Localising local tax – a Reform Scotland briefing

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FAST FACTS

- Local authorities in Scotland are not fully in control of any of their own tax income.
- Local autonomy is undermined when councillors have no real control over local taxation.
- By at least devolving council tax and non-domestic rates in full, councils will have greater room for manoeuvre and so local priorities and circumstances will be more fully taken into account.
- Reform Scotland believes that it is vital that the commissions currently considering local taxation don't simply call for one centrally-set and controlled local tax to be replaced with another centrally-set and controlled tax.

CONTEXT

Reform Scotland has consistently argued that greater power should be devolved not just from Westminster to Holyrood, but from Holyrood to local authorities. Scotland is a diverse country and local authorities need to have responsibility and control over their income to allow them to address the different needs and priorities they face.

Local government taxation has been a regular feature in the press for some time, largely due to the controversy over the council tax freeze. Although Council Tax is supposed to be a local tax, this centrally-imposed freeze has effectively removed what little control local authorities had over local taxation.

In addition to the debate over the freeze, the Scottish Government has set up the Commission on Local Tax Reform, looking at "ways of developing a fairer system of local taxation".

While Labour, the Lib Dems and the Greens are also represented on this Commission, the Scottish Conservatives instead chose to set up its own commission, the Independent Commission for Competitive and Fair Taxation in Scotland, which is also looking at local taxation.

Reform Scotland has responded to both these commissions and this briefing is a summary of our evidence.

BACKGROUND

Devolution was never supposed to stop at Holyrood. However, Holyrood has control in some areas that used to be local authority responsibilities, and one of those is local taxation.

There are two so-called local taxes in Scotland, Council Tax and non-domestic rates.

Although non-domestic rates, or business rates, are a local tax and collected by local authorities, they are set and controlled by Holyrood. This means that not only the rate, but to whom it applies and discount schemes are controlled centrally in Edinburgh. The tax is due on property payable by businesses. Bills are calculated by multiplying an assessed value for a business property by a non-domestic poundage rate. The rates normally apply to premises which are not classed as domestic properties. If a property is used for domestic and non-domestic use, such as a guesthouse, both Council Tax and business rates need to be paid.

Currently, there are winners and losers as a result of the redistribution of business rate revenue. This can be because some councils account for a larger proportion of business rates revenue collected relative to their resident populations than others. Some of this is due to differences in economic performance across the country and some due to council boundaries not reflecting real economic flows.

It could be argued that since 2007, Council Tax has been effectively capped in Scotland. Currently, Council Tax is the only form of taxation local authorities can use to directly raise and retain money from their population. If a local authority were to seek to undertake major investment projects, increasing Council Tax was one of the few ways it could use to be able to generate increased income. However, following the election of the SNP in May 2007, the Scottish Government announced that it was seeking a new relationship with local authorities in Scotland which would see greater freedom for councils over spending through the removal of ring-fencing in return for a freeze in Council Tax. In November 2007, the Cabinet Secretary for Finance and Sustainable Growth, John Swinney, and then President of the Convention of Scottish Local Authorities (COSLA), Pat Watters, signed a new concordat introducing that new relationship. As a result, the level of grants to local authorities which was ring-fenced for specific purposes was cut significantly. Councils were also to be allowed to retain any efficiency savings, rather than their being diverted to Holyrood. However, in return, individual local authorities had to agree to freeze their level of council tax, effectively removing control from councils over the one tax they had at their disposal. This council tax freeze remained in place for the length of the 2007-2011 parliament. In December 2011, agreement was reached between local authorities and the Scottish Government to continue to freeze Council Tax and, as a result, bills have been frozen at 2007/8 levels for eight years. Or, another way of putting it would be to say that for eight years local authorities across Scotland have had no real control over taxing their local populace.

So, although Council Tax is collected and spent locally, local authorities cannot change the rate, and matters regarding how and to whom it applies are also set centrally by the Scottish Government.

As a result of these issues, in Scotland today no tax revenue is under full local control. It is worth highlighting that according to the OECD's fiscal decentralisation database, in countries of a similar size to Scotland, such as Denmark, Finland and Norway, substantially more tax income is controlled locally. However, it is also important to note that for the majority of the period since the creation of the Scottish Parliament the ONLY two taxes which the Scottish Government had any responsibility over were business rates and Council Tax. The temptation to control these income streams from Holyrood was, therefore, great. In saying that, while we appreciate there is a limit to what powers the Scottish Government can devolve to local authorities since the Scottish Government itself does not have a great deal of control over tax revenue, we do believe that progress can be made.

