



Chartered  
Institute of  
Taxation

Excellence in Taxation

**The Commission on Local Tax Reform  
What's the Future of Local Taxation in Scotland?  
Response by the Chartered Institute of Taxation**

## **1 Introduction**

- 1.1 The Chartered Institute of Taxation (CIOT) is pleased to submit comments in response to the call for written evidence above, issued by the Commission on Local Tax Reform (the Commission) in May 2015. Our response is informed by the results of a survey of our members in Scotland.<sup>1</sup>
- 1.2 We have previously responded to a 2008 Scottish Government consultation entitled 'A Fairer Local Tax for Scotland'.<sup>2</sup> We do not repeat in full points made in that response, but we would encourage the Commission to review the document, in particular Part 1, as we make points applicable to whatever system of local taxation is adopted.
- 1.3 The CIOT is apolitical. We comment on the issues below only from a perspective of whether and how the principles can be applied without suggesting what should be done. We also aim to draw attention to potential practical issues which might need to be addressed.

## **2 General Principles**

- 2.1 The Scottish Government has committed itself to a tax system that has regard to Adam Smith's four principles: certainty; the burden proportionate to the ability to pay; convenience; efficiency of collection.<sup>3</sup> We think that these longstanding principles should be given due regard when considering the future of local taxation. Sight should not be lost of the principle of accountability either, ie those paying the taxes should be able to hold those who

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<sup>1</sup> The survey is available on our website: [http://www.tax.org.uk/media\\_centre/LatestNews-migrated/CIOT\\_survey\\_local\\_tax\\_reform](http://www.tax.org.uk/media_centre/LatestNews-migrated/CIOT_survey_local_tax_reform)

<sup>2</sup> The CIOT response is available on our website: <http://old.tax.org.uk/attach.pl/7048/8344/ScotlandFairerLocalTax%20final170708.pdf>

<sup>3</sup> The Scottish Government's Approach to Taxation, Finance Secretary John Swinney's statement to the Scottish Parliament, 7 June 2012: <http://www.gov.scot/News/Speeches/taxation07062012>

raise and spend the tax to account.

- 2.2 The Scottish Government needs to determine its policy objectives and the reasons for local taxation – the option adopted should support the Scottish Government’s aims. It needs to consider the consequences (direct and indirect) of policy decisions, for example, an income-based tax might encourage people that are asset-wealthy but income-poor to remain in high value properties; this may have knock-on implications for housing provision. It should also think about the proportion of local government funding that should come from local taxation.<sup>4</sup>
- 2.3 The remit of the Commission refers to a ‘fairer’ system of local taxation.<sup>5</sup> The CIOT expresses no opinion on the fairness or otherwise of the options explored below as what is fair is very subjective, for example one person might argue that they should pay for the services they use where another might argue that the amount you pay should be based on your earned income. There is a widely held view that the primary feature of fairness is the ability to pay – yet these two concepts are not necessarily the same. The best that can be achieved is probably a progressive tax system; that is one which recognises that society as a whole has to pay for certain people unable to care for themselves and that that burden should fall more on those that can best afford it than on those that cannot.
- 2.4 There is a tendency to focus on income as a measure of the ability to pay. A more holistic approach might be to say that ability to pay needs to take into account not only income but also the resources available to a person (which would reflect wealth as well as income), as well as any necessary outgoings, including those relating to dependants and expenditure necessary to deal with disabilities. Since no two individuals (or households) have the same resources (capital and income), it is unlikely that any single system will be able to achieve a proper balance between ensuring that the tax reflects the use of services whilst at the same time paying proper regard to the ability to pay. We include some examples to illustrate our concerns with respect to measuring the ability to pay at Appendix 1.
- 2.5 Changes to the system of local taxation will inevitably create winners and losers. There will be a need for good communications and information – for example, people are likely to compare the new system of local taxation with Council Tax, so it is important to have good guidance to explain the changes and the reasons for them, particularly if there is a change in scope from the household to the individual. The Scottish Government will also need to decide how to deal with unintended losers. Consideration may need to be given to the balance between compensating them and minimising exemptions and reliefs to keep the tax simple.
- 2.6 Local tax-raising powers could enhance local democracy and accountability, but consideration needs to be given to the practicalities of a system that allows the setting of different rates in different areas. Local taxation can also be innately regressive if set locally. This is because a wealthier area has a higher tax base than a poorer area; if local councils have the power to raise tax and set rates, there are likely to be higher rates of tax in the areas with a lower tax base. By way of example, consider two local councils, A and B, both with the same number of

