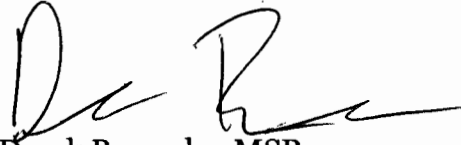


We are happy for this consultation document to be made public.

A handwritten signature in black ink, appearing to read 'Derek Brownlee', with a long horizontal flourish extending to the right.

Derek Brownlee MSP

Shadow Cabinet Secretary for Finance and Sustainable Growth.

## Local Income Tax: The case against

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**Local Income Tax: The case against**

The submission of the Scottish Conservative & Unionist Party  
to the Scottish Government Consultation on local taxation

July 2008

## **1 Introduction**

- 1.1 This document contains the response of the Scottish Conservative and Unionist Party to the Scottish Government's consultation on introducing a Local Income Tax (LIT) in Scotland.
- 1.2 The Scottish Conservatives do not support the introduction of a Local Income Tax in Scotland.
- 1.3 We want to see a reformed Council Tax to deal with some of the problems which have caused public concern. Indeed, we have led the debate on Council Tax reform in Scotland, with proposals such as our Pensioners' Discount, set out in our 2007 Scottish Parliament Manifesto.
- 1.4 We will be happy to work with the Scottish Government to reform the Council Tax if there is a desire to do so. We have set out possible reforms later in this document. A reformed Council Tax can be in place sooner than any new system of local government taxation.
- 1.5 Many of the points raised in this response document are technical, and may be resolved when the Government has clarified its position on LIT. However, there are so many issues of concern that we believe that the Government will need to re-run the consultation process when a draft Bill is available.
- 1.6 Although we will oppose the introduction of Local Income Tax, if we are unsuccessful we wish to minimise the damage it will do to the Scottish economy and to Scottish taxpayers. As such, we have commented on some issues which would arise only in the event of implementation of LIT. Such comments are not in any way an endorsement of LIT, which we believe to be a profoundly misguided policy.

## **2 The case against a Local Income Tax: Executive Summary**

- 2.1 The Scottish Government appears to have decided on substantial reform of Local Government Finance without first considering whether the current role and structure of local government is appropriate post-devolution. Decisions taken now might prejudice the development of local government in the future. (Chapter 4)
- 2.2 Although described as a “Local Income Tax”, the Government proposals are for a single, national tax system, entirely removing local discretion to set the amount of local tax, and consequently damage local accountability and democracy. (Section 6.4)
- 2.3 The fixed rate of LIT prevents Councils from passing on efficiency savings in the form of lower tax bills. (Section 6.5)
- 2.4 Although the Scottish Parliament does have the power to reform or replace the Council Tax, the Government proposals may not be competent under the Scotland Act. (Chapter 3)
- 2.5 The Scottish Government has calculated the yield from LIT on a highly optimistic basis. Tax revenues are likely to be over £100m lower than projected if the tax is introduced in 2011/12. (Section 23.7)
- 2.6 The Scottish Government does not appear to have taken a view on the fundamental issue of how LIT revenues and Scottish Government Grant would be allocated between Local Authorities, so it is impossible to determine with certainty which individuals, groups or local authority areas would lose out under the proposals. (Section 7.1)
- 2.7 The Scottish Government does not appear to have taken a view on the timing of distribution of LIT revenues and Scottish Government Grant, which may create particular problems for rural areas where the rates of self-employment are higher than elsewhere. (Chapter 8)
- 2.8 Local Income Tax would create disincentive effects to work. (Chapter 27)
- 2.9 The Scottish Government has no powers to require HM Revenue & Customs to collect the Local Income Tax, even if it becomes law. (Section 15.2)
- 2.10 It is not feasible to create a system of LIT in Scotland which would permit individual Local Authorities to vary the rate of tax without significant and excessive cost and bureaucracy. (Section 6.2)
- 2.11 LIT may lead to greater numbers of the self-employed incorporating their business, reducing the expected tax yield from LIT. (Section 27.3)
- 2.12 It is unclear whether Pensioners will pay LIT on income which is not taxed under UK Income Tax rules. (Chapter 13)
- 2.13 As the Local Income Tax will almost certainly be subject to legal challenge on the grounds of competency under the Scotland Act, non-payment may be a greater issue than for Council Tax or national Income Tax. (Chapter 30)

- 2.14 LIT will lead to a dramatic reduction in the balance of funding raised by local authorities (Chapter 5)
- 2.15 There is no certainty on the set-up costs which LIT would inflict on the Scottish Government, Local Authorities, business or taxpayers. (Chapter 17)
- 2.16 Transitional arrangements would be costly and difficult to implement and may be contrary to Human Rights legislation. (Chapter 22)
- 2.17 In the short term, LIT, SHT, Water Rates and Council Tax would all require to be collected. The costs of collection of all these taxes and charges could be significant. (Section 17.5)
- 2.18 LIT is preventing substantive discussion on Council Tax Reform. Cross-party consensus that reform is necessary means that change could be accomplished sooner than under LIT. (Chapters 1 and 34)
- 2.19 Several groups will lose out substantially as a result of these changes, with no compensation. (Chapter 28)
- 2.20 The Government's plans to maintain a second homes tax mean that a register of domestic properties will still be required. (Chapter 20)
- 2.21 Avoidance of second homes tax is likely to be higher with LIT as there is no incentive to declare a property a second home and the default position will be that homes are exempt. (Section 31.3)
- 2.22 The principle of taxing only second homes is that wealth, rather than income, is the appropriate tax base for local taxation – completely undermining the Government's rationale for introducing LIT. (Sections 20.1-20.4)
- 2.23 The scope of the second homes tax is vague, creating significant uncertainty for taxpayers. (Section 20.9)
- 2.24 There are technical issues with the definition of residency which add complexity and cost to LIT if a single national rate is applied. (Chapter 11)
- 2.25 The UK Government has indicated that Council Tax Benefit monies will not be available to subsidise LIT. (Chapter 24)
- 2.26 Even if Council Tax Benefit monies were available to subsidise LIT, the Scottish Government has overestimated the amount likely to be available by between £11m and £34m. (Section 23.13)
- 2.27 The collection of water and sewage charges will still be required, whether by Local Authorities or another body. (Chapter 21)
- 2.28 The interaction of LIT with the UK Tax and Benefits system does not appear to have been considered in any detail, meaning that unexpected consequences may emerge for those eligible for benefits and tax credits. (Chapter 19)

- 2.29 LIT undermines the Scottish Government's Economic Strategy by increasing the level of taxation on earnings. The economic stimulus referred to is as a result of lower taxation overall, rather than the shift in tax base. (Chapter 25)
- 2.30 Competitor economies are watching the Scottish experience closely, believing it likely to undermine our international competitiveness. (Section 27.2)
- 2.31 LIT is not as presented, a tax on income, but a tax on some forms of income. This raises concerns about the perceived fairness of LIT. (Chapter 10)
- 2.32 Local Income Tax will raise a substantially lower level of revenues than Council Tax. (Chapter 23)
- 2.33 Revenues under LIT will be more volatile than under Council Tax. There is a serious risk that LIT raises significantly less than anticipated if the growth in taxable earnings is less than that assumed by the Scottish Government. (Section 23.1)
- 2.34 LIT revenues are dependent on a stable UK tax system. Changes to the UK tax system may result in significant changes to actual LIT revenues which the Scottish Government will have no control over. (Chapter 29)
- 2.35 It is unclear whether Local or Scottish Government bears the risk of revenue shortfall (Chapter 9)
- 2.39 Nightshift workers who live in England would be taxed twice – under LIT in Scotland, and Council Tax in England. (Section 11.5)
- 2.40 Higher than expected inflation may undermine the Scottish Government's ability to deliver the efficiency savings on which LIT depends for subsidy. (Section 23.15)
- 2.41 There is uncertainty on what deductions will be available under LIT compared to UK Income Tax. (Chapter 14)

### 3 The Scotland Act

- 3.1 We believe that the case against a Local Income Tax is overwhelming, and that the proposals should be rejected regardless of the issue of competence under the Scotland Act. Although taxation is a reserved matter under the Scotland Act, there is an exception for “local taxes to fund local authority expenditure (for example, council tax and non-domestic rates).”<sup>1</sup>
- 3.2 The key question is what is included within the term “local taxes to fund local authority expenditure.”
- 3.3 We accept that the Scottish Government, in accordance with precedent, has refused to publish legal advice on this issue, or indeed to indicate whether or not such advice has been sought. However we believe the uncertainty surrounding this issue is such that it must be resolved.
- 3.4 On a plain reading of the exception to the reservation, it is not sufficient that a tax is levied to fund local authority expenditure: for a tax to be within the competence of the Scottish Parliament, it must also be a “local tax”. The word “local” would be superfluous if the intention was merely that any tax to fund local authority services would be within the competence of the Scottish Parliament.
- 3.5 During the passage of the Scotland Act, the issue of what “local taxation” would include was debated. The Minister of State (Henry McLeish MP) observed that

*“Just as local government's main services and structure are matter for the Parliament, so, too is its financing... What choices will be open to the Scottish Parliament on local taxation? It will be open to the Parliament to amend or change the system of local taxes, but there is a widespread consensus that property-based taxes are an essential element of the local tax system, as they always have been.”*<sup>2</sup>

- 3.6 This makes clear that the Government intended the Scottish Parliament to have the power to replace the Council Tax, if it chose to do so. However, the Minister went on to expand on what “local taxes” meant:

*“It is the essence of local taxation that tax rates are set by local councils”*<sup>3</sup>

- 3.7 It is clear that the Scottish Parliament has the power to alter, or indeed repeal, the Council Tax. It seems likely that the introduction of a Local Income Tax is permitted under the Scotland Act. However, a credible case can be made that a single, nationally set rate of income tax as set out as the Government’s favoured position is not competent under the provisions of the Scotland Act. We believe that it is more likely that a locally set rate would be competent.

