devolve
Scotland's Centre for Devolution Research

SUBMISSION

WRITTEN EVIDENCE TO THE COMMISSION ON LOCAL TAX REFORM

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Summary of recommendations:

- A property based tax is the most appropriate for financing local government;
- The Council Tax should be retained, but possibly re-named;
- Two additional bands should be created below the present Band D, another should be inserted between the present Bands D and H, and another 'mansion' band above present Band H should be created.
- Ratios should broadly correspond to the property values in the Band;
- A re-valuation of all properties should be carried out as soon as possible;
- A system of periodic and/or rolling valuations should be provided for by statute;
- A system of deferral should be introduced to mitigate the effects of tax rises on certain taxpayers;
- Revenue streams for local government should be diversified.

The author would be more than happy to answer any questions the Commission might have, and to provide further evidence, either in writing or in person, should the Commission so desire it.

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About Devolve

Devolve is a new think-tank drawing together expertise from academics in the fields of political science, law, and economics. Our guiding principles are subsidiarity, democracy, and empowerment. Our aim is to make a substantive contribution to the formation of public policy in Scotland; to inform policy-makers and the public; and to advance the state-of-the-art in the study of devolution.

This evidence precedes our formal launch later this year, and much of the research is primarily drawn from our forthcoming report on local government finance in Scotland.

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INTRODUCTION

That the Council Tax is unpopular should come as a surprise to no one. One reason for this unpopularity might be that Council Tax – like most property taxation – is highly visible. 86% of all Income Tax is collected through PAYE[1], with National Insurance Contributions (NICs) being similarly collected at source. Value Added Tax (VAT) is not a 'payer pays' tax from the perspective of the consumer. For most people, therefore, the Council Tax is one of the few taxes they are asked to pay personally. This, according to Mirrlees[2], can cause people to overestimate its importance. Another possible reason for the unpopularity of the Council Tax is that it is not buoyant – it does not rise automatically year-on-year. It is therefore necessary for local authorities to announce increases in the amount of tax they require people to pay in a way that is not necessary with, say, Income Tax (the amount people will have to pay will automatically increase when their earnings increase). A third reason might be that it is very definite, and allows people to make easy comparisons with the circumstances of others to determine whether or not they are getting a good deal. There's a very strong likelihood that someone will know how much their neighbour pays in Council Tax – however Income Tax payments remain largely private. Finally, there is evidence that suggests that people consider a tax that is levied according to assets, and not income, is unfair.[3]

This is not a uniquely Scottish phenomenon - property taxes are often highly unpopular. Hayashi describes property taxes as being 'one of the most hated taxes in the United States'[4], while the introduction of such a tax in Ireland proved hugely unpopular. Nonetheless, despite their unpopularity, such taxes are a common instrument for financing local government services.

[1] 2013-14 figure, HMRC, 'Tax Receipts and National Insurance Contributions for the UK' (20 March
[2] James Mirrlees, *Tax By Design* (IFS 2011) p383.
[3] Michael Lyons, *Lyons inquiry into local government: final report* (HMSO, 2007).
[4] Tax Foundation, 'Property Taxes and their Limits' (*Special Report No. 166: How do American feel about taxes today?*, 2009) <http://taxfoundation.org/sites/default/files/docs/sr166.pdf > accessed 23 February 2015.

Conceptually, almost every form of taxation could be used at a local level. However the prevailing international tendency is for sales taxes, income taxes, and property taxes, as well as services charges, to be used as an instrument for local taxation. The EU-mandated system of Value Added Taxes precludes the use of sales taxes at anything other than a national level. The remaining options for local taxation primarily includes local income taxation, property taxation, and service charges (including a poll tax).

The Council Tax is an unusual hybrid of these three options. It is in part a tax on property insofar as the liability to charge varies in accordance with the value of the property you occupy. It is in part a poll tax because it doesn't vary very much. And it is in small part an income tax insofar as the income level of the taxpayer is reflected in the availability of Council Tax Benefit to low earners.

PART I: LOCAL TAXATION AND LOCAL ACCOUNTABILITY

Local taxation greatly enhances local accountability, by compelling local authorities to justify its spending choices to the electors from whom they raise revenue. Where the levels of expenditure bear little correlation to levels of taxation, invariably, the link between decisions of voters and decisions of representatives will be weakened. That is not to say that absent revenue raising powers bodies will lack any accountability.

While the Burt commission was firmly of the opinion that the existence of local tax-raising powers is an essential element of accountability,[5] their report cited the Scottish Parliament and Executive as evidence that fiscal autonomy is not necessary for a body to be accountable. However, the report qualifies this conclusion, adding that '[s]hould the case for fiscal reform for the Scottish Parliament become compelling, then we accept that with it might come a stronger argument in favour of tax-raising powers for local authorities.'[6]

Given that fiscal autonomy has been the central issue in consideration of further devolution - with accountability frequently cited as one of the main reasons for such devolution[7] - then it is submitted that the Burt Commission's qualification has been met. There is a logical inconsistency in; on the one hand, seeing fiscal autonomy as essential for the accountability of the Scottish Parliament and Government, but not so necessary where local government is concerned.

As Layfield notes, we have not yet decided how much local autonomy we actually want. The effluxion of time appears to have done little to clarify this. There appears to be a considerable appetite in Scotland, generally, for both greater local autonomy as well as greater redistribution. However, there is a tension inherent in these two positions.

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[5] Sir Peter Burt, *A Fairer Way* (Local Government Finance Review Committee, 2006), p41.
[6] *Ibid.*
[7] Smith Commission, 'Report of the Smith Commission for further devolution of powers to the Scottish Parliament' Edinburgh: Smith Commission.

Local authorities possessed of only a single autonomous revenue stream are comparatively unusual in an international context. Local government in Japan has control over income, sales, and business taxes; as well as, *inter alia*, taxes on motor vehicles, tobacco, and hot springs. The Mayor of New York has at his disposal four major taxes - on property, personal and corporate income, and sales - as well as a litany of smaller taxes and duties. While a hot-tub tax might not be the most fruitful source of revenue for Scottish local authorities, the availability of such options, according to Hambleton, compares favourably with the UK,

> where the council has only one tax - generating a small fraction of revenue spending. And, incredibly, even that is subject to capping by central government. Effective local leadership cannot be expected to proper in such a constrained setting.[8]

It was noted in the introduction to this paper that the Council Tax is a highly visible tax. The Community Charge was designed to allow taxpayers to make easy comparisons between themselves and residents in other authority areas. The fact that such comparisons are also quite easy with respect to the Council Tax is no mere accident. The use of Band D properties as the benchmark seems to confirm this. This might explain why in the 15 years that Councils were setting their own Council Tax rates very little variance emerged between them. It appears that a degree of gaming may have taken place between authorities, with local government in Scotland behaving much like an oligopoly. Rather than competing with each other to levy the lowest Council Tax – as Margaret Thatcher envisaged would happen under the Community Charge – local authorities appear to have done quite the opposite. If this was indeed the case, then the discretion enjoyed by local authorities in setting their own Council Tax is actually quite limited.