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<sup>4</sup> Scottish Government statistics show that Council Tax income for 2013/14 was about £1.98bn (after Council Tax Reduction). This constituted 17% of Total Revenue Funding, compared to 21% from non-domestic rates and 62% from General Revenue Funding: <http://www.gov.scot/Resource/0047/00475413.pdf>. The provisional outturn statistics for 2014/15 suggest a similar percentage (16.9%) of funding for local government from Council Tax: <http://www.gov.scot/Resource/0047/00477389.pdf>. A paper by Fiscal Affairs amalgamates capital and revenue funding, showing that Council Tax formed only 12% of total local government revenues for 2013/14: <http://fiscalaffairsscotland.co.uk/wp-content/uploads/2015/03/Local-Government-Funding-Challenges-March-2015.pdf>.

<sup>5</sup> <http://localtaxcommission.scot/how-we-work/remit/>

taxable units. The average value of each taxable unit in local council area A is £100,000, while that in B is £200,000. In order to raise the same amount of tax, say £10,000 per taxable unit on average, local council A will have to set a rate twice that set by local council B (10% compared to 5%).

- 2.7 Consideration will need to be given to jurisdiction, both in relation to the right to impose the tax and the right to impose duties on third parties to ensure the proper administration of the tax. This might be an issue if the tax changes from being a local tax to a Scottish tax that funds local expenditure. Consideration may also need to be given to knock-on effects on sources of funding from the UK Government that depend on Council Tax and Council Tax Reduction, and also interactions with household water and waste water (sewerage) charges, which are currently linked to the Council Tax band of a property and collected together with Council Tax.
- 2.8 A key consideration will be the administration, collection and practicalities of the local taxation system. There should be ease of administration for all parties. A further point is that the tax and its base need to be kept up to date – one issue with Council Tax is that the values and bandings are outdated.<sup>6</sup>
- 2.9 We would like to assist in ensuring that the local taxation system in Scotland is effective and efficient. We think that the achievement of a tax system that works well for taxpayer and tax authority alike is more likely if the aforementioned principles and considerations are borne in mind.

### 3 Scotland's Current System of Council Tax

*Q1. To what extent does the current system of council tax deliver a fair and effective system of local taxation in Scotland? Are there any features of the current system that you wish to see retained or changed?*

- 3.1 The current system of Council Tax has the following features: a broadly regressive nature (by reference to the tax base) (by way of example we reproduce the Council Tax bands for Edinburgh Council for 2015/16 at Appendix 1); a slab system; a property base although the tax is partly based on occupation; the household is the taxable unit; no direct relationship with the ability to pay; no direct link to services used; it makes allowances for certain household circumstances through its systems of exemptions and through Council Tax Reduction; it also meets the principle of legal certainty.
- 3.2 Council Tax is income-regressive in so far as it affects persons on low incomes who are not entitled to Council Tax Reduction. In addition, it is not particularly wealth-progressive in that its progressiveness is capped at the highest band. Within each band, it is also regressive by reference to the value of the properties to which it applies. It would be possible to amend Council Tax to make it more progressive. This could be done by taking the following steps: review the banding of properties; revalue property regularly; add more bands covering the entire value scale; apply rates of tax to each band rather than one flat sum based on banding. Such changes would mean Council Tax better reflected the value of the property.