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1 Scotland Act 1998, Schedule 5, Part II, Head A1

2 Hansard, 19<sup>th</sup> May 1998, Col 814

3 Hansard, 19<sup>th</sup> May 1998, Col 815

3.8 It appears that the Cabinet Secretary for Finance and Sustainable Growth shares these concerns. As he told the Local Government Finance Review:

*“The Scottish Parliament quite clearly has competence over local taxation. If the Scottish Parliament was trying to devise a taxation system that was a uniform national tax then I think we would get into uncertain waters there because the reserved issues in this area are relatively clearly defined in comparison to some areas of policy.”*<sup>4</sup>

3.9 Similar issues were raised in consideration of the Council Tax Abolition and Service Tax Introduction (Scotland) Bill.<sup>5</sup> That Bill had a single set of income tax rates applied across Scotland. It was certified as being within the Parliament's competence by the then Presiding Officer.<sup>6</sup>

3.10 We do not know the reasons why the Bill was considered to be within the competence of the Scottish Parliament, as the Presiding Officer is under no obligation to state reasons where proposed legislation is believed to be within the Parliament's competence.

3.11 Technically, that Bill placed a duty on Local Authorities to levy the tax,<sup>7</sup> although they had no discretion to set the rate or modify the bands of taxable income. It may be that this was considered sufficient to bring the provisions within the exception set out in the Scotland Act. We doubt that it would be adequate to meet the Scotland Act test.

3.12 The Presiding Officer's view is clearly important, but it is not definitive in determining whether a Bill is or is not within the Parliament's competence – rather it is “something which will be taken into account by ... the UK and Scottish Law Officers in determining whether to refer the Bill to the Judicial Committee of the Privy Council under section 33.”<sup>8</sup>

3.13 If there is any uncertainty around the vires of LIT then, in the event of a Bill being passed, it is likely to be the subject of legal challenge, whether by the UK or Scottish Law Officers or by an individual exercising rights under Judicial Review. As Professor Alan Page of the University of Dundee told the Local Government and Communities Committee “... *any change to the existing system will unavoidably and inevitably raise questions of legality and therefore lead to judicial involvement.*”<sup>9</sup>

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4 John Swinney MSP 3<sup>rd</sup> March 2006, Oral Evidence to the Local Government Finance Review, p.5

5 SP Bill 31, introduced 11<sup>th</sup> November 2004

6 Para 32, Financial Memorandum, Council Tax Abolition and Service Tax Introduction (Scotland) Bill

7 s.5(1)(a), Council Tax Abolition and Service Tax Introduction (Scotland) Bill

8 Explanatory Notes to s.31 Scotland Act 1998

9 Official Report, 28<sup>th</sup> May 2008, Col. 889

#### **4 The role of Local Government**

- 4.1 Before initiating a wide-ranging change in the method of Local Government Finance in Scotland, we believe the Government should first have considered a more fundamental question – what is the role of local government post-devolution?
- 4.2 There has always been a degree of tension between differing tiers of government, pre-and post-devolution. However, the current structure of local government, established in 1995, was created prior to the Scottish Parliament and Government.
- 4.3 We recognise that there is no widespread appetite for reform of the structure of local government in Scotland, and no great desire on the part of either local or Scottish government to consider basic questions such as the division in responsibility between local government and the Scottish Government.
- 4.4 There may be a pragmatic case for not reviewing the structure or role of local government, and instead allowing both tiers of government to concentrate on their current roles. However, decisions on the future of Local Government Finance may have profound consequences for the future role and structure of local government.
- 4.5 A nationally set local income tax, for example, effectively rules out the option of reforming local government based on a vision of enhanced local financial accountability.
- 4.6 We therefore believe that the Government is wrong to propose far-reaching changes to local government finance without first considering the roles, responsibilities and structure of local government, something which should be done in collaboration with local government and the public.
- 4.7 We believe that any changes the Scottish Government makes to local government finance should preserve, in as far as possible, the range of options on how local government might evolve in the future.

## 5 Balance of revenue raised locally

5.1 As LIT would raise less revenue than the Council Tax, the proportion of local government revenue raised by local taxation would decline still further from 20%<sup>10</sup> to just 12.5% (assuming that LIT is considered to be a local tax in the first place).<sup>11</sup>

5.2 The balance of funding raised by local government is important. As the Cabinet Secretary for Finance and Sustainable Growth told the Local Government Finance Review:

*“We also think there is a need to re-evaluate over time the balance of revenue that is generated at local level, versus that contributed by the Scottish Executive, which we think is growing year by year and is therefore eroding local accountability”*<sup>12</sup>

5.3 The issue of the balance of funding is closely allied to that of the discretion which local authorities have to set tax levels. If local authorities have no discretion to set tax levels, then in practice their role will be taking decisions on local spending at the margins (the bulk of expenditure being constrained by being on areas where there is little ability in the short term to alter the pattern of spending, such as education.) It could be argued that, if local authorities have no discretion to set tax levels, it does not matter what proportion of revenue they raise, as the public will assume all responsibility for funding lies with the Scottish Government.

5.4 We believe that local government would be better served by having more discretion over spending and the ability to set tax levels locally. We do not believe that is feasible under LIT.

5.5 It is difficult under the current system to increase significantly the proportion of revenues raised by local government without a radical reshaping of the entire tax system, or removing major items of expenditure, such as education, from local authority control.

5.6 As an alternative to increasing the share of local authority expenditure raised by local authorities, consideration could be given to identifying what proportion of local authority expenditure is, in practice, open to variation over a four year term of office. Ensuring that local taxation raised a significant proportion (or all) of this amount might deal with some of the issues surrounding accountability and the low balance of funding.

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10 Figures for 2008/9, based on £2,276m of Council Tax Revenue (Bib 45130) and £11,137m of Local Government Expenditure (Annex B, Scottish Budget 2007, p.147)

11 Figures for 2010/11, based on £1,501m of LIT Revenue (Bib 45130) and £11,993m of Local Government Expenditure (Annex B, Scottish Budget 2007, p.147)

12 John Swinney MSP, 3<sup>rd</sup> March 2006, Oral Evidence to the Local Government Finance Review Committee, p.2

## 6 The impact on Local Authorities of the lack of discretion to set the rate of Tax

- 6.1 The Government proposal is to set a single, Scotland wide rate of Local Income Tax at 3%.<sup>13</sup> Technical issues around the proposals are set out in Chapters 10 to 14.
- 6.2 We do not believe that it is feasible under a Local Income Tax to have anything other than a single national rate, due to the costs of collection, and the administrative burden of tracking residence across an additional 32 areas. We agree with the Scottish Government that “a locally variable rate would require extensive and expensive bureaucracy.”<sup>14</sup>
- 6.3 The consultation document dismisses the argument that a single national rate reduces local democracy and accountability.<sup>15</sup> We do not agree.
- 6.4 This is the flaw at the heart of LIT: the only way in which it can be made to work is to have a single, national rate – but to do so entirely removes local discretion on taxation, and damages local democracy and accountability.
- 6.5 We believe that local discretion is important. If there is no discretion to set the level of taxation, there is no incentive to deliver greater efficiency beyond a certain level (e.g. beyond that assumed in the funding settlement). This year, Stirling Council reduced its Council Tax level, and was praised by the Scottish Government for doing so.<sup>16</sup> Under a centrally set LIT not only would no authority have the power to reduce taxation, there would be no incentive to take actions which would allow such decisions to be taken.
- 6.6 Although we believe the burden of taxation is too high, and welcome the current freeze in Council Tax, we recognise that there are some who would like to spend more on local government services. Councils would not have that freedom under these proposals, reducing the local discretion to how money is spent rather than how much.
- 6.7 We believe removing the discretion of local government to set the level of taxation raises serious questions about the relationship between local and central government, and government and the people, as well as on the respective roles of the tiers of government in Scotland.
- 6.8 The issue of local authorities losing all discretion to vary taxation locally has already been considered in the Scottish Parliament. During the consideration of the Scottish Service Tax Bill, the Local Government and Transport Committee Report concluded that if enacted “...local authorities would lose financial autonomy ... The Committee considers that this would create a serious democratic deficit in relation to local government. In the view of the Committee, this would be an unacceptable development which could lead to an undermining of the role of local government and elected members.”<sup>17</sup>
- 6.9 Only Tommy Sheridan MSP dissented from that paragraph. The same consequences flow from the Scottish Government proposals.

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13 A Fairer Local Tax for Scotland, para 9

14 A Fairer Local Tax for Scotland, para 13

15 A Fairer Local Tax for Scotland, para 37

16 Official Report, 6<sup>th</sup> March 2008, Col 6734

17 LG/S2/06/R1, para 9

6.10 Explaining his opposition to the same Bill, the Cabinet Secretary for Finance and Sustainable Growth told the Local Government Finance Review:

*“ ... the fault line for us was that it removed local discretion and local decision-making and applied a set of national bands, effectively income and national charges. Now, whether it is one uniform national charge or whether it's a range of national charges, it removes that sense of local discretion ”<sup>18</sup>*

6.11 He continued:

*“So I think the ability to choose at local level what sum of money you are paying in taxation I think is an important part I would say. ”<sup>19</sup>*

6.12 Finally, he added

*“We do think that it would be better, bearing in mind all the other evidence we have given to you about local control, local decision making and local accountability, if local authorities were responsible for a greater proportion of their revenue, and control over the raising of that revenue. ”<sup>20</sup>*

6.13 This mirrored points raised in the Parliamentary debate on the Bill. Alex Neil MSP said

*“... decisions on local taxation must be, by definition, local. The central argument for fiscal autonomy or independence for the Scottish Parliament is that those responsible for spending the money should be responsible for raising the money as well. ”<sup>21</sup>*

6.14 The Cabinet Secretary for Finance and Sustainable Growth observed that

*“... a local income tax should be exactly what it says it is: local. It should put local communities in charge of their revenue and business. ”<sup>22</sup>*

6.15 We believe that the effect of LIT as proposed by the Government on local discretion will be the same as under the proposed Scottish Service Tax Bill – that it would, to quote the Cabinet Secretary for Finance and Sustainable Growth, introduce

*“a system that will nationalise and centralise local taxation – something with which I profoundly disagree. ”<sup>23</sup>*

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18 John Swinney MSP 3<sup>rd</sup> March 2006, Oral Evidence to the Local Government Finance Review, p.14

19 John Swinney MSP 3<sup>rd</sup> March 2006, Oral Evidence to the Local Government Finance Review, p.15

20 John Swinney MSP 3<sup>rd</sup> March 2006, Oral Evidence to the Local Government Finance Review, p.19

21 Official Report, 1<sup>st</sup> February 2006, Col. 22910

22 Official Report, 1<sup>st</sup> February 2006, Col. 22902

23 Official Report, 1<sup>st</sup> February 2006, Col 22938

## 7 Distribution of LIT revenues and Government Grant

7.1 The question of how LIT revenues are allocated is important – but the consultation document appears to be silent on the fundamental question of how Scottish Government funding for local government would be allocated under LIT. The two questions cannot be considered in isolation. An appropriate distribution formula for a nationally set LIT would be unlikely to be the appropriate distribution formula for a locally set LIT.