In any case, the discretion that authorities had over their rate of Council Tax has been effectively eliminated by the Scottish Government's Council Tax Freeze policy. Since the SNP came to power in Scotland in 2007, Council Tax has been

[8] Robin Hambleton, 'Modernising political management in local government' 37 Urban Studies 931.

frozen at 2007 rates across all local authorities. Though initially intended as a temporary measure, before the abolition of the Council Tax and its replacement with a local income tax, eight years on there appears to be little sign of an end to the Council Tax Freeze. The effects of this policy are obvious: local government taxation and expenditure prescribed almost entirely by central government; with the amount of real-terms revenue being raised by authorities gradually being eroded by the effects of inflation.

Fairness

One of the most frequent criticisms of the Council Tax in political discourse is that is it 'unfair'. However, there appears to be little commonality as to what critics of the Council Tax consider to be 'fair'.

Historically, two competing theories have monopolized discourse on a community's justification for levying taxes: the benefit theory; and the ability-to-pay theory.

The justification for the ability-to-pay theory is usually based on some form of sacrifice. Kendrick proposes three forms of sacrifice theory: the equal sacrifice theory; the proportional sacrifice theory; and the least-sacrifice theory.[9] Such theories can be said to be communitarian – through our personal loyalty to a political community, we are obliged to make a form of sacrifice for the benefit of that community.

Under the befit theory of taxation, a state's jurisdiction to tax is justified as being a *quid pro quo* exchange for benefits received from the state. While Mr Justice Holmes' now famous refrain, 'taxes are what we pay for civilized society',[10] is perhaps the most famous espousal of what Dodge describes as a contractarian principle of taxation;[11] it is most certainly not the first. Mill conceived a theory of

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[9] M. Slade Kendrick, 'The Ability-to-Pay Theory of Taxation' 29 *American Economic Review* (1939) 92.
[10] Mr Justice Holmes (dissenting), *Compania General de Tabacos v Collector* (1927) 275 U.S. 87, at 100.
[11] Joseph M. Dodge, 'Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability-to-Pay Principles' [2005] 58 Tax L. Rev. 399.

taxation based upon specific benefits any particular person received from the state[12], although he discounted such a theory on the basis that it would likely result in the poor paying more than the rich. This theory, however, rested upon a narrow definition of benefit.

Modern understandings of the concept of benefit are altogether broader. The benefit received from the state is not defined, nor particularly quantifiable. Here, the benefit includes the maintenance of a system of laws and norms that facilitates the individual's economic wellbeing.[13] This broad definition of benefit legitimizes, as Dodge describes,

> not only taxes, but also government and civil society itself. Here the concept of benefit binds taxation to the core role of government. Crucially, the benefit concept is here diffuse, indivisible, and nonallocable, as opposed to being an aggregation of assorted government activities and programs that inure differentially to various taxpayers and groups thereof.[14]

Both of these approaches to taxation are evident in discussions on local taxation. Margaret Thatcher considered the Rates to be grossly unfair. Her motivation for scrapping them is said to have been inspired by the plight of the 'old ladies of Morningside living in six-bedroomed family houses who had no children at home and only had their bins emptied once a week.'[15] As a tax on property ownership, her Ministers saw little that was just in concentrating the financing of local services in the hands of a comparatively small number of people who consumed very little in the way of local services. It certainly did not sit well with Thatcher's desire to encourage a 'property owning democracy'.[16] Her solution to this was a poll tax. The rationale behind this poll tax was along the lines that as most people, regardless of the size of their properties or levels of income, consumed roughly the same amount of local services, they should all

[12] John Stuart Mill, *Essays on some unsettled questions of political economy* (JW Parker 1874).
[13] Deborah A. Geier, 'Time to Bring Back the "Benefit" Norm?' [2004]33 Tax Notes Int'l 899.
[14] *Supra* note 10, 402.
[15] Butler, et al., *Failure in British government: the politics of the poll tax* (OUP 1994) pp. 63-64.
[16] Amit Ron, 'Visions of democracy in 'property-owning democracy': Skelton to Rawls and beyond' 29 History of Political Thought 89.

contribute equally to the provision of these services. Everyone paying equally for services consumed roughly equally was, in the mind of Thatcher, fair. This conception of fairness corresponds considerably to the benefit theory of taxation - albeit with a somewhat narrow definition of benefit.

History recalls that large swathes of the population did not agree with Margaret Thatcher's conception of fairness. Public discontent over the Community Charge was remarkable - inciting levels of public unrest seldom seen in British society. The source of their disquiet over the Community Charge was that it was, in their opinion, unfair. Under their conception of fairness, the charge was unfair because everyone paid the same, regardless of income – it took no account of individuals' ability to pay.

Upon John Major's accession to the Premiership, Michael Heseltine was appointed Secretary of the State for the Environment, with a special mandate to formulate a replacement for the Community Charge, and to do so quickly. Heseltine had to balance the concerns of those who, on the one hand, felt that the burden of financing local services fell disproportionately on a few people who consumed very little of them; with those who felt that the tax should take account of the means of the payer. The result was the Council Tax compromise.

Intuitively, a tax based on the value of the property you occupy should correspond considerably to means. This seems obvious – people with more money live in nicer houses than people with less money. However, at the same time, an unlimited tax based solely on the value of your property would suffer from the same defect that many saw in the rates – that the burden of financing local services would fall far more heavily on a relatively small number of people. To those who favoured the benefit approach to taxation, this was unfair. A degree of banding and capping was therefore deemed necessary in order to flatten the progressivity of that tax. The effect of this banding is that, before the application of Council Tax Benefit, people in lower income groups pay more as a proportion of their income in Council Tax than higher income groups. Relative to income, the Council Tax is regressive.

