The Royal Society of Edinburgh
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Advice Paper

October 2023, AP23-7

A fairer council tax

Executive Summary

1. The Royal Society of Edinburgh (RSE), Scotland's National Academy, in conjunction with the Young Academy of Scotland (YAS), welcomed the opportunity to respond to the Scottish Government and Convention of Scottish Local Authorities consultation on a Fairer Council Tax.[1] Our consultation response and this expanded Advice Paper draw on our varied expertise, including on the economy, fiscal policy and the public sector. A working group, which included fellows and members of the RSE Economy and Enterprise Committee, was formed to contribute to both the consultation response and this Advice Paper.

2. The unsatisfactory nature of the Scottish Government's electronic consultation submission system and of the questions asked in it led the RSE to also publish this Advice Paper, which incorporates material from its response and includes further details that were not submitted. The Consultation Paper is weak in terms of data and analysis; the questions asked are in some cases badly formulated, for example, Question 3; and the automated system is not user-friendly for inputting responses, which leads to unattractively formatted documents for citizens and external bodies who wish to view what has been submitted.

3. The RSE has published Advice Papers on the Scottish tax system, the most relevant of which are cited here.[2] It supports policies which would make the tax system more progressive but has cautioned against policies which pay inadequate attention to efficiency considerations and to the potential behavioural effects of taxation.

4. The RSE believes that Council Tax cannot be made 'fairer' while still using out-of-date valuations from 1 April 1991 and, for that reason, opposes the proposed increases of the multipliers relative to Band D for properties in Bands E, F, G and H. This Advice Paper makes suggestions as to how the local government finance system, of which Council Tax is part, can be improved.

5. The title of the Consultation Paper is 'Consultation on a Fairer Council Tax'. The RSE does support measures which would make Council Tax fairer, but believes it is impossible to do so without a property revaluation. The use of 1991 valuations breaches the principle of horizontal equity as properties which would have the same 2023 valuation are in different bands. The Institute for Fiscal Studies has concluded that 50% of properties in England are now in the wrong Council Tax band.[3] Restrictions on data access have prevented the extension of their analysis to Scotland and the RSE urges the Scottish Government to address the obstacles to a comparable analysis for Scotland.

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[1] Scottish Government and Convention of Scottish Local Authorities, *Consultation on a Fairer Council Tax*, Edinburgh, July 2023. https://www.gov.scot/publications/consultation-fairer-council-tax/documents/

[2] Royal Society of Edinburgh (2015) *Independent Commission for Competitive and Fair Taxation in Scotland Call for Evidence: Response from the Royal Society of Edinburgh*, Advice Paper 15-12, Edinburgh; Royal Society of Edinburgh (2016) *A Scottish Approach to Taxation: Response from the Royal Society of Edinburgh,* Advice Paper 16-21, Edinburgh; Royal Society of Edinburgh (2019) *Devolved Taxes: A Policy Framework*, Advice Paper 19-08, Edinburgh; Royal Society of Edinburgh (2021) *Response to the Scottish Government's Tax Policy and the Budget Consultation*, Advice Paper 21-13.

[3] Adam, S., Hodge, L., Phillips, D and Xu, X. (2020) *Revaluation and Reform: Bringing Council Tax in England into the 21st Century*, Report 168, Institute for Fiscal Studies, London.

6. The RSE notes that, in considering any Council Tax changes, account needs to be taken of the impact on households and councils and the wider effect on the economy rather than solely looking at the impact on households according to their Council Tax band. Moreover, when making changes to one particular tax vehicle, attention should be paid to the effect on the overall tax system, only part of which the Scottish Government controls.

7. What is required in local authority taxation in Scotland is a consensus between the major parties on how the deficiencies should be addressed. The present situation reflects badly on devolved government, particularly when it seems that policy change in Scotland is impossible without parallel change in England. It might be tempting to suggest the appointment of a committee to investigate local taxation, but the existing problems are well understood and the report of any such committee would most likely be discarded.

8. Instead, it is for the Scottish Government and the Scottish Parliament to agree on a path forward which deals with short-term issues without prejudicing longer-term reform. Civil society organisations will have important contributions to make. The RSE is actively seeking further engagement with the Scottish Government, MSPs, and public bodies, and is willing to help facilitate further discussions regarding tax policy.

