The Commission on Local Tax Reform

Volume 2 – Technical Annex

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THE COMMISSION ON LOCAL TAX REFORM

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Chapter 1 Introduction to Our Technical Annex

Our report, "Just Change: A New Approach to Local Taxation", sets out our findings against each part of our remit when viewed through the lens of the principles of taxation that we adopted as a Commission. Our desire to keep this as concise as possible, whilst still fulfilling our remit, means that it refers to the results of our analysis and research, but does not present the detail. Nor does it present the corresponding evidence from any of our public engagement activities. Rather it simply identifies the key findings.

Our extensive evidence gathering activities included a call for written evidence, an online survey open to all, a series of public listening events with communities across Scotland and engagement with stakeholders and experts from Scotland and around the world.

We also worked alongside Heriot-Watt and Stirling Universities to undertake the most comprehensive quantitative analysis ever conducted in Scotland to understand the relationships between house values, the property stock and household incomes.

Evidence was at the heart of our work, and it is important that this is presented in order to support our findings and conclusions, allow others the depth of understanding that we were able to gain overall as well as to inform future debate and policy formulation.

We therefore publish two companion volumes to "Volume 1: Just Change: A New Approach to Local Taxation".

This technical annex is volume 2, which follows exactly the same format and indeed repeats the same text as "Just Change: A New Approach to Local Taxation" but additionally presents the supporting analysis. For example, in Chapter 5 of Volume 1, we cite the differing impacts of the present Council Tax and alternative tax systems on different households. Chapter 5 of this technical annex reproduces the relevant text alongside the numerical results that underpin the statements made and provides a description of the methodology used to calculate those results.

Additionally, the research we commissioned, along with the outcomes from all of our evidence gathering and public engagement activities, are presented in Volume 3 - the Compendium of Evidence.

The Case for Change

02

Chapter 2 The Case for Change

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.

2.1.1 The main issues which we believe need to be addressed are summarised in this chapter and discussed at length elsewhere in this report. This section starts with a detailed description of how Council Tax operates in Scotland today.

The present Council Tax system

2.1.2 The present Council Tax was introduced in 1993 by the then UK Government to replace the Community Charge. Its structure is set out in the Local Government Act 1992 and the format of Council Tax remains largely unchanged since its introduction.

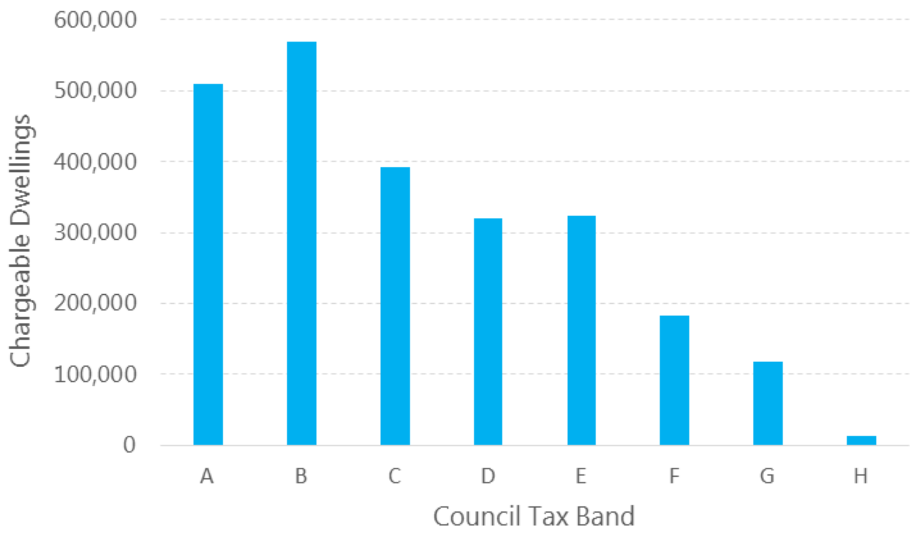
2.1.3 Each of Scotland's 2.4 million residential properties that receive a Council Tax bill (known as chargeable dwellings) are allocated into one of eight bands based on the value of the property on 1 April 1991, or if they are built since this date, an estimate of what the property would have been worth on 1 April 1991. The lowest value properties placed in Band A, and the highest value properties placed in Band H.

Table 2-a: Present Council Tax Bands – 1991 Values

Band	A	B	C	D	E	F	G	H
Lower Band Threshold		>£27,000	>£35,000	>£45,000	>£58,000	>£80,000	>£106,000	>£212,000
Upper Band Threshold	£27,000	£35,000	£45,000	£58,000	£80,000	£106,000	£212,000	
Source: Local Government Finance Act 1992								

2.1.4 As Chart 2-a shows, the distribution of properties is skewed towards the lower bands. Three quarters of chargeable dwellings are in are Band D or below. Conversely, less than 1% of properties are in Band H.

Chart 2-a: Chargeable Dwellings by Band 2013-14



Source: Scottish Local Government Finance Statistics 2013-14, Scottish Government

2.1.5 The Band D charge is set by Councils each year. Band D charges currently vary from £1,024 in Eilean Siar to £1,230 in Aberdeen City. The average Band D charge is £1,149[1]. For the last eight years, local authorities and the Scottish Government have agreed to keep Council Tax rates at 2007-08 levels.

2.1.6 The amount that is charged for properties in other bands is set relative to the Band D charge via a system of multipliers which are set out in the Local Government Finance Act 1992.

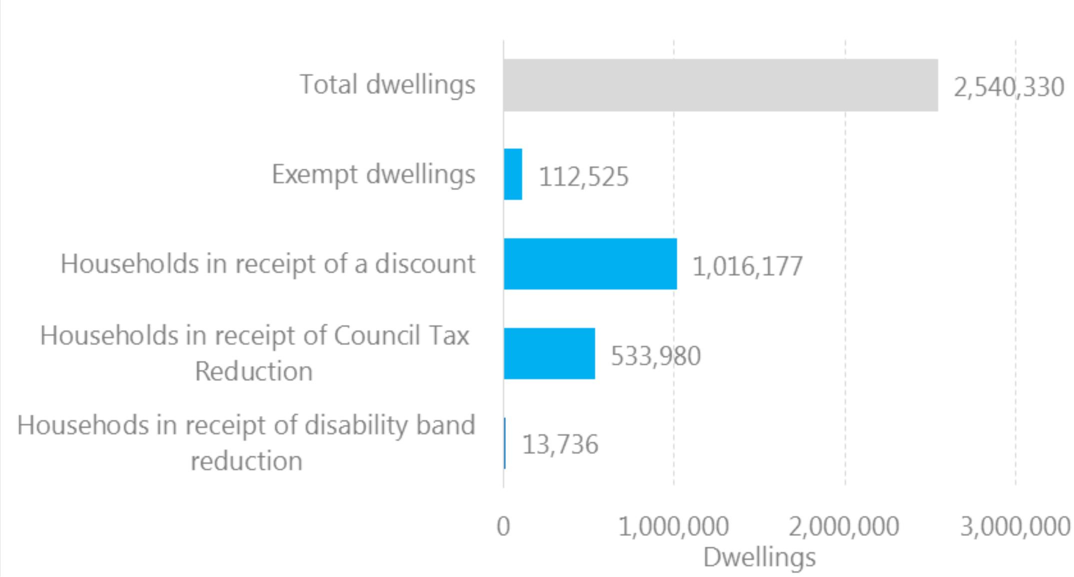
Table 2-b: Present Council Tax Multipliers

Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Multiplier	6/9	7/9	8/9	9/9 (i.e. 1)	11/9	13/9	15/9	18/9 (i.e. 2)
Source: Local Government Finance Act 1992								

[1] Source: Scottish Local Government Finance Statistics 2013/14. Scottish Government

2.1.7 On 1 September 2014, there were a total of 2.5 million residential properties – or dwellings – in Scotland, of which around 5% are exempt, leaving 2.4 million chargeable dwellings. Around two thirds of the occupants of chargeable dwellings are eligible to either a discount or a reduction. The full list of discounts, reductions and exemptions are set out in Figure 2-a - some households may be eligible for two or more discounts and/or reductions.

Chart 2-b: Discounts, Reductions and Exemptions, 2013-14



Source: Scottish Local Government Finance Statistics 2013-14, Scottish Government

2.1.8 Single person discount, which entitles households where only one person is liable for Council Tax to a 25% discount, is claimed by over a third of households in Scotland.

2.1.9 The main 'other discounts' are second home discount and long term empty property discount. Local authorities have discretionary powers to vary second home and empty property discount between 10% and 50%. Since 1 April 2013, local authorities also have the power to remove the discount or set a Council Tax increase of 100% on certain properties which have been empty for one year or more.

Figure 2-a: Discounts, Reductions and Exemptions

Discounts

- Single person discount
- Second home/unoccupied property
- Unoccupied but furnished property (property on market for sale/let)
- Apprentice - Undertaking a programme of training leading to a qualification recognised by the National Council for Vocational Qualifications or the Scottish Vocational Educational Council
- Youth trainee - A person under 25 years of age being trained under one of the relevant criteria
- Student discount
- Student nurse discount
- Child benefit discount – children over the age of 18 are disregarded for Council Tax if the child benefit is still being paid
- Care worker discount
- Severely mentally impaired discount
- Long term patient in hospital discount - a person who has their sole or main residence in an NHS/ Armed Forces hospital or in a residential care home/ nursing home/private hospital/hostel where they receive care or treatment.
- Persons in detention discount - will apply where less than two adults are resident in the property. For the purpose of the discount, adults who meet the qualifying conditions shall be disregarded when counting the number of adults in the house.
- Resident of hostel discount - A person who has their sole or main residence in a hostel or night shelter
- Energy efficiency discount
- Empty properties discount
- Long term empty property discount
- Religious community discount
- Member of International HQ - A person, or a dependent of that person, who is a member of a headquarters or other organisation, as defined in section 1 and the schedule of the International Headquarters and Defence Organisations Act 1964.
- Discount for persons not counted

Reductions

- Disability Reductions Scheme – A band reduction may be applied if someone within the dwelling is disabled.
- Council Tax Reduction (and 2nd Adult Rebate)

Figure 2a (cont'd)

Exemptions

- New dwellings which remain unfurnished/unoccupied for a period of 6 months.
- Dwellings occupied only by students and student halls of residence.
- Unoccupied dwelling for which liability to be met from the estate of the deceased person.
- Unoccupied dwellings where the liable person was formerly resident and has moved to receive personal care in a hospital/home/elsewhere.
- Unoccupied dwellings where the liable person has moved to in order to provide personal care to another person.
- Unoccupied and unfurnished (property on market for sale/let).
- Manses and similar dwellings which are unoccupied awaiting occupation by ministers of religion.
- Dwellings where all liable persons are aged under 18.
- Dwellings undergoing major repair/structural alterations (for up to 12 months from last occupation day).
- Unoccupied dwellings where the liable person is in prison. The dwelling must have been their main home immediately before they went in to prison.
- Unoccupied unfurnished dwellings (for a period of 6 months).
- Unoccupied repossessed dwellings.
- Unoccupied dwellings where the only liable person is a trustee in bankruptcy.
- Dwellings whose occupation is forbidden by law or which are kept unoccupied because of impending compulsory purchase.
- Dwellings owned by a council, Scottish Homes or a registered social landlord which are being kept unoccupied with a view to demolition.
- Dwellings owned by the Secretary of State for Defence and held for the purpose of armed forces accommodation ((though payments in lieu of Council Tax will be paid in respect of these dwellings).
- Unoccupied and unfurnished dwellings which are situated on agricultural land and when last occupied were used in connection with agricultural purposes.

2.1.10 The Disability Reductions Scheme presently applies to approximately 14,000 households where physical adaptations have been made to their property to make it suitable for the requirements of a disabled person. This scheme reduces the Council Tax liability by one band – for example, those in Band B eligible for Disability Reduction will pay the equivalent Band A charge. Where applications are made for a Band A property, the reduction will be equivalent to one ninth of the Band D charge. This will have the effect of a one-band reduction to Band A, had a lower band existed.

2.1.11 On 1 April 2013, Council Tax Benefit was abolished by the UK Government with responsibility for future support transferring to Scottish Ministers, along with a cut in funding of 10%. In order to protect entitlement to support for vulnerable people, the Scottish Government and Local Government reached agreement to fill this 10% gap in funding.

2.1.12 Prior to its abolition, Council Tax Benefit (CTB) was administered by local authorities on behalf of the Department of Work & Pensions (DWP), who met the costs of benefits and the administration of the system. Individuals in receipt of CTB received a Council Tax bill net of the benefit paid by DWP.

2.1.13 This could not be replaced directly in Scotland as benefits are largely reserved to the UK Government. Instead, a different system, called the Council Tax Reduction (CTR) scheme provides a schedule of means tested relief to Council Tax liabilities, resulting in individuals receiving a Council Tax bill reflecting that their liability has been reduced rather than the DWP having paid some or all of their tax.

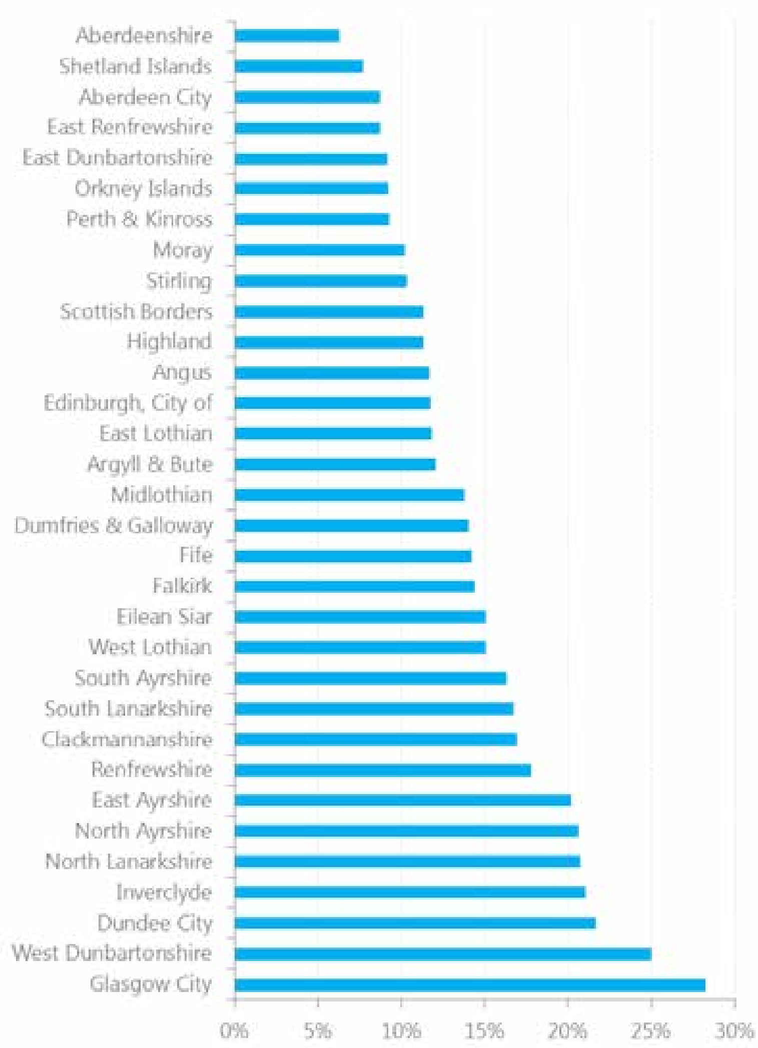
2.1.14 The entitlement criteria for CTR are almost identical to those for CTB. Around a fifth of households who in Scotland who would otherwise be liable for Council Tax have their liabilities reduced by this scheme.

2.1.15 Entitlement to CTR depends on a) household income; b) household circumstances and; c) Council Tax liability. Differing levels of need are reflected in what the scheme refers to as 'applicable amounts'. Thus, households with children or persons with additional support needs have a higher applicable amount.

2.1.16 Households that rely on out of work benefits are, in the majority of cases, entitled to full CTR, meaning they pay no Council Tax. Once income increases above a household's applicable amount, support is withdrawn at a rate of 20p for every £1 of income - this is known as the taper.

2.1.17 The final total reduction in liability for Council Tax Reduction in 2013-14 was just under £360 million. This varied widely by local authorities, reflecting both population differences and different levels of household need. Chart 2-c shows the percentage of gross Council Tax income that was foregone in each local authority in 2013-14 because of the Council Tax Reduction scheme.

Chart 2-c: Income Foregone from Council Tax Reduction as a Proportion of Gross Council Tax Income, 2013-14



Source: Scottish Local Government Finance Statistics 2013-14, Scottish Government

2.1.18 The Commission heard evidence about the perceived unfairness of the present Council Tax - both the Call for Written Evidence and the online survey recorded that around two-thirds of respondents felt that the system was unfair.

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.

2.2.1 The history of local tax and the previous opportunities for reform are discussed in Chapter 3.

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.

2.4.1 These figures are taken from the Family Resources Survey, and assume that those that are entitled to take up Council Tax Reduction actually do so.

Table 2-c: Median Council Tax liability as a % of net household income, 2013-14

Income Decile Group	Before CTR	After CTR, current scheme
1	10.0	0.0
2	6.6	0.8
3	5.6	3.5
4	4.8	3.8
5	4.2	3.7
6	3.6	3.3
7	3.5	3.3
8	3.2	3.1
9	2.8	2.8
10	2.3	2.3
Source: Family Resources Survey, DWP		

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.

2.5.1 The connections between the present Council Tax charges and household income, including the impact of Council Tax Reduction, are explored in detail in Chapter 5.

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.

2.6.1 The views and opinions expressed at our listening events, as well as through our other forms of evidence gathering are referred to throughout this report. This evidence has been at the heart of our work.

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.

2.7.1 The link between local tax and local democracy is explored in Chapter 10.

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.

2.8.1 We have found that there is not widespread understanding of the present Council Tax system and the financing of Local Government. The importance of this for any future reform is discussed in Chapter 9.

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

03

Chapter 3 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.

3.3.1 Our short summary of this recent history draws on a range of sources of information that are already in the public domain. We have chosen not to focus on an exhaustive historical analysis in this report as much of this ground has been covered elsewhere, including in the detailed history of Local Government finance in Scotland set out in 'A Fairer Way: Report by the Local Government Finance Review Committee' published in 2006.

3.3.2 The Council Tax was introduced in April 1993 to replace the Community Charge, commonly known as the Poll Tax. This had been introduced in Scotland in 1989 following the passage of the Abolition of Domestic Rates, etc. (Scotland) Act 1987, and was based on the principle of a service charge, with each adult equally liable to pay. While it included a means tested rebate system, at least 20% of the standard charge was paid by everyone. We understand that the Community Charge was intended to link voting, paying tax and receiving services, but it was widely perceived to be unfair, and opposed by many in Scotland and across the UK.

3.3.3 The strength of this opposition, and the impact of a non-payment campaign associated with it, led to the rapid development of the present Council Tax model. The evidence that we heard suggests that the political conditions, and the very short timescales available, meant that the development of the Council Tax was in many respects predicated on finding a rapid solution to a political problem. This included replacing the most unpopular elements of the Poll Tax while retaining some of its features such as personal discounts for single adults and single person households.

3.3.4 The structure of the present Council Tax as set out in Chapter 2 remains largely unchanged since its introduction. However, the lack of overall change to the Council Tax for approaching 25 years does not mean that the issue of local taxation has not been robustly contested in Scotland. In particular, the evidence that we received highlighted a number of sources of recent debate, including:

- In June 2004, the then Scottish Executive launched the Independent Review of Local Government Finance, and subsequently appointed a Local Government Finance Review Committee under the chairmanship of Sir Peter Burt. The remit of the Committee was to examine options for local taxation, including reform of Council Tax, to identify the issues of implementing any changes to the local taxation system in Scotland, and to make recommendations. It reported in 2006 and recommended that a new local property tax should replace the Council Tax. This new tax would be assessed as a proportion of the capital value of homes in Scotland. However, its findings were rejected at that time by the Scottish Executive.

- It was a manifesto commitment of the Scottish National Party in 2007 to introduce a form of income tax to replace the Council Tax. These plans did not gain the support of other parties, and were not pursued.

- In August 2014, the Commission on Strengthening Local Democracy, chaired by COSLA President Councillor David O'Neill published its final report. The Commission made a range of recommendations relating to Local Government finance and taxation. These included that local taxation, in combination with a system of equalisation through national grant support, should fund at least 50% of Local Government income in the future, and that Local Government should have full local control of the suite of property taxes (Council Tax; Non Domestic Rates; Land and Buildings Transaction Tax) and the freedom to set these in ways that suit local circumstances. The Commission also recommended that local authorities, with the assent of their local electorate, should have a general competence to set and raise new taxes that are suitable to the needs of their local community.

- The decision to freeze Council Tax has been the subject of significant debate. Whilst the policy featured in a number of parties' manifestos in the 2011 Scottish Parliamentary elections and has been considered to be popular with the electorate, many recognise that it cannot go on indefinitely.

3.3.5 Indeed it is it against this background that in June 2014, the Scottish Parliament's Local Government and Regeneration Committee recommended the creation of "*an independent cross-party commission which should include representatives from local government and wider civic society across Scotland*" to consider alternatives to the Council Tax and which ultimately led to the establishment of this Commission.

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 Chart 3-a.

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).

3.6.1 The debate over the balance of funding is not peculiar to Scotland or the UK. Our international literature review undertaken by Professor Ken Gibb and Linda Christie of Policy Scotland at the University of Glasgow showed that there are many different forms of local taxation around the world, but common to all is the difficulty in delivering reform. Indeed, it is clear from their work that past experience from the UK and across the world shows that reform is always likely to be challenging and will inevitably be bound up with the experiences and difficulties of previous reform.

3.6.2 They found a wide variety of local taxes around the world, but their analysis also highlighted some peculiarities of Scotland's current system of local taxation. In particular they found that unlike Scotland and the UK, very commonly the tax base in other OECD countries does not rely on a single tax locally – this is shown in Table 3-a. Sweden, Luxembourg, Israel and Finland all have one tax raising more than 90% of their local tax revenues. Twenty countries operate a diverse system with at least two taxes where the smaller contribution is at least 20%. However, only three countries (UK, Australia and Ireland) rely solely on a single tax at local level. This echoes analysis undertaken in "A Fairer Way – Report by the Local Government Finance Committee" which found that 23 out of 28 countries studied adopted multiple local taxes - usually in the form of a combination of property and income taxes - although it concluded that there would be significant challenges in moving in this direction in Scotland.

Table 3-a: Local Taxation in OECD Countries, 2010

	Income*	Goods & Services	Property	Other**	Local Taxes as % of Local Expenditure
Australia	0	0	100	0	n.a.
Austria	61.4	9.9	15.4	13.3	59
Belgium	36.7	9.9	53.2	0.3	31.9
Canada	0	2	91.2	6.8	n.a.
Chile	0	59.7	40.3	0	n.a.
Czech	0	48.5	51.5	0	39.7
Denmark	89	0.1	10.8	0.1	34.1
Estonia	89.6	2.6	7.8	0.1	45.5
Finland	93.6	0	6.3	0.1	45.7
France	8.4	25.3	53.8	12.5	39
Germany	78.1	6	15.8	0.1	36
Greece	0	21.4	24	54.7	11.9
Hungary	0.2	80	14.2	5.6	19.3
Iceland	77.4	2	20.6	0	67.1
Ireland	0	0	100	0	13.5
Israel	0	4.8	95.2	0	39.1
Italy	25	32.9	9.4	32.7	41.4
Japan	48.6	19.4	29.8	2.2	n.a.
Korea	16.8	26.7	16.3	40.1	n.a.
Luxembourg	92.2	1.4	4.4	2	31.1.
Mexico	0.3	1.7	59.3	38.7	n.a.
Netherlands	0	50	47.6	2.3	8.6
New Zealand	0	8.7	91.3	0	n.a.
Norway	88.5	1.4	4.8	5.3	38.3
Poland	58.2	8.3	29.1	4.4	26.8
Portugal	34.6	26.4	33.9	5.2	24.6
Slovak	0	49.2	50.8	0	11.4
Slovenia	78.5	6.5	11.9	3.2	40.3
Spain	20.6	39.2	29.6	10.6	41.9
Sweden	97.4	0	2.6	0	64.1
Switzerland	84.3	1.3	1.4	13.1	58.5
Turkey	24.5	49.8	11.1	14.5	n.a.
United States	5.2	21.4	73.4	0.1	n.a
UK	0	0	100	0	12.6

* includes income and payroll taxes, **includes social security contributions, other property related taxes and other taxes

Source: Slack and Bird, 2014

3.6.3 Professor Gibb and Linda Christie's analysis also sets out many different sets of hybrid systems run by countries locally. An income tax element may be a supplement or the core form of local tax; it may be a national surcharge on the national income tax that is then redistributed locally or in some cases it may be a genuinely local contribution. For example, six countries rely on property taxes for 90% or more of their local tax revenue (including the UK, Australia, Ireland and Canada). Ten OECD countries rely on income taxes for at least 75% of their local tax revenue (including the Scandinavian group, Denmark, Germany, Iceland, Luxembourg, Slovenia and Switzerland). In all cases, the rate and the total bill may be capped in different ways by the national government. Regardless of how these are formulated locally, the key point is that a common feature of local taxation systems internationally is that they rely on a broader range of taxes than Scotland which relies on one form of local taxation system.

3.6.4 The literature review also highlighted a range of potential benefits in moving towards a mixed system over the longer term, including the scope to lessen the perceived lack of fairness associated with property taxes while benefiting from the technical benefits of a property tax element, the scope to reduce reliance on caps or other circuit breakers on property tax liabilities, and the ability to overcome worries about fiscal flight by reducing the yield of any one tax. However it also acknowledged that challenges would need to be overcome if a multiple tax solution was to be advanced, particular in relation to public perceptions that doing so would add to the tax burden.

3.6.5 The full version of the international literature review, including the potential arguments that it highlights in support of broadening the local tax base, can be viewed at http://localtaxcommission.scot/tell-us-what-you-think/international-evidence-review/ and in Volume 3 of our Report, The Compendium of Evidence.

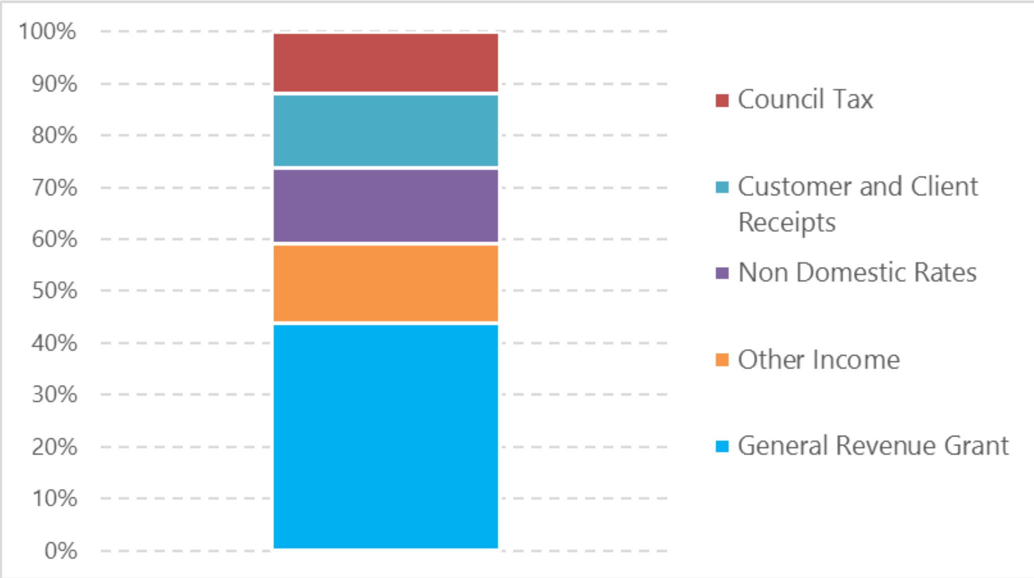
3.7 Across Scotland today, total Local Government revenue is around £16.5 billion, of which Council Tax contributes around £2 billion or just 12%. We found this is not widely understood, with many assuming that Council Tax contributes far more towards the funding of local services. Some challenged whether it was appropriate for locally-elected representatives to have so little control over the funding of the services they have to deliver.

3.7.1 At our public listening event in Dundee, many participants felt that because Council Tax contributes only 12% of the expenditure of local government in Scotland, the current Council Tax, "*or indeed any local tax*", does not link directly to the services provided. Participants in the event at Galashiels highlighted that the amount raised by Council Tax at the moment was only a small proportion of the funds required to make a difference to services in local areas, while one participant in Arbroath suggested that "*local authorities need to be able to raise a higher proportion of their taxes*".

3.7.2 Chart 3-a shows total revenue income for Local Government in Scotland. "General Revenue Funding" makes up the bulk of the revenue income of Local Government. Revenue income funds day-to-day expenditure and is distinct from capital income which funds longer term projects. General Revenue Funding is not ring-fenced, meaning local authorities can spend it how they wish and is distributed amongst Scotland's 32 local authorities using a needs-based grant distribution system that incorporates factors such as population, pupil numbers, demographics, rurality and deprivation.

3.7.3 The next largest income item, "other income" is made up of a number of additional ring-fenced revenue grants and funding from government, the largest being the contribution from the UK Government towards Housing Benefit payments which are administered by local authorities on behalf of DWP.

Chart 3-a: Breakdown of Total Revenue Income 2013-14



Source: Scottish Local Government Finance Statistics 2013-14, Scottish Government

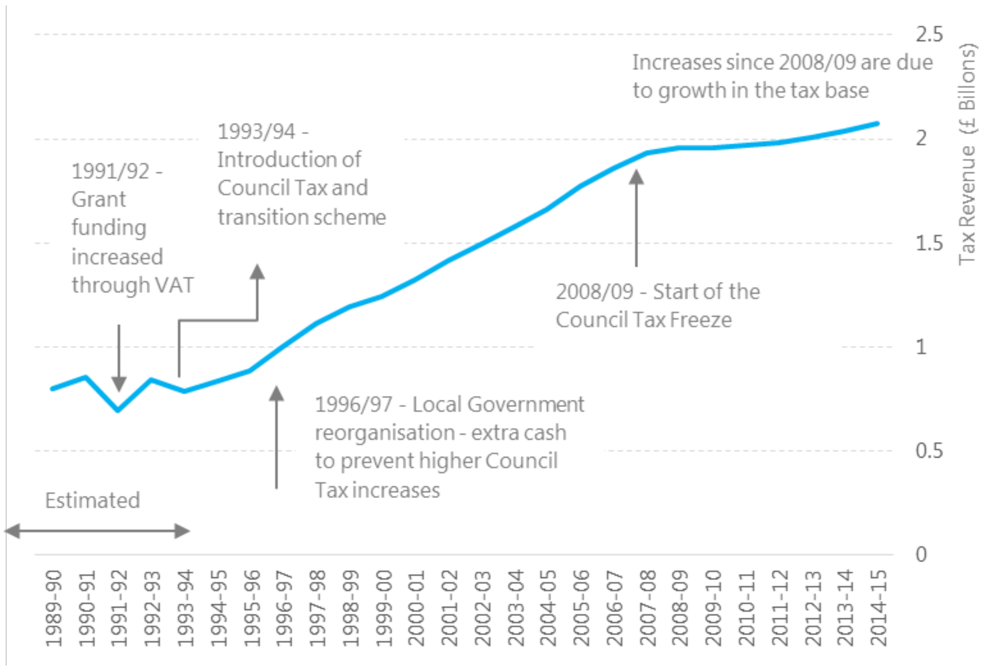
3.7.4 Non-Domestic Rates are collected locally and contribute to the overall funding of Local Government. Rate bills are calculated by multiplying an assessed rateable value by a poundage rate set centrally by the Scottish Government. The treatment of Non-Domestic Rates in the overall funding of Local Government is subject to the same needs based assessment used to calculate the allocation of the General Revenue Grant.

3.7.5 Customer and Client Receipts are mainly derived from charges to service users and rent income. In some interpretations of Local Government revenue income, Customer and Client Receipts are netted off against the expenditure on the relevant items – for example, housing – to derive a Net Revenue Income figure. Council Tax makes up approximately 17% of net revenue income. Although we have not used this interpretation of income in our report, we mention it here for completeness as this figure is often quoted in official sources and in the media.

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".