7.2 The question of how LIT revenues and Scottish Government grant are distributed will determine which individuals, groups and local authority areas will “win” or “lose” under LIT. It is important that this information is available before Parliament votes on the matter. We therefore believe that the Scottish Government should publish details of how LIT revenues and Scottish Government grant will be allocated under LIT no later than the publication of the draft legislation. To give greater certainty, the method of allocation of LIT revenues should be set out in the Bill.

7.3 Three options are mentioned in the consultation paper:<sup>24</sup>

### 7.4 *Distribution according to relevant need*

The consultation document describes this option as distribution according to relative need, “as part of the existing arrangements for funding local government.”<sup>25</sup> It is unclear whether this means that the total sum of revenue raised under LIT would be allocated in proportion to each Council's share of the total local government settlement, or whether a separate needs based criteria would be used.

### 7.5 *Distribution according to population*

This method is probably the simplest option identified, but population is only one criteria used in distributing existing Scottish Government grant, on the basis that although population is a significant factor in demand for services, it is not the only one.

### 7.6 *Distribution according to amount paid by residents in local authority areas*

This option would require the detailed work on identifying the residency of each LIT payer in Scotland which has been discussed elsewhere.<sup>26</sup> For a nationally set LIT, this option would add a significant level of additional bureaucracy, without Councils having any direct ability to influence the amount of LIT revenues raised.

7.7 For a locally set LIT, as residency would have had to be determined in order to levy LIT, this option would be the only fair method of allocation, as it would be pointless to give Councils the power to set their own rate of LIT without ensuring that the financial consequences of that decision were felt at Council level. However, if the distribution of the Scottish Government grant to local authorities is varied, it would be possible for Councils to have a scenario where they lose Scottish Government grant and are forced to levy a higher rate of LIT without that yielding any net additional revenue.

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24 A Fairer Local Tax for Scotland, para 42

25 A Fairer Local Tax for Scotland, para 42

26 Chapter 11

## 7.8 *Other alternatives*

Although not discussed in the consultation paper, it would be possible to allocate LIT receipts to individual councils based on their current share of Council Tax revenues. This would seem to be the simplest method of allocating LIT receipts while the current allocation formula for Scottish Government support remains in place. This method might be suitable as a temporary measure only.

## **8 Timing of distribution of LIT revenues and Scottish Government Grant**

- 8.1 The consultation paper refers to the issue of the timing of income tax payments by the self-employed.<sup>27</sup> It is not clear whether the Scottish Government intends LIT payments collected by HMRC to be passed directly to Local Authorities based on whatever distribution formula is in place, or whether HMRC would pay into the Scottish Consolidated Fund, and the Scottish Government would then distribute the revenue.
- 8.2 The distribution formula chosen would have differing consequences for different local authorities, as levels of self-employment vary from area to area, with rural authorities having higher rates of self-employment than urban authorities.<sup>28</sup> If LIT revenues were distributed to those local authorities where raised, rural authorities could find themselves at a significant disadvantage if distribution of Scottish Government grant was not altered to mitigate the impact of the timing of tax payments.
- 8.3 The Scottish Government should publish its proposals for the timing of payments of LIT revenues and Scottish Government grant to Local Authorities no later than the publication of the draft legislation.

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<sup>27</sup> A Fairer Local Tax for Scotland, para 43

<sup>28</sup> HMRC, Personal Incomes by Tax Year, 2005/6, Table 3.14a - income and tax by borough and district or unitary authority

## **9 Allocation of Revenue Risk**

- 9.1 An allied, but separate, issue to the question of how LIT revenues and Scottish Government Grant are allocated is that of who bears the risk of revenue shortfalls or buoyancy.
- 9.2 Under a locally variable LIT, it seems appropriate the the risk is borne by the Local Authority setting the LIT rate. However, under the proposed nationally set rate, as Local Authorities will have no control over the level of the rate, it is less clear cut.
- 9.3 If LIT revenues are less than expected, the Scottish Government could, in theory, add to the level of Scottish Government Grant given to local authorities. Distribution of this top-up would presumably be on the same basis as allocation of the LIT revenues. However, unless the LIT revenue projections were calculated on an over-optimistic basis, it is more likely that revenue shortfalls will arise when economic growth is slower (or non-existent.)
- 9.4 In these circumstances, it seems more likely that the level of UK Government spending growth will be lower (or skewed towards non-devolved services such as Social Security), and as such the Scottish Government's own resources will not be growing at a rate which would permit such an increase in support to local government without reductions in spending elsewhere.

## **10 Income Subject to Local Income Tax**

- 10.1 The consultation document suggests that LIT will apply to “earned” but not “unearned” income. However, these terms are not defined in the consultation document. It appears that the Scottish Government’s intention is to levy LIT on all forms of taxable income for an individual other than income from savings and investments.
- 10.2 We believe it would be helpful to have greater clarity on what detailed types of income it is proposed will be subject to LIT with direct reference to that which is subject to Income Tax, as set out in s.3 of the Income Tax Act 2007. We presume that the proposals made by the Government are intended to ensure that the same types of income which would be taxable if the Scottish Variable Rate provisions of the Scotland Act were exercised would be taxed under Local Income Tax, albeit that income beyond the basic rate would be taxed too.
- 10.3 The Scotland Act’s provisions on the operation of the Scottish Variable Rate (SVR) removes from the definition of income “...income of Scottish taxpayers which, had it been income for the year 1998-99, would have been income to which section 1A of the Income and Corporation Taxes Act 1988 (income from savings and distributions) applied for that year.”<sup>29</sup>
- 10.4 That definition refers to legislation which has been superceded as a result of the UK Tax Law Rewrite project. The Scotland Act definition has not been revised to take account of the rewriting of the tax legislation.
- 10.5 We believe that the Scottish Government should clarify precisely what types of income it proposes to exclude from LIT, with reference to the rewritten UK tax legislation. We also believe that the Scottish Government should discuss with the UK Government the updating of s.73(3) of the Scotland Act, to preserve the effect of the section but with reference to legislation currently in force.
- 10.6 The decision to exempt from Local Income Tax income from savings and dividends may well be the pragmatic option, but given that the Government’s stated reason for replacing the Council Tax with a Local Income Tax is “fairness” it seems odd to make a policy decision to exempt one type of income whilst taxing another.
- 10.7 It is not clear why it is fair to levy Local Income Tax on £10,000 of Pension Income, but not on £10,000 of savings income – indeed, it may well be the case that the capital value required to generate £10,000 of savings income, or share dividends, is greater than that required to generate £10,000 of pensions income. In other words, the effect of the exemption, as well as discriminating against those with one type of income but not another, is to give a tax exemption to those with greater wealth.
- 10.8 We agree that income from savings and investments should not be subject to Local Income Tax on the grounds of administrative complexity and the yield relative to the cost of collection. However, it is impossible to argue that this decision is objectively “fair”.

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<sup>29</sup> Scotland Act 1998, s.73(3)

## 11 Residency

- 11.1 The latest figures available suggest that around 100,000 people move into or out of Scotland each year.<sup>30</sup> Not all of these individuals will be subject to Local Income Tax.
- 11.2 The consultation proposes using the residency test set out in s.75 of the Scotland Act. Although the Scottish Variable Rate (SVR) has not been used to date, applying a differing test of residency for Local Income Tax would add an additional complexity to the administration of income tax, leading to HM Revenue & Customs being forced to track two differing sets of residency data. It appears that, at present, HMRC does not routinely hold details of the place of residence for individuals, on the grounds that such information is not necessary to determine tax liability.<sup>31</sup>
- 11.3 During the passage of the Scotland Act, and since, there has been criticism of the residency definition used, and the potential difficulties which might result in some cases (indeed the Cabinet Secretary for Finance and Sustainable Growth described the “days test” in s.75(2) as one which would lead to a “colossal bureaucracy” during the debates on that clause).<sup>32</sup>
- 11.4 Potential issues arise for those who work in Scotland but who live outside Scotland.
- 11.5 Nightshift workers from England who work in Scotland would probably be caught by the days test in s.75(2)(b) and liable for LIT (or indeed SVR if applied). These individuals would continue to pay Council Tax in England, but would, in addition, be liable for LIT in Scotland. The Scottish Government has no way of preventing the Council Tax liability arising on their residence in England, so these individuals would find themselves paying local government taxes in two separate areas.
- 11.6 It may be that very few individuals would fall into this category, but the potential problem was seen as sufficiently grave that an amendment was brought forward (unsuccessfully) to exempt them during the passage of the Scotland Bill by the Cabinet Secretary for Finance and Sustainable Growth.<sup>33</sup>
- 11.7 Anomalies will always arise in some cases, and it may be that legislation will be unable to cater for every eventuality.
- 11.8 We believe that the definition of residency for Local Income Tax should be the same as set out in the Scotland Act. If there are any changes which may be made to improve the clarity of the application of the residency tests we believe that the Scottish Government should discuss them with the UK Government with a view to amending the Scotland Act definition. The House of Lords Committee on Economic Affairs has recommended that the rules on determining UK residency for tax purposes should be placed on a statutory footing.<sup>34</sup> This might prove a suitable opportunity for the issue of residency for Scottish taxpayers to be considered as part of a coherent review.

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30 Scotland's Population 2006, General Register Office for Scotland, July 2007, p.36

31 Reviewing the Case for a Local Income Tax, Paper BoF 19, CIPFA, 4<sup>th</sup> March 2004, para 7.12

32 Hansard, 23/2/98, Col 78

33 Hansard, 23<sup>rd</sup> February 1998, Col. 93

34 2<sup>nd</sup> Report 2008, The Finance Bill 2008, 12 June 2008, paras 224-226.

