

To: POLICY & RESOURCES COMMITTEE		Subject: A FAIRER LOCAL TAX FOR SCOTLAND – CONSULTATION PAPER
From: EXECUTIVE DIRECTOR OF FINANCE & CUSTOMER SERVICES		
Date: 22 May, 2008	Ref: AC/BC/HN	

1 Introduction

- 1.1 The Scottish Government has issued a Consultation Paper "A Fairer Local Tax For Scotland", with a closing date of 18 July 2008.
- 1.2 The Consultation Paper proposes a new local taxation system to contribute to the funding of Local Authority expenditure by abolishing Council Tax and replacing it with a Local Income Tax.

2 Background

- 2.1 The proposal for a Local Income Tax (LIT) was a manifesto commitment by the SNP. The Consultation Paper details their intention to introduce LIT during the term of the current Scottish Parliament.
- 2.2 The Council Tax raised £2.2bn funding towards Local Authority Services in 2007/08 (£116m in NLC) of which £391m was paid through Council Tax Benefit (£24.8m in NLC). Pending introduction of a Local Income Tax (LIT) the Scottish Government have provided funding of £70m per annum to Local Authorities to freeze Council Tax levels 2008/09 through to 2010/11.
- 2.3 The Council considered a previous Consultation by the Local Government Review Committee 'Local Taxation in Scotland' at the meeting of Policy and Resources on 19 April 2005. This review was instigated to consider the way in which Local Government services were funded through local taxation.

3 Consultation Paper

- 3.1 The Consultation Paper proposes replacing Council Tax with a Local Income Tax.
- 3.2 The key features of the proposed LIT are summarised below:
- 3% levy on earned income subject to Basic and Higher rates of UK Income Tax
 - Tax free personal allowance matching UK personal allowances
 - Collection by HMRC in conjunction with PAYE and self assessment procedures
 - A tax on second homes, subject to local requirements
- 3.3 The Consultation Paper includes 24 questions regarding the suitability of and manner in which a Local Income Tax could replace Council Tax.

- 3.4 The proposal for Local Income Tax at 3% represents a reduction in the tax yield when compared to Council Tax:

	£m
Council Tax @ 2011/12	£2,326
Local Income Tax @ 2011/12	<u>£1,616</u>
Reduced Yield	<u>£ 710</u>
Represented by	£m
Council Tax Benefit	£429
Revenue Shortfall	<u>£281</u>
	<u>£710</u>

The cumulative sum needed by 2011/12 to continue funding the freeze in Council Tax would be approximately £280m. This sum would be in addition to the £710m above resulting in a reduction of £990m in taxation yield in 2011/12 from Local Income Tax when compared to Council Tax.

- 3.5 The reduction in yield of £990m is anticipated to be addressed by:

	£m	
'Freeze' Council Tax	£280	Scottish Government Funding Identified
Council Tax Benefit	£429	To Be Negotiated with DWP
Revenue Shortfall	<u>£281</u>	Unidentified
	<u>£990m</u>	

Although there is sometime before the proposed introduction of LIT, it will be important to resolve the funding shortfall of £710m as early as possible.

- 3.6 The reduced yield means a lower burden on the tax payer, however, the effect upon individuals and households is dependant upon a number of factors and the outcome cannot be generalised. The table below details the % of family types on average (and the range) affected by the introduction of Local Income Tax.

	Average	Range
Pay Less	67%	57% → 88%
No Change	15%	4% → 38%
Pay More	18%	2% → 30%

The average weekly change in household income by family type ranges from 0.4% - 3.4%. Within each family type there are winners, losers, and those experiencing no change.

4 Consultation Issues

- 4.1 The previous Consultation identified core issues against which any proposed local taxation system could be assessed. In considering the proposed LIT a number of consultation groups (eg, COSLA, IRRV, Directors of Finance) have applied a similar approach and these core issues are commented on the following paragraphs.

