

## Tell us what you think

We have not provided a long list of questions, but we do want to hear what you have to say about some themes. Please respond to as few or as many as you wish. If you would prefer to send us other information, please feel free to do so. However, it would be helpful to keep your response to no more than eight pages.

*If you are able to, please provide evidence or examples in support of what you say. This will help us explore your ideas further.*

### 1. SCOTLAND'S CURRENT SYSTEM OF COUNCIL TAX

**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?**

*You may wish to illustrate your answer with examples from your own experience.*

1. The following parameters are useful for assessing whether a Local taxation system is fair and effective:
  - It must fit and meet local needs;
  - The yield from taxes must be adequate;
  - Where possible local taxation should be policy-linked;
  - It should provide for certainty in the yield;
  - It should be broadly acceptable to the public; and
  - It should be simple to collect and difficult to evade and avoid.
2. No system is going to meet each of these parameters entirely in each and every aspect. The council tax system performs reasonably well in relation to most of these elements. There is wide acceptance of the tax however a lack of acceptability by some of the Scottish public is an area in which it falters. This is due in part to the amount of the tax that is levied and the perceived inequities in the distribution of the burden. It may also be due in part to the link between water charges and council tax and the fact that one bill coming from the local authority gives the impression to the taxpayer that the tax is some 40% higher than it actually is. The level of tax imposed is influenced by several factors, the most important being the amount of and distribution of grant funding made available to Scottish local government. As the Commission is not tasked with considering other issues around Local Government finance, presumably including grant funding, this response merely flags this as an issue. Our response can however examine the issue of perceived inequities.
3. Council tax banding has come under criticism as creating unfairness in the system. It could be argued that perceptions of unfairness in the banding system could be addressed to some degree by the following amendments:
  - Altering bands to reflect current market values. We note however the findings of the Burt Committee on this matter. Any revaluation undertaken to distribute the existing tax burden in line with current property values ( rather than carried out to increase the overall tax yield), would not be sufficient a measure to counter the other inherent problems with the system
  - Resetting the number of bands. We note however the findings of the modelling work undertaken by the University of Stirling for the Burt report, which concluded that “introducing additional council tax

bands has virtually no effect on the burden of council tax”; and that these results were consistent with the outcome of research by Heriot-Watt University for the Scottish Parliament’s former Local Government Committee. We additionally note from that Report that Sir Michael Lyons was surprised to find that adding additional bands would not appear to have a significant impact in making council tax relate more closely to ability to pay. This was largely attributed to the fact that households with diverse levels of income can be found in every council tax band in the UK.

- Changing the ratios of tax charged in respect of the bands. The Burt Inquiry commissioned comprehensive modelling of the impact of changing the multiplier between bands. We note the following outcomes of that modelling:
    - Increasing the multiplier between bands makes council tax more progressive.
    - Single adult households would tend to gain from increasing the ratio of Band H to Band A council tax, because single adults are more concentrated among lower council tax bands.
    - The majority of households either gain from the change in the multiplier or are unaffected
    - The more progressive the council tax structure, the larger the share of households that are at least as well off. But as the structure of council tax becomes more progressive, the losses of those who are made worse off by the changed structure increase. Thus, the more progressive the scheme, the greater the proportion of the population who gain, but those who lose do so more heavily.
    - A tension emerges about the optimum number of bands. As the council tax was made more progressive, so the variation of tax payable at adjoining bands would increase. This scenario, where a small increase in the value of a property can result in a substantial increase in council tax liability, is sometimes described as a “cliff-edge effect”. The effect of this is that a small difference in the 1991 value of a property can make a significant difference in the amount payable each year in council tax
    - Increasing the multiplier between bands would widen the difference in the amount payable by adjoining bands and accentuate the “cliff-edge” effect. The larger the multiplier, the greater the “cliff-edge” between each of the bands.
    - Large number of bands would be required before the “cliff-edge” impact of increasing the multiplier was offset and the more bands that are created, the closer a banded system becomes to one where properties are valued individually.
4. The Institute sees some merit in moving to property valuations based on discrete capital values rather than amending the system of bands. Some commentators have suggested that changing the valuation banding aspect to a system of discrete valuations would be too difficult and costly to implement. Yet Northern Ireland undertook a full and successful, cost effective revaluation of properties for domestic rating in 2007. Their use of the latest valuation information technology together with significant professional overview and checking provided individual capital value assessments, with extremely low appeal rates arising. This suggests that such an exercise within a property-based tax system could be achieved in Scotland if there is a will to do so. In order to provide a full picture it is important to note some essential differences exist between Northern Ireland in 2007 and Scotland as at the present time. As is the norm, the tax was introduced in 2007 based on value levels as at 1<sup>st</sup> April 2005. Between 2005 and 2007 domestic property values in many parts of Northern Ireland doubled in value therefore giving the impression that the property values on which the tax was based were significantly lower than could have been the case. It is almost certainly this fact that contributed to the acceptability of the values and the low appeal rates. It is highly unlikely that a similar market will occur again particularly in Scotland. The Institute has provided

professional input to the revaluation exercise in Northern Ireland and would be pleased to discuss the concept and implementation aspects further with the Scottish Government.

