

LOCAL TAXATION IN SCOTLAND
A CONSULTATION BY THE LOCAL
GOVERNMENT FINANCE REVIEW
COMMITTEE:

A SUBMISSION BY THE CHARTERED
INSTITUTE OF PUBLIC FINANCE AND
ACCOUNTANCY (CIPFA)

March 2005

1. Introduction

1.1 CIPFA is pleased to comment upon *Local Taxation in Scotland A Consultation by the Local Government Finance Review Committee*. This submission by CIPFA contains a range of information for the benefit of the Committee's independent review. The full range of information, which should be considered as part of CIPFA's comments, is listed at Appendix 1.

1.2 CIPFA, is the leading professional accountancy body for the public services, and has provided professional expertise to the UK Balance of Funding Review and to the independent review of local government funding in England and Wales. CIPFA considers that many of the issues identified during these reviews are analogous to the review in Scotland and can therefore be utilised to objectively inform the present review.

1.3 Local government and local government finance have been the subject of regular and considerable reorganisation and review over an extended period from the mid 1970's to date. The independent inquiry held in December 2000 resulted in a number of conclusions which were subsequently passed to Scottish Ministers. As a consequence, commitment to a further review was made. This broadly summarises CIPFA's understanding of the process which has resulted in the current review.

1.4 Since that commitment to review was made there has been a further round of ministerial appointments in Scotland and this resulted in the creation of a Minister for Finance and Public Services Reform. The portfolio is wide and the focus on reform is demonstrable and would appear to signal continuation of a wide modernising agenda which to date has included:

- The Local Government in Scotland Act 2003 which introduced Best Value, Community Planning and modernised capital expenditure controls;
- the current focus on efficiency in Scotland arising from "Building a Better Scotland: Efficient Government Securing Efficiency Effectiveness and Productivity" and from the wider impact of the Gershon review in England; and
- the proposal for the introduction of Business Improvement Districts (BID's) in Scotland.

1.5 Each of these initiatives can be clearly linked to the wider modernising and change agenda in Scottish public services. Any one of these initiatives in isolation would represent significant reform to public services and to local government in particular. The vision for public service delivery in Scotland as set out by Scottish ministers will be translated into a series of strategic objectives. Some of these objectives, challenge public bodies and local authorities in particular to develop services for the community outwith geographical boundaries. Current challenges faced by local authorities include the delivery of shared services and community planning. Any local government taxation review should therefore have regard to these wider objectives and challenges. It is unlikely that any meaningful review of local government taxation can or should be conducted in isolation without regard to the wider strategic objectives.

1.6 CIPFA however is unable to detect where or how this review is in fact linked to that wider agenda and to the impact on funding outwith that of local authorities. Financial planning at a macroeconomic level including funding mechanisms are there to support and ensure delivery of all strategic Scottish public service goals. Any review therefore of local government taxation which fails to take account of these wider issues may serve the status quo but may not serve the progressive direction of Scottish public services.

1.7 Nevertheless, it is understood that the committee's remit is necessarily restricted and this is acknowledged. In CIPFA's view however it is vital that in reaching conclusions, the committee must give cognisance to these wider dimensions and not local authorities in isolation.

1.8 Notwithstanding these remarks, CIPFA's comments are specifically designed to support this specific remit.

2. The Position of CIPFA

2.1 The consultation paper requests views on 41 individual questions. The paper indicates however that there is no expectation that all questions require to be answered. CIPFA, in commending the approach of the Committee which seeks to gather as much information as possible, considers that the matters for fundamental consideration can be distilled into the following key issues:

- **Property Based Taxation:** CIPFA supports a form of progressive property taxation as the basis of local authority funding in Scotland. Based on consideration of cost of collection, collectability and predictability, a reformed Council Tax subject to corrective action on the gearing effect may represent the most appropriate basis;
- **Non-Domestic Rates and the Balance of Funding:** CIPFA considers that Non-Domestic Rates should be returned to the formal control of local authorities. The aim of this should be to work towards a balance of funding of which more than one half is within local authority control; and
- **Local Income Tax:** CIPFA has carried out significant research into models of local income tax and would consider to be in a position where the benefit of that expertise can be provided to the Committee. Notably, expertise as opposed to advocacy of any model of local income tax is offered in these comments although it's introduction in the UK may be a realistic option. In Scotland, it is unlikely that any serious examination into local income tax or any variant thereof, could take place without having due regard to the impact of the 3p tax varying powers of the Scottish Parliament.