Residence as a suitable basis for local taxation

At an international level, we allocate the jurisdiction to tax employment income, for example, to the jurisdiction in which the income is earned.[17] If that principle were to be applied to domestic taxation at a local level - and it is arguable that there is no good reason why it shouldn't - then local income taxes should be payable in the local authority in which you work, rather than the local authority in which you reside.

However, most people's consumption of local services takes place not where they work, but where they reside. This is, of course, not universally and unequivocally the case. Obviously, non-residents who work in a local authority area still benefit from the provision of public roads and footpaths, cleansing and environmental services, and an economic climate to which local government undoubtedly contributes. In addition, it is increasingly common for parents to seek to place their children in schools located closer to their place of work than their place of residence, however this remains extremely limited.

Furthermore, if one of the primary justifications for local taxation is local accountability then taxation anywhere other than at the place of residence makes little sense. With the exception of elections to the City of London Corporation, and Business Improvement District (BID) referendums, voting franchises in the United Kingdom are based entirely upon individuals in their place of residence.

Therefore, if taxation of income makes most sense in the place it is earned, and local taxation makes most sense at the location of residence, income appears to be an entirely unsuitable basis to tax at a local level. This leaves property taxes and consumption taxes as suitable potential candidates for local taxation.

[17] On the basis that the jurisdiction which supplies the employment should have the right to tax it.

Council Tax in the context of the tax system

It is a generally accepted principle of tax optimisation theory that efficient tax systems favour a broader base with a lower rate over a narrow base with higher rates.[18] The rationale is that lower rates reduce incentives to alter behaviour, while a broader base reduces opportunities to gain a tax benefit from altering behaviour. In this respect, poll taxes are the least distortive and most efficient form of taxation, however, for reasons that are obvious this paper does not advocate a return to any such system.

Property taxation is a useful tool for broadening the tax base. At present, a number of taxes on property presently exist in the UK. These include Capital Gains Tax, Stamp Duty Land Tax, Inheritance Tax, and Council Tax. However, with the exception of Council Tax, all of these taxes require some kind of transaction to take place.[19] The Council Tax is, therefore, the only tax on static property presently in operation in the UK.

[18] W. Bradley Hilreth and J.A. Richardson, *Handbook on Taxation* (CRC Press 1999) p.23.
[19] It should be noted that certain trusts are liable to a charge to Inheritance Tax on the total value of relevant trust property every ten years, s.66 Inheritance Tax Act 1984.

PART II: OPERATION OF THE COUNCIL TAX

Legal basis for the Council Tax

The legal basis for the Council Tax in Scotland can be found in Part II of the Local Government Finance Act 1992 (hereafter 'the Act'). The tax is payable in respect of dwellings,[20] and the incidence of the tax falls primarily upon occupiers of dwellings under s75 of the Act. The Council Tax (Liability of Owners) (Scotland) Regulations 1992 (as amended) prescribe a number of circumstances in which owners, and not occupiers, of properties will be liable to pay the Tax.[21] The tax is chargeable daily, and is only payable by the occupiers on those days in which they occupy the property. A discount of 25%, or a percentage specified by the Secretary of State, is to be applied to properties with a single chargeable occupier. Persons are to be disregarded for the purposes of the discount where they are prisoners or certain other detainees, severely mentally impaired, children, students, patients of hospitals or care homes, carers, and homeless persons in temporary accommodation.[22] Further discounts are available under the Council Tax Reduction (Scotland) Regulations 2012.

The first step in calculating the tax is the determination of a property's value on 1 April 1991. s84 of the Act requires that the assessor for each council compiles and maintains a valuation list showing each dwelling existing in the local authority's area, as well as the Council Tax band applicable to each dwelling.

The applicable valuation bands for the Council Tax are prescribed by s74. Dwellings are to be allocated into a valuation band ranging from the lowest band (A) to an unlimited top band (H). The Council Tax payable by properties in each band is in the proportion 6: 7: 8: 9: 11: 13: 15: 18 where 6 is Band A, 7 is Band B, and so on.[23] Local authorities, therefore, have no discretion over the progressivity of the Tax through the bands. Local authorities must then set an

[20] s.72 Local Government Finance Act 1992.
[21] Such circumstances include residential care homes, resident staff, and houses in multiple occupation (such as bedsits).
[22] Schedule 1.
[23] s74(1).

amount of Council Tax to be paid by dwellings listed in valuation band D[24] and then the amount of Council Tax payable by dwellings in each of the other valuation bands in accordance with the abovementioned proportion. Councils are required to set the Council Tax charge at a level that meets their estimated total expenditure for that financial year.[25]

The distribution of properties into the valuation bands across Scotland is as follows:

Table 1: Distribution of properties in Council Tax bands (Scotland)[26]

Band	Number of Properties	%	Ratio	Average Tax
A	545,549	21%	6	£766.00
B	596,594	23%	7	£893.67
C	410,733	16%	8	£1,021.33
D	336,404	13%	9	£1,149.00
E	336,888	13%	11	£1,404.33
F	189,753	7%	13	£1,659.67
G	121,348	5%	15	£1,915.00
H	13,241	1%	18	£2,298.00
Total	2,550,510	100%		

As can be seen from the above table, 60% of all properties are in the bottom three bands – where there is very little progressivity between the bands. The top three bands contain only 13% of properties, where the progressivity between the bands is somewhat steeper.

Because the bands are national[27] there is a considerable inequity between local authorities. For example, while 16% of all properties in East Renfrewshire are in band G (the second highest band); only 2% of all properties in neighbouring East

[24] s93(1).
[25] s93(3).
[26] Scottish Assessor's Association, 'General Statistics: Report 2' (2015) <http://saa.gov.uk/general_statistics.php?&REPORT_NAME=ct_band#report_list> accessed 7 April 2015.
[27] That is to say, the same bands are used in every local authority area.