Accountability

- 4.2 The introduction of LIT will remove the opportunity for Councillors to set a level of Council Tax that is appropriate to meet the service needs for their community. This will remove the accountability of Local Councillors to their community. Their fiscal responsibility will be in determining the spending of funding allocated to the Council without any

involvement/responsibility for setting the amount of tax raised from individuals.

Ability To Pay/Fairness

- 4.3 The introduction of LIT will provide a tax basis that relates the amount of LIT to the income of the tax-payer and addresses some of the concern regarding the regressive nature of taxation. However as the proposal relates to earned income only LIT does not treat equally those individuals with unearned income (eg savings, investments etc)
- 4.4 Whilst the Consultation Paper suggests that 4 out of 5 households will be better or no worse off there is no data available to analyse the effect within the Council area or to support this proposition on a national basis. Further analysis by the Scottish Government should be made available to evidence this and the effect upon the council of distribution of LIT.
- 4.5 The proposed LIT would address some of the issues of the regressive nature of Council Tax, however, the proposal to limit LIT to earned income and to apply a single rate (3%) does mean that LIT is less similar to Income Tax along with which it will be collected. Income Tax is applied to earned income, savings, rental income etc, whilst LIT is only to be applied to earned income. Income Tax has a Basic Rate (20%) and Higher Rate (40%), whilst LIT will be at a Single Rate of 3%.
- 4.6 In addition the proposal to introduce LIT will remove the most significant, and applicable, form of property tax and unnecessarily skew taxation to earned income rather than accumulated wealth in the form of property.

Relationship to the Benefits System

- 4.7 This area has been the subject of significant, but unresolved discussions between the Scottish Government and the DWP, regarding the validity of Scotland continuing to receive funding equivalent to the £429m due for Council Tax Benefit.
- 4.8 The uncertainty regarding this aspect of funding, representing approximately 26.5% of the yield from LIT, is a concern in considering the viability of the LIT proposal and would make any consideration of introducing LIT dependant upon the outcome.

Collection of Tax

- 4.9 The introduction of LIT would remove the need for Local Authorities to operate a collection system other than to pursue and collect arrears of Council Tax.
- 4.10 One consequence of this would be the need for Scottish Water to develop and introduce a billing and collection system for Water and Waste Water charges. At present Scottish Water benefit from jointly collecting their charges with Local Authority's Council Tax, on a single bill, however, they would need to introduce and fund, a stand alone billing system with the introduction of LIT. As such it is likely that the 'public purse', through Scottish Water, would continue to incur a similar expense to that which the Local Authorities currently bear to operate a billing system. In addition the public sector would also bear the cost due to HMRC for collecting LIT. At present there is no indication of the level of these costs within the Consultation other than they are expected to be less than the current costs of collecting Council Tax.
- 4.11 The proposed LIT envisages the collection by HMRC. Consequently the staff and resources within Local Authorities which are currently applied to billing and collecting Council Tax will substantially reduce. Local Authorities will require to address the effect on staffing (eg, staff engaged directly in Council Tax and Council Tax Benefit and staff engaged indirectly in areas including Recovery, Cash Offices, First Stop Shops, etc), assets (Office Accommodation, First Stop Shops, Contact Centres, Cash Offices, Software, Cash Receipting etc), and partnerships (Post Office, Printing, Sheriff Officers, Scottish Water, Banking, etc).
- 4.12 The collection of LIT and IT as a single deduction from earnings may confuse the public as to the amount they are paying towards Local Services.

- 4.13 The collection by HMRC of LIT will introduce a cash flow delay compared to Council Tax where the tax payer makes payment directly to the Council. Based on current levels this could equate to a cash flow loss of approximately £25-£40,000 per month in interest for NLC.
- 4.14 The shortfall in resources from Local Taxation equates to approximately 5% of Local Government expenditure and such a significant sum would impact upon service provision unless the shortfall is met by additional Scottish Government grant.

Preventing Avoidance/Collectibility

- 4.15 There is no available reference data to assess and compare the in-year collection or cumulative collection of Income Tax by HMRC.
- 4.16 Whilst there are clear penalties in respect to Income Tax (eg, interest, surcharge) there is no indication that these would equally apply to LIT or what, if any, other sanctions would apply.