3.8.1 It is important to understand in context the amount of money that is raised through the present Council Tax system. Chart 3-b shows the amount of money that has been raised through domestic local taxation (both the Community Charge and Council Tax) since the abolition of Domestic Rates in 1989-90. The graph highlights the key changes in the level of local taxation and the reasons for these changes are set out below. However, we acknowledge that some significant changes in how Local Government has been funded over this period make it difficult to compare what the balance of central against local funding has been. These are explained below.

Chart 3-b: Community Charge and Council Tax Amounts Billed (cash-terms)



Source: Figures supplied by the Scottish Government

Community Charge

3.8.2 The shift in tax unit from household to individuals increased the volume of transactions, adding to the costs of collection. In 1990, the UK Government responded to the significant increase in Community Charge bills by increasing grant, funded specifically through an increase in VAT. In August 1991, the Personal Community Charge Reduction scheme was introduced to replace the previous transitional relief scheme and was backdated to 1 April 1990. This had the effect of reducing the headline community charge levels by £140 (Chart 3-b Series Point 1991-92). This required a complete re-billing exercise for 1991-92 and also applied to 1992-93.

The Council Tax

3.8.3 The introduction of the present Council Tax was accompanied by the Council Tax Transitional Reduction scheme (Chart 3-b Series Point 1993-94). This restricted the increase in local taxation between the Community Charge and the Council Tax and was only in place for 1993-95.

3.8.4 In the first four years of Council Tax, central government grant to Local Government fell by around 2.5% per annum, whilst Council Tax grew by around 1.5% per annum (real terms). During this time, significant changes in Local Government funding included the transfer of responsibility from Local Government for Further Education from 1 April 1993 (-£204.5m) and the transfer to Local Government for Community Care from 1 April 1995 (£223.2m).

Local Government Reorganisation

3.8.5 The reorganisation of Local Government from 1 April 1996 led to some very significant changes in Local Government finance. As the new authorities set their first budgets, there was an exceptional last-minute intervention to provide additional funding support of £38 million, (Chart 3-b Series Point 1996-97) to alleviate spending reductions and cushion increases in Council Tax caused by some of the new councils inheriting high levels of spending. This was accompanied by transfers of funding to Local Government for the Strathclyde Passenger Transport Executive (£71.5m) and from Local Government for domestic sewerage (£89.7m).

Council Tax Freeze

3.8.6 By 2007-08, the average Band D Council Tax had increased by over 100% in cash terms since its introduction (44.5% in real terms) (Chart 3-b Series Point 2008-09). Following the election of the SNP Government in 2007 a number of changes which impacted on Local Government finance took place. Previously total funding to local authorities by central government had included a core funding settlement and many ring-fenced grants. In agreeing the terms of the Concordat between the new Scottish Government and COSLA, it was agreed that there should be one total Local Government funding allocation and, as a result, the Local Government finance revenue settlement changed from £8.7 billion in 2007-08 to £9.8 billion following the rolling-up of nearly all of the previous individual ring-fenced grants.

3.8.7 At the same time, the Scottish Government and COSLA agreed to keep Council Tax rates at 2007-08 levels. As part of this agreement an additional £70 million each year was transferred to Local Government through the General Revenue Grant.

Other Recent Changes

3.8.8 There have been a number of significant changes in Local Government funding since the introduction of the Council Tax freeze. The most significant is the transfer of responsibility for police and fire from Local Government to Police Scotland and Fire and Rescue Scotland from 1 April 2013 which resulted in a transfer of revenue funding of over £1.2 billion out of the Local Government finance settlement.

3.8.9 In 2011-12 the overall revenue settlement was cut by 2.5% or almost £280m. From 1 April 2013 following the UK Welfare Reform Act 2012 , a sum of £328m (in year one) was transferred into the Local Government finance settlement from the Department of Work and Pensions (DWP) for the Council Tax Reduction Scheme. These Welfare Reforms also resulted in additional funding being transferred to Local Government from the Scottish Welfare Fund (£38m) and the Discretionary Housing Payment (£35m). The introduction of the Children and Young People (Scotland) Act 2014 resulted in an extra £50.7 million for 2014-15 and a further £100m in 2015-16.

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.

<u>How Taxes are Paid</u>

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.

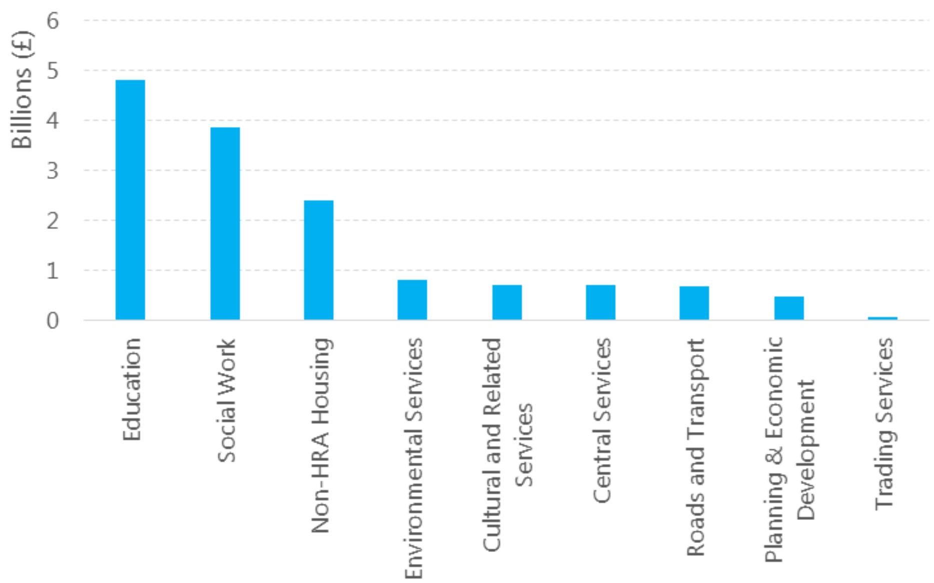
3.11.1 Perhaps unsurprisingly, given that Council Tax has operated for almost 25 years, our evidence suggests that people generally find the Council Tax payment process to be clear and straightforward.

3.11.2 However one area of concern that was raised related to the collection of water and waste water (sewerage) charges. For domestic properties connected to the public water supply and sewers (and without water meters) these charges are based on the Council Tax band of the property, and collected alongside Council Tax by local authorities. Our evidence suggests that people find the dual billing unclear, particularly those in receipt of Council Tax Reduction who pay no Council Tax but still incur water charges. These issues are discussed further in Chapter 9.

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 Chart 3-c.

Chart 3-c: Local Government Expenditure



Source: Scottish Local Government Finance Statistics 2013-14, Scottish Government

3.12.1 Chart 3-a shows the breakdown of gross Local Government expenditure. Education and social work are the largest expenditure items. Non HRA-housing is the third largest item and refers to non-direct housing provision (which is accounted for separately through the Housing Revenue Account) and thus the bulk of this expenditure relates to Housing Benefit payments.

3.12.2 Other items of expenditure are much lower in revenue terms.

- Environmental Services includes waste collection, flood protection, environmental health and cemetery, cremation and mortuary services.
- Cultural and Related Services refers to spending on local museums and galleries, libraries, tourism and sports and recreation.
- Central Services refers to central operations such as tax collection, valuation services, licencing, and registering of births, marriages and deaths.
- Roads and transports include road construction, road lighting, school crossing patrols and maintenance and repairs.
- Planning and Economic Development includes planning and building control services and other economic development initiatives.
- Trading services contributes a small amount of expenditure (estimated at less than 1%) on provision of 'trading services'. These relate 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.

3.13 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.

3.13.1 A specific tax on waste generated by households was suggested by participants at our public listening event in north Glasgow, with the intention that households that generate more waste are taxed more.

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.

3.14.1 In particular, evidence from Independent Living in Scotland highlighted that for people with disabilities to enjoy their basic human rights, participate in society, lead an ordinary life and influence what happens in their community, all local policy, practice and services – and crucially the ways in which money is raised to pay for them – must take account of their human rights and the United Nations Convention on the Rights of Persons with Disabilities (UNCRPD), and promote disabled people's freedom, choice, dignity and control.

3.14.2 Sometimes, people with disabilities need Local Government to raise and spend money differently from the ways in which other members of the community might, in order to ensure their rights are protected. Many such people rely on social care services to enjoy their basic human rights.

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.

3.15.1 At our public listening event in Arbroath for example, participants discussed whether a local tax should reflect consumption of local services. They felt it would be beneficial if tax could relate to the use of services but agreed this would largely be unworkable as it would be difficult to measure service use on an ongoing basis.

3.15.2 Similarly, participants in our listening event in Dundee were against the idea of specific charges for services as they may lead to a decrease in the use of council services. One participant added, "*Councils could charge more for people to use the swimming pool or the gym, but will that encourage people to live healthy lives? There are natural limitations to the degree councils can push local charges.*"

3.15.3 One participant at our listening event in Glasgow involving women's groups noted that *"The purpose of tax needs more emphasis. Good public services need investment. Applying local charges for public services hits the poorest hardest."*

3.15.4 The group in Galashiels also voiced concern about alternate ways of raising local income through applying or increasing charges for local services. One participant noted that "*local authorities increasingly look to increase charges for services and this is an unfair way to pay for essential services. We must stop charging vulnerable people big parts of their income, in order for them to receive essential services*."

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.

3.16.1 For example, in oral evidence from institutional stakeholders, one participant suggested that certain services could be funded from tax revenues whereas others could be provided through charging for them. By contrast, at our Oral Evidence Session with professional institutions and representative bodies, it was suggested that one impact of the council tax freeze was that local government has had to look elsewhere for income, which has impacted on businesses through increased charges and fees.

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

04

Chapter 4 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.

4.1.1 We developed a detailed evidence gathering plan focused on three core objectives:

- To develop a thorough understanding of the present circumstances in relation to local taxation;
- To access expertise and analysis regarding opportunities for reform and their impact;
- To actively engage with people and organisations about options for reform and to capture their views.

4.1.2 One of our initial phases of work was to undertake a series of knowledge building sessions to develop further understanding of the current landscape of local taxation and potential alternatives. The Commission met with a range of organisations and experts as part of this process, including the IRRV, Scottish Assessors Association, Professor David Bell, and others. Further information about these sessions is available on our website.

Figure 4-a: Our Principles of Working

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.

4.3.1 Our Call for Written Evidence was designed to allow people and organisations to share detailed information and suggestions with us. In particular it identified audiences such as institutional stakeholders and policy networks through a series of open ended questions designed to understand the policy positions and/or analysis they wished to contribute. We also designed the format to be as accessible as possible in order to encourage the wider public to respond.

4.3.2 We also invited respondents to highlight ways in which the Commission might engage further with them or the organisations that they represent. The format was also designed to allow for appropriate data handling issues to be dealt with, as well as to collect respondent profile information where appropriate.

4.3.3 The Call for Written Evidence was widely distributed using electronic mailshots and the media to ensure as wide a coverage as possible. We established several ways of responding in order to provide as much choice as possible.

4.3.4 The Call for Written Evidence closed on 22 June 2015 and a total of 203 responses were received. There were 124 responses from individuals and 79 from organisations. Responses from organisations came from Local Government bodies (30%), representative bodies (25%), policy, tax or economic interest groups (20%), third sector or equalities groups (13%) and others (11%). The 'other' category included public sector organisations, responses from political parties at national level, responses from campaigns and one response from a religious organisation.

4.3.5 We commissioned professional content analysis of each response, and a summary report capturing the key themes that emerged from social research specialists ODS Consulting. Its report was published on 21 August 2015 and can be viewed at http://localtaxcommission.scot/tell-us-what-you-think/initial-call-for-evidence/.

4.3.6 Individual responses, where consent was given, were also published online on our website, with relevant personal information retracted according to individual preference. These can be viewed at http://localtaxcommission.scot/submissions/.

4.3.7 Together, this body of evidence became a rich source of information from individuals and organisations who wished to engage with us and help us to explore new ideas, and we are hugely thankful to them all.

Oral Evidence Sessions

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.

4.4.1 A key message framing the Call for Written Evidence was that this was only the first of a range of evidence gathering and engagement activities that the Commission would undertake.

4.4.2 We therefore also established a series of Oral Evidence Sessions in order to explore themes and perspectives with a range of individuals, technical experts and others. These sessions involved Commission members and people or organisations coming together at 'round table' events to discuss the issues and share knowledge and perspectives.

4.4.3 We organised these sessions around loose themes in order to help cover a wide range of topics. Altogether, we held 12 formal panel sessions, involving 54 witnesses, shown in Table 4-b.

Figure 4-b: Oral Evidence Sessions held in 2015

Session	Theme
Monday 18th May	**1. Scottish Property Tax Reform:** Comprising interested observers and academics who have established a network to explore local taxation issues
Tuesday 19th May	**2. Learning from previous work:** Comprising members of previous commissions or studies focusing on local taxation
Monday 1 June	**3. The impact of local taxation on households 1**: Involving representatives of welfare rights and advice sectors, low income groups
Friday 12 June	**4. Society and local taxation**: Perspectives from trade unions, faith groups, reform groups, and the third sector on the future of local taxation
Monday 15 June	**5. Collecting and administering local taxation:** Involving professional associations including SOLACE, Directors of Finance, Property Assessors and others
Friday 19 June	**6. The impact of local taxation on households 2:** including disability groups and carers
Monday 22nd June	**7. Approaches to local taxation in other jurisdictions:** Wales, Northern Ireland, and the Republic of Ireland
Friday 26 June	**8. The role of local democracy:** Focusing on the views of local elected members in relation to the reform of local taxation
Monday 29 June	**9. Institutions and professional bodies:** Bringing together a range of professional bodies and institutions to focus on local tax
Friday 3 July	**10. The perspective of housing professionals:** focusing on the relationship between local taxation and the housing market
Friday 18 September	**11. Wider perspectives on local taxation:** bringing together other witnesses who have recently focused on local taxation issues
Wednesday 23 September	**12. Water and sewerage charging:** bringing together representatives from the water industry to discuss implications for water and sewerage charging

4.4.4 Each session lasted for up to 3 hours, and a list of all our witnesses and the key points that were raised at each session can be found in Volume 3 of this report. All of our sessions, apart from the water industry session, were also broadcast live and are available to view on demand at http://localtaxcommission.scot/tell-us-what-you-think/oral-evidence-sessions/. In total our Oral Evidence Sessions have been viewed over 1200 times.

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.

4.5.1 As part of the Commission's evidence-gathering, Policy Scotland at the University of Glasgow was commissioned to conduct a literature review on international evidence and experience. Professor Ken Gibb and Linda Christie examined different systems of local taxation from around the world and their potential insights they offer to our work.

4.5.2 The work included an analysis of studies carried out for bodies including the Organisation for Economic Co-operation and Development (OECD), International Monetary Fund and the United Nations. It also considered in greater detail a number of local tax systems across the UK, Europe, North America and Australia.

4.5.3 The report was published by the Commission on 7 August 2015 and can be viewed in our Volume 3: Compendium of Evidence or online at http://localtaxcommission.scot/tell-us-what-you-think/international-evidence-review/. The findings of the literature review are referred to throughout our report.

4.5.4 We also had the benefit of speaking directly to Professor Enid Slack from the University of Toronto, who has written extensively on local property tax, and her work featured heavily in the literature review.

4.5.5 We also heard from Jan Olsen, Chief Economist for Local Government Denmark and Roberto Canon, Head of Finance for Galdakano Municipality in the Basque Country, as well as UK and Irish academics and public officials who attended Oral Evidence Session 7. The Commission was also able to speak with Professor Tony Travers, at the London School of Economics. Our thanks are due to all for the time set aside to assist the Commission with its evidence gathering.

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.

4.6.1 We committed to making all of the evidence we received fully accessible. Evidence was therefore taken in public, we published all submissions of evidence that we received (where respondents gave us their permission to do so), and we commissioned expertise to help us design and deliver our evidence gathering, and to independently analyse the results. All of this information is available on our website and in our Compendium of Evidence. We hope that this approach and the significant volumes of information that it generated will be an important legacy of our work.

4.6.2 We also developed a significant digital presence as part of that commitment. Our website was regularly updated to contain information about our meetings and its evidence gathering activities, and to provide information about the issues and context in which we were carrying out our activities. We used social media to promote our calls for evidence, public engagement events, and to share information about how to take part in our evidence gathering process.

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.

Online Survey

4.10.1 We were clear that all of Scotland's 2.4 million Council Tax payers are key stakeholders in the Commission's work and for that reason, we also launched an 'easy access' online survey to encourage and enable individual members of the public to participate in the debate and to capture their views and perceptions.

4.10.2 We commissioned Ipsos MORI to design a set of questions measuring views on priorities for local taxation, views on Scotland's current system of Council Tax, and top priorities for change. Where respondents were willing to provide this, the survey also gathered profile information in order to help analyse the information as fully as possible. The overall format was designed to ensure that respondents would be able to complete the survey within 5 minutes. The survey was delivered through our website, and promoted alongside the call for written evidence. All responses were anonymous, and the survey itself launched on 3 May 2015 and remained open until 25 September 2015. We commissioned ODS Consulting to undertake an independent analysis of the results and its full analysis forms part of the Compendium of Evidence accompanying this report, and can be viewed on our website at http://localtaxcommission.scot/tell-us-what-you-think/online-survey/.

4.10.3 A total of 4,492 responses were received. These responses provide an indication of opinions from those who proactively chose to opt in to the survey and provide their views. It was not intended or designed to provide statistically significant results which could be extrapolated to the Scottish population.

4.10.4 Respondents could choose to complete the survey with or without providing information about themselves. 3,091 people (69%) provided at least some information about themselves. Analysis of this information indicates that certain groups are over-represented within the survey response. This includes men; people in the 55 plus age group; full time workers; couples without children under 16; home owners; and people in properties rated at Council Tax Bands D and over (the higher Council Tax bands). Certain groups are under-represented including women; 16 to 24 year olds; unemployed people; single people with no children; people renting from a council or housing association; and people in properties rated at Council Tax Bands A, B and C. We have been mindful of the over-representation of some groups in our use of the results to inform our conclusions.

Public Listening Events

4.10.5 A core element of our remit was to engage with communities across Scotland to assess public perceptions of the emerging findings of our evidence gathering. We therefore developed a series of events in different locations across Scotland and with a range of networks about what might – and might not – be a fairer way of reforming local taxation in Scotland.

4.10.6 Each event was designed to be participative, and to be attended by members of the Commission to hear views first hand. Workshops were open to the public and were advertised and promoted in local and national media, as well as on our website. Some were held in the evening, others during the daytime, to allow people with different working patterns to attend.

4.10.7 A number of events were convened to enable us to work with specific communities of interest – for example, Housing Association tenants or faith groups. These specific workshops were additionally promoted within, where appropriate, the host organisation's networks including their membership and the specialist press. A number of events were arranged with assistance from a local authority. In these cases, the local authority also hosted the event and promoted it locally: for example, in libraries, community centres, schools, residents' associations and Community Councils.

Figure 4-c: Public Listening Events in 2015

Date	Location	In association with
Wednesday 12 August	Edinburgh	Citizens Advice Scotland
Wednesday 19 August	Stornoway	Comhairle nan Eilean Siar
Wednesday 26 August	Dundee	Dundee Citizens Advice, Dundee City Council
Thursday 27 August	Edinburgh	Scottish Council for Voluntary Organisations (SCVO)
Monday 31 August	Arbroath	Angus Council
Tuesday 1 September	Perth	Faith groups hosted by Letham St Mark's Church
Thursday 3 September	Glasgow	Young Scot
Monday 7 September	Glasgow	Women's interest groups hosted by Glasgow Caledonian University
Monday 14 September	Glasgow	Black and Ethnic Minority Infrastructure in Scotland (BEMIS)
Tuesday 8 September	Glasgow	NG Homes (housing association)
Monday 14 September	Galashiels	Scottish Borders Council
Monday 5 October	Aberdeen	Aberdeen City Council

4.10.8 The workshops were designed to explore our initial findings; members of the public were invited to comment on these and engage in the debate, bringing their own ideas, opinions and critiques.

4.10.9 Events were facilitated, with participants introduced to issues in a way that allowed their views to become informed as part of the event. The majority of events were facilitated by The Democratic Society, a not for profit company that focuses on building a more participative democracy. We also worked with Young Scot and BEMIS to deliver two bespoke events.

4.10.10 Workshops were designed by The Democratic Society, in collaboration with the Commission, with the objective of maximising the inclusion of every participant. The format provided a range of different opportunities to express views, in plenary, break-out groups and through individual feedback either verbally or in writing. Participants were able to provide their views confidentially on postcards distributed at the event, so there was also a route for views that they felt uncomfortable expressing more directly. Participants were also supported by the facilitator to contribute their point of view when they seemed to disagree with stronger voices or the majority view.

4.10.11 The programme was designed to ensure that a wide range of different communities and perspectives were heard. As such, the findings of the public listening events serve to provide a rich understanding of how people perceive and react to the tax systems discussed. It is important to note that, being open to the public, and with some targeting specific communities of interest, the findings from the events cannot be aggregated to demonstrate the proportions of the Scottish population holding particular views.

4.10.12 A full analysis of each public event is contained in Volume 3: Compendium of Evidence. The issues and views that were expressed have had a direct impact on the content of our final report. Indeed, we were hugely impressed by our experience of working with communities and for the considered way in which they approached the issues at all of our events. We are extremely grateful to all of those who gave up their time.

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.

4.11.1 In recognising the importance of understanding the distributional impact of alternative tax systems, we devoted considerable time and resources to its analytical work.

4.11.2 There were two key parts to this distributional analysis. The first was to determine tax liabilities under alternative tax systems, and the second was then to apply these liabilities to different types of households in different income groups. The distributional analysis we carried out was based on a range of data sources and verified against multiple sources where possible. We are confident that the tax liabilities that have been estimated are robust enough to enable us to analyse the implications of the scenarios modelled.

4.11.3 Without doubt, the work that we have undertaken on local taxation, in particular with regards to the property tax, is the most detailed exploration of these matters that has ever been attempted in Scotland. Thanks are due to Professor Chris Leishman and his team at Heriot-Watt University and to Dr David Comerford at the University of Stirling for their invaluable expertise which they have offered to the Commission. We also thank the Scottish Government for its assistance in providing data and modelling tools to enable the Commission to analyse alternative local tax options.

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.

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 Chapter 3, 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.

4.13.1 We heard a lot of support for replacing the present Council Tax system completely. Almost two thirds of respondents to the online survey felt that the present Council Tax system should be replaced with a different system of taxation. The analysis of responses to the call for evidence was clear that three broad alternative options existed: a (reformed) local property tax, a local income tax and a land value tax, with broadly equal support for each. There was also support for a fourth option to combine tax bases.

4.13.2 Although the evidence we received has made clear that the present Council Tax must be replaced, this did not preclude the option of a future local tax with residential property as its base. In our call for evidence, approximately a third of organisational respondents and a fifth of individual respondents supported a property tax. Whilst it is clear that many elements of Council Tax must be reviewed, there were a range of views on how an alternative property tax could operate, with some people supportive of retention of some key elements of Council Tax such as bands and multipliers. Others indicated support for a move towards a non-banded property tax based on discrete property values. We heard overwhelming evidence that up to date values should be the basis on which property tax liabilities are calculated. All but a minority were in favour of the system of reductions, exemptions and discounts being present and extended in a system of local property taxation.

4.13.3 Approximately a quarter of organisational respondents and a third of individual respondents supported a local income tax. There were a range of views on how this could be operated, with some suggesting it should be aligned to the present income tax system with others suggesting new tax collection arrangements, potentially incorporating a different definition of taxable income than is used for income tax in the UK at the moment. Views were split on whether the tax should be centrally set or locally variable. Some also suggested that additional reliefs would be required for certain individual circumstances.

4.13.4 Approximately two-fifths of organisational respondents and a quarter of individuals supported a land tax. Submissions were focussed mainly on description of the tax base and the wider benefits of such a tax rather than a detailed discussion of the tax structure. Most respondents who supported a land value tax described it as a tax on the value of the 'highest and best use' of land, with the liability falling on the owner.

4.13.5 To illustrate the impact of these options, we modelled some examples of the different tax structures.

4.13.6 As well as looking at revaluation, we modelled two examples of possible alternatives to the present Council Tax. One was a reformed Council Tax with the charges in each band altered to reflect relative differences in property values in each band. This roughly equates to a flat rate tax on property values. The second was a property tax on discrete property values which meant that the higher the property value, the higher the tax rate.

4.13.7 We modelled one possible variant of a local income tax, which was a flat rate addition to the basic, higher and additional income tax rates with the thresholds and personal allowance mirroring the UK income tax structure. Because of the existence of the personal allowance, a flat rate income tax is actually progressive with respect to income – those with higher incomes pay tax on a greater proportion of their income.

4.13.8 To illustrate the impact of land value tax, for seven local authorities, we estimated how average land values differ from average property values. As explained below, we were not able to model a tax on land to the same level of detail as property and income

4.13.9 It is important that readers of this report do not view these examples as the Commission's preferred options. It is also important that the estimated rates modelled for these examples are not presumed to be the rates people would pay if any of these scenarios are implemented in the future. This modelling relies on a set of assumptions (outlined below) which rest on economic factors and the decisions of elected representatives. Tax rates and the amounts paid by households also depends on the circumstance of that particular household and any exemptions, reductions or discounts they are entitled to, as well as local discretion in rate setting.

Limitations and assumptions

4.13.10 The modelling work that has been undertaken has been rigorous, but there have been limitations. Our main constraint stemmed from the time considerations associated with the timescales in which we were required to undertake our work and report our findings. A more fundamental barrier has been the availability of data and in particular the lack of fully robust linking of data on current property values to household incomes. In order that the distributional impact of any property related policy reforms can be fully understood, this linkage is crucial. Such data linking is theoretically possible, but has not been required before and would require permission from the relevant data owners. This would need to be agreed between the Scottish Government and relevant UK Government departments. The degree of possible data linkage may also depend on the conditions under which the data was collected.

4.13.11 Our analysis also inevitably depends on a number of assumptions which are summarised in this section. Understanding these assumptions is key to interpretation of the results.

4.13.12 All the analysis has been based on data from the financial year 2013-14, and as such, we are estimating what would have happened if Council Tax had been replaced or reformed at that time. The analysis therefore does not take account of changes to tax and benefit rules since 2013-14, or those that are planned for the future, and so should be seen as a snapshot which illustrates the relative, rather than absolute, impacts of replacement or reform of Council Tax. The modelling also assumes that no behaviour change will occur as a result of the removal or introduction of alternative forms of local taxation, although the potential for this is explored in Chapter 6. Furthermore, the costings are direct in that they do not take account of potential impacts on other Government cost and revenue streams, either through shifts in the tax base or through the impact on household finances.

4.13.13 We have also ensured that alternative tax systems and rates have been calculated so as to raise a revenue neutral replacement to the present Council Tax system. Changes in receipts at local authority level are assumed to be offset by the equalisation mechanism within the Local Government settlement leaving the overall financial situation unchanged at all levels of government[2].

4.13.14 Figures on the amount that Council Tax raised in 2013-14 are publically available via the Scottish Government[3]. Council Tax receipts were £1.98 billion and income foregone due to the Council Tax Reduction scheme was £360 million. In 2013-14 Councils were recompensed for most of this income foregone by a transfer from the UK Treasury via the Scottish Government[4] (£328m) with the residual made up from the Scottish Government (£23m) and local authorities (£8.7m).

4.13.15 We have assumed that a revenue neutral property tax alternative to Council Tax would require net receipts of £1.98 billion, with the current requirement for funding from central government (and from local authorities themselves) for Council Tax Reduction remaining at £360 million regardless of which tax alternative is modelled. In reality, we know that the liabilities of households who currently receive Council Tax Reduction are likely to change if an alternative system is introduced, but the reason this simplifying assumption has been used is twofold:

- The data linking constraint explained earlier in this chapter means that we cannot identify properties that are occupied by Council Tax Reduction recipients. This means that we cannot assess the up-to-date value of their property and hence how their liability would change post-revaluation and what this would mean for income foregone on aggregate.

- If there is a fall in income foregone because, for example, a more progressive property tax system reduces the liabilities of households who claim Council Tax Reduction (or its equivalent), we cannot say whether local authorities or the Scottish Government would retain those savings, or whether they would

[2] This assumption holds on average for local authorities, although for those who have used discretion in the past to increase or reduce Band D Council Tax rate, and therefore do not align to the Scottish average, some movement in local rates may be required to leave local revenues unchanged.
[3] Scottish Local Government Financial Statistics 2013/14, Scottish Government
[4] This was based on a 2012 forecast by UK Government of what Council Tax Benefit would have cost in 2013/14 if it had not been abolished, minus a 10% cut. The amount transferred has been reduced in 2014/15 and 2015/16 in line with the 2012 forecast.

pass these savings back to local tax payers by reducing bills. The same is true if income foregone increases – we cannot say whether local authorities or the Scottish Government would fund this increase, or whether it would need to be funded by increasing local tax bills.

4.13.16 To ensure comparability across tax options, we have assumed that the same £360m of funding, previously provided to fund Council Tax Reduction, is made available to Local Government under our modelling of a local income tax. Local income tax is therefore also required to raise £1.98 billion in receipts under our assumptions.

4.13.17 Every local authority in Scotland currently levies a different Council Tax rate and to simplify the modelling, we used the average Scottish Band D rate (currently £1,149) and assumed that this average would apply for all scenarios, including a local income tax. Clearly where there is local discretion in rates, the impact on households in different local authorities will differ from the results modelled.

4.13.18 We have not attempted to model all household circumstances - because of the number of discounts and exemptions (as set out in Chapter 2 of this report) that can apply to households, liabilities can differ substantially and there were simply too many possible outcomes to sensibly analyse at this stage.

4.13.19 A number of methods for valuing the property tax base were explored by the Commission in conjunction with Heriot-Watt University and the University of Stirling. The income tax example analysed here is based on individual tax liabilities, and is based on the data in the Survey of Personal Incomes. The following section explores the methods for valuing the respective tax bases.

4.13.20 We used a model developed by the Scottish Government which uses Registers of Scotland (ROS) transaction data for 2013-14 to inform an up-to-date spread of property values at local authority level which we have used to update the value of the Council Tax base. This model uses an observed distribution for residential house prices with the parameters determined from the mean and median of the data. Thus, this model assumes that transactions are representative of the whole property stock[5].

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[5] The methodology of the model was developed by Scottish Government analysts for Housing Need and Demand Assessments and then later used to estimate the financial impact of the switch from Stamp Duty Land Tax to Land and Buildings Transaction Tax in Scotland. The log- normal distribution is defined by σ > 0(The shape parameter) and μ ∈ R (the log-scale parameter) which have the following relationship to the raw data:

Mean = $e^{\mu+\sigma^2/2}$

Median = e^{μ}

Thus the parameters may be determined from the mean and median of the data. The relationship has been shown, as part of Housing Need and Demand assessment studies, to hold at the local authority level in Scotland.

The log normal distribution is defined mathematically by:

Probability density function (PDF) = $\frac{1}{x\sigma\sqrt{2\pi}} e^{-\frac{(\ln x-\mu)^2}{2\sigma^2}}$

And Cumulative density function given by:

$$\int_0^x \ln \mathcal{N}(\xi;\mu,\sigma)d\xi = \frac{1}{2}\left[1+\operatorname{erf}\left(\frac{\ln x-\mu}{\sigma\sqrt{2}}\right)\right] = \frac{1}{2}\operatorname{erfc}\left(-\frac{\ln x-\mu}{\sigma\sqrt{2}}\right) = \Phi\left(\frac{\ln x-\mu}{\sigma}\right).$$

Where Φ is the cumulative normal distribution.

Manipulation of these two expressions allows the examination of the assignment of different fractions of the market to different existing Council Tax bands or the impact of the introduction of additional bands. In terms of the calculation of revenues from a property tax, the model uses the partial expectation of the distribution which is given by:

$$g(k) = \int_k^\infty x f(x)\,dx$$

$$g(k) = \int_k^\infty x f(x)\,dx = e^{\mu+\frac{1}{2}\sigma^2}\,\Phi\left(\frac{\mu+\sigma^2-\ln k}{\sigma}\right).$$

generally (for any distribution) and for the log normal. This is related to the conditional expectation E(X, X>g) (the expected value of a distribution given it is above a threshold) by the following formula.

E(X, X>g) = g(x) / p(x>k)

Combining these two concepts, for a assumed property tax, tax revenue is given by:

$$Revenue = t\sum_{i=1}^{n}\frac{g(k_i)-k_i}{(1-X(k_i))}.(r_i - r_{i-1})$$

where n is the number of thresholds, k is the threshold level and r is the rate associated with it (r0 being zero), X(k) is the cumulative log-normal distribution and n is the number of properties. This reflects that it is assumed the rates apply only above the thresholds.

