

18 July 2008

A Fairer Local Tax (CRE 959)  
CSU  
Spur U5b  
Saughton House  
Broomhouse Drive  
Edinburgh  
EH11 3XD

Dear Sir/Madam

**A Fairer Local Tax for Scotland**

I am writing in response to the above consultation. The Scottish Council for Development and Industry's response is enclosed.

SCDI welcomes the opportunity to comment on the proposals to introduce a new system of local taxation to replace the existing Council Tax. In June 2008, as a result of the consultation, SCDI undertook a membership survey on this issue, which highlighted considerable concern regarding the proposals for a Local Income Tax.

One of the main worries is the lack of adequate information regarding a number of fundamental issues in the consultation document. These are discussed in more detail within the response.

SCDI would be happy to work with the Scottish Government to achieve an acceptable solution to local taxation issues and looks forward to receiving the Scottish Government's response.

Yours faithfully

Dr Lesley Sawers  
Chief Executive

# **A FAIRER LOCAL TAX FOR SCOTLAND CONSULTATION**

## **RESPONSE FROM THE SCOTTISH COUNCIL FOR DEVELOPMENT AND INDUSTRY**

### Introduction

1. The Scottish Council for Development and Industry (SCDI) is an independent economic development organisation which strengthens Scotland's competitiveness by influencing government policies to encourage sustainable economic prosperity.
2. SCDI welcomes the opportunity to comment on the proposals to introduce a new system of local taxation to replace the existing Council Tax. In June 2008, as a result of the Scottish Government's consultation, SCDI undertook a membership survey on local taxation, with 60 per cent of respondents supporting the retention of the Council Tax. Just over half of that group support making the tax more progressive by introducing additional bands at the top and bottom of the current range and increased support to pensioners. Just below a quarter of respondents backed a 3 per cent flat rate LIT, as proposed by the Scottish Government, should be introduced.
3. Some of the other conclusions of SCDI's membership survey have helped to inform the content of this submission.

### General Issues

4. SCDI members made some general comments on the LIT proposals and SCDI would welcome further information on how these issues will be addressed.
5. It is still unclear to SCDI whether the Scottish Government has the power to introduce LIT as a nationally set, flat rate 3 per cent on both the current basic and higher rates of income tax under The Scotland Act 1998 (The Act). There are two points here. Firstly, it is arguable whether such a nationally set tax which is collected by HMRC, as proposed, can be classified as a "local" tax. Secondly, this is an issue which could undermine the relationship between a local authority and its population as well as reduce accountability. The subject of accountability was raised in several of the responses SCDI received. Comments touched on the lack of incentivisation for local authorities to target economic growth in their areas due to a lack of direct financial benefit, but also highlighted a lack of connection and accountability between local authority finance and the expenditure on outputs and services provided by local authorities. This would be increased with a nationally set tax rate.
6. Secondly, the tax varying power contained in The Act only granted the power to alter the basic rate of income tax, not the higher rate, as is stated in paragraph four of the Partial Regulatory Impact Assessment that accompanies the consultation. Clarification of the legal position must be provided.

7. Moving from a property based tax and adding to the income tax will narrow the tax base which could mean relying too heavily on one specific source of revenue. The current property based Council Tax is a much more stable base on which to derive revenue than an income tax which can be subject to changeable economic circumstances and would increase the difficulty in forecasting the yield from this source.
8. Furthermore, increasing the tax on income derived from employment can act as a disincentive to employment. Although, as a very progressive tax, a widely defined income tax such as currently exists has many benefits, adding to that burden of income taxation will not support the Scottish Government's priority of increasing the long-term growth rate of the Scottish economy compared to the rest of the UK or our relevant competitors.
9. This touches on one of the issues most regularly raised by SCDI members in response to the membership survey. Whatever option for local taxation is chosen, it must be a system that does not penalise businesses and other organisations through either impacting on their ability to attract staff from outwith Scotland, or could involve the imposition of additional tax burdens on non-Scottish resident employees working in Scotland. It is important to note that not only is the reality of the tax burden relevant here, but perceptions of tax levels must also be considered.