Ayrshire are in band G. 46% of East Ayrshire's properties are in band A (the lowest band), but only 4% of East Renfrewshire's property are in that lowest band.[28]

Because properties were allocated to nationally applicable valuation bands, and the progression of the bands is prescribed by the Act, councils, in reality, enjoy very little autonomy over the Council Tax. Indeed, the only discretion local authorities exercise over the council tax is determining the charge to dwellings in valuation band D. The importance of this discretion should not be understated – as it directly affects both the tax burden on residents and the expenditure levels of the local authority. In England, the variance in Council Tax charges is considerable. The average Council Tax bill for a Band D property in Westminster in 2014 was £678, while the average bill for a Band D property in Kingston-upon-Thames is more than twice that, at £1,679.[29] By contrast, the highest Council Tax bill for a Band D property in the same period in Scotland was £1230.39 in Aberdeen City, while the lowest was £1024 in Eilean Siar.[30]

Until 2013, the Council Tax was accompanied by a welfare benefit – Council Tax Benefit (CTB) – in order to mitigate the effects of the tax on low-income households. As part of the Department of Work and Pensions' reforms to Britain's benefits system, the Council Tax Benefit was abolished to be replaced by the Council Tax Reduction. The Reduction is regulated by the Scottish Ministers and administered by local authorities, and no longer forms part of the benefits system. Individuals are entitled to apply for Council Tax Reduction

[28] *Supra* note 26.
[29] This variation can, in part, be explained by the distribution of properties into different bands – however the difference between the two authorities is not as stark as the differing tax rates suggest. See National Statistics, 'Council Tax levels set by local authorities in England 2014 to 2015 (revised) – Table 7' <https://www.gov.uk/government/statistics/council-tax-levels-set-by-local-authorities-in-england-2014-to-2015> accessed on 7 April 2015.
[30] It should be noted that Aberdeen City has one of the evenest distributions of properties across valuation bands in Scotland, while in Eilean Siar, the majority of the properties is concentrated in the lower three bands. Therefore, notwithstanding the similarity between the two authorities' Council Tax rates, the average bill per household in Eilean Siar is much lower in that authority area than Aberdeen City, as more properties fall into lower valuation Bands. See Scottish Assessors Association, note 28.

where they have little or no income[31] and do not have capital in excess of £16,000.[32] This follows, in part, the recommendation of the Lyons Inquiry that CTB should be replaced by a Council Tax Rebate.[33] However, contrary to Lyons' recommendation, the Council Tax Reduction is not automatic.

Progressivity of the Council Tax

The progressivity of the Council Tax can be assessed by two measures: progressivity to income; and progressivity to property value. Though there is often a correlation between property values and income levels, this need not necessarily be the case. The various stereotypes presented by political actors in public discourse about the Council Tax and its predecessors illustrate the tensions between these two measures of progressivity: the pensioner couple whose children have left their large family home, but have limited income; the family with four working adults residing in a modest family home. A tax that is progressive to property values would tax the pensioner couple more highly; a tax that is progressive to incomes would tax the household with multiple incomes more highly.

Progressivity to Property Values

Properties in lower bands pay less Council Tax than properties in higher bands. This, on the face of it, appears to be progressive to property value. However, the rate at which the Council Tax increases as you progress up the bands is considerably smaller than the increases in the values of the properties in the bands. In this respect, the Council Tax is regressive – higher value properties pay much less Council Tax than lower value properties, relative to their respective values.

[31] Reg. 14(5), Council Tax Reduction (Scotland) Regulations 2012.
[32] Reg 42.
[33] *Supra* note 3.

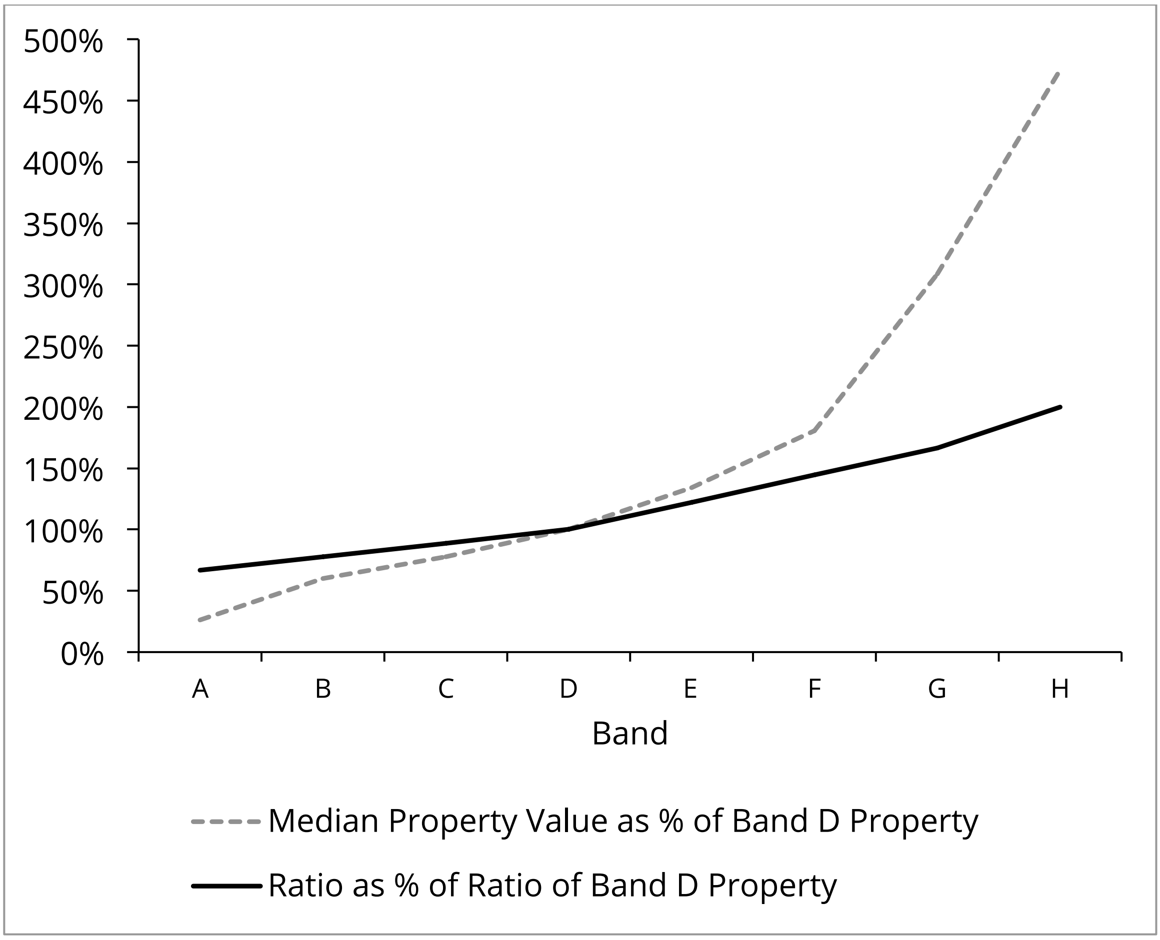

Figure 1: Progression of Council Tax ratios compared to assessed values in each band

The below table illustrates the regressive nature of the tax that is inherent in its design. The median value figure is the median assessed property price in each of the bands. As Band H has no upper limit, a notional median value was determined by adding the average of the difference between the lower limit and the median value for each band to the lower limit for Band H. The median property price in each band was then adjusted to 2014 values using the Halifax House Prices Index for Scotland. The Average Notional Charge on Value is the average Council Tax charge for each band expressed as a percentage of the Adjusted Median Value in each band. It must be stressed that the Adjusted Median Value might, in reality, bear little resemblance to the actual present market value of properties in their respective bands – this is a flaw inherent in a property tax system that is based upon 24 year-old valuations.

