

EAST AYRSHIRE COUNCIL

COUNCIL MEETING - 26 JUNE 2008

SCOTTISH GOVERNMENT CONSULTATION – A FAIRER LOCAL TAX FOR SCOTLAND

Report by the Executive Head of Finance and Asset Management

1. PURPOSE

- 1.1 This report proposes the Council's response to the current Scottish Government consultation paper "A Fairer Local Tax for Scotland".

2. BACKGROUND

- 2.1 The consultation paper sets out in broad terms the methodology for a local income tax. This includes tax rates and allowances, definitions of taxable individuals and definitions of taxable income. The paper discusses the costs of administering council tax and makes some assertions on the relative costs of a local income tax. The potential impact of a local income tax on Scotland's economy is discussed. Options for distributing the local income tax between local authorities are examined in the paper. Consideration is given to two other issues affected by replacing the council tax by local income tax, these are second homes tax and arrangements for collecting water charges.
- 2.2 The consultation paper asks for responses in the form of a questionnaire containing 24 questions. The nature of some of the questions is aimed at individual taxpayers rather than organisations and where this is the case no tick box response is proposed. However, comments relating to the 'individual' questions and the relevant areas of the consultation paper are provided where it is considered appropriate. Proposed responses have also been added to the questions which require a narrative rather than tick box answer. The draft response is attached as an Appendix to this report.

3. COSLA POSITION

- 3.1 COSLA is at present finalising its response to the consultation document. In doing so it has recognised the challenging nature of the consultation, coupled with the range of political views held. COSLA has agreed that its response would be formulated in 3 keys stages.
- Stage 1 – agree the high level principles applicable to any local taxation system namely:- Accountability; Fairness; Stable and Predictable; Ease of Understanding and Public Perception
 - Stage 2 – consider these key principles in terms of the specific consultation proposal.
 - Stage 3 – determine whether or not COSLA supports the proposal

4. KEY ISSUES

4.1 The suggested response set out in the attached Appendix is intended to neither support nor oppose the introduction of Local Income Tax but to highlight some of the technical issues that require to be resolved. It includes a number of key issues which are summarised below

- **Accountability** – The proposal within the consultation that a uniform rate of local tax is set for Scotland as a whole may not result in improved accountability, particularly in respect of local variations in the level of individual service provision. Whilst the Scottish Government's proposals are for a flat rate across Scotland there is an openness to views on alternative approaches. CIPFA has previously suggested that a significant increase in the proportion of funding raised and determined locally would assist in the revitalisation of local democracy and its strategic role.
- **Administration and Distribution** – Perhaps the most difficult area in the administration of any local tax system will be determining who is liable to pay. Regardless of final rules determining residency it will be challenging for Her Majesty's Revenue and Customs (HMRC) to maintain an up to date record of the necessary information to determine liability. This specific point is identified in paragraph 54 of the consultation document. If it is proposed that tax revenues are to be redistributed based upon geographic location of the taxpayer then it will be necessary to maintain this information in a register specific to each Council area. Further to this there will need to be a system of appeal in place which may result in additional administration costs.
- **Projected Revenues** – Current indications are that the overall monies raised from the proposed local income tax will be less than the amount currently raised by Council Tax. The consultation document is silent on how this balance will be financed and consequently how the existing level of service provision will be sustained. CIPFA, in its response to the "Balance of Funding Review" presented a "possible model" of funding which was a simple form of local income tax which would supplement, not replace, council tax. This was viewed as a means to strengthen local tax raising powers.

5. POLICY AND LEGAL IMPLICATIONS

5.1 None arising directly from the report.

6. FINANCIAL IMPLICATIONS

6.1 None arising directly from the report. The suggested response to the questionnaire has however identified that the proposed rate of local income tax of 3% could result in a shortfall in revenue of approximately £281M based upon Scottish Government figures. The Scottish Government would require to identify this funding from other programmes to maintain current levels of service delivery in Local Government.

7. RECOMMENDATIONS

7.1 It is recommended that Members:-

- i) Consider the suggested response to the consultation paper.
- ii) Otherwise note the contents of this report.

