Low Incomes Tax Reform Group
A voice for the unrepresented

Budget 2021-22: Supporting the COVID-19 Recovery
Scotland's Taxes and Fiscal Framework

Response from the Low Incomes Tax Reform Group (LITRG)

1. Executive Summary

1.1. LITRG welcomes the opportunity to respond to the Scottish Government consultation in advance of the Scottish Budget 2021-22.

1.2. The COVID-19 pandemic has had a major impact on Scotland's economy and public finances. We recognise that there are no easy answers in terms of tax policies to support the COVID-19 recovery. It is important that those on the lowest incomes are treated fairly despite the overall climate, that they do not bear a disproportionate financial burden and that the system works for all.

1.3. We do not put forward suggestions of particular powers for devolution or specific policy proposals. Our concern is to ensure that key principles and issues are borne in mind when considering policies.

1.4. We endorse the points made by the Chartered Institute of Taxation in its submission. We use our submission to focus on points that relate particularly to low income, unrepresented taxpayers, and specifically those that relate to the interactions between the tax system and the welfare benefits system.

1.5. Whatever changes are made, they must take into account the position of low-income unrepresented taxpayers and ensure that early efforts are made to identify and address any unintended consequences – for example, how tax changes interact with welfare benefits. Close attention also needs to be paid to the interactions between devolved and reserved

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parts of the tax system. Failure to do this can result in well-intentioned policy not achieving its desired result.

2. About Us

2.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2. LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3. Introduction

3.1. The COVID-19 pandemic is likely to have long-term economic effects on Scotland. We welcome the fact that the Scottish Government is taking this opportunity to consult widely on its options for the Budget 2021-22, with a view to supporting Scotland's economic recovery from COVID-19.

3.2. Perhaps the starting point should be to identify who has been adversely affected by the COVID-19 pandemic, the degree of that effect and then to determine who the Scottish Government wishes to support. The best policies to achieve this can then be explored – whether in tax or other policy areas.

3.3. We are specialists in tax and related welfare benefits for people on low incomes. We provide online guidance on these matters which, in the 12 months to 30 June 2020, received 4.2 million unique visitors.[1] We are regularly contacted by members of the public via our websites with questions about their tax affairs. These enquiries give us valuable insight into how low-income people interact with the tax and benefits systems.

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[1] Our main website for the general public is www.litrg.org.uk

3.4. The tax affairs of people on low incomes are surprisingly complex, frequently burdensome and often contain traps for the unwary. It is crucial that any tax policies take account of all taxpayers, including those who are vulnerable or on low incomes.

3.5. When making changes, we urge policymakers to be consistent in their use of terminology across taxes and benefits. The word 'allowance', for example, can refer to a myriad of things. We also urge policymakers and governmental departments to ensure that unrepresented taxpayers have accurate, detailed guidance at their disposal. Good communication with taxpayers should also be a core part of the strategy of government.

4. Tax Policy – How should the Scottish Government use its devolved and local tax powers to support the COVID-19 recovery as part of Budget 2021-22?

4.1. Interactions between the tax and welfare benefits systems

4.1.1. In terms of raising revenue, the greatest potential is arguably offered by Scottish income tax powers. We would note, while not offering a view on rates and bands, that the Scottish income tax structure is arguably already more progressive than that for UK income tax. In addition, due to the precise nature of Scotland's powers over income tax, there is perhaps less room for manoeuvre than might be perceived at a cursory glance.

4.1.2. The Scottish Parliament has the power to set rates and bands for income tax on the non-savings and non-dividend income of Scottish taxpayers.[2] When considering whether and how to use the income tax powers to support Scottish taxpayers, it is important to bear in mind the complex interactions between the income tax system (both reserved and devolved aspects) and the welfare benefits system. By way of example, the current personal allowance for tax year 2020/21 (set by the UK Parliament) is £12,500. This means that individuals on very low incomes may have taxable income that falls well within this allowance anyway. Indeed, according to the Scottish Government publication "The Scottish Government's Income Tax Policy in the 2020-21 Budget: Analytical Note on Impacts on Income Levels and Equality since 2016-17" 1,983,000 adults in Scotland do not pay income tax in the current tax year, because their taxable income falls within the personal allowance. This is 44% of Scotland's adult population.[3] This means many individuals in Scotland have income too low to allow them to benefit from say the creation of a 0% rate band for Scottish income tax.