Table 2: Council Tax as a tax on property values

Band	Lower Limit	Upper Limit	Median Value	Adjusted Median Value	Ratio	Average Council Tax	Average Notional Charge on Value
A	£-	£27,000	£13,500	£30,122.93	6	£766.00	2.54%
B	£27,000	£35,000	£31,000	£69,171.16	7	£893.67	1.29%
C	£35,000	£45,000	£40,000	£89,253.11	8	£1,021.33	1.14%
D	£45,000	£58,000	£51,500	£114,913.38	9	£1,149.00	1.00%
E	£58,000	£80,000	£69,000	£153,961.62	11	£1,404.33	0.91%
F	£80,000	£106,000	£93,000	£207,513.49	13	£1,659.67	0.80%
G	£106,000	£212,000	£159,000	£354,781.12	15	£1,915.00	0.54%
H	£212,000		£244,643	£545,878.41	18	£2,298.00	0.42%

The most obvious flaw in the above data is with respect to the Band A and Band H properties – as they have no lower and upper limit, respectively. The steepness of the regression between Bands A and B can therefore be explained in part by the fact that very few properties will be completely worthless. Nonetheless, the regression of the Average Notional Charge on Value is quite apparent – with the effective tax rate on a property with an Adjusted Value of £69,171 being 1.29%, while the effective tax rate on a property with an Adjusted Value of £354,781 is 0.54%.

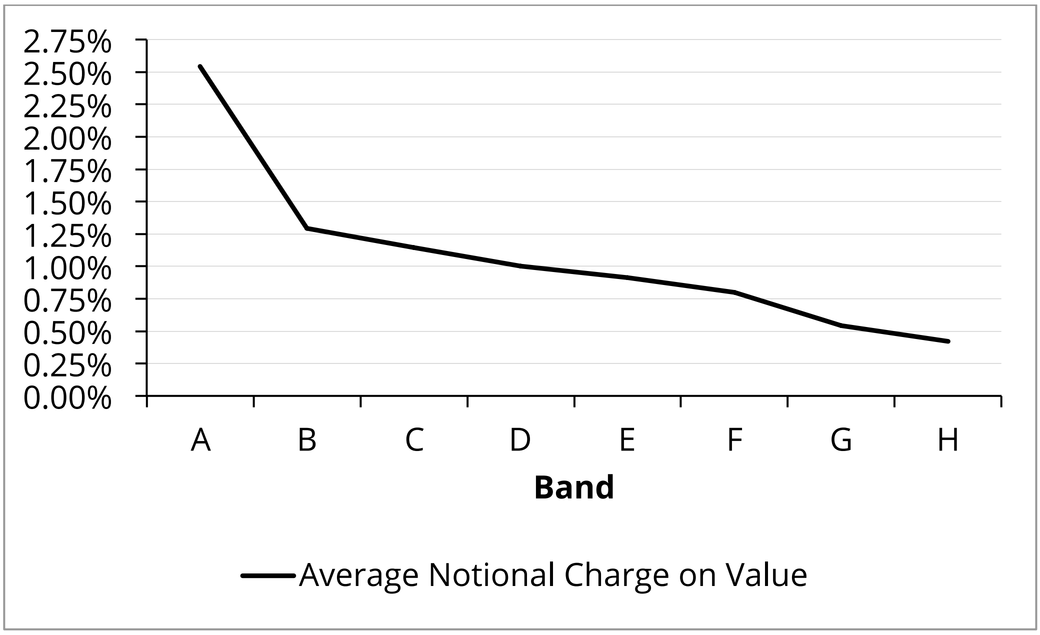

Figure 2: Regression of Council Tax rates as a tax on property values

Progressivity to Income

The incidence of the Council Tax is regressive to incomes. We have already seen how the Council Tax is relatively flat – the highest Council Tax bill in a local authority area can only ever be three times larger than the lowest. We have also seen how the overwhelming majority of taxable properties fall within bands A to D, with a Band A property being charged two-thirds of the amount a Band D property is to pay.

A year after its inception, Giles and Ridge analysed the progressivity of the Council Tax to income, compared to that of the Community Charge. They found that the Council Tax amounted to almost the exact same proportion of income in each decile group as the Community Charge – they were equally as regressive.[34] Sir Michael Lyons Inquiry into Local Government in England conducted a similar analysis over a decade later and reached similar conclusions – the Council Tax is highly regressive to income.[35]

However, there is considerable merit to the observation that '[p]rogressivity is best viewed as a characteristic of the tax system as a whole, rather than a property of each individual element of it.'[36] An even broader view of progressivity might also include consideration of benefits received from the state – at the very least cash benefits. The introduction of the Council Tax was accompanied by a new benefit – Council Tax Benefit – designed to mitigate the burden of Council Tax on those on very low incomes.

When both Giles & Ridge and the Lyons Inquiry took Council Tax Benefit into consideration, both reached similar conclusions – that the availability of Council Tax Benefit substantially reduced the burden of Council Tax on lower income groups. The Lyons Inquiry concluded that once Council Tax Benefit was taken

[34] Christopher Giles & Miles Ridge, 'Right This Time? An analysis of the first year's Council Tax figures' (IFS 1993) p21.
[35] *Supra* note 3.
[36] John Alexander Kay and Mervyn A King, *The British tax system* (Oxford University Press 1983), p139.

into account the burden of the Council Tax on each decile group was broadly similar.

