Local Taxes

reform scotland

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About Reform Scotland

Reform Scotland is an independent, non-party think tank that aims to set out a better way to deliver increased economic prosperity and more effective public services based on the traditional Scottish principles of limited government, diversity and personal responsibility.

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Objective

In a number of Reform Scotland's publications, we have outlined the principle that each tier of government should be responsible for raising as much as possible of the money that it spends. In our report 'Local Power' we argued that local authorities in Scotland should have a wider range of taxes at their disposal and specifically called for business rates to be returned to council control. The aim of this paper is to combine the principles behind earlier publications and, after looking at the different types of local taxes in operation elsewhere, devise a scheme which sees a broad range of tax raising powers devolved to local authorities in Scotland which can cover the majority of council spending. Although this would still mean local authorities needed grant support from the Scottish Government, it would place them in a similar position to local authorities across Europe.

This report does outline a number of different funding mechanisms and taxes which could be used to raise income for local authorities in Scotland. However, it does not pass judgement on the various merits of each of these. It is not the intention of Reform Scotland to suggest an alternative local tax for all local authorities in Scotland, rather the objective of this report is to highlight the different options available and urge the Scottish Government to devolve power down to councils to allow councils, rather than Holyrood, to choose the best funding stream necessary to meet their own local needs and priorities. Just as many currently find it unacceptable that Westminster dictates the funding mechanisms of the Scottish Parliament because it lessens accountability and responsibility, Reform Scotland believes this argument applies equally to the relationship between Holyrood and councils.

Findings

Local authorities in Scotland were responsible for raising only 11.6 per cent of their revenue stream in 2010-11 through 'Sales, Rents, Fees, and Charges'. Although councils are responsible for collecting council tax and non-domestic rates (business rates), business rates have been centralised, with the Scottish Parliament re-distributing the income, while the centrally negotiated council tax freeze has all but removed local authorities' ability to raise taxes from their electorate.

Even if councils did have greater control over council tax, it still only contributes 10 per cent to their total revenue income stream. As a result, if local authorities in Scotland wanted to increase their income by only one per cent to increase expenditure, they would have to increase council tax by 10 per cent.

The link between taxation, representation and expenditure is an important one in an effective democracy. However, the link has been eroded for local authorities.

Voter turnout is often used in other countries as a measure of voter interest/awareness of the issues in question. However, since 1999 Scottish local government elections have been held on the same day as the Scottish Parliament elections, with the last elections to local authorities, in 2007, having a turnout of 52.8 per cent.[1] Between 1976 and 1995 (the last election before local and Scottish elections were held on the same day) turnout varied between 41 and 48 per cent.[2] It will, therefore, be very interesting to see what level of voter turnout is achieved at the local government elections to be held in May 2012, which will be the first not held on the same day as the Scottish Parliament elections since 1995.

Policy Recommendations

Reform Scotland believes that it is important that each of the layers of government in Scotland, be that Westminster, Holyrood or local authorities, are responsible for raising the majority of the money that they spend. Just as 'Devolution Plus' spelt out how we would achieve this for Holyrood, the recommendations in 'Local Taxes' set out how this could be achieved for Scotland's councils.

However, there are two stages to the recommendations Reform Scotland is making for local government finance in Scotland, though one goal – making local authorities responsible for raising far more of what they spend. The first stage represents the changes which can be made now, with the existing powers Holyrood has, while the second stage outlines what we would like to see if the Scottish Parliament were given the greater tax powers outlined in our report 'Devolution Plus'.

1 Herbert. S, "Local government elections 2007 briefing", SPICe, February 2008
2 Scottish Parliament written answers, S1W 11507

What can be done with existing Holyrood powers:

- **Return business rates to local authority control**

  Business rates are a form of local taxation and Reform Scotland believes that as well as collecting the tax, councils should be responsible for setting it too. Just as it has been argued that there is little incentive for the Scottish Government to improve the economy if any increase in revenue as a result of faster economic growth is returned to Westminster, the same argument applies to business rates. There is little incentive for an individual council to develop the local economy if any increase in business rate revenue resulting from a stronger local economy is simply returned to Holyrood. Devolving business rates to local councils would restore the link between local economic development and higher revenues. It would give councils a real incentive to work with local businesses to improve the performance of the local economy.

  Devolving business rates would obviously lead to a reduction in the grant given to councils and would result in a situation of net winners and losers since 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. Reform Scotland recommends that, in the first year of the 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. 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.

  Councils would have an incentive to provide a competitive economic environment. 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 accountability is more likely to provide an incentive for councils 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.

- **Legislate to allow councils to introduce new taxes**
  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 other councils to learn from the experiences of other local authorities. Importantly, it also makes councils less dependent on central government grants.

- **Councils to choose type of local tax**
  As well as giving local authorities freedom to raise and cut council tax as they see fit, we also believe that local councils should be able to choose to whom the tax applies, where discounts can be offered and indeed the type of local tax they wish to operate.There are a number of different types of local taxes which are used around the world, each with its own pros and cons. Reform Scotland believes that it should be up to local authorities to decide what type of tax system they want. There is no reason why, for example, Edinburgh couldn't operate a council tax system while Midlothian used a Land Value Tax. By allowing different forms of tax to exist around Scotland, this would help to increase diversity as well as discovering which systems work best for different communities.

Transferring control of council tax and business rates would increase the proportion of income over which local authorities had control from 11.6 per cent to 32.73 per cent and would represent a good first step in increasing the accountability and transparency of local authorities in Scotland. However, to even reach 50 per cent, greater tax powers need to be passed to councils.