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<sup>6</sup> The amount of Council Tax that households pay depends on their band (A to H), which is based on the value of the property in 1991.

- 3.3 One possible alteration to Council Tax, depending on policy objectives in relation to housing, would be to base it on ownership rather than occupation or to retain the occupation basis, but not to allow discounts for empty properties and second (holiday) homes, unless certain criteria were met meaning the property could not be occupied, for example the property is undergoing renovation, in the process of sale following the death of the owner, the owner is in hospital or a nursing home.
- 3.4 Since Council Tax is a property tax, it does not easily meet the principle of convenience, although this is mitigated in part by the fact that payment can be spread over the year. In terms of efficiency, Council Tax is fairly straightforward to operate and as the system is already established, a reform of Council Tax would result in no set-up costs.

#### 4 Reform of Local Taxation

*Q2. Are there alternatives to the current system of council tax that you think would help to reform local taxation in Scotland? What are the main features of these, and why do you think they would deliver improvement?*

- 4.1 There are a variety of possible alternatives for local taxation. In this response we consider some of the possible systems of taxation, including those based on property/land, income and consumption as well as a per head charge (poll tax). Whether any particular option should be adopted will depend on the policy objectives of the Scottish Government. In all cases, we think it is important to consider the interactions with other taxes, tax credits and benefits, whether the unit of taxation should be the individual or the household, the size of the tax base, how and by whom the tax should be administered,<sup>7</sup> what relationship (if any) the tax should have to the actual local services used and the knock-on effect on the household water and waste water (sewerage) charges.

##### *Land Value Tax (LVT)*

- 4.2 An LVT could be chargeable on the owner of any land, or the occupier (like Council Tax), whether owner or tenant. If chargeable on the owner of a rental property, it is likely that tenants would have to pay higher rentals, as owners would probably try to pass the cost of the tax on. It is likely that those on lower incomes would be compensated, at least to some extent, by Housing Benefit.
- 4.3 An LVT could operate as a tax on the rental value of the bare land – this would require a system for ascertaining such rental values and these would require regular review. Determining land values would probably be difficult, since most domestic transactions concern property, rather than land. An LVT would not in itself take a holistic view of the ability to pay, although it could move towards this by taking account of encumbrances on the land, such as a mortgage. In addition, if similar plots of land are developed in different manners, they would still attract the same LVT, and thus again, the LVT might not reflect ability to pay. The Mirrlees Review considered the question of an LVT.<sup>8</sup>
- 4.4 An LVT might have an effect on behaviour, for example, it might deter the practice of land

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<sup>7</sup> For example, if a local tax is used to fund local services, should it be collected by the appropriate local authority?

<sup>8</sup> Chapter 16 of Tax by Design – Mirrlees Review (September 2011):  
<http://www.ifs.org.uk/uploads/mirrleesreview/design/ch16.pdf>

banking. The impact of an LVT on different types of area in Scotland would need to be considered, for example, the effect on rural areas compared with urban areas.

- 4.5 Like Council Tax, an LVT struggles to meet the principle of convenience – however, partial mitigation would be available through payment by instalments as with Council Tax. An advantage of an LVT though is that, if the tax is payable by the owner of the land the payment system could allow for deferral of the tax, by making it a first charge on the land. Thus the tax would become payable on disposal of the land. A deferral system therefore could be used to resolve the issue of someone having high values of illiquid resources but a low income. In order that the local council did not lose the value of the money, there would need to be an interest charge. Nevertheless, a deferral system might create cash flow problems for councils.
- 4.6 It is likely to be relatively easy to adapt the system for collecting Council Tax to one for the collection of an LVT, which may assist in meeting the principle of efficiency.