- 11.9 However, the definition of residency set out in the Scotland Act can only be used if there is a single national rate. Additional rules would be required if Local Authorities were to be given the power to set their own rate. These are discussed separately in Chapter 12.
- 11.10 There are a range of technical issues which were considered around the time of the passage of the Scotland Act.<sup>35</sup> These would need to be considered in the event of LIT being introduced, or indeed the SVR being exercised.

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<sup>35</sup> Inland Revenue Consultation Document - Scotland Bill Clauses 69-75 (1998)

## **12 Residency issues with a locally variable rate**

- 12.1 If every Scottish Local Authority is able to set their own LIT rate then, even if that discretion is not exercised and in practice every local authority chose to apply the same rate, the mechanism for dealing with varying rates would be necessary. Determining in which of the 32 local authorities an individual would be deemed to be resident would be the key challenge.
- 12.2 An objective measure of residency would be required. The residency test in the Scotland Act could not be used to determine residency within local authority areas as it stands, but can be used as a guide to show how residency would be ascertained.
- 12.3 In any given year, an individual is either a “Scottish taxpayer” or is not. If an individual crosses the days threshold, for example, even by a single day, he is a Scottish taxpayer for the whole of that year. It would be possible to apply the same principle to determining residency for local income tax purposes – so that, in any given year, someone who is a “Scottish taxpayer” will also be treated as a taxpayer for one local authority area within Scotland (but only one). This would seem a simpler approach than apportioning an individual's residency between different local authorities in each year.
- 12.4 There are essentially three residency tests set out in the Scotland Act: the “days test”,<sup>36</sup> the “principal home test”<sup>37</sup> and the specific provisions for MPs, MSPs and MEPs.<sup>38</sup> Applying variants of them to determine local authority residence demonstrates the difficulties. The specific provisions for MPs, MSPs and MEPs would have to be disappplied for determining local authority residence, as all MEPs and a significant number of MPs and MSPs cover more than one local authority area.
- 12.5 Under the “Scottish taxpayer” tests, an individual could, in theory, become a Scottish taxpayer by spending as little as 92 days in Scotland (assuming that they spent 91 days elsewhere in the UK, and were deemed to be UK resident, as a result of the “days” test). Applying similar rules to determine residency within one of the 32 local authority areas in Scotland would be a complex exercise, but it would be odd to have one set of rules for determining residency for SVR, and a completely different set for determining residency for LIT, so presumably the tests for local authority residency under LIT would be appropriately modified variants of the “days test” and “principal homes test”.

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36 s.75(2)(b) Scotland Act 1998

37 s.75(2)(a) Scotland Act 1998

38 s.75(2)(c) Scotland Act 1998

### 13 The Personal Allowance

- 13.1 The consultation document suggests that the Scottish Government favours the personal allowance for LIT being set at the same level as that applying to UK Income Tax.<sup>39</sup> This is undoubtedly the simplest option. Some tax advisers have suggested that *“unless the link between UK taxable income and income subject to LIT is fully preserved, it rapidly becomes apparent that LIT would involve rewriting the UK tax code, a mammoth task”*<sup>40</sup>
- 13.2 We do not believe that the Scottish Government has the capacity (or desire) to undertake such rewriting. However, it is not clear from the consultation document whether the personal allowance available to an individual under LIT would be the same as the basic UK personal allowance, or whether it is intended that the relevant allowances for calculating an individual’s UK income tax liability would be used for calculating their LIT liability.
- 13.3 Although this may appear a subtle distinction, this is a critical issue as different personal allowances operate for distinct groups within the UK Income Tax system: individuals under 65;<sup>41</sup> those aged 65-74;<sup>42</sup> those aged 75 and over.<sup>43</sup> In addition, those eligible for the Blind Person's Allowance<sup>44</sup> have the allowance applied in the UK income tax calculation at the same stage as the Personal Allowance.<sup>45</sup>
- 13.4 We believe that the Scottish Government must clarify its intentions on the calculation and application of the Personal Allowance under LIT.

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39 A Fairer Local Tax for Scotland, Para 8

40 Local Income Tax, Valerie Smart and Rhona Irving, p. 81, CA Magazine, June 2008

41 s.35 Income Tax Act 2007

42 s.36 Income Tax Act 2007

43 s.37 Income Tax Act 2007

44 s.38 Income Tax Act 2007

45 s. 23, Income Tax Act 2007

## 14 Exemptions and discounts

- 14.1 The consultation document states that “*Other than the personal allowances for a local income tax, we do not propose that there should be any exemptions or discounts.*”<sup>46</sup>
- 14.2 We presume that what is meant by this is that other specific policy decisions which could have been taken (for example, to exempt students from local income tax) have been rejected. However, the statement could be read more broadly. It could, for example, be read as meaning that pension contributions would be subject to tax relief for income tax, but not local income tax.
- 14.3 The calculation of UK Income Tax liability is set out in a series of 7 steps.<sup>47</sup>
- 14.4 A series of 27 reliefs, including gifts to charities and payments to Trades Unions and Police Organisations for certain insurance type arrangements, are potentially available before any personal allowance is applied.<sup>48</sup> It is not clear whether any or all of these reliefs would be available in calculating LIT.
- 14.5 We believe that the Scottish Government must clarify which, if any, of the reliefs available against UK Income Tax would be available against Local Income Tax.
- 14.6 In addition, up to 15 tax reductions are available *after* any personal allowance is deducted from income,<sup>49</sup> including the Married Couples’ Allowance, which still applies to certain pensioner couples.<sup>50</sup>
- 14.7 We believe that the Scottish Government must clarify which, if any, of the tax reductions available against UK Income Tax would be available against Local Income Tax.

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46 A Fairer Local Tax for Scotland, Para 18

47 s. 23, Income Tax Act 2007

48 s. 24, Income Tax Act 2007

49 s.26, Income Tax Act 2007

50 s.45 & s.46, Income Tax Act 2007

## 15 Collection and administration of LIT

- 15.1 We believe that the only feasible method of collecting LIT is for responsibility for administration and collection to be undertaken by HM Revenue & Customs. As with the administration of the Scottish Variable Rate, we believe it is right that the Scottish Government should fund any additional costs arising as a result of LIT.
- 15.2 The Scottish Government has no power (other than through the exercise of the SVR) to force HMRC to collect any tax. As collection of LIT in Scotland would require HMRC to have powers to force employers outwith Scotland to collect the tax, we believe that the UK Government would need to introduce legislation to give HMRC the necessary powers.
- 15.3 Although we would not expect the UK Government to initiate legislation to permit the collection of LIT by HMRC until the LIT proposals have received Royal Assent, we believe that the costs and complexities of collection and administration are such that formal discussions should commence in sufficient time to enable the Scottish Parliament to consider the practical implications of any issues arising as part of its scrutiny of the LIT Bill.
- 15.4 With a nationally set LIT, the issues of collection will be essentially similar to those surrounding SVR. We would hope that, as at present, the bulk of tax could be collected at source under PAYE with those not covered by PAYE completing self-assessment tax returns.
- 15.5 There would be a possible additional requirement for self-assessment returns for those covered by PAYE whose residence status was incorrectly recorded or which changed year on year, if that could not be dealt with by an adjustment to the taxcode (e.g. a taxpayer becoming a Scottish taxpayer during the course of the year). In theory, this should only apply for one year. This is an additional administrative burden, but it ought to be possible to develop a simplified self assessment return to cater for most individuals falling into this category.
- 15.6 We note that there is some concern that PAYE could only cope in the event that LIT is based on the current UK Income Tax structure. As two tax advisers from PricewaterhouseCoopers (PwC) put it:
- “It is very unlikely that the PAYE system could cope with differential allowances or situations where the income taxable was computed differently as might occur under the LIT.”*<sup>51</sup>
- 15.7 We assume that, with a nationally set rate of LIT, local authorities would have no need to have details of the income levels of individuals, thus avoiding concerns about confidentiality and the risk of data loss between HMRC and local authorities. We assume that, subject to the method of distribution of revenue selected, HMRC would retain all such data.

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<sup>51</sup> Local Income Tax, Valerie Smart and Rhona Irving, p. 82, CA Magazine, June 2008

## **16 Support for employers**

- 16.1 Information would need to be provided not just to employers as the consultation document suggests, but also to payroll software providers and professional advisers who will also be involved in the operation of any LIT. Any such information would probably be most effective being delivered via existing HMRC channels.
- 16.2 All employers will be required to file PAYE returns electronically by the time LIT could come into force.<sup>52</sup> Appropriate changes to software would be required to ensure LIT was also dealt with electronically.
- 16.3 Individuals throughout the UK would also need to be aware of the possibility that they might be classed as a “Scottish taxpayer” and made aware of their responsibilities and how to ensure that the appropriate tax was levied.
- 16.4 An additional form of support which the Scottish Government could offer is direct financial support to employers faced with the administration of LIT.

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<sup>52</sup> Carter Review of HMRC Online Services, 22<sup>nd</sup> March 2006

## 17 Cost of collection

- 17.1 Although various estimates of the cost of implementing LIT have been produced, the cost of collection will depend to a substantial degree on policy decisions taken.
- 17.2 The cost of collection suggested by the Scottish Government is £30m.<sup>53</sup> However, there is no detail on how this figure was arrived at, and whether it includes costs passed on to the Scottish Government by HMRC, for example.
- 17.3 CIPFA has estimated the cost of introducing LIT at UK level at £330m for start up costs and £110m per annum.<sup>54</sup> Not only would these costs have to be updated for inflation, we do not believe it would be accurate merely to apply a population share to the costs for a Scotland only LIT, as every employer (or potential employer) of a Scottish taxpayer would need to be able to deal with LIT. The costs may well be much higher than the Scottish Government suggests.
- 17.4 The Scottish Government does not appear to have considered the issue of start-up costs in its revenue projections. This is a major oversight.
- 17.5 In the short term, collection of LIT, SHT, Council Tax and Water Rates would be required, costing more than the current system.