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[2] Non-savings non-dividend income consists of employment income, profits from self-employment, pension income and rental profits.

[3] https://www.gov.scot/publications/scottish-income-tax-2020-2021/

4.1.3. Moreover, as we have previously pointed out, universal credit claimants would not see all the benefit from a decrease in their tax liability from such a measure.[4] This is because the basic position for universal credit is that entitlement depends on net earned income, that is, after tax income: therefore a decrease in tax liability (due to the creation of a 0% rate band for example) results in an increase in net earned income and a subsequent reduction in universal credit entitlement. This reduction follows the 63% taper rate, meaning a universal credit claimant only sees 37% of any change to their net earned income.[5]

4.1.4. Whatever changes are made, they must take into account the position of low-income and unrepresented taxpayers and ensure that early efforts are made to identify and address any unintended consequences – for example, how tax changes interact with welfare benefits. Close attention also needs to be paid to the interactions between devolved and reserved parts of the tax system. Failure to do this can result in well-intentioned policy not achieving its desired result.

4.1.5. By way of example, we note that in response to the COVID-19 pandemic, the Welsh government has made provision for a one-off flat rate payment to social care staff. The payment is £500. However, the payments are to be treated as earnings for tax purposes. This means that recipients will be liable to income tax and National Insurance contributions on the payments. As noted in a LITRG news article, a social care worker who earns above the personal allowance threshold, is not claiming any benefits, does not make student loan repayments and who is a basic rate taxpayer, will likely receive £340 net of income tax and Class 1 National Insurance. If they are in receipt of universal credit, that £340 will reduce to £125.80 – significantly less than the £500 initially announced.[6] [7]

4.2. Local taxes

4.2.1. Over the past few years work has been carried out in Scotland to review both non-domestic rates[8] and council tax.[9] Although recommendations made following the Barclay Review have been and are in the process of being implemented, there has been very little change to

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[4] https://www.litrg.org.uk/latest-news/submissions/171124-scottish-government-discussion-paper-role-income-tax-scotland%E2%80%99s

[5] We note that unearned income, such as pensions, is taken into account on a gross basis, and therefore reduces a UC award £ for £.

[6] https://www.litrg.org.uk/latest-news/news/200811-press-release-bravery-bonus-deductions-likely-irk-carers

[7] In addition, it should perhaps be noted that a significant proportion of these deductions – part of the income tax, all the National Insurance and all the reduction in universal credit – flow to the UK Treasury rather than the Welsh Government.

[8] https://consult.gov.scot/rates-review/barclay-review-of-business-rates/

[9] http://localtaxcommission.scot/download-our-final-report/

council tax. One option would be to earnestly review and reform council tax, with a particular focus on ensuring land or property values are reflected more consistently and updated regularly. This would likely mean that people living in more expensive houses would have to pay more. However, the value of the property does not necessarily reflect the ability to pay or household income. Thought would have to be given to solutions to this issue, which may affect pensioners in particular, for example through a system of reliefs, exemptions or payment deferral.

4.2.2. As with the use of income tax powers, before making any changes to council tax, it would be important to consider interactions with other taxes, tax credits, universal credit and other welfare benefits, whether reserved or devolved.

