable, but it would increase the administrative effort involved in devolving a wealth tax. This administrative effort would be higher if the exempt threshold were lower (as it would bring more households into tax).

Further complications are likely to arise in the case of trusts, foundations, and similar vehicles. As discussed extensively in Chamberlain (2020), the issues here are complex even at UK level, let alone at a territorial level within the UK.

Administratively it would be simplest to tax trusts at UK rates according to UK policy, in effect removing trusts from the purview of devolved taxation. But this would be unsatisfactory to the extent that it would provide strong incentives for Scottish taxpayers to place assets into trusts if, for example, a higher rate of tax were set in Scotland. Ultimately, analogous solutions to those proposed in Chamberlain (2020) would likely need to be imported to handle trusts that connect to people in multiple UK nations.

Tax-base mobility

How responsive would the wealth tax base be to different wealth tax policy within the UK? If the base was highly responsive – so that small differences in wealth policy triggered significant relocations of the tax base across the UK – this would significantly reduce the case for devolution of a wealth tax: devolved governments would have little incentive to increase rates for the purposes of raising revenue; indeed they may face incentives to cut rates in 'beggar thy neighbour' type approaches that result in a race to the bottom.

The cases of Spain and Switzerland discussed above show that the behavioural responses to different rates of wealth tax within a country can be large.

However, it is probably important to distinguish between two slightly different sorts of migratory response, which we could term 'real' and 'paper'. 'Real' responses include the physical relocation of taxpayers in response to changes in tax policy; 'paper' responses occur when a taxpayer is able to avoid the higher rates that prevail in one part of the UK not by genuinely relocating, but by reclassifying their taxpayer status relatively straightforwardly on paper.

There is a case for saying that a fiscal federal economist might be relatively unconcerned about 'real' migratory responses. The fact that taxpayers can choose their location based on the basket of taxes they face and public services they receive underpins the notion that fiscal devolution can support efficient public service delivery. However, this argument breaks down if the 'real' response is so substantial that devolved governments have significant incentives to reduce tax rates to capture the tax base from neighbouring jurisdictions. Such a situation can lead to downward tax competition and rates that are sub-optimally low across the whole UK.

'Paper' responses – whereby taxpayers can alter the jurisdiction whose tax rates they are liable for without physically relocating – are potentially more significant in undermining the case for tax devolution. Issues of tax design are important in influencing the extent to which subnational differences in wealth tax policy might trigger these sorts of response.

For example, the degree to which the tax base is responsive to within-UK differences in wealth tax rates (both in real and paper terms) might depend on the structure of the tax at UK level. It seems reasonable to assume that, any variation in wealth tax at devolved level is – initially at least – likely to be fairly marginal in the context of the prevailing UK policy. If the prevailing UK policy involves a high exempt threshold combined with high rates, then the resulting narrow base (few taxpayers) might be relatively responsive to inter-UK variation in rates. In contrast, a lower exempt threshold combined with lower rates might result in a tax base that was relatively less sensitive to variations in tax policy within the UK.

Other aspects around the design of the tax base will also influence the extent to which the base is mobile in respect of different tax policy within the UK. This is why rules around trusts and

similar vehicles discussed in the section on administration are critical in the devolution case. If higher rates in one region can be straightforwardly avoided by placing assets in a trust which is taxed at UK rates, then aspects of the base may be very responsive to variation in policy. It is also why clear rules around the definition of a Scottish etc. taxpayer are in place that limit scope for avoidance simply through the acquisition of another property in another part of the UK.

At this stage however, it is difficult to come to firm conclusions on what the behavioural response to within-UK differences in wealth taxation would be, reiterating the conclusion of Advani and Tarrant (2020) in the context of the UK-wealth tax more generally. It is also too early to say whether there has been any significant migratory response to higher rates of income tax in Scotland.

But the scope for responses will clearly be highly dependent on policy design, particularly in relation to the definition of the tax base, but also on the extent to which the tax is broad based or focussed on the very wealthiest.

If there is concern that devolution of a wealth tax might trigger some form of downward tax competition, resulting in rates that are socially sub-optimal, one solution – at least in the short term – would be to constrain the scope of devolved powers over the setting of rates or bands.

Inter-regional distribution of the tax base and implications for the block grant

It is quite clear that wealth is not evenly distributed geographically across the UK nations (nor indeed the regions of England). Data from the Wealth and Assets Survey shows that median net household wealth in 2016/18 was £295,000 in England, compared to £253,000 in Wales and £233,000 in Scotland. This in itself indicates that 'tax capacity', the amount of tax raised per capita from a given wealth tax, is also likely to vary across regions and nations.