What should be done in a Scotland where Holyrood had greater tax powers and was responsible for raising the money it spent as outlined in Reform Scotland's report Devolution Plus:

- **Raising as much as possible of what you spend**
  Reform Scotland believes that each layer of government in Scotland should be responsible for raising the majority of the money it spends. In order for this to be achieved, more tax powers need to be devolved to local authority control. The easiest ones to devolve are location specific, such as stamp duty, landfill tax or alcohol duty. Currently, the Government Expenditure and Revenue Scotland (GERS) publications detail the amount of revenue each tax raises in Scotland. However, despite living in a digital age, the figures are very crude and based on a number of assumptions. This means that there is no reliable data for what each tax raises broken down by local authority areas, and as a result we are unable to provide a detailed breakdown of which taxes Reform Scotland believes should be handed to our councils. Due to this lack of information, we would call on the Scottish Government, in conjunction with Her Majesty's Revenue and Customs, to look into whether it is possible to collate tax figures in a more comprehensive manner which, in turn, would provide a better insight into the economic performance of different areas. Such work will be necessary anyway if Scotland is to take control over additional taxes, or becomes independent as a result of the forthcoming referendum.

- **Council Tax Benefit/Housing Benefit**
  In addition to giving councils greater control over which form of local taxation they use, we believe that council tax benefit and housing benefit should be devolved down to local authority control. These are two areas where local government has responsibility and it would make sense to give them control over the benefits side of the policy as well to help them develop coherent policies which best suit the needs of their local areas. This is also essential if local authorities are to have greater control over their own local taxation, with the ability to replace council tax with another form of taxation should they choose.

1. Introduction

"The very object of having local representation is in order that those who have any interest in common, which they do not share with the general body of their countrymen, may manage that joint interest by themselves" John Stuart Mill

For some time now, and especially since the SNP's landslide victory in the 2011 Holyrood elections, the topic of the Scottish Parliament's fiscal powers has been gaining momentum. As part of this debate Reform Scotland published our own recommendations on the matter in 2008 setting out how both Westminster and Holyrood should be responsible for setting and collecting the money they spend in Scotland. This was followed up in 2011 with our 'Devolution Plus' submission to the Scotland Bill Committee at Holyrood. It has now become accepted across the political parties that the current status of the Scottish Parliament has to change and that having a spending body with no real powers for raising the money it spends is far from ideal.

Yet the same people advocating greater tax raising powers for Holyrood have been calling for council tax freezes and are reluctant to hand any proper tax control back to Scotland's local authorities. Since 2007 council tax, the only tax which local authorities have control over, has been frozen as part of the concordat with the Scottish Government. As a result, local authorities have had virtually no control over their incomes for four years.

Some may argue that that is the way it should be. Indeed 'A fairer way', the report commissioned by the former Scottish Executive in 2006 considered the prospect of the centre providing 100 per cent of funding to local authorities and commented "The Committee have received no evidence that satisfies us as to the need in principle for locally-set taxes and, in particular, that local tax-raising powers are necessary for local accountability".[3]

Reform Scotland firmly believes that local authorities, like the Scottish Parliament, should be responsible for raising the majority of the money they spend. Attitudes such as those expressed in 'A fairer way' together with policies such as centralising Scotland's police forces and removing local discretion over council tax suggest a worrying trend toward centralisation in Scotland.

3 Scottish Executive, "A fairer way: A report by the local government finance review committee", November 2006

This is a trend that Reform Scotland wants to see reversed because raising their own revenue increases the autonomy of local authorities, promotes diversity and political accountability as well as responsiveness to local preferences.

The argument for greater tax powers for local government is also being pursued on a global scale by the Fiscal Decentralisation Initiative (FDI), a joint initiative including the OECD, World Bank, Council of Europe and the United Nations Development Programme. One of the main objectives of the FDI is to encourage transitional economies in Central and Eastern Europe to improve the capacity of local governments to plan and administer expenditures and raise revenues and to support local governments in their efforts to become more responsive and accountable to their constituencies.[4] Local government in Scotland, indeed the whole UK, is unusual in its reliance on a single tax. Local authorities in most other western democracies have a much wider range of funding streams and, as a result, are less reliant on central grants.

Reform Scotland believes we have outlined a model which will help restore accountability and transparency to Scotland, helping put localism back on the agenda to ensure that policies pursued best meet the needs of different communities the length and breadth of the country.

4 Fiscal Decentralisation Initiative - http://www.oecd.org/document/59/0,3746,en_2649_34533_2675259_1_1_1_1,00.html

2. Local government finance in Scotland

2.1 GERS v SLGFS

In Reform Scotland's report 'Devolution Plus', we reported that while tiers of government in Scotland (Holyrood and councils) were responsible for 59.2% of expenditure in Scotland, they were responsible for raising only 6.4% of total income raised. (Using the 2009/10 figures. The figures following the publication of GERS 2010/11 are 6.3% and 58.3%)

Reform Scotland had wanted to expand on the tables used in 'Devolution Plus' to provide comparable figures for Westminster, Holyrood and local authorities. However, 'Sales, Rents, Fees and Charges' figures, which contribute a significant amount of revenue income to Scottish local authorities, are not explicitly included within Government Expenditure and Revenue Scotland (GERS) figures. Instead, they are accounted for by negative expenditure by councils. As a result, we have been advised by officials that this makes this exercise virtually impossible. Instead we have focused on using the Scottish Local Government Finance Statistics (SLGFS). This has provided the information needed for examining local government finance currently in Scotland, but cannot be compared with the work carried out in 'Devolution Plus'.

2.2 Revenue and expenditure figures

According to the Scottish Local Government Financial Statistics, total local government revenue in 2010-11 was £18.8billion.[5] This includes £0.79billion of capital revenue. Total gross expenditure was £20.8 billion over the same period, including £2.3billion of capital expenditure. Table 1 below sets out a breakdown of the latest income figures and illustrates that councils are responsible for raising only 11.6 per cent of their total income through Sales, Rents, Fees & Charges. Table 2 sets out the latest expenditure figures.