2.2 These key areas form the central focus for CIPFA's comments and where appropriate, these comments are referred back to the questions set by the Committee. These comments should be considered to be CIPFA's initial advice and the Committee should note that we will be pleased to assist with the Committee's review beyond this initial submission.

3. Property Based Taxation – The Council Tax (*Refer Questions 7 – 11*)

3.1 CIPFA considers that it is entirely appropriate that a proportion of the local tax raising capacity in Scotland should be based on a progressive property tax or taxes levied on the 2.2M chargeable dwellings in Scotland. The rationale for CIPFA's support for a property tax relates principally to the collectability, predictability and cost of collection of the tax. There are however a number of reforms to the present system which CIPFA would support. Both the reasons for support and the areas of reform are discussed in detail below.

CIPFA's Reasons for supporting Council Tax

Collectability of Council Tax

3.2 Local authorities in Scotland collect council tax in excess of 90% of the expected level. While there may be scope for improving this, CIPFA would consider that any tax which results in collection levels of this magnitude provides, in itself, a strong argument for retention and would maintain a link between local compulsory levy and local accountability.

3.3 It is understood that levels of collection vary not only between local authorities in Scotland but also when comparison is made with other local authorities in the United Kingdom. It is understood that CoSLA and the Scottish Executive have commissioned research to enable an understanding to be gained of why variations exist. CIPFA commends this initiative and awaits the outcome from that research. Clearly, that exercise will inform the work of the Committee.

3.4 Council tax collection is an area where efficiencies, perhaps gained from delivery of shared backroom services, may be possible. This is a development which would impact directly upon the cost of collection of tax, as well as improving performance in the collection of council tax if this is deemed an objective worthy of pursuit.

Costs of Collection of Council Tax

3.5 A fundamental canon of any taxation system is that costs of collection should be as economic and efficient as is practicable. The cost of council tax in Scotland generally is between 1.5% and 2%. Table 4 below, further analyses the costs of collection of council tax in Scotland over three financial years.

Table 4 Cost of Collection of Council Tax			
	2002/3 £'000	2003/4 £'000	2004/5(est) £'000
Council Tax to be collected	1,744,132	1,833,221	1,935,596
Cost of Collection	33,253	30,568	30,355
Cost of Collection as a % of Tax	1.9%	1.7%	1.6%

SOURCE: RATING REVIEW

3.6 The level of collection costs is reasonable at under 2% and is a principal reason why CIPFA supports the tax. Notably however cost of collection does represent consumption of £30M of resources, a considerable sum under any circumstances. The largest cost of collection in any one council is some £5M of this figure while the smallest individual cost is under £200K.

3.7 A further and current matter to be considered therefore is any potential efficiencies which may be gained in future from the present efficiency agenda in Scotland. The Committee will be aware of the debate on the potential progression by local authorities in Scotland to consider shared services. In particular, current debate has focused upon central services, generally referred to as 'backroom services'. Collection of council tax may be a representative example where both economies and efficiencies could be gained in future from progression to shared services. The debate however is at an early stage and CIPFA would caution against any decision on local taxation which would result in additional costs in the short term when local authorities may be taking steps which could result in reduced costs and/or better efficiencies in the longer term.

Predictability of Council Tax

3.8 In Scotland there has been recent and positive development towards three year budgeting. Essential to this process has been the forward three year funding levels advised by the Scottish Executive. One element of this arrangement has been the requirement by the Scottish Executive and the ability of local authorities to set indicative council tax levels. One by-product of this arrangement is that an element of predictability has been introduced to what was otherwise an annualised compulsory levy. Table 3 sets out a comparison between indicative band D levels for selected local authorities for a two year period compared to actual set band D levels.

3.9 The Band D rates in Table 3 indicate that, for the selected local authorities, from the set indicative levels for 2003/4 to the actual level for 2004/5 there was evidence of stability. The benefit is twofold. Local authorities having been given indicative funding levels can set tax levels in advance which council tax payers can reasonably expect and anticipate to pay. The extent to which council tax payers do anticipate and rely upon future council tax levels is not known. The concept is a positive by-product of being able to set a single level of property tax.

