

**The Commission on Local Tax Reform – What’s the Future of Local Taxation in Scotland?
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Introduction

- 1.1 LITRG welcomes the opportunity to respond to the Commission on Local Tax Reform’s (the Commission) call for evidence on the future of local taxation in Scotland.
- 1.2 We are politically non-partisan and do not have views on the levels of taxation or how local expenditure should be funded – these are matters for elected representatives. Rather we seek to identify practical issues that may arise – not with the aim of indicating that a particular route should or should not be followed, but with the aim of ensuring that whatever system is adopted, the Commission and the Scottish Government are aware of any issues that will need to be addressed. As befits our remit, we are concerned to ensure that the tax, tax credits and welfare systems deliver their aims in an efficient and straightforward way, without unintended consequences for those on low incomes and imposing the least administrative burdens on the taxpayer.
- 1.3 We have previously responded to a 2008 Scottish Government consultation entitled “A Fairer Local Tax for Scotland”.¹ We also made representations to the Lyons Inquiry into local government funding, in 2005 and 2006.² Both submissions contain points that may be of interest to the Commission.

¹ The LITRG response is available on our website: <http://www.litrg.org.uk/News/2008/a-fairer-local-tax-for-scotland>

² The LITRG representations are available on our website:
<http://www.litrg.org.uk/submissions/2006/representations-to-the-lyons-inquiry-into-local-government-funding>

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 In recent years LITRG has engaged with the Scottish Government concerning the setting up of Revenue Scotland, including the development of the Revenue Scotland website and the Revenue Scotland Charter of Standards and Values, and has responded to consultations on the Revenue Scotland and Tax Powers Act 2014. We have been involved in discussions on issues relating to the Scottish Rate of Income Tax and have given evidence to the Finance Committee of the Scottish Parliament on tax management issues relating to low income individuals.
- 2.4 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 General principles

- 3.1 LITRG is an initiative of the CIOT; we support the CIOT's separate submission. Our response focuses on points of concern with direct relevance for the low-income individual.
- 3.2 The Scottish Government has committed itself to a tax system that has regard to Adam Smith's four principles: certainty; burden proportionate to the ability to pay; convenience; efficiency of collection. We think that these principles are also relevant when considering local taxation.
- 3.3 In addition, the Commission will need to consider the interactions of local taxation with other taxes, tax credits, Universal Credit and other welfare benefits. Currently, the household water and water waste (sewerage) charges each household pays are related to their Council Tax band, unless a water meter is installed; thus the impact of any changes to local taxation on charging for household water and water waste (sewerage) will also need to be considered.
- 3.4 Before the Scottish Government comes to consider the alternatives put forward by the Commission, it will need to think about its policy objectives and the reasons for local taxation. It might want to consider for example how much funding for local government it

wants to come from local sources.³ It will also need to consider whether it wishes to tax the individual or the household and how broad the tax base for local taxation should be.

- 3.5 The Commission indicates that its remit is to identify and examine alternatives that would deliver a fairer system of local taxation.⁴ What is “fair” is subjective and we cannot express an opinion on whether a particular tax is fair or not – this includes the alternatives we put forward in this response. There is unlikely to be a single system that achieves a proper balance between ensuring that the tax reflects the use of services whilst at the same time paying proper regard to the ability to pay – this is because no two individuals have the same resources (capital and income); in addition, often the tax system ignores outgoings and dependants. With this in mind, we think that, rather than fairness, a more appropriate concept to consider is whether or not a tax is “progressive”; that is one which recognises that society as a whole has to pay for certain people unable to care for themselves and that that burden should fall more on those that can afford it than on those that cannot. We think that within considerations of a progressive system, there also need to be safeguards for vulnerable citizens, including those on low incomes, the disabled, and pensioners.
- 3.6 If the system of local taxation is to be reformed following the work of the Commission, there should be consultation with taxpayers and other stakeholders concerning the details – this will ensure they understand the impact and burden of the proposals and will help to ensure that practical issues are identified and addressed prior to implementation. In this regard, it is important that the law is clear, to minimise disputes; the rules for implementation and application also need to be clear. Alongside this consideration needs to be given to the mechanics and practicalities of collection and administration, including how collection will work and who will carry it out. It will be necessary to limit the opportunities for scams and blatant avoidance. It is also important for the tax to be cost effective, for local government, taxpayers and intermediaries.
- 3.7 Inevitably reform of the system of local taxation will cause some uncertainty, disruption and extra work for, among others, taxpayers, intermediaries and local government. It is important that all parties work together to overcome challenges. A key remedy will be communications – we think that a communications strategy should be developed as part of the planning. We would be happy to assist in this area, with the aim of ensuring that messages reach all affected taxpayers, particularly those on low incomes.