5 Fiscal Decentralisation Initiative - http://www.oecd.org/document/59/0,3746,en_2649_34533_2675259_1_1_1_1,00.html

Table 1: Local government total income 2010-11[6]

£ Thousands		2010-2011	% Of Total Income
Revenue income.	Revenue Grants	11,081,920	58.80
	General Revenue Funding	8,149,407	43.24
	Ring-fenced Revenue Grants	431,419	2.29
	Council Tax Benefit Subsidy	375,142	1.99
	Other Grants and Subsidies	2,125,952	11.28
	Council Tax	1,923,186	10.20
	Non Domestic rates	2,068,200	10.97
	Sales, Rents, Fees & Charges	2,179,038	11.56
	Education	95,006	0.50
	Cultural & Related Services	81,521	0.43
	Social Work	251,167	1.33
	Police, Fire & Emergency Planning	55,098	0.29
	Roads & Transport	146,068	0.78
	Environmental Services	120,400	0.64
	Planning & Economic Development	97,897	0.52
	Non-HRA Housing	164,339	0.87
	Central Services	113,862	0.60
	Trading Services	66,852	0.35
	HRA	979,571	5.20
	Common Good Fund	7,168	0.04
	Road Bridges	89	0.00
	Other income	799,539	4.24
	Other Grants, reimbursements & contributions, of which:	758,937	4.03
	General Fund	741,031	3.93
	Housing Revenue Account	2,309	0.01
	Common Good	353	0.00
	Road Bridges	15,244	0.08
	Interest & Investment Income, of which:	30,655	0.16
	General Fund	26,185	0.14
	Housing Revenue Account	1,260	0.01
	Common Good	3,157	0.02
	Road Bridges	53	0.00
	Increases in Revenue Balances	9,947	0.05
	Total revenue income	18,051,883	95.79
Capital income	Capital Receipts	141,971	0.75
	Government Grants	548,000	2.91
	Other Grants and Contributions	104,000	0.55
	Other Income	.	
	Total capital income	793,971	4.21
TOTAL INCOME		18,845,854	100.00

6 Scottish Government, 'Scottish Local Government Financial Statistics 2010/11, February 2012

Table 2: Total gross revenue and capital expenditure by local authorities in Scotland in 2010-11[7]

£ Thousands	General Fund Services	Housing Revenue Account	Significant Trading Operations	Road Bridges	Common Good Fund	Total
Revenue Expenditure						
Employee Costs	7,580,561	151,164	453,258	4,075	218	8,189,276
Operating Costs	6,056,339	449,303	498,898	2,225	10,358	7,017,123
Support Service Costs	694,379	58,296	26,060	117	370	779,222
Transfer payments	2,239,666	1,683	.		800	2,242,149
Revenue Contributions to Capital	36,658	140,454	.	9,856	214	187,182
Adjustment for inter account and inter authority transfers	-654,297	-22,664	-709,787	-	-3,421	-1,390,169
Grants to third parties funded by General Capital Grant	63,407	.	.	.	.	63,407
Statutory Repayment of Debt	531,490	105,190	22,378	1,440	2,633	663,131
Interest payments	615,931	122,444	..	..	..	738,375
Contributions to General Fund/ Other	.	1,475	7,816	-554	358	9,095
Total Gross Revenue Expenditure	17,164,134	1,007,345	298,623	17,159	11,530	18,498,791
Capital expenditure						
Acquisition of land, leases, existing buildings or works	91,428	7,302				98,730
New construction, conversions & enhancement to existing buildings	1,349,467	527,225				1,876,692
Vehicles, machinery & equipment	145,920	10,369				156,289
Intangible assets	4,202	840				5,042
Total	1,591,017	545,736				2,136,753
Revenue Expenditure funded from Capital Resources	211,029	380				211,409
Total Capital Expenditure	1,802,046	546,116				2,348,162
TOTAL REVENUE & CAPITAL EXPENDITURE	20,846,953					

7 Scottish Government, 'Scottish Local Government Financial Statistics 2010/11, February 2012

Table 3 provides a breakdown of the £17.2billion of General Fund revenue expenditure which details spending on the various areas of local government responsibility.

Table 3: Local government general fund revenue gross expenditure 2010-11[8]

	Gross Expenditure	% of total general fund gross expenditure
Education	4,856,964	28.30%
Social Work	3,609,012	21.03%
Non-Housing Revenue Account (HRA) Housing	2,361,230	13.76%
Police	1,242,866	7.24%
Environmental Services	792,494	4.62%
Central Services	774,715	4.51%
Cultural and Related Services	738,957	4.31%
Roads and Transport	706,996	4.12%
Planning & Economic Development	512,608	2.99%
Fire	357,138	2.08%
Trading Services	61,552	0.36%
Total General Fund services	16,014,532	93.30%
Interest and investment income	615,931	3.59%
Statutory repayment of debt	531,490	3.10%
Contributions to/from HRA	2,181	0.01%
Total	17,164,134	100.00%

2.3 Taxation, representation and expenditure

The link between taxation, representation and expenditure is an important one for maintaining an effective democracy. However, as the figures illustrate, even if councils had full control over council tax, that taxation would only cover 10 per cent of total revenue income. As a result, if councils wanted to increase their income by only one per cent to increase expenditure, they would have to increase council tax by 10 per cent. So even the smallest of projects a council may want to take on could lead to very large increases in council tax. If councils had control over a number of taxes, the burden could be spread more evenly.

7 Scottish Government, 'Scottish Local Government Financial Statistics 2010/11, February 2012

Often turnout at local elections can be used to gauge public interest in, or apathy to, what is happening in their town hall. However, since 1999 local elections in Scotland have been held on the same day as elections to the Scottish Parliament. The voter turnout in 2007 was 52.8 per cent.[9] This was also the first election to be held under the Single Transferable Vote voting system. Between 1976 and 1995 turnout at local elections varied between 41 and 48 per cent. It will, therefore, be interesting to see what level of turnout is achieved for the local elections to be held in May 2012, the first vote since the elections were de-coupled.

