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**To:** Finance & Resources Policy Board

**On:** 27 January 2016

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**Report by:** Director of Finance & Resources

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**Heading:** Commission on Local Tax Reform

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**1. Summary**

- 1.1 The Commission on Local Tax Reform recently published its final report following a period of evidence taking, investigation and quantitative analysis.
  - 1.2 The report outlines options for local tax raising, concluding that the current Council Tax system must end. No single option however is recommended, this being for political parties to determine. The Commission does recommend that any replacement tax should be progressive, stable, efficient and locally empowering. The Commission also acknowledges that distribution of local government funds will need to be reviewed and adjusted in the event of a new tax being introduced.
  - 1.3 The Commission outlines an expectation that the development of policies in relation to local tax will be put to the electorate in the Scottish Parliamentary election in May 2016.
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**2. Recommendations**

- 2.1 The Board is asked to note the publication of the final report of the Commission on Local Tax Reform (full report attached).
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### 3. **Background**

- 3.1 The Commission on Local Tax Reform was established in February 2015, with a remit to identify and examine alternatives that would deliver a fairer system of local taxation to support the funding of services delivered by Local Government. In doing so, the Commission would consider:
- The impacts on individuals, households and inequalities in income and wealth.
  - The wider macro-economic, demographic and fiscal impacts, including housing market and land use.
  - The administrative and collection arrangements that apply, including the costs of transition and subsequent operation.
  - Potential timetables for transition, with due regard to the 2017 Local Government elections.
  - The impacts on supporting local democracy, including on the financial accountability and autonomy of Local Government.
  - The revenue raising capacity of the alternatives at both local authority and national levels.
- 3.2 The Commission engaged with experts and a range of organisations to understand all aspects of the present Council Tax system, ranging from payment and administration to the impact on the services that it funds; actively sought the views of the public through a programme of listening events across Scotland, and issued a call for detailed written evidence and by an open access survey. The Commission also worked with Heriot-Watt and Stirling Universities to complete a comprehensive programme of quantitative analysis to understand the relationships between house and land values, the property stock and household incomes.
- 3.3 The predominant view of the Commission was that a replacement tax should be progressive, be based on domestic property and if proved feasible, also include income. The Commission found that the current council tax system was regressive, as proportionally more tax is paid by lower income households than higher income. It suggested that a wholly property based tax could not meet a fairness test.
- 3.4 In terms of collecting any new tax, the current collection infrastructure within councils could provide a basis for collecting a property based tax (and administering any reliefs); however there would be significant challenges in collecting a locally determined income tax.
- 3.5 Any changes agreed to the system of tax would require a transition period, both for new administration systems to be developed and the necessary legislation to be put in place; but also to avoid sudden tax changes for taxpayers.

- 3.6 The Commission reaffirmed that an effective local tax system is fundamental to delivering financial accountability for local government and supporting local democratic choice. It also confirmed that tax income for local authorities needs to be stable and predictable, as it does for tax payers; who also need to be assured that the tax they are levied reflects their ability to pay.
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## Implications of the Report

1. **Financial** – Council tax provides a significant proportion of the Council's income. Any reform or replacement of Council Tax could have a significant impact on the overall financial position and financial stability of the Council. The Council is also responsible for collecting Council Tax and retains the risk of non-payment.
2. **HR & Organisational Development** – *n/a*
3. **Community Planning** –  
**Children and Young People** – *n/a*  
  
**Community Care, Health & Well-being** – *n/a*  
  
**Empowering our Communities** – *n/a*  
  
**Greener** – *n/a*  
  
**Jobs and the Economy** – *n/a*  
  
**Safer and Stronger** – *n/a*
4. **Legal** – *n/a*
5. **Property/Assets** – *n/a*

6. **Information Technology** – any replacement for council tax will have significant implications for council tax collection systems and processes.
7. **Equality & Human Rights** -
  - (a) The Recommendations contained within this report have been assessed in relation to their impact on equalities and human rights. No negative impacts on equality groups or potential for infringement of individuals' human rights have been identified arising from the recommendations contained in the report. If required following implementation, the actual impact of the recommendations and the mitigating actions will be reviewed and monitored, and the results of the assessment will be published on the Council's website.
8. **Health & Safety** – *n/a*
9. **Procurement** – *n/a*
10. **Risk** – any replacement system of taxation would present a risk to both the councils current processes and potentially the councils financial stability.
11. **Privacy Impact** – *n/a*

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#### List of Background Papers

none

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**Author:** Alastair MacArthur, Head of Finance 0141 618 7363



# The Commission on Local Tax Reform

Volume 1 –  
Just Change: A New Approach  
to Local Taxation



December 2015



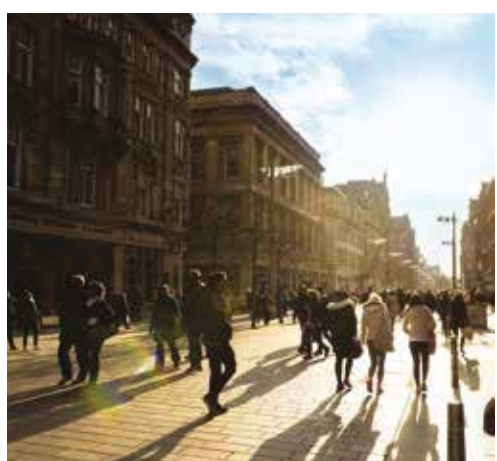
THE COMMISSION ON  
LOCAL TAX REFORM







# Contents



1_	Introduction	2
2_	The Case for Change	4
3_	Taxation and Funding for Public Services	8
4_	Our Approach	16
5_	Can a Local Tax be Fair and Equitable for Everyone?	24
6_	What are the Wider Impacts of Alternative Local Taxes?	36
7_	How Can Alternative Taxes be Administered?	40
8_	When and How Could an Alternative Tax be Implemented?	48
9_	Understanding Local Taxes	56
10_	Local Tax and Local Democracy	62
11_	Certainty for Taxpayers and Local Government	68
12_	What the Evidence Tells Us	74
13_	Conclusions and Recommendations	78
14_	Our Remit	82
15_	Members of the Commission	84
16_	Glossary	86



# Introduction

01





Marco Biagi MSP



Councillor David O'Neill



It has been our privilege to chair the Commission on Local Tax Reform to consider alternatives to the present Council Tax. In presenting this report, we would like to express our sincere thanks to the experts who gave us the benefit of their wise counsel, the people who engaged with us in our oral evidence sessions, those organisations and individuals who responded to our call for written evidence, the many people who participated in our public listening events across Scotland and the thousands who responded to our online survey. We are indebted to you all.

Other bodies have considered alternative means of local taxation, but the Commission on Local Tax Reform is the first to have a membership of representatives from four political parties and from local and central government working alongside experts in public finance, law, housing, welfare and equalities. This alone is a unique and bold statement of intent and we are determined that this work will effect change.

Our approach was evidence based and open minded. All Commissioners sought to explore and understand issues such as why different opinions are held by the public, what the data shows, the experiences of local tax reform in other countries and why some systems of taxation might be more difficult to administer than others.

This report sets out the factual position associated with different systems of local taxation. We do not advocate a single preferred alternative as that ultimately must be a political choice, but we do expect that Scotland will be offered alternative systems of local taxation in the Scottish Parliamentary election in May 2016. Our intention is that this report serves to inform the design of those alternatives – by any political party – and most importantly, also helps the public understand the implications of the choices they are offered.

A handwritten signature in blue ink, appearing to read 'Marco Biagi'.

Marco Biagi MSP, Minister for Local Government and Community Empowerment

A handwritten signature in blue ink, appearing to read 'David O'Neill'.

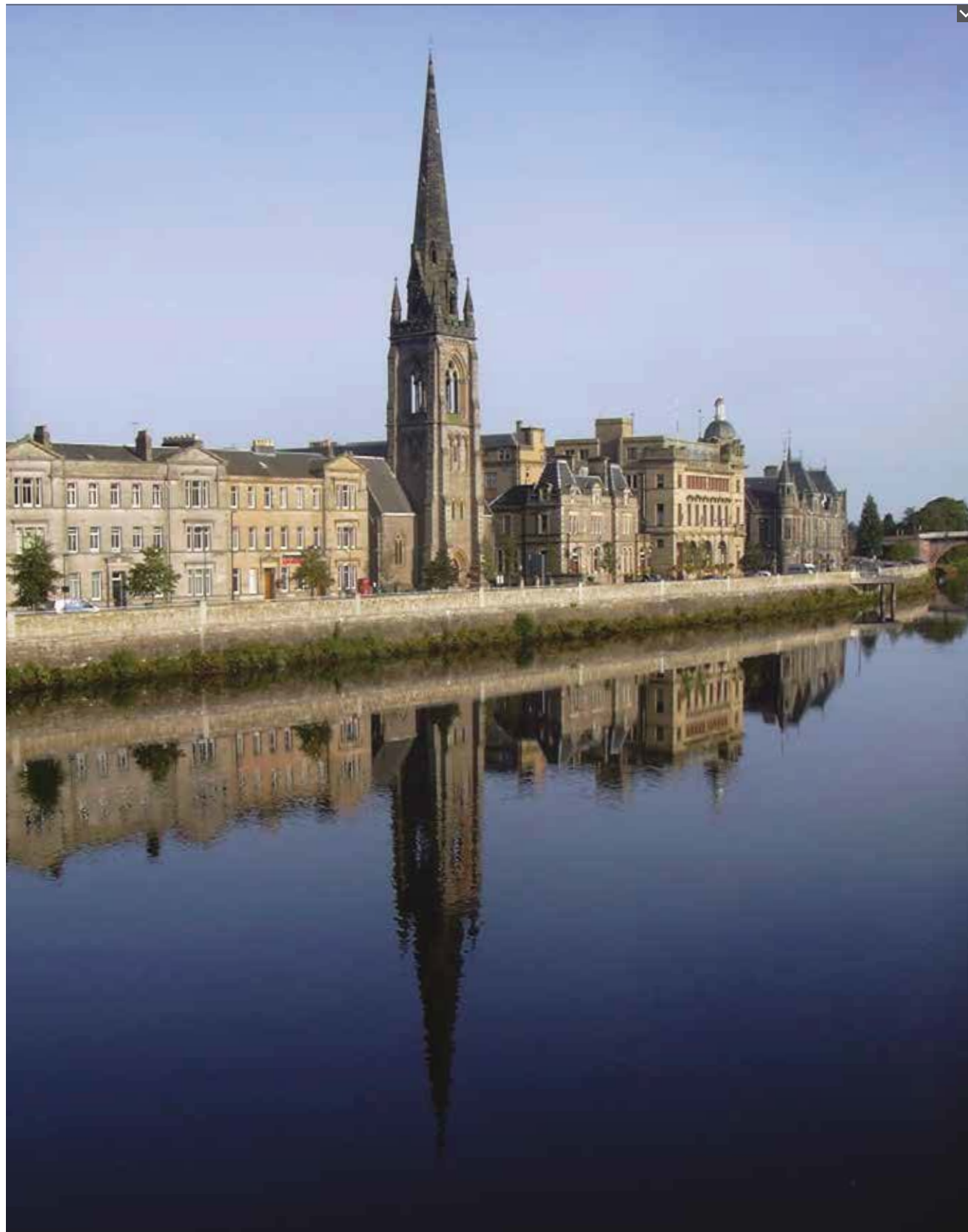
Councillor David O'Neill,  
President of COSLA



# The Case for Change

02

- 2.1 Since its introduction in 1993, the design of the Council Tax has remained almost completely unchanged. The most striking consensus from all of the evidence that we received is that this cannot go on, and we have come to agree that local tax now therefore needs substantial reform.
- 2.2 The reason for this is simple – some people are paying more than they should. This is not a new realisation, yet previous attempts at reform over the past 25 years have failed. These failures have real consequences for households and communities across Scotland. The opportunity for reform cannot be missed again.
- 2.3 Even by its own test of charging households amounts based on the value of the property they live in, the present Council Tax system falls short. People in the most expensive homes pay no more than 3 times the tax on the lowest value homes, even though we estimate those homes, on average, are now worth around 15 times as much. That means people in less expensive homes are paying a higher proportion of their property's value in Council Tax than those in the most expensive homes. And all charges are based on not what the property is worth now, but what it was worth in 1991. For newly built homes, an estimate must be made of what it would have been worth in 1991.
- 2.4 Council Tax is based on the value of the property occupied by the household, so the connection between how much a household has in income and how much it pays in tax will always be looser than if the tax were to be based directly on income. Many reasons can be advanced for taxing property rather than, or alongside income, but in the case of the present Council Tax, the evidence shows that the amount being charged is simply too disproportionate to income to be justified. Paying Council Tax bills costs middle income households 4% of their income on average, compared to 2% for the average highest income households.
- 2.5 Households can have their Council Tax bill reduced on grounds of their income and needs through the Council Tax Reduction scheme, but those households have to have very low incomes indeed. Households with modest incomes or with incomes that vary week-to-week need more help.



- 2.6 The present Council Tax has therefore rightly become discredited in the eyes of the public, and in our participation sessions across Scotland, it was made clear to us that people expect a change.
- 2.7 For eight consecutive years Council Tax bills have been frozen. But this cannot go on forever. Local tax and the funding of local services should be a central part of local democracy, with voters able to make choices about how much tax they should pay and for what level of public service.
- 2.8 History, however, shows that replacing or reforming a tax is not easy. People need to understand why the amount they pay might vary. The challenges of moving to a new approach must be understood and overcome.
- 2.9 In this report, we show that local taxation can be fairer, whilst delivering the scale of revenues needed to maintain the public services that are often the very cornerstones of our society. We show that local tax reform could connect voters better to Local Government. And by showing that the present Council Tax simply fails the test of being proportionate to the ability to pay – however that is measured – we present an unarguable case for change.





# Taxation and Funding for Public Services

- Receipts from the present Council Tax contribute to all local authorities' spending – they are not a charge for a specific service.
- Council Tax contributes only 12% of Local Government funding – most council expenditure is funded by national taxation.
- Amongst all the taxes we pay, Council Tax is especially visible – every household gets a bill.

## Purpose and History of Local Taxation

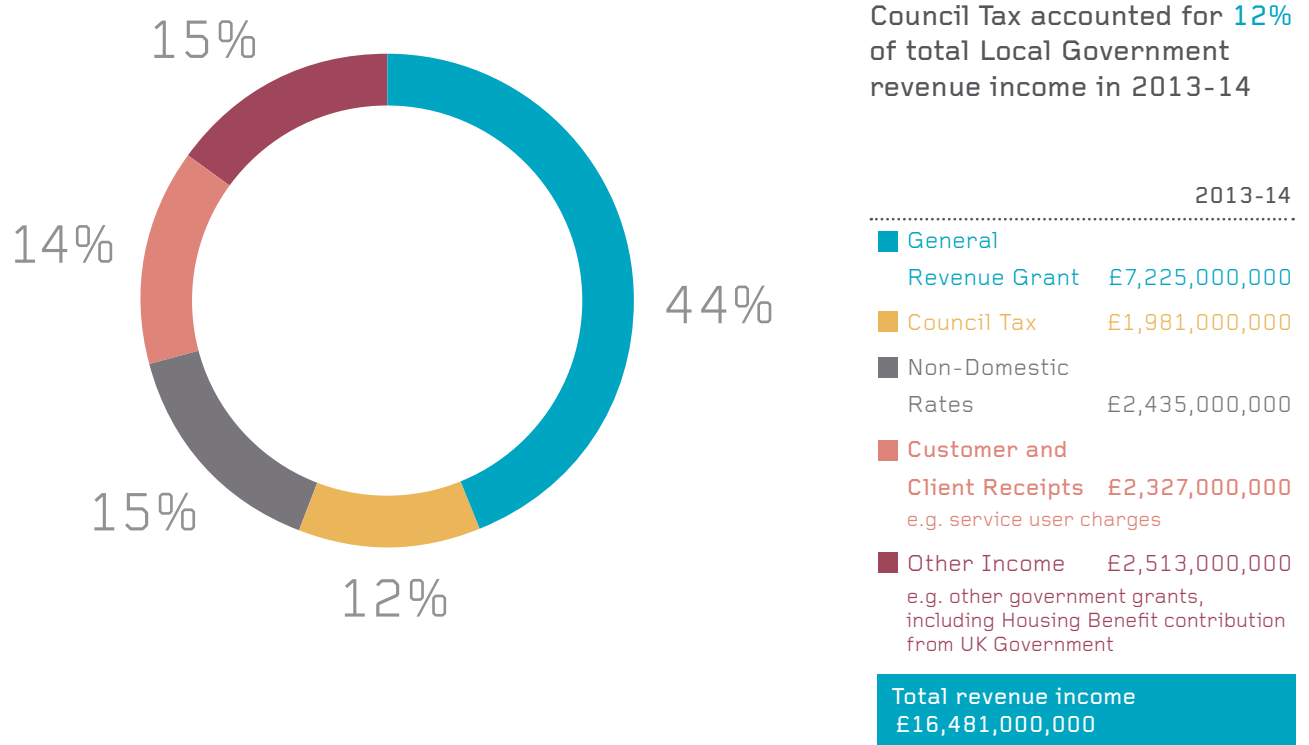
- 3.1 The revenues from the present Council Tax contribute towards the funding of public services delivered by local authorities. The majority of Local Government expenditure is used to provide education, social care and support for housing costs. Councils are also responsible for a wide range of other services including environmental and waste services, roads and transport, local planning and economic development, and local culture and recreational services. None of this could happen without the funding from taxation.
- 3.2 Whilst local taxation can be traced back to the 1579 Poor Law, the current framework has more recent roots. Rates on domestic property were charged throughout the 20th century until 1989, when they were replaced by the Community Charge or “Poll Tax”. This was based on the principle of a service charge, with each adult equally liable to pay. Although it included a means tested rebate system, at least 20% of the standard charge was paid by everyone. The Community Charge was widely perceived as unfair and vigorously opposed by many in Scotland and across the UK, with many participating in a campaign of non-payment. This led to the rapid development of the Council Tax, the design and structure of which has remained largely unchanged since its introduction in 1993.
- 3.3 For the last eight years, local authorities and the Scottish Government have agreed to keep Council Tax rates at 2007-08 levels. The Scottish Government has provided local authorities with an additional £70 million of funding from the Scottish block grant in each year of this freeze. While views differed, we heard a growing perception that this policy cannot go on indefinitely and that it acts as a barrier to different tax and spending choices being offered in local elections.