³ Scottish Government statistics show that Council Tax income for 2013/14 was about £1.98bn (after Council Tax Reduction). This constituted 17% of Total Revenue Funding, compared to 21% from non-domestic rates and 62% from General Revenue Funding:

<http://www.gov.scot/Resource/0047/00475413.pdf>. The provisional outturn statistics for 2014/15 suggest a similar percentage (16.9%) of funding for local government from Council Tax: <http://www.gov.scot/Resource/0047/00477389.pdf>. A paper by Fiscal Affairs amalgamates capital and revenue funding, showing that Council Tax formed only 12% of total local government revenues for 2013/14: <http://fiscalaffairsscotland.co.uk/wp-content/uploads/2015/03/Local-Government-Funding-Challenges-March-2015.pdf>.

⁴ <http://localtaxcommission.scot/how-we-work/remit/>

- 3.8 LITRG would welcome the opportunity to assist in ensuring that whatever local taxation system is adopted, it is effective and efficient. We would also wish to assist in ensuring the local taxation system interacts well with the national tax, tax credits and benefits systems.

4 1. Scotland's Current System of Council Tax

To what extent does the current system of council tax deliver a fair and effective system of local taxation in Scotland? Are there any features of the current system that you wish to see retained or changed?

- 4.1 The current system of Council Tax is, broadly-speaking, regressive in nature; this is in part due to the fact that it is a “slab” tax. It is income-regressive in so far as it affects persons on low incomes who are not entitled to Council Tax Reduction; it is also not particularly wealth-progressive, in that its progressiveness is capped at the highest band. Council Tax has a base in the value of the property owned or occupied – this means there is no direct relationship with an individual or household's ability to pay and also no direct link with the services used.
- 4.2 It would be possible to retain and amend Council Tax to make it more progressive. For example, additional bands could be added at the higher end; percentage rates could be used to make the tax more progressive within each band as well as across all bands; finally property values for Council Tax could be updated and regularly reviewed thereafter.⁵
- 4.3 One feature of the current system is that each local council collects its own tax (as well as the associated household water and water waste (sewerage) charges). This means that the Council Tax is clearly visible as a local tax, collected by the local council for the funding of local government. Arguably this assists local accountability.
- 4.4 Council Tax takes account of disability in a few ways. There is a Council Tax discount for single occupancy, from which some households containing a disabled person may benefit, since some classes of people are not counted as living in the property for the purposes of eligibility, including the severely mentally impaired and a live-in full-time carer of a disabled person. There is also Council Tax Disability Reduction available for certain, eligible disabled people. It normally requires the need for alterations or adaptations to the home or the use of an extra room, and results in the reduction of the property's valuation by one valuation band for Council Tax. The use of this Reduction is discretionary, which can mean it is applied inconsistently. In addition, it does not assist those people with disabilities who do not need extra space or home adaptations.
- 4.5 We think that local taxation reforms need to maintain recognition of disability. In order to do so, it will be necessary to consider the Equality Act 2010 and how it affects local taxation. We think there needs to be better promotion of equality for disabled people; this should adopt a uniform approach, which means that a discretionary regime (as there is now) needs to be supported by monitoring and guidance; or there should be a change to a statutory regime.

⁵ The amount of Council Tax that households pay at present depends on their band (A to H), which is based on the value of the property in 1991.