9 Herbert. S, "Local government elections 2007 briefing", SPICe, February 2008
10 Scottish Parliament written answers, S1W-11507

3. The centralisation of Scottish local government

In 1976, the Committee of Inquiry into Local Government Finance chaired by Frank Layfield Q.C. published its final report. The committee had considered local government finance across Britain and called on the government of the day to choose between a "centralist" model of local government, under which central government would have the main responsibility for local government expenditure; and the "localist" model, under which local authorities would have the main responsibility for the level and pattern of expenditure on local services. The committee advised that a system of local government finance that supported the chosen model was developed. The Layfield Committee itself favoured the localist model and called on the government to devolve tax powers to local government. The committee felt that such a move would increase independence from the centre as well as increasing local accountability.[11] 23 years later the McIntosh Commission into local government in Scotland reported to the then Scottish Government that "reform of local government finance was essential in order to ensure responsible local government." The Commission also commented that the centralisation of business rates and capping of rates had "removed from councils the discretion to decide on behalf of their local electorates where the balance should be struck between levels of service and levels of local taxation".[12]

36 years on from Layfield and 13 years on from McIntosh the lessons have yet to be learnt as local government in Scotland is arguably a lot more centralised.

The following are some examples of the centralisation of power that has taken place in Scotland.

3.1 Rate Caps

The Conservative Government elected in 1979 had pledged to tackle the high levels of local government spending which they believed were spiralling out of control. The politics of the time were very different to today, with a great gulf between the two main political parties and the Conservative Government viewed Labour in local government as a high tax and high spend party. The Conservative Government initially attempted to rein in spending by withdrawing grants from high-spending authorities.[13]

11 House of Commons Communities & Local Government Committee, "The Balance of Power: Central and Local Government", May 2009
12 Local Government Finance Review Committee, 'A Fairer Way', 2006
13 Wood. E, 'The Local Government Bill: Best Value and Council Tax Capping', House of Commons research paper 99/1, January 1999.

Although this policy was designed, rightly or wrongly, to address a problem of the times, it left a legacy of extensive central government interference in the finances of local authorities.

3.2 Council Tax

It could be argued that, since 2007, council tax has been capped in Scotland by the back door. 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 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 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.[14] 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 up until the end of 2012/13 – meaning bills will have been held at 2007/8 levels for six years.[15] Or, another way of putting it would be to say that for six years local authorities across Scotland have had little control over taxing their local populace.

3.3 Business Rates

Non-domestic rates, or business rates, are taxes on property payable by businesses in Scotland. Since 1990 and the creation of the UBR (uniform business rate) business rates have been set by the government, collected by local government, passed to the government and redistributed to local government on the basis of adult population.

14 Concordat between the Scottish Government and Cosla, November 2007
15 http://www.scotland.gov.uk/News/Releases/2011/12/28083825

As a result, the amount of income from business rates received by a council bears no relation to the concentration of business property in its area and is basically part of the council's grant rather than being income over which they have any control.

3.4 Police

Local authorities currently play a large role in the structure of the police with councils being responsible for roughly half of their funding and police boards, to which chief constables are supposed to be accountable, made up of councillors. However, in a statement to Holyrood on 8 September 2011, the Justice Secretary Kenny MacAskill announced that Scotland's eight police forces would be replaced with a single Scottish force. While Reform Scotland accepts that the eight-force-model was a hangover from regional government and there was a real need to improve the accountability and transparency of the police (see Striking the Balance and Reform Scotland Bulletin on Police Numbers) the model set out by the Scottish Government in the Police & Fire Reform (Scotland) Bill[16], removes much of local government's involvement in policing, suggesting that funding comes directly from central government and that the police board is made up of individuals appointed by the Justice Secretary, rather than local politicians. It is not clear how the need for diversity and flexibility could be accommodated within the proposed structure where local commanders may have some level of accountability to local authorities but are also ultimately answerable to the sole Chief Constable. If there is a conflict between some of the policing policies being pushed then ultimately the local needs end up coming second – unless that Chief Constable is, in turn, answerable to a Scottish Police Board made up of representatives of local authorities, as recommended by Reform Scotland.

The danger is that the same principle used to justify centralising Scotland's police forces could be used to remove other areas of local government responsibility, for example social care or housing.

16 Police & Fire Reform (Scotland) Bill and accompanying documents

4. Different local taxes and examples from overseas

In Scotland, local authorities have generally had very limited tax options open to them. This section looks at the different ways local taxes are collected elsewhere. It is not Reform Scotland's intention to recommend that local authorities in Scotland adopt a specific tax; rather we have stated that we believe that councils should have a basket of taxes available to them which they can choose between to reflect local circumstances. The following chapter outlines some of the potential taxes which could be used, as well as examples from overseas.

4.1 Property-based Taxes

Local government taxation in Scotland has, for the most part, been based on some sort of property tax, for example through rates or the council tax. As Sir Michael Lyons stated in his final report local property based taxes have "the advantage that it can provide a strong connection between the tax people pay and their residence in an area. Taxes on property value reflect residents' (and owners') financial stake in a community and its prosperity, and their interest in local services and investment, which themselves impact on the desirability of property in a given area."[17] However, there are different forms of property tax:

- **Council Tax**
  This is the current form of local taxation in place in Scotland and contains a personal and property element. The tax is set by each local authority with eight bands based on the value of the property in 1991. Although there has been no mass revaluation of property since 1991, if improvements are made on a property, once that property has been sold, it may be re-valued. Houses in Band A pay two thirds of band D and one third of band H. The tax assumes there are at least two people living in the property so a 25% discount is available to households where only one eligible adult is resident. Students and under 18s do not need to pay. Council Tax Benefit of up to 100% is available for people who are on income support or low incomes. The amount of benefit depends on the level of the council tax bill, income and savings and personal circumstances.

17 Lyons. M, "Lyons Inquiry into Local Government – Final Report", March 2007

As mentioned earlier, since 2007 through negotiation with central government council tax levels have been frozen.

