

A Fairer Local Tax for Scotland: a consultation

Comments from ACCA Scotland

July 2008

A fairer local tax

Introduction

ACCA Scotland is pleased to comment on the above consultation. While we applaud the aim of 'a fairer local tax' and agree with the sentiment that any tax change should result in the creation of a more prosperous country with "the people of Scotland reaping the benefits", ACCA Scotland would like to express its serious concern regarding the proposal for a 3% local tax.

Comment

From the limited information available to us in the consultation document, we are not persuaded that the preferred option in the consultation achieves fairness, or will seem to be fair by stakeholders.

ACCA's recent discussion paper 'Perspectives on fair tax' <http://www.accaglobal.com/pdfs/technical/tech-tp-ft.pdf> highlights the dilemmas the government faces. You will note that, in its introduction, it acknowledged that fair tax is difficult to define and that it is nearly impossible to satisfy all interested parties. For those reasons the discussion paper highlights three issues which are important to taxpayers and which the Government needs to consider:

- Simplicity
- Transparency
- Burden

Simplicity

'Simplicity' is an important indicator when assessing the fairness of tax systems. The more complex a tax system, the greater opportunities there are for evasion and other forms of abuse and also greater chance for exclusion for non-tax experts who are unable to understand the system. The simplicity of a tax system can be measured for instance by the ease to calculate tax liability, the number of tax rates and allowances and the number of loopholes in the system. Of course 'Simplicity' does not automatically result in 'fairness'. Where conflicts do arise, a trade off is needed.

Transparency

'Transparency' is the extent to which the tax system is designed to be easily understood and accessed. For example, how easy it is to obtain an allowance or deduction for tax purposes for a specific item, say a depreciation allowance for an asset used in the business. Transparency also relates to the extent to which it is understood how much tax is collected, and how this tax funds government activities.

Burden

'Burden' refers to the extent to which certain groups, such as businesses and families, may pay disproportionately more tax. The tax 'burden' may also include the level of administration required in order to comply with the requirements of the tax regime. Taxes that cost a lot to administer not only distort the economy but can place an onerous burden on certain groups.

While we appreciate that fair tax goals are difficult to achieve without a radical overhaul of the complete tax system of the country, which is obviously not currently within the powers of the Government, ACCA Scotland suggests that, in its current form, the consultation document does not fully explore, nor adequately consider, all the available options, nor does it properly address the issues of simplicity, transparency or burden.

Our main concerns are:

- Complexity and uncertainty will result in a low level of compliance

The proposed option would increase complexity and lead to a lack of certainty that others are contributing their fair share. If the tax system lags behind the pace of economic change that may contribute to a breakdown of trust and ultimately threaten the future perceived legitimacy of the tax system. The threat is that, as trust in the tax system decreases, levels of compliance may fall, with the tax effectively becoming voluntary.

- A significant funding gap is likely

Implementation costs, a potential shortfall in funds raised, uncertainty over the current council tax rebate and difficulties with collection could all result in a significant funding gap.

- Collection bottlenecks are likely

It is difficult to envisage how the collection processes can be made to work. The suggestion that HMRC be used fails to recognise the difficulty they will face if all taxpayers are required to self assess all income.

As highlighted in our discussion paper, the majority of UK tax revenue is collected through the PAYE system; it is therefore a matter of concern to read, in the National Audit Office (NAO) report on HMRC's 2006/7 accounts, that as a result of difficulties with the PAYE computer systems, compounded by inconsistent working practices within the Department, it is estimated that each year the Department may not be pursuing some £880 million of tax due, and that taxpayers are likely to have overpaid around £340 million, resulting in potentially five million taxpayers not paying the right amount of tax (NAO 2007). This cannot have a favourable impact on fairness perceptions of a new local tax in Scotland.

- Lack of robustness of the key collection criteria

Residency identification, manipulation, lack of certainty and, ultimately, fairness were issues raised by many ACCA Scotland members. Several members questioned residency and, because of the uncertainty surrounding residency, were unable to consider other questions raised in the consultation. While we recognise further consultation is required on how 'residency' will be applied, unless it is carefully managed, residency identification issues are likely to create an environment where, for some, the tax becomes voluntary.

- 'Red tape' will hinder business

The Government now seems to be proposing a much higher burden of proof and more onerous record-keeping requirements for businesses and individuals. The overall impact of the proposed increase in red tape will adversely affect the 'entrepreneurial spirit' within all sizes and types of business.

- Migration of the mobile workforce

ACCA Scotland members are concerned that the risk of migration, its impact on the demographic profile of Scotland, and its effect on the economy have not been adequately considered.