- 4.6 Council Tax provides exemptions for unoccupied properties where the person is absent and providing personal care to someone else / resident in hospital / care – we think such exemptions should remain in a reformed local taxation system.
- 4.7 Although household water and water waste (sewerage) charges are tacked on to Council Tax, there is no corresponding relief for such charges where a household is eligible for Council Tax Reduction. This can lead to the situation where relief is given in respect of Council Tax, but a household still faces a sizeable bill for water charges. The lack of transparency (both Council Tax and water charges are included on the same bill) also means that often, such water charges will go unpaid, as the householder does not realise they are still due. There needs to be greater consideration of how water charges interact with local taxation.⁶
- 4.8 If Council Tax is retained and reformed following the Commission’s work, the main route to “fairness” will be through the exemptions and discounts; this is because the value of the house does not necessarily reflect the income of the householder or their ability to add to their income. These reliefs would help ensure that a reformed Council Tax takes account of income in addition to the value of the property.⁷ A key imperative is to improve take-up of reliefs.⁸ Means-testing (due to the complexity of form-filling) and presentation as a welfare benefit can reduce take-up, especially among pensioners. It is better to present reliefs as an entitlement⁹ and as producing a fair liability to Council Tax based on circumstances. In addition, awareness of entitlement needs to be increased.
- 4.9 The interaction of Council Tax with tax credits, means-tested and other benefits could be improved. A particular problem is that claimants often face excessively high marginal deduction rates – we think it is important to avoid the situation where one government department pays a credit, for another to claw it back through a reduction in a benefit – this is both wasteful of resources and confusing to applicants, and often results in those eligible not pursuing claims or, more importantly, work opportunities. A current example is that adjustments to working tax credits, which count in full as income for Council Tax Reduction/Housing Benefit (subject only to the additional earnings disregard), can either reduce or increase these benefits. One option would be for working tax credits not to count as income for Council Tax Reduction/Housing Benefit. Alternatively, if working tax credits were more generous, there would perhaps be no need for Council Tax Reduction.¹⁰ In future,

⁶ For example, if there is a change in banding for Council Tax, will this mean new bands for household water and water waste (sewerage) charges?

⁷ This combination should provide a better measure of ability to pay, than simply looking at property value alone or income alone.

⁸ The most recent statistics show that the take-up of Council Tax Benefit was estimated to be 62-69% in 2009/10 – <https://www.gov.uk/government/collections/income-related-benefits-estimates-of-take-up--2>

⁹ One could compare the Rebate Schemes that existed in the 1970s and 1980s.

¹⁰ A further option would be to increase the work allowance in Universal Credit and the first income threshold in working tax credit, subject to such changes being within the gift of the Scottish Government.

this problem of high marginal deduction rates will continue with Universal Credit. Universal Credit itself has a withdrawal rate of 65%, but when combined with Council Tax Reduction, which could have a 20% taper, the overall taper can be 85%. Ideally, there would also be a consistent measure of income across all systems, to make them easier to navigate.

5 2. Reform of Local Taxation

Are there alternatives to the current system of council tax that you think would help to reform local taxation in Scotland? What are the main features of these, and why do you think they would deliver improvement?

- 5.1 There are a variety of possible alternatives for local taxation. Whether any particular option should be adopted will depend on the policy objectives of the Scottish Government. In all cases, we think it is important to consider the interactions with other taxes, tax credits and benefits, whether the incidence of the tax should be on the individual or the household, how and by whom the tax should be administered, what relationship (if any) the tax should have to the actual local services used and the knock-on effect on the household water and waste water (sewerage) charges.