- **Land Value Tax**
  A land value tax (LVT) is supported by the Scottish Greens as a replacement for the council tax, based on the value of the land, not the improvements upon it. The levy would be set at a percentage of either the capital value of the land or the rental value. However, the value of the land can be affected by the permitted use of the land. So, for example, land with planning consent for housing is worth much more than land used for agriculture. According to Andy Wightman in his report for the Scottish Green Party, "A Land Value Tax for Scotland", the philosophy behind a land value tax is:

  "since land is fixed in supply, its value is purely a scarcity value reflecting the competing needs of the community for work, leisure and housing....The land value owes nothing to the owner or to the individual effort and everything to the community at large... The concept becomes very clear when one looks at the input of public investment and the allocation by the community of planning permissions, both of which bestow an uplift in value on the land."[18]

The policy outlined by Andy Wightman includes:

- Replacing council tax and business rates with a LVT.
- Setting two rates of the LVT – a national and local rate.
- The national rate set at 1p per £1 of land value and levied by the retention of an equivalent sum by the Scottish Government from the Aggregate Local Finance for local government. The local rate would be up to local authorities.
- Development of a Scottish Land Use Database with land values, updated every two years.

18 Wightman. A, 'A Land Value Tax for Scotland', Scottish Green Party

- **Non Domestic Rates**

  In Scotland, Non-Domestic Rates (or business rates) are taxes 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 guest house, both council tax and business rates need to be paid.[19]

  It is also worth mentioning Business Improvement Districts (BIDs). Although not a tax in the usual sense, it can be viewed as an optional extension of business rates. A Business Improvement District is a defined geographical area of a local authority, be it a city centre, town or commercial district, which has voted in favour of investing collectively in local improvements in addition to those delivered by statutory authorities. BIDs are developed, managed and paid for by the business sector by means of a compulsory BID levy which the businesses within the BID area must vote in favour of before the BID can be established. Each business liable to contribute to the BID is able to vote on whether or not the BID goes ahead. The interests of both large and small businesses are supposed to be protected through a voting system that requires a majority in the numerical votes cast and the rateable value of votes cast.[20]

4.2 Sales-based Taxes

- **Local Sales tax**

  Sales taxes operate at a local level in a number of other countries, including in many cities in the United States. They tend to be taxes charged just once at the point of sale so are relatively easy to administer and are location specific. A local sales tax can also operate alongside a national sales tax. Some argue that the tax competition across areas also helps contribute to a downward pressure on rates. However, many argue (for example in the Lyons report) that the UK's existing tax on consumption of goods and services, Value Added Tax (VAT), is subject to a number of restrictions in European Union law and could not be legally adapted to allow for local variation.[21]

19 Local Government Finance Review Committee, 'A Fairer Way', 2006
20 www.bids-scotland.com
21 Lyons. M, "Lyons Inquiry into Local Government – Final Report", March 2007

- **Bed tax**
  In December 2011, Edinburgh Council approved plans to introduce a bed tax for the city. The tax would represent about £1-£2 for each night's stay in the city's visitor accommodation. It was estimated that the tax could raise up to £10million a year for the council.[22] Similar taxes exist in a number of cities with a high level of tourism, such as New York City, though no other city in the UK has such a levy. Although the council, which is run by a coalition between the Lib Dems and SNP, had approved the scheme it is unlikely to be introduced. The Scottish Parliament would need to legislate to allow the council to introduce the tax and Fergus Ewing, the Minister for Energy, Enterprise and Tourism, told parliament on 15 December "We have no plans to introduce a bed tax and there are no existing legal powers for local authorities to levy a local bed tax or tourism tax".

  Similar taxes could operate with regard to other specific services.

4.3 Income-based Taxes

- **Local Income Tax**
  Local income tax (LIT), which is an additional tax on income to replace council tax, has been favoured by the SNP and Liberal Democrats in the past. The SNP's proposed version of the tax would see people paying local income tax through HMRC, which would administer and collect the tax, along with national income tax, passing the money to councils depending on their rate.

  The Lib Dems 'Axe the Tax' website explains how they believe the tax could be collected: [23]

  > "One option is for an average rate of LIT to be calculated from the different LIT rates of councils. This would be added to the national rates and deducted through the year. An end-of-year process would ensure a taxpayer pays the correct amount of national and LIT. If your local authority has set a rate of LIT lower than the national average, then you will get a rebate at the end of the year. If your authority has set a rate higher than the average, then you pay a little extra.

22 Carrell. S, "Edinburgh votes for UK's first hotel bed tax to fund its festivals", Guardian, 6/12/11
23 http://campaigns.libdems.org.uk/axe_faq

> Alternatively, the existing PAYE codes, or the PAYE tax allowances, could be adjusted to reflect the LIT rate to be paid by each employee. Before widespread computerisation, it was thought to be too cumbersome for employers, but tax credits suggest this could now work. CIPFA concluded that changing tax allowances would mean there was no extra work for businesses and employers."

Local authorities in many other countries raise money from income. For example, in Denmark 70 per cent of the country's 98 municipalities' income comes from their own income tax with an additional eight per cent from property taxes.[24]

- **Tax Sharing**

  Although many other countries raise money at a local level from some sort of income tax, it is often part of a tax sharing set up where both central government and regional or local government raise money from incomes. Depending on the set up, this can leave less autonomy with the lower level of government, with central government retaining control over the key elements such as the base, though not necessarily. For example, in Canada provincial income tax operates alongside federal income tax. The federal income tax applies to four income brackets. However, there are a range of different approaches taken to income tax by the provinces; there is a flat rate tax in Alberta, whereas there are five income brackets in British Columbia and Nova Scotia.[25]

  As is the case with income tax, many other countries share business taxation between central and local government. For example, in Germany there is a basic corporate federal rate of tax of 15 per cent.cOn top of this an additional 14 to 17 per cent is added to the tax and payable to the municipalities.

4.4 Overseas

In our report Local Power, Reform Scotland set out examples of how local government operated in a number of other countries, highlighting that the lowest tier of government often had a smaller populace or geographical area than in Scotland, yet the politicians had greater control over their income, with control of not just one tax, but often a basket of taxes.

24 Local Government Denmark, "The Danish Local Government System", February 2009
25 http://www.cra-arc.gc.ca/tx/ndvdls/fq/txrts-eng.html

Reform Scotland believes that local authorities in Scotland should also be able to respond to local needs and circumstances and raise money from a wider range of sources. Whilst the next chapter sets out how we think this can be achieved, the following examples, in addition to references to Denmark, Germany and Canada earlier, illustrate how many local tiers of government around the world have access to a basket of taxes from which to raise income and are not just reliant on one, as is the case in the UK.

