

# BETTER THAN BEFORE

## HOW LOCAL TAX REFORM CAN HELP PAY FOR RECOVERY

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*This briefing marks the second in a series looking ahead to the Holyrood elections in May. It builds on IPPR Scotland's Better Than Before report, released in September 2020, outlining the key priorities facing the Scottish government over the next few years in recovering from Covid-19 (Gunson and Statham 2020).*

This briefing makes five recommendations for the next Scottish government:

1. The next Scottish government should commit to closing the tax gap in council tax revenues between Scotland and the rest of the UK, worth between an estimated £600m and £900m per year.
2. The next Scottish government should improve the progressivity of council tax by implementing higher increases on bills for properties in higher bands throughout the next parliament. Increases of 3 per cent (plus inflation) for Bands A-D and of 4 per cent, 5 per cent, 7.5 per cent and 10 per cent (plus inflation) for Bands E, F, G and H respectively each year of the parliament could raise £380m per year by 2025/26.
3. The next Scottish government should extend the council tax reduction scheme so that no one in poverty is asked to pay council tax by the end of the parliament. If in place today this could cost up to £300m per year.
4. The next Scottish government should introduce primary legislation to reform or replace the council tax within the first year of the new parliament. Our view is reform should take the form of a new percentage of value tax introduced alongside the ongoing council tax system or to replace council tax altogether. This would take many years to implement and so action should be taken quickly in the new parliament.
5. The next Scottish government should work with councils to test and introduce new local taxes in the next parliament, to build a basket of taxes at the local level in Scotland. Consideration should be given to the introduction of a local

inheritance tax, local green taxes and other behaviour change taxes to promote fair work, just transition and to narrow economic inequalities.

## INTRODUCTION

It is well-worn observation that Covid-19 has affected everyone, but it has not done so equally. This has never been truer than for the experience of those with higher incomes and higher levels of wealth over the last 12 months.

Covid-19 has made the UK significantly poorer. GDP was almost 10 per cent lower in December 2020 than it was at the start of the year (ONS 2021). The deficit has ballooned (quite rightly) and will need to come down at some point once recovery has been secured. And Rishi Sunak's decision to only pursue a half-hearted stimulus package, less than half of what was needed, risks making us poorer-still over the long-term (Jung et al 2021). Add in the premature decision to withdraw the Job Retention Scheme, and the plain wrong one to cut universal credit later this year, and there are already risks that UK government decisions could make the recovery much weaker than it should be.

But while the pandemic has hit the country's finances, those on higher incomes and those with wealth and property have on average seen their finances improve. Those on higher incomes, more likely to be able to work from home, have on average seen incomes (and health) protected at the same time as seeing spending fall – through 'forced saving' as luxuries such as dinners out and holidays became impossible (Davenport et al 2020). While those who own their own home, have seen house prices in Scotland jump by over 8 per cent through 2020 (ROS 2021).

When it comes to paying for the pandemic, we must do so fairly. We must remember who lost the least through the crisis and ask them to contribute the most through the recovery.

As we outlined in our previous briefing, this next Scottish parliament is likely to be a tax-raising one, as we begin to pay for the costs of the pandemic (Gunson et al 2021). With the UK government currently planning a combination of spending cuts outside of health, and tax rises (including freezing the income thresholds in the rest of the UK) the next Scottish parliament is likely to need to be one that raises significantly more tax revenue than now, just to ensure spending cuts in Scotland are no worse than in the rest of the UK. To go beyond spending plans seen elsewhere, Scotland will need to see tax rises higher than we have seen throughout devolution.

We have already published ideas for income tax reform in Scotland, asking higher earners to pay a small amount more to help lift tens of thousands of children out of poverty (Ibid). But while income tax can do more to raise the vital funds we need, given property prices and savings trends we should also look to how we can tax wealth and property. And for that we will need to look at local tax, and in particular council tax reform, in Scotland.