4.13.21 Whilst not detailed enough to inform address-level impacts of revaluation this approach is robust enough to give us a macro overview of how property prices have changed, on average, since 1991. This in turn allows us to estimate revalued bands for Council Tax. In line with the assumptions previously set out, we have assumed a revenue neutral revaluation by maintaining the same number of properties in each band. Revalued band thresholds are then determined by splitting the distribution accordingly.

Table 4-a: Proportion of Properties by Band (as of 1 September 2013)

Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Proportion of properties in each band	21%	24%	16%	13%	13%	7%	5%	1%
Source: Scottish Local Government Financial Statistics 2012/13, Scottish Government								

4.13.22 Resulting thresholds according to the ROS 2013-14 transaction data take on the maximum shown in Table 4-b.

Table 4-b: Estimated Upper Band Thresholds Post-Revaluation

Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Upper band threshold	£72,000	£110,000	£143,000	£180,000	£246,000	£336,000	£646,000	>£646,000
Source: Commission analysis								

Table 4-c: Estimated Median Property Value Post Revaluation

Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Median property value	£54,000	£89,000	£125,000	£160,000	£208,000	£278,000	£409,000	£795,000
Source: Commission analysis								

4.13.23 As shown in Table 4-c, if revaluation had been carried out in 2013-14, the <u>ratio between the median of Band A and the median of Band H</u> is estimated to have been 15.

4.13.24 To compare the different methods of valuing the property tax base looked at by the Commission, we have produced a summary statistic relating to the level that a flat rate property tax would need to have been set at in 2013-14 to raise £1.98 billion. Using the Transaction Data model, the total tax base is estimated at £354 billion. A flat rate tax rate of 0.66% <u>on total properties,</u> which includes dwellings that are currently exempt from Council Tax, would raise net receipts of £1.98 billion according to this model.

Property Tax Base Modelling: Heriot-Watt Address Level Property Stock model

4.13.25 Professor Chris Leishman at Heriot-Watt University led this work. For seven local authorities[6], data on transactions from 1990 to 2010 was matched to data on property characteristics supplied by the Scottish Assessors Association and the Energy Saving Trust (EST), and a hedonic regression technique allowed for values to be assigned to underlying property characteristics (e.g. detachment, number of bedrooms) and location variables. A further dataset on mortgage transactions from the Council of Mortgage Lenders was used to form an additional location value for each datazone.

4.13.26 The coefficients from these regressions were then used to predict prices for the remaining property stock in the seven local authorities. What resulted was a predicted property value for every address with a relatively high degree of accuracy - the regression yielded R^2 in the region of 0.8.

4.13.27 This analysis was then used to construct new Council Tax bands. As with the Transaction Data model, the number of properties in each band was kept constant to inform new band thresholds.

4.13.28 The predicted thresholds were similar to those using the Transaction Data model. Using the address level property stock model, the sum of predicted prices for the seven local authorities was £121 billion and a flat rate of 0.59% <u>on total properties</u> would have been required to raise the same gross amount as Council Tax did in 2013-14.

[6] The seven local authorities were Aberdeen City, Fife, Dundee City, City of Edinburgh, Dumfries and Galloway, Argyll and Bute and Inverclyde.

4.13.29 The comparison between this approach and the simpler Transaction Data model is instructive. There are notable differences, in particular, in relation to areas where there is a relatively high proportion of social housing stock. The distribution of the property stock informed by transaction data will underrepresent parts of the property stock distribution that do not transact. A model which ensures that all addresses are represented in the property stock distribution does not share this weakness, although there may be some corruption of the predicted price regression from the absence of these values in the transaction data used for the hedonic estimation.

4.13.30 There will be other types of housing with fewer observed transactions (for example, extremely high value properties) and accurate valuation of these properties will require input from professional surveyors. For the majority of housing types however, this type of model is used around the world to value property, and is superior to the Transaction Data Model because it takes account of the full distribution of the stock and is able to factor in that certain types of housing may appreciate faster in value than others.

4.13.31 Although the evidence suggests that this address level property stock modelling is more accurate than the Transaction Data Model, there is a question of scalability. The local authorities analysed have a good geographical spread but we recognise that the average for the whole of Scotland is likely to be significantly impacted by Glasgow because of its relative size. However, we were not able to include this in the analysis because of source data issues[7]. The Transaction Data Model predicts that Glasgow has seen below average increases in house prices since 1991 and, if this is correct, this would imply that scaling up the Heriot-Watt analysis to the Scotland level may overstate the value of the property stock.

4.13.32 A paper submitted to the Commission by Professor Leishman is included in the Compendium of Evidence alongside this report.

[7] Heriot-Watt University relied on transaction data made available by the now disbanded Land Value Information Unit. Issues with the data published for Glasgow, in particular on the disaggregation of market sales from sales at less than market value, have meant that the data for this city could not be used in the modelling work.

Property Tax Base Modelling University of Stirling: Postcode sector level Property stock model

4.13.33 Dr David Comerford at the University of Stirling assisted us through a piece of analysis, primarily aimed to help to illustrate the overall distributional impact of property tax reform and the political economy of such a change. As part of this work, he estimated the value of the property stock using data on transactions and property characteristics (from the Scottish Government's Scottish Neighbourhood Statistics (SNS) datasets) at postcode sector level. This was not the primary focus of his work, and as such the approach is less detailed than the modelling carried out by Heriot-Watt University. Nevertheless, this provides another opportunity to compare estimates of the relative size of the property stock.

4.13.34 Using the University of Stirling approach, the total property stock is valued at £352 billion, which implies that a flat rate of 0.66% on total properties would have been required to raise the same amount as gross Council Tax in 2013-14. Dr Comerford also undertook a direct comparison with the same local authorities that Heriot-Watt University analysed and estimated a required property tax rate of 0.60% - very close to Professor Leishman's estimate of 0.59%.

4.13.35 An attempt was then made to assign property values to households in the Understanding Society database. Using SNS data, it was possible to estimate how property values seem to behave as Council Tax band, median incomes and local authorities are varied. This variation was then imputed onto the Understanding Society data, with some adjustments to ensure that the overall distribution of property values matches that seen in the SNS data (which is inferred given the ROS data) in terms of mean and variance.

4.13.36 One result of note is that the total property stock, summed across Understanding Society households, is lower than the total property stock as informed by the postcode sector property stock regression. This is because there are more properties than households, whilst just one property is assumed per household in the latter. This means that the likelihood is that this estimation undervalues the number of properties and hence the value of the property stock.

4.13.37 It is also known that the median income data from SNS is itself a modelled dataset rather than based on a representative survey. An ideal scenario would be the ability to link representative survey datasets on income, such as Understanding Society, or more preferably the Family Resources Survey which contains a greater examination of incomes, to predict property values at the address level. As discussed earlier, this is theoretically possible, but would require permissions from the data collection authority.

4.13.38 This analysis by the University of Stirling is a welcome step towards being able to understand how property values and income relate to each other, and should be capable of illustrating the broad impacts on households, even if the exact estimations need to be viewed with caution. The majority of the household impact modelling that we have used to inform its conclusions looks at the range of potential impacts on different household types at different points on the income distribution (see Household Model below) and does not make predictions about the net impact when all households are taken together. The conclusions from this University of Stirling analysis are referred to, but we do so with some caution and recommend that further linking work is undertaken before policy makers come to conclusions about the net distributional impact of changes to the present Council Tax system.

4.13.39 A paper submitted to the Commission by Dr Comerford is included in the Compendium of Evidence accompanying this report.

Comparison of the three property tax base valuation approaches

4.13.40 On balance, whilst no analytical model can ever be expected to be fully accurate, the three different exercises in valuing the property stock have produced estimates of a required flat rate property tax to within 0.7 percentage points of each other. We have taken this as a strong indication that we have been able to accurately value the up to date property stock. We are therefore confident that the results of our modelling work are valid enough to make broad conclusions about the impacts of revaluation and the approximate level at which property tax rates would need to be set to replace the present Council Tax system on a revenue neutral basis.

4.13.41 With thanks to both the Scottish Assessors Association and the EST, we were able to access the most complete data available on the characteristics of properties in Scotland. However, in order for fully robust property stock modelling to be used in the valuation of property for tax purposes in future, it is advisable that an exercise is undertaken to verify this data and ensure it is up to date, and to collect data on variables not collected by the Assessors where EST have currently had no choice but to model predicted values. Whilst it can be a useful part of the process, a statistical analysis of property values is unlikely to ever be fully capable of accurately valuing all properties. Future analysis for policy development, and the process of revaluation itself, will need more input from professional surveyors from the Scottish Assessors Association. This is discussed further in Chapter 8.

Income Tax Base Modelling

4.13.42 Figures on the size of the Scottish income tax base are based on estimates of the amount of additional income tax receipts that could have been raised from the non-dividend and non-savings income tax base in Scotland in 2013-14. These figures are shown in Table 4-d.

Table 4-d: Estimated Local Income Tax Revenue 2013-14 from Non Savings Non Dividend Income (rounded to nearest £10 million)

Additions	Revenue raised from the Basic Rate	Revenue raised from the Higher Rate	Revenue raised from the Additional Rate
+1p	£350,000,000	£70,000,000	£20,000,000
+2p	£690,000,000	£140,000,000	£30,000,000
+3p	£1,040,000,000	£210,000,000	£50,000,000
+4p	£1,390,000,000	£290,000,000	£60,000,000
+5p	£1,730,000,000	£360,000,000	£80,000,000
Source: Forecast based on Survey of Personal Incomes 2010/11			

4.13.43 These figures are based on a Scottish Government SPI (Survey of Personal Income) model. The latest publically available data from the SPI are for 2010-11. In the model, the SPI dataset has then been forecast forwards and tax rates and bands for 2013-14 applied to estimate/project total revenues and the static impact of policy changes. This does not take account of any potential taxpayer behaviour change in response to policy changes.

4.13.44 These figures are for 2013-14, based on a modelled distribution of income in Scotland in that year and the relevant income tax parameters for that year. Growth in incomes, growth in the number of taxpayers and changes to income tax parameters (such as increases in the personal allowance) means that these estimates could look significantly different for policy changes in future years.

4.13.45 These figures on the income tax base give us a basis on which to model the scale of the impact of a local income tax scenario. The use of these figures means that the local income tax modelling assumes that the tax would be operated via the Scottish Rate of Income Tax (SRIT) and that the same rate is levied across Scotland. In this scenario, we have added the same rate onto each of the basic, higher and additional thresholds. This is the structure that has been assumed for the purposes of the modelling and should not be construed as the preferred option of the Commission.

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.

4.15.1 The household modelling work that has been undertaken estimates the impact of alternative tax systems on a range of household types with different levels of income. Although we are not able to model the net impact on all households taken together, we know that there are all types of households in properties of different values and in different income decile groups, and so such broad scenario analysis is not without relevance. This analysis is helpful in determining the range of impacts arising from the different tax options for different parts of the population, and also enables us to look at the scale of the transition that different household types would face. Because we cannot look at the net impact, this may be a second-best distributional impact methodology, but has provided a level of detail that has enabled us to inform our conclusions.

4.15.2 We have run a basic micro-simulation model, which has been populated with tax and benefit rules relating to different households types in the financial year 2013-14. As well as UK Government tax and benefit rules, it also contains current Council Tax rates. The model also has the capability to work out the equivalent to CTR for alternative property taxes using the present CTR eligibility criteria.

4.15.3 Using this model, we can input different household types and different levels of household income. The model then calculates net household income (after tax, national insurance and transfers) and works out eligibility for CTR, depending on the level of Council Tax, or property tax[8]. Local income tax is calculated based on earnings (assumed to be non-savings and non-dividend income). CTR eligibility is not applied here, but the relevant 2013-14 personal allowance is. Because 2013-14 rules are used, tax credit and child benefit rules relate to that year.

4.15.4 Some simplifying assumptions are made for the purpose of this modelling:

- For households with two earners, earnings are split equally
- All income for pensioners is assumed to be pension income

[8] For some households, there were no combinations of earnings and transfers that would allow us to reach the specified net household income figure. For these households, we have substituted the closest possible figure. For some households, there may be other combinations of income, tax credits and benefits to arrive at a given net household income figure that are different from those which we have modelled.

- All households are assumed to be owners, so no housing benefit is calculated.
- For households with children, the children are assumed to be one under 14 and one over 14.

4.15.5 The following household types were selected to provide a wide range of understanding of differential impacts depending on household composition and relative age of inhabitants:

- Couple no children 1 earner
- Couple no children 2 earners
- Couple 2 children 1 earner
- Couple 2 children 2 earners
- Single no children
- Single 2 children
- Single pensioner
- Pensioner couple 1 income
- Pensioner couple 2 incomes

4.15.6 In order to examine the interplay between incomes and the relative impact of alternative tax options, the Scottish Government's Income and Poverty statistics were used.[9] Three parts of the income distribution were selected to allow comparisons over the income distribution:

- Relative poverty threshold (60% of UK median income before housing costs)
- Scottish median income
- Scottish ninth decile point (threshold of the tenth income decile)

[9] Source, HBAI dataset, DWP

4.15.7 Net household income is simply household income, net of taxes and transfers. The figures published by the Scottish Government in their Income and Poverty publication are also net of Council Tax and Council Tax Reduction, which we have taken out in order to compare the situation with Council Tax and with alternative substitute systems. The equivalisation scales used by the Scottish Government are modified OECD scales (see figure 4-d).

Figure 4-d: Equivalisation Scales

The weighting used for different household members is as follows:

- First Adult 0.67
- Spouse 0.33
- Other Second Adult 0.33
- Third Adult 0.33
- Subsequent Adults 0.33
- Children aged under 14 years 0.20
- Children aged 14 years and over 0.33

The construction of household level equivalence scales involves summing the appropriate weights:

- An adult couple household would have the weight (0.67 + 0.33) = 1
- A single adult with one child under 14 and one over 14 would be (0.67 + 0.20 + 0.33) = 1.2
- A single adult household with one child under 14 would have the weight (0.67 + 0.20) = 0.87

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.

4.16.1 The property stock modelling work enabled us to do some preliminary work on land value taxation by separating out the value of land from the value of the building which sits on this land. Using the coefficients from Professor Leishman's hedonic regression, an identical hypothetical property was constructed in each datazone. This allowed us to effectively control for building characteristics, and any variation in predicted values across the datazones therefore represented differentials in the value of the location. This is similar to the approach taken by Wightman and Lyons in 2014 in their paper "A Land Value Tax for Northern Ireland".

4.16.2 Differentials in location value would precipitate differentials in tax liability if land values were used as the tax base. However, the impact at address level would also depend on the highest and best use designated for that land parcel. To estimate land value tax liability at address level, we would need a further variable in our hedonic regression to reflect this. To fully value the tax base, and therefore to be able to calculate tax rates required for a revenue neutral land value tax, our model would also need to include empty parcels of land that are designated for residential use by the planning system. Unfortunately, time has been the most significant constraint on our ability to take this work further.

4.16.3 However, because of the work carried out by Professor Leishman, there now exists a platform on which further modelling work could be progressed.

4.16.4 The same limitation which prevents data linking between households and their property will prevent distributional impacts of land value taxes from being assessed even if land value tax liabilities had been determined. As land value taxes are commonly attributed to a tax on owners, rather than occupiers, a complete land registry for residential properties is also a key requirement. There is currently a requirement for Registers of Scotland to complete the Land Register by 2024.

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.

4.17.1 At Oral Evidence Session 1, Professor Mark Stevens put forward an outline of how a hybrid system could work. His proposal was to create a tax which relates a household's liability both to the value of a property and to its ability to pay from current income. The result would be that (a) for a given property value, a household with a higher income would pay more than one for a lower income; and (b) for a given income, a household living in a more valuable house would pay more than one living in a cheaper one. In contrast to the present Council Tax Reduction scheme, the sensitivity of the tax to income would run across the income spectrum, rather than simply protecting people on low incomes.

4.17.2 We have included Council Tax Reduction, or an equivalent, in our property tax modelling but even here we have run into limitations on what we can model. Producing a full hybrid model which takes into account income and property values for every household is beyond our modelling capabilities at this time.

4.17.3 This limitation prevented practical development of other hybrid options because without knowing the size of a hybrid tax base, we could not determine sufficiently the rates that would have been needed to generate a revenue neutral tax take.

Other alternatives: Additional Tax Bases

4.17.4 One other area where some limited quantification of the evidence was carried out was on potential revenue gained from a tourist tax. The following figures are illustrations of the amount of money that could be raised across Scotland based on numbers staying in commercial serviced accommodation, such as hotels, motels and bed and breakfasts. As such, these numbers may be conservative if it is assumed that other accommodation types could be subject to the tax although there would be additional difficulties in enforcing a tax levied on all accommodation types.

4.17.5 Some, including VisitScotland, have previously argued that such a tax would have a negative effect on the number of tourists visiting Scotland. The figures below do not account for any such behaviour change.

4.17.6 A number of other European countries and/or cities levy such charges, for example, Dublin, Warsaw, Berlin, Athens and Budapest. Many levy charges as a percent of the accommodation charge.

4.17.7 Clearly, areas with greater numbers of tourists are going to benefit from such a tax more than others. While we only modelled a 'tourist tax' we heard in evidence of a range of other potential local taxes that could be developed, where there was a clear case for these and a local mandate to do so, and we address this in greater detail in Chapter 10 of our report. How such a system would work alongside the Local Government settlement would need to be decided.

Table 4-e: Estimated Annual Amounts Raised from a Tourist Tax in Scotland (2014)

Tax Base		£1 tax	£2 tax
International Visitors	Per visit tax	£1,831,000	£3,661,000
	Per night tax	£21,681,000	£43,363,000
GB Visitors	Per visit tax	£5,790,000	£11,580,000
	Per night tax	£13,400,000	£26,800,000
Total	Per visit tax	£7,621,000	£15,241,000
	Per night tax	£35,081,000	£70,163,000
Source: International Passenger Survey, Great Britain Tourism Survey			

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?

05

Chapter 5 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.[10]
- A system of land tax is promising, but gaining a full understanding of its impact would require further analysis

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.

[10] Jackie Baillie MSP was not able to agree this recommendation

The Ability to Pay

Definition of Fairness and Equity

5.3.1 Progressivity and regressivity are terms that are often used as a test of whether or not a tax is equitable and fair. The economic literature is clear that the relationship of the tax to its tax base determines progressivity. A tax rate that increases as the taxable amount increases is progressive.

5.3.2 The following definition of progressivity is set out in the Mirrlees Review:

5.3.3 *"There is a strict economic definition of progressivity. 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"*

5.3.4 A tax system where the marginal amounts paid in tax increases as the value of the thing that is being taxed increases is not enough to be progressive – the average tax rate itself must increase.

5.3.5 If a tax is to be progressive, it must satisfy this condition. However, it is clear that people also attach an additional condition to fairness –that taxes should be directly related to 'ability to pay' with the most commonly associated measure of ability to pay being current income. This view was not universally held - some also were of the view that wealth, or even 'consumption' of housing services, was a good enough barometer of ability to pay. These interpretations are discussed later in this chapter.

5.3.6 The concept of equity is also closely related to fairness, and is often described in the literature in two forms: 'vertical equity' – those who have more should pay more is closely aligned with the concept of progressiveness. 'Horizontal equity' additionally dictates that a tax system should treat similar circumstances in similar ways. Again, there is debate over the extent to which horizontal equity should relate solely to the tax base, or to 'the ability to pay' of those that are paying the tax.

5.3.7 As described in Chapter 4, we have produced examples of potential alternatives to the present Council Tax system. In line with our remit, this chapter looks at the impact of these alternatives on individuals and households to see how well they align with definitions of fairness and equity – both with respect to the tax base and with respect to income. We also look at how different tax options relate to wealth.

5.3.8 Because the present Council Tax is levied on households, we have assumed that both income and responsibility for paying Council Tax is shared equally amongst adults in the household. This therefore masks any differential impacts on individuals within the same household. The Commission was reminded in submissions it received that for many households this may not be a valid assumption. The impact on individuals of varying this assumption is considered in the results section.

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.

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.

5.7.1 The tax base for Council Tax is made up of residential properties, subdivided into bands with each band paying a set proportion of the Band D rate which is set by local authorities. The proportions each band pays are determined by the band multiplier, which is a fraction or multiple of Band D. Whilst the multipliers, and therefore the tax liability increases through Band A to H, multipliers do not increase proportionately with property value and hence the tax rate (total liability divided by property value) falls for each band. The following graphs contrast an example of a progressive tax against Council Tax to illustrate why it is correctly referred to as a regressive tax.

5.7.2 In the example set out in Chart 5-a, the tax rate increases as the value of the tax base increases. Chart 5-b shows how the present Council Tax compares. The tax rate falls as the value of the tax base increases.

Chart 5-a: An Example of a Progressive Tax Structure

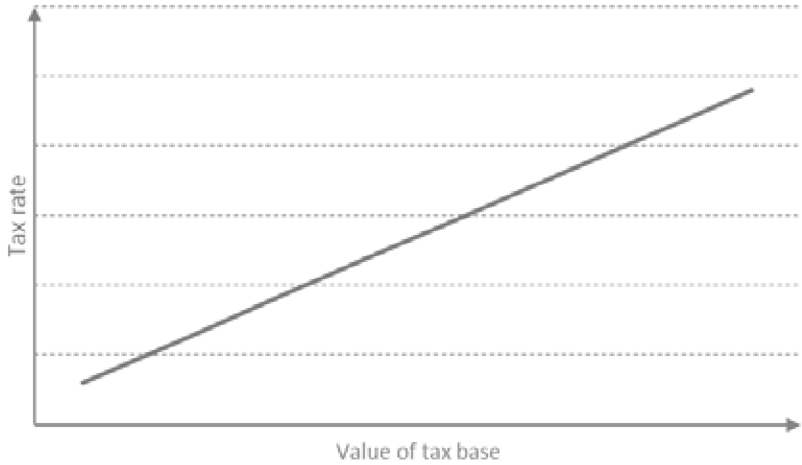
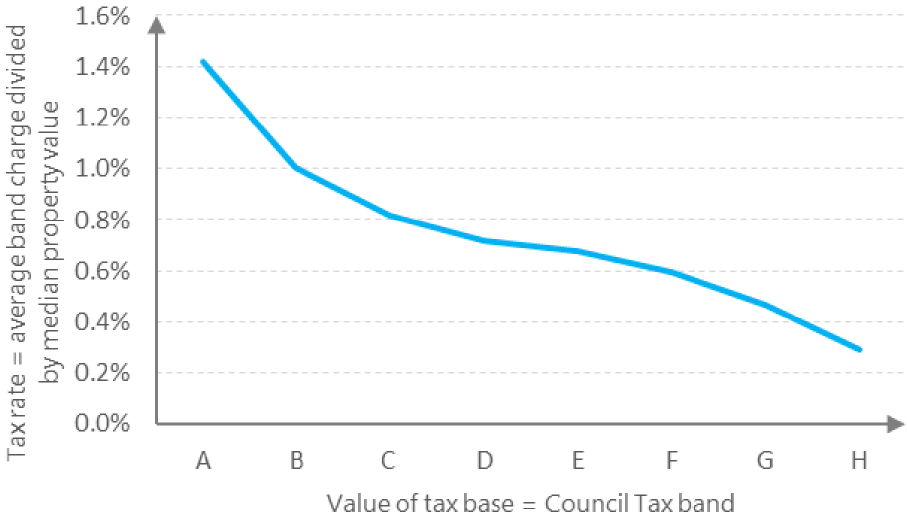


Chart 5-b: The present Council Tax Structure (based on estimates of up-to-date property values for the median of each band)



5.7.3 Many individuals and organisation highlighted the unfairness of this tax structure to us. In the online survey, over a fifth of those who discussed the Council Tax system specifically felt that higher tax rates were required for high value properties and this also came through in the bulk of written responses to the call for evidence, as well as in Oral Evidence Sessions. These issues forms a core part of the case for change, set out in Chapter 2.

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.

5.8.1 Chart 5-c shows how Council Tax relates to income, before and after application of Council Tax Reduction. Income deciles are shown along the x axis, with income increasing left to right. Council Tax liability, as a percentage of net household income is shown along the y axis. Each data point relates to the present Council Tax liability for the median household in each income decile group.

Chart 5-c: Council Tax Liabilities by Income Decile

5.8.2 As the graph clearly shows, Council Tax liabilities, before Council Tax Reduction, fall as income increases; hence Council Tax is regressive with respect to income. Once Council Tax Reduction eligibility is taken into account, the liabilities for the lower income deciles fall meaning that those in income deciles one and two pay, on average, less Council Tax than those in the income deciles above. Nevertheless, we heard from many groups and individuals that Council Tax Reduction did not go far enough to protect those on low incomes. This is discussed further later in this chapter.

5.8.3 We also heard that the regressive structure of the present Council Tax system (in relation to property values) disadvantages poorer households because they tend to live in lower value homes. Support for a more progressive property tax structure was also favoured by many because it was felt that it may benefit middle income households (who currently pay more than those with the highest incomes) as well as low income households. For example, one individual submitted a paper from the Resolution Foundation[11] to support this.

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.

Alternative Property Tax 1: Design

5.9.1 Our first example of an alternative tax system, Alternative Property Tax 1, retains the band and multiplier structure of Council Tax, but sets these multipliers relative to the current spread of house values between Band A and Band H, as informed by the Transaction Data Model described in Chapter 4. This is an example of how Council Tax could be structured so as to be proportionate rather than regressive with respect to its property tax base.

[11] Resolution Foundation (2010)

5.9.2 All exemptions, discounts and reductions that are currently part of Council Tax remain in this example. We used median values in each band (as set out in Chapter 4) to calculate multipliers, and retained Band D as the reference band. The results are set out in Table 5-a.

Table 5-a: Existing and Estimated Multipliers under Alternative Property Tax 1

Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Median value in each band	£54,000	£89,000	£125,000	£160,000	£208,000	£278,000	£409,000	£795,000
Existing multipliers (shown as decimals)	0.67	0.78	0.89	1	1.22	1.44	1.67	2
Alternative Property Tax 1 multipliers	0.33	0.55	0.78	1	1.28	1.74	2.56	4.97
Source: Local Government Finance Act 1992 & Commission analysis								

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.

5.10.1 This new structure, if implemented in 2013-14, would have reduced the amount raised on aggregate because the reduction in charges in Band A-C would not have been offset by the higher charges for Bands E-H due to the bias of properties towards the lower end of the band distribution. Therefore, in order to raise a revenue neutral amount of receipts, there would need to have been an upward adjustment made to the charges in every band[12]. We have estimated that the following charges would have been required to maintain revenue neutrality.

Table 5-b: Estimated Charges under Alternative Property Tax 1

Band	A	B	C	D	E	F	G	H
Estimated 'proportional' charges	£397	£662	£939	£1,204	£1,542	£2,096	£3,083	£5,986
Estimated 'proportional' charge divided by median value in each band	0.74%	0.75%	0.75%	0.76%	0.76%	0.76%	0.76%	0.76%
								Source: Commission analysis

5.10.2 Income foregone from CTR is assumed to stay the same in this analysis for the reasons set out in Chapter 4. If we assume that the distribution of CTR recipients throughout the band distribution stays the same post revaluation, we can estimate the impact on CTR income foregone of a more progressive multiplier structure by substituting alternative multipliers for the part of the tax base where CTR is received. Under the alternative property tax modelled in this example, this would reduce income foregone by £100 million, and enable a reduction in Band D rates of around £50 if this was recycled back into the Council Tax system[13].

5.10.3 To illustrate the scale of impact on different households, we have estimated the proportion of equivalised net household income that would be spent on the property tax alternatives, compared to Council Tax if it had been replaced in 2013-14. Full results tables are contained at the end of this chapter.

[12] This would be achieved by changing the Band D rate which would then result in adjustment to the other band rates through the multipliers. In order to calculate this change accurately in the event of a property revaluation, we would need to know how revaluation changes the distribution of discounts by band. This in turn necessitates an understanding of the households that live in the properties that change bands. In the absence of that knowledge, we have assumed that the distribution of properties receiving discounts would not change following a revaluation, and therefore the total equivalent number of dwellings in each band stays the same.

[13] This is worked out as follows: substituting alternative multipliers for the current distribution of properties where CTR is received would lead to income foregone falling from £359 million to £257 million. Divided by a recalculated Band D equivalent of 1,970,539 produces a figure of £52.

5.10.4 As we assume CTR, or an equivalent, remains, the impact on households would have depended on the liability attached to their property <u>and</u> the circumstances of the occupants. Those who were on full CTR (principally those on out of work benefits) would have seen no change, regardless of the value of their property. None of the households we have modelled on the relative income poverty threshold would have been eligible for full CTR because they had some earnings although many households would have been eligible for partial CTR.

Alternative Property Tax 1: Results

5.10.5 Our key findings are set out below. These findings artificially separate the impact on the dwelling (due to its band) from the impact on households (due to the circumstances of the occupants) in order to aid interpretation of the results.

- **Every property in Band A – C (60% of dwellings), would have had a lower liability.** Every household in a dwelling in Band A – C would have paid the same (because of CTR) or less than under the present Council Tax.

- **Every property in D – H (40% of dwellings) would have had a higher liability**. Under this option, households would have either paid the same (because of CTR) or paid more.

5.10.6 As noted above, eligibility for partial CTR means that some households would not face higher charges even if the liability attached to their property changed as this depends on income levels:

- **Eligibility for partial CTR would mean that the majority of households on the income poverty threshold would not have paid more** if they were in Bands D – H than under present Council Tax the exception being a small number of working age households with no children[14].

- **Median income households would have faced the impact of higher charges in Bands D - H in most cases** although all households would have been eligible for partial Council Tax Reduction if they were in a Band H property and some would have also been eligible for partial Council Tax Reduction in Band G properties. This has the result of capping the increase in bills.

[14] This would not be the case if either of the modifications to low income support, modelled later in this chapter, were adopted.

- **Households on the threshold of the tenth income decile would all have been liable for higher charges if they were in Bands D – H.**

5.10.7 It will only be possible to accurately measure the net distributional impact across the whole population with more robust data linking (as described in Chapter 4) but the Table 5-c can help to make judgements on the overall progressiveness with respect to income of Alternative Property Tax 1.

5.10.8 Table 5-c shows the impact of Alternative Property Tax 1 for an adult couple household with no children. The percentages show tax liabilities as a proportion of net household income. Three equivalent families with different net household incomes are analysed. The grey shaded cells refer to the median Council Tax band for their income decile group under current Council Tax values (i.e. 1991 values)[15]. As noted, this could change after revaluation but we would expect there to be at least a loose correlation between income and property values.

Table 5-c: Council Tax & Alternative Property Tax 1 as a Proportion of Net Household Income

All figures are % of net household income for a couple no children household	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Council Tax								
Relative Income poverty threshold	5.2%	6.1%	7.0%	7.8%	9.6%	11.3%	11.3%	11.3%
Scottish median	3.1%	3.6%	4.1%	4.6%	5.6%	6.7%	7.7%	9.2%
10th income decile	1.7%	2.0%	2.2%	2.5%	3.1%	3.6%	4.2%	5.0%
Alternative Property Tax 1								
Relative Income poverty threshold	2.7%	4.5%	6.4%	8.2%	10.5%	11.3%	11.3%	11.3%
Scottish median	1.6%	2.7%	3.8%	4.9%	6.2%	8.5%	12.4%	15.4%
10th income decile	0.9%	1.5%	2.1%	2.7%	3.4%	4.6%	6.8%	13.2%
Source: Commission analysis								

[15] For reference, according to the Family Resources Survey, in 2013/14:

- a household on the relative income poverty threshold is in the second income decile group where the median household was in Band B
- the median income household is on the threshold between the 5th and 6th income decile groups. The median household in the 5th and 6th income decile groups taken together was in Band C.
- The threshold for the 10th income decile is in between the 9th and 10th income decile groups where the median household was in Band E. Source: Family Resources Survey 2013/14, DWP

5.10.9 The regressiveness with respect to income in relation to the present Council Tax persists with Alternative Property Tax 1. The tax structure, although proportionate with respect to its tax base is regressive with respect to income. VAT has a similar status – it is a flat rate tax on consumption of goods and services, but because lower income families spend a greater proportion of their income on consumption, it is regressive when considered against income.