## Council Tax and Local Government Funding

- 3.4 Contrary to the views frequently expressed to us at our public participation events, Council Tax makes a relatively small contribution to overall local authority spending. Instead, it is the General Revenue Grant from the Scottish Government that makes up the largest component of Local Government funding as set out in Figure 3.1.
- 3.5 The introduction of the Scottish Rate of Income Tax (SRIT) in April 2016 will not in itself change this. Nor will replacing the present Council Tax with a new system of local taxation that raises broadly the same amount of money. The principal source of funding for the delivery of local services would continue to be the grant from the Scottish Government, funded in part by receipts from the SRIT and by its own block grant from the UK Government. Thus, the General Revenue Grant will continue to be drawn from receipts of all national taxes applied across Scotland and the UK.
- 3.6 The size of contribution that locally set taxes make towards Local Government funding – often referred to as the “balance of funding” – has varied over the years. In the late 1980s, for example, prior to the introduction of the Community Charge, the balance of funding was almost 50:50 between central government and local funding, derived principally from domestic and business rates. The research conducted for us by Policy Scotland at the University of Glasgow indicates that local taxes presently contribute well over a third of local expenditure in many countries in the Organisation for Economic Co-operation and Development (OECD).
- 3.7 Across Scotland today, total Local Government revenue is around £16.5 billion, of which Council Tax contributes around £2 billion or just 12%. We found this is not widely understood, with many assuming that Council Tax contributes far more towards the funding of local services. Some challenged whether it was appropriate for locally-elected representatives to have so little control over the funding of the services they have to deliver.
- 3.8 While the £2 billion raised by Council Tax is less than the amounts raised from other sources, it is still a large sum that plays a critical role and which Local Government could not conceivably forego. Council Tax is the source of tax revenue with the most local control, with every council in principle able to vary the rate up or down based on its own choices. However, a consequence of Council Tax being such a low proportion of all Local Government revenues is that for a particular council to achieve a modest percentage rise in overall spending, a disproportionately large increase in Council Tax would be required – this is known as the “gearing effect”.
- 3.9 Although the wider system of Local Government finance is beyond our remit, these issues, and the level of public understanding associated with them, are very relevant to how local taxation can be reformed in a way that will be broadly supported by the public.



**FIGURE 3.1**  
**LOCAL GOVERNMENT REVENUE INCOME BY SOURCE**



## How Taxes are Paid

- 3.10 Usually, individuals do not have to make a special effort to pay taxes. For example, VAT is included in the purchase price of the item or service being taxed. For most people, income tax is withheld from salaries by employers under the PAYE system.
- 3.11 Council Tax is different – it is not part of a price or deducted from a salary. It is a tax that people have to make the physical effort to pay. It is therefore visible – every household gets a Council Tax bill, even if in receipt of Council Tax reduction.

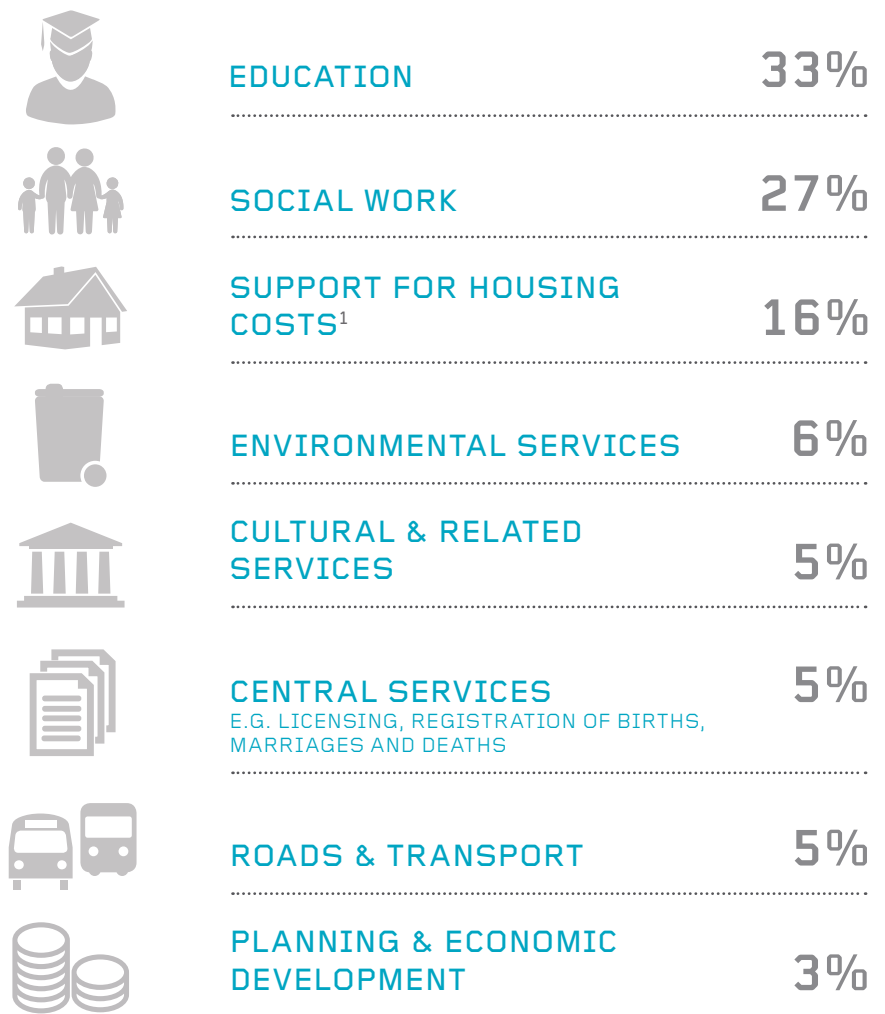
## Taxes and User Charging

- 3.12 Taxes – both national and local – are general contributions rather than charges for the use of a particular service. For example, taxes on tobacco are not specifically for the funding of healthcare. Instead, the receipts are pooled with all other tax receipts and contribute to the funding of all public expenditure. Spending on services delivered by Local Government in Scotland is shown in Figure 3.2.
- 3.13 We heard some opinions suggesting that a local tax should relate to the public services an individual or household consumes – an example sometimes cited being large households that generate more rubbish should be charged more. This highlights the distinction between a tax – whose receipts are pooled and used to fund services generally – and a charge for a specific service.
- 3.14 This is important – there are some public services people can choose to use or not, but in many cases, people may not have that choice. We heard compelling evidence that described how some public services can be the difference between thriving versus just surviving, between enjoying fundamental human rights and human dignities or suffering without them.
- 3.15 We have also heard evidence that there are particular groups who, for differing reasons, are more likely to make use of public services. When spending on public services is reduced, leading to a removal or reduction in the provision of services, there is a disproportionately greater impact on certain groups of people. A system of charging for public services would mean that those groups – often the most vulnerable in society in the need of the most support – would bear the cost of the services they need. Such a scenario would be cause for concern because their need to use particular services is not related to their ability to pay for them.





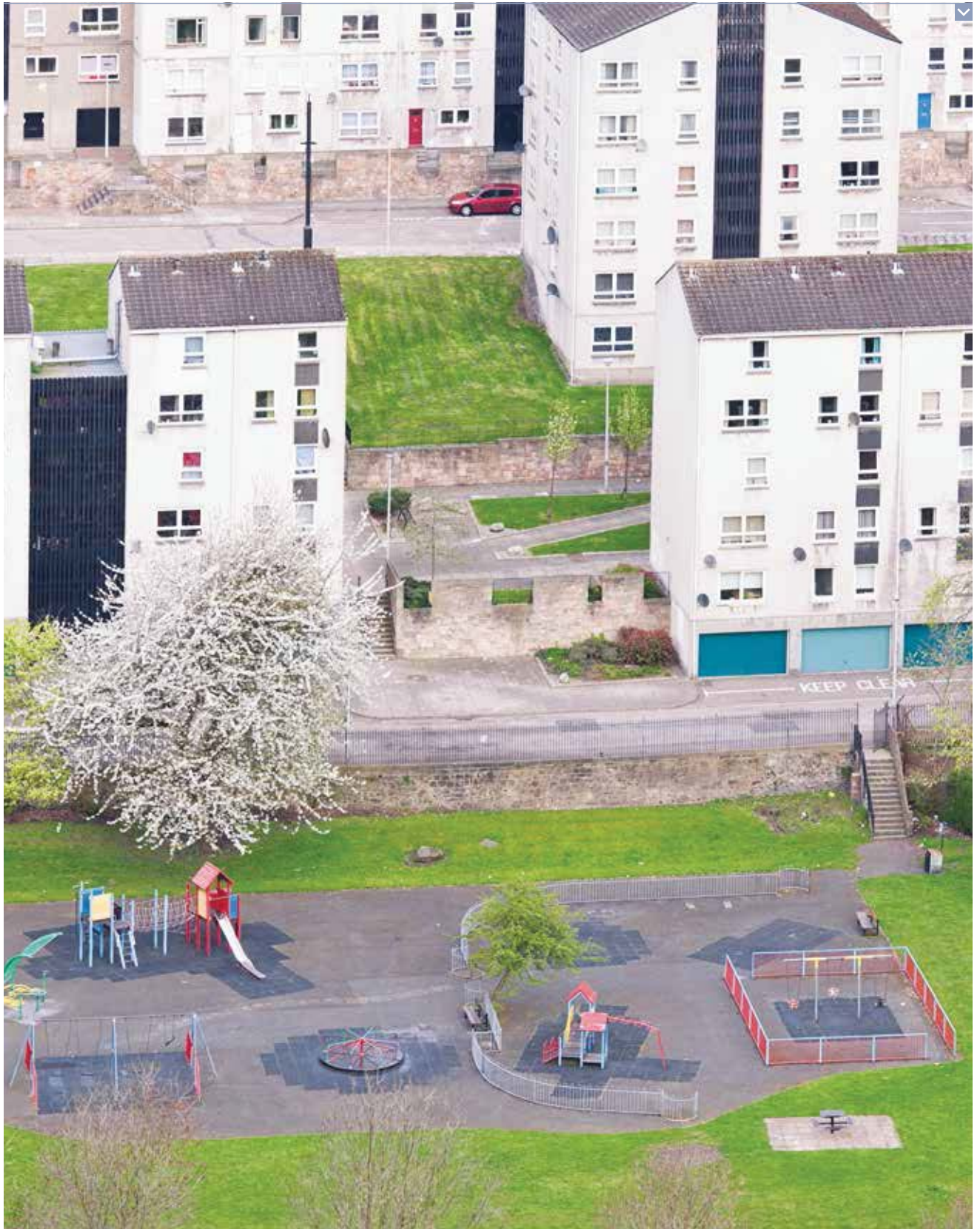
**FIGURE 3.2**  
**LOCAL GOVERNMENT EXPENDITURE IN SCOTLAND 2013-14**



<sup>1</sup> This includes Housing Benefit payments but does not include expenditure on direct provision of housing. This is recorded separately through the Housing Revenue Account (HRA).

There is a small amount of expenditure (estimated at less than 1%) on provision of "trading services". This relates to a small number of services that councils charge for on either a cost-neutral or for-profit basis. This expenditure is more than offset by income from these services, returning a profit for Local Government overall.

- 3.16 For these reasons, our analysis focuses on alternative tax – rather than charging – systems. But it means we also recognise the importance of a tax being seen as fair and legitimate in allowing sufficient revenue to be raised in ways that minimise the need for local authorities to charge for services that individuals cannot choose to do without. Receipts from fees and charges are and will remain a significant source of funding for Local Government, but we heard evidence of both positive and negative impacts of their uses in different contexts.
- 3.17 We therefore strongly believe that any replacement to the present Council Tax should not be a system of charges for specific services, but should continue to be a tax that contributes towards the general funding of local services.





# Our Approach

- We engaged with experts and a range of organisations to understand all aspects of the present Council Tax system, ranging from payment and administration to the impact on the services that it funds.
- We actively sought the views of the public through a programme of listening events across Scotland, a call for detailed written evidence and by an open access survey.
- Working with Heriot-Watt and Stirling Universities, we completed the most comprehensive programme of quantitative analysis ever attempted to understand the relationships between house and land values, the property stock and household incomes.

## Our Principles

- 4.1 We agreed a set of values to underpin and guide our work and meetings, and the conduct of our public engagement and evidence gathering. These prevailed throughout our work, including in the preparation of this report which has the evidence we have collected at its heart.

### Figure 4.1 The Principles We Used to Guide our Work

In pursuing the remit, Commissioners will be:

- \* **Ambitious:** taking a long-term view and not being restricted by the current practices or pre-existing positions regarding any potential alternatives.
- \* **Open:** listening to all views through widespread engagement, accessible public reporting, and by encouraging interaction with their work.
- \* **Independent:** fulfilling their role autonomously outwith the formal decision-making structures of any organisation, and distinguishing between their day-to-day roles and responsibilities and their role as independent Commissioners when carrying out Commission activities.
- \* **Inclusive:** developing and reflecting a wide range of perspectives and views from across communities, civic Scotland, local and national government, and others.
- \* **Questioning:** providing a forum for debate and reflection, but with a common purpose of delivering the Commission's remit in the allotted timescales.
- \* **Practical:** responding positively to challenges and opportunities, working together to share and evaluate ideas, and developing a shared understanding that respects the spectrum of opinions represented by members of the Commission.
- \* **Evidence-based:** using relevant evidence from home and abroad to inform our work, and commissioning research and analysis where appropriate.
- \* **Deliberative:** providing appropriate space for the Commission to reflect on the evidence that it receives and to debate options either in public or in confidence, with appropriate records of those discussions made public.

- 4.2 The structure of this report reflects not just our remit, but also certain principles of taxation that the options for reform could be tested against, including equity and fairness, administrative and economic efficiency, and autonomy and accountability.



## Gathering Evidence and Commissioning Research

- 4.3 Our evidence base includes several thousand pages submitted by over 200 respondents, including 79 organisations as diverse as Barnardo's and the Institute of Chartered Accountants of Scotland. This ensured that we could understand the views and positions of a very wide range of interests from across society as well as draw on an independently prepared analysis of all responses.
- 4.4 To supplement this call for written evidence, we held 12 oral evidence sessions where we explored specific issues in greater depth. These engaged 58 expert witnesses from bodies as diverse as the Institute for Fiscal Studies and the Coalition of Carers in Scotland.
- 4.5 We have sought to understand overseas experiences and practices, commissioning a review of international literature from Policy Scotland at the University of Glasgow, and engaging with experts from Denmark, the Basque Country, the Republic of Ireland and learning from the experiences of recent reform within the UK in Wales and Northern Ireland.
- 4.6 All of the research work we have commissioned is published alongside this report, whilst our commitment to be open and inclusive during our deliberations meant all our oral evidence sessions were webcast. Where consented by the author, responses to our call for written evidence can be downloaded from our website, as can a record of all of our meetings.

### FIGURE 4.2 SOURCES OF EVIDENCE



203

**DETAILED RESPONSES TO  
OUR CALL FOR EVIDENCE**

Including: Local Government, Representative Bodies, Policy Tax and Economic Interest Groups, Third Sector and Equalities Groups, and Individuals.



4,492

**RESPONSES TO OUR  
ONLINE SURVEY**



58

**EXPERT WITNESSES AT 12  
ORAL EVIDENCE SESSIONS**



12

**PUBLIC LISTENING  
EVENTS OR WORKSHOPS  
HELD IN COMMUNITIES  
ACROSS SCOTLAND**



16

**ACADEMICS AND PRACTITIONERS FROM SCOTLAND AND AROUND THE WORLD  
PROVIDING PROFESSIONAL ADVICE AND SUPPORT**

## Listening to What People Think

- 4.7 A distinctive feature of our approach has been to actively engage with the public to both canvass their opinions and help us understand how people react to alternative local taxes. Our remit committed us to do this and we believe it adds a vital dimension to our findings, given the potential challenges associated with change.
- 4.8 There were two components of this public engagement. Our website featured an online questionnaire which attracted nearly 4,500 responses. This provided us with a sense of the views that prevail amongst the members of the public most motivated to contribute to debate on this issue and some of the anecdotal opinions they hold. We then further developed our understanding of those views and how people think in a series of facilitated public listening events across Scotland. These were open to the public and promoted in the local and national press, as well as some being targeted at specific communities of interest such as housing association tenants and faith groups.
- 4.9 To supplement this, we also worked with Young Scot, which hosted an event in Glasgow engaging young people aged 15-25 from across Scotland. Additionally, BEMIS, a national umbrella organisation which supports ethnic and cultural minority communities and individuals, hosted a workshop with Commissioners to consult and engage its membership on the alternatives to the present Council Tax.
- 4.10 Our public engagement sought views from far and wide, but we emphasise that the findings cannot be assumed to be representative of the whole of Scotland. However, these processes helped us hugely to understand the scale of the issues which a new local tax system must address.

## Our Quantitative Analysis

- 4.11 Complementing this substantial body of qualitative evidence, we undertook, in association with Heriot-Watt and Stirling Universities, the most comprehensive analysis ever performed on the Scottish housing stock, including modelling up-to-date property and land values, and examining how property and income taxes relate to household incomes.
- 4.12 Council Tax currently raises around £2 billion, and a replacement tax needs to be capable of raising the same. Responses to the call for evidence identified three suitable alternatives that could do this and that could be applied locally – taxes on property, taxes on land and taxes on income – although there were an array of suggestions on exactly how these could operate in practice. This result is confirmed by the Policy Scotland at the University of Glasgow research which found that these were the three principal tax bases used by Local Government in other OECD countries. Our quantitative analysis examined each alternative to try and understand how their potential impacts differed and what they might mean in practice for households across Scotland.



## FIGURE 4.3 REPLACEMENT OPTIONS

The present Council Tax raises around £2 billion to help pay for Local Government expenditure.