This will likely come as little consolation to those who consider income to be the only measure of someone's means – however the author finds little sympathy with such a narrow view. As Kay and King argue

> income is a measure of taxable capacity, but it is not the only one, nor necessarily the best. Income, supplemented by information about housing consumption, may give a better guide to a household's standard of living than either of those variables alone.[37]

This reflects that intuitive point that wealthier people live in more expensive houses. This is borne out by evidence.

The Warwick Institute for Economic Research found that the number of owner-occupiers in higher Council Tax Bands (E to H) on low incomes amounted to only 2% of all owner-occupied properties.[38] The reality is that there is an overwhelming concentration of wealth in higher income groups. The Office for National Statistics recently found that the total wealth of people in the lowest 10% of earners was about 15% more than their total income, the total wealth of those in the top 10% of earners was 1100% that of their total income.[39]

That is not to say that the impact of the Council Tax on that small minority of people who are actually asset rich but cash poor should not be understated. The Warwick survey of owner-occupiers identified one interviewee who had to pay a £103 monthly Council Tax bill out of a net-weekly income of £123.[40] However, McLean argues that such persons should 'face the true cost of living in expensive houses.'[41] The Council Tax Reduction exists to mitigate the effects of the Tax on those who are both asset poor and on low incomes, while a litany of financial

[37] *Supra,* p149.
[38] Warwick Institue for Economic Research, *'Wealth rich but income poor'?: Council tax and the relationship between household income and property value* (University of Warwick, 2004).
[39] Office for National Statistics, *Wealth and Income, 2010-12* (ONS, 2014).
[40] *Supra* note 37.
[41] Iain McLean, 'Can local taxation be progressive?' 12 Public Policy Research 111.

products exists to allow people to generate income from their assets (discussed below). The taxpayer should not be in the business of subsidising inheritance.

PART III: REFORMING THE COUNCIL TAX

It is increasingly apparent that local taxation based upon property values is the most suitable. On this basis, there is nothing inherently wrong with the Council Tax – its defects are in its operation and structure. However, there exist a number of options that can go some considerable way to addressing these defects.

If the Council Tax is to be retained, there are a number of reforms that could be introduced to address some of the flaws in the present system. These reforms are concerned with the allocation of properties into bands, and the ratios applicable to those bands; the process for determining the value of properties; and reliefs that ought to be available.

Banding and ratios

The distribution of bands is clearly designed to reflect the value of properties, and not the number of properties within them. As Table 1 shows 60% of all properties fall within the lowest three bands, A, B, and C. As the ratios applicable to these bands are 6, 7, and 8, respectively, it is quite apparent that for the overwhelming majority of properties there is very little difference in the amount of council tax they actually pay. This, undoubtedly, gives the impression that the Council Tax, in reality, bears a considerable resemblance to the Poll Tax. There is, therefore, a strong case for introducing more bands at the lower levels of the tax (that is, below those properties which presently fall within Band D).

There is, of course, a danger in introducing too many bands, especially at lower levels. This is because the more bands there are the narrower they will be. It follows that the narrower the bands are, the greater the likelihood that properties will be wrongly allocated. This was undoubtedly a concern in the initial setting of the bands, with the gap between the upper limits of bands A and B, and B and C, being £8,000 and £10,000, respectively. Were the bands to increase in increments much smaller than that, the scope for error greatly increases.

However, it is arguable that this is less concerning today. House price inflation has broadened the distribution of property values. As Table 3, below, shows the gaps between Council Tax bands broaden considerably when adjusted for house price inflation. The gaps between the upper limits of bands A and B, and B and C, once adjusted, are now approximately £18,000, and £22,000, respectively. It is therefore highly arguable that there is now scope for an additional two bands below what is presently Band D.

Table 3: Breadth of Council Tax bands, original and adjusted

Band	Lower Limit	Upper Limit	Gap	Adjusted Lower	Adjusted Upper	Adjusted Gap	Ratio
A	£-	£27,000	£-	£-	£60,246	£-	6
B	£27,000	£35,000	£8,000	£60,246	£78,096	£17,851	7
C	£35,000	£45,000	£10,000	£78,096	£100,410	£22,313	8
D	£45,000	£58,000	£13,000	£100,410	£129,417	£29,007	9
E	£58,000	£80,000	£22,000	£129,417	£178,506	£49,089	11
F	£80,000	£106,000	£26,000	£178,506	£236,521	£58,015	13
G	£106,000	£212,000	£106,000	£236,521	£473,041	£236,521	15
H	£212,000		£-	£473,041		£-	18

Furthermore, in recent years a number of parties have proposed additional taxation on very high value properties – a so called 'Mansion Tax'. Support for such a proposal has primarily been from the Labour Party and the Liberal Democrats. Although neither has provided much detail on how they would implement such a policy, it is understood that the Liberal Democrats' proposal would be to do so through the Council Tax system. If the Commission is minded to recommend a higher tax burden on very high value properties, then it is proposed that the simplest way to do so would be through the Council Tax system.

However, as can be seen from Table 1, the number of properties in Scotland that fall into Band H is very low – approximately 0.5% of all properties in Scotland. The number within Band H that could be classified as a 'mansion' (however defined, but presumably more specific than a mere Band H property) will be a smaller number still. Furthermore, it is likely that that those properties that could be classified as 'mansions' would be concentrated in a very small number of local authority areas. It is unlikely, therefore, that many more bands above H would raise very much extra in the way of additional revenue. In reviewing its own system of Council Tax bands, the Welsh Government concluded that only one additional band above Band H was practicable. It is likely that the same is true of Scotland. However, the breadth of the upper bands leaves considerable scope for the introduction of additional bands between Bands D and H.

As the progressivity of the Council Tax is determined by the ratio assigned to each band, these ratios ought to be reassessed too. As Figure 2 illustrates, the Council Tax is presently regressive to property values. There will doubtless be some attraction in making the tax progressive to property values – that is to say that the effective percentage charge on value increases for higher value properties. This would be a highly radical approach and one that might well be met with considerable public disquiet. We therefore propose that a more acceptable compromise would be to construct the Council Tax as an effectively flat percentage charge on property value. The simplest way to do so is to assign each band a ratio that better corresponds to the value of the properties within it.

Table 2 illustrates the regressiveness of Council Tax relative to property value. The total notional revenue received from such a structure in 2014 is approximately £2.8bn. The actual revenue received was somewhat lower – approximately £2bn – with Council Tax reduction accounting for almost half of that shortfall, as well as various other reliefs and exemptions, such as for single occupants and students. Nonetheless, the £2.8bn figure provides a useful basis for comparison.