Effect On The Economy/Economic Growth

- 4.17 The proposed LIT is based on the premise that there requires to be the same funding for local services and as such will have no effect on the economy from this perspective. In raising the funds the proposed LIT will provide 2 out of 3 households with an increase in disposable income which would have a positive effect on the economy, however, as the same amount of funding is to be raised then other areas of the economy will have reduction in spending which will compensate. Broadly the impact on the economy may be negligible.
- 4.18 Public perception of the effect on the economy may be positive due to 2 out of 3 households paying less LIT than Council Tax, however, perception may also be affected by a view that taxes are however in England and Wales (20%, 40%) whilst in Scotland (23%, 43%).
- 4.19 The additional 3% levy on earnings may act as a disincentive to people working additional hours as a further 3% of their income will be paid towards local services.

Stability and Predictability / Buoyancy

- 4.20 The Council Tax system benefited from a stable and predictable tax base being properties. The main factor influencing this each year was the growth in the tax base of approximately 1%, a relatively small variation.
- 4.21 LIT stability and predictability will depend upon earnings and employment and these are more likely to be subject to wider variation than property based taxes.
- 4.22 In order to ensure that the necessary revenue is raised there may be a need to vary the level of LIT annually and this would create a degree of uncertainty for the tax payer.
- 4.23 LIT will be a taxation basis which responds well reflecting changes in the economy as they are experienced through earnings and employment levels.

Shift To A New System: Timing And Transitional Arrangements

- 4.24 The introduction of any new tax system is a significant undertaking and needs appropriate consideration to ensure that the change programme is managed effectively and that the impact on taxes raised and funding for service delivery is minimised.
- 4.25 The proposal for LIT at present has a number of significant uncertainties which make it difficult to assess the viability of the scheme:
- Likelihood of additional funding equivalent to £429m of Council Tax Benefit
 - Need to identify funding of £281m of revenue shortfall
 - The ability and cost of HMRC to operate LIT
 - The ability and cost of Scottish Water to bill and collect Water and Waste Water charges
 - The need to inform the public of the new system

5 Consultation Response

- 5.1 The proposed responses to the questions posed within the Consultation Paper are detailed in Appendix 1 based upon the considerations of the issues noted above. These responses and the Committee report will be submitted together in response to the consultation paper.
- 5.2 The report and Consultation responses will also form the basis of the Council's contribution to the collaborative responses from COSLA, CIPFA Directors of Finance, IRRV.

6 Recommendation

- 6.1 The Committee is asked to :
- (i) Approve the report and the Council's draft response, as detailed in Appendix 1, to the Consultation Paper.



Executive Director of Finance & Customer Services

For further information on this report please contact Brian Cook on telephone: 01698 403929.

APPENDIX 1

A FAIRER LOCAL TAX FOR SCOTLAND CONSULTATION

Q1 In your view, should the local income tax personal allowance be the same, higher or lower than the UK income tax personal allowance.

A1 The same. There is no evidence to suggest any advantages to altering the Local Income Tax personal allowance from that used by HMRC, indeed having the same allowance would probably be better understood and accepted by the public.

Q2 Do you think a flat rate of 3% is too high, too low or about right?

A2 It is unclear whether the 3% rate is right as the consultation paper does not provide sufficient detail to determine the effect of an LIT at this rate. The SNP manifesto identified the 3% rate for LIT and the consultation proposal accords with this. It is clear that the 3% LIT will not raise enough tax revenue to support the funding of the existing level of service delivery. The funding shortfall that would then exist could mean that funds are reassigned from other priority areas with an adverse impact.

Q3 Would you be inclined to pay more Local Income Tax (ie, above 3%) to provide for better quality local services?

A3 The proposal is for a Local Income Tax based on a single national rate of 3%. This precludes any opportunity to raise funds for local priorities / needs. It would be unfair to expect that everyone in Scotland should pay an additional % to benefit an increase in services in any single locality.

