

## **Managing Scotland's Public Finances: A Strategic Approach Response from the Low Incomes Tax Reform Group (LITRG)**

### **1 Executive Summary**

- 1.1 The Scottish Government has set out four priorities. To make progress against these, taxation policies could be used both to raise revenues to fund policy actions and also to assist with redistribution.
- 1.2 Scottish income tax perhaps offers the greatest scope for raising revenue, while also offering some scope for redistribution. However, there are significant constraints due to the limited extent of the Scottish income tax powers and the interactions, not only with reserved income tax policy, but crucially with reserved welfare benefits policies.
- 1.3 Council tax offers the most scope for redistribution. A CIOT survey from early 2023 suggests the general public would be in favour of changes to council tax. Moreover, the fact that property values on which it is based are now over thirty years old means that arguably reform is long overdue.
- 1.4 We think the Scottish Government's draft tax strategy should include a variety of elements, such as,
- provision for clear guidance and public awareness-raising measures,
  - a plan for evidence-gathering (including consultation) to support policy proposals,
  - a clear process and timetable for tax policy changes,
  - a timeframe and process for consideration of interactions, for example with reserved policies,
  - a process and timeframe for ensuring there is effective and efficient administration in place,
  - requirements for impact assessments and post-implementation evaluation,
  - a clear legislative process.
- 1.5 Improved public understanding and wide consultation may assist with addressing concerns about behavioural change in response to tax policies.

### **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 who are least able to pay for professional advice. We also produce free information, primarily via our website [www.litr.org.uk](http://www.litr.org.uk), to help make a difference to people's understanding of the tax system.
- 2.2 LITRG works extensively with key stakeholders such as HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the tax system. LITRG also considers the welfare benefits system, and other related systems, to the extent that they interact with tax.
- 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 This call for evidence has been published to inform the Finance and Public Administration Committee of the Scottish Parliament's pre-budget scrutiny for 2025/26. The call for evidence focuses on three key areas:
- Progress on the Scottish Government's public service reform programme
  - The Scottish Government's approach to taxation<sup>1</sup> – including what its draft tax strategy should include and how potential behavioural responses impact businesses and individuals
  - How the Scottish Government is using its capital expenditure to achieve innovation, productivity and growth.
- 3.2 Our expertise lies in the area of tax, as well as its interactions with student loan repayments, tax credits, universal credit and other welfare benefits. Our response concentrates on the second of the key areas covered by the call for evidence – we have answered question two and questions seven to nine. We think it is essential that the Scottish tax system, its policy-making framework and the process for making and amending tax legislation operate effectively and with credibility. This means there must be transparency and accountability in respect of tax policy decisions.

- 4 **Scottish Government priorities. In May 2024, the First Minister set out his four priorities to guide the Scottish Government's decision-making on policy and the budget. He said his four priorities are: eradicating child poverty, growing the economy, tackling the climate emergency and delivering better public services.**

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<sup>1</sup> The Scottish Government sets out its approach to taxation on its website: <https://www.gov.scot/policies/taxes/>

**Q.2 What taxation and spending decisions should the Scottish Government take to make most progress against each of the First Minister's four priorities, within the current financial climate?**

- 4.1 Our answer looks at taxation decisions only. We do not provide views on the required level of taxation, nor on where the burden of taxation should fall. These are matters for politicians. But we note that taxation policies could be used both to fund Scottish Government policies in the areas of priority and also to redistribute resources, to reduce the number of children living in poverty for example.
- 4.2 It should be noted that Scotland's particular combination of funding sources may place constraints upon some of its policy decisions. It is funded by a combination of revenues from Scottish taxes, the block grant and limited borrowing.<sup>2</sup> The capital and resource borrowing powers were enhanced in the updated fiscal framework, published in August 2023.
- 4.3 Not only are there constraints on Scotland's budget as a result of its funding sources, but there are constraints on the tax revenue element of the Scottish budget because of the limited nature of devolved tax powers. Scotland's devolved tax powers currently consist of the fully devolved Land and Buildings Transaction Tax and Scottish Landfill Tax, the partially devolved Scottish income tax, and the local taxes council tax and non-domestic rates. In addition, there are taxes that are going through the process of being devolved, such as the Scottish Aggregates Tax, which is expected to take effect on 1 April 2026.