It is worth noting the Chartered Institute of Public Finance and Accountancy's (CIPFA) submission to the Scottish Parliament's Local Government and Regeneration Committee from March 2014 where they highlighted the problem of a lack of local control over, and accountability for, local taxation:

"We recommend: That as part of a revised system of funding, there should also be a review of the proportion of resources which can be raised locally; as part of this:

- *Responsibility for, and control of local taxation should sit clearly at the local level; and*

- *The level of resources raised from local taxation should promote accountability to local citizens for local choices and incentivise growth of the local economy, attract investment and deliver positive outcomes for the local area."*

POLICY RECOMMENDATION

Local priorities cannot in anyway be accounted for in the way that local taxation operates at present because local councillors have no real control over local taxation. By devolving Council Tax and non-domestic rates in full, councils will have the ability to take local priorities and circumstances more fully into account. This will not lead to a postcode lottery when it comes to local taxation as local councillors will quite clearly be accountable for the decisions they make. If those decisions are unpopular, local people will be able to vote them out.

Devolve council tax in full to local authorities: Whilst Reform Scotland welcomes the fact that all political parties in Scotland are considering the issue of local taxation, these reviews should not lead to a situation where one centrally-controlled local tax is simply replaced with another centrally-controlled local tax.

We believe that local authorities should have complete control over their local tax - including the rates and bands. This would allow individual councils - should they choose - to retain, reform or replace Council Tax with another form of local taxation. Crucially, this would be a decision about a local tax made by a local authority for its local area, taking into account local circumstances and priorities.

As a result, we see no problem with some local authorities maintaining a Council Tax system, while others may opt to choose from a range of different forms of taxation, including a land value tax. The most important element is that the tax is fully devolved to the local authority and, therefore, local councillors making decisions on local taxation are fully accountable to the local people affected by those decisions. At present, it is far from clear who is accountable for spending decisions made by local authorities - is it the councillors making those decisions, or ministers for removing their ability to raise additional income?

Local authorities need far more control over their own expenditure and, as a result, this must extend beyond simply Council Tax, or a replacement for Council Tax.

Devolve Business Rates in full to local authorities: Reform Scotland also believes that non-domestic rates should be devolved to local authorities in full. This would allow local authorities to vary how and to whom the tax applies based on their own circumstances. Currently, there are net winners and losers in the central redistribution of non-domestic rate revenue. To ensure that this policy did not create a situation where some councils suddenly receive more money and others less, Reform Scotland recommends that, in the first year of operation, the Scottish Government grants to each council should be based on the grant they received the previous year, less the business rates collected from the council area in that previous year. Councils would then receive the revenue raised from business rates in their area, with the remaining part of their revenue grant adjusted to ensure no council was better or worse off. Each council would then have to decide whether to retain the business rates inherited or to seek to increase or reduce business rates for their area.

Councils would have an incentive to provide an attractive economic environment, but the decision would be up to them. For example, a council could seek to increase business rates which might have the effect of increasing income in the short term but is likely to lead to poorer economic performance and lower income from business rates in the longer term. However, the increase in local financial autonomy and accountability is more likely to give councils an incentive to design business taxation policies and broader local economic development strategies to support the growth of local businesses, encourage new business start-ups and attract businesses to invest since this will benefit the council directly by increasing its income from business taxes. Passing control of business rates to local authorities would also mean giving them control over business rates relief schemes. As a result, it would be up to each individual local authority how the tax operated within their area. The change to the grant level would remain the same in future years and would not be affected by whether the individual council collected more or less in business rates. This is essential as it provides an incentive for all councils, regardless of how much they currently receive in business rates, to improve economic growth in their area. It is also cost neutral to the Scottish Government. It is often argued that the Scottish Parliament has little incentive to improve economic growth as the benefits would accrue to the Treasury at Westminster, and the same principle applies here.

Additional taxes: In addition to devolving these taxes, once further devolution to Holyrood has occurred, we believe there is merit in devolving further taxes, as well as some welfare powers, to local authorities.

Leaving aside the merits of particular small taxes such as bed taxes, Reform Scotland believes that local authorities should be able to introduce such taxes if they feel they are appropriate for their area. If the electorate disagrees, they can vote the councillors out. Such small schemes also increase diversity and allow councils to learn from the experiences of other local authorities. Importantly, it also makes councils less dependent on central government grants.

Publish local authority information within GERS: Reform Scotland believes that it would be useful for future editions of Government Expenditure and Revenue Scotland to separate out Scottish Government income and expenditure from local authorities' income and expenditure to allow the figures to be compared. For example, 'sales, rents, fees and charges' contribute roughly the same amount as council tax and non-domestic rates, but don't feature in GERS. It should be possible to set out clearly the total income streams for both the Scottish and local authority levels as well as total expenditure streams.