5.10.10 Despite the regressiveness with respect to income, looking at the current median Council Tax bands for each income group (i.e the grey shaded boxes in Table 5-c), and the proportionate multipliers used in Alternative Property Tax 1, the gap between the amounts that different households are spending as a percentage of their net household income is narrower than with Council Tax. This system is therefore less regressive than the present Council Tax with respect to income.

Figure 5-a: Varying assumptions on household split of income and liabilities

One other assumption made in this is analysis is with regards to pooling of income and tax liabilities for two adult households. Equal division of local tax bills and even split of earnings is unlikely to be the reality in every household. This was mentioned specifically at one of the public listening events where it was stated that a new system must acknowledges and build in issues around household incomes, how resources are shared or pooled.

The table below shows how varying these assumptions can greatly impact on the individual.

Impact of varying assumptions of income split and tax liability paid for a couple with no children household for Alternative Property Tax Scenario 1:

Council Tax Band	A	B	C	D	E	F	G	H
Proportion of net hh income available to indivudal - assumes tax liability split 50/50								
20%	4%	7%	9%	12%	16%	21%	31%	35%
50%*	2%	3%	4%	5%	6%	8%	12%	14%
80%	1%	2%	2%	3%	4%	5%	8%	9%
Proportion of tax bill paid by individual - assumes hh income is pooled (so 50% is available to individual)								
Full bill paid	3%	5%	7%	10%	12%	17%	25%	28%
Half of bill paid*	2%	3%	4%	5%	6%	8%	12%	14%

*Assumption made elsewhere in this analysis

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.

Alternative Property Tax 2: Design

5.11.1 The second tax example modelled, Alternative Property Tax 2, is based on total dwellings, rather than chargeable dwellings. In this scenario, currently exempt households would therefore be liable. The tax is levied on actual property values rather than bands. We have also removed discounts in this example, including single person discount. Additionally, we have attempted to make the tax broadly progressive with respect to income for the three parts of the income distribution we have been using in the household analysis (relative income poverty threshold, median income and threshold of the tenth income decile).

5.11.2 We have calculated the rates below to raise the same amount of revenue Council Tax, assuming the cost of CTR stayed the same. The charging structure as shown in Table 5-d operates using thresholds and the percentage rates for each band apply to the part of the value over the relevant threshold and up to the next threshold.

Table 5-d: Alternative Property Tax 2: Rates used for Modelling

Threshold (lower bound)	£0	£40,000	£100,000	£150,000	£200,000
Tax rate applied to band	0.00%	0.85%	0.90%	0.95%	1.00%

Source: Commission analysis

5.11.3 To reiterate, this is not intended as a recommendation on the exact composition of a future local tax system, but instead has been used in order to illustrate the key impacts of different broad approaches and whether it is indeed possible to make a property tax progressive with respect to income.

Table 5-e: Existing and Alternative Property Tax 2 Charges and Effective Tax Rates (for median property value in revalued, Council Tax bands)

Council Tax Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Median value in each band	£54,000	£89,000	£125,000	£160,000	£208,000	£278,000	£409,000	£795,000
Existing charges (applies to whole band)	£766	£894	£1,021	£1,149	£1,404	£1,660	£1,915	£2,298
Alternative Property Tax 2 charges (modelled on median property in band)	£119	£417	£735	£1,055	£1,485	£2,215	£3,525	£7,385
Effective tax rate for median property in band	0.22%	0.47%	0.59%	0.66%	0.71%	0.80%	0.86%	0.93%
Source: Commission analysis								

5.11.4 This is one example of a progressive tax structure that we have structured in a deliberate way. There are many different ways that rates could be structured in order to make a property tax progressive with respect to its tax base. Our example above includes as zero rate for the value of properties under £40,000 which is an optional feature of a tax structure. However, as stated in the Mirrlees review[16], the simplest form of a progressive tax is one which includes a zero rate below a given threshold (known as the personal allowance in income tax) with anything above this zero rate threshold taxed at a flat rate.

5.11.5 We have estimated that a zero rate threshold of £50,000 would imply a 1% flat rate to raise the equivalent of the present Council Tax system. A zero rate threshold of £10,000 would imply a 0.7% tax rate to raise the equivalent of the present Council Tax system. These would both be examples of progressive rates.

[16] Mirrless Review (2011)

Alternative Property Tax 2: Results

5.11.6 These results show the impact of Alternative Property Tax 2 on the estimated median property value for revalued Council Tax bands, in order to enable comparisons with Council Tax and the Alternative Property Tax 1 modelling results.

5.11.7 Key findings are set out below. These findings artificially separate the impact on the dwelling (due to its band) from the impact on households (due to the circumstances of the occupants) in order to aid interpretation of the results.

- **The median property in Band A – C (60% of dwellings), would have had a lower liability.** A household in the median property in Bands A – C would have paid the same (because of CTR) or less than under the present Council Tax.

- **The median property in E – H would have had a higher liability.** Every household in the median properties in Band E - H would have paid the same (because of CTR) or more.

- **The liability for the median property in Band D would fall but** whether households would be better or worse off would dependent on whether the household was eligible for single person discount which is removed under this scenario.

5.11.8 As noted above, eligibility for partial CTR means that some households would not face higher charges if they occupy relatively more expensive homes:

- **Eligibility for partial CTR would mean that the majority of households on the income poverty threshold would not have paid more than they currently do under any alternative** - the exception being a small number of working age households with no children[17].

- **Median income households would have faced the greatest impact of any higher charges** although all households would have been eligible for partial Council Tax Reduction in Band H homes, and some would also have been eligible for partial Council Tax Reduction in Band G homes.

[17] This would not be the case if either of the modifications to low income support, modelled later in this chapter, were adopted.

- **Nearly all households on the threshold of the tenth income decile would have faced the impact of higher charges in full,** but Council Tax Reduction would have lowered liability for households in the median of Band H occupied by single parent households with two children and pensioner couples.

5.11.9 Table 5-f shows Alternative Property Tax 2 for a couple household with no children. The percentages show tax liabilities as a proportion of net household. Three equivalent families with different net household incomes are analysed. The grey shaded cells refer to the median Council Tax band for their income decile group under current council rules (i.e. 1991 values)[18]. As noted later, this could change after any revaluation but we would expect there to be at least a weak correlation between income and property values.

Table 5-f: Council Tax and Alternative Property Tax 2 as a Proportion of Net Household Income (for median property value in Council Tax bands)

All figures are % of net household income for a couple no children household	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**
Council Tax								
Relative Income poverty threshold	5.2%	6.1%	7.0%	7.8%	9.6%	11.3%	11.3%	11.3%
Scottish median	3.1%	3.6%	4.1%	4.6%	5.7%	6.7%	7.7%	9.3%
10th income decile	1.7%	2.0%	2.2%	2.5%	3.1%	3.6%	4.2%	5.0%
Alternative Property Tax 2								
Relative Income poverty threshold	0.8%	2.8%	5.0%	7.2%	10.1%	11.3%	11.3%	11.3%
Scottish median	0.5%	1.7%	3.0%	4.2%	6.0%	8.9%	14.2%	15.4%
10th income decile	0.3%	0.9%	1.6%	2.3%	3.3%	4.9%	7.7%	16.2%
Source: Commission analysis								

[18] For reference, according to the Family Resources Survey, in 2013/14:

- a household on the relative income poverty threshold was in the second income decile group where the median household is in Band B;
- the median income household was on the threshold between the 5th and 6th income decile groups. The median household in the 5th and 6th income decile groups taken together was in Band C;

- The threshold for the 10th income decile is in between the 9th and 10th income decile groups where the median household was in Band E. Source: Family Resources Survey 2013/14 DWP

5.11.10 This alternative shows that a household on the threshold of the tenth income decile occupying a property that is worth £795,000 (the estimated median of Band H) would have paid significantly more under this alternative than under the present Council Tax – their liability more than triples. Because this is tax on discrete property values, there is no capping of charges for the most expensive homes - those with properties worth more than £795,000 would have an even higher liability. Conversely, those in a Band A property would have seen their liability fall by over 6 times. As previously stated, this is a fairly extreme version of a progressive tax to illustrate its impact and does not represent a preferred or recommended option.

5.11.11 Whilst it is likely that those in the most expensive homes are higher up the income distribution, that is not always the case. Council Tax Reduction will protect median income households from the full charge if they are in the most expensive homes, but they still face a significant increase in liabilities compared to the present Council Tax.

5.11.12 If revaluation had also been carried out, the median Council Tax bands for each income decile group may have changed, and as such this progressivity may not hold. More significantly a property tax alone is unlikely to ever be progressive across the whole income distribution. For example, under the current system, the median Council Tax band for income decile groups 3 and 4 is Band B which is also the median Council Tax band for income decile group 2. Therefore, whichever system is implemented, on average, income decile 2 will pay proportionally more than income decile 3 and 4. This illustrates that progressive property tax rates by themselves cannot guarantee income progressivity.

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.

5.12.1 Some responses to the online survey suggested that a revaluation would provide an opportunity to provide new bands for higher value properties. These thoughts were echoed at the public listening events.

5.12.2 The Welsh revaluation in 2005 was accompanied by a new band, Band I, for properties over £424,000 which accounted for 0.4% of properties at the time of revaluation.

5.12.3 Our analysis shows that adding in a new band would have had little impact on the progressivity of the tax if it had been implemented in 2013-14 in Scotland. Adding an additional Band I by splitting Band H has a negligible impact on revenues meaning it will only impact on those households who move into Band I, and will not raise enough revenue for other band rates to be reduced by more than a marginal amount, even when the Band I multiplier is set relatively high.

5.12.4 A new band threshold at £750,000 (with the current, revalued, Band H threshold staying at £646,000) would mean 6021 dwellings would move into new Band I. This analysis is based on a revalued valuation roll, with existing multipliers for A - H.

5.12.5 Setting a Band I multiplier of 3 (much higher than the Welsh Band I multiplier of 2.3) would raise around £8 million, and would mean that Band D rates could be reduced by £3.60 per year. Using current multipliers, that would mean an annual saving of £1.20 per year for Band A properties.

5.12.6 Adding a Band I is likely to affect those in the top income decile the most, given that they are the most likely to currently have a property in Band H. However, as there are households in each income decile currently living in a Band H property this change could affect households in all income deciles. Because we do not know which Band H properties would become Band I properties until they are revalued, we can’t currently estimate the distributional impact.

5.12.7 We heard from Professor Ken Gibb from the University of Glasgow in the first Oral Evidence Session that adding further bands at the top alone would not solve the perceived problems of the present Council Tax system, and this is supported by our analysis.

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*".

5.15.1 Our analysis has indicated that a property tax structured to be less regressive than Council Tax would be likely to reduce income foregone because presently households who claim Council Tax Reduction are more likely to reside in relatively lower value properties. This means that reducing the regressiveness of the multipliers, or moving to a more proportionate property tax will in itself reduce the burden on many lower income households

5.15.2 However, we have retained Council Tax Reduction in all our analysis, in recognition that some households will not be able to afford to pay either part or all of their local tax bill regardless of the level it is set at – they simply do not have sufficient income left over once essential living expenses have been covered.

5.15.3 Evidence summarised in the Literature Review showed that measures to reduce the incidence of tax on identified vulnerable groups, in particular those on low income, is widespread amongst OECD countries. As stated in the literature review, such steps were normally identified in the form of income progressive measures designed to alleviate the symptoms of typically income regressive property tax systems.

5.15.4 In Scotland, Council Tax Reduction assists those on very low incomes - the way it currently operates is set out Chapter 2. As shown earlier in this Chapter, Council Tax Reduction has a notable impact on households at the very bottom of the income distribution many of whom are on out of work benefits and entitled to full Council Tax Reduction. But the Commission has heard evidence from a number of organisations which suggests that the system of reductions, discounts and exemptions should be reviewed and extended for some households.

5.15.5 Written and oral evidence to the Commission from Citizens Advice Scotland (CAS) highlighted that single person households are by far the most common type of household to seek advice on Council Tax debt arrears. Despite being eligible for single person discount, single person working-age households where there are no children have always had support for CTR withdrawn at relatively lower levels of income, as they are assumed to have lower living costs than larger households. However, our evidence suggests that the level of support they receive should be proportionate to their needs. For that reason, we explored the level of support given to this household type relative to other types of household in order to see whether this type of household is being treated disproportionately.

How has eligibility for Council Tax support changed since 1993?

5.15.6 Council Tax Reduction retains the same eligibility criteria as its predecessor Council Tax Benefit. Eligibility rests on measuring income against 'applicable amounts', which are used throughout the Benefit System and are supposed to reflect the amounts that different types of households require to live on. These amounts are uprated each year to reflect increases in the cost of living. The basic principle of uprating policy over the past 20 years has been to uprate applicable amounts using a measure of inflation (although this measure has changed over time, and since 2013, a rate of 1% has been used instead).

5.15.7 However, our analysis has found that since 1993, applicable amounts for households with children and pensioners have risen at a faster rate than for working age adults with no children, and at a faster rate than inflation. We have not been able to find any information on how applicable amounts were originally set, and we do not know whether previous governments actively came to the decision that single person working age households did not require their support to be uprated at the same level as pensioners and households with children.

5.15.8 Although single person working age households were particularly highlighted by CAS, written and oral evidence from third sector groups that suggest the support available to all low paid households should be reviewed. The Child Poverty Action Group, among others, suggested that the personal allowance for CTR should be increased and/or the rate at which CTR support is withdrawn as income increases should be reduced.

How do CTR applicable amounts compare to other measures of household need?

5.15.9 The Minimum Income Standard (MIS) for the UK is an annually updated programme of work which reports on how much income households need in order to be able to afford an acceptable standard of living. It is carried out by the Centre for Research in Social Policy with funding from the Joseph Rowntree Foundation.

5.15.10 *"MIS is based on detailed research with groups of members of the public specifying what items need to be included in a minimum household budget. The groups are informed by expert knowledge where needed, for example on nutritional standards. The results show how much households need in a weekly budget and how much they need to earn in order to achieve this disposable income."*[19]

5.15.11 Table 5-g below shows how the Minimum Income Standard for different types of households compare to the applicable amounts used in CTR calculations.

[19] More information is available on the Loughborough University website: http://www.lboro.ac.uk/research/crsp/mis/

Table 5-g: Minimum Income Standards vs Applicable Amounts 2013-14 (all figures are weekly amounts)

Household Type	Minimum Income Standard*	Council Tax Reduction Applicable Amount	Applicable Amounts as a % of MIS
Single no children	£186	£73	39%
Couple with 2 children	£449	£266	59%
Lone parent with 2 children	£358	£229	64%
Single pensioner (65 or over)	£151	£166	110%
Source: Loughborough University			

5.15.12 In summary, applicable amounts for all working age households fall short of Minimum Income Standards, with the applicable amount for single households with no children furthest away from the benchmark set by the Minimum Income Standard. In contrast, pensioner applicable amounts are above the levels stated by the Minimum Income Standard.

5.15.13 We also heard evidence that more needs to be done to improve take-up of CTR to ensure that those who are eligible for support receive it. This point was particularly raised by third sector organisations, some of whom wrote detailed submissions about the complexities of claiming Council Tax Reduction and suggested that this could be a reason for low take-up, particularly amongst pensioners and couples with children. There were also suggestions that all reliefs, not just CTR, need to be targeted for higher take up, and that reliefs and reductions would be better presented as ‘entitlements’ in order to encourage take-up.

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.

5.16.1 As an example of the potential additional income foregone if eligibility for Council Tax Reduction was changed, we analysed the financial impact if Minimum Income Standards were adopted instead of applicable amounts[20]. Assuming no other changes to Council Tax, it is estimated that income foregone from CTR would increase by between £160m - £230m with the lower estimate representing the income foregone if take-up was at the same level as was estimated for CTB. Initial analysis indicates that it is those in the fourth income decile that would benefit the most from this change (many in the bottom income decile groups cannot benefit further because they are already eligible for full CTR under current applicable amounts).

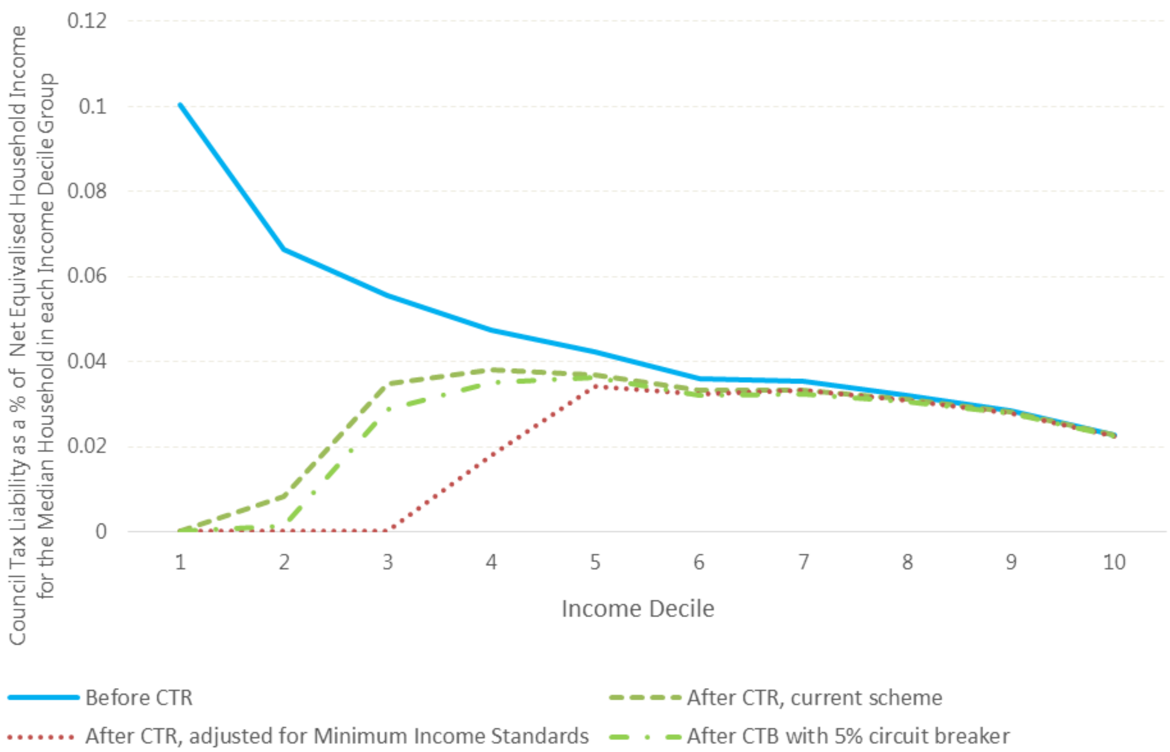
5.16.2 We also looked at the concept of Circuit Breakers. According to the literature review undertaken for us by Policy Scotland at the University of Glasgow, Circuit Breakers are used in the United States, with the basic premise that property tax liabilities cut-off once the liability reaches a set proportion of household income. This means that the household is not spending, what is assumed to be, a disproportionate amount of their income on property tax. We have chosen 5% as the cut-off as an illustration, although this is not based on any particular rationale.

[20] Pensioner applicable amounts were kept the same and not reduced in line with Minimum Income Standards

5.16.3 A circuit breaker of this sort would provide a system of protecting low and middle income households, but would be more basic in its approach than Scotland's Council Tax Reduction scheme, as it would only assess household income, and exclude any assessment of the amount required a household requires to live on. A number of organisations have warned us against an approach to income support that does not take account of the composition of households and different living costs. We therefore looked at the rationale for introducing a circuit breaker on top of the existing Council Tax Reduction system in Scotland and the impact this would have for different types of households.

5.16.4 As well as capturing those that are not currently eligible for Council Tax Reduction, but are paying more than 5% of their net household income in Council Tax, Circuit Breakers can also lessen the rate at which relief is withdrawn as income increases for some of those only eligible for partial Council Tax Reduction.

Chart 5-d: Alternatives to Council Tax Reduction



Source: Commission analysis

5.16.5 Relating this back to the household income levels used elsewhere in our analysis, households on the relative income poverty threshold would be expected to pay no property tax. Median income groups living in relatively more expensive homes, would see their liability capped at lower levels than under Council Tax Reduction.

5.16.6 Not all households would be affected by a 5% circuit breaker. Some households on the relative income poverty threshold already have their liability reduced to less than 5% through Council Tax Reduction[21]. If a circuit breaker was levied on net household equivalised income, and based on the current Council Tax system, some households on the threshold of the tenth income decile would benefit, but according to our analysis the bulk of beneficiaries would be median income households.

5.16.7 As noted in Chapter 4, we have made no judgement about how changes to a Council Tax Reduction scheme should be funded. Although we have identified significant costs associated with increasing support through Council Tax Reduction or an equivalent type of system, other changes to a property tax, for example, introducing more progressive multipliers, may have the counter effect and reduce income foregone. More analysis is required to calculate the net financial impact of different measures taken together.

[21] See tables at the end of this chapter for more information

5.16.8 Whilst support for low income households is a key consideration for local tax reform, the Commission also heard evidence that reductions, exemptions and discounts for other vulnerable households also need to be reviewed. We heard evidence that not only are households that include people with disabilities more likely to be in low income groups, they also have additional living costs which exacerbate the financial situation for these households. In submissions and Oral Evidence Sessions, third sector organisations put forward research to indicate that carers also face additional costs. All these submissions made the point that recent cuts to services and increased charges for some have made the financial situation for carers and people with disabilities more challenging. Whilst CTR does include extra premiums in recognition of disability and caring responsibilities, the Commission has heard evidence which supports a review of these premiums, as well as the other discounts and exemptions for these households.

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.

5.17.1 According to the Wealth and Assets Survey[22], over the period 2010-12, the 10% highest income households earned around 25% of all household income, whereas the wealthiest 10% of households owned almost 45% of all wealth. The wealthiest 10% owned eight times as much property wealth as the bottom 50% of household combined and 56 times as much as the least wealthy 40% combined.

[22] Wealth and Assets Survey, 2010/12, ONS

5.17.2 Owner occupiers currently are exempt from capital gains tax and since the 1960s have not paid tax on imputed income from their property. Dr David Comerford, in his working paper for us, described this as a form of subsidy for owner-occupiers. For these reasons, we heard considerable evidence that many people feel that owner-occupiers are under-taxed. Analysis of the Call for Written Evidence highlighted views relating to the importance of a progressive recurring property tax to improve the distribution of wealth in society.

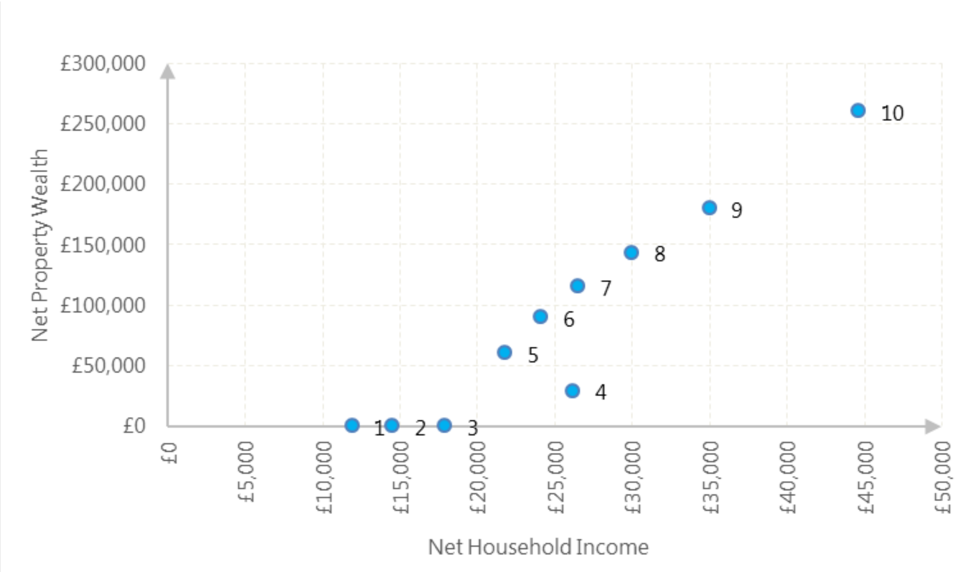
5.18 The extent to which ownership of property is indicative of ability to pay has been questioned in evidence to the Commission. In oral evidence to us, the Institute for Fiscal Studies advanced a rationale that "*housing should be taxed like other consumption*" – in effect making such a tax almost 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.

5.18.1 A property tax on occupiers could be interpreted as a consumption tax on housing services. Such an interpretation was put forward by the Mirrlees Review as a replacement to the present Council Tax and (the then) Stamp Duty Land Tax. Stuart Adam from the Institute for Fiscal Studies (IFS) gave evidence to the Commission in Oral Evidence Session 2 where he reiterated the support of the IFS for such a system.

5.18.2 Chart 5-e shows the relationship between net property wealth and income according to the most recent Wealth and Assets Survey. Each dot on this diagram represents a wealth decile. Those in the three lowest wealth deciles either do not hold property wealth or have net negative property wealth (negative values are shown as zero in the Wealth and Assets survey data).

5.18.3 Those in the fourth wealth decile have higher incomes than those in the fifth and sixth wealth deciles, which is explained by younger working age households owning property with a mortgage versus those who have retired and have lower incomes but are more likely to own outright more of their property. After wealth decile five, the relationship between wealth and income is more closely correlated.

Chart 5-e: Property Wealth vs Income



Source: Wealth and Assets Survey 2010-12, ONS

5.18.4 This disconnect between wealth and income was cited, in particular by individuals, in the call for evidence. Many gave examples of how the present Council Tax system was putting pressure on their own household, in particular for those who have retired and have seen a reduction in income.

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.

5.19.1 Some concerns were raised over the suggestion that older people in substantial property wealth holdings who have a high property tax liability should move to a cheaper home. There were questions raised over whether this would cause undue distress to some households who have a strong emotional attachment to their home. Third sector groups representing carers, disabled and older people in Oral Evidence Session 6 stated particular concern regarding this issue.

5.19.2 There are also other practical considerations. The Coalition of Carers Scotland highlighted to the Commission that it may be especially difficult for carers to move or downsize as they may have built up a network of support locally, or their house may have been adapted to suit the needs of the person they care for.

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.

5.20.1 At the Oral Evidence Sessions, we discussed with a number of witness whether a tax on landlords would be automatically translated into higher rents. Theoretically, if property tax reduces property values proportionately to the liability on the property, rents should also adjust downwards. Whether or not this transmission mechanism would operate freely was thought by some to be dependent on the flexibility of the rental market (for example, we heard that this has not happened in the Republic of Ireland due to the depressed property market) although there was some who conversely thought it would be passed on to tenants regardless. Overall, there was no consensus in the views expressed to the Commission on this matter.

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).

5.21.1 Under either a proportionate of a progressive system, those who own higher value homes will pay either the same proportion or a higher proportion of their property's value in tax than those that own lower value homes. Compared to present Council Tax, where those in higher value homes pay proportionately less than those in lower value homes, this offers a better connection to wealth. There may also be an impact on levels of property wealth if a new tax system has a subsequent impact on property values (this is discussed further in Chapter 6). For example, a progressive tax could reduce property values for higher value properties proportionately more than for lower value properties. This could therefore reduce property wealth inequalities by reducing the gap in the value of high value property compared to low value property. Analysis of responses to the call for evidence highlighted that some felt that regressiveness in the present Council Tax creates wealth inequality.

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.

5.22.1 For tenants, in the majority of cases there will be a relationship between either income levels or accumulated (non-property) wealth and the amount of rent that is affordable. Rent, in turn, should reflect the value of a property. Hence where there is a free choice in the property that a household rents, a property tax that is proportionate to property value (and therefore rent) should be proportionate to their ability to pay. This may not be true in all cases however, and indeed there may be some households that are paying levels of rent that are not reflective of their income or accumulated wealth - for example, because of lack of supply of rental accommodation. In addition, for those in council or social housing, the amount of rent the household pays may not be reflective of the market value of their home.

5.22.2 There are some that have expressed the opinion that the value of a rented home is not indicative of ability to pay for that household, precisely because their status as tenants means they have no net property wealth and hence have lesser ability to pay. This was reflected in the written submission from Shelter Scotland. They suggested that income should more directly be taken into account when assessing liabilities for those who rent or alternatively that they should be offered a tax rebate.

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.

5.24.1 Whilst the issue of asset-rich cash-poor households was raised as a concern by many groups, others reminded the Commission that this issue should not shape the tax system for everyone else. Deferral schemes were offered by witnesses as a possible way of addressing this issue. This would imply rolling up tax liabilities for owner occupiers until properties are sold, or inherited. The Literature Review found that the option to defer payments has been available in different forms in Denmark, France, Germany, the Netherlands, Spain, Sweden, parts of the United States and Northern Ireland.

5.24.2 Although many witnesses from third sector organisations told the Commission that such schemes would be welcome, in Oral Evidence Session 7, we heard that the deferral system in Northern Ireland which was introduced in 2010 was taken up by 13 households, and following an evaluation of its effectiveness it was closed to new entrants in 2012. In Oral Evidence Session 8, COSLA stated that they had not considered such a scheme in detail, but had some concerns over whether deferment would affect a Council's ability to spend over the medium term. We also heard from witnesses at the Oral Evidence Sessions about the current deferral system available for care home charges in Scotland. This allows people to enter into a legal agreement to have part of their fees paid by the local authority with the balance settled from their estate. Anecdotally, we heard from witnesses at the Oral Evidence Sessions that this scheme was not popular amongst families that were affected by it.

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.

5.25.1 A number of witnesses, including Stuart Adam from the IFS, told us that there was no place for single person discount in a property tax system and that it should be removed. Others, principally those representing older households were opposed to the removal of single person discount, and cautioned that without this discount, single pensioner households in particular may be adversely affected.

5.25.2 Whichever new system of local taxation is brought in, it will need to assess the relevance of each exemption, reduction and discount and how its existence or removal will affect households when all changes to the tax system are taken together. As already highlighted earlier in this chapter, single person households are amongst those that appear to be under-supported from existing reduction schemes. Increasing liabilities for these households may not be appropriate unless other actions are taken to ensure that lower income households are getting the support they require.

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.

5.26.1 As explained in Chapter 4, a working paper submitted to the Commission by Dr David Comerford at University of Stirling attempted to model the impact on the GINI coefficient of a change to a flat rate proportional tax on owners of properties, whilst retaining income based reliefs. In this instance the paper also assumed that an increase in the flat rate would be required in order to refund local authorities for their liability for social housing. His results indicate that such a tax would lead to a fall in the GINI coefficient[23] of 0.2. Dr Comerford's work is at a relatively early stage, but it does suggest that there is potential for property taxes to impact positively on inequality.

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.

[23] Gini index measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution. Source: www.worldbank.org

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.

5.30.1 The most commonly suggested change to Council Tax that came through the online survey was in relation to revaluation. Approximately a quarter of respondents raised this issue. The majority of people at the public listening events also identified the need to undertake a revaluation exercise if property is a feature of a local tax system.

5.30.2 A number of witnesses in the Oral Evidence Sessions challenged whether assessors were able to correctly allocate newer properties into bands based on an estimate of their 1991 value. This concern was also raised in the online survey, as well as at the public listening events. The Scottish Assessors Association told us that it is able to deliver this, and have relatively few appeals as a result, but that it can be hard for it to find appropriate comparator properties for some new builds, particularly those that are built to specifications that did not exist in 1991.

5.30.3 There have been significant changes in relative poverty values across Scotland since 1991. Heriot-Watt's modelling work suggests that, for the seven local authorities listed, 57% of properties would change band if revaluation had taken place in mid-2014. Around half of these are in a higher band than they would be after revaluation, indicating that their property has risen in value at a lower rate than the Scottish average since 1991 and they would therefore pay less Council Tax after a revaluation. The other half are in properties that have risen in value higher than the Scottish average since 1991, and would therefore pay more after revaluation.

Table 5-h: Estimates from Heriot-Watt Working Paper on the Number of Properties Changing Band post-Revaluation

Up 1 band	22%
Up 2 bands	5%
Up 3 or more bands	1%
Stay in the same band	43%
Down 1 band	22%
Down 2 bands	6%
Down 3 bands or more	1%
	Source: Heriot Watt analysis for the Commission

5.30.4 Further Analysis of the financial implications for households whose properties move bands is examined further in Chapter 8.

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.

Local Income Tax Example: Design

5.31.1 Using information from the Survey of Personal Incomes, as documented in Chapter 4, we have estimated that a rate of 4.5p on each income tax band would have been sufficient to raise a revenue neutral amount of Council Tax in 2013-14[24]. This figure is based on a forecast, and as such, may differ from the amount that would actually have been raised if Scotland was operating a local income tax of 4.5p in 2013-14[25] and because of changes to the income tax base since 2013-14, a different rate would need to operate today to be a revenue neutral replacement for Council Tax.