The extent to which these differences in wealth distribution will translate into differences in tax capacity will depend on the tax exempt amount and the rate schedule adopted. A relatively high tax exempt amount would act to concentrate revenues in the places where relatively high wealth individuals reside, particularly if combined with high rates on those individuals. The distribution of relatively high wealth individuals is particularly skewed geographically, which is likely to exaggerate differences in tax capacity (Advani et al., 2020).

What does this imply for the devolution of a wealth tax?

It seems unlikely that the devolved governments would be willing to accept a situation whereby additional spending in a nation was directly proportional to the additional revenues from a devolved wealth tax (assuming revenues generated are relatively significant). Such a situation would enable the UK government to increase spending in England relatively more than it would enable the devolved governments to increase spending in Scotland, Wales or Northern Ireland. The devolved governments would argue that this went against the notion of the UK as a 'pooling and sharing' fiscal union.

It also raises a question about how revenues from the tax in England would interact with the Barnett formula. Revenues from a wealth tax in England would, if they led to increased spending on health, education, or other 'devolved' functions, generate a consequential increase in the devolved governments' block grants.

There is a solution to these issues, and that is to follow the arrangements adopted in recent rounds of tax devolution to Scotland and Wales. Under this model, an *initial deduction* would be

made to the devolved governments' block grants equivalent to an estimate of the revenues that the UK government would have raised from the UK wealth tax if that tax had applied in Scotland/Wales/NI in the year prior to it being fully devolved. In practice, estimating that initial deduction would probably mean there would need to be a transitional year in which the wealth tax applied UK wide in order to ascertain the revenues raised from that tax in each devolved nation in that baseline year. The value of that deduction (BGA) would then grow over time at the same rate as revenues from the wealth tax had grown in rUK.

This model would share the same broad characteristics as the model under which devolved income tax operates. Initial differences in tax capacity are effectively equalised away in full; but after this point, devolved budgets benefit from faster growth in revenues relative to the equivalent revenues in rUK (and conversely bear the costs of relatively slower growth), whether or not that differential growth comes from tax policy changes or a different performance of the tax base. The devolved budgets would be protected from UK-wide shocks that reduce revenues from a wealth tax (as such a shock reduces the size of the deduction that is made from the block grant). And taxpayers in devolved nations do not benefit from tax policy increases in rUK that do not apply in the devolved nations (as any increase in block grant flowing from higher UK government spending in England is offset by a higher deduction to that block grant due to higher rUK revenues from the wealth tax).

Nonetheless there are of course risks with such an approach. The approach implicitly assumes that, if a wealth tax were not devolved, then revenues to the UK government from Scotland, Wales and NI would grow at the same rate as in England; in other words, that the growth rate of English revenues is an appropriate and fair way to estimate the counterfactual 'how much revenue has the UK government foregone as a result of transferring revenues from a wealth tax to each of the devolved nations?'.

Of course this is a questionable assumption. Indeed the Wealth and Assets Survey indicates that median net wealth has grown more quickly in London and the South East of England than other parts of the UK over the past ten years. This is likely to reflect somewhat faster house price appreciation in these regions, combined with the rapid growth in financial wealth, which has tended to benefit the already wealthy. The devolved governments may well be unwilling to sign up to a framework that effectively requires them to match the growth rate of wealth tax revenues in England when that relative growth is largely exogenous to (i.e. cannot be influenced by) their policy responsibilities.

There may be alternative ways to calculate the indexation to the block grant adjustment that may be more amenable to the devolved governments. One of these may be to use a basket of English regions excluding London and the southeast to estimate the counterfactual. Another might be to move away from the notion of full revenue transfer all together, adopting instead an arrangement whereby the tax remains essentially reserved, but where the devolved governments have some scope to vary tax rates, and are able to capture the revenue effects of any tax rate differential. This approach would have two primary drawbacks. First, in the case where rates remain uniform across the UK, it does nothing to enhance the revenue autonomy or accountability of the devolved governments. Second, in the case where policy is varied, there would need to be a mechanism to estimate how much revenue the devolved government would have raised under the UK policy in order to estimate the revenue impact of the policy. This would not be uncontentious in the case of a wealth tax which may be subject to relatively high rates of behavioural response.

Identifying a mechanism for adjusting the devolved governments' block grants in such a way as to respect notions of 'fairness' for taxpayers in England and the devolved nations, whilst also

retaining the aspects of tax devolution that promote accountability, will be one of the major barriers to devolving elements of a wealth tax.