Context

9. The introduction of Council Tax was a solution to the political problem of the time, which was bringing back a domestic property tax to replace the Community Charge (Poll Tax), in a way that was not unacceptable to those in more expensive properties. This worked relatively well at the time. It addressed the "elderly widow in the large family home" problem by offering a 25% discount to single occupants and ensured that those in large houses did not pay "too much", not just by using banding but by making sure the tax liability was not proportional to property values. Banding was useful as it mitigated against large numbers of valuation appeals, which had become common in the 1970s and 1980s. Whilst Council Tax worked politically at the time, it no longer works.

10. This is, in large measure, a consequence of the failure of successive governments to undertake a revaluation, probably influenced by memories of the political reaction to the 1986 domestic rates revaluation, which led to the introduction of the Poll Tax. In 2006, Scotland's then First Minister (Jack McConnell) disowned on the day they were published the recommendations of the Burt Committee,[4] which his Labour-Liberal Democrat Government had commissioned. There has since the introduction of the Council Tax been no Scottish revaluation. In contrast, Wales revalued for Council Tax in 2003; Northern Ireland revalued for Domestic Rates in 2005, though this was done by the Secretary of State for Northern Ireland during Assembly suspension. Revaluation is never politically easy, but it becomes even more fraught when seriously out-of-date valuations result in large changes after revaluation. Those households facing higher tax bills complain, while those receiving lower tax bills are silent, even if total tax revenues are held constant.

11. In the 32-year period since 1991, there has been a big shift of economic prosperity from the west of Scotland to the east of Scotland. This means that there is a geographical problem with 1991 valuations as well as an inter-household problem. Put bluntly, Council Taxpayers in the west are generally overpaying Council Tax, and those in the east are generally underpaying.

12. Those now-flawed valuations cannot support changes to the existing multipliers in the name of vertical equity. The transition from Domestic Rates through Poll Tax to Council Tax deliberately narrowed the differential between the payment at the highest and lowest bands, now three times. The Consultation Paper notes that the capital value differential is now about 15 times, though this is partly eliminated via the more progressive Land and Buildings Transaction Tax (LBTT) levied on these higher value properties. With up-to-date valuations, the RSE might support a higher differential, while noting that attention should be given to possible behavioural effects, such as making Scotland a less attractive location than England for high-income households who contribute a large proportion of Scottish Income Tax revenues.

13. It is important to remember that what matters for vertical equity is the effect of the tax system as a whole. Some taxes will be regressive, as are those on alcohol and tobacco and some environmental taxes that have been adopted partly to change behaviour. Although the lack of progressivity is not a decisive argument at the level of individual taxes, it may make it more difficult to achieve the desired level of progressivity in the tax system as a whole. There is also the question of whether progression should be measured solely against income and whether more attention should be paid to taxation of wealth, of which property is a visible part. The appropriate measure of progression for Council Tax is uncertain, as it is partly a tax on housing consumption and partly a tax on one form of wealth.

The Case against changing the multipliers in the absence of a property revaluation

14. The proposals in the Consultation Paper are more likely to hinder future reform of Council Tax than to help, for the reasons discussed below.

15. First, the motivation of the Consultation Paper appears to be to raise a relatively small amount of additional revenue. The Convention of Scottish Local Authorities (2021) has calculated that the £2.9 billion proceeds of Council Tax would be £600 million higher if local authorities had been allowed to make their own decisions.[5] If Council Tax is now lower in

[4] Burt, Sir Peter (2006) (chair) *A Fairer Way: Report by the Local Government Finance Review Committee*, Edinburgh.

[5] Convention of Scottish Local Authorities (2021) *Live Well Locally: Our Shared Ambition for Everyone in Scotland Made Possible with Fair Funding*, Edinburgh.

Scotland than in England, this owes much to the nine-year freeze imposed by the Scottish Government. Moreover, the stated comparison in the Consultation Paper is invalid because the 'anchor' Band D relates to different 1991 capital values: over £45,000 and up to £58,000 (Scotland) but over £68,000 and under £88,000 (England). Properties in Band D in Scotland would be in Bands B or C in England while properties in Band D in England would be in Bands E or F in Scotland.