***Scottish income tax***

- 4.4 Scottish income tax perhaps offers the most potential for raising revenue, and some scope for redistribution, despite the fact that Scottish income tax powers are quite limited.<sup>3</sup> We do not offer a view on possible changes to rates and bands, other than to note that with six rates and bands the structure is arguably already more progressive than that for UK income tax.
- 4.5 Before further changes are made to Scottish income tax rates and bands, it would be necessary to consider the knock-on effects for welfare benefits (both devolved and reserved). This would help ensure that any policy changes are effective in terms of their policy aims.
- 4.6 By way of illustration, we look at how income tax and universal credit interact. Let us take a parent who is a universal credit claimant and a Scottish basic rate taxpayer in 2024/25. If the Scottish Government were to, say, introduce a nil rate band of income tax in 2025/26, of £5,000, with the aim of addressing child poverty, how would it affect this parent? As a taxpayer, they would see their income tax liability fall by £1,000, by comparison to 2024/25. However, as a universal credit

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<sup>2</sup> The borrowing (capital and resource) available to Scotland is set out in the Fiscal Framework Agreement: <https://www.gov.scot/publications/fiscal-framework-agreement-between-scottish-uk-governments/>

<sup>3</sup> Scotland only has the ability to set the rates and bands for the income tax that Scottish taxpayers pay on their non-savings and non-dividend income. However, this power provides more flexibility than is available in Wales, where they only have the ability to partially set income tax rates that Welsh taxpayers pay on their non-savings and non-dividend income.

claimant, they would see their benefit claim reduce by £550, as a direct result of the change to their income tax liability. This is because universal credit claims are calculated using net income (after tax and National Insurance contributions have been deducted), and there is a taper of 55% that applies to earned income. So, in the end, the parent would see their overall income increase by only £450. A basic rate taxpayer who is not eligible to claim universal credit would see their income after tax increase by the full £1,000. So, the policy would benefit people other than those it is targeting, and in some cases, they would actually benefit to a greater extent than those targeted by the specific measure. This shows how such interactions can reduce the effectiveness of policy changes in achieving their objectives. So, there might be more targeted policies outside of the tax system that could help reduce child poverty, for example.

- 4.7 It is not only interactions with the welfare benefits system that can prevent income tax policies from effectively tackling poverty or increasing the take-home income of those on the lowest incomes. Increases to the personal allowance and reductions in the lowest rates of income tax make no difference to those on the lowest incomes, who pay no income tax due to the level of their earnings. Figures published with the Scottish Budget for 2024/25 show that 35.5%, or 1,647,000 adults in Scotland are non-taxpayers. Instead, changes to the universal credit system (for example, increases to work allowances or changes to the taper rate) might increase the household income of those on the lowest incomes more effectively.<sup>4</sup> Such measures might be more effective in tackling child poverty and encouraging more people into the workforce.
- 4.8 When considering changes to Scottish income tax, the Scottish Government needs to assess the benefits of this against other options such as using devolved social security powers or changes to council tax, in terms of their relative impacts on work incentives, and the income and quality of life of the lowest paid. There also needs to be careful consideration of the benefit of particular measures on different sections of the population, such as working age versus retirement age. For example, the recent reductions in the National Insurance rates (UK-wide) were of benefit to working age people in work, but not of benefit to those over state retirement age, even if they were in work.

### **Council tax**

- 4.9 Council tax perhaps offers the most potential for redistribution. There have been few changes to council tax, despite several reviews taking place since its introduction. At the start of 2023, the CIOT commissioned a survey to look at attitudes to council tax reform in Scotland. Of those surveyed who expressed a clear opinion either for or against an end to the present system, the vast majority were in favour of it ending. However, there were a variety of views about what should take its place.<sup>5</sup>
- 4.10 One option might 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. Such a review could include the bands and rates. Currently the property values used are those as at 1991 for properties

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<sup>4</sup> We note that the Scottish Government and Scottish Parliament do not have powers over universal credit.