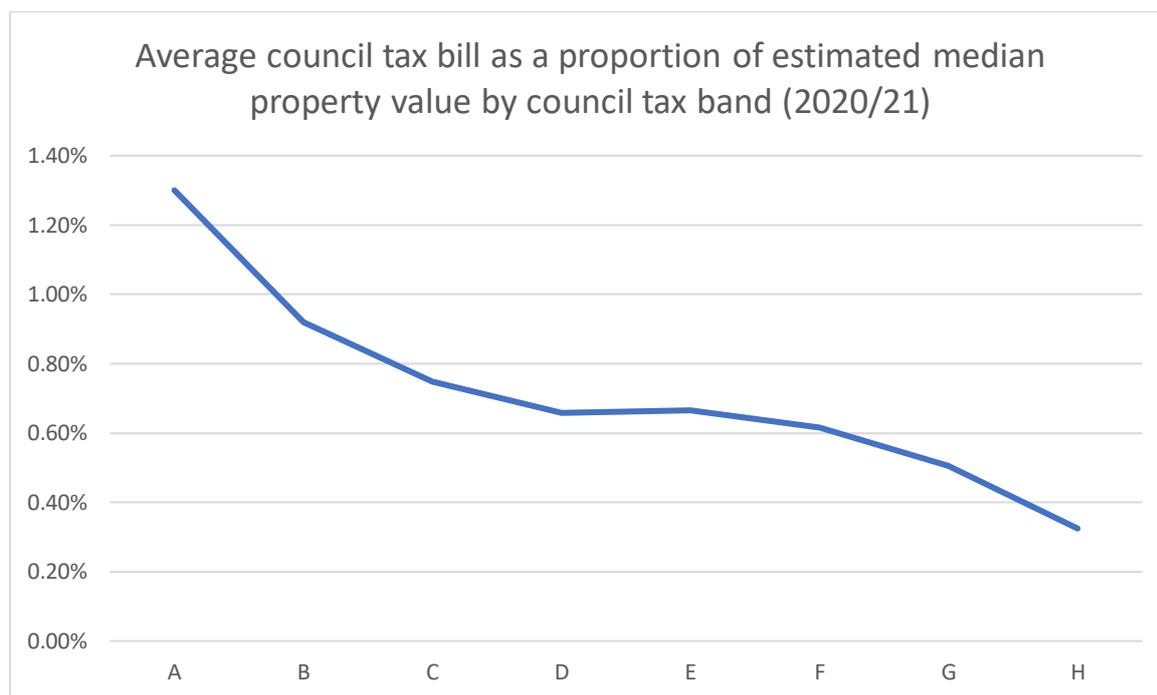
Up until the devolution of income tax powers a few years ago, it was local tax that dominated at election time, whether through calls for reform of council tax

bands, a council tax freeze, or replacing the council tax with a land value tax or local income tax. However, despite multiple reviews and commissions we have seen only very limited reform since devolution in 1999.

It is worth reminding ourselves as to some of the problems with the existing council tax system.

It is regressive by value. As figure 1 shows, council tax bills are lowest as a proportion of home value for those in the highest value properties (The Commission on Local Tax Reform 2015).

**Figure 1 – Average council tax as a proportion of estimated median property value by council tax band (2020/21)**



**Source: IPPR Scotland calculations (see annex 2)**

It is regressive by income too. Bills are the lowest as a proportion of income for the highest income households. The table, from the Local Tax Commission’s final report, shows the strong impact that council tax reduction (CTR) has for the very poorest but also shows that households with low to middle incomes (deciles 3, 4 and 5) pay the highest council tax bills as a proportion of income (Ibid).

**Table 1 – Median Council Tax liability as a % of net household income before and after council tax reduction (CTR) (2013/14)**

Income decile group	Before CTR	After CTR
<b>1 – lowest income</b>	10.0	0.0
<b>2</b>	6.6	0.8
<b>3</b>	5.6	3.5
<b>4</b>	4.8	3.8

<b>5</b>	4.2	3.7
<b>6</b>	3.6	3.3
<b>7</b>	3.5	3.3
<b>8</b>	3.2	3.1
<b>9</b>	2.8	2.8
<b>10 – highest income</b>	2.3	2.3

**Source: The Commission on Local Tax Reform 2015**

It is out of date. Property values have changed hugely over the last 30 years and the council tax has not kept up to date. This leaves properties in the wrong bands with some paying too much and others paying too little (Ibid).

It does not raise enough money. The council tax in Scotland, if set at the same level seen in Wales or England would raise somewhere between £600m and £900m a year more than it does now (Fraser of Allander 2019).