#### *Local Income Tax (LIT)*

- 4.7 A LIT would be aimed at basing the local tax liability on the ability to pay. However, an income tax system tends to be a relatively blunt instrument and on its own does not truly measure ability to pay, because it takes no account of any resources other than income. By investing in non-taxed resources, the potential taxpayer can avoid income taxes. Examples of other anomalies that can make a LIT less progressive include: the lack of recognition of dependants; the lack of recognition of the income split between members of households and their ability to use personal allowances. A question must also arise as to whether the progressivity of a LIT might be compromised by having more than one tax authority take a view on the same measure ie income. In order to make a LIT progressive in nature, it is arguable that it should be based on income after tax, ie net income, not gross income.
- 4.8 For a LIT, it would be necessary to consider who would be liable to the tax and whether it would be based on individual or household income. It would probably be simpler to base a LIT on an individual's income. The definition in the Scotland Act 1998 should probably be the starting point in determining who is subject to a LIT, but some amendments would be needed to take account of differences between a national income tax and a LIT.<sup>9</sup> In particular, it would be questionable to regard a person as a Scottish taxpayer for LIT purposes for the whole of a year if for a substantial part of the year they were resident outside Scotland and paid Council Tax (or its equivalent) to another authority. The interaction with Council Tax for those moving to and from Scotland during a tax year would probably lead to some complexity. There would also be issues to resolve for people coming to Scotland from overseas and leaving Scotland to live overseas.
- 4.9 It would be necessary to consider to which types of income a LIT would apply. Ease of administration would tend to suggest that the same tax base (including allowances, deductions and reliefs) as for national income tax should be used. Exclusions of certain types of income can cause problems for several reasons – increased opportunities for avoidance; a need for clear definition; a lack of neutrality; inadvertent incorrect payments; higher costs of administration; increased complexity; and reduced reflection of the ability to pay.
- 4.10 One of the key issues for a LIT (as with any local tax) will be its administration and collection.

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<sup>9</sup> HMRC have to identify Scottish taxpayers for the purposes of the Scottish Rate of Income Tax (SRIT); it would be complex for HMRC to have to also identify to which local authority an individual owes a LIT. It should be noted that for SRIT, someone will generally be a Scottish taxpayer for a complete tax year.

An administration system needs to include compliance activity (including checks and sanctions), collection enforcement, settlement of disputes (both via judicial proceedings and outside the courts), tax avoidance measures, and safeguards for taxpayers. In terms of collection, there are probably two main options – central collection mainly at source by HMRC via PAYE and self assessment; direct collection by local councils (as currently for Council Tax) or perhaps by HMRC or Revenue Scotland. Which of these is more appropriate could depend on the nature of a LIT.

- 4.11 For example, if it operates as a few additional percentage points (set centrally) on top of basic rate income tax and uses the same tax base as national income tax, this is likely to add only a modest burden to administration in terms of collection. There might be further costs depending on how the LIT is shared between and distributed to councils.
- 4.12 If a LIT uses a different tax base to UK income tax, however, then it may be complex to integrate it into the PAYE and self assessment systems and difficult for employers (and pension payers) to administer, not to mention difficult for taxpayers to understand their liability, because of the separate calculation required. In addition, if each local council is able to set its own rate of LIT, this might be extremely burdensome for employers to operate. It may also not be cost effective for software companies to develop the software necessary to automate the collection of a LIT.
- 4.13 Individuals within the self assessment system pay some or all of their UK income tax liability after the end of the tax year. If Council Tax is collected under self assessment with UK income tax, councils may face cash flow issues, particularly in the year of transition from Council Tax to a LIT. Collection via PAYE and self assessment would probably not be particularly transparent, and there is perhaps a danger that a LIT would be perceived as a national tax. People need to see and understand what tax they are paying, to whom and why. If a LIT was collected via PAYE and self assessment, we think it would be imperative from an administrative perspective to restrict variations between a LIT and national income tax and also between LITs set by local councils.
- 4.14 Collection by local councils could well be more expensive, but it might encourage accountability. Local administration might support the perception that a LIT is a local tax, rather than simply another national tax. It could also avoid potential PAYE complexity. Direct collection of a LIT would mean that the tax base could be different from that for national income tax, if desired, without creating complexity for PAYE and payroll systems. It would also allow for more local divergence: councils could set their own rates, for example. We set out a possible alternative for the collection of a LIT in our response to the 2008 consultation.<sup>10</sup>