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<sup>53</sup> Annex A, Abolition of Council Tax and Introduction of LIT: Revenue Projections, Scottish Government, March 2008

<sup>54</sup> Balance of Funding Review - Report, para 5.20 and 5.22, ODPM, 2004

## **18 Variations on the Local Income Tax Proposals**

18.1 The consultation document suggests a number of ways in which the proposals could be altered, which could apply regardless of whether the rate of local income tax was set nationally or locally.<sup>55</sup>

### *18.2 Differing levels of LIT for basic and higher rate taxpayers*

In theory, having identified those taxpayers subject to LIT, and provided that the definition of taxable income was the same for LIT and UK Income Tax, it would be possible to apply a differing rate of LIT for basic and higher rate taxpayers. We believe that the Government is correct to reject this option, not only for the administrative reasons cited (if local variation were permitted, there could then be 64 differing rates of Income Tax applying in Scotland), but also because we believe that there would be little prospect of a lower rate being set for the higher rate tax band than for the basic rate band. In general terms, tax systems distort least where the rates are flatter. A rate even higher than 3% applying only to Higher Rate taxpayers would, as well as compounding the problems around incentives and competitiveness, take the Scottish tax system further away from being a flat system.

### *18.3 Capping of LIT at a level set by Ministers*

The document refers to two options in relation to capping - it appears that these two options are to cap the rate at which LIT might apply to higher rate taxpayers, and to cap the amount of LIT which any individual would pay.

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<sup>55</sup> A Fairer Local Tax for Scotland, para 14

## **19 Interaction with the UK Benefit System**

- 19.1 The availability of the monies currently funding Council Tax Benefit is discussed elsewhere.<sup>56</sup>
- 19.2 The UK Tax and Benefit system is incredibly complex, and the interaction of tax credits and benefits other than Council Tax Benefit need to be taken into account in any assessment of the consequences of introduction of LIT. It is not clear whether any assessment has been undertaken by the Scottish Government on what the impact of LIT on different types of households at differing levels of income would be.
- 19.3 As the Scottish Government has no control over the design of the tax and benefit system, it is important that the effect of changes, both on individuals and overall, is understood. We recommend that a detailed assessment of the impact should be published prior to the Scottish Parliament considering LIT.
- 19.4 It appears possible that recipients of tax credits may be worse off under LIT than recipients in the same situation elsewhere in the UK. We believe the Scottish Government should publish detailed analyses of the impact of LIT on tax credit recipients in Scotland.

## 20 Register of second homes

- 20.1 The consultation document proposes to retain a tax on second homes on the grounds that *“it is reasonable that those who are fortunate enough to have two or more homes pay an extra contribution towards taxation.”*<sup>57</sup>
- 20.2 We agree that it is fair that such a tax exists, as it does under the existing Council Tax system.
- 20.3 However, we believe the Government's position on the second home tax is muddled. Owning a second home is a measure of wealth rather than income. The Government argues that Council Tax is unfair because it is not directly related to income. If the Government wants local taxation to be linked to “ability to pay” then it should not impose a tax on second homes since LIT would already have been levied on the earnings of anyone with a second home (assuming the residency test was met.)
- 20.4 Only if the Government concedes that it is “fair” to tax property can the case for a second homes tax be made – in which case the entire case for LIT is totally undermined.
- 20.5 In the event of LIT being introduced, there would still need to be a register of every domestic property in Scotland if a second homes tax was retained. Under the current system, the assumption is that Council Tax is due on a property unless an exemption is claimed. Those who would otherwise be liable to pay Council Tax on a property which is treated as a second home have an incentive to notify the local authority to claim relief.
- 20.6 Under LIT, the vast majority of properties would not be covered by a second home tax. The default position would therefore have to be that a domestic property was exempt from Second Homes Tax unless information to the contrary was held. It would still be necessary to maintain a list of every domestic property in the country, in order to provide certainty to Local Authorities on which properties had been assessed as second homes and which had not. The Local Government Finance Review was told that
- “it would be impossible to administer a system for levying tax on second homes without maintaining the data we already maintain for the council tax system, an assessment of the value of the properties, etc, etc. I think a hybrid of that sort would be very difficult to administer.”*<sup>58</sup>
- 20.7 Although the number of bills issued would be much lower under SHT than under Council Tax, to prevent avoidance of SHT would require much more effort on the part of Local Authorities than the current Council Tax second home provisions do.
- 20.8 Local Authorities would need to undertake appropriate work to satisfy themselves that the property is indeed a second home, and this would be a significant burden. As John Symon, Head of Finance, at Perth & Kinross Council, told the Local Government Finance Review *“... even under the current system we find it very difficult to identify second homes. If the system is not property based, I think it would be impossible.”*<sup>59</sup>

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57 A Fairer Local Tax for Scotland, para 51

58 John Symon, Head of Finance, Perth & Kinross Council, Oral Evidence to the Local Government Finance Review Committee, 31/8/05, p.10

59 Oral Evidence to the Local Government Finance Review Committee, 31/8/05, p.12

- 20.9 The Government intends that SHT would raise “about the same amount of money” from second homes as does the Council Tax.<sup>60</sup> However, it appears that the Government is considering allowing Councils a discretion to set the rate of tax applied to such properties on the grounds that “a one-size fits all approach across the whole of Scotland may not be appropriate.”<sup>61</sup> This is rather ironic given the central theme of the Government's LIT proposals is to remove local discretion. Although it is feasible to give Local Authorities discretion over a property based tax, it is also essential that taxpayers have certainty.
- 20.10 Regardless of whether the Scottish Government is proposing an entirely different system of second home taxation, or a continuation of the current one, the details of the scheme must be set out in full prior to Parliament considering the legislation.
- 20.11 We believe that Local Authorities should continue to collect any second homes tax.

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60 A Fairer Local Tax for Scotland, para 55

61 A Fairer Local Tax for Scotland, para 55

## **21 Domestic water charges**

- 21.1 There is an administrative saving in Local Authorities collecting water charges together with Council Tax. However, in the event of abolition of Council Tax, there is little reason why Local Authorities should be expected to continue to collect Water Charges. In such a case, we believe that Scottish Water should be given the responsibility of ensuring that Water Charges are collected, albeit with the flexibility to contract out collection to a third party.

## 22 Transitional Arrangements

- 22.1 The consultation document rejects transitional arrangements because they would result in “richer people paying a reduced share of the local taxation bill at the expense of poorer taxpayers.”<sup>62</sup> That statement is based on the premise that local income tax benefits “poorer” taxpayers and imposes a burden on “richer people”.
- 22.2 However, Local Income Tax will increase the tax levied on many groups which might be considered to be “poorer” (e.g. Students) whilst reducing the tax burden of many who might be considered “richer people” (e.g. those with substantial dividend or savings income).
- 22.3 Further, even if Local Income Tax did benefit “poorer” taxpayers at the expense of “richer people”, only if transitional relief were funded by a higher rate of local income tax would it be at the expense of “poorer” people, as the Scottish Government has no mechanism for directly imposing a financial burden on them in any other way.
- 22.4 The difficulty in determining transitional arrangements, which the consultation document makes no mention of, is that in moving from a property tax levied on households to an income tax based on individual earnings. Transitional arrangements could therefore only be put in place on a household basis.
- 22.5 Although some individuals within a family will have access to details of the income levels of other adults within a household, not all will. An individual claiming transitional relief would be able to deduce the level of income of other individuals in the household from the relief granted (or the reasons for rejection of relief.) Not only is such a process cumbersome, it raises privacy issues which may raise doubts as to whether it was compatible with the Human Rights Act.
- 22.6 We do not believe that the Government's arguments against transitional arrangements have been thought through. We believe that administrative complexity would mean that a meaningful transitional relief scheme would be difficult and costly to administer, and might be subject to legal challenge.

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<sup>62</sup> A Fairer Local Tax for Scotland, para 23

## 23 Tax Yield - Analysis of the Scottish Government Figures

23.1 As COSLA noted in its submission to the Local Government Finance Review Committee

*“The yield from the Council Tax is more stable and predictable than a tax based on income. The general tax base is very stable with the number of chargeable dwellings varying only very modestly from year-to-year to reflect new houses and deleted properties. The yield from Council Tax is much less variable between years than an Income Tax or Sales Tax. Council Tax complements the national tax systems and provides a broad tax base.”*<sup>63</sup>

23.2 The main revenue assumptions were not included in the Scottish Government's consultation document, instead being published as a result of a Parliamentary Question.<sup>64</sup> It is clear that LIT will generate significantly lower revenues than Council Tax if implemented as proposed.

23.3 *LIT Revenues*

23.4 Income Tax receipts have grown rapidly over recent years, reflecting growth in incomes and tax policy decisions. The recently published GERS document shows income tax receipts in Scotland rising at rates of between 3.6% (2003/4) and 9% (2005/6).<sup>65</sup>

23.5 On this basis, the projected growth in income tax receipts shown in the Scottish Government's projections of between 4.8% and 4.9% per annum between 2009/10 and 2011/12 might seem reasonable. However, the earlier growth in tax revenues came at a time of economic growth at a rate higher than seems likely for the foreseeable future.

23.6 As the Budget Report states *“With a longer period of output below trend incorporated into the Budget forecast, earnings growth is expected to be subdued for longer than assumed in the Pre-Budget Report. This lowers PAYE and NICs receipts”*<sup>66</sup>

23.7 If Income Tax receipts grow at less than 4.8% per annum, the Scottish Government projections will be overstated. Applying the growth rates for the Scottish economy as a whole produced by the Ernst & Young Item Club<sup>67</sup> (1.8% for 2008, 2.2% for 2009 and 2.6% for 2010) produces LIT revenues of £1,457m in 2011/12, £117m less than predicted by the Scottish Government. We believe this to be a more realistic assessment of likely revenues.

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63 (reproduced in FI/S2/05/R6), para 2.13

64 S3W-10894

65 Government Expenditure and Revenue Scotland 2006-2007, Scottish Government, June 2008, table 4.2

66 FSBR, HM Treasury, March 2008, C.53

67 Economic Prospects 2008, Scottish ITEM Club, 2007

### 23.8 *Council Tax Benefit*

23.9 The issue of whether Council Tax Benefit would be available in the event of introduction of LIT is considered elsewhere.<sup>68</sup> The Government assumes that CTB would deliver the following pattern of revenues<sup>69</sup>:

2008/9	£391m
2009/10	£405m
2010/11	£419m
2011/12	£429m

23.10 The underlying data relied upon by the Scottish Government has been updated since publication of the Scottish Government projections, and the figure for 2010/11, the latest available, is now expected to be £444m.<sup>70</sup> At first glance, this suggests that the Scottish Government has marginally underestimated the amount of CTB.