Each of the reviews and commissions that have been set up to look at council tax reform has come back with similar conclusions: Council tax should be replaced by a more progressive property tax, whether as part of a basket of local taxes (including for example land value taxes) or by itself.

So, if the diagnosis and prescriptions have been clear, why the lack of reform?

Partly, it is because any kind of property tax is likely to be highly visible to people (people get bills they physically have to pay) and therefore unpopular. Reform is therefore seen as politically high risk. Equally, in replacing the council tax with a more progressive alternative, you are likely to ask small amounts of people (in higher value properties) to pay a lot more – for which they will loudly not thank you – while reducing the tax bills of large amounts of people by only a small (and potentially unnoticeable) amount – for which they may loudly not thank you.

Council tax, therefore, despite its flaws, has one crucial thing going in its favour: it is already in place.

### **Our aims for reform**

We wanted to consider what options there are for reform, and also some of the options that might help us combine the right answer in policy terms with the right answer in political terms.

Firstly, while we are very interested in land value taxes and other local taxes, we share the view of the Local Tax Commission, that these would need to be introduced alongside a property-based tax not to replace it, at least to begin with (Commission on Local Tax Reform 2015). This would give time for pilots or smaller-scale versions of some of the taxes never seen in Scotland before to be introduced, to test ideas that have great merit in theory, to prove they work in practice.

Secondly, and connected, we are interested in looking at what reform could take place early in the next parliament, and ideally soon after the next local government elections in Scotland (in 2022). This would allow changes to take place early so that greater amounts of revenue could be raised by the end of the parliament. Given the public spending context, reform of council tax is likely to need to be revenue-raising, not revenue neutral.

Thirdly, for any new property tax, our aim would be to increase bills as a proportion of value for those in the highest value properties, whilst reducing the bills for those on the lowest incomes.

### **Policy options**

So what options are there for reform?

Firstly, in our view **the next Scottish government should adopt reforms to the existing council tax system to close the tax gap between Scotland and the rest of the UK**. This should be done in a way that improves the progressivity of the current council tax system. More fundamental reform will take time, and so changes are needed that can improve the current system and raise more funds in the meantime.

One option here would be to amend the ratios between council tax bands, as was carried out in 2017/18. By readopting the council tax cap of 3 per cent plus inflation for Bands A to D, and adopting larger increases for Bands E, F, G and H in each year of the next parliament, the progressivity of the current system could be improved quickly. These changes would require only secondary legislation and could be implemented in time for 2022/23. Increases of 3 per cent plus inflation for Bands A-D and increases of 4 per cent, 5 per cent, 7.5 per cent and 10 per cent plus inflation for Bands E, F, G and H, in each year of the parliament, could raise an additional £95m in 2022/23 and £380m per year by 2025/26. As with increases to higher bands seen in 2017/18 financial help could be provided to low to mid income families in higher band properties, to ensure they did not lose out. This would improve the progressivity of the council tax system over time, but it would still be regressive and out of date, based on valuations more than 30 years old.

Secondly, **the next Scottish government should adopt reforms so that no one in poverty should be asked to pay council tax**, reducing bills for the lowest income households. This important change should not wait for fundamental reform of council tax.

The clear option here would be to use increased revenue to expand the council tax reduction scheme to ensure that by the end of the parliament no one in poverty should pay council tax. Currently the council tax reduction scheme provides support to over 500,000 families in Scotland (Scottish Government 2020a). But to access it you must have very low incomes. Extending support could reduce property tax for all low-income families and ensure financial support does not begin to be withdrawn until people have reached the poverty line. This could be achieved through secondary legislation and so reform could begin in 2022/23. As well as extending the council tax reduction scheme, much

more needs to be done to improve take-up of the reduction scheme. Automation from existing Scotland and local payments and entitlements should be considered (such as Scottish child payment, school clothing grant, best start grant and free school meals).

To give an idea of cost, the Commission on Local Tax Reform calculated that it would take around 25 to 30 per cent of council tax revenues to set the council tax reduction scheme at the level of minimum income standards (an income level above the poverty line for most families) (The Commission on Local Tax Reform 2015). If in place today, the same level of funding would need around £300m per year of additional investment.