5. In addition to the issues around the banding system, the IRRV has previously made representations to the United Kingdom Governments to overhaul other elements in the council tax system to make it more robust and more acceptable to the public. These relate to:
  - Committing to undertaking regular revaluations. The unwillingness to have a council tax revaluation is itself a cause for the tax to fall into disrepute. It also misses the opportunity for changes in the levels of value in a locality to be reflected in the system.
  - Introducing a rebate scheme which reflects a well-targeted system of relief. Amendments to the system of reliefs (balanced by overall yield) could more easily resolve issues of affordability than a wholesale change to the whole basis of taxation.
  - Undertaking a comprehensive review of both status discounts and exemption categories.

## 2. REFORM OF LOCAL TAXATION

**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?**

6. There are many benefits in maintaining a property-based tax. Such taxes generally:
  - Are cheap to administer, maintain and enforce and are predictable;
  - Are difficult to avoid. By contrast, under a local income tax system legal avoidance would be much easier, which would reduce tax yield and yield certainty; and contribute to funding gaps;
  - Do not add new compliance burdens on taxpayers. A considerable amount of property information is already in the public domain – hence inspections for council tax are very low as a proportion of total casework; and
  - Provide a compatible addition to the varied taxes paid across the country.
7. The IRRV advocates the retention of a reformed property-based system, based either on discrete capital values or numerous bands. The Institute also believes that a reformed property tax should continue to be administered by Local Authorities, to ensure that the public continue to recognise the important links between what they pay, who they pay to, and what services they receive in return. The Institute believes that this is essential to ensure local accountability and to maintain the health of local democracy.
8. Councils should not, however, be restricted to the ability to raise a single tax and should have the discretionary power to raise supplementary taxes that are appropriate to their local area, for example environmental taxes, a Local Tourist Tax; and localisation of (or part thereof) the Scottish Lands & Buildings Transaction Tax (former stamp duty). Such an approach would provide a mix of stable and predictable sources such as property/land tax and alternative buoyant sources.
9. In addition to those options raised in the above paragraph, the Scottish Government could also consider easing the burden of local taxation by considering other significant sources of income. Such sources could, as examples, include an introduction of a levy on internet retailers; and a land tax. These are discussed further in the following paragraphs.

### The Introduction of a Levy on Internet Retailers

10. Over the last three years, Governments in many countries have become more concerned about the impact of the internet retailer on the bricks and mortar retailer. This issue has been approached in many different ways and this note seeks to clarify the potential rate liability of internet retailers in the UK in contrast with other countries around the world.
11. Any internet retailer operating in the UK will have an administrative centre, which would consist of call centre facilities, administrative buildings and a distribution warehouse. Any of these facilities that satisfy the four ingredients of rateable occupation would attract non-domestic rate liability. Many of the major on-line providers use outsourced facilities and again these would attract non-domestic rate liability. However, the actual internet traffic determining the transaction itself would escape liability. There are situations where on-line retail activity is operated from a dwelling house, in these circumstances an effort would be made to place a value on the commercial part of the building and then the retailer could be charged rates in the normal way however the difficulty is in finding the location and then identifying a separate rating assessment.
12. Many have considered if the pulses on the internet could be measured and if some form of virtual rating assessment could be created but under the current legislation and case law in all parts of Great Britain and Northern Ireland this would be most unlikely. The problem is that this sort of traffic already attracts rate liability through the providers of telecommunications. In these circumstances major providers of cables are rated on a basis which attempts to place a value on the volume of activity. The later situation means that any attempt to create an assessment based on virtual traffic could amount to double taxation.
13. There are also difficulties with the majority of the bricks and mortar retailers, who run online services, alongside their normal retail activity. These retailers, range from major chains through to small high street retailers. If there is a desire to level the playing field between the bricks and mortar retailer, and the online retailer, we believe this can only be achieved by a form of sales tax or a transaction tax. In Europe, it is often said that a sales tax would be in conflict with European Law because of the levy of value added tax. This only leaves the option of a transaction tax which would be relatively easy to administer and collect because it could be operated by the retailer themselves as part of the selling processes. These matters have attracted some interest in the media and the wider on line industry.
14. The approach of a sales tax or a transaction tax does exist in Countries around the World. In the USA each individual municipality has the option to levy a sales tax in addition to conventional property taxes. This has been the practice for a number of years however in the last two years there have been significant moves to raise a levy on internet retail transactions.
15. The Institute has carried out some research in this area and would be happy to make it available to the Commission.