The Commission has identified three possible alternatives that could realistically raise the same.



**REPLACEMENT  
PROPERTY TAX**



**TAX BASE =  
VALUE OF  
LAND +  
BUILDINGS**



**LAND  
VALUE TAX**



**TAX BASE =  
VALUE  
OF LAND  
ONLY**



**LOCAL  
INCOME TAX**



**TAX BASE =  
TAXABLE  
INCOME**

**TAX INCOME = TAX BASE x TAX RATE**

4.13 To help us with this process, and purely for the purposes of illustration, we created examples of alternative taxes and looked at the impact on households if these had been implemented instead of the present Council Tax in the financial year 2013-14. The alternatives are described in Figure 4.4, but none should be taken to represent a recommendation or a blueprint for a future alternative tax. Rather, they were chosen to help inform our understanding of the various impacts of the alternative taxes and where the key trade-offs lie. Furthermore, the detailed results of our analysis (presented in our Volume 2: Technical Annex) must not be interpreted as predicting how much households would pay if these examples were actually implemented – this will depend on not just the local tax rates that will be determined by individual councils, but on many other factors such as what discounts, exemptions and deductions apply. We hope that putting this work in the public domain will allow a richer, more informed debate about local taxation to take place in the run-up to the Scottish Parliamentary election in May 2016.

#### FIGURE 4.4

##### EXAMINING THE ALTERNATIVES – the different local tax systems we analysed

**Local income tax:** We mirrored the UK income tax structure and added an additional flat rate tax to the basic, higher and additional rates of income tax.

**A reformed, proportionate Council Tax:** We retained the main features of the present Council Tax, including the Council Tax Reduction scheme, but changed the charge for each band to reflect differences in relative property values in each band.

**A steeply progressive property tax:** We modelled a tax based on each household paying a percentage of the value of their home in tax – the higher the value of the property, the higher the tax rate. We kept the same eligibility for an equivalent to the Council Tax Reduction scheme.

**Other themes that were explored include:**

**Revaluation:** For a subset of 700,000 homes across Scotland, we estimated a 2014 property value using information from market sales data, allowing us to assess how relative prices in different areas, and for different types of property, may have changed since 1991.

**Land Value Tax:** For seven local authorities, we estimated how average land values differed from average property values.

- 4.14 Whilst emphasising that our analysis cannot be used to indicate how much specific households might be required to pay, our modelling is based on the assumption that any replacement would raise the same amount as Council Tax. This required an implied tax rate for each to be calculated, which then allowed us to calculate individual tax liabilities – and thus the impacts – on a range of different circumstances.
- 4.15 We looked at different household types in the same income band, and at the same household type across different income bands to give a broad overview of the potential range of impacts. For each household type, we estimated the proportion of income, after tax and transfers, that they would pay in each example. We consider it very important that household circumstances are taken into account when assessing equity and how it relates to ability to pay. A household with children needs a higher income to maintain the same standard of living as an identical household without children. This process of adjusting income is known as “equivalisation”, and has been used throughout our analysis. We have also assessed households where there are people with additional support needs who are more likely to have higher essential living expenses. We consider this in more detail in Chapter 5.
- 4.16 Early on, we realised that we would not be able to fully separate out the value of the land tax base from the property tax base. Some preliminary analysis on land value tax has been carried out to help us to understand how liabilities would differ from a property tax, but without being able to estimate the total stock of residential land, tax liability modelling has not been possible, and our analysis has been limited to geographical comparisons with property taxes. The results from this are further explored in Chapter 6.
- 4.17 As well as highlighting property, land and income as possible tax bases, we also heard suggestions that the local tax base could combine some of these approaches in a hybrid system or be expanded to include other tax bases. Whilst the impact of these options could not be analysed as fully, we have considered the implications of these alternatives as part of our quantitative analysis process.



## Equalities

- 4.18 As we are not making specific recommendations on a particular policy or process, there has been no formal process of subjecting our deliberations and recommendations to a formal equality impact assessment within the terms of the Public Sector Equality Duty. However, our approach throughout reflects the spirit of the public duty and has been consultative and engaged with a wide cross-section of the public and specialist interests. The protected characteristics set out in the Equality Act 2010 have been integrated in our qualitative and quantitative analysis as far as the available data has allowed.
- 4.19 Our work sought to put considerations of equality, discrimination, and disadvantage into sharper focus than previous studies of local taxation, and we have made these considerations central to our approach to data collection and analysis. We have consulted with women's groups, disability organisations and organisations led by disabled people, carers' organisations, and organisations representing low-income groups and welfare advice and anti-poverty advocacy organisations.
- 4.20 The evidence from these consultations and from the quantitative analysis presented in this report has reinforced both the perception and reality of the unequal impact of the present Council Tax system and demonstrates some of the ways in which reform can address persistent inequalities.

# Can a Local Tax be Fair and Equitable for Everyone?

- International examples are diverse and show that there is not a universal understanding of a fair local taxation system.
- The predominant view of the Commission is that any reform of local tax has to include recurrent tax on domestic property, but that any such system needs to be more progressive than the current Council Tax system.
- The predominant view of the Commission is that Local Government's tax base should, if it could be proved feasible, be broadened to include income as this is widely perceived to be a fairer basis on which to levy a tax<sup>1</sup>.
- A system of land tax is promising, but gaining a full understanding of its impact would require further analysis.

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<sup>1</sup> Jackie Baillie MSP was not able to agree this recommendation

- 5.1 The concepts of fairness and equity in a taxation system are not straightforward and are often subjective. Governments across the world today recognise their importance, but differ on the definition. "Fairness" is often interpreted as being substantially based on the "ability to pay", though that term in itself can be understood in several ways. An "equitable" tax will apply equally to two people or households who are in similar circumstances. An "equitable" tax will also not have any disproportionate impacts on particular people or household types, localities or parts of the population, though again different observers will disagree over what is proportionate and what is disproportionate in any system.
- 5.2 A tax that is based on the ability to pay and treats all equitably is more likely to deliver stable revenues, not just because it will, by definition, be affordable, but also because it is likely to benefit from greater public acceptance.
- 5.3 Our remit requires us to assess **"the impacts on individuals, households and inequalities in income and wealth"** of alternative local tax systems, and we therefore consider in detail whether alternatives to the present Council Tax can be fair and equitable.

### The Ability to Pay

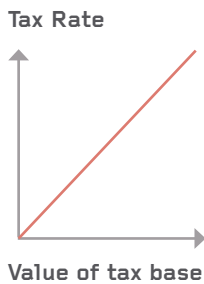
- 5.4 There is strong, but not unanimous, initial public challenge to the idea that any tax based on property or land values is truly related to ability to pay. Some believe that a tax based on property and/or land values can never be fair. This is because they attach a strong importance to income in their definition of fairness, as they perceive it connects to ability to pay. Others maintain that property or land should be taxed, believing that ownership of a property or land indicates a degree of wealth that in turn indicates the ability to pay. However, this opens the question of whether ownership and occupation of property indicates the same ability to pay.
- 5.5 The review of international evidence conducted for us by Policy Scotland at the University of Glasgow very much confirms the difficulty in defining "ability to pay", as well as the practical challenges of designing a local tax system conforming to this principle of fairness. Indeed, this research demonstrates that across the OECD, practices are diverse and that there is not a universal understanding of a fair local taxation system. The research also showed that most OECD countries operate more than one source of local taxation, and in most instances include property and often income within this mix.
- 5.6 Our analysis explores the different impacts on household incomes of different tax systems by modelling some illustrations of more progressive property taxes, as well as considering a flat rate local tax on income. We also considered the impact of these different tax systems on wealth, and looked at whether wealth is related to income. The available data did not support the same level of analysis for a land value tax, but if land could be valued accurately, we see it as being a variant of a property tax that separates the values of the land and the building from the overall value. As such, it would have similar impacts on income and wealth as a property tax, depending on the design.

## FIGURE 5.1 PROGRESSIVE, PROPORTIONATE AND REGRESSIVE TAXES

Many people associate fairness with whether a tax is progressive or not. But what does that mean?



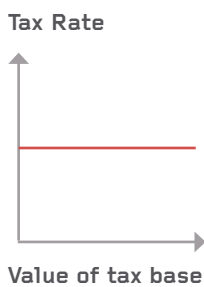
### PROGRESSIVE TAXES



The lower the value of the tax base, the lower the tax rate

This is broadly how income tax is structured – above certain thresholds, the tax rate increases

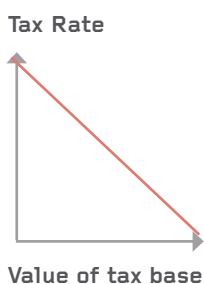
### PROPORTIONATE TAXES



The tax rate is a flat rate

This is how VAT is structured – most goods and services attract a 20% VAT rate regardless of price

### REGRESSIVE TAXES



The lower the value of the tax base the higher the tax rate

This is broadly how Council Tax is structured

#### WHAT IS A TAX BASE?

It is the quantity of the thing being taxed e.g. the value of land or property or the total of earnings.

#### WHAT IS A TAX RATE?

A tax rate is the percentage rate which applies to the tax base. For example, the basic rate of income tax is 20%.

Council Tax operates via a system of band charges. An implied tax rate for each property can be calculated by dividing the Council Tax bill by the value of the property.

### MEASURING FAIRNESS AGAINST INCOME

Sometimes, people use terms like regressiveness to describe how the tax rate changes as incomes change.

That is why VAT is often called regressive. It is a 20% flat rate on the value of goods and services, but because lower income households spend relatively more of their

income, on average they spend more proportionately on VAT.

The same would be true of a proportionate, or flat rate, property tax because, on average, housing costs make up a larger proportion of a lower income household's expenditure.

Some think that this interpretation of progressiveness and regressiveness is more important than how a tax relates to its tax base. That is why we look at both interpretations.

The present Council Tax is regressive whichever interpretation is used.

### **Can a Property or Land Tax be Fair and Equitable?**

- 5.7 The present Council Tax is regressive. Tax on the highest value properties is exactly three times the tax on the very lowest value homes. But even when the Council Tax began, those highest value properties were worth around eight times, or more, than the lowest. This regressivity was built in from the start.
- 5.8 Our analysis confirms that the present Council Tax is also regressive when measured against household incomes. Although the tax rate is determined by the property value, this results, in most circumstances, in the share of household income going on Council Tax being greater at lower incomes than at higher incomes.
- 5.9 We looked at the impact of a property tax that is proportionate to property values. Our analysis is based on an estimate of the property tax base in 2013-14. The figures we have produced can only be viewed as an illustration of the scale of the changes if a proportionate property tax replaced the present Council Tax. The actual rates that each household would pay will depend primarily on the value of property in the valuation year and, importantly, the rate set by the council in that local authority area. However, it is clear that a proportionate system would lead to relative changes in the liability of lower value properties in relation to higher value properties.
- 5.10 Our analysis estimates that, in 2013-14, adapting the present Council Tax to achieve this proportionality would require the tax on the highest value homes to be 15 times the tax on the lowest value homes. In this example, the liability for Band A would halve, and the liability for Band H would be 2.5 times higher than at present. This system would still result in lower income households spending a greater share of their income on local tax than higher income households.
- 5.11 We looked at whether a property tax could be structured so that it is progressive with respect to both property values and to net household incomes. Our analysis suggests that even with substantially higher rates for the most expensive properties, a property tax cannot be progressive with respect to income for all households. By itself, a property tax cannot meet this test of fairness.
- 5.12 One other suggestion to improve fairness further was the reform of the present Council Tax to create an additional band above the current highest of Band H, as was implemented in Wales in 2005. While this would allow an increase in the difference between the charges applied to the properties at each end of the scale, Band H at present consists of less than 13,000 properties in Scotland out of the 2.4 million in total. The potential effect on overall progressivity of splitting a band that already includes relatively few properties is therefore extremely small.



## FIGURE 5.2 WHAT COULD A REFORMED PROPORTIONATE COUNCIL TAX SYSTEM LOOK LIKE?

### CURRENT SYSTEM



CURRENT LEGISLATION DETERMINES THAT A PROPERTY  
IN BAND H INCURS THREE TIMES AS MUCH TAX AS A  
PROPERTY IN BAND A

### PROPORTIONATE SYSTEM



WE HAVE ESTIMATED THAT IN 2013-14, PROPERTY  
IN BAND H WAS WORTH, ON AVERAGE, 15 TIMES THE  
VALUE OF BAND A

PROPERTY IN BAND H WOULD HAVE INCURRED 15 TIMES  
AS MUCH TAX AS A PROPERTY IN BAND A UNDER A  
PROPORTIONATE SYSTEM

## Discounts and Reductions

- 5.13 We recognise the importance of reduction (or relief) schemes to ensure those without the means to pay the tax are protected. Indeed, we heard much evidence pointing to the futility of taxing those who simply could not pay.
- 5.14 The present Council Tax Reduction scheme is such a system of income based relief that also takes account of need. It is highly targeted, providing different levels of support for different household circumstances. But our analysis shows this support is greater for pensioner households and those with children than for in-work households without children. This is confirmed in evidence we received that some households may not be receiving the support that they need. Even after factoring in Council Tax reduction, the present Council Tax system is largely regressive for those households with incomes above the lowest 20%.
- 5.15 We also heard that the Council Tax Reduction scheme's complexity can make it hard to access. We do not have data describing how many of those entitled to a Council Tax reduction apply for this relief, but the Department of Work and Pensions (DWP) had estimated that of those entitled to the preceding Council Tax Benefit, 62% to 69% by caseload and 64% to 71% by expenditure actually claimed. Whilst entitlement criteria for the Council Tax Reduction scheme uses many of the criteria and thresholds from the present DWP benefits systems, we heard evidence that application is awkward and especially so for those whose working hours and/or income vary frequently. Overall, these difficulties reflect international experience – in their report to us, Policy Scotland at the University of Glasgow concluded that: "Finding the right way to compensate low income taxpayers remains a critical issue for property taxation".
- 5.16 However, if it was more effective and accessible, a scheme that reduced liability according to income and need could allow a fairer property tax to be operated. Particular options for improving the Council Tax Reduction scheme (or a replacement system of relief) include increasing the allowances made for living expenses, or making the rate at which the discount is withdrawn as income rises much less sharp. This may mean greater amounts of revenue foregone by local authorities than at present, which would have to be replaced to maintain revenues and thus the same level of local service provision. One way this might be achieved could be by an increase in the revenue raised from other local taxpayers.

## Property Taxes and Wealth

- 5.17 Our remit also requires us to consider the relationship between property taxes and wealth. Occupation of high value property could be indicative of relatively high levels of current income or high levels of wealth, or both. We heard views that, at present, wealth is undertaxed and has reviewed evidence that levels of wealth inequality are greater than income inequality.



- 5.18 The extent to which ownership of property is indicative of ability to pay has been questioned in evidence to the Commission. In oral evidence to us, the Institute for Fiscal Studies advanced a rationale that “housing should be taxed like other consumption” – in effect making such a tax almost a proxy for VAT. However, property is an asset that, for owner occupiers at least, does not produce a tangible revenue stream out of which to pay a property tax. There is some evidence of a link between net property wealth and income, but there are circumstances for which this does not hold. For example, retired owner occupiers are more likely to own their home outright but their income is likely to be lower than a working-age household who are more likely to have an outstanding mortgage.
- 5.19 Even where net property wealth is not a proxy for current income, we heard some express a view that net property wealth means there are substantial holdings of wealth that could be realised if the property was sold. For some, there may be reasons why selling a home is not practical, such as suitable alternatives not being available. For others, selling a property might represent a difficult and emotional choice because it has been a long-standing family home.
- 5.20 The present Council Tax is levied on occupiers and this proves easy to collect. The alternative, of taxing owners (generally a feature of land taxes) can be harder to enforce, especially in cases where the owner is a company or overseas. We have also heard mixed views as to whether a tax on owners would indeed be paid by landlords, or would instead be recovered by increasing the rents charged to occupiers.
- 5.21 For these reasons, we therefore considered the impact of property taxes on wealth where the tax is paid by the occupier. If applied in a proportionate or more progressive way, property taxes based on property value offer some, but not complete, connections to the wealth of owner occupiers (although those with mortgages will pay proportionately too much based on their actual wealth holdings).
- 5.22 Proportionate or more progressive property taxes paid by tenants may also link to other forms of wealth, such as in circumstances where renting a particular property is an elective choice, although this may be linked more closely to current income than accumulated wealth. However, many tenants, and in particular tenants of social housing, may not have a choice over where they live and in such circumstances, occupancy of a property has little or no relation to wealth.
- 5.23 The imperfect link between ability to pay and a property tax could be addressed by a system of reliefs as described earlier in this chapter, whilst enabling those links to wealth where it is an appropriate reflection of ability to pay to be maintained. Such reliefs could apply to land as well as property taxes.

- 5.24 We also considered if it was possible for a tax on property to be deferred until the property is sold. Whilst theoretically appealing, when such a scheme was implemented in Northern Ireland for pensioners, it was taken up by so few people that it was closed. We understand this was because the concept of bequeathing property with a claim of deferred local tax on the title was not attractive.
- 5.25 The present Council Tax system provides many exemptions and discounts which are not means tested. Some of these, in particular the single person discount, have been challenged in evidence on the grounds of fairness. Others have cautioned against removing any discount or exemption without fully understanding the consequences, some of which may be unintentional. For example, we have heard that the removal of single person discount could have a detrimental impact on single pensioner households. Any new system must therefore be based on a full consideration of all current discounts and exemptions. Within a new system, such reliefs should be kept under review to ensure they remain fit for purpose.
- 5.26 Our analysis therefore indicates that a more proportionate property tax, implemented alongside a more progressive system of income and need based reliefs, would be much fairer than the present Council Tax and connect better to both the income and the wealth interpretations of “ability to pay”. The public opinions we accessed, especially at the listening events, were often open to such a proportionate, mixed (or hybrid) system, whilst research conducted for us by the University of Stirling confirms the potential benefits of such arrangements.

