

Commission on Local Tax Reform: International Evidence Review Executive Summary

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July 2015

Introduction

The broad-based Commission on Local Tax Reform was established by the Scottish Government and COSLA to investigate reform of the existing council tax system in Scotland. Reform would be based on a number of criteria, not least that the proposals should be based on fairness. As part of the evidence-gathering, Policy Scotland at the University of Glasgow was asked to complete an evidence review drawing on international evidence and experience about local taxation, different models of local taxes and, in particular, experience with local tax reform in recent years.

Council Tax: Design and Critique

The council tax was introduced in 1993 in the wake of the community charge (poll tax) political uproar. The council tax is a banded property tax. All properties were valued at 1991 prices and then allocated into seven later eight bands. All bands were set at a rate relative to the benchmark band D property. However, each band was set as a fixed percentage of band D, compressing the tax bill compared with actual property value distributions. Single adult households received a personal discount and in addition a rebate system ensured that low income households qualified for up to 100% rebates (tapered away as income rose above relevant social security thresholds).

The council tax was grafted onto the community charge system of local government finance with nationally levied rates on non-domestic property and a simplified grant system. The council tax has not undergone any subsequent general revaluation (except in Wales) but there have been other important changes. The UK coalition government ended national rebates in England, and cut the assumed level of support by 10%. In Scotland, the Government chose to fund this cut from the block grant and essentially maintain the rebate system as was (now called council tax reduction). Second, as part of the concordat with local government the Scottish Government has been running a council tax freeze for eight years again paid for out of the Block. Third, after the 2007 Scottish election, the then minority SNP government explored but then rejected replacing council tax with an income tax drawing on their powers to vary Scottish income tax rates.

The main criticisms of council tax are as follows.

- The failure to revalue for more than 20 years undermines the credibility of a tax that is based on property values and their relative distribution. Successful property tax systems employ a statutorily enforceable programme of regular revaluation.
- The weighting of the banding system protects those with higher property values and means that the council tax is a larger burden on low value properties. Despite the rebate system and the personal discounts, the council tax is seen by many as unfair in terms of reflecting ability to pay.
- There is evidence at a UK level that low value property markets face a higher council tax burden than higher value markets.
- The freeze on taxes is a large and growing cost on the Block and is of greater benefit to those living in high value properties. COSLA and others have argued that it also cumulatively weakens local democratic accountability.

Summary of Evidence Review

The evidence review drew on a combination of formal digital literature searches using social science search engines, google, snowballing from the sources identified, grey literature searches and more discrete subjective-knowledge-based sourcing of material. The search yielded more than one hundred usable sources of information.

Preliminary questions for the evidence review included trying to set the UK in an international context and also setting out key sources of confusion about the impact or incidence of local taxes. While the UK, in an OECD context, has a proportion of GDP devoted to property taxes, when we look at local taxes as a whole, the UK's position is unusual not because the tax take as a whole is high but because it is dependent on property taxes only, rather than the mix of taxes found elsewhere. Second, how we decide to interpret the impact of property taxes i.e. as a tax on consumption or on wealth, shapes in turn how we define whether it is fair or not. Arguably, one may also want to look at the fairness of the tax system as a whole but the point is, once one has taken a view about the nature of the tax in isolation, then the parameters of the debate about its fairness are fixed in place.

The evidence review conducted a high level overview of other cross-national studies from OECD, IMF, UN Habitat and several academic studies, making the following general points:

- There is a wide variety of local taxes in operation across the OECD and property or income taxes, for instance, vary in design term considerably.
- Land and property taxes are generally considered to have specific positive features which lead them to be widely supported by analysts: they are hard to avoid, local government services are delivered to occupiers and owners; public

services can lead to uplift in land values; as an autonomous source of revenue they are accountable and they are visible and salient and thus also accountable; land registry systems have wider value in the property market. Property taxes may make a small but significant contribution to improving the performance of the housing market. But property taxes have negative dimensions too – they are presumptive and their visibility makes them unpopular and they are prone to political intervention as a result including failing to regularly reassess property values.