The solution would be to allow the LIT to be set locally and each Council would then be able to identify and respond to local needs through the setting of their local taxation.

Q4 Do you believe the level should be set locally or nationally?

A4 The LIT should be set locally to allow needs to be met and accountability to be maintained between the public and their elected Councillor. This will allow local needs and aspirations to be met based on the local mandate which has been endorsed by democratic elections and representations. There should not be a cap set on the amount Local Authorities need to provide local services and meet local needs.

Q5 Among the following, which should or should not be taxed as part of Local Income Tax?

A5	Earned Income / Wages?	-	Yes
	Income from Pensions?	-	Yes
	Income from Savings?	-	Yes
	Income from Financial Investments	-	Yes
	Income from Second Homes	-	Yes

The proposed LIT suggests savings and investments be exempted on the basis of simplicity. Such an exemption would mean that many individuals would not contribute towards the cost of local services for significant elements of their income. This reduces the fairness of LIT as it does not take into account the ability to pay of those with significant unearned income.

Q6 In your view, do you think that there should be any special exemptions or discounts from a local income tax?

A6 No.

Q7 Do you agree that a Scottish taxpayer should be defined using the definition already contained in the Scotland Act, described at paragraph 19 above?

A7 Yes.

Q8 In your view should transitional arrangements for individuals apply? If yes, please give your reasons and provide any comment on how you think transitional arrangements should be funded.

A8 Yes. Where individuals / households are affected by a substantial changes to their liability there should be a transitional scheme to protect their finances. It seems equitable that where businesses benefit from transitional relief in NDR, citizens should enjoy the same with Local Income Tax.

Q9 Which of the following do you think should collect a Local Income Tax?

Her Majesty's Revenue and Customs (HMRC)? ✓
A Scottish Government collection agency?
A private sector collection agency?
Local Authorities?
Don't know.

A9 If the system is a national set rate of LIT then HMRC are the obvious choice as they currently have the infrastructure, systems and processes that would form the basis of billing and collection. If funding for local needs is to be encouraged and LIT is to be locally set then the collection would be better handled by the local councils.

Q10 Do you think local income tax should be collected at source or through payment?

Collected at source?
Collected through payment?
A combination of collection at source and by payment? ✓
Don't know

A10 A combination of collection at source (employees, savings etc) where possible and by payment (self employed, rental income etc) where necessary reflecting the current systems used for IT.

Q11 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?

Information booklet for employers. ✓
Designated advice hotline. ✓
Website with a selection of 'Frequently Asked Questions (FAQ's)'. ✓
Workplace visits. ✓
Road shows for employers. ✓
Media advertising. ✓
None.
Other (please specify).
Don't know.

A11 It will be imperative for Government to ensure that employers are fully aware of the obligations that will arise from LIT and it will be necessary to utilise all of the suggested mediums as appropriate. There will be a need for early information to be made available of the intent to introduce LIT as there will be significant work for employers and software companies to introduce compliant systems and processes.

Q12 In your opinion, will the introduction of a local income tax have positive economic impacts for Scotland?

Yes.

No.

Don't know. ✓

A12 The consultation paper does not provide sufficient analysis / information to determine this. The Scottish Government should ensure that research is undertaken and outcomes considered, and consulted upon if necessary, which would allow individuals / organisations to make their view known based on evidential grounds.

Q13 To what extent would the tax rate influence your decision to live in Scotland?

A lot.

A little.

Not at all.

A13 This would clearly be a matter of choice for each individual / household however the introduction of Local Income Tax may be a factor in people deciding to locate in Scotland or in influencing where to move to when they have a decision to make in terms of employment / residence.

Whilst it is suggested that the negative effects of Local Income Tax are only focussed on a small minority (based in statements/data in consultation paper) this group are the highest earning decile and each decision to reside outside Scotland would mean a greater than average loss of revenue from Local Income Tax.

Q14 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). ✓

A14 Previous studies on behavior indicate that the deductions (Income Tax, National Insurance and potentially Local Income Tax) are a disincentive to additional working as they reduce the earnings. The introduction of Local Income Tax could be a disincentive to work more as for every extra hour's pay a further 3% will be paid towards Local Income Tax.