Visibility

The criteria discussed in Section 2 indicated that visibility of one's tax liabilities is an important factor in deciding on the appropriateness of a particular tax being devolved. If a taxpayer has little idea how much of a given tax that they pay over the course of a year (which may be the case with VAT for example), then devolving this tax may do little to improve the accountability of the devolved government for its policy choices.

A wealth tax, assuming it was paid through some form of self-assessment (see Troup, Barnett and Bullock, 2020), would be highly visible to those who were liable for it. As such it would meet this criterion for devolution.

Incidence

The criteria discussed in Section 2 also suggested that the incidence of a devolved tax should fall primarily on the beneficiaries of devolved government spending, again for the purposes of establishing clear lines of financial accountability between the devolved government and its electorate.

Assuming liability was based on residence, the incidence of a devolved wealth tax would fall primarily on the beneficiaries of devolved government spending. However, depending on the structure of the tax, its incidence may fall on a relatively narrow group of beneficiaries. If the incidence fell on a particularly narrow group of taxpayers, then this would mitigate against devolution of a wealth tax on grounds of accountability. To put this in some context, note that 56% of Scottish adults were liable for Scottish income tax in 2017/18.

Stability

Conventionally it is argued that taxes on highly volatile tax bases are inappropriate for devolution given that devolved governments typically do not have the tools required to manage that volatility.

Revenues from a tax on wealth would presumably be more cyclically volatile than revenues from the largest yielding taxes that are currently devolved in the UK. Advani, Chamberlain and Summers (2020) show that, depending on the specific measure of wealth used, UK wealth per adult declined by around 10% following the financial crisis, and has since increased by 30%.

Income tax is also potentially fairly volatile (UK revenues declined approximately 8% between 2008 and 2009). Most property based taxes such as non-domestic rates and council tax are very stable – (partly because the base is mainly determined by the number of liable properties, which is not very volatile, and partly because property revaluations are undertaken infrequently). In contrast, stamp duty on property transactions is a relatively volatile tax, since the base depends significantly on the number of transactions taking place, which is very responsive to economic conditions.

So it seems likely that a wealth tax would be more volatile than most existing devolved taxes, but not as volatile as taxes on property transactions, although the latter account for a relatively small proportion of devolved revenues.

But does the volatility question matter? It could be argued that, assuming a devolved wealth tax operated alongside 'block grant adjustments' of the sort described above, then volatility is less of an immediate concern, as the BGAs absorb that volatility.

That argument is of course true, as long as the volatility is symmetric between the devolved jurisdiction and the UK. In other words, as long as the business cycles of the devolved territories are correlated with the business cycles of the UK, then volatility shouldn't be an issue if tax devolution is operationalised alongside BGAs (or something similar). Evidence to-date suggests that the business cycles of UK territories are highly correlated, so perhaps the volatility question should be of secondary concern.

7. Devolution within England?

The discussion so far has assumed that the question of interest is whether a UK wealth tax could be devolved to Scotland, Wales and/or Northern Ireland.

In principle, the question of whether a wealth tax should be devolved within England would be subject to the same set of considerations around factors such as preference heterogeneity, base mobility, and so on.

However, if one is talking about devolution to English regions, an obvious stumbling block is that, with the exception of the Greater London Assembly, that are not currently political institutions at regional level that a wealth tax could be devolved to. To the extent that the main arguments for tax devolution are to improve the accountability of devolved political institutions, devolution of a wealth tax within England feels like the answer to a problem that does not currently exist.

In theory a wealth tax could be devolved to individual local authorities. In practice however the relatively small geographical size of these jurisdictions is likely to undermine the case for devolution of a wealth tax. At a small geographical level there would be far more scope for tax-base mobility, far greater challenges in identifying residence status, less of a correspondence between residence and benefit, and greater variation in tax capacity.

If it is felt that local government should have greater tax autonomy, it would make more sense to relax some of their existing constraints around council tax and business rates, or to consider other land and property based taxes. On average, around 21% of English local authorities' revenue is generated from council tax and 11% from non-domestic rates, with the remainder coming from central government grant (Amin-Smith Harris and Phillips, 2019), although in practice, local authorities' ability to vary tax policy, or even to capture the revenue effects of differential tax revenue growth over time, is very limited.

Within England there are also a number of combined authorities, sometimes with an elected mayor, and sometimes with a range of devolved policy responsibilities covering health, education and economic development. The largest of these combined authorities include the West Midlands and Greater Manchester, both of which cover populations of over 2.5 million.