Conclusion

Regrettably, life is not as black and white as is envisaged in the consultation document. In our opinion the issues of simplicity, transparency and burden have not been adequately addressed. We also believe that many will view the proposed change as simply a new tax thus creating the perception that Scotland is a high tax country. We question whether this is really what the Government wants and suggest that the proposal is reviewed with the aim of using this as an opportunity to create a more wealthy and entrepreneurial Scotland by introducing a true fair tax.

We thank you for the opportunity to comment and hope that the Government chooses to work with us and others to further consider all options, rather than

proceed and risk introducing a tax that is not fair. In any case we will be happy to work further in this and any other tax area.

Respondent Information Form: “A Fairer Local Tax for Scotland”

Question 1 - In your view, should the local income tax personal allowance be the same, higher or lower than the UK income tax personal allowance?

If introduced, the same personal allowance rates should be used, as changes to personal allowance limits or the introduction of staggered banding or other allowances can only result in a more complex system. Any change to current allowances will result in the aim of a fairer tax system not being achieved.

Question 2 - Do you think a flat rate of 3% is too high, too low or about right?

ACCA Scotland is concerned that implementation costs, a lack of funds raised, uncertainty over the current council tax rebate and collection issues could result in a significant funding gap. The consultation does not contain sufficient information to allow stakeholders to properly consider the question. The uncertainty over an appropriate rate will result in the aim of a fairer tax system not being achieved.

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

It is important that each factor affecting perception of a fair tax is reviewed. Although we are currently unable to see how the 3% local tax proposal would achieve these goals, an increased tax rate should not be ruled out. However the type of message delivered by including such a question gives rise to uncertainty thus eroding one of the principles of fairer tax.

Question 4 - Do you believe the level should be set locally or nationally?

Given our earlier observations over the new tax proposal, and in order to achieve consistency and certainty, the level should initially be set nationally.

Question 5 - 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?**

If the aim of the proposal is to mirror the current UK tax system, and not to create a hybrid scheme, all the income types listed should be taken into account. Any alteration would result in a hybrid scheme and, while we appreciate that the fair tax goal is difficult to achieve without a radical overhaul of the complete tax system of the country, and obviously this is not currently within the powers of the government, new taxes that start as a hybrid scheme will be questioned by all stakeholders.

However, by extending local income tax to all areas of income, those residing in Scotland, unlike other parts of the UK, would be required to undertake some form of self assessment be this via an annual tax return or some other income return.

Two large tax payer groups - employed basic rate taxpayers and pensioners with another source of income, such as savings income - will now have to complete returns.

HMRC have issued notices to some other taxpayers that tax returns are not required unless their circumstances change.

Clearly, the measures proposed will require these groups to provide a return of all income.

Question 6 - In your view, do you think that there should be any special exemptions or discounts from a local income tax?

As commented earlier, 'hybrid' schemes, or other variations, reduce perceived fairness.

Question 7 - Do you agree that a Scottish taxpayer should be defined using the definition already contained in the Scotland Act? (for more information on this definition see paragraph 19 of the consultation document)

Tax return and PAYE processes are not currently designed to provide this information for every taxpayer. The current information provided by a taxpayer may include a combination of contact address, principle private residence and residence and domicile details.

Suitable mechanisms would need to be discussed with collection agencies. Identification and collection failure could result in the scheme becoming optional for some.

Question 8 - 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.

It is unclear when the change will occur. Individuals and businesses would need time to assess any change, amend records and reassess costs.

It is also difficult to see how the government would be able to achieve a fiscal balance, due to the different tax payment times for employed and self employed persons, without introducing transitional arrangements.

We suggest that change can be eased by transitional arrangement and should be considered for each stakeholder group.

Question 9 - Which of the following do you think should collect a Local Income Tax?

As a collection service already exists, and is managed by HMRC, in the interest of reducing collection costs, discussion should be undertaken with them. Any alternative is likely to result in increased complexity and additional burden for all stakeholders.

Question 10 - Do you think local income tax should be collected at source or through payment?

Fair tax needs to reduce collection/payment complexity. Clearly, when looking at one tax and single sources of income (employment) the better option for government is to collect at source. However, this would result in an added burden and increased complexity for business.

Members from both large and small businesses have raised questions as to how the collection process will work, and what the anticipated extra costs in running the scheme will be, how sub-contractors and migrant workers and their place of residence will be policed and who will be responsible for the process. Advice and other forms of support to employers, including incentives, in recognition of the additional burden to business will need to be considered.

If the local income tax is collected at source employed individuals with another source of income will, under the proposal, be required to suffer two collection types - deduction and payment. The self employed can only be required to self

assess and pay. Accordingly, local income tax will require more than one collection type.

Question 11 – 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?

The proposal, if adopted, would result in all employers in the UK reviewing and changing procedures. If they currently use payroll software they will need to ensure software providers build in a local tax option for any Scottish-based employees. Employers will also require appropriate assistance to ensure that their workforce is informed of the change. In order to achieve successful collection we suggest that all the support options mentioned will be required, together with financial incentives. The risk is that employers will consider that Scottish based employees will increase their costs and that this will result in the perception that Scotland is a high tax country.