Table 4: Council Tax if ratios correspond to value

Band	Median	Adjusted Median	Ratio	Average Tax	Average Notional Charge on Value	Number of Properties	Notional Gross Revenue
A	£13,500	£30,123	2	£459.60	1.53%	545,549	£250,734,320
B	£31,000	£69,171	3	£689.40	1.00%	596,594	£411,291,903
C	£40,000	£89,253	4	£919.20	1.03%	410,733	£377,545,773
D	£51,500	£114,913	5	£1,149.00	1.00%	336,404	£386,528,196
E	£69,000	£153,961	7	£1,608.60	1.04%	336,888	£541,918,036
F	£93,000	£207,513	9	£2,068.20	1.00%	189,753	£392,447,154
G	£159,000	£354,781	16	£3,676.80	1.04%	121,348	£446,172,326
H	£244,642	£545,878	24	£5,515.20	1.01%	13,241	£73,026,763
							£2,879,664,474

As Table 4 illustrates, using a ratio that better corresponds to property values would substantially lower Council Tax bills in Bands A, B, and C, while the bills of properties in Bands F, G, and H would be subject to sizable increases.

Interestingly, this redistribution would notionally raise a little more revenue. However, as the Council Tax Reduction, *etc.*, fall primarily upon lower banded properties the actual revenue raised would likely be a good deal higher still. Were this a revenue-neutral exercise then this additional revenue could be used to reduce Council Tax for all bands. Alternatively, such a re-rationalising would provide welcome additional revenue for local authorities.

The measures proposed therefore are as follows:

- an additional two bands below Band D;
- an additional band between Band D and Band H;
- a further band above Band H;
- application of ratios that reflect the value of properties within each band.

Using the 1991 valuations adjusted for house price inflation, it is proposed that the structure of bands and ratios should be as follows:

Table 5: Proposed new bands and ratios

Band	New Lower	New Upper	Median	Ratio	Average Tax	Average Notional Charge on Value
1	£-	£60,000	£30,000	6	£574.50	1.92%
2	£60,000	£70,000	£65,000	7	£670.25	1.03%
3	£70,000	£80,000	£75,000	8	£766.00	1.02%
4	£80,000	£90,000	£85,000	9	£861.75	1.01%
5	£90,000	£100,000	£95,000	10	£957.50	1.01%
*6	£100,000	£120,000	£110,000	12	£1,149.00	1.04%
7	£120,000	£150,000	£135,000	15	£1,436.25	1.06%
8	£150,000	£180,000	£165,000	17	£1,627.75	0.99%
9	£180,000	£240,000	£210,000	21	£2,010.75	0.96%
10	£240,000	£470,000	£355,000	35	£3,351.25	0.94%
11	£470,000	£800,000	£635,000	60	£5,745.00	0.90%
12	£800,000	£-	£800,000	90	£8,617.50	1.08%

*Band 6 is the former Band D.

It should be noted that these bands are not based upon real present day values. Once real present day values have been determined it should be possible to better structure the bands to reflect actual values, however the broad distribution of properties would likely remain relatively similar. Finally, it is proposed that in any substantial re-banding the naming of the bands should be changed from letters to numbers. This is simply to avoid the perception that people have moved up a band, and that they might therefore have to pay more tax, when in fact their tax liability – as this paper proposes – would actually decrease.

Valuation

The discorrelation between Council Tax bands and present-day property values undermines the legitimacy of the Tax. The Lyons Report noted that 'an out of date tax base will mean that the credibility of council tax as a property tax will gradually be eroded.'[42]

There is a tremendous unwillingness amongst political leaders to update property values. Inevitably in any revaluation of properties there will be winners and losers – and the fear is that the losers will be more vocal than the winners. Mirrlees describes this as 'one of the most egregious demonstrations of the "tyranny of the status quo".[43]

The political hesitation to engage in a substantial revaluation is perhaps understandable when looking at Wales' experience. One third of properties were placed in a higher band, while only 8% of properties were assigned to a lower band. A fact that was pointed to by opponents of revaluation in England - and likely the explanation for the UK Government abandoning its plans to do so.

Increases in property taxes that arise as a consequence of increases in property values are almost always unpopular. This, as Hayashi points out, raises

[42] *Supra* note 3.
[43] *Supra* note 2.

something of a puzzle.[44] Individuals' liability to Income Tax increases when their income rises and yet doesn't provoke the same ire from taxpayers as an increase in their liability to property taxes. The most likely explanation is that the increase in the overall wealth of a taxpayer that results from an increase in the value of their property is not necessarily matched by an increase in available cash.

The effect of the system of bands in the Council Tax is that – except at the margins – minor differences in the value of property should not have any effect on tax liability. Of course, where no revaluation takes place, variations in the value of properties has no effect on the liability to tax.

Most properties remain in the same band to which they were assigned in 1991. Confidence in the accuracy of these valuations has been undermined over the years, with various reports of gross errors as a result of so-called "second gear valuations".[45]

The longer historical property valuations are relied upon the more detached from reality the Tax becomes. Furthermore, the longer revaluation is deferred the harsher the impact of such a revaluation will seem. We also find ourselves, every time a new house is constructed, engaging in the bizarre exercise of attempting to determine what the value of this house would have been in 1991. A system of periodic or even rolling revaluation is therefore desirable.

Periodic revaluation

The starting point for keeping the tax base up to date should be a system of periodic revaluation. There ought to be a statutory obligation upon authorities to update property valuations with a specified frequency. The appropriate frequency with which these revaluations should take place depends somewhat on whether or not a system of rolling revaluations is adopted as well (discussed

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[44] Andrew T. Hayashi, 'Property Taxes and Their Limits: Evidence From New York City', (2014) 25 *Stanford Law And Policy Review* 33.
[45] So called because, owing to the rushed nature of the Council Tax rollout, valuations were allegedly done in some instances by driving slowly around residential areas and ascribing valuations to properties on the basis of fairly cursory assessments.

below). More frequent revaluations will reduce shocks and lend to the impression that such revaluations are routine. Though the forthcoming revaluation has been postponed by two years, a five-year interval between revaluations is normal for Non-Domestic Rates. It may be, however, that domestic property prices do not vary as sharply – relatively speaking – as the rateable value of non-domestic property – and a longer interval may therefore be more appropriate. It is proposed that a ten-yearly periodic revaluation might be the most appropriate frequency.