5.31.2 The option we have modelled is effectively a nationally set local income tax, which illustrates the impact on households. Obviously, if rates differed by local authority, the impact of local income tax on households in that area may be different from that which we have modelled here.

[24] This figure was calculated using rounded figures provided to the Commission by the Scottish Government. Unrounded figures may produce a different result. The Commission was advised that the amounts could be used additively, and as such, the method to arrive at the revenue neutral amount was to sum BR + 1p, HR + 1p and AR + 1p and multiply by 4.5. Alternative methods, by using the +4p and +5p figures produced estimates of £1,740 million and £2,170 million and reconciling these figures to the £1,980 million produced estimates of 4.4p and 4.6p respectively. Based on these calculations, 4.5p is taken as an appropriate rate to use here.

[25] The figures provided to us by Scottish Government differ slightly from the estimates of total income tax from NSND income that the Office of Budget Responsibility estimate for 2013/14. There is a divergence of £100 million between the Scottish Government approach and the OBR published forecasts for a 10p Scottish Rate of Income Tax. These differences are due to data availability and slight methodological difference. This indicates a difference of around £45 million for a local income tax of 4.5p depending on which method is used.

Local Income Tax Example: Results

5.31.3 Despite being a flat rate tax, the existence of the personal allowance (effectively a zero rate band) means that those with greater incomes pay tax on a higher proportion of their incomes. A flat rate income tax is therefore progressive with respect to income.

5.31.4 Our analysis showed that if a 4.5p local income tax had replaced Council Tax in 2013-14, a household in the tenth income decile would have paid proportionately more of their income in tax than an identical household in the middle income decile, who would have paid proportionately more of their income in tax than an identical household in the bottom income decile. This is shown in Table 5-i.

Table 5-i: Modelled Local Income Tax as a Percentage of Net Household Income

All figures are % of net household income for a couple no children household	**Local Income Tax**
Relative Income poverty threshold	0.0%
Scottish median	1.7%
10th income decile	3.9%
	Source: Commission analysis

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.

5.35.1 Chapter 4 set our view that gross earnings are not a realistic enough exposition of a household's ability to pay one higher living expenses associated with larger families, and those with additional support needs, are taken into account. In Oral Evidence Session 3, witnesses discussed problems associated with taxation in general and that unlike benefits, taxes take no account of necessary outgoings. This was also highlighted in the independent analysis of our Call for Written Evidence, where some felt that in certain situations, higher expenditure costs would need to be taken into account.

5.36 Chapter 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.

5.37.1 This issues is shown in Table 5-j. Households with one income have been selected to aid comparability. The larger the household, the larger the essential living costs, and the larger the amount of local income tax each must pay. Pensioners have a slightly higher personal allowance and hence pay a slightly lower amount of tax for the same level of income as a working age household.

Table 5-j: Comparison of Median Income Households

Household type	Modelled LIT as a % of net equivalised household income
Couple no children (1 earner)	3.4%
Couple 2 children (1 earner)	4.8%
Single no children	3.0%
Single 2 children	4.2%
Single pensioner	2.1%
Pensioner couple (1 income)	3.3%
	Source: Commission analysis

5.37.2 The disparity between the amount of tax paid by one-earner and two-earner households is shown in Table 5-k. Two identical two-adult households will have different local income tax liabilities depending on the distribution of earnings between the two adults. If only one works, under the current income tax system, then there is just one personal allowance taken into account when calculating local income tax liabilities, and so tax is paid on a higher proportion of income than when there are two earners and two personal allowances.

Table 5-k: Comparison of One and Two Earner Households

All figures are % of net household income for a couple no children household		Modelled Local Income Tax as a % of net household income
Relative Income poverty threshold	2 Earners	0.0%
Scottish median	2 Earners	1.7%
10th income decile	2 Earners	3.9%
Relative Income poverty threshold	1 Earner	2.3%
Scottish median	1 Earner	3.4%
10th income decile	1 Earner	5.6%
		Source: Commission analysis

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.

Figure 5-b: Main Analytical Results - How to Use the Results Tables

These tables show the possible outcomes for all the households we have modelled against 3 examples of alternative local tax systems. These alternatives are illustrative scenarios and should not be viewed as the Commission's preferred structure of any alternatives to the present Council Tax system.

The impact on households is shown as a proportion of their net household income (after income tax, national insurance and transfers).

The amount each household type pays in Council Tax after Council Tax Reduction (assuming those eligible take it up), is shown as a proportion of their net household income in the top line. Council Tax bands are used throughout the tables to show the impact on households if the present Council Tax system was to be removed and replaced by an alternative system. For the alternative property tax systems, this impact will also depend on the value of the property that the household occupies. For local income tax, property value does not alter the tax liability, but whether the household is better or worse off with under a local income tax will depend partly on their current liability under Council Tax.

These modelled scenarios alter the tax structure and do not take account of any movements in Bands if a revaluation was undertaken. We do not know the distribution of household types, or income deciles, by Council Tax band post revaluation, hence we cannot show the net impact of these changes, or indeed whether all of these modelled scenarios would be borne out in reality. In particular, if the number of properties in Band H stays the same post revaluation, less than 13,000 properties (<1%) of the total number of properties, would be in Band H. Not all household types in the income deciles shown may be in Band H. However, we do know that all parts of the income distribution are presently found in every Council Tax Band, so it is a possibility. The Band proportions are shown at the top of each table to aid interpretation of the number of properties that may be affected by the changes shown. Current breakdowns of bands for the income groups represented are also shown, and act as a guide to the extent of the impact if these changes were implemented using the 1991 values that are currently in use.

The colours are also intended to aid interpretation:

- Green cells represent households that would either pay the same or less due to the change to the alternative tax system.
- Amber cells show household that would pay marginally more in the alternative tax system, to within 0.5 percentage points of their net household income (hence this is lost in the rounding).
- Red cells are households that would pay more by at least 0.5 percentage points under the alternative systems of their net household income.

Relative income poverty threshold								
Council Tax Band	A	B	C	D	E	F	G	H
Scotland % of total propeties in each band	*21%*	*23%*	*16%*	*13%*	*13%*	*8%*	*5%*	*1%*
2nd Income Decile % of total propeties in each band (1991 values)	*28%*	*33%*	*15%*	*12%*	*7%*	*4%*	*1%*	*0%*
Couple no children 1 earner								
Council Tax (current)	5%	6%	7%	8%	10%	10%	10%	10%
Alternative Property Tax 1	3%	5%	6%	8%	10%	10%	10%	10%
Alternative Property Tax 2	1%	3%	5%	7%	10%	10%	10%	10%
Flat Rate Local Income Tax	2%	2%	2%	2%	2%	2%	2%	2%
Couple no children 2 earners								
Council Tax (current)	5%	6%	7%	8%	10%	11%	11%	11%
Alternative Property Tax 1	3%	5%	6%	8%	11%	11%	11%	11%
Alternative Property Tax 2	1%	3%	5%	7%	10%	11%	11%	11%
Flat Rate Local Income Tax	0%	0%	0%	0%	0%	0%	0%	0%
Couple 2 children 1 earner								
Council Tax (current)	3%	4%	5%	5%	5%	5%	5%	5%
Alternative Property Tax 1	2%	3%	4%	5%	5%	5%	5%	5%
Alternative Property Tax 2	1%	2%	3%	5%	5%	5%	5%	5%
Flat Rate Local Income Tax	1%	1%	1%	1%	1%	1%	1%	1%
Couple 2 children 2 earners								
Council Tax (current)	3%	4%	5%	5%	6%	6%	6%	6%
Alternative Property Tax 1	2%	3%	4%	5%	6%	6%	6%	6%
Alternative Property Tax 2	1%	2%	3%	5%	6%	6%	6%	6%
Flat Rate Local Income Tax	0%	0%	0%	0%	0%	0%	0%	0%
Single no children								
Council Tax (current)	5%	6%	7%	8%	10%	11%	11%	11%
Alternative Property Tax 1	3%	5%	7%	8%	11%	11%	11%	11%
Alternative Property Tax 2	1%	4%	7%	10%	11%	11%	11%	11%
Flat Rate Local Income Tax	0%	0%	0%	0%	0%	0%	0%	0%
Single 2 children								
Council Tax (current)	3%	4%	4%	4%	4%	4%	4%	4%
Alternative Property Tax 1	2%	3%	4%	4%	4%	4%	4%	4%
Alternative Property Tax 2	1%	2%	4%	4%	4%	4%	4%	4%
Flat Rate Local Income Tax	0%	0%	0%	0%	0%	0%	0%	0%
Single pensioner								
Council Tax (current)	3%	3%	3%	3%	3%	3%	3%	3%
Alternative Property Tax 1	3%	3%	3%	3%	3%	3%	3%	3%
Alternative Property Tax 2	1%	3%	3%	3%	3%	3%	3%	3%
Flat Rate Local Income Tax	0%	0%	0%	0%	0%	0%	0%	0%
Pensioner couple 1 income								
Council Tax (current)	3%	3%	3%	3%	3%	3%	3%	3%
Alternative Property Tax 1	3%	3%	3%	3%	3%	3%	3%	3%
Alternative Property Tax 2	1%	3%	3%	3%	3%	3%	3%	3%
Flat Rate Local Income Tax	2%	2%	2%	2%	2%	2%	2%	2%
Pensioner couple 2 incomes								
Council Tax (current)	3%	3%	3%	3%	3%	3%	3%	3%
Alternative Property Tax 1	3%	3%	3%	3%	3%	3%	3%	3%
Alternative Property Tax 2	1%	3%	3%	3%	3%	3%	3%	3%
Flat Rate Local Income Tax	0%	0%	0%	0%	0%	0%	0%	0%

Table 5-I: Full Results for Households on Relative Income Poverty Threshold

Median income								
Council Tax Band	A	B	C	D	E	F	G	H
Scotland % of total propeties in each band	*21%*	*23%*	*16%*	*13%*	*13%*	*8%*	*5%*	*1%*
5th & 6th Income Decile % of total propeties in each band (1991 values)	*22%*	*26%*	*18%*	*15%*	*11%*	*5%*	*2%*	*0%*
Couple no children 1 earner								
Council Tax (current)	3%	4%	4%	5%	6%	7%	8%	9%
Alternative Property Tax 1	2%	3%	4%	5%	6%	8%	12%	14%
Alternative Property Tax 2	0%	2%	3%	4%	6%	9%	14%	14%
Flat Rate Local Income Tax	3%	3%	3%	3%	3%	3%	3%	3%
Couple no children 2 earners								
Council Tax (current)	3%	4%	4%	5%	6%	7%	8%	9%
Alternative Property Tax 1	2%	3%	4%	5%	6%	8%	12%	15%
Alternative Property Tax 2	0%	2%	3%	4%	6%	9%	14%	15%
Flat Rate Local Income Tax	2%	2%	2%	2%	2%	2%	2%	2%
Couple 2 children 1 earner								
Council Tax (current)	2%	2%	3%	3%	4%	4%	5%	6%
Alternative Property Tax 1	1%	2%	3%	3%	4%	6%	8%	11%
Alternative Property Tax 2	0%	1%	2%	3%	4%	6%	9%	11%
Flat Rate Local Income Tax	5%	5%	5%	5%	5%	5%	5%	5%
Couple 2 children 2 earners								
Council Tax (current)	2%	2%	3%	3%	4%	4%	5%	6%
Alternative Property Tax 1	1%	2%	3%	3%	4%	6%	8%	11%
Alternative Property Tax 2	0%	1%	2%	3%	4%	6%	9%	11%
Flat Rate Local Income Tax	3%	3%	3%	3%	3%	3%	3%	3%
Single no children								
Council Tax (current)	3%	4%	5%	5%	6%	7%	8%	10%
Alternative Property Tax 1	2%	3%	4%	5%	7%	9%	14%	14%
Alternative Property Tax 2	1%	2%	4%	6%	9%	13%	14%	14%
Flat Rate Local Income Tax	3%	3%	3%	3%	3%	3%	3%	3%
Single 2 children								
Council Tax (current)	2%	2%	3%	3%	4%	4%	5%	6%
Alternative Property Tax 1	1%	2%	2%	3%	4%	5%	8%	10%
Alternative Property Tax 2	0%	1%	2%	4%	5%	7%	10%	10%
Flat Rate Local Income Tax	4%	4%	4%	4%	4%	4%	4%	4%
Single pensioner								
Council Tax (current)	3%	4%	5%	5%	6%	7%	8%	10%
Alternative Property Tax 1	2%	3%	4%	5%	7%	9%	10%	10%
Alternative Property Tax 2	1%	2%	4%	6%	9%	10%	10%	10%
Flat Rate Local Income Tax	2%	2%	2%	2%	2%	2%	2%	2%
Pensioner couple 1 income								
Council Tax (current)	3%	4%	4%	5%	6%	7%	8%	9%
Alternative Property Tax 1	2%	3%	4%	5%	6%	8%	10%	10%
Alternative Property Tax 2	0%	2%	3%	4%	6%	9%	10%	10%
Flat Rate Local Income Tax	3%	3%	3%	3%	3%	3%	3%	3%
Pensioner couple 2 incomes								
Council Tax (current)	3%	4%	4%	5%	6%	7%	8%	9%
Alternative Property Tax 1	2%	3%	4%	5%	6%	8%	10%	10%
Alternative Property Tax 2	0%	2%	3%	4%	6%	9%	10%	10%
Flat Rate Local Income Tax	1%	1%	1%	1%	1%	1%	1%	1%

Table 5-m: Full Results for Median Income Households

10th income decile threshold								
Council Tax Band	A	B	C	D	E	F	G	H
Scotland % of total propeties in each band	*21%*	*23%*	*16%*	*13%*	*13%*	*8%*	*5%*	*1%*
9th & 10th Income Decile % of total propeties in each band (1991 values)	*6%*	*12%*	*11%*	*17%*	*25%*	*15%*	*14%*	*1%*
Couple no children 1 earner								
Council Tax (current)	2%	2%	2%	3%	3%	4%	4%	5%
Alternative Property Tax 1	1%	1%	2%	3%	3%	5%	7%	13%
Alternative Property Tax 2	0%	1%	2%	2%	3%	5%	8%	16%
Flat Rate Local Income Tax	6%	6%	6%	6%	6%	6%	6%	6%
Couple no children 2 earners								
Council Tax (current)	2%	2%	2%	3%	3%	4%	4%	5%
Alternative Property Tax 1	1%	1%	2%	3%	3%	5%	7%	13%
Alternative Property Tax 2	0%	1%	2%	2%	3%	5%	8%	16%
Flat Rate Local Income Tax	4%	4%	4%	4%	4%	4%	4%	4%
Couple 2 children 1 earner								
Council Tax (current)	1%	1%	1%	2%	2%	2%	3%	3%
Alternative Property Tax 1	1%	1%	1%	2%	2%	3%	4%	9%
Alternative Property Tax 2	0%	1%	1%	2%	2%	3%	5%	11%
Flat Rate Local Income Tax	7%	7%	7%	7%	7%	7%	7%	7%
Couple 2 children 2 earners								
Council Tax (current)	1%	1%	1%	2%	2%	2%	3%	3%
Alternative Property Tax 1	1%	1%	1%	2%	2%	3%	4%	9%
Alternative Property Tax 2	0%	1%	1%	2%	2%	3%	5%	11%
Flat Rate Local Income Tax	5%	5%	5%	5%	5%	5%	5%	5%
Single no children								
Council Tax (current)	2%	2%	3%	3%	3%	4%	5%	6%
Alternative Property Tax 1	1%	2%	2%	3%	4%	5%	8%	15%
Alternative Property Tax 2	0%	1%	2%	3%	5%	7%	12%	17%
Flat Rate Local Income Tax	5%	5%	5%	5%	5%	5%	5%	5%
Single 2 children								
Council Tax (current)	1%	1%	1%	2%	2%	2%	3%	3%
Alternative Property Tax 1	1%	1%	1%	2%	2%	3%	4%	8%
Alternative Property Tax 2	0%	1%	1%	2%	3%	4%	6%	14%
Flat Rate Local Income Tax	6%	6%	6%	6%	6%	6%	6%	6%
Single pensioner								
Council Tax (current)	2%	2%	2%	3%	3%	4%	5%	6%
Alternative Property Tax 1	1%	2%	2%	3%	4%	5%	7%	15%
Alternative Property Tax 2	0%	1%	2%	3%	5%	7%	11%	15%
Flat Rate Local Income Tax	4%	4%	4%	4%	4%	4%	4%	4%
Pensioner couple 1 income								
Council Tax (current)	2%	2%	2%	3%	3%	4%	4%	5%
Alternative Property Tax 1	1%	1%	2%	3%	3%	5%	7%	13%
Alternative Property Tax 2	0%	1%	2%	2%	3%	5%	8%	14%
Flat Rate Local Income Tax	5%	5%	5%	5%	5%	5%	5%	5%
Pensioner couple 2 incomes								
Council Tax (current)	2%	2%	2%	3%	3%	4%	4%	5%
Alternative Property Tax 1	1%	1%	2%	3%	3%	5%	7%	13%
Alternative Property Tax 2	0%	1%	2%	2%	3%	5%	8%	14%
Flat Rate Local Income Tax	3%	3%	3%	3%	3%	3%	3%	3%

Table 5-n: Full Results for Households on the Threshold of the Tenth Income Decile

What are the Wider Impacts of Alternative Local Taxes?

06

Chapter 6 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.

6.1.1 This clustering behaviour was part of the reason why the Scottish Government brought forward proposals to replace Stamp Duty Land Tax (SDLT) with Land and Buildings Transaction Tax. The 'slab' structure of SDLT distorted the housing market by making it unattractive to buy a home at a price immediately above a threshold, as the tax then charged on the whole sum is significantly higher than the tax payable on a slightly lower purchase price.

6.1.2 These effects are illustrated in Chart 6-a below which shows the distribution of house sales in 2013, with 'spikes' of transactions clearly obvious just below the SDLT thresholds.

Chart 6-a: Property Transactions 2013-14

Source: Registers of Scotland

6.1.3 The analysis of the responses to the consultation on "Taking forward a Scottish Land and Buildings Transaction Tax" cited widespread support for a progressive tax structure which removed the slab structure that produced this behavioural response.

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.

6.2.1 Taxation has many purposes, but the primary aim of local tax is to raise funds to pay for local services. From an economic point of view, taxation will always produce an efficiency loss. At a very simplistic level, taxation reduces disposable income and will lead to households or businesses spending, investing or saving less than if the tax did not exist. They may also change their behaviour so that they pay less tax - as the case of Stamp Duty Land Tax exemplified. It is widely accepted that adverse behavioural effects of a tax should be minimised, other than certain taxes where there is a particular action that government is seeking to mitigate (or encourage).

6.2.2 Different forms of local taxation will have a different range of impacts. In some cases, we have found that as well as serving its primary purpose of raising revenue, there are positive behavioural impacts which may result.

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.

6.3.1 This chapter covers each of the three 'core' replacement options: a tax on residential property, a tax on residential land and a local income tax, and explores potential wider impacts, both negative and positive.

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.

6.4.1 Both land and property tax can, theoretically, have a role in reducing house prices because the tax should be capitalised into the value of the asset. Empirically, this is difficult to prove, although the IFS found evidence that the abolition of domestic rates in the late 1980s had an inflationary impact on house price growth in the region of 10% - 18%[26].

6.4.2 We heard evidence in Oral Evidence Session 1 that property tax could form part of a policy mix to create more stability in the market and to counter speculative house purchasing. This point was made by Shelter Scotland and echoed by Professor Mark Stevens, one of the authors of the Joseph Rowntree Foundation Housing Market Task Force[27], which concluded that taxation has a role in stabilising the housing market, along with other factors. The literature review cited econometric analysis published by the OECD[28] which suggests that property taxes can play a small but significant role in reducing house price volatility.

[26] Rosenthal, L (1999)
[27] Joseph Rowntree Foundation Housing Task Force report (2011)
[28] Blochinger, H (2015)

6.4.3 Evidence from the Northern Ireland Executive in Oral Evidence Session 7 suggested that its move to a capital based property tax in 2007, where rates and tax bills for every property were published in 2006, had no impact on the property market at a time when values were rising considerably, although it may be contended that the rates charged were too low to have an impact regardless of market conditions.

6.4.4 One of the conclusions of the literature review undertaken for us by Policy Scotland at the Glasgow University was that whilst land and property taxes may have desirable impacts on housing and land markets, this depends on design. With respect to property taxes in particular, the literature review concludes that measures aimed at addressing perceived issues of property tax (of which delayed revaluation is one of these measures) means that the economic efficiency of property and land taxation can be undermined.

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.

6.5.1 Scottish Government statistics[29] show that there were over 10,000 hectares of derelict or urban vacant land in Scotland in 2014 and the stock of derelict and urban and vacant land only fell by approximately 1% compared to the previous year. Whilst there will be a number of factors that influence decisions to develop land, many of those who answered the call for evidence and gave evidence to us at Oral Evidence Sessions felt that land taxes could encourage development on these sites because there would be an (additional) cost to holding vacant land.

[29] Scottish Vacant and Derelict Land Survey 2014, Scottish Government

6.5.2 At the same time, the tax would have no negative impact on homeowners' decisions to improve their home, as an increase in the value of a property would not be reflected in a higher land tax liability. The only exception to this would be if the permissions for development on the land were changed. In this instance, the value of the land would increase to reflect this additional development potential.

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.

6.6.1 As well as the potential for positive behavioural change, economists generally agree that land tax is the most 'efficient' tax instrument available to policy makers because the potential for adverse behavioural reactions are limited. Whilst a land tax can have an impact on the price of land (as with property – see 6.4) because the amount of land in Scotland is fixed, a change in price cannot lead to a change in the size of the tax base either now or in the future.

6.6.2 This viewpoint was reflected in the Call for Written Evidence. Approximately two-fifths of organisational responses and a quarter of individuals supported a land value tax, with their main reasoning relating to the economic benefits of such a tax. Policy, tax and economic interest groups were significantly more supportive of a land tax than others. A small number of respondents to the Call for Written Evidence felt that a land value tax had the potential to replace all existing local taxes, and many more felt that there was scope for it to replace non-domestic rating. However, there were some concerns expressed in the Call for Written Evidence on the wider impacts of a land value tax. Some were concerned that it may lead to overdevelopment on some sites and queried whether it may lead to lower income households leaving higher value inner city land, in particular if regeneration efforts are leading to improved land values (the latter concern would also apply to a regularly revalued property tax).

6.6.3 A tax on both land and buildings (commonly referred to as a property tax) is not as efficient as land taxation because the act of putting buildings on land is a productive use of land which will be made less attractive if buildings, as well as land, are taxed. This is far more of an issue for economic efficiency with taxation of commercial premises because these buildings are an input into the production process. Although not as fixed as land, the current property supply can be thought of as relatively fixed – it is unlikely that a recurring property tax could be set at a level that would make alternative uses of land more profitable to the extent to which it would trigger widespread demolition of residential property. It could however dis-incentivise new home building in marginally profitable locations and make home extensions/improvement less attractive. This disincentive for home improvements was noted by individuals in the Call for Written Evidence.

6.6.4 As covered in detail in the literature review by Policy Scotland at the University of Glasgow, economic theory argues to minimise inefficiency effects, tax should be levied on those tax bases where there is least likely to be any behavioural change from the imposition of the tax. On that basis, the most efficient tax that we have considered is a tax on land, and the least efficient (or most distorting) is a tax on earnings.

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.

6.8.1 Aside from economic growth considerations, the economic efficiency of taxation also relates to the extent to which taxes can be avoided or evaded and the cost of collection.

6.8.2 We heard evidence in support of land and property taxes because they are physical assets and are therefore difficult to conceal. In the Call for Written Evidence, many felt that the present Council Tax is hard to avoid, with homeowners easily identified. In its evidence to us, one of COSLA's stated 'Principles of Local Taxation' was that *"Local Taxation should be administratively efficient and difficult to avoid*". The same submission stated that the present Council Tax scores highly against this measure with in-year collection rates (the difference between what was billed and what was collected) above 95% in 2013-14.

6.8.3 Conversely the evidence that we heard also highlighted the potential for relatively more avoidance and evasion if a local income tax was in operation. HMRC produces estimates of the "tax gap" for different taxes that it collects. The tax gap could be due to a range of factors including inaccuracies in tax returns, to deliberate tax avoidance and evasion. Whilst difficult to estimate in absolute terms, the HMRC data shows that self-assessment income tax returns had a tax gap of 16.9% and PAYE income tax had a tax gap of 1.5%. Therefore, whilst PAYE is able to deliver better levels of compliance than the present Council Tax, the self-assessment element of income tax was subject to higher levels of non-compliance. A local income tax system based on the HMRC tax collection system would inherit these levels of compliance with the aggregate impact dependent on the amount of non-savings non-dividend income paid through PAYE and self-assessment taxpayers in Scotland.

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.

6.11.1 Analysis of the Call for Written Evidence highlighted concerns that an additional income tax may provide a disincentive to work and would weaken Scotland's economic performance. In their written response, one individual submitted evidence from the 2010 OCED paper "Tax Policy Reform and Economic Growth"[30] which indicated that to encourage economic growth, the tax burden should be shifted away from income towards consumption and residential property.

6.11.2 As with any financial decision, there are likely to be many competing factors that influence work decisions. Some of these factors may not be financial at all – for example, they may relate to the wellbeing of family members. Even if there is a clear incentive to increase or reduce hours worked, the labour market may not be flexible enough to allow this, particularly in periods of economic uncertainty.

[30] OECD (2010)

6.11.3 The interplay of local benefits with the wider welfare system is complex. We heard from witnesses at the Oral Evidence Sessions who highlighted the importance of ensuring that any means tested reduction to local tax is as well aligned as possible with the wider welfare system. This needs to be considered for any income component of a local tax system, not just a local income tax, including reform of Council Tax. The present Council Tax Reduction taper means that 20% of income over a household's applicable amount is expected to be paid in Council Tax. Our analysis has shown that there are households who are paying part of their Council Tax even though they are not liable for income tax and are receiving tax credits. The lack of integration between Universal Credit and Council Tax Reduction was also cited by a number of witnesses as a concern.

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.

6.12.1 The 1991 property tax base, which is the basis for the present Council Tax, showed regional variation in the number of Band D equivalents, which is a weighted measure to show relative value of the property stock in each local authority. Modelling work carried out by Professor Chris Leishman at Heriot-Watt University attempted to update this using 2014 data. This analysis found that because there has been divergent growth rates in property values across Scotland since 1991, revaluation would lead to significant relative changes in the amount of tax collected in different local authorities. Broadly speaking, local authorities where house price growth has been above the Scottish average would see an increase in Council Tax collected, and those where growth has been lower than the Scottish average would see a fall in Council Tax collected.

6.12.2 The modelling work was confined to seven local authorities because of time and resource limitations, but there was a method in choosing geographically varied local authorities in a mix of urban and rural areas. Of the seven local authorities modelled:

- Edinburgh and Aberdeenshire had more than 40% of properties moving up at least 1 band;
- Argyll and Bute, Dumfries and Galloway and Fife had more than 40% of properties moving down at least 1 band; and
- Dundee and Inverclyde saw the majority of properties remaining in the same band, but both had more properties moving down than moving up.

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.

6.13.1 The following maps illustrate our estimates of the difference between average property values and average land values for datazones around Scotland.

6.13.2 Each map is split into datazones. The property value maps show the average property prices, with each colour representing a quintile. The darkest blue represents the top quintile, or the top 20% datazones by property value in the seven local authorities. As the maps show, Edinburgh and Aberdeenshire have the highest concentration of dark blues and hence have the greatest concentration of high value properties compared to the other 5 local authorities (note that datazones are of different geographic sizes, meaning that some colours may appear to be more prevalent than others).

6.13.3 The land value maps are produced on a slightly different basis. These maps show the average property value of the same $100m^2$ 3 bed detached house in each datazone. This is used to show differentials in land values– the characteristics of the property are held constant so the only variable that can differ is the location. The values are artificially constructed using Heriot-Watt University's hedonic regression based on these conditions and may not represent any actual 3 bed property within a particular datazone, but the point of this exercise is to hold all variables constant, apart from land, and observe the value in different locations. As with the mean property price, these values are separated into quintiles. The darkest blue datazone represents the datazones where this hypothetical 3 bed detached house is the most expensive (which means the location component is the most expensive. The yellow datazones show areas where the location component is cheapest).

6.13.4 The reason for showing the two maps side by side is to help us to understand how land prices differ from property values. Differentials in property values, shown on the left hand set of maps, reflect size and build quality of properties, as well as the value of the location. The maps on the right hand side only reflect differentials in the value of the location. One important factor is missing here – the average size of plots in each datazone. If we had this variable, we could construct an average land price per plot and compare this directly to average property prices. Despite the absence of this information, we have been able to compare the areas with the most expensive properties with the areas where we estimate land values are the highest, and identify where there are major differences.

6.13.5 In many areas, the difference between the two maps is subtle. However, two maps stand out. Aberdeenshire has fewer datazones in the top 20% for land values compared to property values and the highest land values appear to be concentrated close to Aberdeen and not in more rural areas. This is likely to represent the relatively higher land values associated with being closer to a major city.

6.13.6 Conversely, Edinburgh contains more datazones in the top 20% for the land value estimate than for average property prices. This possibly represents the relatively high cost of city centre land, even though tenemental properties are, on average, fairly small, so when taken together, property values are lower in some parts of central Edinburgh than other local authorities we have analysed. Many datazones in central Dundee also move up by a quintile which possibly again reflects lower value housing on relatively expensive city centre land. This does not mean that residents of Dundee and Edinburgh will necessarily pay more under land value tax rather than local income tax, because for tenements, the liability will be split between the flats. But it does suggest that the Edinburgh and Dundee tax bases would be more valuable per square metre relative to more rural areas than would be the case with property taxes.

