The Scottish Government announced last week that the assignment of Scottish VAT revenues to the Scottish budget is likely to be delayed – possibly until after the fiscal framework review in 2022. Giving evidence to the Finance and Constitution Committee last week, Derek MacKay said: '*I am becoming increasingly minded to postpone VAT assignment until VAT powers can be further discussed at the time of the fiscal framework review*'.

Following the recommendations of the Smith Commission, around half of the VAT revenues raised in Scotland were to be assigned to the Scottish budget. Revenue *assignment* is not the same as *devolution* of tax powers – the Scottish Government was to have no power to vary any aspect of VAT policy. Instead, the Scottish budget would be dependent to an extent on the strength of growth of VAT receipts in Scotland relative to the growth of VAT receipts in rUK.

VAT assignment was initially pencilled in to take place in 2019/20, but now looks increasingly unlikely to happen before the next Holyrood parliamentary session.

So why the delay? Essentially, there has been no resolution to the problematic issue of how to reliably estimate Scotland's share of UK VAT receipts.

VAT is a complex tax that flows across companies located throughout the UK. Most if not all stakeholders agree that to ask businesses to report the locations of their input purchases and/or sales would be complex and onerous – particularly for business operating from locations across the UK. Instead, the objective was to estimate the Scottish share of VAT by estimating expenditure on VATable goods by Scottish households and visitors to Scotland.

But there is likely to be significant uncertainty in the resulting estimate of the Scottish VAT share. Despite a boost to the main survey of household spending, the proposed methodology relied at its heart on a survey of just 750 households. Consequently, it is likely that the Scottish budget could vary substantially simply as a result of random fluctuations in survey data from year-to-year – when that might not reflect to any strong degree what was happening to 'actual' Scottish VAT receipts.

And given that 'actual' Scottish outturn VAT receipts do not and never will exist, VAT assignment basically involves estimating something that doesn't actually exist with not very good data – arguably a strange way to enhance the financial accountability of the Scottish Parliament.

In its current form therefore, the VAT assignment proposal and methodology would bring risk and complexity to the Scottish budget, without any upside in terms of policy flexibility.

So a decision to delay VAT assignation seems broadly reasonable, but how can the VAT impasse be overcome?

One argument put forward is that what is needed is more and better data. ‘Better data’ in the sense of further boosts to samples, and ‘more data’ in the sense of more years of Scottish VAT estimates in order to understand better the risks involved. But neither of these things will overcome the fundamental uncertainties involved in trying to estimate a variable that will never actually be observed which is the root cause of the government’s (and parliament’s) reticence about VAT assignment.

A second argument is that Brexit might provide the opportunity to *devolve* VAT to the Scottish Parliament (EU laws preclude the devolution of VAT within a member state). It remains unclear whether VAT devolution will become legally permissible. This will depend on the form of post-Brexit relationship the UK has with the EU, and the UK may choose to remain within the EU VAT area post-Brexit, given increased scope for evasion and fraud if it does not.

But even if it is legally permissible, it is not clear how VAT devolution would resolve the estimation issue – we would still need to either estimate Scottish VAT revenues via surveys of expenditure, or to introduce a much more complex system of VAT reporting for businesses across the UK.

And it is not clear how the Scottish Government might exercise any VAT policy competence, particularly given that several of the more desirable reforms to VAT would be more difficult to implement unilaterally than at EU-level.

The reality is that few if any taxes are perfect candidates for devolution, but VAT is surely one of the least well suited.

But if VAT assignment is difficult and VAT devolution seems unlikely and of dubious merit, where do we go from here? Are there other taxes that would be better suited to devolution in place of VAT?

After income tax and VAT, the next most significant taxes in revenue terms are National Insurance Contributions and Corporation Tax. Whilst there might be some merit in devolving NICs (not least given its links with income tax), as a tax on the same base as income tax it may expose the Scottish budget to greater volatility – and there would be questions about NICs role as a contributory benefit that provides access to UK-administered benefits.

Corporation Tax is problematic to devolve given the mobility of the tax base – and whilst the UK Government has given the green light to Corporation Tax devolution in Northern Ireland, it is also seeking to recoup from the NI budget the impact of a lower headline Corporation Tax rate in Northern Ireland on reduced Corporation Tax revenues in the rest of the UK – which may reduce the extent to which politicians in Northern Ireland feel able to exercise their new fiscal power.

Beyond this, the most significant revenue streams (that are not already devolved) are the indirect taxes – on fuel, alcohol and tobacco. There may be some attraction to devolution of one or more of these taxes given that policy for health, transport and the environment is largely devolved.

If we have learnt one thing since the Smith Commission however it is that fiscal devolution can be a complex business (legal disputes have held up the devolution of Aggregates Levy and Air Passenger Duty, whilst VAT assignment has been delayed by administrative complexity). Any future recommendations for fiscal change will need to ensure that proposals are resilient to legal, institutional and administrative challenges.