#### *Environmental Taxes (ETs) and Consumption Taxes (CTs)*

- 4.15 ETs could be based on actual emissions and/or waste generation; CTs could be based on use of local services.
- 4.16 Both ETs and CTs may be regressive. For example, a family with a young baby may generate more waste. They might also have a disproportionate impact on vulnerable groups, for example older people may generate more emissions through greater use of heating appliances. People with disabilities, young families and those on low incomes may make more use of local services, since these include social services typically provided mainly to people of low means. It

<sup>10</sup> We refer to section 9.12 of the CIOT response, which is available on our website: <http://old.tax.org.uk/attach.pl/7048/8344/ScotlandFairerLocalTax%20final170708.pdf>

might be possible to make a system of CTs more progressive, by having them weigh more heavily on luxury items than on necessities. Alternatively, it might be possible to compensate those of low means via tax credits and/or benefits – this would be less likely to distort the system.

- 4.17 ETs are ideally used with the aim of altering behaviour rather than raising income. If a household or individual is able to reduce the amount of tax they pay by altering their behaviour, a local taxation system of ETs could create a very insecure source of revenue. There might also be unfortunate indirect consequences, such as an increase in fly-tipping.
- 4.18 ETs and CTs are likely to meet the principle of certainty, and the system of collection and administration could probably fit in with existing charging systems, making them relatively efficient. For example, each provider of goods or services subject to the tax could account for the tax to the local authority in which it is situated, regardless of where customers/users come from.

#### *Per Head Charge (PHC)*

- 4.19 A PHC would essentially be a flat rate charge on all adults in Scotland – a tax per head of population. Each council would be able to set its own rate or charge. This has previously been used, most recently (and unsuccessfully) with the community charge (the ‘poll tax’).
- 4.20 An issue with all adults paying an equal flat rate charge is that this would not take into account ability to pay. The community charge utilised the electoral roll as a basis of identifying those liable to the charge, meaning it was possible to avoid payment by removing oneself from the electoral roll. This meant collection of the tax was often difficult. The experience of the community charge demonstrates that the perception of a tax and the ability to collect it efficiently can be important factors to consider.

#### *Hybrid Local Taxation System*

- 4.21 A hybrid system of local taxation could attempt to ensure that all resources are considered, but even a hybrid system is likely to ignore necessary outgoings and dependants. It is unlikely to reflect fully the ability to pay, although it may come closer to doing so than a single tax.
- 4.22 There are a variety of options for a hybrid system. We suggest a few below, but the list is not intended to be comprehensive:
- use the Scottish Rate of Income Tax (national tax) alongside a reformed Council Tax;
  - combine a LIT with a property tax (all properties) or a tax on vacant properties/second homes;
  - combine an LVT or property tax with CTs/ETs;
  - combine a LIT with a property tax and CTs/ETs;
  - combine a property tax with CTs/ETs and a per head charge.
- 4.23 A hybrid system that consists of both a LIT and a property tax may ostensibly take into account a person’s wealth as well as their income, and may therefore be considered to be a good measure of the ability to pay. It should be noted however that a property tax only takes into account one particular type of wealth. To impose a combination of an income tax and a wealth tax on one taxpayer but to use only income tax on another who may have other assets (but not property) would probably be no better than a single tax option at taxing according to ability to pay.

- 4.24 One issue that may need to be addressed under a hybrid system of local taxation is how to deal with second homes, holiday homes and vacant properties.<sup>11</sup> The decision as to how to tax these will need to look to general housing policy in Scotland and take into account likely behaviours that may stem from those decisions. If a decision is taken to tax such properties, it may be appropriate to offer exemptions or discounts in certain circumstances, for example where the house is undergoing renovation works or where the owner has died and the heirs are in the process of selling.
- 4.25 In terms of administration and collection, a hybrid system of local taxation is likely to be more complex and expensive than a system based on one tax. It might also involve more than one collection authority, for example both HMRC and the councils for a system combining a LIT and a property tax – this could be confusing for the taxpayer. In addition, a hybrid system might be perceived as making people pay more, whether or not that is actually the case, and therefore might not be well-received by the general public. Communications in respect of a hybrid system would therefore be key.