Land Value Tax (LVT)

- 5.2 A LVT would probably be payable by the owner of any land. It is likely that this might be passed on to tenants in the form of higher rentals, which might cause problems for tenants on low incomes if it were not a separate element of the “rent” that could be identified and targeted with any reliefs or exemptions.
- 5.3 To solve problems concerning the ability to pay, one option for a LVT system would be to allow deferral of payment, with the land itself as security. The LVT could be a charge on the property and the landowner would have to pay any deferred tax on disposal of the land. Consideration would need to be given to the interactions with other costs to be covered by the value of the land, for example care home fees, and also possible double taxation, in respect of capital gains tax or (in the case of a death) inheritance tax. In addition, consideration would be needed as to whether payment deferral might create cash flow issues for councils.
- 5.4 It would probably be relatively easy to adapt the system for administering and collecting Council Tax to one for the collection of LVT. Because of the property basis, it would probably be fairly simple for people to understand the tax.

Local Income Tax (LIT)

- 5.5 A LIT would ostensibly be aimed at basing tax liability on the ability to pay. However, an income tax system tends to be a relatively blunt instrument and on its own does not truly measure the ability to pay, because it takes no account of any other resources, nor does it take account of dependants or necessary outgoings. For example, it might not tax those with substantial property wealth and tax-free investments but with relatively low incomes.
- 5.6 The incidence of the tax should be considered, i.e. whether it is based on individual or household income. Would children be liable (as they are for national income tax) if they have sufficient income, or in the case of it being assessed on a household basis, would their

income be included in the total of the household's income? How would account be taken of people moving between local councils, and into and out of Scotland?

- 5.7 It is also necessary to consider what income would be chargeable to the tax and what reliefs, deductions and allowances would be available. For example, would a LIT simply tax the same income that falls into national income tax and would it encompass overseas income? Differences between the tax base for national income tax and a LIT would affect the tax base and introduce additional complexity, particularly if Pay As You Earn (PAYE) and self assessment were used to collect the tax. Would there be exemptions or reliefs for low income groups in addition to those provided by the national income tax system? If not, this would keep the tax base broad and minimise complexity. It might also ensure buy-in from all parts of society. But, it might lead to hardship, for example for disabled people.
- 5.8 People with disabilities face many additional costs in everyday life¹¹ – the Council Tax system recognises this. The UK tax system in general does not give across the board allowances for disability; this means that the burden of a LIT will be higher on disabled people. Consideration should be given as to whether a LIT should recognise these additional costs.
- 5.9 It will be necessary to consider administration and collection procedures. HM Revenue and Customs (HMRC) may appear to be the obvious organisation to do this, however there is a question of resources, both in terms of headcount and IT systems. Also, if HMRC collect a LIT, there could easily be the perception that income tax has simply increased in Scotland; there is a danger that the local identity (and a degree of accountability) of the tax will be lost. People need to see and understand what tax they are paying, to whom and for what purpose. It may be possible for local councils (or Revenue Scotland) to collect a LIT, using a similar billing system to that used for Council Tax. The difficulty will lie in obtaining income information efficiently.
- 5.10 A LIT might require all individuals to provide income details to the tax collection authority, placing an unnecessary burden on a vulnerable group. It should be noted that not all individuals are within the self assessment income tax system and therefore do not currently have to provide their income details to HMRC.¹² A LIT therefore risks increasing the burden for all – individuals who would have to provide full details of their income, employers if they are asked to collect a LIT and the tax authority required to administer the tax, whether that is HMRC, Revenue Scotland or the local councils.¹³
- 5.11 If PAYE and self assessment are used to collect a LIT, we have concerns over the ability of the PAYE coding system to cope – in particular, we think it would increase complexity for those

¹¹ <http://www.jrf.org.uk/publications/disabled-peoples-costs-living> (Disabled people's costs of living – Joseph Rowntree Foundation – October 2004).

¹² Much of what LITRG does aims to ensure that those on low incomes can stay outside self assessment and be dealt with by simpler methods, such as PAYE.