4.2.3. In our response to The Commission on Local Tax Reform, we suggested possible ways of amending the current system to make it more progressive, given it is, broadly speaking, regressive in nature at present. Many of the points we made in that submission continue to be valid.[10]

4.3. Policy and Legislative Processes

4.3.1. The Scottish Government began a review of the tax policy-making process in Scotland in 2019; this included a consultation, 'Devolved taxes: a policy framework', which was published in March 2019.[11] LITRG and the CIOT submitted a joint response to this in June 2019.[12] This consultation focused on the approach to planning, managing and implementing fully devolved tax policy in Scotland. As we noted in our submission, we thought the overall proposed policy and legislative cycle looked appropriate. We believed it would help to deliver a fair, simple and certain tax system. It would also help to avoid unintended consequences for all stakeholders, including taxpayers and the Scottish Government. While we welcomed the proposed regular and structured cycle, we also noted the need for enough flexibility to deal with urgent issues outside the parameters of the normal cycle. Implementing these new policy and legislative processes should also help to ensure meaningful and constructive stakeholder engagement.

4.3.2. The CIOT has been involved in the work of the Devolved Taxes Legislation Working Group (DTLWG) which was set up by the Scottish Government together with the Scottish Parliament in March 2019. The DTLWG brings together stakeholders, including the CIOT, with an interest in the development of tax legislation.[13] The DTLWG was set up with the aim

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[10] https://www.litrg.org.uk/latest-news/submissions/150622-what%E2%80%99s-future-local-taxation-scotland

[11] https://consult.gov.scot/financial-strategy/devolved-taxes-policy-framework/

[12] https://www.tax.org.uk/policy-technical/submissions/devolved-taxes-policy-framework-ciot-and-litrg-response

[13] https://www.gov.scot/groups/devolved-taxes-legislation-working-group/

of taking forward recommendations made by the Budget Process Review Group in its June 2017 report.[14] In particular, the DTLWG has explored options for alternative legislative processes for devolved taxes legislation and has examined the need for a Finance Bill. The DTLWG published its interim report in February 2020 for consultation and the CIOT responded.[15] Although LITRG has not been directly involved in that group, we endorse the views set out by the CIOT. In particular, we agree that it is important that the work of that group is continued and concluded and agree with the view that a regular Finance Bill process in Scotland would provide Scotland with a practical avenue for carrying out tax changes. In particular, this is important in maintaining the tax legislation, ensuring it suits the current economic and commercial environment, and also would provide a route for correcting any errors in the legislation that only become apparent once the legislation is tested in practical circumstances.

4.3.3. We do not believe that the coronavirus pandemic changes the need for new tax policy and legislative processes for tax in Scotland. If anything, we think the pandemic has highlighted the importance of expediting the changes that have already been explored in the Scottish Government policy framework consultation or are in the process of being considered by the DTLWG. This is because the implementation of these changes should improve engagement, scrutiny and flexibility in relation to tax policy-making and legislative activity.

4.3.4. If the Scottish Government wishes to make use of its existing tax powers, it is essential that there is an open consultation process. This should help to ensure that any changes made are likely to achieve their policy objectives and work effectively; it should also help to identify any interactions with welfare benefits, and reserved policies, as well as any potential unintended consequences.

4.3.5. For all changes to existing devolved and local taxes, it is essential that adequate time and capacity is given over to ensuring that the taxes can continue to be administered effectively and efficiently and that there is clear and accessible guidance for affected taxpayers, as well as awareness-raising of any changes, their timing and what they mean for taxpayers.

5. Tax Policy – Are there any further tax powers that should be devolved to the Scottish Parliament to facilitate our ability to support the economic recovery?

5.1. We do not use our response to advocate for the devolution of particular tax powers. Instead, we set out some of the key considerations that we think should be kept in mind when determining tax powers suitable for devolution.

5.2. We endorse the points made by the CIOT in their response, such as that there should be a full and thorough consultation process, consideration of the four tax canons of Adam Smith,

[14] https://www.parliament.scot/parliamentarybusiness/CurrentCommittees/100930.aspx

[15] https://www.tax.org.uk/policy-technical/submissions/devolved-taxes-legislation-working-group-interim-report

the *locus* of the tax, whether it would be imposed and administered at a national or local level and how it will fit into the Scottish tax system.