Table 3 Comparison Between Selected Indicative and Actual Council Tax Levels				
	2003/4		2004/5	
	£	£	£	£
	Indicative	Actual	Indicative	Actual
Aberdeen City	1,020	1,030	1,108	1,071
Aberdeenshire	966	966	1,014	1,014
East Ayrshire	1,014	1,014	1,064	1,064
Fife	981	981	1,015	1,015
Highland	989	989	1,039	1,039

SOURCE: RATING REVIEW

3.10 This submission now addresses areas where reform is possible and commences with a consideration of areas where the council tax is capable of being challenged on whether it is a progressive tax.

Reforms supported by CIPFA

Progressiveness of Tax

3.11 The following may indicate why council tax is not wholly progressive:

- the part property and part personal based nature of the tax;
- the lack of a direct link between the basis of taxation and the ability to pay the tax;
- there is a reasonably static tax base in the form of the number of properties, yet somewhat paradoxically, there are also elements of a shifting tax base given the requirement to discount taxation where there is single occupancy of a property;
- there is a complex national benefit system, rather than a local, benefit system. The system seeks at the point of application to means test the ability of an individual to pay. Notably, ability to pay is not an issue on levy of the tax but on application for benefit; and
- there is a prescribed relationship between a narrow range of property bands, none of which has been subjected to revaluation since April 1991.

3.12 CIPFA would support a package of reforms which addresses some or all of the above issues which would result in the council tax becoming more progressive.

Relationship Between Council Tax Bands A to H

3.13 In 2004/5 the highest level of Band H tax in Scotland is £2,270 while the lowest level of Band A tax at the local authority in question is £757. The prescribed and narrow relationship between Band H and Band A maintains the regressive nature of the tax. There is a strong case for expansion of the Bands and reconsidering the extent of the relationship between the highest and lowest band.

Revaluation

3.14 There has been no revaluation of the council tax property base since 1991. Other commentators will provide detail on the technical merit of revaluation. CIPFA considers however that the elapsed time alone since revaluation provides a robust reason for considering a current revaluation.

Accountability

3.15 CIPFA is pleased to note that accountability is recognised as a core issue and questions how appropriate or indeed relevant is the idea of local accountability. The specific issue raised by the Committee is that local authority expenditure is generally directed towards statutory requirements or objectives set by the Scottish Executive. Services are delivered locally and it is appropriate that accountability is and is seen to be local. This is an area however where reform and improvement is readily possible. At present, each council tax bill is accompanied by a

document as prescribed by legislation and generally referred to as 'the council tax leaflet'. This leaflet sets out the budgeted and forward spending plans of each local authority. The actual spending by a local authority is accounted for in the annual statement of accounts produced after the end of the financial year in question. The statement of accounts do not however incorporate budgeted expenditure to enable comparison to be made. Equally, the statement of accounts are not circulated directly to each council tax payer. There is therefore a gap of accountability in that proposed spending is issued direct to council tax payers but details of actual spending is not.

3.16 CIPFA believes therefore that, rather than questioning local accountability, the challenge is in fact to engage further with council tax payers and with recipients of services and to ensure that information is presented in a meaningful and useful format. Clearly, this would promote accountability further. There is therefore work to be done on both modernising the information presently available and also on ensuring that there is a clear link between proposed and actual spending. CIPFA would propose therefore that the council tax leaflet is modernised and consideration given to ensuring that the relationship between actual and proposed spend is readily available to stakeholders. In Scotland CIPFA provides professional accountancy services to The Local Authorities Scotland Accounts Advisory Committee (LASAAC). LASAAC has undertaken considerable recent work already in improving the accounts of local authorities. The substance of the work resulted in a prescribed form of summarised accounts in a format more acceptable to lay readers and other stakeholders. A logical progression would be to build upon this work by linking the summarised accounts to a reformed council tax leaflet.