Alex McPhee
Executive Head of Finance and Asset Management

AMcP/RB
19 June 2008

LIST OF BACKGROUND PAPERS

A Fairer Local Tax for Scotland – Scottish Government Consultation.

Any person who wishes any further information on this report should contact
Alex, McPhee, Executive Head of Finance and Asset Management, Tel: (01563) 576300

Response Forms

Respondent Information Form: "A Fairer Local Tax for Scotland"

Please ensure that you complete the respondent information form and equal opportunities monitoring form as well as the questions below.

Question 1 – in your view, should the Local Income Tax personal allowance be the same, higher or lower than the UK income tax personal allowance?

The same Higher Lower Don't know

One argument in support of a system of Local Income Tax is that it can be integrated within the wider UK Income Tax system. It follows therefore that if the personal allowance was the same as that within the National Income Tax regime the system would be easier to administer by HMRC and would be more easily understood by taxpayers.

Question 2 – Do you think a flat rate of 3% is too high, too low or about right?

Too high Too low About right Don't know

This question is aimed at individuals and no response has been provided for the Council.

The proposal to set a uniform rate throughout Scotland may not improve accountability, particularly in relation to local variations in service provision.

Allowing each Council to set its own rate would introduce added complexity and administration costs however.

Question 3 – Would you be inclined to pay more Local Income Tax (i.e. above 3%) to provide for better quality local services?

Yes No Don't know

This question is aimed at individuals and no response has been provided for the Council.

As far as the level of tax is concerned, it is accepted that the proposed 3% rate will result in a shortfall in revenue of approximately £281m based on Scottish Government figures in the first year of operation (2010/11). This assumes that the Treasury will continue to include Council Tax Rebate Grant, estimated at £400m, in the Scottish Block Grant. This leaves a serious question about the future financing of Local Government, paragraph 30 acknowledges this position but provides no definitive proposals on how this shortfall is to be addressed. As it stands at present, this cost will have to be borne by the public sector in aggregate and therefore impacts on overall levels of future service delivery.

Further clarification of the specific funding assumptions is therefore required.

Question 4 – Do you believe the level should be set locally or nationally?

Locally Nationally Don't know

Question 4 (continued)

If you believe the level should be set locally, should Scottish Ministers be able to cap the rate?

Yes No Don't know

It is accepted that if each Council had the scope to set local tax rates this would result in a more complex and costly system to administer which is acknowledged in the consultation paper. However, consideration should be given to whether this may be an acceptable trade off for a higher level of local accountability. As a basic principle Councils should be answerable to their electorate for decision on levels of local taxation and services provided using these funds.

Question 5 – Among the following, which should or should not be taxed as part of Local Income Tax?

• **Earned Income/Wages?**

Yes No Don't know

• **Income from Pensions?**

Yes No Don't know

• **Income from Savings?**

Yes No Don't know

• **Income from Financial Investments?**

Yes No Don't know

• **Income from Second Homes?**

Yes No Don't know

The existing proposal not to tax income arising from savings and/or investments could create anomalies and conflicts with an argument based upon ability to pay that is advanced in favour of a Local Income Tax system. This is particularly so as those who are not in employment would not pay Local Income Tax irrespective of the level of income from other sources.

Question 6 – In your view, do you think that there should be any special exemptions or discounts from a Local Income Tax?

Yes No Don't know

If yes, please state what for and share with us any thoughts on how you think these might be funded?

For simplicity, liability should be based on the same rules as for UK income tax. This would remove the need for any discounts and exemptions.

Question 7 – Do you agree that a Scottish taxpayer should be defined using the definition already contained in the Scotland Act? (For more information on this definition see paragraph 19 of the consultation document)

Yes No Don't know

If you disagree, how would you propose residency be defined?

Liability - Perhaps the most difficult area in the administration of any local tax system will be determining who will be liable to pay. Whatever the residency rules are, neither employers nor HMRC will currently have the necessary information to determine liability (this is recognised in paragraph 54). There is an issue for example about how up to date employer and HMRC records are in holding employee home addresses. Further, if redistribution of income raised from the tax is to be based on those who are contributing, there will need to be some form of "register" of those subject to the tax for each Council area. Whatever residency rules exist, a formal appeal process will be required.