- Spain: In Spain, local authorities generate income from tax on real estate, paid by property owners; mechanically powered vehicles, paid by owners of cars and transport vehicles; tax on construction, installation and works, paid by the person responsible for the work; and a tax on the increase in value of urban land paid on the sale of urban property or land.[26]

- California: In the American state of California, local authorities are allowed to impose any tax not otherwise prohibited by state law.[27] Cities are not allowed to tax alcohol, cigarettes and personal income. However, the personal income restriction is not consistent across America with people employed in New York City paying city taxes in addition to state and federal income tax.

- Norway: In Norway, there are limitations placed by central government on the right of municipalities and counties to levy taxes and they are limited by maximum rates set by the Parliament annually. Taxes accounted for 44 per cent (municipalities) and 41 per cent (counties) of total income in 2006. Municipalities collect most of their tax money from individual and corporate income as well as property tax. Counties receive only income tax.[28]

26 http://ec.europa.eu/youreurope/business/managing-business/paying-taxes/spain/index_en.htm
27 Government Code section 37100.5
28 Norwegian Ministry of Local Government & Regional Development, “Local Government in Norway”, 2008

5. A new model for local government finance

In 'Devolution Plus', Reform Scotland set out a model which would enable the Scottish Government to raise as much as possible of the money that it spends. We believe this principle should also apply to local authorities. However, we accept that until greater fiscal powers have been devolved to the Scottish Parliament, it is very difficult to achieve this aim satisfactorily for Scottish councils. Therefore, we have set out our recommendations in two stages. The first represents what can be done now, while the second considers how powers which Reform Scotland has argued should be devolved to Scotland, could then in turn be devolved to local authorities to help them achieve this goal.

While we have outlined a number of different types of taxes above, Reform Scotland has not discussed the various pros and cons of each.

What can be done with existing Holyrood powers:

- Council Tax

  With regard to council tax, Reform Scotland believes that policies which attempt to manipulate councils into freezing their council tax, policies which were supported by most political parties at the last Scottish election, should be abandoned. The decisions of councils and local councillors should be transparent and they should be accountable to their electorate and such policies undermine this. If councils wish to lower or raise tax in accordance with their budgets and priorities they need to have the freedom to do so.

  However, beyond this we also believe that local councils should be able to choose to whom the tax applies, where discounts can be offered and indeed the type of local tax they wish to operate. For example, if one council wants to introduce a land value tax rather than the council tax, it should be free to do so. Alternatively, if one council wants to scrap second home discounts while another council wants to increase them, reflecting their local circumstances, they should be free to do so.

Obviously, under the current devolution settlement there are limits on the choice of tax available to councils, but the sentiment is clear – councils should be able to choose the type of local taxation and to whom it should apply. This would allow some councils, should they wish, to increase local taxation on second homes, without forcing other councils, who may disagree, to have to adopt the same policy. As local taxation is collected locally, there is no reason why differences cannot exist.

If local authorities had full control over council tax, this would increase the amount of their total revenue income which they are fully responsible for raising from 11.6 per cent to 21.8 per cent.

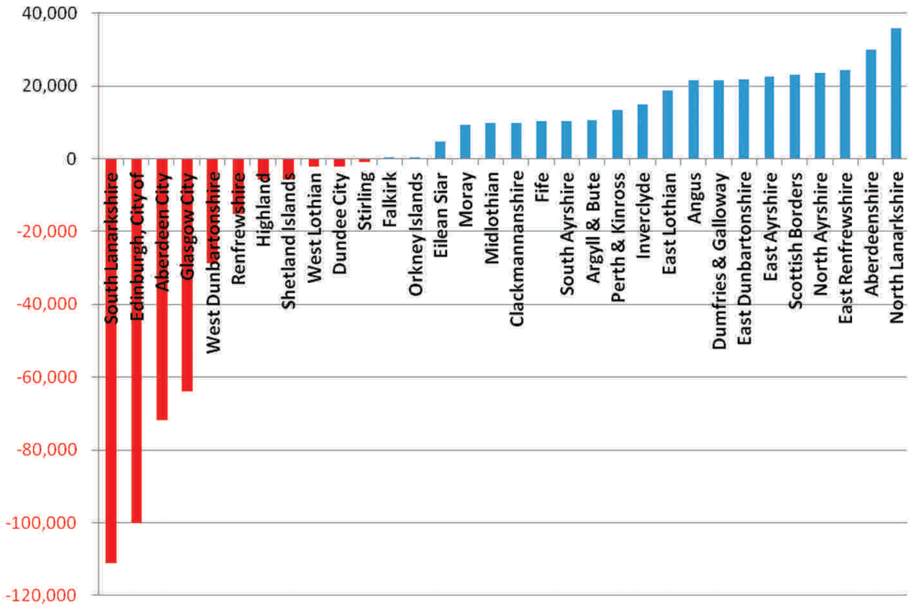
However, it is still unsatisfactory for any level of government to be solely reliant on one type of tax.

- Business Rates

Business rates are collected locally and Reform Scotland believes that councils should be able to retain the income they raise. This would give local authorities a real incentive to increase economic growth and address specific problems they are facing. For example, a council could opt to reduce business rates on shops in the high street by increasing the rates on out-of-town developments if that was the policy preference of the council.

Currently there are winners and losers as a result of the redistribution of business rates as illustrated in Figure 1. 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.

Figure 1: Difference between non-domestic rate (NDR) income in 2010-11 and the redistributed amount received (£000s)[29]



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 the 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

29 Scottish Government, "Scottish Local Government Finance Statistics 2010-11", February 2012. The overall difference in the amount distributed in Table 2.13 and the mid-year estimate on Table 2.11 is explained by the calculation used in Annex D of the Scottish government's report.

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.