- Around the world, governments use a battery of policy to soften the unpopularity of property taxes, premised on a current income fairness incidence perspective. These include the use of rebates, deferral systems, limits on payments, progressive rate structure, caps, delayed reassessments and ‘circuit breakers’ that limit payments.
- Several countries have recently embarked on property tax reform. The reasons for the reforms have been related to national tax reforms, local government finance reform, specific changes to local taxation based on principles of reducing inequality, raising revenue or tax simplification.
- There are clusters of countries that employ variants of land value taxation and others that rely to a greater or lesser extent on local income taxes. These are both often used in combination with other local taxes. The UK is unusual for its reliance on one domestic local tax. There are in-principle and empirical debates for and against combining local taxes: can they be revenue-neutral (and be perceived to be so); can they reduce revenue-risk and can they better align local service demand to specific forms of tax payment?
- There is extensive evidence of the wider economic impacts of property taxation. Apart from impacts on housing investment decisions, recurring taxes are widely preferred to transaction taxes (which may impede mobility); there is also scepticism about the ability of tax breaks to encourage investment location decision-making.

The evidence review also looked at a number of systems and described a range of national approaches in more detail.

Slack and Bird (2014) distinguish four general issues for property tax reform: establishing the preferred tax base, how to assess the tax base, how to set the tax rate and thus the tax bill, and, how to run the system itself? Almy (2013) concludes that *‘unless the tax structure is simple enough to be efficiently administered, and fair enough to gain the confidence of the population, administrative reform by itself will not succeed.’* Slack and Bird (2014) identify six principal challenges and differentiate ways forward as a result of those challenges into promising and those that are less promising.

- Saliency. The high visibility of the tax requires change to be transitioned and for improvements in local services to go alongside tax reform.
- Liquidity Constraints (e.g. the cash poor- asset rich problem). These suggest deferral and other payment options and against value phasing-in change.
- Perceived Regressivity based on comparisons with current income. This suggests a range of ways of reducing this impact including low income exemptions.
- Volatility in terms of large movements in individual taxpayer bills. The authors argue for annual evaluations and for phasing in reform.
- Presumptive Tax. The antagonism to the form of tax requires education and consultation, phasing-in and good systems of appeal.
- Inelasticity. The tax base is less buoyant than incomes and this is a problem for revenue risk rather than the tax payer and is another argument for more regular i.e. annual revaluations.

Overall, reform is multi-dimensional, political and complex:

“...property tax reforms could clearly be designed and implemented much more sensibly than appears to have been the case. To do so, however, countries need to recognise clearly both the nature of the task facing would-be reformers and also the complexity of the task they face....inextricably related to very long-lived assets and often deep-rooted social beliefs and norms.” Slack and Bird, 2014, p.26

Conclusions

The review had six main conclusions.

First, there is a disconnect between the economic and in-principle arguments about local taxes in general, and property taxes in particular, and how they are perceived by people and politicians.

Second, the prior question of how one judges the incidence of property taxation is also fundamental. If one starts from view that the property tax is one on housing services as opposed to wealth then completely different conclusions are arrived at as to tax fairness and any interpretation of the evidence will be conditioned by ones' perspective on incidence).

Third, land and property taxes may have desirable impacts on housing markets and land use but that also depends on design – there is plenty of international evidence suggesting it can go wrong (Slack and Bird, 2014; Almy, 2013; Norregaard, 2013).

Fourth, the synthesis of different local tax experiences across countries, tell us a lot about property tax reform and how difficult it can be to achieve. The reform criteria set out by

Slack and Bird can be used to assess the council tax (or indeed other options that might arise) – it would seem to suggest that there were many in-built problems with council tax as a model from day one.

Fifth, systems of local tax and the inter-governmental finance and distribution of services are highly idiosyncratic. They are the product of long periods of evolution and punctuated periods of reform. With such different contexts, design details and complex interactions with other taxes, one must be cautious about reading too much into the simple transferability of local tax systems across nations with often very different governance institutions. Policy transfer in order to reform local tax problems should not be embarked on lightly.

Finally, it is apparent that, internationally and unlike the case in the UK, cities and national systems of local government typically have more than one local tax at their disposal and frequently have many taxes at their disposal although one would need to evaluate the administrative cost of their development and running costs as well as their buoyancy and capacity to generate revenues.