Colour key:

- Bottom quintile
- 2nd quintile
- 3rd quintile
- 4th quintile
- Top quintile

Estimated differentials in mean **property value**

Illustration of estimated differentials in **land value**

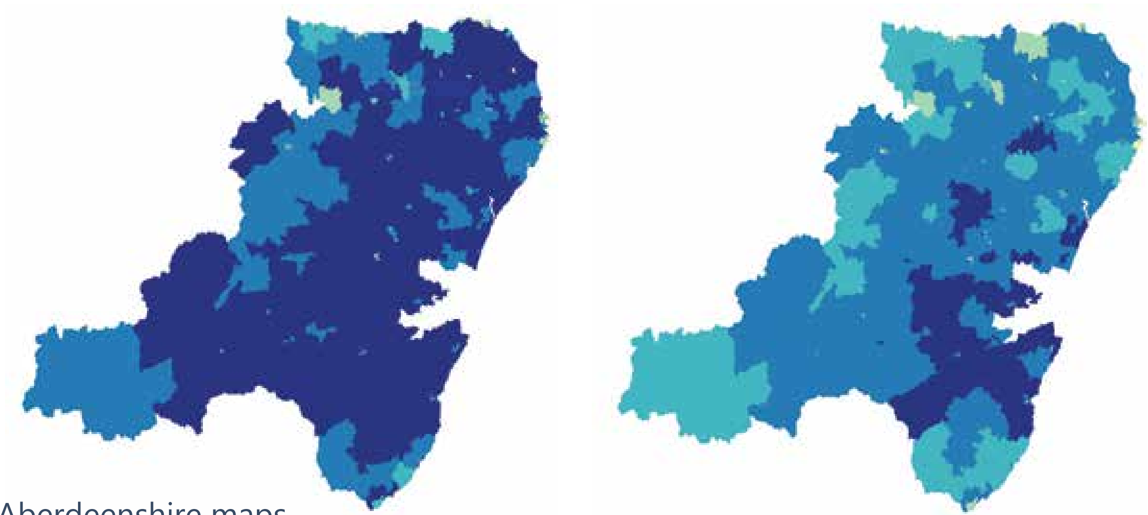


Figure 6-a: Aberdeenshire maps

Estimated differentials in mean **property value**

Illustration of estimated differentials in **land value**

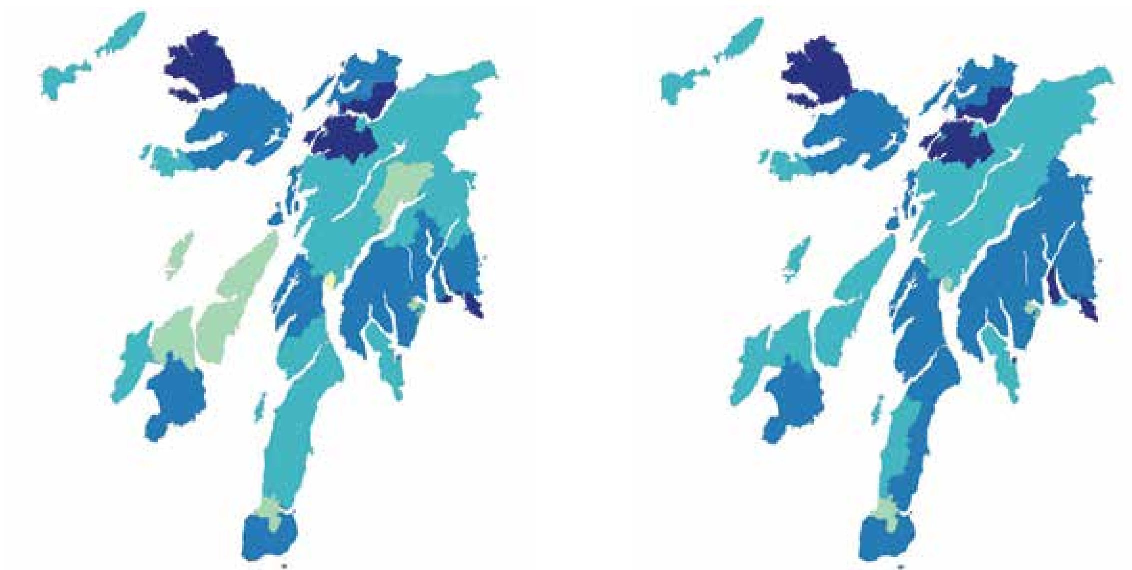


Figure 6-b: Argyll and Bute maps

Estimated differentials in mean **property value**

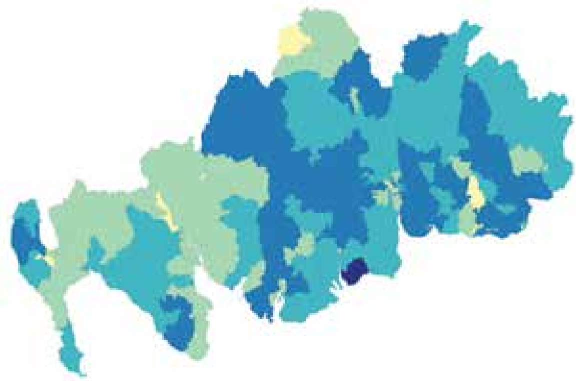


Illustration of estimated differentials in **land value**

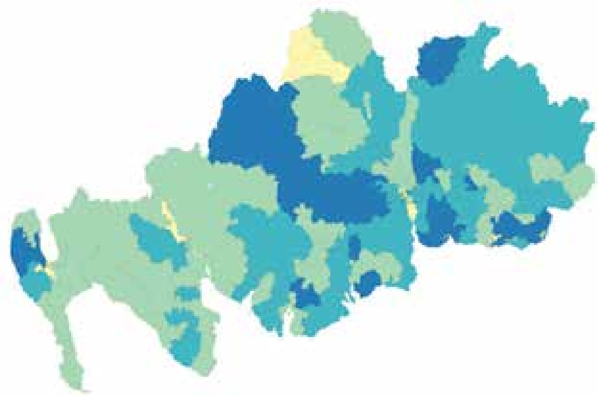


Figure 6-c: Dumfries and Galloway maps

Estimated differentials in mean **property value**

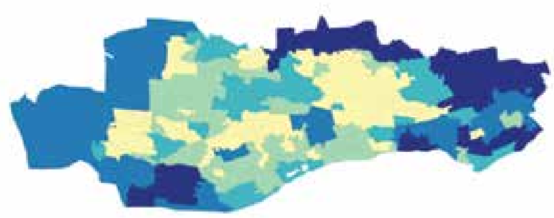


Illustration of estimated differentials in **land value**

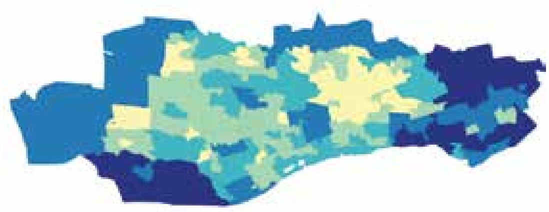


Figure 6-d: Dundee map

Estimated differentials in mean **property value**

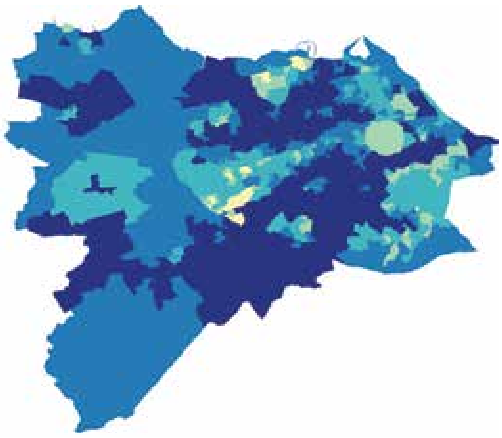


Illustration of estimated differentials in **land value**

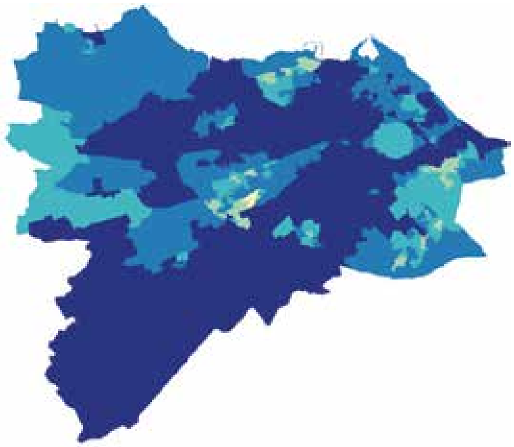


Figure 6-e: Edinburgh maps

Estimated differentials in mean **property value**

Illustration of estimated differentials in **land value**

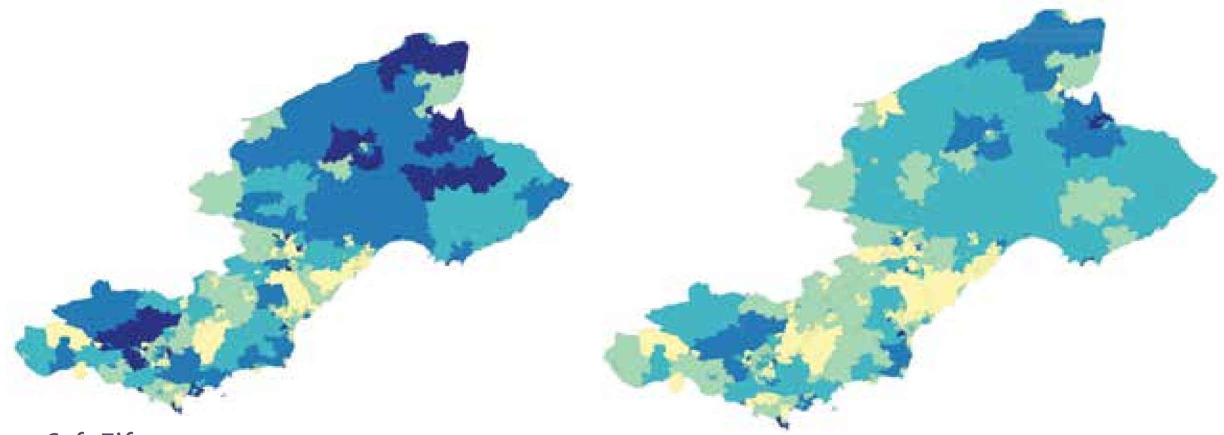


Figure 6-f: Fife maps

Estimated differentials in mean **property value**

Illustration of estimated differentials in **land value**

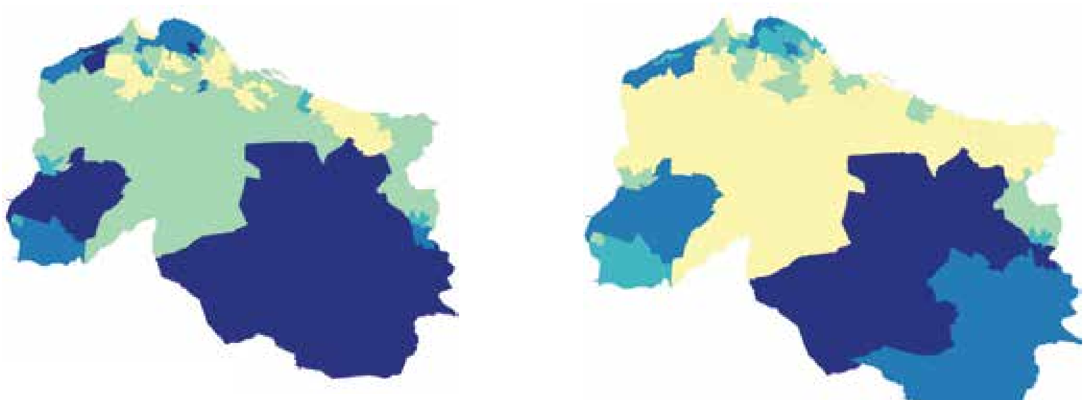
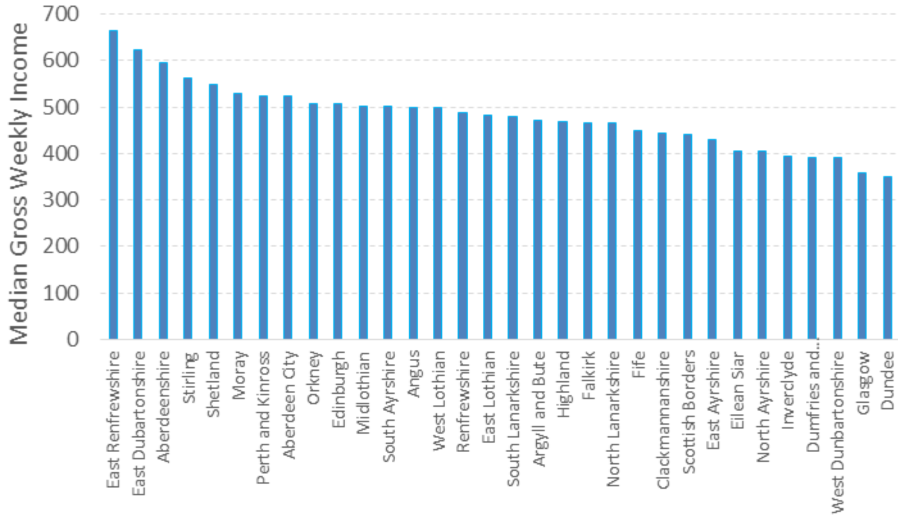


Figure 6-g: Inverclyde maps

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.

6.14.1 There are no official figures currently available which would enable us say with certainty how the geographical distribution of the local income tax base would look. However, the Scottish Neighbourhood Statistics makes available some modelled local authority income estimates, relating to the year 2008-09[31]. Although these are out of date for the purposes of our analysis and do not give us the size of the tax base (which is also dependent on working age population) they illustrate that there is a spread of incomes throughout local authorities in Scotland and that therefore there are likely to be substantial geographical variances in the local income tax base.

Chart 6-b: Modelled Estimates of Income by Local Authority



Source: Scottish Neighbourhood Statistics/Improvement Service

[31] These figures are modelled estimates of gross weekly median income including transfer. They are based on survey evidence and linked to local and neighbourhood data on population, household circumstances and characteristics. More information can be found on the Improvement Service website.

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.

6.15.1 As confirmed by CIPFA Scotland in Oral Evidence Session 5, the Scottish Government's equalisation mechanism would redistribute the General Revenue Grant to offset changes to the tax base[32]. However, the differential geographical impacts will change the amount of taxation raised locally and for those local authorities where growth has been lower than the Scottish average, the ratio of tax raised locally to General Revenue Grant would reduce. This may have an impact on local accountability and this, along with wider questions regarding the balance of funding, is explored in Chapter 10.

[32] Most Councils currently charge rates close to the Scottish average, meaning that equalisation would totally offset any possible changes to revenue. However, where there is divergence from the Scottish average coupled with large changes in the relative value of the tax base, Council's may need to adjust rates marginally either up or down if they intend to maintain the same level of revenue.

How Can Alternative Taxes be Administered?

07

Chapter 7 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.

7.6.1 A brief explanation of Council Tax Reduction scheme is set out in Chapter 2.

7.6.2 The Housing Benefit and the Council Tax Reduction scheme entitlement criteria are set out in detail in legislation (for example, The Council Tax Reduction (State Pension Credit) (Scotland) Regulations 2012 and The Council Tax Reduction (Scotland) Regulations 2012). These are extremely complex documents, and more accessible descriptions of entitlement and administration are published by various welfare rights organisations, including the Child Poverty Action Group Scotland, whose leaflet http://www.cpag.org.uk/sites/default/files/CPAG-scot-factsheet-CTR-June-15.pdf sets out the similarities and difference between the two measures in plain English.

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.

7.7.1 Powers exercised under Section 37 of the Water Industry (Scotland) Act 2002 by the Water and Sewerage Services to Dwellings (Collection of Unmetered Charges by Local Authority) (Scotland) Order 2014 establish the legal requirement for local authorities to collect water and sewerage charges on behalf of Scottish Water. The charges themselves are described in Scottish Water publications.

7.7.2 In its written submission submitted in advance of our final Oral Evidence Session, Scottish Water noted that it makes a payment of £18 million pa to local authorities in respect of the administrative costs of collecting water and sewerage charges.

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.

7.8.1 The Scottish Government publishes National Statistics on the collection and billing of the present Council Tax each year. These show that the total Council Tax collected as of 31st March 2015 for the 2014-15 year totalled £1.98 billion[33]. The collection costs identified by CIPFA Scotland in its evidence represent a little under 1.9% of this figure.

7.8.2 Funding of local authorities' administrative costs for operating the Council Tax Reduction scheme is complex, reflecting the administrative efficiencies of operating the two schemes together, even though one is a benefit and the other an entitlement to a reduction in tax liability. Historically, an "administration subsidy" was paid by DWP for the administration of both Housing and Council Tax Benefits, but the abolition of Council Tax Benefit has resulted in DWP (presently) continuing to make payments to Councils on the basis of their estimated Housing Benefit and Council Tax Reduction scheme caseloads. The Scottish Government makes a further payment to cover the estimated administration costs of applications for Council Tax Reduction with no associated Housing Benefit claim. For 2015-16, the DWP payment to Scottish local authorities was set at £27.7 million (the DWP Housing Benefit Circular HB S6/2014 of 19th November, available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/376885/s6-2014-scotland.pdf describes this) and we understand the Scottish Government contribution was set at £6.46 million.

[33] Council Tax Collection Statistics (2014/15), Scottish Government

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.

7.10.1 Further detail on the operation of the UK Income Tax system is widely available, for example on HMRC's website at https://www.gov.uk/income-tax, with further detail on the SRIT at https://www.gov.uk/scottish-rate-income-tax.

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.

7.11.1 The Commission met officials from HMRC to hear of their approach to identifying Scottish tax payers. To inform that discussion, HMRC submitted a paper, the text of which is reproduced at Figure 7-a.

7.11.2 The implementation costs quoted in paragraph 7.11 were taken from HMRC's update on the SRIT for the Scottish Parliament's Finance Committee of 21st October 2015, which records:

"*The UK Government's third annual implementation report on the Scotland Act 2012 (published in March), confirmed that the cost of implementing the SRIT was now estimated to be in the region of £30m-£35m (made up of £10m-£15m of IT costs and £20m of non-IT costs). This remains the current estimate.*

The previous estimate for the annual running costs was £4.2m per year – this was the original estimate prepared in November 2010 when the Scotland Bill was introduced to Parliament. Since then, further work has been carried out to refine this figure. As outlined in previous evidence to the Committee, HMRC has always anticipated that, if the Scottish and UK rates diverge, there will be an increase in running costs. The customer insight research supported this, by clarifying that Scottish taxpayer customers would be more likely to call HMRC if the Scottish rates were higher than the UK rates and as set out above a divergence in the rates would increase the amount of compliance activity required.

If the SRIT is set at 10%, the running costs are estimated to be £2m-£2.5m. If the rate is set at a figure other than 10%, the figure is estimated to be £5.5m-£6m. These figures do not include costs arising from the long-term solution for RAS pension schemes, which will be implemented in 2018-19, as the details of this solution are still under development. "

Figure 7-a: Paper from HMRC to the Commission on Identifying Scottish Taxpayers

The Scottish Rate of Income Tax

Identifying Scottish taxpayers

HMRC has been developing its approach to identifying Scottish taxpayers so that the Scottish rate can be correctly applied to their income, in consultation with the Scottish Government.

The key to Scottish taxpayer identification is the location of an individual's main place of residence. Scottish taxpayer status applies for a whole tax year – if an individual's main place of residence is in Scotland for the majority of the tax year, they will be a Scottish taxpayer. HMRC will produce guidance to assist taxpayers in determining their main place of residence. As is the case with Council Tax, this will be based on an individual's circumstances; it is not an elective regime.

HMRC hold complete addresses for the vast majority of UK resident taxpayers, which they use for correspondence purposes, and they will use these as a basis for the identification of Scottish taxpayers. HMRC has identified a risk that using these addresses, without further corroboration, might not provide sufficient confidence that the Scottish rate has been correctly applied, and has been exploring options to supplement its data with information from other sources.

HMRC's approach will involve UK wide HMRC data being compared with other data on residence (for example, the Scottish Electoral Register) to identify individuals who appear to live in Scotland, but for whom HMRC hold an address elsewhere in the UK. Once this scan has been completed, HMRC and Scottish Government will work together to agree a suitable and proportionate strategy which may include contacting these individuals. HMRC are examining other data sources to supplement their own data. As part of this, the Scottish Government has consulted on whether HMRC should be given access to NHS Scotland's address data.

Following this activity to improve the quality of HMRC address data, HMRC will write to customers who they believe to be Scottish taxpayers in autumn 2015. Alongside this, HMRC will be undertaking publicity to raise awareness of the Scottish rate throughout the UK. This will encourage taxpayers whose main place of residence is in Scotland, but who have not been contacted directly as part of the campaign, to notify HMRC of their correct address, and to remind taxpayers of the need to notify HMRC when they change their address.

Once this activity has been completed, in spring 2016, HMRC will issue PAYE tax codes to employers and pension providers as usual. Those applying to Scottish taxpayers will indicate that the Scottish rates should be used in relation to these employees.

For customers who move home from elsewhere in the UK to Scotland (or vice versa) during the tax year, HMRC will make adjustments to their tax code to reflect any change of status. Broadly, if a customer moves in the first half of the tax year this is likely to trigger a change of Scottish taxpayer status (as the new home will be their main place of residence for the majority of the tax year).

HM Revenue & Customs
8/5/2015

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.

7.13.1 We received evidence from a number of sources including responses to our call for written evidence about the impact of Councils being required to collect water and sewerage charges from households. The issue was explored in some detail at Oral Evidence Session 3 with welfare rights and low income groups.

7.13.2 The evidence about the way some people prioritise the repayment of debts was provided by the IRRV at Oral Evidence Session 5.

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.

7.23.1 HMRC publish information on “tax gaps” annually (see: https://www.gov.uk/government/statistics/measuring-tax-gaps-tables). The 2015 publication provides information for the 2013-14 year from which the figures of 1.6% and 15.4% for PAYE and self-assessment respectively were taken. The Scottish Government publishes national statistics on Council Tax collection which presents the total amounts billed and collected by local authorities in a given year.

7.23.2 HMRC publish statistics that break down receipts from income tax by source at https://www.gov.uk/government/collections/income-tax-receipts-statistics. These show that receipts from income tax paid by self-assessment rose from 13.5% of total receipts in 2004-15 to 14.5% in 2014-15.

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.

7.26.1 In identifying this option, we use the term "PAYE" to indicate a withholding system operated by employers. Our considerations relate to this fundamental principal without going in to greater detail of whether this should include replicating the cumulative nature of the PAYE system or one based on deducting tax on the week or month in question with a final end-year adjustment. HMRC's PAYE system of withholding income tax from earnings (and from private and occupational pensions) involves exact cumulative deduction – i.e. when calculating tax due each week or month, the employer considers income not simply for the period in question but for the whole of the tax year to date. Tax due on total cumulative income is calculated and tax paid thus far is deducted, giving a figure for tax due this week or month. The cumulative system means that, at the end of the tax year, the correct amount of tax should have been deducted.

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.

7.27.1 In discussion during Oral Evidence Session 9 involving institutions and professional bodies such as the Institute of Chartered Accountants of Scotland and the Chartered Institute of Taxation, it was suggested that "a tax should not be introduced if the administration costs outweigh the benefits". Responding to our Call for Written Evidence, the Scottish Retail Consortium noted:

"The Retail Industry is Scotland's largest private sector employer and it is highly unlikely we could support an additional administrative and cost burden of this

nature and scale [such as collecting an alternative local tax based on income] *on employers."*

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.

7.28.1 Our understanding of overseas practices reflects available published information, for example pages 34-35 of *Fiscal Federalism in the European Union,* edited by Amedeo Fossati and Giorgio Panella. Certainly, the collection of local and national –or in the case of federations, state and federal – income taxes in Canada, Switzerland and USA is dependent on taxpayers submitting tax returns.

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.

7.29.1 Estimates of the numbers of taxpayers in the present HMRC self-assessment and PAYE systems are not routinely published. The estimate of three quarters of taxpayers being in the PAYE system is derived from data published in Chapter 12, Administration and Compliance, of *Dimensions of Tax by Design* in "The Mirrlees Review of Taxation" for the Institute of Fiscal Studies. The same source was used for the estimates of the administrative costs of the PAYE and self-assessment systems. The Mirrlees review was published in 2010, so we recognise that these figures will not be up to date, but we assume that the broad picture they portray will have remained largely unchanged. The costs of collecting the present Council Tax repeat the estimate from CIPFA Scotland in its evidence to us, quoted earlier in this chapter.

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?

08

Chapter 8 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.

8.1.1 Section 74 of the 1992 Local Government Finance Act sets out that the amount of Council Tax due for properties in each valuation band will be a fixed proportion – as set out in Chapter 2 of this report. It also sets out the ranges of property values that define each valuation band, but notes that either of these may be changed "*by order*", meaning the Act confers powers to allow these to be changed by subordinate legislation.

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-a: Law Making in Scotland

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.

The Costs of Undertaking a Property Valuation

Initial Costs

8.13.1 Evidence provided to us by the Scottish Assessors Association suggested that the costs of carrying out a revaluation or implementing any new system would require detail on both the structure and the appeals processes involved in any new system. The issue would also be affected by peak periods of activity in the Non–Domestic Rates (NDR) revaluation cycle and the lead-in time to implementation.

8.13.2 Nevertheless, looking at implementation of a domestic property revaluation on its own, the SAA anticipated costs as set out in Table 8-a.

Table 8-a: Estimates of Costs of Undertaking a Property Revaluation

Valuation approach	**Estimated cost - no requirements to issue notices**	**Estimated cost - Including issue of Notices**
Banded System	£5.5 - £6 million	£6.5 - £7million
Discrete Valuation System	~£7.5 million	~£8.5 million
		Source: Scottish Assessors Association

8.13.3 They also noted that costs would depend on whether there would be a requirement on Assessors to issue a Notice to all households advising taxpayers of their new band/value or if this would simply be part of the billing process. Assessors did not issue such Notices in 1993 so the estimated cost of that possibility is shown separately.

8.13.4 These estimates assume that preparations would commence in autumn 2016 with a new system taking effect from either 1st April 2018 or 1st April 2019. The longer implementation timescale may provide for more accuracy and as such this extended timescale would probably be a requirement of a discrete valuation system.

8.13.5 The above estimates also assume that the evidence available (i.e. property sales volumes) and appeal rates reflect a 'normal' property market. Either of these factors could be affected by fluctuations, such as a sudden and/or deep recession, in the open market and could lead to uncertainty and additional administration.

8.13.6 Upwards cost adjustment may also be required if the basis or details of any new system, such as the valuation assumptions or the exemptions applied, were significantly altered from the current system or required significant software development.

8.13.7 The SAA also indicated that the timescale for implementation may be shortened and the costs decreased should suitable computer aided mass appraisal (CAMA) methodologies be made available to Assessors. Such methods, they reported, are likely to be of assistance as a check on values thereby minimising errors in valuation. These methodologies have not, however, been fully evaluated by Assessors for their accuracy and further work would be required to establish applicability and to quantify their effect on implementation times and costs.

Ongoing Costs

8.13.8 For the purposes of considering ongoing costs, the SAA has assumed that there would be regular recurring 5 yearly revaluations. It has also been assumed that the revaluation cycle would be appropriately scheduled in relation to the NDR revaluation cycle.

8.13.9 From the experience of revaluation in 1993, Assessors indicated that an appeal rate of approximately 4% in a banded system might be anticipated, resulting in around 100,000 proposals/appeals nationally. The resource required to deal with these would be dependent upon the how quickly it was deemed necessary for each case to be resolved and a discrete valuation system is likely to attract a higher proposal rate with cases possibly requiring more resource.

8.13.10 The costs of administering Valuation Appeal Committee hearings would also need to be considered. There are various funding mechanisms in place for these, often channelled through Assessors' budgets but, in any event, these would constitute a significant cost.

8.13.11 Taking all of the above into account, the SAA has indicated that maintenance costs, excluding Valuation Appeal Committee costs, would be limited to £2.5 million (banded system) - £3.5 million per year (discrete valuation system) on an ongoing basis, although if significantly more appeals were received than has been assumed there may be an additional cost in the year(s) immediately following implementation.

8.13.12 For comparison, we looked at the costs of revaluing properties for Council Tax purposes undertaken in Wales for Council Tax from April 2005 onwards. The VOA (Valuation Office Agency) states these were £5,198m[34]. Work started in early summer 2003 and continued until late September 2004. All Welsh homes (circa 1.3 million) were revalued at a common valuation date of 1 April 2003. The compiled list was used to calculate new tax bills from 1 April 2005. A final decision on banding was announced in September 2003.

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.

[34] Valuation Office Agency (2015)

Preparing for Land Value Taxation

8.14.1 In its submission to us the SAA noted its significant concerns regarding the implementation of a land value tax. However, if land value taxation was deemed a viable option, the SAA believe that an extended transition to such a system should be applied as this would allow:-

(a) The development of the required infrastructure such as digitised land registrations, and
(b) The fundamental changes and swings in tax liabilities to be planned for by tax payers.

8.14.2 Given the requirements to capture a whole new data set, develop the necessary skills and experience in analysis of land sales, the need for new ICT systems and additional personnel to implement and operate a parallel land value tax system, the SAA estimates that the costs involved in producing and maintaining values would be at least as much again as those indicated above for a property based tax. Collection systems would also require to be implemented in billing authorities, further adding to the cost.

8.14.3 They also reported likely costs involved in operating a land value tax appeals system, and reported that the lack of public understanding of land values, which for the purposes of land valuation may need to be derived by computer models, would be very difficult to reconcile.

8.14.4 SAA also reported that a land value tax, as an additional tax for vacant ground could, however, be implemented and operate along with a non-domestic property tax and a tax on property.

Protecting Tax Payers 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.

Transitional Arrangements: Northern Ireland

8.19.1 Northern Ireland, unlike Scotland, England and Wales, did not implement either the Community Charge or the Council Tax and retained the Domestic Rating system. The Northern Ireland Executive reformed the system on 1 April 2007, moving to individual capital value assessments for domestic properties, rather than 'rateable values', which were based on evidence derived from the private rented sector in the late 1960s.

8.19.2 Where there were significant increases in rate bills as a result of the move to capital values ratepayers needed time to adjust to the new levels. Therefore 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 from what it would have been under the existing system (not taking into account any increase resulting from the uplift in Regional Rate). A requirement was that the ratepayer had liability for rates on the property on both 31 March 2007 and 1 April 2007. Where such liability did not occur on both dates then transitional relief was not awarded.

8.19.3 The relief was based on the difference between the new bill (calculated using the new capital value) and a hypothetical base-case bill that identified what the liability for the property would have been had no revaluation taken place).

Figure 8-b: Transitional Relief Frameworks used elsewhere in the UK

How it worked	What it cost	When it took place
The Northern Ireland Executive reformed the Domestic Rating system in April 2007 based on individual capital value assessments for domestic properties. 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.	£32 million over three years. This was paid by the Northern Ireland Assembly to Local Government to compensate for tax revenues foregone.	The scheme was phased in over 2007-08, 2008-09 and 2009-10. 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.
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. 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.	£11m in year one. This was paid by the Welsh Assembly Government to Local Government to compensate for tax revenues foregone.	The schemes operated between 2005-06 and 2007-08. In year 1, dwellings did not experience more than a one band increase above their pre-valuation band. In year 2, dwellings did not experience more than a two band increase above their pre-valuation band. In year 3, dwellings did not experience more than a three band increase above their pre-valuation band.

8.19.4 The scheme was phased in over the three years 2007-2008, 2008-2009 and 2009-2010 with tapering levels of relief, i.e. full relief in year one, with two-thirds and one-third in years two and three. The full rate bill was payable in the fourth year, i.e. from 1 April 2010. The cost of transition was £32m. This was paid by the Northern Irish Assembly to Local Government to compensate for tax revenues foregone).

Transition Arrangements: Wales

8.19.5 Wales is the only part of the UK that has revalued the Council Tax base. New Council Tax bands and valuations came into effect on 1 April 2005. This was the first revaluation of domestic property in Wales since Council Tax was introduced in 1993, and no revaluations have taken place since. Properties were revalued as of 1 April 2003 and the new bands and valuations were announced on 1 September 2004 and affected Council Tax Bills from 2005-06.

8.19.6 In the Welsh Assembly Government's 2002-03 consultation on the new band thresholds, it was predicted that around 25% of households would move up by one or more bands, 50% would stay in the same band and 25% would move down. The prediction was based on a sample of properties, which was subsequently found not to be representative of the stock of properties in Wales. According to figures released by the Welsh Assembly Government after the revaluation had taken place, 58% of dwellings in Wales remained in the same band, 8% moved down, 33% moved up.

8.19.7 Revaluation led to a shift in the band thresholds, and a slight redistribution of properties though the band structure, although the majority of properties remained in Bands A-C. The impact was different by region, and urban areas in particular saw more properties moving up the band structure than in more deprived areas. There were relatively few appeals; 1.8% of the tax base.

8.19.8 Following revaluation and re-banding of domestic properties in Wales, the Welsh Assembly Government introduced a transitional relief scheme to ensure that no household's Council Tax bill rose by more than one band in each of the first three years.

- In 2005-06 (year 1) transitional relief ensured that households did not experience more than a **one band** increase in Council Tax liability;
- In 2006-07 (year 2) transitional relief ensured that households did not experience more than a **two band** increase in Council Tax liability (i.e. a two band increase above the band having effect immediately before 1st April 2005);
- In 2007-08 (year 3) transitional relief ensured that households did not experience more than a **three band** increase in Council Tax liability (i.e. a three band increase above the band having effect immediately before 1st April 2005);

8.19.9 Transitional arrangements were automatic in so far as there was not a requirement for applications by taxpayers.

8.19.10 The transitional relief scheme cost £11m in year one, and was funded by the Welsh Assembly from within their departmental expenditure limit. It was designed to compensate councils for the income they forewent by not billing the actual Council Tax bands. This means that it was not at the direct cost of councils whose taxpayers benefited from the changes.

8.19.11 A new valuation band, Band I, was introduced at the top end of the scale and applied to properties valued at £424,001 and above.

Estimates of the potential scale of transition for the options we analysed

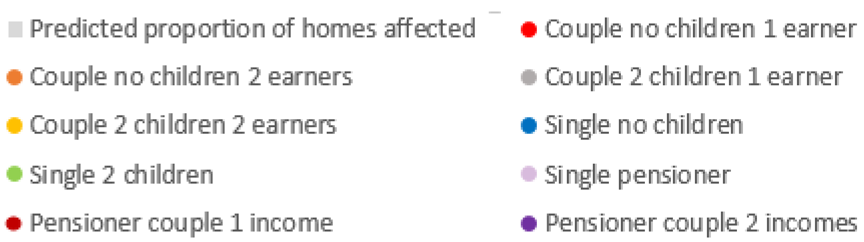
8.19.12 We have estimated the scale of changes in household liability that would have been required for Alternative Property Tax 1 as outlined in detail in Chapter 5. This option involved substituting multipliers which were proportional to the median property value in each band instead of the current regressive multipliers. As noted in Chapter 5, if these changes had been implemented in 2013-14, Bands A - C (60% of dwellings) would have seen a fall in liability and Bands D – H (40% of dwellings) would have seen an increase in liability. The following analysis shows estimates of the magnitude of the change between Council Tax and Alternative Property Tax 1 for different households.