23.11 However, the DWP figures, based on the 2008 Budget assumptions, are based on an increase in Council Tax in line with the average of the past three years.<sup>71</sup> This assumption will overstate Council Tax Revenues if the Council Tax Freeze is maintained, and hence lead to DWP assuming a higher amount of CTB benefit being due than is likely to be the case.

23.12 The total sum of CTB arising in Scotland may increase due to other factors, such as policy measures taken by the UK Government, or an increase in the number of households eligible for the benefit. A more reasonable assumption would be that CTB would grow in line with the growth in Council Tax Revenues over the period – which the Scottish Government predicts to be between 1.4% and 1.5% per annum over the period to 2011/12. Applying that rate of growth to the projected outturn for 2007/8 of £395m produces a total of £418m.

23.13 The range of Council Tax Benefit in 2011/12 is therefore likely to be between £395m (assuming no increase on the 2007/8 projected outturn) and £418m (assuming that CTB yield is equivalent to the 2007/8 outturns plus projected growth in Scottish Council Tax Revenues).

### 23.14 *Subsidy*

23.15 Even on the Scottish Government figures, which assume high levels of growth in tax revenues, and the retention of all Council Tax Benefit monies, there is a shortfall of £281m in yield by 2011/12. The precise source of this balance of funding has yet to be identified, although it appears to be based on an assumed level of efficiency savings. The higher inflation environment which the UK appears to be entering will make it more difficult to deliver the level of efficiency savings which are being relied upon to deliver the subsidy for LIT.

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68 Chapter 24

69 Annex A, Abolition of Council Tax and Introduction of Local Income Tax: Revenue Projections, Scottish Government, 18<sup>th</sup> March 2008

70 DWP, Housing Benefit and Council Tax by Country, Table 8

71 FSB, HM Treasury, March 2008, C.66

## 24 Council Tax Benefit

- 24.1 Council Tax Benefit reduces Council Tax bills by a significant amount. It is clear that, without the level of resource available under Council Tax benefit, LIT would need to be set at a much higher rate, or resources would need to be transferred from other spending areas to fund local government.
- 24.2 We understand that the UK Government has decided that an equivalent sum to the total Council Tax Benefit in Scotland will not be available in the event of the abolition of the Council Tax. The Scottish Government insists that this sum should be available and has based its assumptions on the financing of LIT on the basis that it is. It is difficult to see this dispute as anything other than a continuation of the partisan positioning of the Labour Government at Westminster and the SNP Government in Edinburgh.
- 24.3 It is not clear to what extent there has been any formal communication or discussion between the two governments over this issue. The interests of Scottish taxpayers would be better served if both Governments set out their arguments in detail and discussed the issue of whether or not Council Tax Benefit monies should be available if Council Tax was abolished in the appropriate forums, rather than in a war of words in the columns of the Scottish press.
- 24.4 Whatever the outcome of the discussions on whether Council Tax Benefit monies should be available or not, it is clear that the impact of that decision is of material significance to the financial plans for LIT put forward by the Scottish Government.
- 24.5 We do not believe that the LIT proposals should be brought forward until it is clear what decision has been reached; as the SNP said in its submission to the Local Government Finance Review in 2005
- “Before any reform of local authority taxation can be considered, it is vital that an assurance is given that this sum [i.e. Council Tax Benefit] will continue to be allocated to Scottish local authorities in the event of the abolition of the council tax.”<sup>72</sup>*
- 24.6 We believe that some of the issues are less clear cut than either the Scottish or UK Governments would like to pretend.
- 24.7 Two of the arguments put forward by the Scottish Government rely on the 2007 Statement of Funding Policy published by HM Treasury.<sup>73</sup>

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72 SNP Submission to the Burt Review, 24/3/05, p. 1

73 Funding the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly: Statement of Funding Policy, 5<sup>th</sup> Edition, October 2007

24.8 The first argument put forward by the Scottish Government<sup>74</sup> is that the Statement of Funding Policy lists Council Tax Benefit as a component of the Scottish Block, post devolution. This refers to the reproduction of a Parliamentary Answer published before the Scotland Act was passed, which set out general principles

*"... In order to help inform debate about these arrangements during the passage of the Scotland and Wales Bills, the government published yesterday a statement of the principles which govern the existing Block/Formula arrangements and which will continue to do so under devolution.... The Government intends that this population-based formula will apply to changes in almost all the expenditure under the control of the Scottish Parliament and National Assembly for Wales. ... The Government will also want to consider whether this approach or another formula is appropriate in relation to provision for Council Tax Benefit and Housing Benefit which will both come within the Scottish Block for the first time after devolution..."*<sup>75</sup>

24.9 Subsequent to that answer being published, during the passage of the Scotland Act, the UK Government decided to remove Council Tax Benefit from the Scottish Block.

24.10 It is for the UK Government to explain why a statement about Council Tax Benefit being within the Scottish Block has been reproduced with no qualification in the official Treasury guidance about the funding of the Scottish Government, when a policy decision to the contrary was taken prior to the Scotland Bill becoming law.

24.11 However, the Scottish Government cannot easily argue that Council Tax Benefit is within the Scottish Block, as senior members of the Scottish Government have already conceded that it is not. SNP political adviser, Mr Noel Dolan, told the Local Government Finance Review

*"... it was the original proposal of Alastair Darling that Council Tax Benefit money would be paid over to the Scottish block. They clearly changed their mind on that subject between that point and the passage of the Scotland Act"*<sup>76</sup>

24.12 The Cabinet Secretary for Finance and Sustainable Growth added

*"... In the sense of when the politics of the Scotland Act were being discussed, the very clear intention was that Council Tax Benefit would be an integral part of the Scottish block, therefore to be determined by the Scottish Executive and something changed in the process. ... that was the original proposal and has changed..."*<sup>77</sup>

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74 A Fairer Local Tax for Scotland, para 47

75 Extract from Annex A to the 2007 Statement of Funding Policy, reproducing a written answer from 9<sup>th</sup> December 2007. This position is consistent with the White Paper "Scotland's Parliament", Cm 3658, July 1997, para 7.25

76 Oral evidence to the Local Government Finance Review Committee, 3<sup>rd</sup> March 2006, p.16

77 Oral evidence to the Local Government Finance Review Committee, 3<sup>rd</sup> March 2006, p.16

24.13 The second argument is in relation to a reimbursement mechanism in the Statement of Funding Policy which the Scottish Government argues has not been operated for some years.<sup>78</sup> We presume that this refers to the rule that

*“1. Council Tax Benefit adjustments: if, due to decisions by the Scottish Executive or the National Assembly for Wales or their respective local authorities, the costs of Council Tax Benefit subsidy paid to local authorities changes at a disproportionate rate (both higher or lower), relative to changes in England, then balancing adjustments may be made if appropriate to the relevant devolved administration's Departmental Expenditure Limit. In such cases the Government applies a formula to calculate balancing adjustments based on the relevant percentage changes in Council Tax;”<sup>79</sup>*

24.14 This principle might give the Scottish Government a reason to argue for compensation via the Scottish Block for lower Council Tax Benefit payments which have arisen as a result of the Council Tax Freeze, but this is an entirely separate issue as to whether Council Tax Benefit monies should continue to be paid in the event of abolition of the Council Tax. Indeed, the same section is specifically prefaced by a caveat that *“This Statement is drafted on the assumption that current forms of local taxation continue.”<sup>80</sup>*

24.15 The question as to why the procedures set out in that principle have not been followed to date by the UK Government (although the principle makes adjustments permissible rather than mandatory) is one for the Scottish Government to pursue via the dispute resolution process set out in the Statement of Funding Policy.<sup>81</sup>

24.16 The third reason put forward is that the move to LIT would not put any additional costs on the UK Exchequer. There is already a general principle set out in the Statement of Funding Policy which would allow additional costs imposed on one Government by the actions of the other to be recovered -

*“Principle 8*

*Where decisions taken by any of the devolved administrations or bodies under their jurisdiction have financial implications for departments or agencies of the United Kingdom Government or, alternatively, decisions of United Kingdom departments or agencies lead to additional costs for any of the devolved administrations, where other arrangements do not exist automatically to adjust for such extra costs, the body whose decision leads to the additional cost will meet that cost”<sup>82</sup>*

24.17 There is no specific principle to deal with the situation where the actions of one Government lead to the other gaining, although it is open to the Scottish Government to negotiate for a change to the Statement of Funding Policy according to the procedure set out.<sup>83</sup>

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78 A Fairer Local Tax for Scotland, para 48

79 6.3.1, Statement of Funding Policy, 2007

80 6.3, Statement of Funding Policy, 2007

81 Statement of Funding Policy, para 12.2

82 Statement of Funding Policy, para 3.2

83 Statement of Funding Policy, para 12.1

## **25 Impact of LIT on the Scottish Economy**

- 25.1 The consultation document claims that “*A reduction in taxes through the abolition of the council tax has the potential to provide a stimulus to the Scottish economy...*”<sup>84</sup> We do not doubt that a reduction in taxes has the potential to provide economic stimulus – but there are two distinct issues in relation to the Government proposals.
- 25.2 First, the “reduction in taxes” arises not from the abolition of the council tax, but in setting LIT at a level which raises less tax revenue than Council Tax. If the Government contends that a reduction in the level of taxes raised in Scotland will lead to economic stimulus, and thus contribute to achieving its growth target, then that applies as much to Council Tax as it does to LIT. A reduction of £281m in Council Tax yield would lead to the same result.
- 25.3 In addition to the reduction in the overall level of taxation raised, there is a shift in the distribution of it, in effect from households to earnings. We are not aware of any evidence that an increase in the rate of income tax has a positive correlation with economic growth, or provides any economic stimulus. If the Government contends that there is such evidence, we would be happy to study it – as, we presume, would the First Minister's Council of Economic Advisers.