<sup>5</sup> The CIOT published the survey in February 2023 at <https://www.tax.org.uk/ciot-publishes-poll-data-on-attitudes-to-council-tax-reform-in-scotland>

already constructed at that time, or a nominal 1991 value for new-build properties. Thus, they are more than 30 years out of date. We agree with the OECD that, "Regularly updating property values is ... key to the efficiency, equity and revenue potential of recurrent taxes on immovable property."<sup>6</sup> We set out our views on the problems with the current system of council tax and the out of date property valuations in more detail in our response to the 2023 consultation "A Fairer Council Tax".<sup>7</sup> We acknowledge that any significant reform to council tax would create winners and losers, but there are ways to mitigate those effects and to build a broad consensus, for example by using a consultative approach to developing policy options in this area.

- 4.11 Well-considered reform of council tax, following proper consultation, including up-to-date valuations of properties, could assist the Scottish Government with the achievement of more than one of the priorities. Although the structure is arguably more progressive than that in England, because of the increases in the multipliers for Bands E to H in 2017, nevertheless, the tax continues to place a disproportionate burden on lower value properties. Around 454,000 households claimed council tax reduction in March 2023;<sup>8</sup> this is approximately 18% of households, as National Records Scotland estimated that there were 2.54 million households in Scotland in 2023.<sup>9</sup> Reform could assist with ensuring that Scotland is fairer and more progressive (subject to how this is defined), by making council tax more proportionate to the current value of properties. This might reduce the need for such a proportion of households to claim council tax reduction; this is important, as there are always people who will not claim the benefits or reductions they are entitled to, whether because of a lack of awareness or the lack of practical support to do so. Reform may also help to tackle child poverty. It might offer some scope to raise more revenue, which might make more funding available to help meet other priorities such as improving public services.

### ***Climate change***

- 4.12 Given the priority to tackle the climate emergency, the Scottish Government should examine whether there are tax policy options that might support its environmental objectives. This could include policy options for environmental taxes, like Scottish Landfill Tax. But it could also include policy decisions in respect of non-environmental taxes. For example, the Scottish Government could ensure that property taxes, both devolved and local, and their policies, complement and support environmental objectives. At the very least, care should be taken to ensure that tax policies do not actively work against Scotland's environmental objectives and climate change commitments.

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<sup>6</sup> Chapter 3.3, Housing Taxation in OECD Countries (2022): [https://www.oecd.org/en/publications/housing-taxation-in-oecd-countries\\_03dfe007-en.html](https://www.oecd.org/en/publications/housing-taxation-in-oecd-countries_03dfe007-en.html)

<sup>7</sup> <https://www.litrg.org.uk/submissions/consultation-fairer-council-tax>

<sup>8</sup> <https://www.gov.scot/publications/council-tax-reduction-scotland-2022-2023/pages/2/>

<sup>9</sup> <https://www.nrscotland.gov.uk/news/2024/number-of-households-continues-to-increase>

- 5 Taxation. The Scottish Government plans to publish a draft tax strategy alongside its Medium-Term Financial Strategy. It established a Tax Advisory Group which first met in July 2023. Its purpose includes providing advice on: “the development of a tax system that is fit for purpose, delivers sustainable public finances and supports high quality public services and a flourishing economy”, building on the Scottish Government’s Framework for Tax 2021. The Scottish Government said: “We want to build a tax system that works for everyone in Scotland, while allowing us to continue to deliver high-quality public services and keep our finances on a sustainable footing.”**