## 5 Local Priorities

*Q3. 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?*

- 5.1 Accountability seeks to ensure that taxpayers have the ability to choose who sets the charges and so, if they are unhappy with levels of taxation, they can vote them out. It follows that for there to be true accountability, it is necessary to identify the extent to which the local council has control over expenditure and also the extent to which it is capable of raising the income needed to meet controllable expenditure.
- 5.2 Funding for local government comes partly from central sources, and partly from local taxation in the form of Council Tax and business rates.<sup>12</sup> There is probably little understanding of the relative proportions of such funding among the general population and hence room for improvement in terms of accountability.
- 5.3 This is a complex issue that is not within the scope of the CIOT's expertise so we do not discuss it further but it is important to note that before there is a decision on what to do about taxation, there needs to be a policy decision on what can be expected of local authorities as tax collectors.

## 6 Further Information

*Q4. We would like to keep the conversation going. Please tell us about any events, networks or other ways in which we could help achieve this.*

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<sup>11</sup> Houses to let are not 'second homes' as such and arguably should not fall within the provisions of any tax on second homes, holiday homes or vacant properties, even when vacant for spells between lets.

<sup>12</sup> A paper by Fiscal Affairs amalgamates capital and revenue funding, showing that Council Tax formed 12% of total local government revenues for 2013/14: <http://fiscalaffairsscotland.co.uk/wp-content/uploads/2015/03/Local-Government-Funding-Challenges-March-2015.pdf>.



6.1 No comment.

## **7 The Chartered Institute of Taxation**

7.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 17,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation  
3 July 2015

## Appendix 1

### *Ability to pay - examples*

- A person can be asset rich and income poor (X) – how do you measure their ability to pay, and how do you compare their position with that of someone who currently has high income but is asset poor (Y)? Do you measure person X's ability to pay solely on income? If so, would it be fair for person X not to pay local tax while person Y does? Is it fair that X can then effectively pass the benefit of not paying to his or her heirs, while Y has nothing to pass on?
- The distribution of income may be such that two couples earning identical aggregate incomes may pay different amounts of tax – couples A and B both earn £50,000. The spouses in couple A earn £25,000 each, whereas in couple B, one spouse earns £50,000, the other earns nothing. Couple A is able to make use of two personal allowances, paying income tax on only £28,800 ( $50,000 - (10,600 \times 2)$ ); couple B can only make use of one personal allowance and thus pays income tax on £39,400 ( $50,000 - 10,600$ ).
- How do you compare two people with the same level of income and the same level of wealth, but where the sources of income and the assets are different? For example, person J has earned income and his assets consist of business investments; K on the other hand has investment income and her assets consist of a valuable residential property and tax-free savings.

### *Council Tax*

The table below shows the Council Tax bands for Edinburgh Council for 2015/16. The final column, rate of tax/£1,000, is based on the upper level of each band – the marginal rates on additional value will vary. It will be seen that, if a house is valued at £28,000, the rate of tax paid on the extra £1,000 over Band A is £129.89.

<b>Band</b>	<b>Property values</b>	<b>Council tax £</b>	<b>Rate of tax/£1,000 £</b>
A	Below £27,000	779.33	28.86
B	£27,001 to £35,000	909.22	25.98
C	£35,001 to £45,000	1,039.11	23.09
D	£45,001 to £58,000	1,169.00	20.16
E	£58,001 - £80,000	1,428.78	17.86
F	£80,001 to £106,000	1,688.56	15.93
G	£106,000 - £212,000	1,948.33	9.19
H	Above £212,000	2,338.00	