8.19.13 The impact on different households is shown as a percentage of equivalised net household income rather than looking at the scale of the changes in cash terms only. This approach allows us to understand where changes to the tax structure could have a significant impact on a household's standard of living. For example, an increase in tax liability of £1,000 per year may be easily affordable for a household with income of £100,000 a year, but could be unaffordable for a household with more limited income.

8.19.14 The analysis assumes the changes were made in 2013-14 and indicates that some households would have seen large increases in liability compared to how much they would have paid under Council Tax, but many would have seen only small changes and indeed some would have seen a fall in liability.

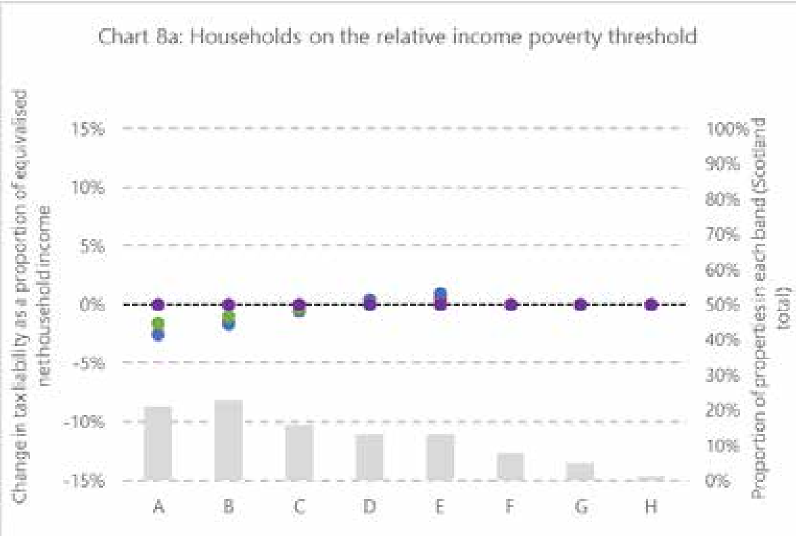
8.19.15 The net impact of these changes across Scotland would have depended on the distribution of household types and particular circumstances, for example eligibility for discounts and exemptions. As discussed in earlier in this report, analysis of the net impact across Scotland has not been possible. The following analysis of household types uses the three different parts of the income distribution used in Chapter 5. It is assumed eligibility rules for Council Tax Reduction remained unchanged.

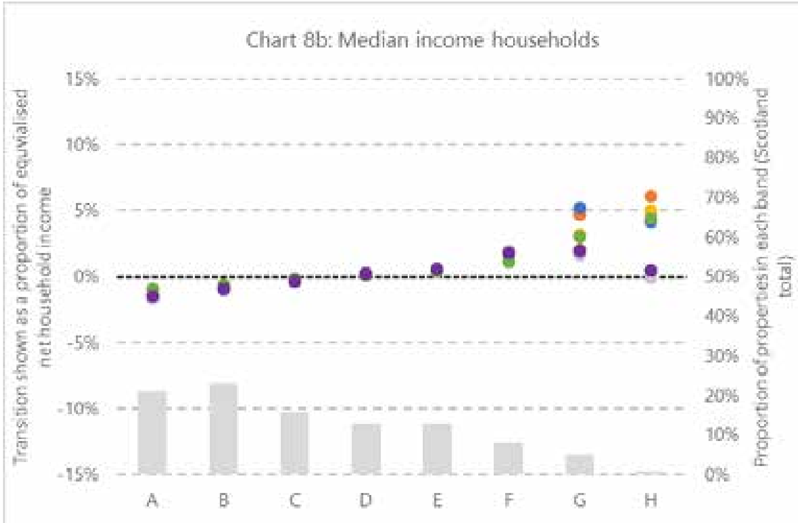
8.19.16 Figure 8-c shows the range of transitional impacts for all the household types analysed in Chapter 5. Each household type is represented by a dot on the following graphs but not all household types are visible on the graph because the dots overlap. The key for the graphs is:

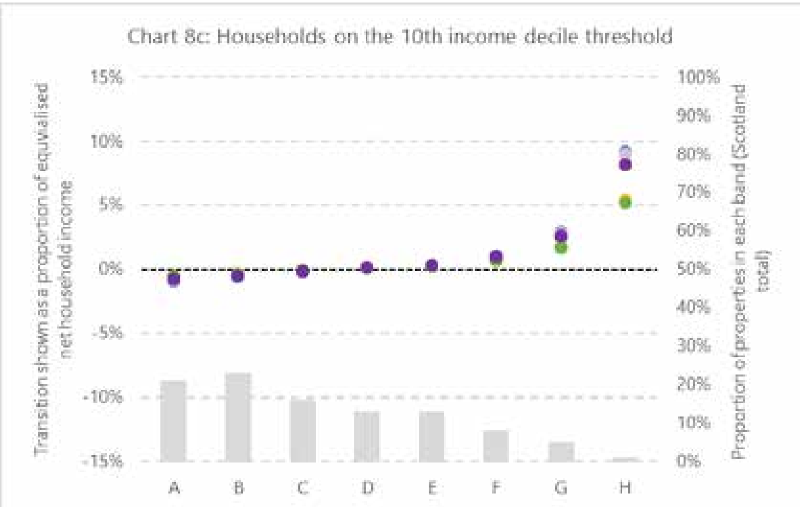


8.19.17 Bands are shown on the x-axis, and the change in liability between Council Tax and the alternative tax as a percentage of equivalised net household income is shown on the y-axis.

Figure 8-c: Transition to Alternative Property Tax 1 – a banded system where the band charge is proportional to the median value of the properties within that band







8.19.18 **Households on the Income Poverty Threshold:** Most households on the income poverty threshold would have seen little or no increases in their tax liability because they were eligible for partial CTR above Band C. The worst affected households in this income bracket would have seen an increase of less than 1% in tax liability taken against their household income. This is before any changes to CTR eligibility have been considered which could offset any increases in liability for these households.

8.19.19 Households on the income poverty threshold would have benefited the most out of all the income groups analysed if they were in Band C or below. We have estimated that some in Band A would have seen their liability fall from 5% of their net household income to 3% under Alternative Property Tax 1.

8.19.20 **Median Income Households:** Changes in tax liability would have ranged from a 1% fall to a 6% rise. The majority of household types analysed would have seen relatively little change (equating to less than 1% of net household income).

8.19.21 Figure 8-c shows that median income pensioner households would have seen a noticeable increase in their tax liability if they were in Bands E or F, but not if they were in Band H. This is because they are already eligible for partial CTR under present Council Tax in Band H meaning their liability will not have risen regardless of any change to the Band H charge.

8.19.22 **Households on the tenth income decile threshold:** Households facing the largest transition in Band H would have seen their liability increase from 6% to 15% of their net household income.

8.19.23 Every household above Band C would have seen some increase in their liability but again the majority of household types analysed would have seen relatively little change in their liability as a proportion of equivalised net household income (less than 1%). It is clear that the biggest transitions for all the households analysed would have occurred for households at this equivalised income level in Band H properties, as even pensioners would have been eligible for the full rates payable.

The scale of transition: Revaluation

8.19.24 The process of revaluation would also have led to changes in tax bills for some households. Whilst there are likely to be regional divergences, as referred to in Chapter 6, the precise impact on households will also depend on the characteristics of individual properties. For example, properties that have been extended since 1991 that have not been sold since may see their band upgraded if a revaluation takes place.

8.19.25 In collaboration with Heriot-Watt University, we have been able to look in detail at relative house values in seven local authorities. The figures below show estimates of predicted numbers moving bands in the seven local authorities analysed if revaluation had taken place in mid-2014. The methodology that Heriot-Watt used for this is described in Chapter 4.

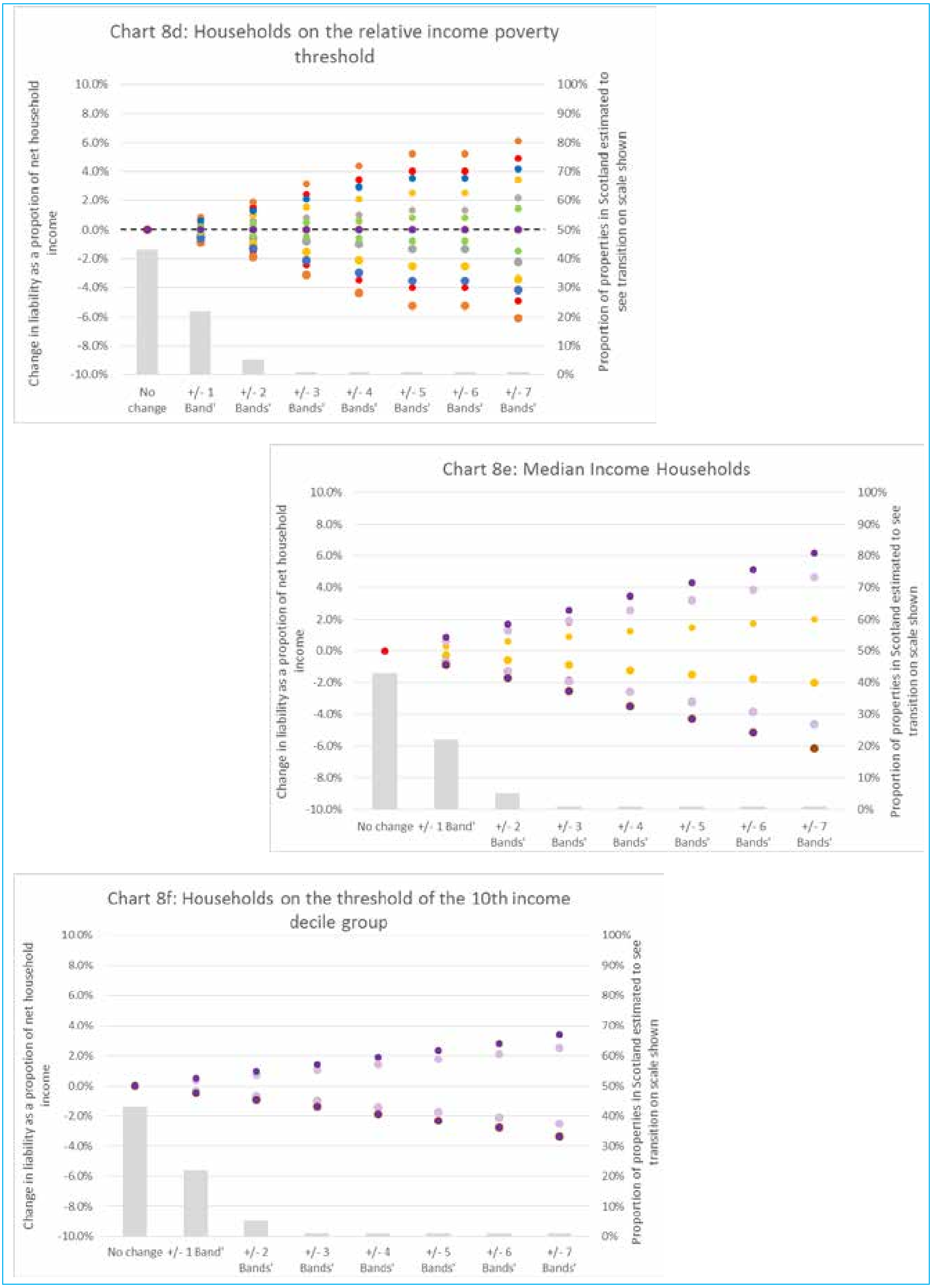
Table 8-b: Estimate of Properties Moving Band Post-Revaluation

	Up at least 1 band	**Remain in same band**	**Down at least 1 band**
Aberdeenshire	40%	41%	18%
Argyll & Bute	20%	34%	46%
Dumfries and Galloway	15%	36%	49%
Dundee	19%	52%	29%
Edinburgh	42%	42%	16%
Fife	14%	45%	41%
Inverclyde	14%	56%	29%
Total	**28%**	**43%**	**29%**
Source: Heriot-Watt analysis for the Commission			

8.19.26 One key finding is that 43% of properties were estimated to have not changed band at all. This implies that the value of their home rose roughly at the same rate as the average for the seven local authorities.

8.19.27 The majority of instances where properties would have changed band would have been limited to a change of one band only. Under current multipliers, this would have implied a change of between +/- £128 and +/- £383 per year, depending on the original banding. As Figure 8-d shows, this equates to a change of between 0% and 0.9% of net household income for households on the relative income poverty threshold, and between 0.4% and 0.5% for households on the threshold of the tenth income decile group.

Figure 8-d: Transition to a Revalued Council Tax



8.19.28 According to the Heriot-Watt analysis, 5% were estimated to have moved up two bands and 6% were estimated to move down two bands. In terms of household income, this equates to a change of between 0% - 2% of net household income for households on the relative income poverty threshold, and between 0.4% - 0.7% for households on the threshold of the tenth income decile group.

8.19.29 The analysis predicted that 2% would have moved up or down by more than two bands. The scale of the impact on different household types in different parts of the income distribution is shown in Figure 8-d. The scale of the change depends on CTR eligibility (hence why there is such a range of impacts for households on the relative income poverty threshold in particular) and whether the household is eligible for single person discount (which accounts for the two different potential outcomes for households on the threshold of the 10^{th} income decile group). The figures shown in Figure 8-d range up to +/- 6% of net household income for a household moving from Band A to Band H. However, it must be remembered that this outcome, whilst theoretically possible, is extremely unlikely.

8.19.30 We do not have robust enough data to draw conclusions on whether lower income households or higher income households are more or less likely to move up the bands or down the bands post revaluation. However indications from the modelling work has indicated that local authorities where there are higher proportions of CTR recipients are more likely to have seen below average increases in property values since 1991. This would indicate that lower income households would be more likely, on average, to move down the band structure but more analysis is needed to understand this fully.

Alternative Tax Options – Local Income Tax

8.19.31 A move to a local income tax would involve a change in the rates of local tax paid for households. Generally speaking, those with higher incomes will be more likely to pay more local income tax than the present Council Tax. However, because the scale of the transition also depends on how much somebody would have otherwise paid in Council Tax, some median income households who occupied lower value housing would pay more, and some tenth income decile threshold households who occupied higher value housing would have paid less than under the present system.

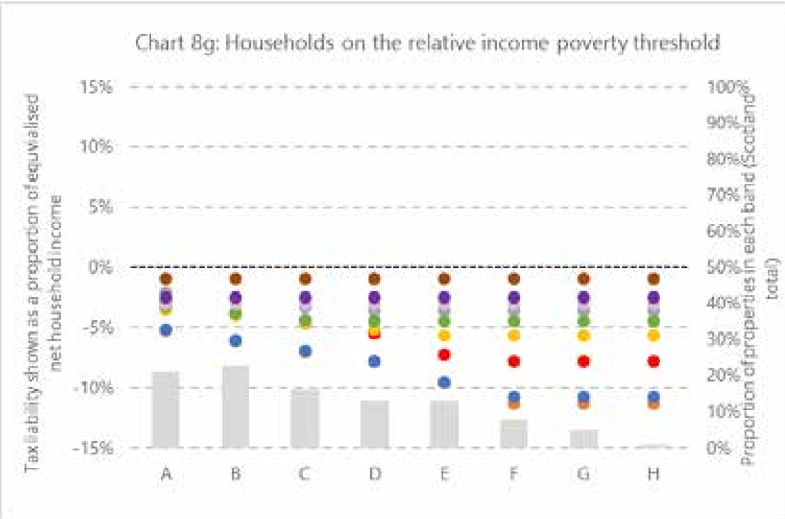
8.19.32 Figure 8-e use the same key as the property tax transition section. The graphs show the change in tax liability for each household type from a move from Council Tax to our local income tax example. The x-axis still shows Council Tax band to illustrate the point that the scale of the transition will also depend on the current amount you are paying in Council Tax.

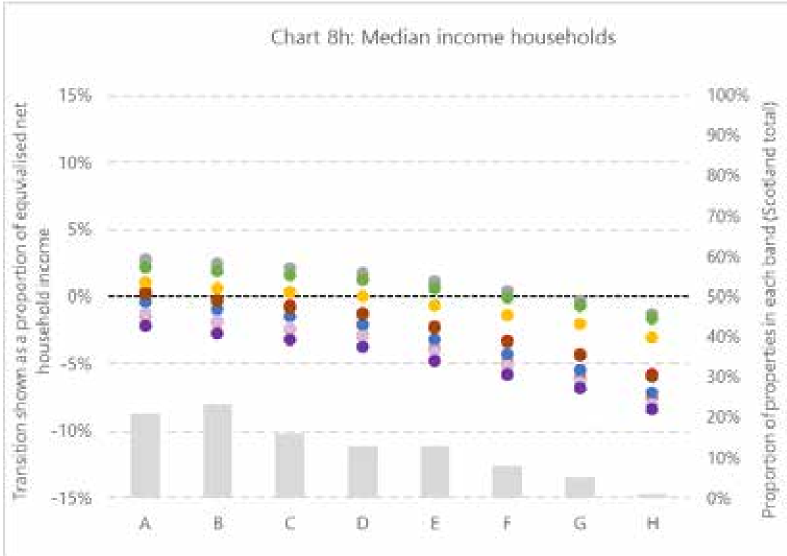
8.19.33 **Households on the Income Poverty Threshold:** All households on the income poverty threshold would have paid less than under present Council Tax if our example local income tax had been implemented in 2013-14.

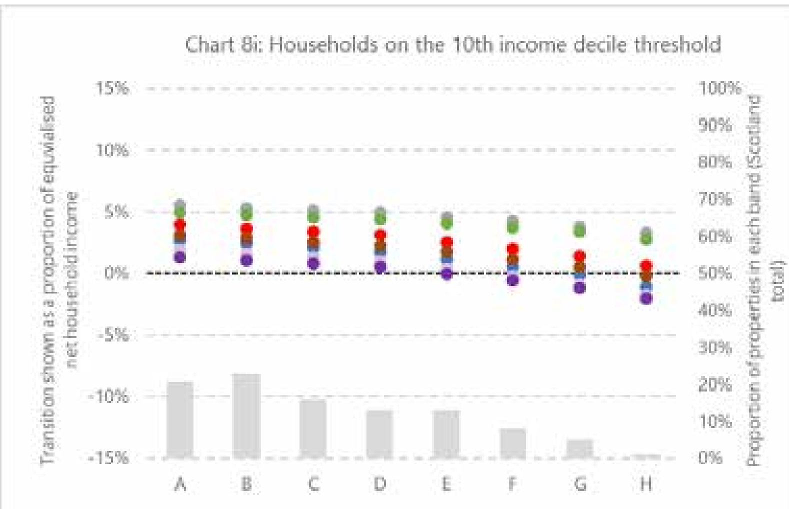
8.19.34 **Median Income Decile Households:** The impact is mixed for these households. Many in Band A properties would have paid more under the local income tax option modelled, but all in Band H would have paid less.

8.19.35 **Households on the tenth income decile threshold:** The general trend here is that households on the tenth income decile threshold would have paid more under the local income tax option modelled. However, some in Band F, G and H would actually have paid less under this option. The local income tax option modelled does not therefore guarantee that all those at the top of the income distribution would take a higher burden than they presently do.

Figure 8-e: Transition to a Revalued Council Tax







Understanding Local Taxes

09

Chapter 9 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.

<u>What We Found</u>

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.

9.2.1 We also recognise that the extent to which members of the public are clear about local taxation and able to understand its operation and impact is strongly linked to many dimensions of our findings. Perceptions of fairness that we have explored earlier in this report are, for example, linked to the extent to which people understand how local taxation alternatives would operate in practice, what the impact on their own circumstances is, and how much is understood about how others would be affected too.

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.

9.7.1 Because each event involved members of the public and a variety of communities of interest, we were able to expand and check on the evidence that had already been provided by institutional stakeholders in our Call for Written Evidence and panel sessions with witnesses. Full reports from each of these events are provided in the Compendium of Evidence that accompanies this report. Together with our online survey, this package of evidence provided a rich source of information about the challenges and opportunities around understanding local taxation.

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.

9.8.1 While some participants favoured a particular model over another, our listening events suggested that those involved thought each potential model of reform had a number of positive and negative aspects. An over-riding issue for all participants was the fairness of any changes, and perceptions of fairness and simplicity of administration were, in many instances, held to be more important than the technicalities of the system itself.

9.8.2 In the Western Isles, for example, participants were concerned about ease of understanding in relation to any reform:

"The more complicated the tax is, the more opaque the tax system becomes."
(Participant in Stornoway Listening Event)

9.8.3 One key dimension to this was in relation to identification of who pays. Across all of our evidence gathering, we often heard that there were many different potential complexities relating to individuals' circumstances, such as occupants and landowners, beneficiaries of inherited properties and tenants or those who owned second homes. For any tax option, it was considered important to be clear about who would be liable for paying tax and what they would pay, as this was felt to have the potential to significantly impact on perceptions of fairness and willingness to pay.

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.

9.9.1 Our online survey asked respondents about the extent to which they agreed with a series of seven statements about the current Council Tax system. Respondents were asked to indicate whether they strongly agreed; tended to agree; neither agreed or disagreed; tended to disagree; strongly disagreed or didn't know.

9.9.2 We found that most respondents have a relatively strong understanding of the current system: over half of respondents felt that the Council Tax system was easy to understand.

9.9.3 Over two thirds of respondents felt that paying Council Tax was a simple process. We also found that almost half of respondents felt that it was not clear how the Council Tax they paid was spent on local services, although over a third felt that it was clear. Approximately 6% of respondents indicated that the system needed to be more transparent. Those commenting on transparency generally felt that members of the public required more information and more choice about how the money raised through Council Tax was spent locally.

9.9.4 Yet while understanding and clarity of the current system was relatively strong overall, our analysis revealed that this was not consistent across all respondents. Home owners were more likely to believe the system was easy to understand and simple to pay, compared with those renting their property. While 40% of owners strongly agreed it was simple to pay, this fell significantly for council tenants (16%), housing association tenants (19%) and private renters (17%). Renters were more likely to support a different local tax system than home owners. Those in higher Council Tax bands were also more likely to say that the system is easy to understand, is simple to pay, that it is clear how money is spent, and that it protects those who can't pay.

9.9.5 People with physical or mental health conditions were slightly less likely to believe the Council Tax system was fair and easy to understand, but overall responses were very similar to those who did not report any physical or mental health conditions. People on lower incomes were less likely to feel that the system was easy to understand, simple, protects those who can't pay, or is clear in terms of how money is spent. Single people (with or without children) were less likely to believe paying Council Tax was simple, and less likely to believe the system protects those who can't pay. There were no clear trends or divergences in opinion based on ethnic origin.

9.9.6 Our Call for Written Evidence also suggested most organisational respondents felt that the Council Tax was relatively simple, efficient and transparent, regardless of the extent to which they supported other aspects of system. Many cited its high collection rates and low administration costs. Most felt that the tax was difficult to avoid while being straightforward and easy for customers to understand and to pay, with simple collection and administration arrangements. A small number of respondents highlighted that the physical location of property provided a clear and direct link between the individual being taxed and the local area.

"The current Council Tax is relatively effective in the respect that it is a property tax and property taxes are hard to avoid and easy to collect. Property taxes can also be easy to understand."

(Shelter)

"One feature of the current system is that each local council collects its own tax... This means that the Council Tax is clearly visible as a local tax, collected by the local council for the funding of Local Government. Arguably this assists local accountability."

(The Low Incomes Tax Reform Group)

9.9.7 Many of the respondents to our Call for Evidence who did not feel that the current Council Tax system was fair or efficient identified that this was linked to a lack of clarity regarding the ability to pay. Many also cited that the rules and mechanics of Council Tax caused difficulties for some vulnerable households. The points are looked at in more detail in Chapter 5.

9.9.8 One participant in our Dundee Listening Event, for example, commented that:

"[the] change over from Council Tax Benefit to Council Tax Reduction [was] first announced as existing regulations/guidance...remain[ing] in place for one year...[it has been] subsequently extended but no new guidance published and many sources on Council Tax benefit have now been removed. Public are now confused and ill-informed about the current situation."

(Participant in Dundee Public Listening Event)

9.9.9 Concerns were raised by a number of third sector and equalities organisations that the rules surrounding the Council Tax Reduction scheme were complex and difficult to understand, resulting in low uptake, particularly from pensioners and couples with children. Some respondents wished to see a more robust discount scheme which allowed families and individuals to climb out of poverty, while others felt that reductions required to be streamlined. Further information about the operation of the Council Tax Reduction scheme is provided in chapters 2 and 5 of this report.

9.9.10 Some participants in our listening events also highlighted that the current system was also unnecessarily complex because of the ways in which information about the present Council Tax is communicated and that a future system based on similar principles would need to address this issue of communication:

"You don't know where you stand – it needs to be clearer."
(Participant in Edinburgh Public Listening Event)

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.

9.10.1 Approximately a third of organisational respondents and a fifth of individual respondents to our Call for Written Evidence supported using a property tax as a basis for reforming local taxation. Organisations including RICS, the Scottish Assessors Association and a range of Local Government stakeholders indicated that they favoured the retention of a property based system due to its stability, clarity and efficiency.

9.10.2 Most respondents to our Call for Evidence suggested that any reform of local taxation based on property would require property values to be re-valued soon, and then on a regular basis. For many, this was an important component of supporting the overall understanding and function of any system of property based taxation. This was also the most commonly suggested change made through our online survey, with approximately a quarter of respondents raising this issue. There was particular concern about the variation between valuations for existing properties and new build properties.

"A revaluation is overdue - get that done as soon as possible so people can understand the basis of their tax."
(Respondent to Online Survey)

"If the current Council Tax style of property tax remains in place, then RICS recommends that frequent revaluations of domestic properties are included in future legislation and that they take place at least every five years."
(RICS)

"Widespread revaluations are needed as the present valuations do not reflect current prices."
(Individual response to Call for Written Evidence)

9.10.3 At the listening events, while the idea of a property tax was generally familiar, and therefore mostly well understood, many people similarly found it difficult to understand that the Council Tax is based on property values that are now approaching 25 years old, and felt this served to confuse the system and potentially undermine its fairness.

"A property tax based on out-of-date housing valuations is insane."
(Participant in Dundee Public Listening Event)

9.10.4 However, much less clear was the impact of any revaluation of the property tax base, both in terms of how this might affect participants' own circumstances, and the impact across different parts of the country. Participants were not clear on how new values or bands should be decided, and they noted that this could lead to confusion.

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.

9.11.1 At our public listening events, a land value tax was generally a difficult concept for participants to understand, and it was perceived as more complex than systems based on property and income.

9.11.2 There was also a feeling that many communities could struggle with the concept, particularly those that live in areas where complexities around land value might occur, such as in urban areas with flats and high-rise buildings, as well as whether landlords or tenants would be responsible for making payment and the impact that this might have on renting costs. Some thought that a land value tax could also damage links between tenants and their local authority if a land tax was paid by the land owner, and that this might make it harder for these people to understand the connection between their Council Tax and local services.

9.11.3 Concerns were also raised that a land tax could be complex and challenging to introduce, particularly in relation to developing and implementing the new systems that would be required to operate this in practice.

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.

9.12.1 Indeed, approximately two-fifths of organisational respondents and a quarter of individuals to our Call for Written Evidence supported a land tax, although many different potential permutations of this were identified.

9.12.2 These respondents suggested that the likely complexity involved in introducing and administering a land tax could be more limited than others had suggested, citing for example that 80% of land was already registered for ownership, and pointing to methods of land valuation used in other countries, such as the USA and northern Europe. Some felt that the system could be straight forward to maintain once it was set up, provided there was sufficient lead in time and clarity on the method of land valuation.

9.12.3 Many participants at our listening events also expressed interest in the principles of land taxation, and believed it could be broadly fair as a means of deciding how much tax people should pay locally. Where participants already had knowledge of land taxes and were supportive of its principles, we heard that the main challenge would involve providing opportunities for communities to familiarise themselves with the model. There were a small number of participants who noted that it was easy for them to understand:

"There is difficulty when anything new is brought forward, but the proposal of land tax is not inherently complex."

(Participant in Galashiels Public Listening Event)

9.12.4 We heard that if any form of land value tax were to be implemented, most participants in our listening event acknowledged that considerable steps would be required to explain the system, partly because it was felt that most people had little or no concept of the system, and little to compare it with in the current tax system. In contrast, income and property taxes already exist either as part of a national tax system, or existing local taxation.

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.

9.13.1 Approximately a quarter of organisational respondents and a third of individual respondents to our call for evidence supported a local income tax. However, there was less clarity about options in relation to the operation of a local income tax, meaning that respondents discussed different advantages or challenges associated with a variety of different systems.

9.13.2 Results from our online survey showed that a third of respondents fully supported the statement that the amount of local tax you pay should be based on your income and 39% said that this was their one top priority for a local taxation system. The groups that supported this in particular were more likely to either be in the 16 – 24 age bracket, or retired. Those working full and part time were less likely to support a tax based on income. Households with higher incomes were less supportive of a tax based on income. Those in the highest income band were more likely to support a tax based on use of local services of equal taxation for everybody. These results do not necessarily suggest that these groups thought such systems are fairer or easier to understand for all, but it does suggest that preferences are likely to be influenced by personal circumstances.

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.

9.14.1 Our public listening events suggested that while the concept of a local income tax was generally easy to understand due to people's familiarity with centrally collected income tax, there is confusion about how the system would be implemented. While many participants were often in no doubt that the concept of a local tax based on income was simple, straightforward, and easy to understand, we commonly found that participants found it more challenging to understand the idea of local income tax in practice than they initially thought they would, and that while a superficially simple model, underlying complexities were therefore often identified.

"In principle it's easy to understand, but the devil is in the detail."

(Participant in Arbroath Public Listening Event)

9.14.2 A number of questions were raised, such as:

- Would current exemptions and reductions apply?
- Would personal savings and dividend income be taken into account?
- Would water and sewage still be charged separately?
- Would the number of dependents be taken into account?
- How would the tax differentiate between households and individuals?
- How would a local income tax affect the self-employed?

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.

"It sounds quite difficult to set up, let alone adjust."

(Participant in Perth Listening Event)

9.15.1 Many felt that the nature of this relationship and how it would work would not be clear, and that more was required to ensure that HMRC could implement any such approach. Some noted that different levels of administration and different computer systems would also have to work seamlessly together. A number of Local Government bodies specifically felt that a local income tax was likely to prove complex to operate in practice.

9.15.2 Our evidence therefore suggests that 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

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.

9.16.1 Water and waste water charges for domestic properties connected to the public water supply and sewers (and without water meters) are based on the Council Tax band of the property. Scottish Water indicated the need for any reform of local taxation to reflect closely on the issues that would be presented in relation to water and sewerage charges, and that the existing system automatically recognised variations in ability to pay charges without additional bureaucracy and complexity. They wished to see the foundation of the current system retained because Council Tax bandings were the basis for collecting water and wastewater charges from almost all households in Scotland.

"Any revisions to the Council Tax regime would need to retain the benefits that the current system offers to household water and wastewater customers."

(Scottish Water)

9.16.2 Currently, Council Tax and water and sewerage charges, where relevant, appear on the same bill. We heard that people find this dual billing unclear, particularly those in receipt of Council Tax Reduction who pay no Council Tax but still incur water charges. We heard from a range of stakeholders as diverse as Citizens Advice Scotland and IRRV Scotland that while full relief under the Council Tax Reduction scheme is generally well understood, significant issues are often encountered because only up to 25% relief is available for water and sewerage charges.

"Although household water and water waste charges are tacked on to Council Tax, there is no corresponding relief for such charges where a household is eligible for Council Tax reduction... The lack of transparency (both Council Tax and water charges are included on the same bill) also means that often such water charges will go unpaid, as the householder does not realise they are still due."

(The Low Incomes Tax Reform Group)

"Water and sewerage charges are poorly communicated, leaving many on full Council Tax reductions receiving an unexpected bill."