## Valuation of Property

- 5.27 The valuation of property is obviously fundamental to a tax based on property values. The evidence we received suggested that the continued use of the 1991 value of each property to calculate that property’s Council Tax bill today contributes to perceptions of unfairness among both experts and the public. Indeed, some cite this to further discredit the present arrangements.
- 5.28 We recognise that property tax liabilities should ideally be linked to up-to-date property values. The present Council Tax, based on 1991 values, means people living in properties that have increased in value by more than the Scottish average since 1991 are likely to be paying less than they should, whilst others in properties whose value has not kept pace with the Scottish average are paying more than they should. Only properties where values have grown in line with the Scottish average are paying what they should. The Scottish Assessors Association (SAA) provided convincing evidence that they are able to apply fair and accurate, but nevertheless hypothetical, 1991 valuations to new properties. However, the need to do so – especially as some types of property did not exist in 1991 – is a concern.

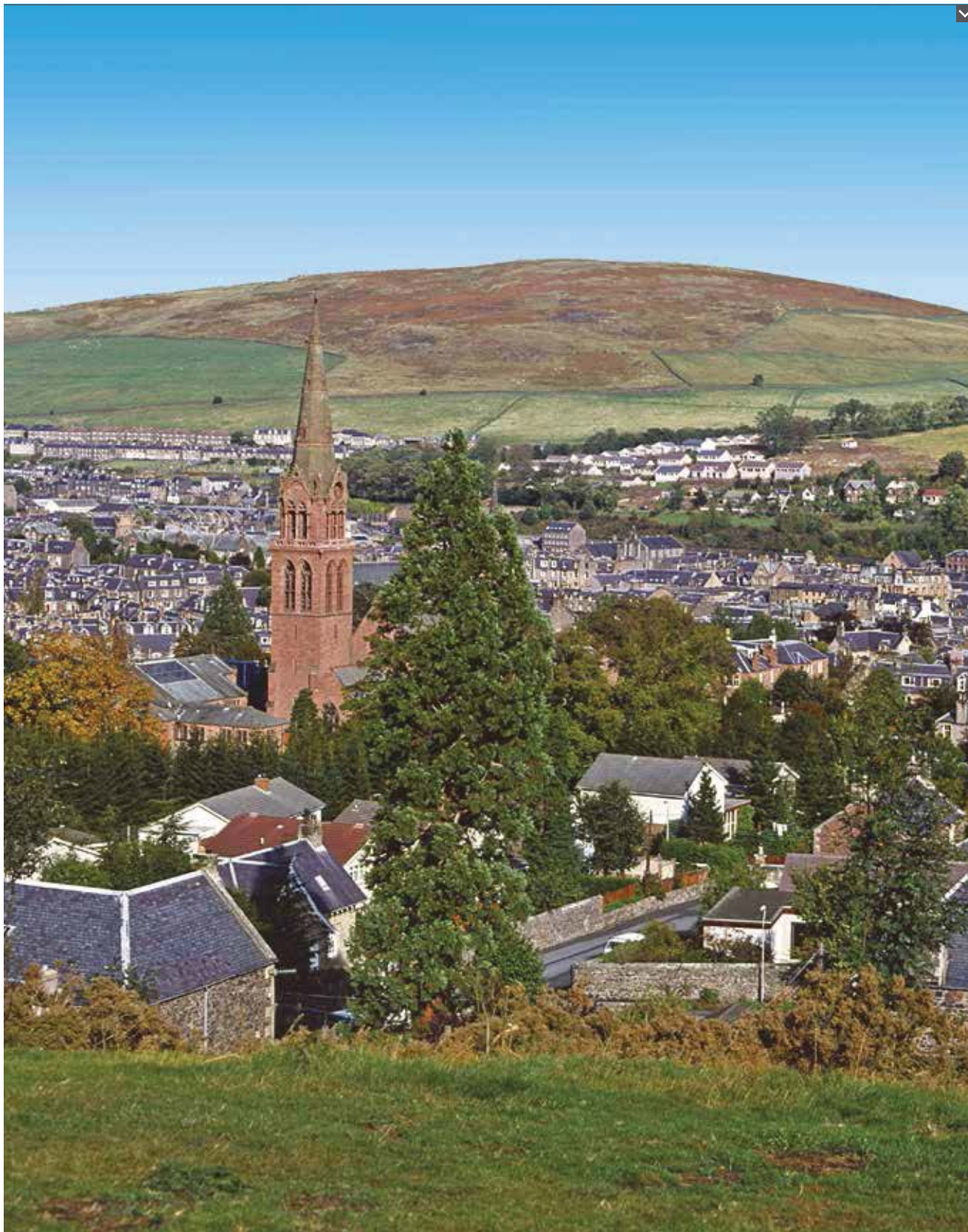
- 5.29 In collaboration with Heriot-Watt University, we have been able to analyse the impact of revaluing properties for a subset of around 700,000 properties in seven local authorities across Scotland whilst maintaining the other elements of the present Council Tax system. In this analysis, we adjusted the bands to keep the number of properties in each band the same. Although we recognise that computer models alone will never be able to accurately value every property, the findings from this analysis are instructive, suggesting that 57% of properties in Scotland would have changed Council Tax band if revaluation had taken place in 2014, with roughly an equal amount moving up as moving down. Around 44% of properties would have moved up or down by one band, 11% would have moved up or down by two bands, and around 2% would have moved up or down by three bands or more. 43% of properties would have remained in the same band.
- 5.30 Some evidence indicated that the longer the time taken between property valuations, the greater the potential change in relative values. Our analysis confirms this, and shows that if Council Tax was retained and properties were revalued, many would change bands. Although tax liabilities would also be driven by the locally determined rates, income based relief schemes, transitional arrangements (and a number of other factors), the scale of potential change indicates that whilst keeping valuations up-to-date is desirable, an initial revaluation of properties would be politically challenging to deliver. The research by Policy Scotland at the University of Glasgow indicates that the difficulties arising from deferring the revaluations within a property tax system are widely experienced in other countries and are not unique to Scotland. This challenge must be overcome and we believe that a well-designed transitional framework to enable taxpayers to adjust would help to improve public acceptance.

### Can a Local Income Tax be Fair and Equitable?

- 5.31 A tax on income, by description, should relate directly to the ability to pay and thus be fair and equitable (as long as a regressive tax structure is not put in place). Our analysis confirms that connecting local income tax to ability to pay – as understood by income – is much easier than for taxes on property or land, as income and ability to pay are linked in a more obvious way. Furthermore, our analysis also shows that, even for income taxed at a flat rate, a household on a low income will pay proportionally less local income tax than an identical household with high income.
- 5.32 In contrast to a property tax, which must be adjusted for some households in order to relate to current income, the challenge for a local income tax is to ensure that it applies to all forms of income.
- 5.33 In Chapter 7, we set out ways in which a local income tax might be collected. This highlights that, in practical terms, it would be very difficult for savings, investment and dividend income to be subject to local tax. This in turn could mean that some individuals with potentially significant wealth providing substantial unearned income would pay little or no local tax. If this administrative constraint could not be overcome, a local income tax would have no direct impact on combating inequalities in wealth as it would tax current income rather than the wealth accumulated through income over time.
- 5.34 Although not a universally-held view, we encountered some public perceptions that a local income tax has an element of “unfairness” – it would not apply to the wealth implied by a person residing in a high value property but living on a modest income. Others, as highlighted earlier in this chapter, saw this relatively lower charge for the asset-rich cash-poor as a positive feature, especially in the case of pensioners. This division again reflects the conflicting opinions held on the ability to pay.
- 5.35 Income tax could also be challenged as not being adequately connected to income after necessary costs – such as those of a family or related to disability – are taken into account. This is in contrast to the approach taken by the Council Tax Reduction scheme, which gives different allowances to households of different types based on an estimation of the costs of living, taking into account factors like the number of children and additional support needs. Such targeting requires individual circumstances to be assessed and introduces administrative and compliance costs that are likely to be prohibitive if they were to apply to the entire working population. Furthermore, linking personal circumstances to the tax system is often the subject of challenge and significant dispute, as evidenced by the debate within the 2010-2015 UK Coalition Government about the introduction of a married couples’ allowance to the UK income tax system.

- 5.36 Figure 4.4 describes our analysis of a local income tax that was based on one scenario of a flat rate rather than different rates applying at the basic, higher and additional tax thresholds. We emphasise that the purpose of this modelling is to inform our understanding rather than to present a preferred system. Indeed, it is impossible to say exactly how much households would pay if a “revenue neutral” local income tax was introduced in future. This is because local income tax bases will change substantially every year as local populations and labour markets change, earnings grow (or fall), and the UK Government revises the definition of income and the level of the personal allowance. However, our analysis allows us to look at the relative impacts of a local income tax – irrespective of whether the rate is different from the one we have assumed, the relative impact across households with the same income should stay broadly the same.
- 5.37 One important finding, confirming the point made in paragraph 5.31, is that once income is adjusted to take account of the different costs of living, a household in the same income decile that has children is more likely to pay a higher proportion of their equivalised net household income under local income tax than households without children. In addition, because personal allowances are calculated for individuals, households with two earners will pay tax on a lower proportion of equivalised net household income than households with the same income but one earner. These factors challenge whether or not a local income tax is indeed equitable by our measure, though this must be considered alongside the parallel challenge that property taxes also depend on income and need-based relief schemes to ensure liabilities adapt where households of different circumstances live in similar properties.
- 5.38 The general approach to income taxation in the UK is to allow a certain amount of income to be earned before income tax applies (the personal allowance) with the benefit system providing some additional support to households with children and those with additional support needs. As new tax and social security powers are transferred to Scotland, there may be an opportunity to shape a local income tax to be more equitable across all households, although this would be a significant change to existing practice. This, along with the challenges of taxing dividends and investments, illustrates that it is difficult to achieve both fairness and administrative efficiency in any one single tax instrument.







# What are the Wider Impacts of Alternative Local Taxes?

- Taxes on property or land are hard to avoid as they are based on something fixed, whereas taxes on income present more challenges to collect.
- Taxes based on the value of property already influence the decisions people make about how much they are prepared to pay for houses.



- 6.1 Taxes can change the way people behave. Under the pre-2014 Stamp Duty Land Tax for example, homes being sold at £125,001 and £250,001 faced much greater charges than homes priced £1 less. Property transactions therefore clustered at £125,000 and £250,000 as homebuyers sought to minimise the amount of tax they had to pay.
- 6.2 Ideally, taxes will not influence the way people and businesses make decisions, rather they should be made on merit and not as a response to a tax system. The exceptions to this are where a tax is applied to something undesirable, such as on carbon use, tobacco or the landfilling of waste. In those cases, taxes are specifically designed to change behaviours.
- 6.3 Our remit, requiring us to consider **"the wider macro-economic, demographic and fiscal impacts, including housing market and land use"**, therefore means we have assessed whether alternative taxes will influence the decisions people make and what the wider consequences might be.

#### Local Taxes and the Choices People Make

- 6.4 Taxes on both property and income can influence what people do. Our call for evidence highlighted some research showing that recurring taxes on property have some impact on the prices people pay for homes – so if a property incurs a high level of taxation then people will factor that into the maximum price they are prepared to pay for it. Similarly, people appear to be prepared to pay more for property if it incurs little or no tax liability. Research on this in the UK is not extensive, but work carried out to analyse the impact of the abolition of domestic rates at the end of the 1980s did find evidence of a resultant increase in prices when taxes on residential properties were removed temporarily.
- 6.5 Those arguing for land taxes base much of their case on the benefits arising from the way people would respond. They suggest land taxes would create an incentive to develop land to its fullest potential use, because the same charge would be levied irrespective of whether the site is abandoned or put to productive use. Owners and potential developers of derelict land would be particularly affected. For domestic owners, a tax solely based on land values would not provide any disincentive for people to improve their home and thereby increase its value.
- 6.6 One other argument for land taxes relates to the fact that the quantity of land is fixed. A land tax is levied on the value of the land itself and not what is built on it. A land tax may make the price of land fall because, as with property, tax liabilities influence the amount of money people are prepared to pay. Furthermore, it is not possible to manipulate the market by reducing the supply of land or destroying land that already exists. For these reasons, a land value tax is favoured by many economists as being the tax that influences behaviour the least.

- 6.7 Neither land nor buildings can be moved and therefore both are difficult to conceal. This means the scope for people to do things to avoid or reduce a local land or property tax bill is limited, short of moving to a lower value property or to a different local authority area.
- 6.8 This is not the same for a local income tax. Collecting a local income tax would necessitate additional effort to overcome the likely increase in tax avoidance activity. There would be an incentive to reduce local tax liabilities on earned income, for example, by seeking to receive income as dividends if these were not subject to the tax.
- 6.9 If a local income tax was locally set, allowing councils to determine their own rate of local income tax in their local authority area, over time, such a system would see variation across the 32 local authority areas in Scotland. We heard claims that this might result in high-earning individuals (who would be paying the most under a local income tax, irrespective of their property value) seeking to live in a local authority with the lowest rate or indeed in a different part of the UK – behaviour sometimes referred to as fiscal flight. Large differences in the level of property tax might be expected to have a similar impact – the present Council Tax already varies from area to area and increased local flexibility, or changes to the structure of the present arrangements, could result in such variations becoming greater.
- 6.10 The replacement of the present Council Tax with a local income tax would also mean the loss of one taxation instrument designed to induce behavioural change – the premium that can be levied on the bills of unoccupied properties to encourage owners to bring them back into use.
- 6.11 A local income tax, replacing the present Council Tax, and applying on top of the existing income tax rates, could also lead to other changes in behaviour. It may reduce incentives to work for some households, for example where there may be a fine line between the benefit of hours worked versus the cost of paying for services such as childcare. This must be viewed in the context of labour market opportunities and whether or not adjusting hours worked is a realistic possibility. However, it could also reduce incentives to work altogether, for example, for those households currently on out-of-work benefits, higher income tax rates will reduce the benefit associated with returning to work. This disincentive is also present in the tapering of the current Council Tax Reduction scheme (which is included in our models of alternative property taxes), where 20% of “excess” earnings are expected to be put towards current Council Tax bills. Indeed there are households in work that pay all or part of their Council Tax bill but who do not pay income tax because their earnings are below the personal allowance.

## Geographical Impacts

- 6.12 Changing the base of a property tax to up-to-date values (rather than those from 1991) will result in a geographical shift in the tax base within Scotland. House price increases have not been the same in all areas. This means that some local authorities would become more dependent on grants from central government and others less so. The analysis we conducted with Heriot-Watt University looked at the likely impact on seven local authorities and found that all else being equal, revaluation would increase the size of the Council Tax base in Edinburgh and Aberdeenshire, and lower the size of the tax base in Argyll and Bute, Dumfries and Galloway, Fife, Dundee and Inverclyde.
- 6.13 The geographical impacts of a land value tax would be largely similar to a property based tax, although our analysis has found a likelihood of higher tax bills per square metre of land in valuable city centre locations and lower liabilities in outlying and rural areas. The actual liability for a household will depend on the amount of land owned and the planning permissions that exist on that land, as well as eligibility for any discounts, reductions or exemptions.
- 6.14 A shift in the tax base from the present Council Tax would also occur under a local income tax – some areas are associated with higher income levels than others. Therefore all alternative systems would see some areas raise more or less tax revenue than compared to the present arrangements.
- 6.15 As a result, the distribution of central government funds to local authorities will need to be reviewed and adjusted in order that no local authority loses out if the size of its tax base falls.

# How Can Alternative Taxes be Administered?

- Existing local tax collection staff and administrative infrastructures provide a basis for the collection of a future alternative local property tax.
- The administration of a locally determined income tax would require radical changes to existing practices.
- Existing HMRC income tax collection systems might provide a basis for collecting a locally set income tax, but this would be a major undertaking, could not extend to income from savings and dividends, and would need the support of the UK Parliament.
- The alternatives to using HMRC income tax collection systems include a Scottish collection body or individual local collection arrangements, both of which create significant administrative and compliance challenges.

- 7.1 Our analysis so far has focused on the amounts of tax people would be required to pay and the impacts this would have. Yet some taxes can cost more to collect than others, and indeed, some taxes place a greater bureaucratic burden on those who pay the tax – sometimes called the compliance cost.
- 7.2 By requiring us to consider **“The administrative and collection arrangements that apply”**, our remit means we must understand what would be involved in the collection and administration of alternative tax systems.

### The Current Council Tax Collection Arrangements

- 7.3 Under the present arrangements, each local authority bills each household for the Council Tax due on their home, based on the tax rates set by that council, the information it has about who lives there and which valuation band the property falls into. Councils also administer the Council Tax Reduction scheme, which requires details of the income, benefits received and wider circumstances of the household.
- 7.4 There is an established administrative infrastructure to deliver these functions. Professional standards for such staff are supported by the Institute for Revenues, Rating and Valuation (IRRV). Local authorities' business processes are enabled using specialist software provided by a small number of suppliers familiar with the local authorities' requirements and the policy environment. The creation and maintenance of property valuations is a statutory role – the Assessor – distinct from other Local Government officers. Most councils delegate the duties of the Assessor to Valuation Joint Boards covering a number of local authority areas. Valuation Appeal Committees, comprising independent lay people appointed by the Sheriff Principal, provide an important function, determining appeals in relation to the valuation of property or the calculation of Council Tax liabilities. Appeals regarding a local authority's assessment of an individual's entitlement to a Council Tax Reduction are dealt with differently by panels comprising tribunal judges and convened by the Scottish Tribunals Service.
- 7.5 Councils also presently administer the Scottish Welfare Fund for the Scottish Government and Housing Benefit on behalf of the DWP. This latter function will be increasingly removed from local authorities as the DWP rolls out the Universal Credit programme.