Thirdly, **the next Scottish parliament must prioritise fundamental reform of council tax in Scotland**, with primary legislation introduced within the first year of the next parliament.

There are a number of options here for reforming property tax.

One option would be to introduce a new percentage of property value tax. This was looked at as part of the Local Tax Commission's work, and at that time (2013/14) they found a tax set at around 0.7 per cent of a property's value would be cost-neutral with the current council tax system<sup>1</sup>. A flat percentage of value property tax would see lower value properties pay less than the current system and higher value properties pay more. This system could see local variability by council. However, it would require a full-scale revaluation, which may delay its introduction to the end of the next parliament or start of the following (in 2026/27), with a transition period following. Equally, to raise more revenue than the existing council tax system a higher percentage tax rate would be needed.

A second hybrid option would be to introduce a new percentage of value tax alongside the ongoing council tax system, again set at 0.75 per cent of value, for new property purchases only. This would see the percentage of value tax act as a floor on council tax bills, with people paying the higher of the ongoing council tax system or 0.75 per cent of property value. Local councils could have the power to vary this percentage above or beneath the nationally set level. This would also require primary legislation, which could take up to two years, and could roll-out from this point. Full roll-out would take place when it was judged that sufficient properties were on the new system to make phasing out of the old council tax system more seamless, which could be achieved by 2030/31<sup>2</sup>. Once fully rolled-out this would see lower value properties, on average, pay the same

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<sup>1</sup> This included all properties (including those currently exempt from council tax). The rate may be higher now given increases in council tax revenue since this time.

<sup>2</sup> To give an illustration. We estimate it would take just less than seven years to see up to a third of properties on the new system and just over ten years to see up to half of properties on the new system. Once the decision is made that a critical mass of properties has been reached, all properties could transition onto the new system. If introduced in 2023/24 this could see full roll-out achieved by between 2030/31 or 2033/34.

us under the existing council tax system, with higher value properties on average paying more. As an illustration, if it were fully rolled-out now, this could raise around an additional £350m per year compared to the current system.

Introducing a new hybrid property value tax for new property sales only could have a number of crucial advantages. It would avoid the risk of seeing lower income families pushed out of higher value homes through tax increases, perhaps homes they have lived in most of their lives. Tax liability would only change if you moved home, and so you could budget accordingly. Also, with devolution of land and buildings transactions tax (LBTT – formerly stamp duty), the Scottish government now has access to values of homes at point of purchase, which could be used to calculate the new hybrid tax bill without need for further physical valuations in the short-term at least.

It would also have at least two clear disadvantages. Introducing for new purchases only would mean additional revenue would take longer to come through. However, even here the disadvantages may not be as great as first seems. On average, just under 5 per cent of dwellings in Scotland change ownership each year (Revenue Scotland 2021). And so up to a quarter of homes would be on the new system within five years, and up to half within ten. Once sufficient critical mass had been achieved, all properties could move on to the new system, with valuations required only for those not already on the new system.

The second disadvantage would be administration costs for local councils. Implementing for new purchases only, would mean councils would need to run two administration systems for a period of time, until a critical mass of properties on the new system had been achieved, and all properties were moved on to the new hybrid system. While this may surmountable it would add to costs and complexity for local councils.

### **Should property tax be paid by owners or residents?**

Reform of council tax would offer the opportunity to consider whether property tax in Scotland should be levied on residents (as now) or on owners. Clearly, a property tax where owners are liable would have some potential major benefits in terms of progressivity and bring property tax in Scotland closer to a property wealth tax.

However, there is a risk that at least some of any tax levied on owners would be passed on to tenants, where owners let the property. Given council tax reduction is applied to those who pay the bills, an equivalent scheme for a tax levied on owners could help low-income owners and landlords but not low-income tenants who see tax increases passed on in rent increases. And given current powers held by the Scottish parliament, it may not be possible to provide additional housing support to low-income tenants in these circumstances. Without mitigation there would therefore be risks that applying a tax to owners could see housing costs increase, and poverty increase, for some of the lowest income tenants in Scotland.

While we would be supportive of the tax liability moving to owners as part of council tax reform in principle, careful consideration would have to be given as to the risk of increasing costs for low-income tenants, and any mitigations that may be possible through existing powers or with further devolution.