Rolling revaluation

The only time we ever know the market value of a property is when it is sold. That is the nature of a market value. However, accounting for deemed transactions is a hugely commonplace practice for the purposes of taxation – often done so with far fewer open market comparators than exist with respect to property. We have available to us a far more sophisticated toolkit for measuring the value of properties than we did in 1991.

A system of rolling revaluations could be used in addition, or as an alternative, to periodic revaluation. Valuation bands could be published annually, adjusted for property price inflation. Where a property changes hands at market value – or some other determination of contemporary market value takes place – which property will be assigned to the applicable band for that financial year. Houses that increase in value in line with average prices would therefore not shift bands when their updated value is determined. However, where the change in the value of a property has been significantly higher or lower than the average change it may, therefore, be assigned to a different band to reflect its change in relative value.

The Land Register of Scotland has been fully operational across Scotland for over a decade, and in certain parts of Scotland for many more. Records of properties should include valuation index keys, outlining their features and characteristics, in order to make comparisons with others.[46]

The following process for updating property values between valuations is therefore proposed.

Base valuation

The starting point for any updated valuation ought to be the price paid for the property in a recent arm's length open market transaction. Where no recent transactions over the property have taken place, a recent independent and verified valuation for some other purpose (such as Inheritance Tax or mortgage application) might also be used. That failing, the most recent statutory valuation may be used.

Updating valuations

Properties vary in value for two reasons: either because of changes in the condition of the property; or because of changes in the prevailing market price in a particular area. Both of these variations are quite easily measurable. Once a base valuation has been determined, changes in the value of a property can be obtained by considering both improvements to individual properties, as well as the prevailing trend in the value of properties in the area.

Improvements or dilapidations

Property owners ought to be required to report substantial improvements or dilapidations made to the property. This should not include simple redecoration, or like-for-like replacements of fixtures and fittings, but of substantial enhancements to the property itself. This might include extensions and conversions, re-arrangement of internal configuration, installation of a conservatory, improvements to necessary services such as plumbing and wiring.

[46] For example, a three bedroom, semi-detached, two-storey house, with garage, of a particular area measured in square metres, with a particular size of garden. A property could reasonably be expected to have a similar market value to other nearby properties with all or most of the same characteristics.

Documentary evidence of the value of these improvements should be provided. The value of these enhancements is ultimately the amount by which these enhancements increase the value of the property. This should usually bear some considerable correspondence to the amount that a purchaser of a property would have to expend on making these enhancements themselves. Therefore, in most instances, the enhancement in value will be reflected in the cost of making these improvements – and documentary evidence as to the cost of the improvements would therefore be acceptable.

Irregular increase in market value

The value of properties in a particular area can increase sharply as a consequence of factors beyond the direct control of the property owner. This can include provision of new or improved local services and amenities, improvements in local school standards, and crime statistics. It is also entirely possible that prevailing social conditions could cause properties to increase in value rather more slowly than might be typically expected, or even decline. Where Land Registry data shows a change in property prices at variance with the prevailing trend in a particular area then valuations for properties should be revised accordingly.

Independent valuation

A final option that ought to be available to a taxpayer is to provide a verified independent valuation of their property by a Chartered Surveyor at his own expense. Invariably, this likely would only occur where a taxpayer feels that the value determined by one of the foregoing means was incorrect. It may well be the case, for example, that comparators used to determine property prices are inexact, or an open market price was, for some unrelated reason,[47] considerably higher than its normal market value would otherwise have been.

[47] A particular sentimental motive, for example.

Reliefs

There exists a wide range of financial products that allow owner-occupiers to liquidise the capital value in their homes – so called 'equity release schemes'. These products allow homeowners to receive either a cash lump sum and/or an income (usually by using the capital to purchase an annuity) in exchange for a share of the ownership of, or granting of a security over, their homes, all the while retaining a right to reside within the property.

It is arguable that such products suffer from the perception that they amount to "selling-off the family silver". Such products are usually marketed as a means to allow pensioners to make the most of their retirements, not to meet the burdens of an ever-increasing council tax. However, the alternative is for local authorities to forego large amounts of income from high value properties in order to satisfy their owners desire to live in these high value properties for their entire lives and (eventually) leave them in their entirety to their children.

Allowing pensioners to defer payment would be similar in effect to pensioners using equity release schemes to meet their council tax bills. Presentationally, deferral might not suffer from the negative perceptions attached to borrowing to meet present liabilities. Furthermore, for those local authorities that do not wish to absorb the immediate cost of deferral, financial markets could easily provide products to authorities in consideration of the eventual payment of such council tax liabilities. This amounts to, in effect, the council arranging for equity release over such properties, rather than the taxpayer.

There is no way of knowing how popular an option deferral might be. The fact that interest would have to be applied to any deferral would surely act as some incentive to pay bills as they become payable wherever possible. However, deferral would go some way to making it easier to defend the assertion that the Council Tax takes into account the taxpayer's ability to pay.

Other recommendations

It is also recommended that the revenue base of local government should be diversified. This would have the advantage of increasing the proportion of revenue local authorities raise autonomously, whilst simultaneously reducing the likelihood of "revenue shock" should a decline in their sole source of income occur.

Prospective candidates for further devolution to local government include environmental taxes such as landfill tax and the plastic bag tax, and the power to levy hotel taxes. Though not the subject of the present inquiry, the continued nationalisation of Non-domestic Rates ought to be reviewed in the near future as well.

The on going discussion surrounding the Smith Commission process and the new Scotland Bill should keep in mind the potential for further devolution of revenue powers to local government.

From a cosmetic perspective, it might be worth re-naming the Council Tax. Its sheer unpopularity amongst taxpayers means that any programme of substantial reform to the Tax, such as this paper suggests, ought to be reflected in its appearance. "Local Property Tax" might be a more appropriate name.

Finally, a greater effort ought to be made to preserve the fiscal autonomy of local government in Scotland. Political parties should refrain from running in national elections on policies that fall exclusively within the ambit of local control. The Scottish Government should respect the autonomy of local government by ending the Council Tax freeze, and allowing local authorities to set the Tax at the level they feel is most suitable. Furthermore, the Scottish Parliament should legislate to protect the fiscal autonomy of local government. Though the Parliament cannot actually bind itself, or its successors, it would be a powerful gesture of respect for the fiscal autonomy of Scotland's councils.