- 7.6 The administration of the Council Tax Reduction scheme is complex, although eligibility criteria are very similar to those for Housing Benefit. This reflects the intention that both attempt to target assistance by accounting for wider household circumstances beyond a simple estimate of income. Entitlement criteria often replicate those used elsewhere in the benefits system (for example, entitlement to particular disability benefits is used as a proxy to describe a degree of need associated with a particular level of disability) and many cases are “passported”. This term is used to describe a situation where the entitlement to a particular benefit (for example Jobseekers’ Allowance) of itself provides sufficient information about need and income to bypass a more detailed needs assessment. These interdependencies contribute to a perception that the legislation and the entitlement criteria for Council Tax Reduction can appear to be overwhelmingly complex. However, we recognise that administration is facilitated by the sharing of data between Her Majesty’s Revenue & Customs (HMRC), DWP and local authorities and, because the Council Tax Reduction scheme “piggy backs” on particular criteria used in the benefits system, alternative ways of assessing individual need would entail duplication of effort.
- 7.7 Local authorities are required by statute to collect Scottish Water charges which, for domestic properties, are based on their Council Tax band with a system of discounts applying. Local authorities bill and collect these charges alongside Council Tax, receiving around £18 million per year from Scottish Water to meet administrative costs.
- 7.8 In their evidence to us, the Chartered Institute of Public Finance and Accountancy (CIPFA) and their local authorities’ Directors of Finance Section estimated that Council Tax collection costs by local authorities in 2014-15 were £25.980 million with valuation costs a further £10.768 million. Together, these amount to around 1.9% of the tax collected. Administration costs for the Council Tax Reduction scheme are hard to isolate from the total costs of administering Housing Benefit and the Council Tax Reduction scheme combined. Around 80% of Housing Benefit claims have an associated application for a Council Tax Reduction. For 2015-16, the DWP and Scottish Government combined made payments totalling around £34.5 million to cover the estimated costs of local authorities administering the two systems.

## The Current Income Tax Collection Arrangements

- 7.9 Presently, income tax is a UK-wide tax, set by the UK Government and Parliament, administered by HMRC and with receipts accruing to the UK Exchequer. It is collected in one of three ways:
- under the Pay as You Earn (PAYE) system, it is withheld from salaries and pensions by employers and pension providers – those administering the very thing that is taxed;
  - it is withheld (at the basic tax rate only) from interest and returns on some other types of investments by banks, funds and other financial institutions – again those administering the very thing that is taxed; and
  - it is collected under the self-assessment regime for those whose full income tax liability cannot be collected by employers or pension providers. This includes people who are self-employed, those who have significant investment income or those whose income comes from more than one source.
- 7.10 After April 2016, HMRC will collect the SRIT, using the existing PAYE and self-assessment systems. Special PAYE "S" codes will be issued to Scottish taxpayers and payroll systems will use these to collect Scottish income tax. SRIT will not apply to income from savings and dividends which will continue to be taxed at the UK basic rate.
- 7.11 Establishing the systems required to collect the SRIT required the identification of all Scottish taxpayers, the development of HMRC's own business processes and systems, and created compliance costs for employers whose payroll systems needed to be adapted to apply a different rate of income tax for employees identified as being Scottish taxpayers. Implementing the SRIT is estimated to cost £30 million to £35 million in HMRC start-up costs with no estimate available for the compliance costs to business. Indications from HMRC are that the subsequent annual running costs for the SRIT would be £2 million to £2.5 million if the rate was the same as elsewhere in the UK or £5.5 million and £6 million if a different rate was to be set. These higher costs reflect the likely additional compliance work that would be needed.



## Debt Collection

- 7.12 Ensuring compliance with a tax system is an important element of maintaining fairness as it ensures that those who are liable to a tax pay what is owed. Local authorities and HMRC both have substantive and rapidly enforceable powers to recover outstanding debt, including arresting earnings, freezing bank accounts and the confiscation of property.
- 7.13 We heard evidence that local authorities' collection of water charges was a complicating factor in the understanding of Council Tax debts. This is especially the case as maximum relief from water charges still leaves a liability of 75%, even if the household is entitled to a full Council Tax reduction. We also heard evidence that some households' prioritisation of debt repayment can be based on the scale of the penalties for late payment. Late payment of Council Tax initially means the loss of entitlement to pay in instalments, but continuing non-payment results in the council obtaining a summary warrant from a Sheriff Court and the taxpayer automatically incurring a penalty of 10% of the debt. To some, this is preferable to the late or non-payment of other debts that can incur a higher penalty.

## Administering Alternative Property Taxes

- 7.14 Depending on the scale of the change, alternative property taxes might reasonably be expected to be implemented by adapting the existing revenue collection arrangements within local authorities and the associated bodies described above. In the next chapter we identify some of the issues that transition would raise, including the revaluation of properties. Business processes and IT systems, as well as the role of the Assessors, Valuation Joint Boards and Valuation Appeals Committees may need to be adapted, depending on the nature of the tax that was implemented, and so there would be some cost. But overall, existing staff and structures could provide the basis for the administration and collection of a new or revised local property tax in the longer term, including, potentially, a local tax on land values. This would also afford an opportunity to integrate land value and ownership data on the Registers of Scotland's Land Register.
- 7.15 The administration of a system of income based and needs-assessed relief to a local property tax can be expected to continue to be complex. It is not clear how this might be impacted by the roll out of Universal Credit or the expected increased devolution of support for housing costs.

## Administering a Local Income Tax

- 7.16 In some countries, Local Government is assigned a fixed proportion of receipts from the national income tax. This gives Local Government a material stake in the national economy and makes the origin of its funding more evident. But since this does not allow for local variation, this is not a locally controlled tax. A more sophisticated assignment system might involve estimating the amount of national income tax paid in each local authority area and making that a transparent part of the funding from central government. This, again, would not be a locally controlled tax, but could connect the funding for Local Government with local economic performance.

- 7.17 Although income tax is a fundamental part of the existing tax system, the administration of a locally determined income tax would require radical changes to existing practices. In theory, there are three potential means of collecting a locally determined income tax – collection by HMRC, collection by local authorities, or the establishment of a separate income tax collection system on a Scotland-wide basis.
- 7.18 We therefore considered how a locally determined income tax might be administered, firstly by examining collection by HMRC. The establishment of the SRIT will demonstrate the capacity of the existing income tax system, administered by HMRC, to apply a different tax rate on earned income based on where the taxpayer lives. Indeed, liability (or otherwise) for SRIT is based on a distinction between those who are chiefly resident in Scotland and those who are chiefly resident elsewhere. Our understanding of the processes undertaken by HMRC to identify Scottish taxpayers suggests that for most circumstances, this was not a major issue, although there were some types of case that proved more difficult to resolve. These included students starting work, offshore workers, members of the armed services, anybody who moves to or from Scotland during the year, people who live in Scotland and work elsewhere or vice versa and people who have two houses – one of which is in Scotland – for any other reason. We therefore consider that determining residence would be a significant factor for a locally variable tax.
- 7.19 Having identified which taxpayers reside in which local authority area, mechanisms would need to be established to enable a locally determined rate of income tax to apply to residents in each of Scotland's 32 local authority areas. Hence, the capability of the existing PAYE and self-assessment systems to support this would need to be ascertained and explored with HMRC and payroll and pension providers.
- 7.20 Importantly, as HMRC is a department of the UK Government, accountable to the UK Parliament through a UK Government Minister, using HMRC to collect a locally variable income tax across Scotland's 32 local authority areas would need the support of the UK Government and Parliament. If UK legislation was required, this support would need to extend to creating space in a legislative programme.
- 7.21 One consequence of the PAYE system being used to collect a locally determined income tax would potentially be that two employees of the same organisation, in the same roles with the same salaries, would pay different rates of tax as a consequence of their home addresses. Although this presently happens with Council Tax, this would require a strong level of public understanding to work, as well as robust administrative procedures to ensure the correct rate of tax was collected and to deal with changes such as people moving house.
- 7.22 The SRIT, and the proposed Scotland Bill 2015 income tax provisions do not apply to income from savings and dividends as this was not considered to be administratively practicable. However, if UK Government consent was received for HMRC to collect a locally determined income tax, we think the scope for that to apply to income from savings and dividends should be re-examined, both with HMRC and with industry representative bodies such as the Association of British Insurers and the wider tax profession.

- 7.23 The collection of a locally determined income tax by HMRC would also mean that local authorities' revenues would be subject to HMRC's collection performance. HMRC estimate the difference between the amount of tax that should be collected and what is actually collected as being 1.6% of liabilities under PAYE and 15.4% of liabilities under self-assessment. We did not take evidence on whether these differences may derive in part from HMRC's operational practices. By comparison, Council Tax in-year collection rates are around 96%. However, other evidence clearly suggests that income tax deducted at source by employers' payroll systems will inherently collect more of the tax due and at lower cost than if collected after salaries have been paid. The Institute for Fiscal Studies "Mirrlees" review of "Tax by Design" states that "withholding (such as under PAYE) is an extremely effective way of collecting income tax because it reduces the risk of non-compliance and takes advantage of the economies of scale in tax remittance". Consequently, using HMRC to collect a local income tax would suggest that the income of a local authority would depend on the proportions of taxpayers in that area paying tax by self-assessment and by PAYE. This may also introduce a revenue risk into the future given that the proportion of income tax paid under the self-assessment scheme may be increasing.
- 7.24 The collection of a locally varied income tax by HMRC alongside the SRIT (and the proposed Scotland Bill 2015 income tax provisions) would also mean that the tax base of local authorities would have some dependence on the decisions of other levels of government – for example in defining income itself, what the personal allowance is and any interactions with the benefits system, including the present system of tax credits. In more extreme circumstances, the tax rate determined by one level of government could influence the scope for other jurisdictions sharing the same tax base to apply the tax rates they wish. Mechanisms for managing these interactions and dependencies, which are being developed for the SRIT, would therefore be needed.
- 7.25 The alternative approaches of collecting locally determined income tax by local authorities themselves, or by a Scotland-wide tax authority (Revenue Scotland would be the obvious institution for this, although presently has no role in income tax collection) would make such a locally determined income tax less dependent on the national tax policy decisions of the UK and Scottish Governments. However, there would be significant practical challenges in establishing a collection system for a locally variable income tax either by local authorities or through a Scotland wide authority for local taxes.
- 7.26 Replicating HMRC's PAYE system would necessitate establishing a system to deduct a locally determined income tax at source and require employers to administer employees' income tax for not just HMRC, but also for either one Scotland-wide tax authority or up to 32 local tax authorities. Even in the case of one Scotland-wide body, there would be multiple new tax codes to reflect the different rates set by each local authority – as would be needed if HMRC were the collection agency.

- 7.27 We did not take evidence on the practicability of this specific approach, but we received evidence from employer representative organisations indicating likely opposition to employers being tasked with collecting local taxation in any form because of the additional costs likely to be created. Employers have, however, had to update systems to administer SRIT from April 2016, and may well have to update them again before any further tax powers are introduced, such as those set out in the Scotland Bill 2015.
- 7.28 Rather than seeking to replicate the PAYE system, an alternative way of collecting and administering a locally determined income tax separately from the national and SRIT would be to introduce the common overseas practice of requiring everybody to submit a tax return. Many countries we examined that operate some form of local income tax system do so on the basis that all citizens are required to submit tax returns – something akin to the HMRC self-assessment regime.
- 7.29 We have seen estimates suggesting that around three-quarters of Scottish taxpayers are in the PAYE system and do not have to submit tax returns. Therefore introducing a tax return system purely for a local income tax would represent a far-reaching change, raising likely issues of public acceptance. It is also the case that the administrative costs to government of withholding income tax at source are much less than under a tax return system – for PAYE they have been estimated at 0.7% of revenues compared to 4.5% under self-assessment. By comparison, Council Tax collection costs are estimated to be around 1.9% of total revenues.
- 7.30 This therefore presents a difficult choice if a locally determined income tax is to be implemented. A locally set income tax administered as part of the wider Scottish and UK tax system would maximise collection rates and minimise the associated compliance and administrative costs, but is unlikely to be able to include all types of income and would require the support of the UK Government and Parliament. In the absence of that support, the alternatives of either duplicating the HMRC systems at the Scottish or local levels, or collecting a locally determined income tax entirely by some form of self-assessment, introduce different costs and benefits. These options would be much less dependent on the decisions of the UK Government but acceptance from employers and/or the public may be difficult, they are likely to be more expensive to administer, and may collect a smaller proportion of the taxes due.
- 7.31 Whichever system was employed, a locally determined income tax would represent a significant administrative change to existing practices either within HMRC, local authorities, or any new or existing Scottish body.

# When and How Could an Alternative Tax be Implemented?

- New primary legislation to establish a wholly new system of local tax could not be delivered before the Local Government elections in 2017.
- Structures already exist to administer alternative property taxes, but transition would still incur costs and take a number of years to implement – even more so if land was to be taxed separately.
- Establishing a locally determined income tax would be a substantial administrative task, although a system of assigning income tax revenues to Local Government, potentially by local authority area, would be much less challenging.
- Any change will lead to some individuals paying more and some paying less. A transitional framework to avoid sudden changes to their tax bills, and allow taxpayers to adjust to new liabilities, is desirable and the cost of such an arrangement should be assessed.

- 8.1 Whilst the previous chapter considered how taxes might be collected in the long term, our remit requires us to consider **"the costs of transition"** and **"potential timetables for transition, with due regard to the 2017 Local Government elections"** and means that we have to consider what would be necessary to get from the present arrangements to the alternative tax systems we identify.

### Legislative Changes

- 8.2 To be legal and enforceable, a tax must be set out in law. The present Council Tax is defined in the Local Government Finance Act 1992. However, changes to the valuation of properties, the ratios that determine how much properties in each band are charged as a proportion of Band D and the Council Tax Reduction scheme can be made by secondary legislation. Any more substantial changes would require an Act of the Scottish Parliament. Speed of parliamentary passage and complexity are not however necessarily linked – the present Council Tax Reduction scheme is set out in secondary legislation but is considerably longer than the primary legislation setting out the Council Tax itself.

#### FIGURE 8.1 LAW MAKING IN SCOTLAND

**Primary legislation** is initially set out as draft law in a Bill. In most cases, the Scottish Government will conduct a 12-week public consultation on a proposed policy. Once the Bill has been introduced to Parliament, the lead Committee may issue a call for written evidence and take oral evidence from witnesses. Further stages provide for amendments to be proposed and the content debated, before Parliament votes on whether to pass the Bill. If passed, the Bill is submitted to Her Majesty The Queen for Royal Assent, after which it becomes an Act of the Scottish Parliament. Overall, the passage of a Bill through Parliament can take over 12 months, depending on its length and complexity. The Act will then come into force on a designated date some time thereafter.

**Subordinate legislation** (often called delegated or secondary legislation) is law most often made by Ministers under powers granted to them in primary legislation (for example to prescribe timing and implementation). In most cases the Scottish Government conducts a 12-week public consultation of its proposals for subordinate legislation. Parliamentary scrutiny of subordinate legislation involves fewer stages than for primary legislation and is usually conducted by Committees. This entire process can take as long as between 8-12 months, although is frequently less.

- 8.3 A switch to a fundamentally different local tax system would require primary legislation. There would need to be substantive consultation to inform the significant administrative effort in drafting a Bill which would be subject to full parliamentary scrutiny. Depending on the scale of the change and likely political challenge arising, this process might be expected to be achieved in perhaps two or three years, meaning that any alternative system introduced in this way could not be enacted before the Local Government elections in 2017.
- 8.4 This timetable may need to be extended further if the legislation for a new tax collection arrangement was dependent on the UK Parliament and Government. This would be the case for a locally determined income tax collected by HMRC, but also if the existing legal provisions for the sharing of data held by other government departments, such as HMRC or DWP, needed amendment.
- 8.5 Changing the basis of local taxation will have an impact on the derivation and collection of Scottish Water charges. Although not our primary concern, this secondary impact will need to be addressed.

### **Administrative Changes**

- 8.6 As discussed in the previous chapter, local authority staff presently collecting Council Tax provide the obvious means to collect an alternative local property tax in the future. Transition to a new arrangement would place additional demands as IT systems and business processes would need to be revised whilst the existing Council Tax continued to be collected. This could be expected to carry additional costs and there will need to be a common understanding between Local Government and the Scottish Government of how these might be met. We have not sought to quantify these costs as they depend on whether an alternative property tax – and any relief system – could be implemented and administered by the adaptation of existing systems and using existing staff or whether new software, systems and staff structures are needed. This also impacts on the likely time needed to implement an alternative tax. A further consideration is whether sufficient certainty can be provided in advance of legislative change for resources to be committed before the parliamentary scrutiny is concluded and a new tax system passed into law.
- 8.7 Transition to a locally determined income tax would represent a more far-reaching change from existing arrangements. In the previous chapter, we identified that a locally variable income tax could, in theory, be administered by three alternative mechanisms. The most practicable solution with the least compliance cost is likely to be for HMRC to collect this by identifying taxpayers by local authority area and extending the SRIT to apply income tax varied in each of the 32 local authority areas. We have not estimated the cost of this transition, but HMRC's start-up costs for the SRIT of £30 million to £35 million might indicate the likely order of magnitude. Part of these start-up costs will have arisen from identifying Scottish taxpayers – we do not know the extent to which the information captured for this purpose could be further broken down to individual local

authority areas. The remainder of the start-up costs will have arisen from extending HMRC systems and business processes to administer the SRIT itself. HMRC have not estimated the likely compliance costs of employers changing payroll systems to support the SRIT, but this will need to be considered for a local income tax.

- 8.8 In the previous chapter, we also considered the possibility of local authorities, or a national Scotland-wide body, collecting a locally variable income tax by either replicating the existing PAYE and self-assessment systems or collecting the tax wholly by self-assessment. We did not take evidence on the likely establishment costs of these options, but common to all is that they would require the creation of entirely new administrative capabilities to duplicate some of HMRC's existing income tax administration.
- 8.9 Collection of local taxes by a body other than local authorities would impact upon the revenue and benefit functions within local authorities, potentially reducing the numbers of staff needed, although it may be that TUPE conditions might apply.
- 8.10 The previous chapter also noted that some countries assign a proportion of national tax receipts to Local Government. This might be enhanced if it was possible to estimate the income tax receipts in each local authority area in order to assign each council a share of national income tax estimated to have been paid by residents. The latter, more sophisticated option, could be achieved by estimation (and indeed is likely to depend on bespoke analysis of various HMRC statistics such as the Survey of Personal Incomes and information regarding tax credits). Although not without its complexities, this would be a simpler exercise compared to the changes needed to implement a local variable income tax.