Avoidance - It may be possible to avoid a Local Income Tax based on residency. For example, the main income earner in a family may work outside the UK.

Administration - There may be difficulties in administration of the Local Income Tax due to the location of both the employer and the associated tax office. For example, an individual may live in Kilmarnock, work in Glasgow; be paid by a London based employer and have an English tax office.

Question 8 – In your view should transitional arrangements for individuals apply?

Yes No Don't know

If yes, please give your reasons and provide any comments on how you think transitional arrangements should be funded.

It would seem reasonable that arrangements are put in place to limit any significant impacts arising from a change in the method of taxation. Transitional arrangements have worked well in respect of other systems. It is possible that a change to the tax system will result in winners and losers with the potential for some households to face significant increases in their local tax liability and many individuals' e.g. adult children living in a household will be paying a local tax for the first time. The existence of transitional arrangements may reduce the level of resistance which is inevitable on the introduction of the tax.

Question 9 – 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?

It seems sensible that HMRC should be responsible for the assessment and collection of the tax.

The consultation paper does not identify any estimate of the additional cost to HMRC of administration of the tax which will require to be established. The consultation paper gives no indication of costs involved with Local Income Tax and although it identifies a cost of £12m in respect of the gross expenditure on Council Tax Valuation, this amount includes non domestic as well as domestic properties and as such it would be unlikely that it could be recognised as a saving.

There are other factors, which need to be considered in looking at the cost of a Local Income Tax system. The consultation paper recognises that HMRC will need to carry out annual "residency checks". This can only be done efficiently by maintaining a register of liable taxpayers. The cost of carrying out this work will require to be established.

The consultation paper does not make reference to any anticipated costs arising from redundancy, either within Assessors Departments or within the administration of Council Tax. The possibility of any significant levels of redundancy together with the expected costs that a change from the current system of Council Tax would bring will require to be quantified.

Question 10 – 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?

It is considered that taxing at source would be the most effective method. However it is recognised that an element of self assessment will be necessary to collect from individuals outwith the PAYE regime.

Question 11 – 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? Please tick all boxes that apply;

- Information booklet for employers
- Designated advice hotline
- Designated advice e-mail
- Website with a section of “Frequently Asked Questions (FAQs)”
- Workplace visits
- Roadshows for employers
- Media advertising
- None
- Other (please specify)
- Don't know

Employers will be faced with additional costs in administering the proposed tax. Whilst any form of guidance/help for employers will be welcomed, financial assistance may also be required particularly for small businesses. Some employers may seek financial recompense if they are required to separately account for tax revenues to Scotland.

Question 12 – In your opinion, will the introduction of a Local Income Tax have positive economic impacts for Scotland?

Yes No Don't know

The anticipated revenues that would be raised through a Local Income Tax are lower than currently raised through Council Tax. The consultation document does not provide any detail of how this gap would be bridged. These will be important, if services are to be maintained at current levels.

Although paragraph 33 of the consultation states that “a reduction in taxes through the abolition of the Council Tax has the potential to provide a stimulus to the Scottish economy and contribute positively towards the Scottish Government’s aim to make Scotland a “Wealthier and Fairer” place” the document does not explicitly set out how this would be achieved.

Question 13 – To what extent would the tax rate influence your decision to live in Scotland?

A lot A little Not at all

This question is aimed at individuals and no response has been provided for the Council.

Question 14 – 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

1 2 3 4 5 Don't know

I am likely to work fewer hours

1 2 3 4 5 Don't know

I am likely to work in a different location

1 2 3 4 5 Don't know

I am likely to change jobs to a different sector

1 2 3 4 5 Don't know

It will have no impact on my work patterns

1 2 3 4 5 Don't know

Other work impacts (please specify)

(Note: 1 is strongly agree and 5 is strongly disagree)

This question is aimed at individuals and no response has been provided for the Council.