The examples below set out how the policy would work at both ends of the spectrum, while Annex 1 details how the proposals would work for every council and how the policy is cost neutral to the Scottish government:

- Edinburgh
  In 2010-11 £288million was raised from business rates in Edinburgh, though the council only received £189million following re-distribution.[30] Under Reform Scotland's proposals Edinburgh Council would retain all £288million. However, the remaining part of the council's revenue grant would be reduced by the £99million difference, meaning that in the first year of operation there should be no overall difference to the council's income. However, if Edinburgh council adopted policies which saw an increase in the amount collected in business rates, it would continue to keep all that income and its grant WOULD NOT be adjusted to take account of this. Equally if the council saw a fall in business rates income, it WOULD NOT get an increase in its government grant.

30 Scottish Government, Scottish Local Government Finance Statistics 2009/10

- **Aberdeenshire**
  In 2010-11 £67million was raised from business rates in Aberdeenshire, though the council received £96million following re-distribution.[31] Under Reform Scotland's proposals the £96m business rates element of Aberdeenshire's grant would be removed and the council would keep the £67m it raised in business rates directly. This would leave the council £29m worse off therefore the council's remaining revenue grant would increase by £29million. If Aberdeenshire managed to increase its business rates revenue in future years, the council would still retain the additional £29million. Equally, if business rates fell, there would be no additional increase in the grant. (As illustrated in Annex 1)

  Although areas such as Aberdeenshire have less potential to increase their income than the big cities, giving control over the tax to the authority gives the power to adjust it to local circumstances. For example, while rural areas may not have the big shopping centres of the cities, they do have high streets, many of which are suffering. Being in full control of the tax would enable councils to experiment with schemes such as offering a year's business rate holiday to companies which locate in their high streets.

  There would be no cost to this policy as the income each council received in year one would be the same as the previous year, since their remaining grant would be adjusted to take account of the difference in the business rates income they receive.

  Transferring business rates back to local control would mean that local authorities were responsible for raising an additional 11 per cent of total revenue income.

  As a result of these two policies in relation to council tax and business rates, councils could almost treble the level of income they were responsible for raising to 32.7 per cent.

31 Scottish Government, Scottish Local Government Finance Statistics 2009/10

- **Legislate to allow councils to introduce new taxes**
  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 responsible out. Such schemes also increase diversity and allow councils to learn from the experiences of others. Importantly, it also makes councils less dependent on central government grants.

- **What can be done under 'Devo Plus':**
  Reform Scotland believes that in order to achieve accountable and transparent governance, each layer of government should be responsible for raising the majority of what it spends. It is impossible for the Scottish Parliament to devolve further tax powers to local authorities at present because the Scottish Parliament itself has no other tax powers. However, in 'Devolution Plus' Reform Scotland set out a plan which would enable the Scottish Parliament to be responsible for raising its own expenditure by devolving a number of taxes. Our specific proposals are outlined in Table 5 overleaf:

Table 5: Reform Scotland's tax recommendations at 2010-11 figures

	£ million raised in 2010-11[32]	Should be set & collected by Westminster	Should be set & collected in Scotland
Income tax	10,634		10634
Oil Revenues (Scottish Geographic share)	7,951		7,951
National insurance contributions	8,018	8,018	
VAT	8,560	8,560	
Other taxes on income & wealth	362		362
Other taxes, royalties & adjustments	694	694	
Corporation tax (excl North Sea)	3,114		3,114
Capital gains tax	244		244
Fuel duties	2,339		2,339
Vehicle excise duty	470		470
Stamp duties	595		595
Tobacco duties	985		985
Alcohol duties	895		895
Betting and gaming & duties	113		113
Air passenger duty	183		183
Insurance premium tax	210		210
Landfill tax	99		99
Climate change levy	61		61
Aggregates levy	54		54
Inheritance tax	159		159
Non-domestic rates	1,891		1,891
Council tax	1,986		1,986
Interest and dividends	183		183
Gross operating surplus (30:70 to reflect expenditure levels)	2,934	880.2	2,053.8
Rent and other current transfers	395	395	
Total	53,128	18,547	34,581
Percentage of total income		30%	56%

Of the taxes listed above, we think there is some merit in considering devolving a number of the taxes, especially those which are location specific, for example Stamp Duty, Landfill Tax or any of the so-called 'sin taxes'. However, for the purposes of this report Reform Scotland has not set out specific proposals as the necessary figures are not available. The figures used in GERS are estimates, or best guesses which a small team of Scottish statisticians and economists compile to give the most accurate picture of Scotland's income and expenditure. Unfortunately, because they are based on so many assumptions it is not possible to get any of the above figures broken down by local authority area.

32 GERS 2010-11 table 3.1
33 Although this group includes some 11 separate revenues (as set out in the detailed methodology paper on the GERS website), the two largest – TV Licences and National Lottery Distribution Fund - account for 66 per cent (£437 million) of this estimate for Scotland. This group also contains a small accounting adjustment to align the revenue estimates to those in the April 2011 UK Public Sector Finances Statistical Bulletin. This adjustment is apportioned to Scotland on the basis of Scotland's share of total onshore UK tax revenue.
34 Excludes non-domestic rates local authorities pay themselves

Rather than compound assumptions, Reform Scotland would call on the Scottish Government, in conjunction with Her Majesty's Revenue and Customs, to examine whether it would be possible to start compiling a more comprehensive set of figures based on what is actually raised. While some taxes may be more difficult than others, it should not be impossible in a digital age to know how much each tax actually raises in each area. Such information isn't just helpful to set out how taxes could be devolved down to local authorities in Scotland, but if the Scottish people are to be asked in a few years whether Scotland should be independent, or even whether we should have additional tax powers, the least the public deserve is the information necessary to make an informed decision.

- **Council tax benefit/housing benefit**

  Under the proposals Reform Scotland set out in 'Devolution Plus', we also called for welfare powers currently totalling just over £7billion to be devolved, primarily where they related to areas where the Scottish Parliament already had a degree of responsibility. This included council tax benefit and housing benefit. Therefore, in addition to giving local authorities greater control over their choice of local taxation, we believe local authorities should also be given control of the benefits that go alongside local taxation and housing. It makes far more sense for the same level of government to be responsible for the benefit that goes along with the taxation or service they operate.