### **The Valuation of Property**

- 8.11 Whilst we note in Chapter 5 the potential desirability – and associated political challenge – of the revaluation of property to support an alternative property tax, the act of revaluation is significant and distinct from other changes needed to administer a property tax. If a move to an alternative property tax required all properties to be revalued (whether on an individual property basis or to bands), this would have an impact on the cost and scale of the exercise. The SAA estimated that a revaluation exercise to a revised system of property valuation bands could be achieved at a cost of £5.5 million to £7 million and take two to three years. This would require additional resources, which could be minimised if this exercise could be achieved around the workload associated with the 2017 revaluation of business property. An exercise to revalue properties to discrete values would, according to the SAA, cost £7.5 million to £8.5 million. The SAA also highlighted the likely volume of appeals that would arise from a revaluation exercise, with revaluation to individual property values (as opposed to bands) increasing the likelihood of appeals and potentially increasing the cost and time needed to complete such an exercise.



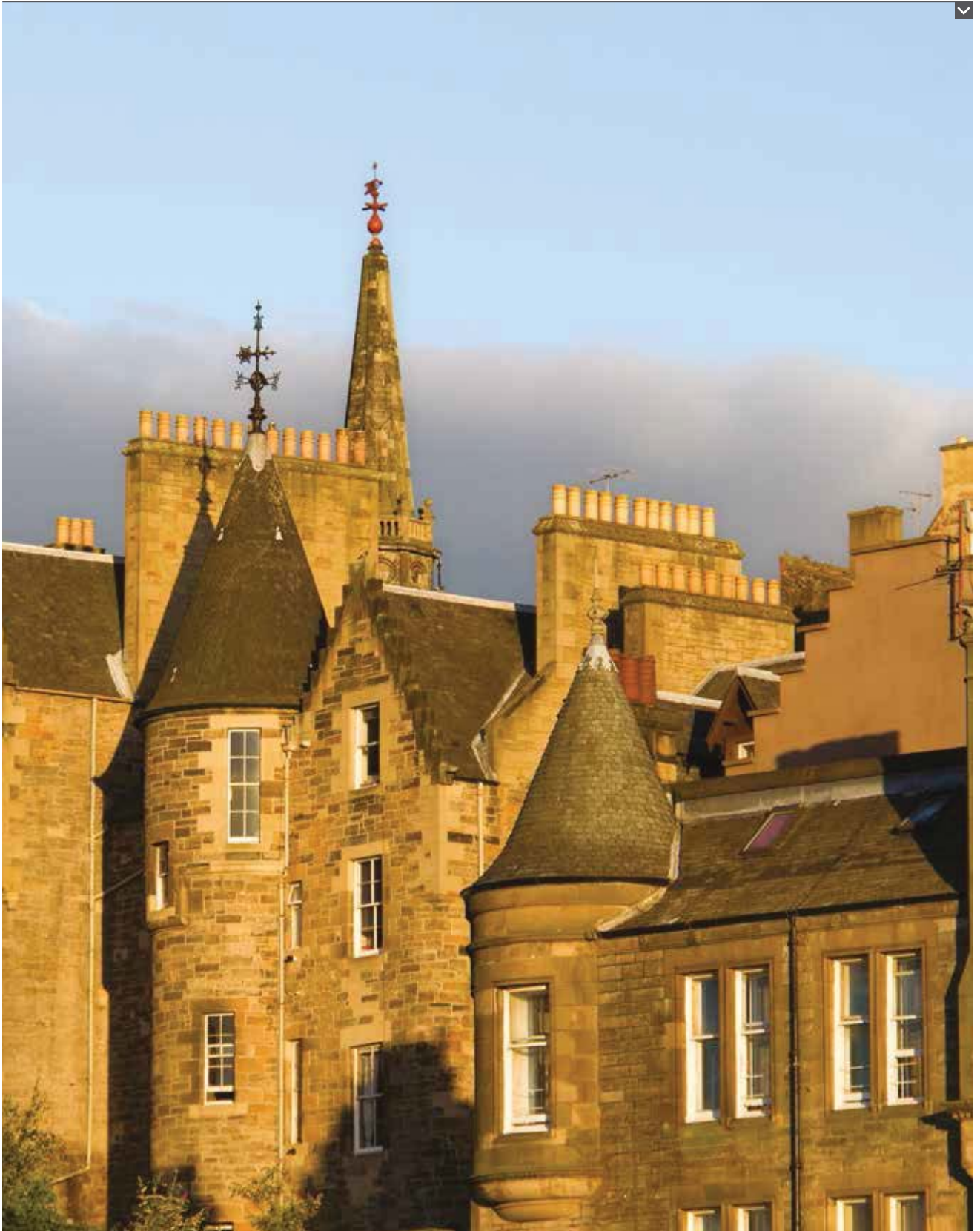
- 8.12 We worked closely with Heriot-Watt University to model the impacts of revaluation by using Computer Assisted Mass Appraisal (CAMA) techniques – the first time this has been achieved for local authority areas in Scotland. In correspondence to us, the SAA indicated that the two to three year estimates to revalue properties may be shortened and the costs decreased by developing this methodology alongside more traditional valuation techniques.
- 8.13 Given that revaluation becomes more politically and administratively challenging as the time since the last valuation increases, there is a strong case for distancing any revaluation process from short-term political pressures. This could be achieved by making regular revaluations, for example every five years, a legislative requirement.
- 8.14 These considerations are all based on an alternative property tax being based on the capital value (either as part of a banded system or a discrete value) of buildings and land combined and hence informed by current sales data. Switching the basis of a property tax to land values only would be complex – we heard evidence of potential ways this could be achieved, but a concern was expressed that knowledge of land ownership and land values was not sufficiently complete to support an early implementation of a land value tax. The evidence suggested that a more realistic approach to such a tax might be based on estimates of land values being developed and disaggregated from overall property values over a number of years, with this data combined with Registers of Scotland's Land Register. This would still incur costs, with the SAA estimating that doing so would at least double its equivalent estimate for a revaluation of buildings and land. However, the experience of countries such as Denmark demonstrate that a land value tax can be made to operate.

## Protecting Taxpayers from the Impact of Change

- 8.15 Irrespective of what the preferred alternative tax system is, our analysis confirms that any replacement for the present Council Tax would see the tax liabilities of many individuals and households changing – some will pay more and some less. A fairer, more progressive property tax, for example, would see those in lower value homes pay less but the tax due on higher value homes increase. Such changes would ultimately be the purpose of making a local tax fairer, but the change should not be introduced in such a way as to impose sudden and extreme increases in people's tax liabilities.
- 8.16 A similar problem of change creating sudden large increases to individual liabilities could face the recipients of discounts under the present Council Tax system, such as people with disabilities or full-time students. Any changes either to an alternative property tax or a local income tax would need to consider continuing discounts to avoid unforeseen sharp increases for categories of household currently receiving them.
- 8.17 Structural changes to tax systems can create particular issues, potentially changing the way in which local tax is paid. For example, a couple who presently make one household payment on their home for Council Tax would, under a local income tax, see local tax deducted from both their individual incomes.
- 8.18 A robust transitional framework is therefore needed. This would ensure that people have enough time to take any action needed to be able to pay their tax bills into the future. Such a framework could also help a new system gain public acceptance, although the visibility of local taxation means that change will remain politically challenging to deliver. Evidence from Northern Ireland and Wales, however, demonstrates that this is achievable. Furthermore, the conclusions from the review of international literature by Policy Scotland at the University of Glasgow note that "anticipating....short run transitional problems in advance of desirable long term impacts is a key way to lay the ground for reform".
- 8.19 Both the Welsh and Northern Irish examples were based on additional funding being added to support the schemes. It may be possible for the transitional relief framework to be designed to be self-financing (i.e. the phased application of higher bills operates in step with the phased application of lower bills). This highlights that the costs of a transitional framework should be assessed and considered as part of any projections of how much revenue would be raised by an alternative tax system.

**Figure 8.2**  
**Transitional Relief Frameworks Used Elsewhere in the UK**

How it worked	What it cost	When it took place
<p>The Northern Ireland Executive reformed the Domestic Rating system in April 2007 based on individual capital value assessments for domestic properties.</p> <p>A transitional scheme was introduced and applied to private dwellings, private storage premises and private garages. Households automatically qualified for transitional relief where they experienced an increase of more than 33% in their rate liability on moving to the new system, compared to what the liability for the property would have been had no revaluation taken place.</p>	<p>£32 million over three years.</p> <p>This was paid by the Northern Ireland Assembly to Local Government to compensate for tax revenues foregone.</p>	<p>The scheme was phased in over 2007-08, 2008-09 and 2009-10.</p> <p>Relief was tapered, with full relief in year one, 66% relief in year two and 33% in year three. The full rate bill was payable in year four.</p>
<p>Following revaluation and re-banding of domestic properties, the Welsh Assembly Government introduced a transitional relief scheme to ensure that no household's Council Tax liability would rise by more than one band in each of the first three years above the band that they were in immediately before revaluation took place.</p> <p>Transitional arrangements were applied automatically; there was not a requirement for taxpayers to apply for the relief. The scheme did not extend to protection for second homes.</p>	<p>£11 million in year one.</p> <p>This was paid by the Welsh Assembly Government to Local Government to compensate for tax revenues foregone.</p>	<p>The schemes operated between 2005-06 and 2007-08.</p> <p>In year one, dwellings did not experience more than a one band increase above their pre-valuation band.</p> <p>In year two, dwellings did not experience more than a two band increase above their pre-valuation band.</p> <p>In year three, dwellings did not experience more than a three band increase above their pre-valuation band.</p>





# Understanding Local Taxes

- There is currently no consensus on the single best option for reform, or indeed about whether one option can deliver adequate reform on its own.
- Understanding is strongest in relation to the present Council Tax, and property based alternatives to it. The principles of a local income tax are often readily understood, although our public engagement suggests that people have questions about its operation that could impact on its potential acceptability in practice.
- A tax on land is a new and potentially complex concept for many people to understand, although we found that support was often strong amongst those who have built up their knowledge of it.
- Effective reform must be coupled with clear information about the case for change, what this means for individuals and households and how local government receives funding and spends money.
- Any new system should be designed to minimise the need for complex relief schemes and ensure that any reliefs are straightforward to understand and administer, and that take-up is increased.

- 9.1 A core part of our remit required us to **"engage with communities across Scotland to assess public perceptions of emerging findings"**. We invested substantial effort in this process, and the steps that we undertook were perhaps the most comprehensive of their kind to date in this country.

### What We Found

- 9.2 It was clear to us from our engagement with the public that many perceptions of alternative tax systems are heavily influenced by their ease of understanding, and the degree to which their operation in practice is clear.
- 9.3 These perceptions are all the more important because our research suggests that most people are unclear about the role of local taxation and how Local Government receives funding and spends money at the moment. We of course acknowledge that systems of taxation and public finance are complex, and that most of the people that we engaged with had no reason to have detailed understanding of the breadth of the operation of the current system, let alone alternatives to it. However, we consider there to be significant scope to improve clarity in the future, both in terms of the principles of any reformed system, and the broader links between local taxation and local democracy.
- 9.4 Indeed, our engagement showed very clearly that, regardless of the alternative that is chosen, people in Scotland have a strong desire to understand the operation of any alternative system and its fairness. In particular, people told us that they wanted to be clear about not just the implications of reform for their own circumstances, but on how equitable and fair any reforms are for others too.
- 9.5 Our research also suggests that perceptions of fairness are strongly linked to people's sense of the overall purpose of the system of local taxation. Put most simply, we consistently heard that people support a more progressive system. While not universal, we also heard that a system of local taxation is seen as a crucial component of a well-functioning democracy, and that the line of sight between how local taxes are set and spent should be made as strong as possible.
- 9.6 To us it follows, therefore, that the core of any successful transition to a new model of local taxation is an effective and comprehensive programme of information to ensure that all those affected can understand the system and its impact on them. This must extend beyond just the mechanics of the tax itself, in order to explain how decisions relating to local taxation are made, and how the money generated is spent to deliver against local priorities.
- 9.7 Through our series of listening events, we were also able to gauge the extent to which the members of the public that we engaged with had a clear level of understanding about the options for reform.

- 9.8 We found that no one single option for reform emerged as more popular than the others. However, we did find different levels of understanding in relation to different models, and that perceptions of fairness were often bound up in the degree of clarity regarding how different options for reform would operate in practice. This suggests to us that detailed design issues need to be thought through as early as possible in the transition to any new system.

### Public Understanding of Taxes on Property and Land

- 9.9 With the exception of the short-lived and controversial Poll Tax, property taxes (previously the Domestic Rates) have long been the main source of household taxation in modern Scotland. Perhaps unsurprisingly, we found that having operated for almost 25 years, the present Council Tax system is therefore generally well understood compared with other options that were considered. Responses to our online questionnaire also suggested that the majority of respondents found the payment process for the present Council Tax to be clear. However, we also heard about aspects of the present Council Tax that were not easy to understand, and in particular about the need to simplify what is perceived to be a complex Council Tax Reduction scheme.
- 9.10 More surprisingly, many of the regressive components of the current Council Tax were often not as well understood, nor was the fact that the tax base had not been revalued for approaching 25 years. However, these deficiencies were readily understood once the current system was explained. We also found that members of the public generally believed that the Council Tax accounts for far more than the 12% of total Local Government revenue that it currently does.
- 9.11 Land value taxes were the least well understood of the property taxes that we explored. Many people had little or no previous knowledge of this option, despite its relative prevalence as part of the local tax mix in Europe and beyond. In many instances, we found that this lack of clarity translated into concerns about how the tax would work in practice. Common questions related to the application of land taxes in tenement properties or properties with mixed residential and commercial components, their potential impact on the housing market, and their application and impact in rural areas in relation to agricultural land and crofting. We also commonly found there to be unresolved debate about whether land taxes should apply only to land for housing use, or more broadly to non-domestic properties too.
- 9.12 Despite this, we also encountered many individuals who were very conversant with the concept of land value taxation and were active advocates for it. We conclude, therefore, that much more work is needed to translate the economic theory underpinning land value taxes into easily understood formats before public understanding can match that of property and income based alternatives.

## Public Understanding of Taxes on Income

- 9.13 Our research suggested that the principles of a local income tax system are relatively easy to understand, and, in principle, capable of being perceived as being fair. In particular, at the events that we held, local income taxes were often seen as a potential option for reform because they were perceived to have positive scope to link to an individual's ability to pay.
- 9.14 However, outstanding questions about the operation of any local income tax system in practice also caused many to pause. In particular, the fairness of a system that could potentially exclude unearned income was questioned, particularly in cases where it was felt that the consequence of a local income tax would be to remove people from the system who would otherwise be well placed to contribute towards local services.
- 9.15 Concerns were also raised about the administration of a locally determined income tax. It was generally felt that a system of local administration would be costly and complex to engage with, and that national collection through HMRC, or in time a Scottish body, would be likely to be required. Moreover, concerns were raised that in such a system, it could be unclear how councils would control tax rates locally, thereby weakening rather than strengthening local decision making over tax and spend choices as a result. Our evidence therefore suggests while this was initially considered to be a straightforward option for reform by many, a number of complexities arising from the design and operation of any local income tax system would need to be resolved if it was to be clearly understood and enjoy public support.

## Water and Sewerage Charges

- 9.16 We also heard a considerable volume of evidence highlighting issues of clarity and understanding in relation to water and sewerage charges. Currently, these bills are issued on behalf of Scottish Water by local authorities at the same time as Council Tax bills.
- 9.17 We heard that while administratively efficient, the impact of this current approach is not only confusing, but potentially harmful too. While we acknowledge that water and sewerage is a charge rather than a tax, and therefore outwith our remit, we do consider it confusing that vulnerable households in receipt of 100% Council Tax Benefit only receive a reduction of up to 25% in the water and sewerage charges that are billed alongside them. We were also particularly concerned by evidence from Citizens Advice Scotland and others which reported that many households do not understand that they remain liable for payment, and that up to one in five households had accrued arrears in water and sewerage charges as a result.



9.18 While we therefore acknowledge the administrative efficiency of the dual billing process, we conclude that as an immediate step the separate nature of these charges, even if they remain on one bill, needs to be made clearer to households in order to help prevent them from falling into debt. While not part of the system of local taxation itself, we would also welcome a further consideration of the system of reductions in relation to water and sewerage charges.

### Emerging Issues

9.19 For all of these reasons, we place particular emphasis on the need to deliver clarity in any system of local taxation because we recognise that successful integration and acceptance of any reform by a future government will require clear understanding amongst those that are liable to pay. The basis for calculating somebody's tax must be transparent and demonstrate that current shortcomings are addressed. Not only that, but our public engagement highlighted that the relationship between local taxation and the wider system of Local Government finance is not widely understood. We heard persuasive arguments suggesting that clarifying and strengthening the system of local accountability around local taxation, and in particular the extent to which people are able to exercise local choice and control over tax and spend decisions that affect them, has the potential to deliver democratic renewal within communities.

9.20 Together, these issues seem to us to be at the core of the job of building the case for change, and securing support for a reformed approach in future.





# Local Tax and Local Democracy

- An effective local tax system is fundamental to delivering financial accountability for Local Government and supporting local democratic choice.
- A new system should offer greater flexibility to Local Government.
- Local authorities with lower tax bases should not lose out as a result of the shift in the tax system.
- Broadening the local tax base could also include environmental, resource, sales or tourist taxes, as appropriate to local circumstances and local authority decisions.
- Local taxation only accounts for 12% of total Local Government revenue; the gearing effect associated with this will not be addressed simply by replacing the present Council Tax.

- 10.1 The ability of any sphere of government to determine the taxes it raises and how they are spent is a fundamental part of the democratic process. Accountability for these decisions is strongest when communities are offered choices about not just their priorities for public service provision, but also about the levels of taxation required to deliver these. An effective system of local taxation can therefore fundamentally strengthen democracy in Scotland and ensure that Local Government is financially accountable to its electorate.
- 10.2 As a Commission, our remit required us to consider the impact of alternative local tax systems **"on supporting local democracy, including on the financial accountability and autonomy of Local Government"**. We therefore set out to ensure that our evidence gathering and analysis spanned not simply the technical processes of local taxation, but crucially, the opportunities to ensure that any reform would be capable of strengthening communities and supporting local democratic decision making.