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<sup>84</sup> A Fairer Local Tax for Scotland, para 33

## 26 Impact of LIT on individual workers

- 26.1 Whilst recognising that high income tax rates discourage work, the consultation document suggests that *“local income tax is unlikely to cause people in Scotland to change their current working patterns. We know that most people will be financially better off under our proposals.”*. This appears to be assertion, rather than the conclusions of any research. What is beyond doubt is that under LIT, there is an added disincentive to work beyond what exists at the present time as the marginal rate of tax will increase. LIT at 3% may or may not affect an individual's working patterns, but it will certainly not encourage working.
- 26.2 We recommend that the Scottish Government commission independent research on the issue of increasing income tax and its impact on work incentives prior to introducing LIT legislation.

## 27 Impact on incentives

- 27.1 The Scottish Government appears to concede that the LIT may be a disincentive to work, as the consultation document states “*A higher personal allowance could encourage people to work because they would not pay local income tax on more hours.*”<sup>85</sup>
- 27.2 Competitor nations and regions seem to believe that a Local Income Tax will disadvantage them. Politicians in Northern Ireland have decided against proceeding with a Local Income Tax, in part due to concerns that “*potential economic consequences would disadvantage Northern Ireland as a tax competitor and may act as a disincentive for people to locate here (inc. NI born graduates). High earners and large companies may relocate.*”<sup>86</sup> There is no reason why similar considerations would not apply to Scotland.
- 27.3 As unincorporated businesses pay Income Tax rather than Corporation Tax, there will be an added incentive for the self-employed to incorporate their business. Although other factors will be relevant, and the whole issue of taxation of small businesses is under review, this is a further complicating factor.
- 27.4 LIT will make Scotland a less attractive place in which to do business. It will be more difficult to attract businesses and talented individuals than is the case at present. We have profound concerns about the negative effects of introducing LIT.

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85 A Fairer Local Tax for Scotland, para 7

86 NI Assembly Committee for Finance and Personnel, Report 06/07/08R, 7<sup>th</sup> November 2007, Para 100

## 28 Distributional Impact

28.1 LIT is often presented in simplistic terms as a measure which will help those on lower incomes. This oversimplifies the situation, and ignores the significant groups of individuals who will lose out as a result of LIT.

28.2 As the Institute for Fiscal Studies has noted,

*“Not everyone with a low income would gain: those who currently pay no net council tax – because they receive full council tax benefit, because they are students, or because liability for the tax falls on relatives living in the same household – have nothing to gain from the abolition of the council tax, and those in such a position who also pay income tax would lose from the proposed reform.”<sup>87</sup>*

28.3 Issues around Pensioners and the Personal Allowance have been discussed elsewhere.<sup>88</sup> It is clear that full time students as a group will lose out significantly under LIT due to the lack of an exemption as operated under Council Tax.

28.4 In general terms, those full time students who also have paid employment do so because they do not have the levels of income to support themselves otherwise. It is odd for a tax allegedly predicated on "fairness" such as LIT that students from wealthier backgrounds who do not need to work pay no tax, and those from poorer backgrounds who do are penalised.

28.5 The interaction of LIT with those on the minimum wage depends on the level of minimum wage received and the Personal Allowance, but a student on the minimum wage working full time out of term would only need to work for 9 hours each week in term to be paying LIT.<sup>89</sup> A student working full time for the whole year, except in term time, at minimum wage, could find that only 4 hours work each week in term led to liability under LIT.<sup>90</sup>

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<sup>87</sup> IFS, "Analysis of the SNP proposal for a capped local income tax", 14/3/07

<sup>88</sup> Chapter 13

<sup>89</sup> Assuming the higher rate of NMW, the 2008/9 Personal Allowance at £5,435, 4 weeks holiday, 30 weeks term, 18 weeks at 40 hours paid employment. Even assuming the lower rate of NMW, and that the Personal Allowance is at the level of £6,035 set in the emergency budget, the threshold is 20 hours.

<sup>90</sup> Same methodology as used for previous example. Threshold for lower rate NMW and higher personal allowance is 14.5 hours per week in term time.

## **29 Impact of changes to the UK Tax Structure**

- 29.1 By aligning the UK personal allowance and LIT allowance, there is a risk that the revenue raised by LIT could be affected by actions of the UK Government. The Personal Allowance is typically indexed in line with inflation.<sup>91</sup> Where earnings growth is faster than inflation, that should lead to a real terms increase in tax yield. Failure to index the Personal Allowance, or uprating by less than inflation, could have the same effect.
- 29.2 However, the Personal Allowance has been increased by rates above inflation in previous years, and, although it is not clear whether the increase announced for 2008/9<sup>92</sup> is a temporary or permanent measure, it demonstrates the potential for LIT yield to be significantly affected by policy decisions taken by the UK Government. Although the Scottish Government has declined to quantify the effect of the decision to increase the Personal Allowance by £600 for 2008/9 if applied for future years,<sup>93</sup> on the basis of information provided in Parliamentary Answers, it would reduce the revenue projected to be raised by LIT by around £45m by 2010/11.<sup>94</sup>
- 29.3 Significant increases in the level of the UK Personal Allowance have been proposed from time to time as a simple way to reduce the tax burden on the lowest paid and to simplify the tax and benefits system. If such a policy was introduced at UK level, there would be unlikely to be any consideration of the impact that such a decision would have on Scottish LIT yield, and without the protection which is available to preserve the yield of SVR,<sup>95</sup> the consequences would have to be addressed by the Scottish Government out of its own resources.
- 29.4 Increases to the UK Personal Allowance would therefore lead to a reduction in LIT revenue which would need to be met from within existing Scottish Government or Local Authority resources.

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91 s.57 Income Tax Act 2007

92 Hansard, 13<sup>th</sup> May 2008, col 1201

93 S3W-12934

94 S3W-12224

95 s.76 Scotland Act 1998

## **30 Tax Evasion**

- 30.1 It is possible that some taxpayers (whether currently paying Council Tax or not) would seek to deliberately evade Local Income Tax, most likely by understating their taxable income or disputing their residency status. It is difficult to ascertain how serious a risk this may be – generally evasion of UK Income Tax is not seen as a major problem.
- 30.2 However, previous experience with local government finance has demonstrated that politically motivated campaigns to encourage law breaking can encourage some individuals to knowingly refuse to pay taxes which are due.
- 30.3 Whatever system of Local Government Finance is in operation, the Scottish Government should work with Local Government, and, where appropriate, the UK Government, to ensure that illegal tax evasion is treated with the appropriate level of severity and that taxes which are owed are collected.
- 30.4 If LIT is introduced, it is important that taxpayers are clear in relation to their liability. Any suggestion that LIT had been introduced ultra vires could lead to major problems of non-payment. The Scottish Government must ensure that any such issues are addressed.
- 30.5 As Professor Alan Page of the University of Dundee told the Local Government and Communities Committee, *“The nightmare scenario would be that we ended up in a poll tax situation, in which people would refuse to pay, saying that the Scottish Parliament has no power to impose a local income tax. The question of legality needs to be got out of the way.”*<sup>96</sup>

## **31 Tax Avoidance**

- 31.1 It is possible that some individuals will take perfectly legal steps to avoid LIT. As the Minister for Enterprise commented during the consideration of the SST Bill,
- “I worry about wealthy and skilled people who are mobile and about young couples who find that they need to be mobile. I also worry about the rise of the 90-day Scot—people who organise their lives so that they spend no more than 90 days a year in Scotland but who still manage to keep strong contacts with Scotland.”*<sup>97</sup>
- 31.2 Although the LIT is undoubtedly less punitive than SST, it is more punitive than the current system, and so some of the effects predicted are likely.
- 31.3 Avoidance of SHT will be higher than at present as there will be no incentive to declare a property a second home.

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96 Official Report, 28<sup>th</sup> May 2008, col. 889

97 Official Report, Finance Committee, 25th October 2005

## **32 Equality Issues**

- 32.1 A move to LIT would involve a significant shift in the tax burden between different groups.
- 32.2 We accept that LIT is not designed to create specific problems from an equality perspective. However, there may be unintended consequences which arise.

## **33 Other tax options**

### *33.1 Environmental Taxes*

We do not believe that environmental taxes are suitable replacements for the Council Tax. If the object of environmental taxes is to change behaviour in order to achieve an environmental impact, then tax yield will be very low if the measure achieves what is intended. The principal aim of local government taxation is to raise revenue for Local Government.

### *33.2 Land Value Taxation (LVT)*

Land Value Taxation has been proposed as an alternative to the Council Tax. We believe that practical issues surrounding the administration of LVT would make it difficult to implement. We also believe the interaction with existing taxes (from s.75 agreements and business rates to reserved taxes) would need to be carefully considered. We note that a recent interim report to the Northern Ireland Assembly on LVT concluded that “introducing a system of land value taxation to replace the current domestic and non-domestic systems would be difficult and not in line with international trends.”<sup>98</sup>

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<sup>98</sup> Land Value Taxation: An International Overview, University of Ulster, 2<sup>nd</sup> November 2007, reproduced in Appendix 5 to Report 06/07/08R, Committee for Finance and Personnel, Northern Ireland Assembly

## 34 Options for Council Tax Reform

34.1 Council Tax was widely welcomed when introduced as fairer than either the Poll Tax or rates which preceded it. Public awareness of Council Tax is high, and it is transparent. Council Tax has also demonstrated a flexibility to deal with changes in circumstances – for example, when introduced, Council Tax covered 65 local authorities rather than 32 as at present.

34.2 Unlike LIT, Council Tax could cope with an increase in the number of local authority areas, allowing a move to a more local system of local government if that was desired in future.

### 34.3 *Reducing the level of Council Tax*

34.3.1 We believe that it is the level of Council Tax, rather than the underlying principles, which has caused public anxiety over Council Tax.

34.3.2 If there is £281m available to subsidise LIT, that money is also available to subsidise Council Tax bills. The £281m reduction in tax yield could equally be applied to Council Tax, resulting in a significant reduction to Council Tax levels. It would be possible to reduce the Band D level of Council Tax by a specific percentage, or to use the money to fund other discount schemes (such as the Pensioner Discount explored below).