¹³ HMRC now collect a large amount of information about the amount of income individuals receive (through real time information (RTI) and from deposit takers), which feeds into P800 calculations for those individuals outside self assessment. The collection of this information could remove the need for payers of LIT to report their income to HMRC, with the caveat that it will not be completely accurate – so people would need to check their position and report any differences.

taxpayers trying to understand their PAYE codes. It should be noted that there is also a 50% cap in respect of PAYE, such that no more than 50% of an individual's PAYE income can be taken via PAYE each payday. If a LIT is introduced and collected via PAYE, it is likely that more people will have to enter the self assessment system as PAYE will be unable to collect sufficient income tax and LIT.¹⁴

- 5.12 We have concerns that there would be an increased burden for small employers, who are currently dealing with various changes, including real time information (RTI), auto enrolment and the Scottish Rate of Income Tax. In this regard, we question whether it is fair to ask employers to collect a LIT on the behalf of local councils?¹⁵ There would be additional costs for employers if they had to pay the LIT to each local authority in which their employees live.
- 5.13 Communications would be key if PAYE were used, as the introduction of a LIT would affect employers based throughout the UK, not just Scotland. Taxpayer communications would also need to be a priority as the introduction of a LIT would represent a switch from a property/household tax to an income (individual/household) tax.
- 5.14 The consideration of interactions between a LIT and other taxes, tax credits and welfare benefits is likely to be a particularly important issue, for example in the area of defining what income should be taken into account. This is likely to be the case for those on a low income who are liable to pay LIT and are also entitled to receive certain credits and/or benefits based on post-tax income. For example, Pension Credit is awarded on the basis of topping up post-tax income to a minimum level. Treating LIT as a tax when calculating post-tax income, rather than as a levy which is disregarded, will affect the level of top up received by way of Pension Credit.

Environmental Taxes (ETs) or Consumption Taxes (CTs)

- 5.15 Both ETs and CTs might assist in linking the system of local taxation with the local services used – so the more an individual or household uses local services, the more CTs and/or ETs they pay.
- 5.16 Ideally, ETs aim to alter behaviour rather than to raise income. If altering behaviour can alter the amount of tax paid, a system of local taxation built around ETs could mean that the source of revenue for local government is insecure. A system of local taxation built around CTs might discourage many people from using certain services, leading them to close.
- 5.17 Systems of local taxation formed of ETs / CTs could be regressive, for example, a family with a young baby, people with particular medical conditions or older people will possibly generate more waste and / or use more energy. In addition, in many cases the use of local services may be inversely proportionate to the ability to pay, since some local services are

¹⁴ This could affect low income individuals, since some taxable income like the state pension is not taxed at source, and is taxed through PAYE by including it in the PAYE code for another source of income. An option would be to disapply the cap in so far as it is breached because of a Scottish LIT.

¹⁵ Unlike with PAYE where the employer receives the benefit of the employee working for them, there is no direct benefit to employers as such from a LIT, and many employers will pay their own local tax in the form of business rates.

often provided to those of low means, for example social services typically provided to people with disabilities and educational services typically rendered to parents of children.

- 5.18 ETs and CTs by their nature do not take account of an individual or a household's ability to pay; a system of reliefs would probably need to compensate for this. It might be better to do this via tax credits and welfare benefits rather than through exemptions for specific goods or services, which would risk distorting the system.
- 5.19 From an administrative viewpoint ETs and CTs would probably be more manageable than some, in that each provider of goods or services could account for the tax to the local authority in which it was situated regardless of where its customers or users came from.

6 3. Local Priorities

How well do you think that communities' local priorities are accounted for in the way that local taxation operates at the moment? If there is room for improvement, how should things change?

- 6.1 This is a complex issue, outside the remit and expertise of LITRG. We make a few general comments only. For there to be true accountability, it is necessary to identify the extent to which a local council has control over expenditure and the extent to which it is capable of raising the income necessary to meet controllable expenditure.
- 6.2 We think there is probably room for improvement in respect of public awareness of how local government is financed and its functions. It would be ideal if the local taxation system, including its administration, assists in raising such awareness.

7 4. Further Information

We would like to keep the conversation going. Please tell us about any event, networks or other ways in which we could help achieve this.

- 7.1 We would welcome the opportunity to participate in further discussions. We have contacts with the two tax charities Tax Help for Older People and TaxAid.

LITRG
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