### Local Government's Present Financial Autonomy

- 10.3 In recent years, the Council Tax freeze has removed variation in local tax rate setting between local authorities. Whilst this policy featured in a number of parties' manifestos in the 2011 Scottish Parliamentary elections, and has been considered to have been popular with the electorate, it should not be assumed that it will go on indefinitely. Democratically elected councils should be able to make local tax and spending choices by being able to vary the rate of local taxation that applies in their local authority area.
- 10.4 The present degree of local financial autonomy is also currently distorted by a gearing effect. As we have already highlighted, our analysis shows that just 12% of gross revenue income is currently generated from the Council Tax. Even a large rise in Council Tax would therefore only increase a council's budget by a small amount. When allied to the visibility of Council Tax – when compared to national taxes – it becomes politically challenging for a council to vary the Council Tax in order to meet a particular local priority. Although the remit of the Commission is not to consider the wider system of Local Government financing, this is an important influence on how the public react to, and think about, local taxation.

- 10.5 This position was reflected in the evidence we received that argued that the financial accountability of Local Government would be enhanced if it was responsible for raising a greater proportion of its own revenues, and that doing so could help to reinvigorate local democratic participation as a result. Again, this is beyond our remit, but we recognise that simply replacing the Council Tax with a new model of local taxation will not fundamentally alter the current balance of Local Government funding. However, one key attribute for a replacement to the present Council Tax is that it has the potential to raise revenues of similar scale, and that it also provides a suitable basis should a council wish to vary local taxes according to local priorities. Our quantitative analysis confirms that taxes on property, land and income have the capacity to do this, whilst other optional taxes, such as a tourist bed tax, do not, but could nonetheless have a future role in supplementing core budgets where there is local mandate to do so.
- 10.6 At the same time, our engagement activity highlighted some concerns about the variation in tax-raising capacity in different local authority areas across the country – we also raise this issue in Chapter 6. This points to a key element of the evidence we received in this area; the need for an effective system of equalisation as part of any reform in order to reflect different local tax bases, the different costs of providing services in different parts of the country, and different patterns of need and demand. Indeed, we were not made aware of any country internationally where Local Governments do not require national grant support for these reasons.

### Local Tax and Democratic Choice

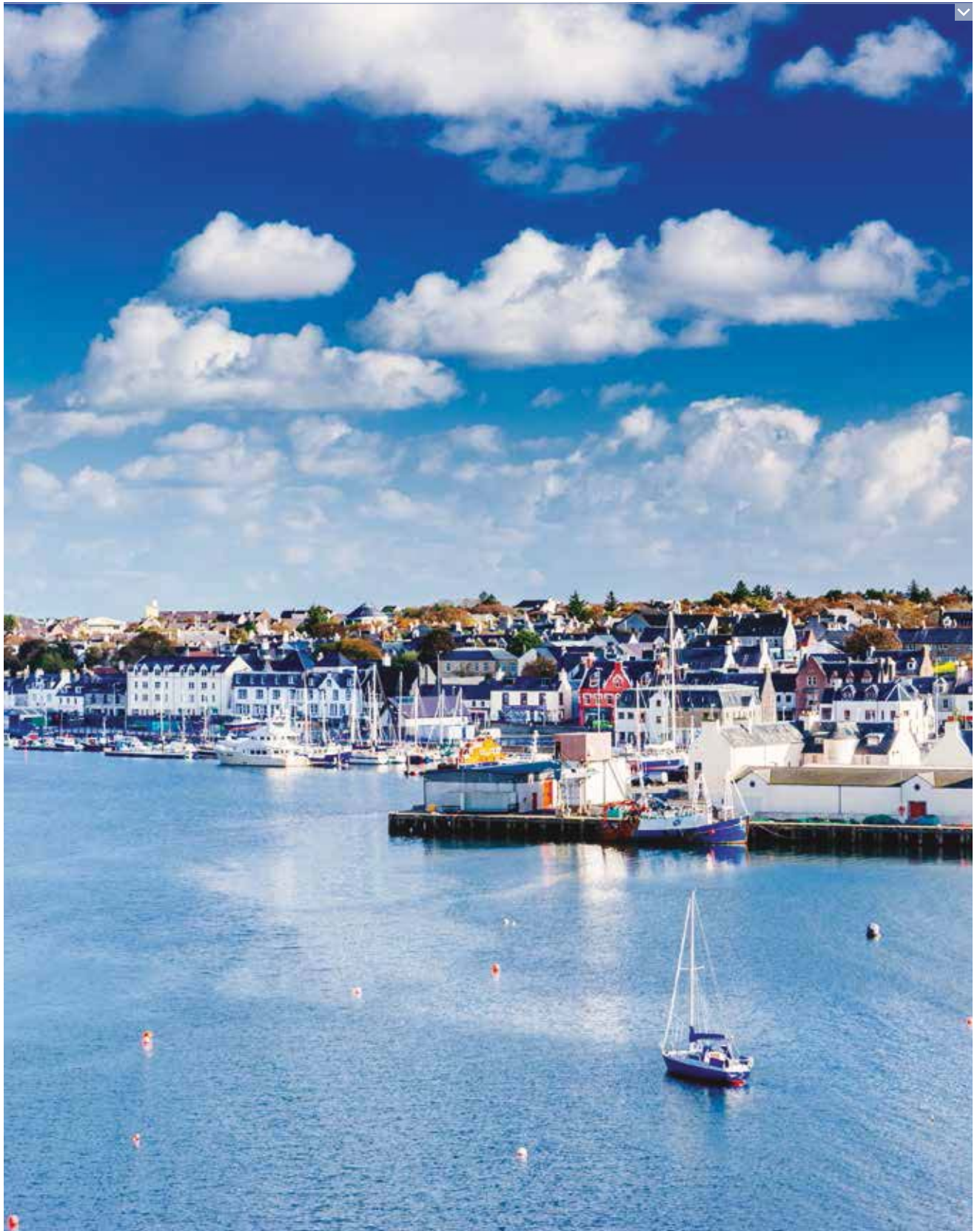
- 10.7 A further dimension to the connection between local taxation and local democratic choice is to consider who pays the tax and who votes. A local property tax levied on occupiers who, by virtue of living in that locality have a material interest in local service provision, will clearly contribute to local accountability. However, this relationship can become complex in that not everybody in a household will contribute to the bill; as with the present Council Tax, there can be many consumers of services but only one taxpayer.
- 10.8 A different set of circumstances exists for a local income tax. The visibility of a locally determined income tax collected alongside national taxes would depend on the design and administration of the system. The introduction of the SRIT in April 2016 may provide some insights into how this might look in practice. A local income tax collected by HMRC, effectively “piggybacking” on the SRIT, would mean that the income tax base would be defined by the UK Government and that some elements such as the personal allowance would have to be accepted rather than subject to local decision making. This kind of constrained local autonomy is not unfamiliar within the Council Tax; while a council can set a Band D rate, each of the other band charges is a fixed proportion of that Band D rate, which along with the bands into which properties are divided, are set nationally in legislation. However, complexities associated with setting and collecting local income taxes were perceived in some of the evidence that we received to suggest that a local income tax could in effect lead to local tax rates becoming determined nationally rather than locally.

- 10.9 A local income tax would, following the introduction of the SRIT, result in three jurisdictions sharing the same tax base. This is not an uncommon practice in federal countries, but would be a new development in Scotland. Indeed, the review of international literature by Policy Scotland at the University of Glasgow highlights that the local tax base in Scotland is unusually narrow in international terms. Evidence from federal countries indicates that sharing a tax base requires a degree of co-ordination in tax policy to avoid circumstances such as one jurisdiction applying such a high rate of income tax that there was no “tax room” remaining for the other jurisdictions to apply their rate of tax.
- 10.10 We also noted in Chapter 7 that this system of tax collection means that income from investments and savings could not be easily subject to local taxation and that those who do not pay income tax for other reasons would also not pay. In other words, whilst a property tax levied on households will not connect every member of the electorate to the local tax, a local income tax would not be paid by every voter either.
- 10.11 Overall, the balance of evidence we heard suggests that a local income tax, if administered as part of the wider income tax system, would potentially not support local accountability as well as a local property tax could. But in drawing this conclusion, we should also highlight that creating a revised property tax would also require the Scottish Parliament to determine the extent of local variation that should apply. For example, should councils only be permitted to vary the tax rate, or could they also choose to apply different exemptions, discounts and reliefs? Clearly, providing more local scope for differences would increase the extent to which the tax system is locally determined. This would need to be weighed against the suitability of local variations, but the evidence we received indicated an appetite for Local Government to have broadly greater flexibility over its local tax system.
- 10.12 Finally, the evidence that we received described a wide range of potential scenarios and options in relation to local taxes. However, one common theme related to the scope to empower individual local authorities, subject to them securing a local democratic mandate, to have the discretion to apply an additional local tax within the local authority area, or on people who are visitors to it. Broadening the local tax base in this way could include environmental, resource, sales or tourist taxes, as appropriate to local circumstances and local authority decisions. The evidence we received suggested such additional local taxes would not be designed to generate large sums, but could offer an opportunity to generate additional revenues to invest in local priorities. We see no reason in principle why such options should not be identified, developed, and, if found to be workable, made available.

## Local Taxation and Democratic Renewal

- 10.13 Although views differed on the best route for reform, our evidence confirms that a tax that is billed and collected by a local authority can help to build a strong link between how money is raised locally and spent locally. Arguably, the visibility of local taxes means that a well-designed system has good scope to achieve this compared to national taxes.
- 10.14 Indeed, regardless of specific preferences for reform, we consistently identified demand for debate on the issue of local taxation to involve communities at local level. Rather than our work becoming the end of the process of tax reform in this country, we hope that it can therefore start a new way of thinking about the relationship between local decisions about public services and how these are paid for.
- 10.15 Broadening the tax base, deepening local democracy and improving local fiscal autonomy are, we hope, therefore inevitable outcomes of the evidence we heard. This debate need not be confined to periodic reviews; the process of reform and dialogue about improvement and change could become much more integral to Scotland's ongoing process of democratic renewal and participation. We hope that the publication of our report provides an important first step, and that the reforms of local taxation that we expect to see put to the electorate in party manifestos for the Scottish Parliamentary election in May 2016 continue with that process in earnest.









# Certainty for Taxpayers and Local Government

- Local Government needs revenues to be stable or have a means of managing variation in receipts.
- Property tax receipts tend to be more stable, but also less buoyant, than receipts from taxes on income.
- The amounts of tax people pay need to be predictable.
- The amounts of tax people pay need to reflect their continuing ability to pay.

- 11.1 Our remit requires us to look at **"the impacts...on individuals and households"** and the wider **"macro-economic... and fiscal impacts"** of alternative local tax systems. Part of our work has therefore been to address the degree of certainty that alternative tax systems might provide for taxpayers regarding their bills and the stability of receipts for Local Government.

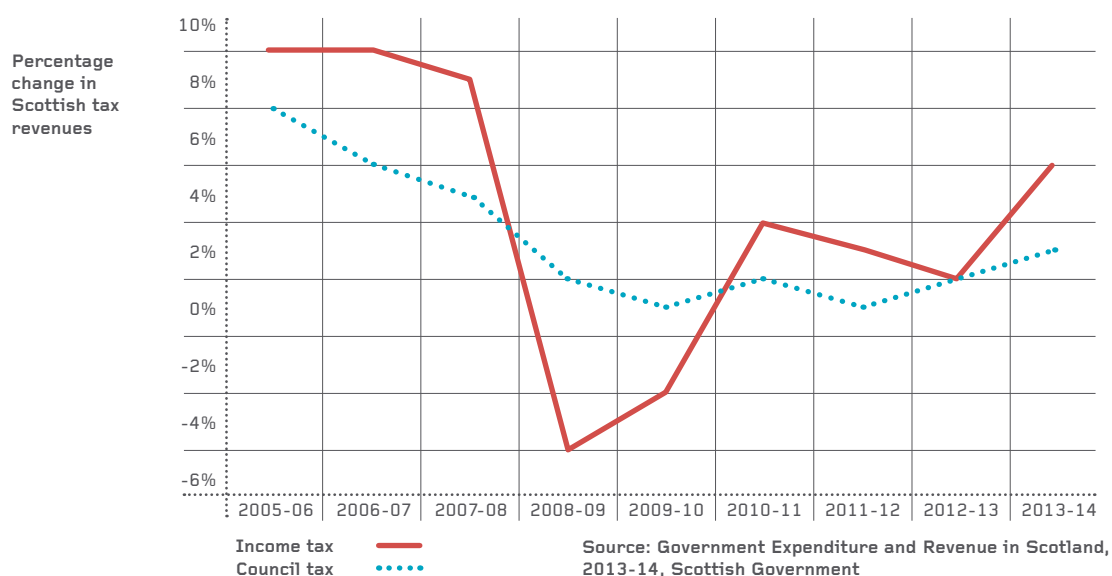
### Stability of Revenues

- 11.2 Most public services are delivered by employees, so a local authority needs stable revenue streams in order to pay its staff. In Chapter 3, we set out how the greater part of the funding for Local Government comes from the grant from central government, with Council Tax receipts only funding around 12% of council spending. Whilst highlighted as unsatisfactory in the evidence we received, in recent years this arrangement has provided Local Government with a degree of revenue stability to fund public services.
- 11.3 Volatility in tax revenues can occur as the result of economic shocks, but there is also a degree of volatility that arises in-year, across the economic cycle and during gaps between tax payments being due and the receipt of payment taking place. The lower predictability of income tax receipts, especially the self-assessed contribution that is collected only after the taxable financial year has ended, would also require councils to take appropriate measures to manage such fluctuations in their receipts. Local authorities therefore need the means to manage any volatility in revenues by saving and borrowing.
- 11.4 The introduction of the SRIT in April 2016 will mean that the funding for public expenditure in Scotland will, in the future, have a direct dependency on Scottish income tax and be exposed to any fluctuations, both upwards and downwards, in receipts. The creation of a local income tax would concentrate that dependency on the Scottish income tax base in comparison to tax receipts deriving from both income and residential property. This should be understood if it was the preferred choice of a future Scottish Government.
- 11.5 Tax receipts from property tend to be more stable than receipts from income taxes, which fluctuate more with the economic cycle. Overall, the available revenue to fund public services will be more stable if it derives from a range of taxes. This will have been a consideration when the IMF, European Central Bank and European Commission required Greece and Ireland to implement a tax on domestic property as a condition of their 2010 refinancing programmes.

- 11.6 The different tax alternatives we have considered are associated with differing administration and collection regimes, but we consider that taxes based on property and income can be managed in a way to ensure that a high proportion of liabilities are collected. Overall, a lower proportion of local income tax liabilities could be expected to be collected because of the recognised lower compliance rates associated with the self-assessment regime, although as we described in Chapter 7, the tax gap reported by HMRC for income tax collected under PAYE is in fact smaller than the equivalent statistic for Council Tax.
- 11.7 The relative stability of tax receipts from property compared to those from income is highlighted in Figure 11.1. Part of the present Council Tax's apparent stability is in part due to properties not having been revalued. Had a revaluation occurred in 2008 or 2009, then Council Tax receipts might have fallen unless councils had increased the rates. Although a land value tax has never been applied in Scotland, if it was established and administered effectively in a way that was understood and considered to be "fair" by the public, there is every reason to assume that receipts would follow a similar pattern of stability and variation as other property taxes.



**FIGURE 11.1**  
**ANNUAL PERCENTAGE CHANGE IN SCOTTISH TAX REVENUES –**  
**INCOME TAX AND COUNCIL TAX**



- 11.8 In any of the alternative tax systems (as we noted in Chapter 10), substantial change would require the reconsideration of the formulas for the grants made by the Scottish Government to local authorities. These are intended in part to help local authorities with comparably lower tax bases provide broadly equivalent levels of service to elsewhere. A revised system of taxation means these formulas would need to be adapted to provide the same degree of equalisation, while still allowing the intended scope for local variations based on democratic choice. Ideally, that local democracy and choice should also provide an incentive for each council to grow the local economy. Increased local prosperity would see wages rise and property values increase and thus, receipts from property and local income taxes increase. This is sometimes referred to as “buoyancy”. The key consideration is how those authorities that are less successful or are simply starting with greater disadvantages should be treated by the new central grant mechanisms.

### **Creating Certainty for Taxpayers**

- 11.9 Our public engagement confirmed that people need to understand how much tax they are going to be expected to pay. They need to be able to budget for each week or for the next year – unexpected increases can cause difficulty and in some cases, lead to people being unable to pay. This is a further dimension to the need for a tax system to be “fair” and based on ability to pay, so that if somebody, for example, loses their job, they need to know that their tax bill will reflect their changed circumstance. A local income tax would, by definition, adjust to reflect a reduction in pay (although would not if somebody’s circumstances changed but their income remained the same). A system of means tested reliefs to a property tax, if adequately targeted, could potentially accommodate either circumstance.
- 11.10 Our analysis sets out some illustrative examples of the different tax models to help politicians and others involved in the discussion understand the impact of different tax options and where the trade-offs occur. The analysis shows the impact of the tax systems had they been implemented in 2013-14 and does not represent a collective view of how tax systems should be applied or developed. The amount of tax that individuals pay under a new local tax system will be determined by a range of factors including the design of the tax, the tax rates set locally and potentially the wider benefits system.
- 11.11 Any replacement for the present Council Tax would result in the amounts households pay changing. A fairer, more progressive property tax, for example, would see those in lower value homes pay less but the tax due on higher value homes would increase. The way in which local tax is paid could also change. For example, a couple who presently make one household payment on their home for Council Tax would, under a local income tax, see local tax deducted from their individual incomes.

11.12 Such changes would ultimately be the purpose of making a local tax fairer, but the change should not be introduced in such a way as to impose sudden and extreme increases in people's tax liabilities. As discussed in Chapter 8, a robust transitional framework is needed to help people adjust. This would ensure that people have enough time to take any action needed to be able to pay their tax bills into the future and would assist in the political challenge that will come from implementing change.