34.3.3 The main advantages of an across the board reduction are the administrative simplicity and the ability to benefit all Council Taxpayers. While we acknowledge that this option would create some issues around the balance of funding of local authorities, we believe the Government should explore it further. As Fergus Ewing MSP said

*“It is reasonable to say that the Council Tax per se is not unfair, but because of the high level that it has reached, its unfairness is becoming increasingly manifest year on year.”<sup>99</sup>*

### 34.4 *Introducing a Pensioner Discount*

34.4.1 The Scottish Conservatives proposed a 50% discount in Council Tax for Pensioner Households in our 2007 Scottish Parliament Manifesto. This proposal would target help at a group of people who are largely on fixed incomes. We believe the principle is straightforward to understand, and it would be relatively simple to administer.

34.4.2 Since the 2007 election, there has been some criticism, not of the principle of the Pensioner Discount, but of the proposal to award a 50% cut. It has been suggested that an across the board reduction by a set sum of money would benefit the poorer more (although if the logic of that argument is accepted, then Council Tax bands are linked to ability to pay). Others criticise it because it is universal: that is precisely why we believe it to be simple to administer, and capable of delivering benefit to Pensioner households.

34.4.3 We believe that a Pensioner Discount is a simple way to help a section of society which has been confronted with Council Tax bills increasing faster than income. Although our preference is for a 50% discount, we are keen to see help delivered to Pensioners as soon as possible. We would be happy to explore options around a fixed cash sum discount if that could be introduced more quickly.

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99 Official Report, 1<sup>st</sup> February 2006, Col 22933

#### 34.5 *Making it easier to pay by direct debit*

At present, not all local authorities allow payment by direct debit each month (typically payments are permitted over 10 months instead.) Encouraging Councils to allow Council taxpayers to pay in 12 instalments rather than 10 would make it easier for some individuals to budget for their Council Tax payments.

#### 34.6 *Discounts for regular or early payment*

In Northern Ireland, a 4% discount on rates is applied if payment is made within one month of the Bill being issued. The Northern Ireland Committee for Finance and Personnel has recommended a similar discount being introduced for payment by direct debit.<sup>100</sup> Dumfries & Galloway Council currently operates a discount for full prepayment, but it does not appear that any Scottish Local Authority operates a direct debit discount. A similar discount could be introduced as an option for local authorities to offer, or could be introduced on a Scotland wide basis if central funding ensured that local authorities did not lose out. If successful in raising the payment levels of Council Tax, this option would be less expensive to implement than at first glance.

#### 34.7 *Increasing uptake of Council Tax Benefit*

34.7.1 Help the Aged, although critical of some aspects of the Council Tax system, notes that *“Council Tax benefit, if claimed, can be highly effective in alleviating the worst effects of Council Tax on deprived older people.”*<sup>101</sup> The organisation states that there are several reasons why Council Tax Benefit (CTB) is not claimed by pensioners: *“they are unaware of it, unaware that they are eligible, or discouraged by the often complicated application forms and means-testing that an application entails”*

34.7.2 These issues are part of the reason why the Conservatives proposed an automatic Pensioner Household Discount. There is no reason why the same issues do not apply for the non-pensioner population who are eligible for CTB.

34.7.3 We believe that the Scottish Government should work with local government and the UK Government to increase the take-up of Council Tax Benefit by those who are eligible.

#### 34.8 *Energy Incentives*

Although we do not favour replacing Council Tax with an environmental tax, one of the benefits of Council Tax is the ability to offer incentives on a local level. In some English local authorities, discounts are given to Council Tax Bills if certain energy efficiency measures are taken. We believe this is worth exploring as part of a package of Council Tax reform.

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100 2<sup>nd</sup> Report, 2007, 06/07/08R, para 43

101 Help the Aged in Scotland Policy Briefing, Council Tax, 2007

### 34.9 *Revaluation*

34.9.1 A criticism commonly levied at the Council Tax is the fact that bandings are based on property valuations from 1991. It is often suggested that, since property prices have increased substantially since then, a revaluation would lead to a significant increase in Council Tax bills (and yield).

34.9.2 However, we believe it would be possible to operate a revaluation on a revenue-neutral basis. We believe that the current number of bands, and ratios between bands, could be maintained, using current property values, without increasing the total Council Tax yield (and hence bills). Applying a new set of Scotland wide bands on such a basis might lead to some discrepancies between different parts of the country (effectively the burden of council tax would shift from those areas with lower house price growth since 1991 to those with higher rates), but would prevent the across the board Council Tax increases which opponents of the Council Tax regularly refer to.

34.9.3 We believe it would also be possible to introduce a new system of Council Tax with local bands. In principle, local authorities could be given the power to set their own bands, though not to deviate from the ratio between bands, or the number of bands. This could mean that a revaluation could be achieved on a revenue neutral basis not just in Scotland, but in each local authority area.

### 34.10 *Discount for Local Authority Bond Holders*

The Scottish Government appears keen to promote the issue of Local Authority Bonds under the banner of the Scottish Futures Trust. The Scottish Government has confirmed that it would be possible for local authorities to offer a Council Tax discount to the holders of such bonds to incentivise investment.<sup>102</sup>

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102 S3W-13603

## Annex A: Responses to the Consultation Questions

- Q1 In your view, should the local income tax personal allowance be the same, higher or lower than the UK income tax personal allowance?

*Dealt with in Chapter 13*

- Q2 Do you think a flat rate of 3% is too high, too low or about right?

*We do not support LIT as a matter of principle. Issues on tax yield are dealt with in Chapter 23.*

- Q3 Would you be more inclined to pay more Local Income Tax (i.e. above 3%) to provide for better quality local services?

*We do not support LIT as a matter of principle. Issues on tax yield are dealt with in Chapter 23.*

- Q4 Do you believe the level should be set locally or nationally? If you believe the level should be set locally, should Scottish Ministers be able to cap the rate?

*Dealt with in Chapter 6.*

- Q5 Among the following, which should or should not be taxed as part of Local Income Tax?

Earned Income/Wages?  
Income from Pensions?  
Income from Savings?  
Income from Financial Investments?  
Income from Second Homes?

*Dealt with in Chapters 10 and 20.*

- Q6 In your view, do you think that there should be any special exemptions or discounts from a local income tax? If yes, please state what for and share with us any thoughts on how you think these might be funded?

*Dealt with in Chapter 14*

- Q7 Do you agree that a Scottish taxpayer should be defined using the definition already contained in the Scotland Act? If you disagree, how would you propose residency be defined?

*Dealt with in Chapters 11 and 12*

- Q8 In your view should transitional arrangements for individuals apply? If yes, please give your reasons and provide any comments on how you think transitional arrangements should be funded.

*Dealt with in Chapter 22.*

Q9 Which of the following do you think should collect a Local Income Tax?

- HMRC?
- A Scottish Government Collection Agency?
- A private sector collection agency?
- Local authorities?
- Don't Know

*Dealt with in Chapter 15.*

Q10 Do you think local income tax should be collected at source or through payment?

- Collected at source
- Collected through payment
- A combination of collection at source and by payment
- Don't know

*Dealt with in Chapter 15*

Q11 If the Government were to offer support to employers to implement these proposals, which would be the most appropriate medium of support in your view?

- Information booklet for employers
- Designated advice hotline
- Designated advice email
- Website with a section of "Frequently Asked Questions (FAQs)"
- Workplace visits
- Roadshows for employers
- Media Advertising
- None
- Other
- Don't Know

*Dealt with in Chapter 16.*

Q12 In your opinion, will the introduction of a local income tax have positive economic impacts for Scotland?

*Dealt with in Chapter 25.*

Q13 To what extent would the tax rate influence your decision to live in Scotland?

*The impact of LIT on individuals is dealt with in Chapters 26 and 27.*

Q14 To what extent do you agree with the following statements about the impact that a local income tax might have on your working patterns?

- I am likely to work more hours
- I am likely to work fewer hours
- I am likely to work in a different location
- I am likely to change jobs to a different sector
- It will have no impact on my work patterns
- Other work impacts (please specify)

*The impact of LIT on working patterns is dealt with in Chapters 26 and 27.*

Q15 On a scale of 1-5, where 1 is strongly agree and 5 is strongly disagree, how important is it that your local authority has the power to set a tax?

*Dealt with in Chapter 6.*

Q16 Please provide any comments you may have about local income tax and accountability and democracy

*Dealt with in Chapter 6.*

Q17 If you have any specific comment about the impact of our proposals on equality issues, please tell us what these are

*Dealt with in Chapter 32.*

Q18 Do you feel that the money raised from a Local Income Tax should be distributed to councils according to:

- Need?
- Population in each area?
- The amount of local income tax raised in each area?
- Don't Know
- Other

*Dealt with in Chapter 7.*

Q19 To what extent do you agree that Scotland should receive equivalent monies to Council Tax Benefit, after the abolition of the Council Tax?

*Dealt with in Chapter 24.*

Q20 To what extent do you agree that local authorities should play a part in setting a second homes tax?

*Dealt with in Chapter 20.*

Q21 To what extent do you feel second homes tax should be collected by:

- HMRC?
- A Scottish local collection agency?
- A private collection agency?
- Local authorities?

*Dealt with in Chapter 20.*

Q22 Which do you feel is the fairest approach to taxation?

- Council Tax
- Land Value Tax
- Local Income Tax
- Environmental Tax
- None of the above
- Don't Know

*A reformed Council Tax. Dealt with in Chapter 34.*

Q23 Which approach do you feel will provide a more wealthy Scotland?

- Council Tax
- Land Value Tax
- Local Income Tax
- Environmental Tax
- None of the above
- Don't Know

*A reformed Council Tax. Dealt with in Chapter 34.*

Q24 If a Local Income Tax is introduced, what would be the most significant factor (good or bad) for you?

- That the Council Tax will be abolished
- I/My household shall be better off
- I/my household shall be worse off
- That a Local Income Tax system would be fairer than the council tax
- That it will help to make Scotland a wealthier and fairer place to live and work
- Don't Know
- Other

*Either the SNP or the Liberal Democrats would have broken a manifesto promise.*

## **Annex B: Abbreviations used**

CTB	Council Tax Benefit
HMRC	HM Revenue & Customs
LIT	Local Income Tax
LVT	Land Value Tax
PAYE	Pay As You Earn
SHT	Second Homes Tax
SST	Scottish Service Tax, proposed by the Scottish Socialist Party in Session 2.
SVR	Scottish Variable Rate, as set out in the Scotland Act