### Land Tax

16. Taxing land value as an alternative or a supplement to the current approach of taxing "land and property" could be introduced. It is said that a land value tax could be more transparent with significant added value for other administrative uses such as the transacting of property.

17. To deliver a precise land valuation for each individual land parcel in Scotland to replace council tax and non-domestic rating would be expensive and could be fraught with complexity. If however it was to be introduced as an additional local tax to council tax and the non-domestic rating system the volume of parcels to be valued would be much lower as one would only be seeking to place a value on vacant sites and possibly derelict buildings. Of course if agricultural land was seen as a target the task would be much greater and generate significantly more income.
18. The content of each Land Value Tax record could include digitised elements of the Ordnance Survey map to give context to location if available in digital format. Information from the Land Registry and the local land and property gazetteer could add to the record. Additionally, the public sector has access to core reference information nationally, public duty obligations and widely based information requirements.
19. This suggestion envisages the creation of comprehensive land and property maps with zones of value for land and property based on the most up-to-date evidence. The map could have overlays according to the type of property being considered and would form the basis of use of the concept of “highest and best use” which would form the value base for the additional land tax. We acknowledge that such an approach would require significant resource, particularly in the set-up stage.

#### *The Concept of Highest and Best Use*

20. Highest and best use is a concept in land valuation. It states that the value of a land plot is directly related to the potential use of that land; the highest and best use is the reasonably probable use that produces the highest value. This use, the highest and best use, may or may not be the current use of the land.
21. In order to be considered as the highest and best use of a property, any potential use must pass as series of tests. The exact definition of highest and best use varies, but generally the use must be:
  - legally allowable;
  - physically possible;
  - have demand in the marketplace; and
  - result in the maximum market value for the property
22. Only those uses that are or may be allowed can be considered as a potential highest and best use. This may exclude uses that are not now and can not be expected to be allowed by zoning, Uses forbidden by government regulations, and uses prohibited by deed restrictions or covenants. For example, a property that is in an area that is zoned only for single family residential houses could not legally be used for a commercial or industrial facility.
23. Any potential use must be physically possible given the size, shape, topography, and other characteristics of the site. For example an airport would not be fit on a 10,000 square foot plot, therefore that use would fail the physical possibility test.
24. The use must have sufficient demand in the marketplace to have value. A use with no demand has no market value, and therefore cannot be considered a highest and best use.
25. The use must yield the maximum market value for the property in the marketplace. A vacant 40,000 sq. ft.

property may have possible residential, commercial, and industrial uses that pass all three previous tests. The use that would yield the maximum value in the marketplace would be the highest and best use.

26. For example, take the property that has the three possible highest and best uses. The value as a residential plot may be £50,000, the value as a commercial lot may be £100,000, and the value as an industrial lot may be £75,000. The Highest and Best Use would be as a commercial use because it yields the highest market value. That would be the market value of the land even if it was purchased for industrial or residential use.
27. The economic concepts of utility and substitution drive the highest and best use analysis. The highest and best use of a land plot determines its utility to a potential purchaser. The purchaser of such a plot would pay no more than a competing property with the same utility while a seller would accept no less than a seller of a comparable property.
28. Valuation on the basis of best use would almost certainly diminish the amount of green open spaces. Such spaces are critical to the ambience of any location and to the well-being of the community. There is currently a requirement within planning legislation to incorporate greenery within any new development and such spaces, if subject to best use taxation would almost certainly disappear through time.
29. Again, the Institute would be pleased to discuss these concepts in further detail.

### **3. LOCAL PRIORITIES**

**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?**

30. Priorities of local communities should be accounted for primarily through the local setting of the tax rate. The freezing of the council tax in recent years has eroded that accountability. The Institute would advocate that any form of local domestic property taxation should be set locally, in order to achieve local accountability.
31. Other options in a reformed system could include greater local control over both the setting of band limits and band widths and the setting of charging ratios between the bands.