Those people who will be brought within the local tax system for the first time (e.g. adult children living at home with parents) may see the tax as a disincentive to work. However further quantification of this would be necessary.

Question 15 – 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?

1 2 3 4 5 Don't know

It is considered that this is an important contributing factor to local accountability.

Question 16 – Please provide any comments you may have about Local Income Tax and accountability and democracy.

A Local Income Tax, set at a national level could be viewed as a disincentive to local accountability. It would remove the discretion from local authorities over the level of resources available to deliver local priorities.

Question 17 – If you have any specific comment about the impact of our proposals on equality issues, please tell us what these are.

The fairness of any system of local taxation needs to be considered not only from the perspective of the individual taxpayer but also for local government and the communities that they serve. The distribution of Central Government Grant would require to address this.

Question 18 – Do you feel that the money raised from Local Income Tax should be distributed to Councils according to:

- Need?
- Population in each year?
- The amount of Local Income Tax raised in each area?
- Don't know
- Other (please specify)

If the rate of tax is set locally then the sum raised must be returned to the individual Councils. As at present the Grant Distribution Formula would require to adjust allocations to take account of the ability to raise tax. If the level is set nationally then a needs based distribution formula would be sufficient.

**Question 19 – 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)**

1 2 3 4 5 Don't know

Council Tax benefit exists to provide help to those on low incomes to meet their Council Tax obligations. The fundamental principle of an income tax system is that it is founded on a concept of ability to pay and therefore there should be no requirement for a benefit system.

The UK government provides finance to local authorities across the UK in order to support the costs of Council Tax benefit. In practical terms, this is a form of local government funding. Since local government is a devolved responsibility this funding should be considered as part of the Scottish Budget.

It should also be noted that local authorities in England would still receive these monies, even if Council Tax were replaced by a LIT in Scotland. Therefore whether it is classed as Council Tax benefit or general revenue funding it would seem equitable that the overall funding was continued as a corresponding level.

**Question 20 – 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)**

1 2 3 4 5 Don't know

Paragraph 55 refers to raising the same income from second homes and empty properties as is currently raised. However the excess income is not directly available to Local Authorities to fund services as it should be transferred to Registered Social Landlords to support social housing. An ability to influence tax rates however may support the overall economic and social policies being advanced by each Council.

Question 21 – To what extent do you feel second homes tax should be collected by:

- **Her Majesty's Revenue and Customs (HMRC)?**

1 2 3 4 5 Don't know

- **A Scottish local collection agency?**

1 2 3 4 5 Don't know

- **A private collection agency?**

1 2 3 4 5 Don't know

- **Local authorities?**

1 2 3 4 5 Don't know

Any system for taxing second homes would require a register of such properties to be maintained, this in itself may prove costly to maintain and difficult to administer in practice.

Section 6 – Specific Comment

If Council Tax is replaced with a system of Local Income Tax consideration should be given to the requirement on local authorities to continue to bill and collect water and sewerage charges on behalf of Scottish Water.

To continue with the arrangement would require Councils to maintain a property database to collect charges for which they have no accountability.

Question 22 – 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

Property taxes have a proven record of being cheap to administer and hard to avoid, although there are flaws in the existing Council Tax system. A reformed property or Council Tax system based on regular revaluations of property values, could improve the fairness of the Council Tax system. In addition, the Council Tax Benefit system could be amended by removing the current capital limits which prevent those with savings from qualifying for assistance and a removal of non dependent deductions. It is recognised that any changes to the benefit scheme are matters for the Westminster Government.

Whilst a Local Income Tax is designed to tax individuals based on their ability to pay there may be an unfair element as some people may avoid paying tax by not declaring earnings. In addition tax on investment income may be costly to collect.

It may be that Councils could have access to more than one local taxation system as is the case in some other countries with Local Income Tax supplementing a reformed Council Tax.

Question 23 – 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

This question is aimed at individuals and no response has been provided for the Council.

Question 24 – 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

Question 24 (continued)

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)

This question is aimed at individuals and no response has been provided for the Council.