Gearing

3.17 The contribution by central government, in the form of the Scottish Executive, towards the costs of local authorities services is fixed in advance of the financial year. The practical impact is that if local authorities spend more or less than the Scottish Executive expects, the whole of any additional spending requires to be funded by the council tax. Any savings, where appropriate, can be used to relieve pressure on the council tax. Typically a change of +/- 1% in local authority spending results in a change of about +/- 4% in the council tax. This relationship between the percentage change in spending and the percentage change in council tax is what is known as gearing.

3.18 In CIPFA's view, the gearing effect has an invidious impact on local government's autonomy since the burden of any additional local expenditure above the level of Grant Aided Expenditure (GAE) is borne solely by council taxpayers. As a result, local authorities are effectively encouraged, however inadvertently, to spend at the level of their GAE. This has a particularly detrimental impact on the funding of discretionary services and mitigates against authorities taking full account of local priorities.

3.19 The proposed solution by CIPFA is the return of non-domestic rates to local authority control which would reduce the gearing effect of the council tax. In Section 4 following, we go on to consider how this might be achieved in practice and set out some of the research based issues which might arise from CIPFA's proposal.

4 Non-Domestic Rates and the Balance of Funding (*Questions 26 – 31*)

4.1 In CIPFA's view, the key issue preventing positive change to the current revenue grant system is the balance of funding between centrally provided and locally raised finance. If local democratic renewal and greater community involvement are to be achieved, it is essential that local authorities enjoy financial autonomy and accountability. This means that they must be responsible not only for raising the majority of the money they spend but for deciding how it is used to meet local needs and aspirations. If this were the case, authorities could be rightly held responsible for the decisions they take and for demonstrating community involvement and participation.

4.2 In CIPFA's opinion, what is needed is a fundamental shift in the balance between local and central tax raising towards a situation where more than half of local authority spending is financed locally. Under the current system, where only around 20% of local expenditure is financed through local taxation, local autonomy is severely constrained, particularly given that the Scottish Executive as the major funder seeks to exert influence over how funds are spent.

4.3 To have a positive effect, a change in the balance of funding would need to be accompanied by genuine local financial freedom. If the Scottish Executive continued to influence or to control spending patterns, changing the balance between the sources of funding would have only limited effect.

4.4 In addition to the effect that the balance of funding has on local autonomy there are significant behavioural implications arising from the overall level of funds under debate. As the Scottish Executive provides so much of local government's funding, clearly, decisions over how that total is distributed are crucial. Each local authority effectively has a duty to its electorate to be seen to gain as much of the available funding as possible. A direct result of this is that significant time and energy is devoted in most if not all local authorities to understanding and seeking to influence the minutiae of funding formulae.

4.5 The relative importance of the grant settlement can also have a distorting effect on policy decisions at the local level with local authorities less willing to follow avenues that could adversely affect the data upon which their GAE's are based.

4.6 In CIPFA's view, the most straightforward way of achieving a shift in the balance of funding would be to return the business rate to local authority control. CIPFA believes that this is the right course of action to follow, not only because of the greater financial independence and autonomy that it would afford local authorities but also because it would:

- re-establish effective links between businesses and local authorities to complement authorities' community leadership and economic development roles; and
- reduce the gearing effect of the council tax.

4.7 In setting out these comments, CIPFA does recognise that local authorities are not democratically accountable to businesses. There would therefore be understandable concern, however unfounded, that the return of a local business rate could provide opportunity to levy a higher relative proportion of increases in spending upon businesses. Clearly, this would be as damaging to local financial accountability as the current position may be considered to be. CIPFA therefore believes that there should be a link between the business rate and the council tax yields and that this should be transparent to all and applied consistently.

4.8 The business rate base varies across Scotland. CIPFA would envisage a continuing role for the Scottish Parliament in equalising the resources available to local authorities in Scotland. However, in the interests of accountability and transparency, the impact of equalisation should be made clear at the local level. One method to achieve this could be the modernisation of the present council tax leaflet which at present accompanies council tax bills. A modernised document aimed at both council tax payers and the business community would provide a link between both levies and locally delivered services.

4.9 Clearly a number of issues would require to be addressed before the responsibility for setting the non-domestic rate for non-domestic properties could be returned to local authorities. Those issues would include:

- the relationship between the council tax and the non domestic rate. A current anomaly is that council tax valuation is based on the capital values of domestic properties whereas the non domestic rate continues to be levied on rental values;
- the approach to resources equalisation in the RSG system; and
- local authorities' accountability to the non-domestic taxpayer.