The options for reforming council tax in this briefing paper offer the opportunity to raise more tax revenue over the coming years. Given the fiscal context this is likely to be hugely important to avoiding deeper cuts in Scotland, and to helping to invest to deliver against priorities such as fair work or poverty reduction. Additional revenues could be retained by individual local authorities, pooled and distributed across local authorities in Scotland, or used to free-up central funding which currently goes to fund local services. These would be policy decisions for the next Scottish government, in consultation, but regardless of which option is chosen, these reforms could deliver additional investment for public services in Scotland.

### **Beyond property tax**

However, while the options above would offer a significantly improved property tax, it would still be a property tax. There are opportunities for the next Scottish parliament to begin to think more imaginatively about how it uses its full powers over local tax, beyond taxing property. We have previously considered options such as a local inheritance tax, a local carbon tax, a low pay levy on businesses that instigate low pay business models, or a fair work supplement on business rates asking those businesses who do not meet fair work criteria to pay more tax to help reduce bills for those that do. We have, alongside many others, looked at whether a local land value tax would have merit.

Our fourth proposal is that **the next Scottish government should test and introduce new local taxes in the next parliament, to build a basket of taxes at the local level in Scotland**. Given the near full powers over local tax, it is policy innovation at the local level that may offer the greatest opportunities to broaden Scotland's tax base, to help to pay for Covid-crisis in a fair way, and in particular to align tax incentives and disincentives to help to drive the change we want to see – whether that be the just transition, land use, fair work, inclusive growth, wellbeing or reducing poverty.

The next Scottish parliament will need to be a tax-raising one, if we are to invest what is needed to meet ambitions for a Covid recovery built on social, economic and climate justice. When it comes to paying for pandemic we must do so fairly, and remember who has lost the least through the crisis when it comes to paying for the recovery. In this briefing we have outlined some of the ways that local tax can help to raise the revenue we need, from property and wealth, and to drive the change we need, to ensure we emerge from the crisis stronger than we went into it, so that we can build a Scotland better than before.

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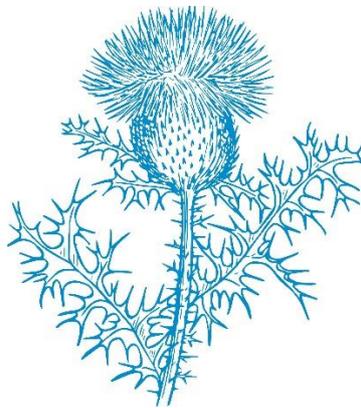
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**Annex 1 – costings for a hybrid council tax/percentage of value tax**

We calculated potential yield from a percentage of value tax combined with the existing council tax system. We did this by uprating the estimated median and upper threshold calculations for 2013/14 undertaken by the Local Tax Commission to present day. We did this using the UK Property Price Index Scotland datasets.

**Table A.1 - Local tax Commission estimated upper threshold and median value by council tax band 2013/14**

Band	A	B	C	D	E	F	G	H
Upper threshold	£72,000	£110,000	£143,000	£180,000	£246,000	£336,000	£646,000	>£646,000
Median value	£54,000	£89,000	£125,000	£160,000	£208,000	£278,000	£409,000	£795,000

**Source: The Commission on Local Tax Reform 2015 (p57, Volume 2)**

**Table A.2 - IPPR Scotland estimated upper threshold and median value by council tax band inflated to 2020/21**

Band	A	B	C	D	E	F	G	H
Upper threshold	£89,428	£136,626	£177,614	£223,570	£305,545	£417,330	£802,367	>£802,367
Median value	£67,071	£110,543	£155,257	£198,729	£258,347	£345,291	£508,000	£987,433
Dwellings per band Scotland (Sep 2020)	499,845	575,744	408,663	345,554	345,211	203,442	130,702	13,726
2020/21 average council tax bill	£872.15	£1,017.51	£1,162.87	£1,308	£1,718.87	£2,125.87	£2,561.95	£3,205.16

**Source: IPPR Scotland calculations using Commission on Local Tax Reform 2015, ROS 2021 and Scottish Government 2020b**

This allowed us to estimate what a Proportional Property Value Tax could raise set at various percentages of home value by band in gross terms. We were then able to adjust values down to net terms to take account of existing proportions of revenue spent on discounts, reductions and exemptions.