**Q7. What elements should a new draft tax strategy include to achieve such a tax system?**

- 5.1 Since 2019, the Scottish Government has been carrying out work to improve both the tax policy-making process in Scotland and the associated legislative processes. LITRG has been pleased to be able to provide input, both through written submissions and by attending meetings. For example, we submitted responses to consultations on the development of a tax policy framework, which ultimately resulted in the publication of the Framework for Tax in 2021.<sup>10</sup>
- 5.2 The Scottish Government held a roundtable in March 2024, to set out its objectives for and obtain ideas on what to include in its draft tax strategy. LITRG attended and our response is informed by our understanding of those objectives. It is unfortunate that events have prevented the publication of the draft tax strategy for consultation, as the draft could have informed our response to this call for evidence. We understand that the intention remains to publish the completed tax strategy alongside the Scottish budget 2025/26. We welcome the decision to ensure there is still an opportunity for stakeholders to provide their views to the Scottish Government via a series of stakeholder meetings.
- 5.3 In order to achieve the proposed tax system, a tax strategy would need to set out clearly how the tax system can support the Scottish Government’s financial strategy. We think a tax strategy should include a variety of elements, which we examine below.

***Public awareness and guidance***

- 5.4 One element of a tax strategy should be to provide for clear and accessible guidance for affected taxpayers, as well as awareness-raising measures in respect of new policies and policy changes, including their timing and what they mean for taxpayers. Better public awareness and discussion about tax should help ensure that the tax system works for everyone in Scotland. Ideally, taxpayers should understand what tax they pay, to whom they are paying it (UK or Scottish Government or local authority) and why. Website information should include practical guidance on Scottish taxes, such as that available on the Revenue Scotland website for the fully devolved taxes. In particular,

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<sup>10</sup> <https://www.gov.scot/publications/framework-tax-2021/pages/1/>

there needs to be helpful guidance on Scottish income tax on mygov.scot. On the main Scottish Government website, useful additions to the information could include a calculator such as the one on gov.wales, which tells people how their Welsh rates of income tax are spent.<sup>11</sup>

### ***Evidence-gathering***

- 5.5 To ensure that the tax system works from a financial point of view, there need to be strong decision-making processes with robust procedures for scrutiny. This means the strategy would need to set out how the Scottish Government gathers evidence to support and evaluate its tax decisions. It also means that the strategy needs to include a roadmap for tax engagement in Scotland. This should be aimed at ensuring the evidence-gathering and consultation processes have integrity and are transparent.
- 5.6 The tax strategy should require investment of time and resources in building relationships with a wide range of stakeholders who can provide useful input. There should also be a requirement to consider the best consultative approaches for a particular policy proposal. There should be some flexibility to ensure accessibility and to give all relevant stakeholders the chance to provide meaningful input.

### ***Tax policy-making timetable and process***

- 5.7 We think it would be helpful for the tax strategy to set out a clear process for tax policy changes – this would include a normal timetable and the mechanisms needed. Currently, despite the Framework for Tax 2021,<sup>12</sup> there is a lack of consistency, with some policies following lengthy and detailed consultation and engagement (aggregates levy), and others being surprise announcements (council tax freezes). This lack of consistency, and the lack of opportunity for stakeholders to provide input in respect of some policies, means that it is not possible to ensure that the tax system works for everyone in Scotland. Not only should there be a consistent consultation process, but there also needs to be a known end-point, which could usefully be an annual tax or finance bill. See our comments below on legislative process.

### ***Consideration of interactions***

- 5.8 When making tax policy decisions, it is important that the Scottish Government and Scottish Parliament give detailed consideration to interactions between Scottish tax policies (both national and local taxes) and those for reserved taxes (including the reserved aspects of income tax). In addition, consideration needs to be given to interactions between Scottish tax policies and Scottish social security policies, as well as between those policies and UK reserved social security policies. This will help ensure that policies achieve their intended objectives. See our comments in response

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<sup>11</sup> <https://www.gov.wales/calculate-welsh-income-tax-spend>

<sup>12</sup> <https://www.gov.scot/publications/framework-tax-2021/>

to question 2. The tax strategy should set out and facilitate the timeframe and process for incorporating these considerations.