5.3. Consideration would need to be given to how the tax would interact with reserved and devolved taxes, and care taken to identify any necessary consequential amendments to UK and Scottish tax legislation. In addition, interactions with devolved and reserved welfare benefits would need to be considered.

6. Tax Policy – Are there any new tax proposals you would like to see implemented by the Scottish Government?

6.1. We do not use our response to advocate for the implementation of particular tax proposals. Instead, we set out some of the key considerations that we think should be kept in mind when looking at new tax proposals.

6.2. If new tax proposals are brought forward, it is essential that there is a full and thorough consultation process, as has indeed generally been the case with Scottish taxes to date, such as Land and Buildings Transaction Tax and use of the powers over Scottish income tax. Ideally, going forward, this consultation would be carried out according to a new tax policy framework process, as consulted on by the Scottish Government in 2019.[16]

6.3. In our response to The Commission on Local Tax Reform we considered a number of new tax policies as alternatives to council tax, including a land value tax, a local income tax, environmental taxes and consumption taxes.[17] We noted some of the key considerations that would be required in respect of each of these.

6.4. We endorse the comments made by the CIOT in their response to this consultation in respect of wealth taxes.

7. Fiscal Framework – What particular fiscal challenges have been highlighted as a result of the Covid-19 emergency? What changes, if any, should be made to the scope of devolved fiscal powers under the Fiscal Framework? What fiscal rules should the Scottish Government follow?

7.1. The Fiscal Framework lies outside our area of expertise. We offer a few brief comments

7.2. We have previously suggested that there should be an examination of the fiscal impacts of the coronavirus support programmes and how funding announced by the UK government

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[16] Devolved Taxes: a policy framework: https://consult.gov.scot/financial-strategy/devolved-taxes-policy-framework/

[17] https://www.litrg.org.uk/latest-news/submissions/150622-what%E2%80%99s-future-local-taxation-scotland

has translated into funds for the Scottish government, via the block grant. This would be in order to try to determine whether or not the Fiscal Framework has operated appropriately.[18]

7.3. We therefore welcome these questions within this consultation. It is hoped that this will also provide responses to feed into the consideration of the Fiscal Framework when it is reviewed in 2021.

8. Tax Education

8.1. For the last two years (2018 and 2019), the CIOT has undertaken a poll of the Scottish public and found a decline in awareness and understanding of the devolved tax regime.[19] In the 2019 survey, for example, 86 per cent of respondents said they need better information about how taxes are decided in Scotland. The poll also identified that the number of people who could correctly identify that income tax was a tax shared between Holyrood and Westminster fell from 34 per cent in 2018 to 26 per cent in 2019. This problem is not unique to Scotland. Last year, a Deloitte survey found that a majority of people in the UK do not understand their personal tax affairs.[20]

8.2. We understand that the Scottish Government has been carrying out work to improve communications about tax with the general public; this needs to be built on and should consider interactions between the Scottish and the UK powers and responsibilities. Improving the general public's awareness and understanding of tax powers, and their devolution should help to improve the accountability and credibility of the tax system in Scotland, and therefore taxpayer buy-in.[21] This should assist in gaining public acceptance of any tax policy changes or the introduction of any new taxes to Scotland.

8.3. LITRG would be pleased to assist the Scottish Government in progressing this work.

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[18] https://www.litrg.org.uk/latest-news/submissions/200601-call-views-advisory-group-economic-recovery

[19] https://www.tax.org.uk/media-centre/press-releases/press-release-new-poll-discovers-more-four-fifths-scots-lack and https://www.tax.org.uk/media-centre/press-releases/press-release-poll-scots-still-failing-understand-devolved-taxes-support

[20] https://www2.deloitte.com/uk/en/pages/press-releases/articles/the-tax-education-gap-majority-of-the-uk-dont-understand-personal-tax.html

[21] https://www2.deloitte.com/uk/en/pages/press-releases/articles/the-tax-education-gap-majority-of-the-uk-dont-understand-personal-tax.html

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