Question 12 - In your opinion, will the introduction of a local income tax have positive economic impacts for Scotland?

The introduction of any tax, unless it is seen as fair, will have a negative impact, even if only in the view of those looking to invest or reinvest in Scotland, or simply to employ Scottish-based employees.

The level of economic impact will mainly depend upon:

- Timeframe. For example, there could initially be hardship for those who have made financial decisions based upon the assumption of a continuing council tax regime, such as second home owners in negative equity
- Public perception. For example does the proposal send a signal, whether fair or not, that Scotland is a high tax country?
- The success of Scottish Government in negotiations with the UK government on:
 - administration of collection
 - adjustments in funding for:
 - council tax benefit et al
 - self-employed tax collection

Question 13 - To what extent would the tax rate influence your decision to live in Scotland?

ACCA Scotland members are of the opinion that the question is, in the main, aimed at hourly-paid staff.

Several members highlighted threats and burdens to Scottish business, highlighting residency as a problem.

Individuals may wish to circumvent rules by 'appearing' English for tax collection purposes, for example, using addresses south of the border when completing forms.

Any changes to the current procedures of noting contact addresses were seen as additional red tape burdens for business.

Question 14 - To what extent do you agree with the following statements about the impact that a local income tax might have on your working patterns? (select on a scale of 1- 5 where 1 is strongly agree and 5 is strongly disagree)

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)

ACCA Scotland members questioned whether its motive was "pay less tax by working less" and questioned its relevance to salaried individuals.

If the government is concerned that the proposals may have the effect, or perceived effect, that Scotland is a high tax country then further consultation and communication should be considered.

Questions were also raised as to why a migration question wasn't asked. Many cite difficulty in attracting suitable employees with both professionally skilled people and casual and seasonal workers being given as examples. It was considered that a perception of high or uncertain taxes would lead to difficulty in attracting both skilled and casual/seasonal workers and possibly to the migration of skilled persons.

One ACCA member commented "As a company operating in the hospitality sector, a local additional tax (even if there is compensation by reducing local authority rates) will seriously affect our competitive standing with other parts of the UK, and lead to increased costs which will impact the level of business that

we can attract. Staffing will become more difficult in an industry that has notorious problems in retaining staff.”

Question 15 - 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?

In Question 4 we have already stated a preference for a nationally set tax and laid out our reasons.

Question 16 - Please provide any comments you may have about local income tax and accountability and democracy.

No points to raise

Question 17 - If you have any specific comment about the impact of our proposals on equality issues, please tell us what these are.

We agree that a full and meaningful impact assessment is required. We are concerned that the proposals should carefully consider the cost of collection and the impact on business activity.

Question 18 - 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 (please specify)

Systems of distribution of a national tax to local councils by central government will not satisfy all interested parties. Distribution by reference solely to population or amounts raised in an area would be transparent and simple, but fails to recognise individuals' needs, local needs or cost savings based upon economies of scale. Distribution by reference solely to need will not be transparent nor simple. This illustrates why a national distribution formula should be considered.

Question 19 - To what extent do you agree that Scotland should receive equivalent monies to Council Tax Benefit, after the abolition of council tax?

Clearly, discussions to agree a new and appropriate formula will be required. The formula would need to be known before the setting of a flat rate.

Question 20 - To what extent do you agree that local authorities should play a part in setting a second homes tax?

A move to taxing property and not individuals, as the proposal suggests will create a hybrid system. Similarly, numerous local second home tax rates rather than a rate set nationally would create uncertainty. This would result in the aim of a fairer tax not being achieved.

Question 21 - To what extent do you feel second homes tax should be collected by:

- Her Majesty's Revenue and Customs (HMRC)?
- A Scottish local collection agency?
- A private collection agency?
- Local authorities?

See the reply to question 20.

Question 22 - Which do you feel is the fairest approach to taxation? (select 1 only)

Council Tax

Land Value Tax

Local Income Tax

Environmental Tax

None of the above

Don't know

While we appreciate that fair tax goals are difficult to achieve without a radical overhaul of the complete tax system of the country, which is obviously not currently within the powers of the Government, ACCA Scotland suggests that, in its current form, the consultation document does not fully explore, nor adequately consider, all the available options, nor does it properly address the issues of simplicity, transparency and burden discussed earlier.

Question 23 - Which approach do you feel will provide a more wealthy Scotland? (select 1 only)

Council Tax

Land Value Tax

Local Income Tax

Environmental Tax

None of the above

Don't know

Please see the reply to question 22.

Question 24 - If a Local Income Tax is introduced, what would be the most significant factor (good or bad) for you?

ACCA members commented that whatever system is decided upon, it must be fair and relevant to all.