4.10 In 2004 CIPFA, in partnership with Rita Hale & Associates Ltd published The Relocalisation of the Non-Domestic Rate – A Discussion Paper. The paper was based on research undertaken in England and addresses:

- the link between council tax and NDRI; and
- arrangements for equalisation.

4.11 The main conclusions from the research are:

- over the 22 years covered by analysis, revenue spending has risen by 260% but the domestic sectors contribution towards the cost of those services has risen by 337% over the same period;
- the domestic sectors contribution towards the costs of local government services rose faster than the non domestic sectors contribution over the entire period;
- the non domestic rate poundage has increased by 26.9% but the average Band D council tax has risen by 93.6%;
- if non domestic rates were to be returned to local control and the level of the non domestic rate multiplier linked to the ANCT for spending at FSS, the effect of this would be to raise the non domestic sectors contribution towards the cost of local services by about £400m or about 2.8%. This would still leave the contribution from the non domestic sector at a significantly lower level that it was in 1989 when expressed as a proportion of local government spending ie 27.2%; and
- rates were not a significant overhead cost and that the impact of returning the non-domestic rate to overall local control would be barely perceptible.

4.12 The paper referred to is included as part of CIPFA's submission and is commended to the Committee as authoritative research on possible options for the non-domestic rate and consequently, the balance of funding. The conclusions do demonstrate that in fact the council tax payer has carried a disproportionate burden from increase local authority expenditure.

5. Non-Property Based Taxation – A Local Income Tax *(Refer Questions 16 – 25)*

5.1 Considerable interest has been generated in recent years on the application of local income tax (LIT) as a source of revenue for local authorities. Debate has generally, and in the main, been at a high policy level with only limited attention applied to both detail and to the crystallisation of the complexities which would accompany the introduction of such a tax.

5.2 CIPFA's paper entitled *A Taxing Issue – A Local Income Tax Exemplified*, is enclosed as part of this submission. This research was undertaken by CIPFA on behalf of the Office of the Deputy Prime Minister to inform the Balance of Funding Review. This paper does not seek to rehearse the full content of the paper but this section summarises some of the headline matters for consideration.

5.3 At the outset it is important to appreciate that CIPFA does not necessarily advocate a system of local income tax. However because of the professional research undertaken we consider that we are uniquely placed to provide empirical evidence on the proposition to the Committee and consider that it may be a realistic option for introduction in the UK.

5.4 Scotland is unique as a UK devolved administration in that in addition to the power to administer its own affairs, there is a tax varying power which would enable income tax in Scotland to be varied by up to 3p in the pound sterling. It is unlikely that any serious examination into local income tax in Scotland could be considered without having due regard to the impact that invoking this power could have. Clearly, it is not possible nor indeed desirable to pre-empt any decision of Parliament in this regard, but it is necessary for the purpose of the review for the Committee to consider the issues which may arise.

5.5 Broadly, CIPFA considers that there will be two circumstances in which a local income tax (LIT) would be introduced:

- as a replacement for council tax; or
- as a supplement to existing local revenue sources, including the council tax.

LIT - A replacement for Council Tax

5.6 A LIT would be a progressive form of taxation in that, simplistically, the level of tax levied would be relative to income and therefore, relative to the ability to pay the tax. CIPFA has previously promoted the view that a tax on income could provide buoyancy within the economy. The core rationale for this view is that economic growth in Scotland would ultimately be reflected in the tax yield even without any tax increase in a fiscal year.

5.7 The level of taxation would inevitably be of primary interest to potential taxpayers. CIPFA's work in England estimated that LIT as a replacement for council tax would result in average LIT rates in the pound of 3.9p in Inner London to 4.58p in shire areas. In Scotland, CIPFA's research would indicate preliminary LIT rates ranging from 2.93p in Moray to 6.98p in West Dunbartonshire. These figures were calculated before any resource equalisation on an income tax basis. Clearly further research would be required before robust taxation levels could be presented.