There may in principle be a case for devolution of a wealth tax to these city-regional combined authorities. Arguably however, if there was appetite for further tax devolution, it would seem appropriate to start by relaxing constraints on the local operation of land and property taxes, rather than a new wealth tax (the city-regions do not currently have any significant tax powers beyond the individual authorities' council tax and non-domestic rates). Beyond this, partial devolution of income tax rate-setting may be the next best option, as suggested recently by the IFS (Amin-Smith, Harris and Phillips, 2019).

8. Conclusions

A number of characteristics of a wealth tax are likely to lend to its appropriateness as a tax to operate at devolved level. It is potentially quite a high yielding and stable tax, linked to residence and highly visible to those who are liable.

Nonetheless, devolving a wealth tax would bring a particular set of challenges. Whilst HMRC has already adopted a definition of Scottish and Welsh taxpayer status that could form the basis of a definition for wealth tax, additional issues around the location of physical assets and the taxation of trusts will require further consideration.

There remains significant uncertainty over the extent to which different rates of a wealth tax within the UK might trigger some form of migratory response. Evidence from Spain and Switzerland suggests that such levels of response can be substantial. If so, this may constrain devolved governments in their ability to vary wealth tax policy (or worse, bias devolved governments to only vary policy in a downward direction).

Evidence on the likely significance of these migratory effects in the UK is slim. But what we can say is that the way in which the tax base is defined will influence the size of the effect. Clear rules on what constitutes a 'Scottish' etc. taxpayer – which make it difficult to for a taxpayer to alter her residence status without real relocation – are critical. The taxation treatment of trusts and similar vehicles creates a further challenge in limiting the behavioural responses to a devolved wealth tax.

Whilst there is an established method for adjusting the block grants of the devolved governments to accommodate new tax powers, geographic variation in the growth of the tax base over time – for reasons largely exogenous to devolved government control – may cause some reticence on the part of devolved governments to take on wealth tax in such a framework.

Which particular elements of a wealth tax – if it were devolved – should devolved administrations have autonomy to vary, and with what degree of constraint?

One conclusion is that if a wealth tax was operated as a one-off, then the costs of operating that tax at devolved level are likely to outweigh any benefits. The administrative challenges of identifying taxpayer status would be almost as high as for a recurrent tax, yet it is unclear how a one-off tax would improve the accountability of the devolved parliaments; or how complications around the uneven distribution of the tax base, discussed above, would be addressed.

A second conclusion is that pure revenue assignment – where the devolved governments are allocated a share of the revenues raised in their jurisdictions but have no ability to vary policy – is again an approach for which costs are likely to exceed benefits. The prevailing view so far of Scottish VAT assignment is that the significant costs and risks around estimating the 'Scottish share' are likely to outweigh any benefits in terms of accountability.

Beyond these two points, any further conclusions are likely to be heavily influenced by aspects of tax design at UK level. A wealth tax involving a very high exempt amount – so that the tax is effectively a tax on the 'super wealthy' – would be less appropriate for devolution given the mobility of the base, its uneven UK distribution, and that, by excluding most of the devolved electorate from the tax, it would do little to improve accountability.

If the wealth tax were devolved, then it would seem most appropriate for HMRC to administer the tax in each of the devolved administrations. Requiring existing devolved tax authorities, Revenue Scotland and the Welsh Revenue Authority, to collect the tax at a devolved level would

presumably imply diseconomies of scale compared to what would be required to adapt HMRC's national approach with identifiers for taxpayer residence and asset location.

Partly because of this, and partly because of the need to mitigate the potential for behavioural responses, it would seem appropriate for the UK government to set the broad parameters for the tax base – including the type of assets the tax is applied to, allowances and reliefs, the treatment of debt deductibility, etc. For consistency, it would also make sense for the UK government to determine the rules and processes for valuation.

Although there is no constitutional requirement for it to do so, it would seem appropriate for the UK government to consult the devolved governments on these broad issues if the tax is ultimately to be devolved.

Devolved administrations could then be offered the scope to vary rates, and potentially thresholds, within their jurisdictions. The obvious question that follows is the extent to which they should have autonomy to vary rates and/or thresholds without constraint, or with predefined ranges. This is ultimately a political question – greater autonomy implies greater accountability but with the risk of larger divergence in tax policy and more significant behavioural responses.

There is also the question of whether the wealth tax should be devolved in full or shared – for example so that the UK rates were halved in the devolved nations, with the devolved governments responsible for setting rates 'on top' of this (with UK thresholds applying in the devolved territories). This would represent a relatively constrained degree of autonomy for the devolved governments. It may mitigate some of the effects of tax rate competition. But it would not mitigate any of the issues around administrative costs or the issues around interaction with the block grant.

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