(Citizens Advice Scotland)

9.16.3 A number of respondents to our Call for Written Evidence, including organisations and individuals across all respondent categories, highlighted the need for change in this context. Key concerns in relation to clarity and understanding for taxpayers were:

- it may be confusing for customers – both local authorities and third sector organisations highlighted that customers can be confused about their liability for water charges, particularly if they receive Council Tax Reduction, and see the whole bill as "the cost of the council" without realising that approximately a quarter of the bill relates to water charges;

- it places full responsibility on local authorities – a number of respondents were concerned that the onus of managing the financial relationship with water customers rested on local authorities, rather than with the service provider; and

- it can be unclear how much local authorities should pay to Scottish Water – one local authority was concerned that the amount it paid to Scottish Water was not directly related to the amount it had collected in water charges.

9.16.4 A small number of written submissions also referred to the established formula for calculating the amount to be paid to Scottish Water by local authorities based on estimated Council Tax collection rates. Some highlighted that technology now enabled more precise arrangements to be put in place.

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.

9.19.1 Many of our participants in public events highlighted this need too, against an anxiety that new changes could lead to confusion. Based on the views that we were provided with, we believe that this process should be more than simply a generic description of changes, but also provide specific information for individuals to help them understand the impact of the change for them. That requirement is all the more important given that we found that there appears to be no single overall model of reform that people in Scotland find consistently clear and easy to understand, and that there appears to be support for mixing tax systems to broaden the basis for local taxation.

9.19.2 Indeed, from those countries that had recently embarked on reform, we heard about the absolute requirement for an effective approach to communication as part of effective transition arrangements. An important feature of recent changes in Ireland, for example, was that Irish Revenue Commissioners explained the tax clearly and that people understood the impact before the system was introduced. In Wales, at the time of revaluation, a clear communications campaign was also developed by the Welsh Government and local authorities.

9.19.3 Many participants at our events suggested that people need to see a visible local connection between taxes that they pay and the services provided in the local community that these pay for. This was felt to be an important factor in making the local tax system transparent and strongly linked to spending on local priorities. We encountered a common perception that better transparency and accountability would increase people's willingness to pay, and appetite for participation in local decision making.

"It would be helpful if councils could show what this is going towards, then people would be more comfortable."

(Participant in Edinburgh Listening Event)

9.19.4 A small number of individual respondents to our Call for Evidence commented that they felt that their local council was not responding to local priorities, although a similar proportion of individuals felt that their local council was doing reasonably well, despite financial and other pressures. Many indicated that it was very hard to judge how local priorities were accounted for, as the wider system of decision-making and processes were complicated and not always clear.

9.19.5 Approximately 6% of respondents to our online survey also indicated that their priority for reform was to make the system more transparent. Those commenting on transparency generally felt that members of the public required more information and more choice about how the funds gathered through Council Tax were spent locally.

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

10

Chapter 10 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.

10.4.1 Such issues became a strong thread in our evidence. While some aspects lie outwith our remit, the volume of evidence that we received was significant, and we therefore consider it important to reflect on what we heard.

10.4.2 Our Call for Written Evidence included two questions that helped us to address these issues:

- How well do you think that communities' local priorities are accounted for in the way that local taxation operates at the moment?
- If there is room for improvement, how should things change?

10.4.3 The independent analysis undertaken of the responses to our Call for Written Evidence demonstrated that approximately two thirds of respondents felt that the present Council Tax system was broadly unfair and that one of the common reasons cited for this was that local taxation needed to have a stronger link with local democracy. Many respondents wanted to see a stronger link between local taxation and the wishes of local communities. Most felt that local priorities were not well accounted for within the present Council Tax, feeling that there was a disconnect between local priorities and the operation of local taxation. Key concerns included:

- the proportion of Local Government funding raised locally – which many felt should be closer to 50%;
- low awareness among communities that Council Tax income represents only 12% of overall funding for Local Government;
- the Council Tax freeze – which many felt was undermining the link between local taxation and local communities, and contributing to financial constraints that were impacting on communities;
- wider pressures on local authorities – with some feeling that councils are able to do little more than comply with their statutory duties;
- the top down nature of local taxation which was felt by many to be determined nationally, and without local flexibility.

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.

10.5.1 Our Call for Written Evidence and Oral Evidence Sessions highlighted questions about the impact of this balance of funding on local accountability for taxes raised and spent. In international terms, we heard that this limited local tax capacity was highly unusual, with most European democracies raising a higher percentage locally.

10.5.2 While not universal, we heard support for Local Government to raise more of the money that it spends across the dimensions of our evidence gathering, including comments such as:

"Central taxation needs to be cut, so that local taxation can raise the necessary funds for local spending."

(Individual response to Call for Evidence)

"Increase the proportion of tax raised locally rather than depend on government grants."

(Individual response to Online Survey)

"Local authorities need to be able to raise a higher proportion of their taxes".

(Participant in Arbroath Public Listening Event)

10.5.3 Evidence from COSLA suggested while the trend in Scotland and the UK over the last 50 years has been to reduce the percentage of revenues raised via local taxation and increase reliance of grants from central government, in international terms the most empowered Local Governments can raise more than 50% of their own income and in many systems Local Government raise 40% - 50% of total public income.

10.5.4 Approximately 5% of respondents to our online survey commented on where the power to set local tax rates and mechanisms should lie. Of these, approximately three quarters felt that local authorities should have more power over local tax, and the remainder felt that the Scottish Government should have more power over local tax. Many respondents who felt that local authorities should have more power over local tax also felt that the Council Tax freeze should be ended.

10.5.5 Respondents to our survey who felt that the Scottish Government should have more control over local tax indicated that a central decision about tax rates would lead to more consistency, and would avoid differences across the 32 local authority areas. Some of these comments indicated dissatisfaction with local councils, and a belief that Council Tax was set too high due to unnecessary council spending.

10.5.6 Respondents to our Call for Written Evidence who felt that local authorities should have more power over local tax generally indicated that this would create better links in terms of local accountability, local democracy and meeting local needs:

"Local priorities cannot in any way be accounted for in the way that local taxation operates at present because local councillors, as discussed earlier, have no real control over local taxation."

(Reform Scotland)

"We believe that permitting local communities to have a greater say on local budgets is beneficial, provided the process is equitable, transparent and properly accounted. It is vital that rural areas of urban authorities are not forgotten."

(Scottish Land and Estates)

"The main benefits of fiscal devolution to councils are – greater local democratic accountability and participation; diversity sources of tax revenue...; provide greater flexibility and control over budgets at local level; provide an incentive to grow local economies; provide a revenue stream against which to borrow for, and repay, infrastructure investment – which will in turn further enhance the local economy and tax base."

(Scottish Cities Knowledge Centre)

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.

10.6.1 A number of organisations and individuals that responded to our Call for Written Evidence highlighted that levels of local taxation should be a matter for individual councils and outwith the scope of national government control; this was similarly echoed by witnesses in a number of Oral Evidence Sessions.

"The ability to set and collect local taxation is a key component of an effective local democracy, and is central to the accountability relationship between councils and the communities that they serve."

(COSLA)

10.6.2 Some of the evidence that we received highlighted questions about the current Council Tax Freeze in this context. Many local authorities as well as representative bodies drawing membership from Local Government indicated that they did not support this policy. Many other organisations questioned whether this policy should continue. In oral evidence the STUC, for example, told us that the status quo did not reflect well on Scottish democracy, and the Church of Scotland highlighted that the freeze had impacted on those who rely on free and subsidised local services. Some responses to our online survey also highlighted their view that the Council Tax system didn't appear to gather enough to enable local authorities to provide adequate services – with some expressing concern about the Council Tax freeze.

"The standstill on Council Tax levels is regressive, not providing material advantage to the lowest income households, and also infantilises local authorities and those who elect them by denying them options of specifically increasing local taxes to support proposed initiatives and expenditure."

(Centre for Scottish Public Policy)

10.6.3 In the written evidence that we received, the ability to set tax rates locally was not promoted as a way of increasing taxes, but about the ability to vary taxes in order to reflect local circumstances and priorities.

"Our aim is not to promote more, or less, taxation and spending: it is simply to make sure that the decisions about these issues are made locally... local people should decide on levels of local taxation in relation to the services they want..."

(Edinburgh Labour Group)

10.6.4 In our online survey, however, opinion was more mixed in terms of whether councils should set local tax rates according to the priorities of their local communities (47% supported the statement to some extent), or whether local tax rates should be set by the Scottish Parliament (35% supported the statement to some extent). While over a third of respondents felt that councils did not have enough control over Council Tax rates, a similar proportion felt that they did.

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.

10.7.1 Some – particularly individual respondents – had concerns that if more tax was raised locally, more affluent areas would always be able to gather more tax than those which were less affluent, meaning that inequalities could not be addressed. It was for these reasons that the Society of Local Authority Lawyers and Administrators in Scotland (SOLAR) and others highlighted that the existing Local Government funding framework equalises support to local authorities, and that any changes to local tax bases would therefore need to be addressed in deciding the block grants made by the Scottish Government to local authorities.

<u>Local Tax and Democratic Choice</u>

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.

10.8.1 At our public listening events, for example, while views sometimes differed, we heard from participants that a property tax system had the potential to develop a strong local dimension to taxation because it provided a distinct bill to the home compared to potentially less visible and payment of income tax through the PAYE system. This, it was felt, would help clarify that taxes would be paid according to where people lived, not where they work.

"It's obvious, rather than hidden in your pay cheque."

(Participant in Stornoway Public Listening Event)

10.8.2 At our public listening event in Aberdeen, participants highlighted that a local tax being perceived as genuinely local was important to them. They felt that paying a centrally collected form of local income tax, either to HMRC or even to a tax authority based in for example Edinburgh or Glasgow would not 'feel local', whereas paying a local tax to Aberdeen City Council would feel local to them.

10.8.3 Many of the expert witnesses that gave oral evidence to the Commission cited the role of a property tax in any reformed system of local taxation. Micheál Collins of the Nevin Institute, Dublin, for example, told the Commission in oral evidence that a recurring property tax is an important part of a stable taxation base, and that a property tax structured so that revenue flows to Local Government is an important part of local democracy.

"Any strategy to reduce wealth inequality needs to include taxing property. For Local Government a property tax's advantages are practical - it's easy and cheap to collect. Property is easy to find and value. It can't be hidden or moved abroad, nor does it appear suddenly as changes to existing and new buildings require agreement with local authority planning departments. The yield from a property tax is stable and enables the kind of long-term planning which Local Government needs to be able to do."

(UNISON Scotland)

10.8.4 A number of witnesses expressed a view that it would also be straightforward in principle for Councils to alter the rate of local tax under a property or land based model in accordance with local service needs and preferences, although many noted that this would require local authorities to have more discretion over the system than currently exists.

10.8.5 The difficulty, however, of making decisions in this context was also recognised:

"It is such a visible tax there will be significant political inertia in increasing a local property tax".

(Participant in Galashiels Public Listening Event)

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.

10.9.1 As we explore elsewhere in our report and in the literature review that we commissioned from Policy Scotland at the University of Glasgow, the local tax base is already unusually narrow in Scotland and the UK. For example, unlike London, Paris, New York, Tokyo, Madrid, Berlin all have access to at least five local sources of revenue whereas London relies only on the Council 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.

10.10.1 In our public listening events, some concerns were raised that, as well as being perceived as unfair, this would also potentially reduce the connection between local taxation and local decision making and accountability.

10.10.2 We also found some varied opinions on whether different income tax rates could be set for different local authority areas, and for people in different situations. Some felt that a local income tax could be set locally, according to local needs and circumstances. However, we also heard that administering a system of local income tax across each of Scotland's local authorities would be challenging. There was generally little appetite for local income tax collection arrangements to be established, and we heard that in Denmark recent reforms there had sought to move to a national approach for reasons of efficiency. The evidence instead suggested that any local income tax would most likely need to be collected through HMRC, which was felt to pose challenges for local accountability; not only would the tax base be set by the UK Government, but so too were fears expressed that if a local income tax was set through the Scottish Government's tax powers, this could lead to local tax rates becoming determined nationally rather than locally.

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.

10.11.1 Some of the evidence we heard suggested that it would be possible for many more aspects of the design and control of a local property or land tax to be devolved locally. While there was widespread agreement that local control of the tax rate was necessary in any reform, some suggested that local control could also be extended to other potential aspects, such as how any associated property bands might be set, and any system of discounts and reliefs. Some advocated significant local discretion should be provided for in any reform:

"...we see no problem with some local authorities maintaining a Council Tax system, while others may opt to choose from a range of different forms of taxation, including a land value tax. The most important element is that the tax is fully devolved to the local authority..."

(Reform Scotland)

10.11.2 A number of local authorities also felt that local areas should have more flexibility in setting their own discounts and reductions. For example, one local authority suggested that Council Tax reductions could be used to attract key public sector workers to the area. Another felt that Council Tax could be used to help to regulate the housing market. Some individual respondents also supported the concept of more local flexibility.

10.11.3 However, we also heard evidence about the need to find an appropriate balance between these opportunities and the overall cohesiveness and administrative efficiency of a reformed system, and that this might require a consistent framework to operate across Scotland on issues such as discounts and reliefs and other potential elements of the 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.

10.12.1 A number of written evidence submissions, including those from CIPFA Scotland and Directors of Finance, COSLA, Common Weal, and others, called for local authorities to be provided with powers of this sort, although they were opposed by the British Hospitality Association in relation to bed taxes levied on visitors who stay in hotel accommodation.

10.12.2 Opportunities for such local taxes were also highlighted by some respondents to our online survey, and flagged up by participants as an option for reform in several public listening events. Sometimes these were seen as a way of raising money to support specific local priorities, such as local infrastructure or tackling local health issues. A common example, although others were identified, was in relation to the potential introduction of a 'tourist tax'.

10.12.3 We also noted international evidence which suggested that similar powers already operate in other jurisdictions and can contribute to specific priorities. For example the international literature review we commissioned identified that in Hamburg, Germany, the culture and tourism tax raised locally is re-invested in culture, sports events and promoting tourism rather than going into the general local taxation fund.

10.12.4 Proponents of additional local taxes were clear that they should not be seen as a substitute for a primary local taxation system. They argued that minor taxes of this kind would not be designed to generate large sums or address the wide Local Government balance of funding. However, they were felt to offer a significant opportunity to empower communities to address local issues at a local level, invest in specific priorities, or tackle local issues where agreement within communities had been reached to do so.

10.12.5 We did not fully consider all of the technical requirements associated with the introduction and operation of such taxes. However, this need not be an impediment to the exploration of such issues as part of the scope to spread local taxation across a wider tax base. Local authorities would need to be clearly mandated to operate any such taxes, and similarly transparent about the administration of these. There would also need to be clarity on how funds are used, particularly where the rationale for their introduction is in relation to specific local priorities. It will also be important that the costs of establishing and maintaining any such schemes do not outstrip their potential revenue, and that legal issues associated with EU restrictions on varying taxes like VAT or Excise duty are fully understood within the Scottish context.

10.12.6 However, if such taxes could be demonstrated to target important local issues, then it could be anticipated that they would enjoy local support.

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.

10.14.1 Many responses to our Call for Written Evidence highlighted links between wider goals around local community empowerment and local taxation. Some felt the new Community Empowerment Bill could provide a driver in engaging with communities in discussions about local priorities. Some individuals suggested that there was scope for some funding to be devolved more locally than local authority level – for example through community councils, as well as through accessible and engaging ways for local people to participate in decisions about local spending. Equality and third sector organisations stressed that it was important to ensure that everyone had the chance to participate in decision making, including those who experience inequalities and disadvantage. A small number of organisational respondents also pointed to examples of more community involvement at local level working in Europe, where countries have smaller municipalities and greater local responsibilities.

"We recommend that the Commission make recommendations on mechanisms to ensure that seldom heard voices are supported and are not drowned out in favour of the majority – both in terms of the way in which a new form of taxation is designed and the mechanisms developed locally to spend that tax."

(Independent Living in Scotland)

10.14.2 As discussed in Chapter 9, we heard evidence suggesting public understanding of the link between local taxation and local democracy is not well understood, and that the financial accountability of Local Government to its electorate has been eroded. We heard that some local authorities such as City of Edinburgh Council had begun to develop interactive web tools for local residents to model how they would allocate budget, and that a range of authorities are delivering participatory budgeting approaches. These kind of steps have been viewed positively, although we are also conscious of the evidence that we heard suggesting that the reform of local taxation should enable Councils to exercise stronger local democratic choice and control over not just spending decisions, but over how resources are generated locally too.

10.14.3 Evidence from Common Weal highlighted an interaction between local responsibility and a willingness to pay tax; making the argument that empowering communities in relation to taxation and spending will help build a fairer and more engaged society. The Scottish Council for Voluntary Organisations also told us that raising more revenue locally may encourage engagement, with participatory budgeting empowering communities to make decision about this.

"It needs a connection to the locality, with an increased proportion of tax raised locally kept locally, alongside better participatory forms of engagement..."

(Scottish Council for Voluntary Organisations)

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

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Chapter 11 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.

11.2.1 Council Tax revenues have, in the past, been able to provide relatively stable and therefore predictable receipts. In COSLA's submission to the Commission, one of its Local Taxation Principles related to the requirement for stable revenues. COSLA stated that it believes that Council Tax receipts are stable, with some modest buoyancy apparent each year due to new housing stock.

11.2.2 The stock of residential properties is known, and any changes to the stock (demolitions and rebuilds) are likely to be known in advance through the planning system. Therefore local authorities should be able to estimate, with relative certainty, the total number of residential dwellings in advance of the financial year. The number of properties where households are eligible for exemptions, discounts or reductions may change each year, which introduces some uncertainty at the margins, as has the creation of Council Tax Reduction.

11.2.3 Under Council Tax Benefit (CTB), local authorities were recompensed in full (minus a small margin to account for fraud and error) for income foregone through operating the scheme by the UK Government. The ending of CTB also brought about a 10% cut in the money transferred to Scotland to pay for the replacement Council Tax Reduction scheme, and since 2013, Scottish Government and local authorities have worked together to meet the shortfall.

11.2.4 Because household financial circumstances can change frequently, income foregone from CTR is hard to predict with accuracy. However, eligibility for CTR is closely aligned with other DWP means tested benefits, meaning that forecasts of these benefits can be used to try and predict changes to income foregone for CTR.

11.2.5 As already mentioned, Local Government and the Scottish Government worked together to make up the estimated shortfall in funding from the Government when CTB was abolished. Whether or not such an agreement will continue depends on future negotiations on the Local Government settlement. If Local Government is required to cover any increase to the cost of CTR, this will either need to come from reductions in spending elsewhere in the local authority budget or from an increase in the local tax rate.

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.

11.3.1 The alternative to stable and predictable revenues is that local authorities will need to manage any volatility in revenues by saving and borrowing. This sort of system is likely to be particularly necessary if a locally set local income tax was to be the sole local tax option for Councils.

11.3.2 Whilst the current equalisation arrangements with Scottish Government could help to redistribute revenues to take account of relative changes to the tax base between local authorities each year (for example, if a large local employer closes and there is a demographic shift of the income tax base away from one local authority to another), the mechanisms that are currently in place do not extend to central government providing additional funding to Local Government if tax revenues fell on aggregate across the local tax base.

11.3.3 Research from Policy Scotland at the University of Glasgow shows that income taxes make up part of the local tax base for many countries across the OECD, but the introduction of a local income tax in Scotland may require a shift in the way Local Government operates, potentially with the need for more reserves in order to smooth out fluctuations in income tax receipts.

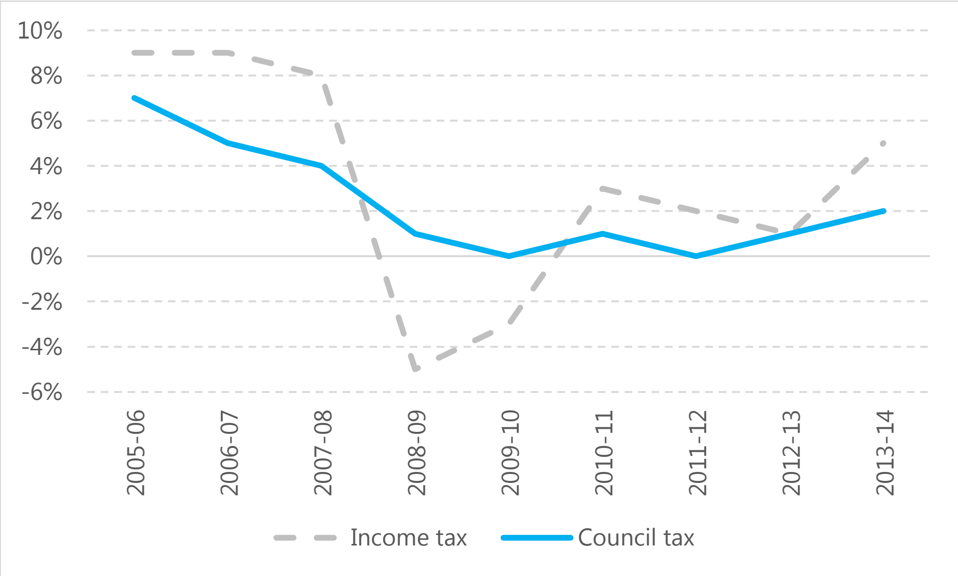
11.4 The introduction of the SRIT in April 2016 will mean that the funding for public expenditure in Scotland will, in the future, have a direct dependency on Scottish income tax and be exposed to any fluctuations, both upwards and downwards, in receipts. The creation of a local income tax would concentrate 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 Chart 11-a. 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.

Chart 11-a: Annual percentage Change in Receipts – Income Tax vs Council Tax



Source: GERS 2013-14, Scottish Government

11.7.1 The income tax base is far more buoyant than the property tax base for a number of reasons:

- The number of people in the income tax base is far more variable than property tax because the number of people in employment varies with the economic cycle. The number of properties does not normally reduce during a recession.
- Income taxes are generally accepted to relate to current (or recent in the case of self-assessment) income. Revaluation of the tax base is therefore automatic and if income rises or falls, this will be reflected in tax revenues each year. Theoretically, local income tax rates could be adjusted each year to offset fluctuations in income. However, this would be administratively very difficult because it is extremely difficult to predict income tax receipts accurately, even in-year. Furthermore, it would require counter-cyclical adjustments to income tax rates, which, in a recession would likely exacerbate already falling incomes.

11.7.2 The combination of these factors means that revenues from a local income tax are likely to be far more responsive to economic conditions than those from a property tax. In addition, it is less likely that changes to a local income tax base could be predicted with the same certainty as changes to the property tax base because income is more variable than property.

11.7.3 These concerns were noted in the analysis of responses to the call for evidence. Some local authorities indicated that they recognised that more buoyant or responsive systems of tax may provide higher rewards, but that these systems also came with higher risks. In particular, concerns were expressed that self-employment may lead to peaks and troughs in collection through the year and that the volatility of the tax base would lead to an immediate impact on tax collected.

11.7.4 Similarly, attendees at the Galashiels public listening event felt that local income tax was too reliant on prosperity and so revenues would vary depending on the economic circumstances. They also felt that fluctuations in the pattern of individuals' incomes would be hard for councils to cope with. The worst case scenario was that this unpredictability could even lead to cash flow problems for councils, which may encourage councils to borrow or increase tax every year:

"*A council needs to know what income it is going to receive or it will increase taxes and this might encourage more people to cheat and avoid tax*."

Participant, Galashiels public listening event

11.7.5 Organisational respondents, including local authorities, other public sector organisations and representative bodies, indicated that they value the stability and predictability of the current Council Tax system. Local authorities largely welcomed that the amount generated through the tax did not change dramatically in response to economic trends. Angus Council, for example, said in its submission, "*One of the core advantages of the Council Tax system is its stability and predictability and in the current challenging financial climate for public services this is of vital importance... The Council believes the benefits of stability and predictability in a system of taxation should not be underplayed.*"

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.

11.8.1 As set out in COSLA's written submission, there is some buoyancy in the Council Tax system each year due to additions to the Council Tax base. This can come both from the addition of new build properties to the housing stock, and from extensions that are added to the Council Tax roll on sale of a property. Increases in property value since 1991 have not led to increases in Council Tax receipts.

11.8.2 Council Tax receipts have increased since 1991. Rather than being due to increases in the tax base, this has largely been due to rate increases.

11.8.3 Even if a revaluation did take place, this would not necessarily lead to buoyancy. For example, the other locally collected tax that contributes to the funding of local services, Non-Domestic Rates (NDR), is usually revalued every 5 years but standard practice is for revaluation to be revenue neutral – that is, no additional revenue results even if the value of the tax base has increased. Rates for NDR in Scotland are set centrally and are a set percentage of the total non-domestic rateable value (which roughly equates to rental values). To maintain revenue neutrality, the poundage rate is adjusted to offset changes to the tax base. This results in broadly stable and predictable tax revenues over revaluation cycles. As with Council Tax, there is a small degree of buoyancy in the system from growth in the stock of non-domestic properties.

11.8.4 Regular revaluation of Council Tax or an alternative property tax could introduce more buoyancy into the system if it was so wished. The modelling we undertook has assumed that revaluation would be revenue neutral, but this is purely for illustration. If buoyancy was the aim of revaluation, then new thresholds could be constructed so that the number of properties in higher bands increased or alternatively, as put forward in the call for evidence and the online survey, there could be an opportunity to introduce new bands for higher value properties and such a change could be used to increase revenues if so wished.

11.8.5 However, as mentioned above, buoyancy is not the objective of revaluation for NDR. Instead, the objective is to ensure that relative changes in the value of commercial property is taken into account. This revenue neutrality principle that is generally used for NDR revaluations ensures stable revenues are provided to finance Local Government. Evidence from local authorities places high value on the stability that Council Tax provides, and it is therefore unlikely that non-revenue neutral revaluations (which could result in gross income going down as well as up in times of recession) would be welcomed.

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.

11.9.1 Participants at our first public listening event in Edinburgh expressed a view that local authority revenue based on a local income tax would be subject to volatility as a result of the impact of changes in the local and wider economy. Participants were concerned that there would be frequent fluctuations causing disruptions for both the council and taxpayers. Participants highlighted potential problems such as a factory closure in an area. Such an event would increase the need for local services at the same time as tax revenues were decreasing.

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.

11.11.1 At our public listening event in Arbroath, participants required further information on how a local income tax would work if was applied through PAYE on an individual's income. They felt that the system needed to be flexible enough to take account of household earnings. This view was also reflected in discussions at the public listening event with women's groups in Glasgow who suggested that the system should be based on household earnings rather than the earnings of individuals. This, they felt, would be a more accurate assessment of ability to pay and would be fairer if everyone who had income contributed.

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.

11.12.1 Participants in our first public listening event in Edinburgh noted the potential impact of a change from the present Council Tax to, for example, a local income tax. They were concerned that some people might see large shifts in their tax burden, and if the application of benefits and discounts was delayed for any reason, people could build up debt while waiting for the changes to take effect.

What the Evidence Tells Us

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Chapter 12 What the Evidence Tells Us

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

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Chapter 13 Conclusions and Recommendations

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.[35]

[35] Jackie Baillie MSP was not able to agree this recommendation

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.

Our Remit

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Chapter 14 Our Remit

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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Chapter 15 Members of the Commission

- Councillor Susan Aitken, SNP Local Government Convenor and Leader of SNP Group, Glasgow City Council
- Jackie Baillie MSP, Shadow Cabinet Secretary for Finance, Constitution and Economy (joined the Commission May 2015)
- Councillor Catriona Bhatia, Leader of Liberal Democrat Group and Deputy Leader, Scottish Borders Council
- Marco Biagi MSP, Minister for Local Government and Community Empowerment (Co-Chair)
- Councillor Angus Campbell, Leader of Comhairle nan Eilean Siar and Leader of the Independent Group at COSLA
- Isobel d'Inverno, Convenor of the Tax Law Committee of the Law Society of Scotland and Director of Corporate Tax at Brodies LLP
- 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
- Dr Jim McCormick, Scotland Advisor, Joseph Rowntree Foundation
- Dr Angela O'Hagan, Lecturer in Social and Public Policy at Glasgow Caledonian University and Convenor of the Scottish Women's Budget Group
- Councillor David O'Neill, President of COSLA (Co-Chair)
- Don Peebles, Head of the Chartered Institute of Public Finance and Accountancy (CIPFA) Scotland
- Andy Wightman, Writer and Researcher, representing the Scottish Green Party
- Alex Rowley, MSP for Cowdenbeath and formerly Shadow Minister for Local Government and Community Empowerment (February to May 2015)

Glossary

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Chapter 16 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.

Burt Committee review / Burt review

'A Fairer Way, Report by the Local Government Finance Review Committee', published November 2006, available at: http://www.gov.scot/Resource/Doc/153766/0041377.pdf

CAMA

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

CAS

Citizens Advice Scotland.

CIPFA

Chartered Institute of Public Finance and Accountancy.

Circuit breakers

Used in the United States as a form of tax relief, whereby property tax liabilities are cut off once the liability to tax reaches a certain proportion of household income.

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. Most people on Income

Support, Jobseekers Allowance Income Based, Employment Support Allowance Income Related or Pension Credit Guarantee qualified for full Council Tax benefit and would not be required to pay Council Tax (except water and waste water (sewerage) charges in Scotland). See also CTR.

CTR

The Council Tax Reduction scheme. CTR 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.

Devolved Taxes

Taxes introduced by the Scottish Parliament pursuant to its powers under Part 4A of the Scotland Act 1998 (as amended by the Scotland Act 2012).

DWP

Department for Work and Pensions.

ECB

European Central Bank.

GERS

Government Expenditure and Revenue Scotland, an annually published report compiled by statisticians and economists in the Office of the Chief Economic Adviser of the Scottish Government, available at http://www.gov.scot/Topics/Statistics/Browse/Economy/GERS

GINI co-efficient

The Gini coefficient (also known as the Gini index or Gini ratio) is a measure of statistical dispersion intended to represent the income distribution of a nation's residents, and is the most commonly used measure of inequality.

Equalisation

Equalisation is a term more commonly used in Federations to describe the systems 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.

Equivalisation

Equivalisation is a standard methodology that adjusts household income to account for different demands on resources, by considering the household size and composition.

HMRC

Her Majesty's Revenue & Customs.

Hybrid tax

We refer to a hybrid tax to mean the merging together of the land / property tax base with the income tax base to create a 'hybrid' form of local taxation.

ICT

Information and communications technology.

IFS

Institute for Fiscal Studies.

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.

JRF

Joseph Rowntree Foundation.

LBTT

Land and Buildings Transaction Tax, one of the two devolved taxes, introduced by the Land and Buildings Transaction Tax (Scotland) Act 2013.

LIT

Local income tax.

LVT

Land value tax.

MIS

Minimum Income Standard for the UK is an annually updated programme of work which reports on how much income households need to afford an acceptable standard of living. It is carried out independent of government by the Centre for Research in Social Policy with funding from the Joseph Rowntree Foundation.

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.

NSND income

Non-savings, non-dividend income. This term is used to describe the amount of someone's income to which a tax may apply, i.e. income from employment, self-employment, pensions and rental income but excluding their income from savings and dividends. The Scottish rate of income tax (SRIT) will apply to the non-savings, non-dividend income of Scottish taxpayers from 1 April 2016.

OBR

Office for Budget Responsibility.

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 and 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 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’.

RICS

Royal Institution of Chartered Surveyors.

ROS

Registers of Scotland.

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).

SCVO

Scottish Council of Voluntary Organisations.

‘Slab’ tax structure

A ‘slab’ tax structure describes a tax where the amount of the value of the asset being taxed (such as a property) is assessed in bands or ‘slabs’ to determine an amount of tax to be paid, or a single tax rate which is applied to the whole amount.

SPI

Survey of Personal Incomes, published by HMRC.

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 10p in the pound less than taxpayers in the rest of the UK) plus SRIT. Thus if SRIT is set at 10p, 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.

STUC

Scottish Trades Union Congress.

Tax administration

The activity of a tax authority in collecting and managing a particular tax. Hence the administration costs of a tax 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 base

Measure upon which the assessment or determination of tax liability is based.

Tax compliance

This is the term used to describe the degree to which a taxpayer complies (or fails to comply) with the tax rules, for example by declaring income, filing a return, and paying the tax due in a timely manner. Hence the compliance cost of a tax to the tax authority is any cost arising from any of its activities, the purpose of which is to ensure that taxpayers pay the correct amount of tax due.

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.

UNCRPD

United Nations Convention on the Rights of Persons with Disabilities.

VAT

Value Added Tax.

VOA

The Valuation Office Agency. Provides advice to government in UK and Wales on valuations and property advice needed to support taxation and benefits. See SAA for Scotland.

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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