### ***Tax administration***

- 5.9 The tax strategy should also set out a process and timeframe for ensuring that adequate time and capacity is given over to ensuring there is effective and efficient administration of taxes, whether in relation to policy changes or new policies. In respect of Scottish income tax, the Scottish Government needs to be clear about the service it expects from HMRC and hold the tax authority to account. Poor customer service could have a negative impact on Scotland's revenues from Scottish income tax. This is because it may make it more difficult for some taxpayers to understand or fulfil their tax obligations. As a result, they may make errors, fail to meet deadlines or even disengage entirely with the tax system. In respect of the fully devolved taxes, there needs to be a process for ensuring that Revenue Scotland's digital services reduce burdens for the taxpayer, agent and Revenue Scotland. In respect of all taxes, there should always be alternative channels available for the digitally excluded and those who are less digitally capable.

### ***Impact assessments and post-implementation evaluation***

- 5.10 A tax strategy should set out a clear process for undertaking and publishing impact assessments, whether in relation to economic and financial outcomes, equality and fairness, the environment and sustainability or taxpayer behaviour. There should also be a process for evaluating outcomes post-implementation of a policy. This should include a programme to review whether assumptions made in evaluating impacts prove to be correct, or whether there have been unintended consequences as a result of a policy. It should also allow for taking note of interactions that are only spotted post-implementation, and which might then need to be dealt with via consequential legislative amendments. Evaluation should also assess whether a policy has met its intentions. This may require some concepts used in policy-making to be defined more clearly. For example, if a policy is introduced with the aim of increasing 'fairness', there would need to be an explanation of what fairness looks like in respect of that policy. Metrics would need to be devised to allow the policy to be evaluated. It should perhaps also include a framework for ongoing evaluation of existing policy measures, to check that they continue to meet their objectives, and if not, whether the objectives or the policy measure need to change. For example, the Scottish Government has committed itself to an approach to making tax policy that aims to adhere to Adam Smith's four principles of tax, including that taxes should be proportionate to the ability to pay of the taxpayer. The failure to revalue properties for council tax since 1991 means that an evaluation of the tax against such overarching objectives might show that the policy in respect of council tax needs to change, or that the Scottish Government needs to transparently acknowledge that council tax has different objectives to those currently stated.

### ***Legislative process***

- 5.11 Alongside the policy-making process, there needs to be a legislative process that has integrity and credibility. We think it is important that the work of the Devolved Taxes Legislation Working Group (DTLWG) is picked up in earnest. The DTLWG was set up by the Scottish Government together with the Scottish Parliament in March 2019. It brought together stakeholders, including the CIOT, with an



interest in the development of tax legislation.<sup>13</sup> The DTLWG explored options for alternative legislative processes for devolved taxes legislation and examined the need for a Finance Bill. We believe there is a strong case for adopting an alternative legislation process for the devolved taxes, and we think that an annual finance or tax bill process would provide Scotland with a practical avenue for carrying out tax changes. It is our view that the current processes do not offer a sufficient balance between the competing needs of speed, scrutiny and responsiveness. It is also sometimes difficult to find parliamentary time and a legislative vehicle for required changes. This is illustrated by the need to include unrelated tax administration changes in the recent Aggregates Tax and Devolved Taxes Administration (Scotland) Bill.<sup>14</sup>

- 5.12 Additional advantages of an annual finance bill process would be a likely improvement in taxpayer awareness and understanding of Scottish taxes. This is not only important for ensuring accountability, but it may also help to improve taxpayer buy-in to the tax system.

## **6 Q8. How should a new draft tax strategy address potential impacts of behavioural change on individuals, businesses, and the overall tax take?**

- 6.1 One way of addressing the possibility of behavioural change is to improve public awareness and understanding of tax and tax devolution. This can help to improve the accountability and credibility of the tax system in Scotland; it can also improve taxpayer buy-in, which in turn may help to address behavioural effects.<sup>15</sup>
- 6.2 The importance of timely and high-quality guidance from government sources must not be underestimated. Good-quality guidance benefits all types of taxpayer and can also serve to deter tax abuse or strained interpretations of legislation. It is of particular importance to taxpayers who cannot afford independent bespoke advice, but who are exposed to complex issues around tax, including its interaction with social security benefits.
- 6.3 It is important for individuals and businesses to understand what different tax policies and changes in tax policies mean for them.<sup>16</sup> This is so that they are in a position to make the best decisions for their own circumstances. However, it also means that they are less likely to be misled by media reports, social media or other individuals and businesses, since there can be a lot of misinformation