5.8 In the case of a national 3p variation in Scotland, it is feasible that this could be invoked to provide specific funding for local services. The relationship between the funding raised nationally within Scotland and the impact on formula funding for Scottish public sector block expenditure would require to be addressed. Simplistically, raising an additional 3p in the pound income tax in Scotland may not have a neutral effect on formula funding received by the Scottish Executive.

LIT - A Supplement to Existing Revenue Sources

5.9 The extent to which a LIT can be introduced as an acceptable and credible supplement for council tax will be influenced by one prime consideration, namely, the extent to which additional funding can be generated thereby relieving pressure on other levies and positively influencing the present balance of funding.

LIT - Practical Considerations

5.10 CIPFA has carefully considered the practical issues which would require to be addressed should LIT be a credible option whether as a replacement for council tax or as a supplement. We have concluded that it is unlikely that an LIT could be introduced in one part of the UK only. A particular issue in Scotland is that income taxation (beyond the varying powers) is not a reserved matter and change to the powers of local authorities in Scotland would also require amendment to primary UK legislation.

5.11 CIPFA's research also identified the following issues where further detailed consideration will be necessary:

- cost to business;
- impact upon collection rates;
- timescale for introduction including both legislation and practical system testing and introduction; and
- any arrangements of a transitional nature required to managed the move to a new system.

6. Non Property Based Taxation – Other Options *(Questions 22 – 25)*

6.1 CIPFA recognises that there may be a number of other specific taxes that are capable of making a significant contributions to funding for a local authority in particular locations and which may also have policy benefits in terms of influencing behaviour. A high profile example may be road user charging (congestion tax/charges). A further option, again locality related, may be a tax on tourism.

6.2 CIPFA considers however that these should not be seen as a substitute for options such as a local income tax or for the relocalisation of the business rate, which are likely to have a much more radical impact upon the balance of funding.

7. Other Issues *(Question 41)*

7.1 Local authorities are in receipt of approximately £8B aggregate external financing from the Scottish Executive. This paper has already identified that this represents some 80% of external financing required by local authorities. In summary and in reality the funding of local authorities is to large extent directly dependent, inter alia, upon the financial management practices within the Scottish Executive.

7.2 CIPFA has observed that in recent years, a practice has developed which has resulted in additional monies being regularly provided to local authorities during a financial year with an expectation, usually an express requirement, that the additional monies fund expenditure for the financial year in which the additional monies have been disbursed. A further characteristic of this practice is that the additional monies may be disbursed at a late stage in the financial year.

7.3 Clearly, a number of reasons many of them valid, will be behind the apparent late disbursement of funding. There is however an impact upon both the Scottish Executive and local authorities as a consequence of this practice. Late disbursement of funding may restrict the ability of both the Scottish Executive and local authorities to demonstrate that best value has been achieved and timing alone may drive a spending decision based on the requirement to disburse and therefore spend within a prescribed period of time. Where time pressure, rather than the legislative requirement to achieve best value becomes a key driver for public expenditure then that public expenditure, while achieving policy intention, may be difficult to justify in terms of best value.

7.4 CIPFA considers that this matter is entirely appropriate to be considered as part of this review given the clear inter-relationship between the Executive and local authorities. While CIPFA has formed no formal conclusion on this practice, clearly to enable taxation monies to be properly spent locally in an economic, efficient and effective manner, the quality of any local spending decision will be limited by the national 'spending' decision in a Scottish Executive Department. In this regard CIPFA has noted CoSLA's comments on ring-fencing of new funds and the resultant resources required to demonstrate that resources are in fact directed towards the prescribed purpose. It may be that increased ring fencing and late disbursement of funding are in fact related matters.

Appendix 1: Local Taxation in Scotland A Consultation by the Local Government Finance Review Committee

List of Appended and Accompanying Submissions from CIPFA

1. Rating Review – Actuals of Income & Expenditure 2003-2004 (CIPFA 2004)
2. Rating Review – Estimates of Income & Expenditure 2004 –2005 (CIPFA 2004)
3. A Taxing Issue – A Local Income Tax Exemplified (CIPFA 2004)
4. The Relocalisation of the Non-Domestic Rate – A Discussion Paper (CIPFA 2004)
5. Balance of Funding Review – Report (ODPM 2004) *(Note that this report is provided for the assistance of the Committee but does not necessarily reflect the views of CIPFA)*