# What the Evidence Tells Us



# 12



- 12.1 The present Council Tax arrangements do not relate to the ability to pay – whether measured against wealth or income – and have become widely discredited.
- 12.2 The present Council Tax Reduction scheme is a highly complicated system, does not provide sufficient support for people who we would consider to be on low or precarious incomes, and has a low take-up rate.
- 12.3 The ability of Local Government to make choices about how local taxes are raised and spent, and to be held accountable for those choices, is part of the democratic process and an important part of any reform.
- 12.4 Any change must support an enduring and stable tax base for Local Government.
- 12.5 There are, broadly, three alternative types of recurring taxes that could be applied annually at the local level to replace the present Council Tax – taxes on property, taxes on land and taxes on income. There are attractions to creating taxes that combine elements of each, especially because no one type of tax provides a perfect, readily implementable solution – all have advantages and disadvantages.
- 12.6 Opinions are divided on the fairness of each. There is strong, but not unanimous, initial public challenge to the idea that any tax based on property or land values – including the present Council Tax – is truly related to the ability to pay. The balance of opinion from the many organisations and professionals who have engaged with the Commission is that property or land taxation is an effective and economically sound basis for local tax, although some also articulated support for taxes on income. Ownership of property or land is taken by many to imply a degree of wealth that in turn indicates the ability to pay.
- 12.7 International examples are diverse and show that there is no one understanding of a fair local taxation system, and that almost all countries use more than one type of tax.
- 12.8 Property tax receipts tend to be more stable, but also less buoyant, than receipts from taxes on income.
- 12.9 Well-designed taxes on property or land are harder to avoid than taxes on income.
- 12.10 A fairer tax on property would be one that is more proportionate to property values. This would lead to relative changes in the liability of lower value properties in relation to higher value properties.
- 12.11 A property tax that is more proportionate to property values would still not be proportionate to incomes. A system of relief would therefore be needed for those without the income to meet their liability that is more effective than the current Council Tax Reduction scheme.



- 12.12 Property taxes are ideally based on regularly and frequently updated valuations. However, our analysis shows moving from the present 1991 values used for Council Tax would of itself change the liabilities for many. This, and the evidence from overseas, indicates that whilst desirable, an initial revaluation of properties would be politically challenging to deliver.
- 12.13 The public attaches a strong importance to income in its definition of fairness, perceiving it to connect to ability to pay. It is this factor which underpins the opinions and evidence received advocating a local income tax. In order to meet this test of fairness, local income taxes would need to apply not just to income from earnings, but also to income from dividends and investments, which would be an administrative challenge. This illustrates that it is difficult to achieve both fairness and administrative efficiency in any one single tax instrument.
- 12.14 Existing HMRC income tax collection systems might provide a basis for collecting a locally determined income tax, but this would be a major undertaking, could not extend to income from savings and dividends and would need the support of the UK Parliament. The alternatives include a Scottish collection body or individual local collection arrangements, both of which present challenges to operate.
- 12.15 Any change will affect household or individual tax liabilities. There is strong support for a system of transitional relief operating over several years to protect households from sudden major changes to their tax bills. Structural changes create particular issues. For example, income taxes are generally based on individual incomes and the Council Tax is charged to households.
- 12.16 Changing the fundamentals of the local tax system would require primary legislation. It would be hard to pass an Act before the Local Government elections in 2017. Changing tax collection and administration systems following the enactment of a new tax may take perhaps two years or longer, depending on the scale of the change.
- 12.17 A revised tax on property is the most readily administered alternative tax system. A move to a land value tax would require better knowledge of land ownership and values to be developed over a number of years.





# Conclusions and Recommendations



13

- 13.1 The present Council Tax system must end.
- 13.2 We believe history shows that reforms to local taxation are politically challenging, and therefore emphasise that this is one area of public policy that would benefit greatly from a period of cross-party agreement and consensus in order to create an enduring, stable settlement needed for Scotland as a whole, for Local Government and for local democracy.
- 13.3 We have concluded that any new system of Local Government taxation should continue to be one of general tax contributing to the general funding of local services, rather than a system of charges for specific services.
- 13.4 The new system should offer greater flexibility to Local Government and thereby strengthen local democracy. Local rate-setting wherever possible should be an explicit feature of reform.
- 13.5 As far as possible, any new system should be designed to minimise the need for complex relief schemes for individuals or households. Such a system should ensure that any reliefs that are available are straightforward to understand and administer and that take-up is increased.
- 13.6 Local and central government must make substantial efforts to increase public understanding of local taxation and how Local Government receives funding and spends money. This should be clear and transparent to taxpayers throughout their experience of the system.
- 13.7 In contrast with previous attempts at reform, we are not persuaded that a single tax instrument can simultaneously deliver greater equity for taxpayers and autonomy for Local Government whilst also being efficient and readily implementable. A replacement system, therefore, would benefit from including multiple forms of tax which would allow local taxation as a whole to be fairer. A well-designed system that draws revenue from multiple sources would provide more options for local democracy, delivering greater financial accountability and autonomy to Local Government. A broadening of the local authority tax base would be advantageous, and would make Scotland more consistent with most OECD countries.
- 13.8 We emphasise that the total amount of tax raised depends entirely on how any replacement system is designed, including the rates set. There is no intrinsic link between the numbers of taxes operated and how much is collected in total. Council Tax currently raises £2 billion per year but if two replacement taxes were set at rates that meant they each raised £1 billion they would together raise no more than at present. Any political party or organisation putting forward detailed proposals for a new system should make clear the effect that system can be expected to have on the total amount of tax paid in Scotland.

- 13.9 Any move to a fairer tax system will also inevitably lead to a situation where some individuals will pay less and some will pay more. We therefore believe it is vital to establish a transitional framework to enable taxpayers to adjust to the new system and new tax liabilities. The cost of such assistance should be assessed and considered as part of any projections of how much revenue would be raised by the new system.
- 13.10 A new system will also mean the distribution of central government funds to local authorities will need to be reviewed and adjusted. We believe that local authorities with lower tax bases should not lose out as a result of any such shift in system, whilst retaining meaningful local flexibility in levels of local taxation. Local authorities will also need to have sufficient means under the new system to mitigate risks by managing fluctuations in revenues across the economic cycle, in-year and during gaps between liability arising and receipt of payment.
- 13.11 To meet these principles, any move to a fairer system will therefore need time. We believe this means reform should be thought of and put forward as a programme, with the public offered a longer-term vision and actions which can be taken in the short term identified. In delivering a programme of reform, the Scottish Government and Local Government should work in a genuine partnership with each other.
- 13.12 The predominant view of the Commission is that any reform of local tax has to continue to include recurrent tax on domestic property, and we recognise that, as with all available options, there are difficulties that must be addressed if any system is to be seen as fair and accepted by the public. We have modelled two approaches – a reformed, proportionate Council Tax and a progressive tax on capital values – but we repeat these are both simply illustrations. At the very least, any such system needs to be more progressive than the Council Tax. This should occur through making the initial household liabilities more progressive and by creating an extensive income based relief that also takes account of need, and is better for households on low and precarious incomes than the existing Council Tax Reduction scheme. The substantial political challenge of linking liabilities to up-to-date property values must also be overcome.
- 13.13 We believe that a system of land value tax is promising, but that, while the work done for the Commission has been of unprecedented scale, gaining a full understanding of its impact would require further analysis. Any system of administering property based taxation should provide sufficient flexibility in time that site values could form a tax base for a system of land value taxation. Further work should be done over the next parliamentary term to assess both general and targeted land value taxes, and their introduction should be given consideration as part of a broadened system of local taxation.

- 13.14 The predominant view of the Commission is that Local Government's tax base should, if it could be proved feasible, be broadened to include income. Income is widely perceived to be a fairer basis on which to levy a tax, although a locally variable income tax presents substantial administrative challenges. Progressing such a longer-term programme of reform would require early dialogue with the UK Government to ascertain their willingness to allow the use of HMRC to apply a locally variable rate of income tax and to calculate start up and ongoing collection costs, as well as testing the scope to include income from savings and investments. A system of assigning local authorities a share of receipts from the SRIT could provide an interim option, but this would not allow for local variations.<sup>2</sup>
- 13.15 We have identified that taxes on property, land and income are the three potential tax mechanisms that have the revenue raising capacity to match the present system. Broadening the local tax base could include environmental, resource, sales or tourist taxes, as appropriate to local circumstances and local authority decisions. We see no reason in principle why such options should not be identified, developed, and, if found to be workable, made available to Local Government. These options would not be anticipated as forming the main basis for local taxation, but could, in addition to the aforementioned options, make a contribution to local revenues.
- 13.16 We recognise that political parties in Scotland will attach different weights to the considerations we have set out on each of the tax options, and will therefore draw different conclusions about the best way forward. Our expectation is that this report informs the development of those policies which will be put to the electorate in the Scottish Parliamentary election in May 2016 and beyond.
- 13.17 We believe this is the time to reform local taxation. We have conducted more in-depth analysis of potential forms of tax available than ever before to inform debate and the construction of detailed proposals. We have concluded that there is no one ideal tax but we have shown that there are ways of designing a better tax system. There is now a real prospect of beginning a programme to make local taxation fairer – more progressive, more stable, more efficient and more locally empowering.
- 13.18 We entrust those charged with taking this work forward to respect the spirit in which the Commission was established and has discharged its obligations. We are confident that with the goodwill established between the parties in the Commission that this can be achieved.
- 13.19 This is an opportunity that must not be missed.

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<sup>2</sup> Jackie Baillie MSP was not able to agree this recommendation



# Our Remit

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The Commission on Local Tax Reform was established jointly by the Scottish Government and the Convention of Scottish Local Authorities in February 2015. The agreed remit was:

To identify and examine alternatives that would deliver a fairer system of local taxation to support the funding of services delivered by Local Government.

In doing so, the Commission will consider:

- The impacts on individuals, households and inequalities in income and wealth.
- The wider macro-economic, demographic and fiscal impacts, including housing market and land use.
- The administrative and collection arrangements that apply, including the costs of transition and subsequent operation.
- Potential timetables for transition, with due regard to the 2017 Local Government elections.
- The impacts on supporting local democracy, including on the financial accountability and autonomy of Local Government.
- The revenue raising capacity of the alternatives at both local authority and national levels.

In conducting its work, the Commission will engage with communities across Scotland to assess public perceptions of the emerging findings and to reflect this evidence in its final analysis and recommendations.





# Members of the Commission

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15



From left to right:

- Andy Wightman, Writer and Researcher, representing the Scottish Green Party
- Councillor Angus Campbell, Leader of Comhairle nan Eilean Siar and Leader of the Independent Group at COSLA
- Dr Jim McCormick, Scotland Advisor, Joseph Rowntree Foundation
- Councillor David O'Neill, President of COSLA (Co-Chair)
- Dr Angela O'Hagan, Lecturer in Social and Public Policy at Glasgow Caledonian University and Convenor of the Scottish Women's Budget Group
- Councillor Catriona Bhatia, Leader of Liberal Democrat Group and Deputy Leader, Scottish Borders Council
- Don Peebles, Head of the Chartered Institute of Public Finance and Accountancy (CIPFA) Scotland
- Jackie Baillie MSP, Shadow Cabinet Secretary for Finance, Constitution and Economy (joined the Commission May 2015)
- Isobel d'Inverno, Convenor of the Tax Law Committee of the Law Society of Scotland and Director of Corporate Tax at Brodies LLP
- Marco Biagi MSP, Minister for Local Government and Community Empowerment (Co-Chair)
- Councillor Susan Aitken, SNP Local Government Convenor and Leader of SNP Group, Glasgow City Council
- Councillor Rhondda Geekie, Leader of East Dunbartonshire Council and Leader of Labour Group at COSLA
- Mary Kinninmonth, Trustee, Scottish Association of Citizens Advice Bureaux (Citizens Advice Scotland), Chair of Citizens Advice Scotland Policy Forum
- (Not pictured) Alex Rowley, MSP for Cowdenbeath and formerly Shadow Minister for Local Government and Community Empowerment (February to May 2015)



# Glossary

### **BEMIS**

Black and Ethnic Minority Infrastructure in Scotland. The national umbrella body supporting the development of the Ethnic Minorities Voluntary Sector in Scotland.

### **Buoyancy**

Buoyancy in tax terminology generally refers to the change in tax revenues as a result of changes to the tax base. For example, the Council Tax base is made up of residential properties. If more properties are built, the tax base gets larger.

Buoyancy can also result from increases in the value of the tax base. For example, with income tax, if earnings increase, receipts from income tax increase. The counter to this is that if earnings fall, the size of the tax base also falls. So buoyancy can be both positive and negative.

Our definition of buoyancy refers strictly to changes in the size of the tax base and excludes changes in receipts deriving from changes in tax rates.

### **CAMA**

Computer Aided Mass Appraisal. CAMA is a generic term for any software package used to help establish property values for property tax calculations.

### **CIPFA**

Chartered Institute of Public Finance and Accountancy.

### **Council Tax Reduction scheme**

The Council Tax Reduction scheme was introduced from 1 April 2013 following the UK Government's abolition of Council Tax Benefit (CTB). Rather than being a benefit, it is a means tested schedule of reductions to individuals' Council Tax liabilities, administered by local authorities.

### **COSLA**

The Convention of Scottish Local Authorities

### **CTB**

Council Tax Benefit was paid by DWP (usually directly to local authorities) to assist individuals pay their Council Tax. It was abolished by the UK Government on 31 March 2013. It was means tested and administered by local authorities.

### **DWP**

Department for Work and Pensions.

### **Equalisation**

Equalisation is a term more commonly used in Federations to describe the system of grants from the federal government to the states or provinces so as to allow broadly equal levels of service provision, irrespective of relative wealth, prosperity and wider circumstances, in all parts of the country.

The system of determining the amount of the General Revenue Grant paid by the Scottish Government to each local authority is also an example of equalisation. An agreed formula that takes account of many factors including population, deprivation and rurality is used to calculate the amount paid to each of Scotland's 32 local authorities which is intended to enable each to provide their residents with public services comparable to elsewhere.

**HMRC**

Her Majesty's Revenue & Customs.

**IMF**

International Monetary Fund.

**IRRV Scotland**

The Scottish branch of the Institute of Revenues, Rating and Valuation. The IRRV is a nationally approved awarding body for vocational and examination-based qualifications for professionals working in local taxation and revenues, benefits and property valuation. It also seeks to influence the course of legislative and professional matters through dialogue with government bodies and other professional organisations and through commissioning and conducting original research.

**Mirrlees Review**

"Tax by Design", was the final report of a review of the UK tax system by the Institute for Fiscal Studies led by Sir James Mirrlees, published 13 September 2011, available at: <http://www.ifs.org.uk/publications/5353>.

**OECD**

The Organisation for Economic Co-operation and Development.

**PAYE**

In the UK, the pay as you earn (PAYE) system is a system of income tax withholding that requires employers to deduct income tax and National Insurance contributions from the salary of their employees. The PAYE system requires that employers must then remit the deducted amount to HM Revenue & Customs.

**Progressive tax**

"A tax is said to be progressive when the average tax rate rises as the tax base rises. So an income tax is progressive when the average tax rate rises as income rises." – Mirrlees Review. A tax system where the (marginal) amounts paid increase as the taxable amounts increase is not enough to be progressive – the (average) tax rate itself must increase. See also "proportional tax" and "regressive tax".

**Proportional (or proportionate) tax**

A proportional tax applies a flat rate for all values of the tax base. See also "progressive tax" and "regressive tax".

**Regressive tax**

A regressive tax is one where the average tax rate decreases as the tax base rises. See also "progressive tax" and "proportional tax".

**SAA**

Scottish Assessors Association. The Assessor is responsible for the preparation and maintenance of the Council Tax Valuation List which requires that each property's band reflects the Assessor's opinion of its open market value as at 1 April 1991, but taking account of its physical state and its locality as at 1 April 1993 (or for new properties, when they enter the list).

### **SRIT**

Scottish Rate of Income Tax. The Scotland Act 2012 introduces the power for the Scottish Parliament to set a Scottish Rate of Income Tax (SRIT) from April 2016. The UK Government will deduct 10 pence in the pound at the basic, higher and additional rates of income tax on the non-savings and non-dividend (NSND) income for Scottish taxpayers, i.e. income from employment, self-employment, pensions and rental income. The Scottish Parliament will then set SRIT which will apply equally to these three rates. Scottish taxpayers will thus pay a "UK income tax" (to the value of 10 pence in the pound less than taxpayers in the rest of the UK) plus SRIT. Thus if SRIT is set at 10 pence, income tax will remain the same for Scottish taxpayers as in the rest of the UK.

SRIT will supersede the existing tax varying power, the Scottish Variable Rate (SVR) set out in the Scotland Act 1998 which gave the Scottish Parliament the power to vary up to 3 pence in the pound at the basic rate of income tax.

### **Tax administration**

The activity of a tax authority in collecting and managing a particular tax. The administration costs of a tax to a tax authority are those incurred by the tax authority in collecting and managing the tax.

### **Tax avoidance**

Tax avoidance is the legal use of the rules of the tax regime to reduce the amount of tax payable by means that are within the law. See also "Tax evasion".

### **Tax evasion**

Tax evasion is an illegal practice where a person or organisation intentionally avoids paying a tax liability. Those caught evading tax are generally subject to criminal charges and penalties. See also "Tax avoidance".

### **Tax gap**

The tax gap is the difference between the amount of tax due and the amount collected.

### **TUPE**

Transfer of Undertakings (Protection of Employment) Regulations 2006; protecting employees whose business is transferred to another business.

### **VAT**

Value Added Tax.

### **Withholding tax**

A withholding tax, sometimes referred to as a retention tax, is a government requirement for an employer to withhold or deduct tax from the payment of income to an employee and remit the tax to the government. Income tax under the PAYE system is an example of a withholding tax, where the payment of tax is withheld from the payment of the employee's salary and the tax payment is remitted by the employer to the tax authority.







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