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<sup>13</sup> <https://www.gov.scot/groups/devolved-taxes-legislation-working-group/>

<sup>14</sup> <https://www.parliament.scot/bills-and-laws/bills/aggregates-tax-and-devolved-taxes-administration-scotland-bill>

<sup>15</sup> <https://www.deloitte.com/uk/en/services/tax/perspectives/tax-education-gap.html>

<sup>16</sup> Over the past few years, the CIOT has undertaken a poll of the Scottish public. The polls have continued to show a low level of awareness and understanding of the devolved tax regime (<https://www.tax.org.uk/news-press-release-poll-scots-still-failing-to-understand-devolved-taxes-but-support-new-levies>, <https://www.tax.org.uk/210407holyrood>, <https://www.tax.org.uk/poll-suggests-growing-confusion-over-scottish-taxes>). This problem is not unique to Scotland.

about tax. One recent example is that a number of people making money through online platforms thought about giving up their activity, because of the misleading media coverage about a so-called "new side hustle tax". In fact, the change was the introduction of new reporting requirements for various online platforms. We produced news articles and guidance to try to counter the misinformation.<sup>17</sup>

- 6.4 There needs to be a holistic approach to this, so that communications about Scottish taxes consider tax and social security together and their interactions. There also need to be communications about interactions between Scottish and UK tax (and welfare benefits) powers and responsibilities. Guidance produced by different government departments should be joined-up, so that taxpayers can always find the guidance they require.
- 6.5 We have encouraged HMRC and the Scottish Government to raise awareness of Scottish income tax by taking advantage of the positive messages they could use. For example, Scottish taxpayers who pay pension contributions under relief at source pension schemes need to contact HMRC to claim their extra tax relief, if they pay tax at the intermediate, higher, advanced or top rate of Scottish income tax. A positive message about the ability to claim additional tax relief would be a useful hook to engage taxpayers. This could lead the taxpayer to explanations of the division of powers between the UK and Scottish Parliaments. So, from raising awareness about eligibility to claim tax relief and how to claim it, it is possible to build taxpayer understanding of the devolution of tax powers. This helps to increase transparency and accountability in relation to devolved powers.
- 6.6 In response to question 7, we mentioned consultation. Wide and effective consultation may also assist in addressing potential behavioural change. It would allow stakeholders to raise their concerns and for the Scottish Government to address them as appropriate. Ultimately it is for the Scottish Government to weigh such concerns up, as to which are legitimate, while also being aware that some stakeholder groups are better able to make their concerns heard than others.

## **7 Q9. What actions should the Scottish Government take to grow the tax base and increase labour market participation, productivity, and Scotland's economic growth?**

- 7.1 As noted in our response to question 2, Scottish income tax perhaps offers the Scottish Government the most options in terms of raising tax revenue. We also noted the various constraints on income tax powers. To some extent, the size of the income tax base depends on the quantum of the personal allowance, as well as the decisions as to what is taxable income and which amounts can be deducted from that income. These are all decisions for the UK Government and Parliament. While the personal allowance remains frozen at £12,570, the income tax base is likely to grow automatically, due to inflationary increases in wages and pensions.

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<sup>17</sup> <https://www.litrg.org.uk/news/new-rules-gig-economy-workers-your-questions-answered>, <https://www.litrg.org.uk/news/more-side-hustle-tax-help> and <https://www.litrg.org.uk/news/side-hustle-tax-mythbuster>

- 7.2 Many of the policies that might assist are outside our remit. However, improved public understanding of tax and good clear guidance may assist with compliance, and therefore reduce tax revenue loss.

LITRG

6 August 2024