### The Scottish Government Proposals

#### Ability to Pay

10. SCDI notes that there are fundamental problems with the current Council Tax. It is considered to inflict a disproportionate burden on those with medium to low incomes and is, therefore, not properly related to ability to pay, which should always be a major factor for any form of taxation. SCDI notes the statement by the Cabinet Secretary for Finance and Sustainable Growth in the foreword of the consultation document that 'The Government wants taxation in Scotland to be fairer and based on ability to pay' and the fundamental issue that property tax can not always be linked to ability to pay due to those on low incomes sometimes living in high value properties, especially given recent house price trends.
11. However, the proposal to introduce a LIT which will be based on a narrow definition of earned income according to the consultation, also does not seem to equate well with ability to pay given that unearned income and other wealth will be excluded.
12. SCDI believes that improving the link between ability to pay and the current Council Tax could be achieved by adding to the number of bands and ensuring the property values on which it is based are kept more up to date. The benefits system should also be properly utilised to ensure those on low incomes are properly supported.

## Funding Gap

14. The consultation paper states that the 3 per cent rate that is proposed would not provide the equivalent amount of revenue as is currently accrued from the Council Tax and that an adjustment to local authority funding would be required to bridge this gap and ensure continued proper funding of services. A considerable funding gap has been identified by several sources including local authority finance directors and academics and there is ongoing debate concerning the continuation of Council Tax Benefit revenue that is sourced from HM-Treasury. This is extremely concerning. Any funding gap would either need to be filled by the introduction of a higher flat rate on the basic and higher income tax rates, cuts in local authority services or, if funded by central government as implied by the consultation document, would inevitably put pressure on other spending requirements in what is already a tight fiscal environment. Any of these options would raise concerns and further information is required on both the extent of and solution to this funding gap.

## Who will pay?

15. There are a number of issues regarding defining who will pay the LIT and how it will be administered.
16. Mention has already been made regarding the possible difficulties in attracting staff to Scotland. If the impact on individuals of different local taxation systems in different parts of the UK is sufficiently large, it seems likely that people will be less inclined to live in the higher taxed area. SCDI notes that paragraph 33 of the consultation document specifically states that ‘a reduction in taxes through the abolition of the council tax has the potential to provide a stimulus to the Scottish economy’. Notwithstanding the issues regarding bridging any funding gap set out in paragraph 14 above and the impact this will have on the Scottish economy, much more detailed information and analysis is required on the impacts on the dynamics of the Scottish economy, labour market and on different earnings groups of introducing such a change before any satisfactory conclusions can be drawn on the effects it would have.
17. SCDI made similar points in regard to the issues surrounding the fiscal powers provided to the Scottish Parliament where one of the key problems was deemed to be the lack of independent evidence which might help inform decisions. The ongoing debate about the appropriate level of fiscal powers for Scotland reflects the importance of the right fiscal regime in promoting economic growth. However, SCDI members noted that fiscal issues were not necessarily the most important factor in determining economic growth and identified issues such as improving the skills of the workforce and increasing productivity; encouraging greater private sector research and development; and ensuring an effective contribution from the public sector in support of growth. This last point is especially important in the present context of funding local authorities.

18. It was concluded from that study that, the way that public finances in Scotland are raised is an important factor. Public sector funding must be generated and used in a way that is accountable, that imposes appropriate discipline on public spending and at least does not hamper economic growth. The full report and statement of findings can be accessed at <http://www.scdi.org.uk/pi/2007/2584.pdf> and <http://www.scdi.org.uk/pi/2007/2687.doc>.
19. The LIT would also bring into the local taxation system groups who are currently exempt, in particular, younger employees living in the parental home. One in ten households in Scotland now has a non-dependent adult living at home with parents, and the current difficulties regarding affordability and the ability of first-time house buyers to obtain mortgage finance would seem to indicate this statistic will only rise. These people are currently not liable for Council Tax but would be liable for LIT as currently proposed.

### Administrative Costs

20. The introduction of a LIT will, undoubtedly, increase the administrative costs on business as the proportion of local tax for which employees are liable will need to be calculated. This will require changes to existing payroll systems. For businesses that have operations in Scotland and other parts of the UK, this may require the introduction of a completely different payroll system for Scottish based staff incurring even extra cost.
21. There may also be an added administrative burden in identifying a Scottish tax payer. Although the consultation document states that the definition of a Scottish taxpayer as set out in The Act will be used, several SCDI members have raised this issue and significantly more clarity is required. For example, how would staff that frequently travel or work between Scotland and the rest of the UK be designated or how would offshore workers be categorised?
22. Finally, once having defined a Scottish taxpayer there is an ongoing risk that business will come under pressure to increase remuneration to their Scottish workforces to compensate for the higher tax liability undermining the competitiveness of Scottish operations.

### Conclusion

23. In conclusion, there is considerable concern regarding the introduction of LIT and the consultation document does not provide adequate information regarding a number of fundamental issues. SCDI would be happy to work with the Scottish Government to answer the question of how to develop a fair and practical framework for personal local taxation.

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**18 July 2008**