6. Conclusion

There is a great deal of discussion within Scotland at present about the importance of the Scottish Parliament having greater responsibility for raising the money it spends. People and organisations, including Reform Scotland, have argued that making the parliament more responsible for the money it spends would provide a much better incentive structure for politicians and, therefore much greater attention being paid to the delivery of value for money in public spending and the balance between spending and its costs in terms of higher taxes. It also addresses the issue of democratic accountability and the relationship between the different levels of government. Reform Scotland believes that this argument applies just as much to Scottish local authorities as it does to Holyrood, which is why we have tried within this paper to set out how our councils could become much more fiscally responsible and accountable.

The UK Government is funded through a basket of taxes, which can be balanced to reflect ongoing priorities and to meet objectives. Giving local authorities control over a basket of taxes to raise their income would allow them to spread the cost of local services to meet their objectives.

The continued blurring of responsibility between local and central government in Scotland has obscured the lines of accountability between the voters and town halls. It is, therefore, all too easy for the buck to be passed between councillors and MSPs when things go wrong, with the electorate unsure as to who is responsible for bad, or good, policy decisions. This makes it harder for them to decide how to cast their vote.

Healthy democracy needs clear lines of accountability, with decisions taken as close to the people they affect as possible. The best way to deliver this is for each layer of government to be responsible for raising as much as possible of the money that it spends. This would also help increase understanding and interest in local government.

Centralised government isn’t right for the UK, but it isn’t right for Scotland either.

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Annex 1. NDR and General Revenue Funding (formerly Revenue Support Grant) distribution in 2010-11 and under Reform Scotland's proposed model

The following table demonstrates how Reform Scotland's proposals to allow each local authority to keep the non-domestic rates they raise would not leave any councils better or worse off in the short term and would be cost neutral to the Scottish government. The figures are taken from the Scottish Local Government Financial Statistics 2010-11, published by the Scottish Government in February 2012 and the Local Government Finance Circular No.1/2010 which detailed the General Revenue Funding settlement for 2010-11. Annex D of the Scottish Local Government Financial Statistics 2010-11 details the calculation which explains the difference between the amount of NDR actually raised and the amount redistributed.

Authority (£000s)	Non-Domestic Rate income	Re-distributive NDR income	Difference between amount raised and amount received	General revenue funding	Total of GRF and distributive NDR	Reform Scotland model proposed NDR income in year 1 of operation	Reform Scotland model proposed General Revenue funding income	Reform Scotland model proposed total of GRF and distributive NDR	Difference between total of GRF & NDR and under Reform Scotland's proposals
Scotland	2,136,388	2,068,200	-68,188	8,017,090	10,085,290	2,136,386	7,948,904	10,085,290	0
Aberdeen City	155,672	84,193	-71,479	254,934	339,127	155,672	183,455	339,127	0
Aberdeenshire	66,764	96,621	29,857	316,320	412,941	66,764	346,177	412,941	0
Angus	22,711	44,141	21,430	164,336	208,477	22,711	185,766	208,477	0
Argyll & Bute	25,620	36,214	10,594	183,939	220,153	25,620	194,533	220,153	0
Clackmannan-shire	10,269	20,200	9,931	76,264	96,464	10,269	86,195	96,464	0
Dumfries & Galloway	37,959	59,455	21,496	246,289	305,744	37,959	267,785	305,744	0
Dundee City	58,825	57,010	-1,815	243,482	300,492	58,825	241,667	300,492	0
East Ayrshire	25,426	47,987	22,561	184,258	232,245	25,426	206,819	232,245	0
East Dunbartonshire	20,137	41,904	21,767	141,432	183,336	20,137	163,199	183,336	0
East Lothian	19,677	38,455	18,778	130,738	169,193	19,677	149,516	169,193	0
East Renfrewshire	11,425	35,702	24,277	140,176	175,878	11,425	164,453	175,878	0
Edinburgh	288,506	188,733	-99,773	569,111	757,844	288,506	469,338	757,844	0
Eilean Siar	5,707	10,484	4,777	101,628	112,112	5,707	106,405	112,112	0
Falkirk	60,476	60,652	176	218,525	279,177	60,476	218,701	279,177	0
Fife	134,426	144,812	10,386	507,872	652,684	134,426	518,258	652,684	0
Glasgow City	297,399	233,786	-63,613	1,110,912	1,344,698	297,399	1,047,299	1,344,698	0
Highland	93,300	87,794	-5,506	386,982	474,776	93,300	381,476	474,776	0
Inverclyde	17,413	32,325	14,912	142,097	174,422	17,413	157,009	174,422	0
Midlothian	22,526	32,237	9,711	121,491	153,728	22,526	131,202	153,728	0
Moray	25,929	35,122	9,193	128,054	163,176	25,929	137,247	163,176	0
North Ayrshire	30,918	54,389	23,471	219,991	274,380	30,918	243,462	274,380	0
North Lanarkshire	94,425	130,258	35,833	505,317	635,575	94,425	541,150	635,575	0
Orkney Islands	7,643	7,959	316	64,891	72,850	7,643	65,207	72,850	0
Perth & Kinross	44,342	57,694	13,352	192,920	250,614	44,342	206,272	250,614	0
Renfrewshire	82,866	67,946	-14,920	260,096	328,042	82,866	245,176	328,042	0
Scottish Borders	22,012	44,989	22,977	173,215	218,204	22,012	196,192	218,204	0
Shetland Islands	14,201	8,795	-5,406	86,289	95,084	14,201	80,883	95,084	0
South Ayrshire	34,235	44,685	10,450	160,149	204,834	34,235	170,599	204,834	0
South Lanarkshire	235,013	124,084	-110,929	446,849	570,933	235,013	335,920	570,933	0
Stirling	35,984	35,354	-630	137,469	172,823	35,984	136,839	172,823	0
West Dunbartonshire	64,774	36,390	-28,384	167,013	203,403	64,774	138,629	203,403	0
West Lothian	69,806	67,830	-1,976	234,051	301,881	69,806	232,075	301,881	0