Q15 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?

A15 Strongly Agree (1) that the Local authority should have the power to respond to local needs / aspirations and set the appropriate level of taxation to meets these needs. This is a significant aspect of the accountability between the public and their elected members. The Council believes it is imperative, and indeed embedded in the ethos of local democracy, that there are revenue raising powers.

Q16 Please provide any comments you may have about local income tax and accountability and democracy.

A16 It is necessary to ensure that local communities believe that by voting for a local representative that they can fulfil election promises and this may involve raising a different revenue from neighbouring authorities. The proposed LIT will result in Council's being reliant on the Scottish Government distributing all funding on the basis of GAE, tax payer residence and Councils will have no scope for varying local taxation to meet local needs. This will remove accountability of elected members to their communities.

Q17 If you have any specific comment about the impact of our proposals on equality issues, please tell us what these are.

A17 Insufficient information / analysis within the consultation to take respond to this. The Scottish Government should undertake research to allow an informed view to be given.

Q18 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).

A18 The distribution should be on the basis of need reflecting local circumstances.

Q19 To what extent do you agree that Scotland should receive equivalent monies to Council Tax Benefit, after the abolition of council tax? (where 1 is strongly agree and 5 is strongly disagree).

A19 Strongly disagree (5) as the payment of Council Tax Benefit is made to support relief for payees of Council Tax, where Council Tax is being abolished there is no premise for continuing the payment of Council Tax Benefit.

The proposal for LIT contained in the consultation paper does not expect Local Income Tax to raise the same level of revenue as Council Tax. Consequently there is not a level of funding being generated based on the need to provide services. Any shortfall in funding for services arising from a decision to introduce Local Income Tax should be met from Scottish Government but without reducing the spend on other priority areas or sectors.

Q20 To what extent do you agree that local authorities should play a part in setting a second homes tax? (where 1 is strongly agree and 5 is strongly disagree).

A20 Strongly disagree (5) with continuing with a second home since it can only recover a relatively small amount of revenue (approximately 0.67% of the taxbase within the Council) and will be administratively difficult to collect. As the proposed LIT intends not to tax savings and investment income it seems inequitable to set up a system to tax Second Homes which would collect considerably less tax revenue.

It is unfair to propose local setting of taxes for the small amount of revenue for Second Homes on the principal that the revenue will be used to further local policy / needs whilst suggesting that the significant revenue from LIT should be a national rate unrelated to local need and accountability.

Q21 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. ✓

Don't know.

A21 If required to be collected it is best done by local authorities

Q22 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.

A22 The development of Council Tax would be the most suitable approach to local taxation and reflects the Council's response to the previous consultation 'Local Taxation in Scotland'.

The principle of tax on property is long established and in use in many countries (consultation identifies 26 instances out of 28 Countries) to provide funding towards local services as property taxes are easy to identify and hard to avoid. If there is funding available to subsidise the funding shortfall of LIT then its use may be better targeted to address the limitations of the existing Council Tax system. This would have the benefit of modifying an existing tax system, be understood by the public and build upon the current best practices which exist for the billing and collection of Council Tax.

Q23 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. ✓

A23 The consultation paper does not have sufficient information to provide an informed response to this question. If the respective taxes are to raise the same level of revenue then there is limited impact on the net wealth of Scotland.

Each tax base may have a different effect on the distribution of wealth in that individuals may be better/worse off under different tax systems.

Q24 If a Local Income Tax is introduced, what would be the most significant factor (good or bad) for you? (select 1 only).

That the Council Tax will be abolished.

I / my household shall be better off.

I / my household shall be worse off.

That a Local Income Tax system would be fairer than the Council Tax.

That it will help to make Scotland a wealthier and fairer place to live and work.

Don't know.

Other (let us know what the significant factor is). ✓

A24 Other – It would be a missed opportunity for the Scottish Government to use the additional shortfall funding that LIT will need to develop the existing Council Tax system and address its limitations.