16. Second, increasing the multipliers on Bands E to H, in a situation where many properties will be in the wrong band, would provoke justified opposition and further damage the credibility of Council Tax. These changes are estimated to affect 28% of all properties and to raise an additional £176 million (6.1% of the estimated 2023-24 yield of £2.9 billion) before any extension of existing reliefs. Changes to the multipliers raise issues about the legitimate expectations of households who made housing-choice decisions in the context of frozen levels of Council Tax and the existing multipliers. Rather than tweak the existing system, the Scottish Government should engage with political parties and civil society to build a consensus on what should be done about local authority funding and taxation.

17. Third, residential property taxes encounter the problem that some households are asset-rich but income-poor. Given that there has been no revaluation since 1991, a revaluation, whenever done, will result in a significant redistribution of the tax burden even if total revenues are held constant at the Scottish level.

18. There are two ways of addressing this problem. The Council Tax Reduction (CTR) scheme currently costs £370 million. In Scotland, unlike in England, local authorities are not penalised for having a higher proportion of Council Taxpayers in need of such support. Such a scheme is devised to offset low incomes. There are also strong arguments for having a deferral scheme (at least for owner-occupied properties) under which tax payments can be deferred until the property is sold or the householder dies, at which time it becomes a claim on the estate. However, such a scheme should only be introduced in the context of revaluation or a comprehensive reform of property taxation. In-depth work would be needed on the detail of such a scheme. It would require borrowing but the revenue borrowing powers of the Scottish Government are restricted, and local authorities are obliged by law to balance their revenue budgets taking one year with another. Questions also arise about any interest rate charged on the deferred liability: the liability, for example, could be simply a percentage of the capital value at the time of realisation with perhaps discounts for cash payment. There is also obvious political sensitivity about taxation at death.

19. Fourth, property taxation is fully devolved to the Scottish Parliament. The LBTT is an improvement on Stamp Duty Land Tax, not least for having removed the 'slab' system. However, transaction taxes such as LBTT damage the efficiency of the property market, inhibiting moves. In economic terms, it would be preferable to raise the combined amount of money from a higher residential property tax and a much lower transaction tax linked to property registration. The political obstacle is that voters are much more sensitive to the highly visible and annual Council Tax than to the periodic LBTT, which is avoidable if one does not move or invisible if one privately rents.

20. Fifth, there is no mention in the Consultation Paper of the way in which Council Tax bands are used for water charging in Scotland. When Council Tax multipliers were changed in 2017, Scottish Water continued to use the original multipliers. Scottish Water charges an unmetered Band D household £502.29 for combined water supply and wastewater treatment (multiplier of 1) and a Band H household £1,004.58 (multiplier of 2). If the proposed Council Tax multiplier (3.00125) were to be used for water charges Band H would pay £1,507.50. This calculation shows the irrationality of what is supposed to be a charge for water as opposed to a tax. The combined billing makes the Council Tax seem larger than it is. Those in higher bands have incentives to opt for water metering, meaning that the relative burden shifts to those in lower bands or whose property is more difficult to meter.

21. Households that receive 100% CTR due to their financial circumstances and therefore do not pay any Council Tax, are required to pay water and wastewater charges for the services they receive. However, homes that receive CTR may also receive a reduction of up to 35% on their water and wastewater charges through the Water Charges Reduction Scheme, automatically applied by the local authority which does the billing. When the multipliers for Council Tax were changed in 2017, those for Scottish Water charges remained unchanged (as mentioned above in Section 20), and the fact this is not referred to perhaps implies that the same was intended to happen again.

22. Changing the multipliers in the way proposed would generate unequal amounts of extra revenue for councils, as the proportion of properties in Bands E to H will vary, as will the proportion of properties within each of these bands. Some councils will have their budgetary position eased, and others may not. Or there will be changes in the grant distribution formula which take all, or a proportion of, these extra revenues from the councils with higher proportions of Band E-H properties. For the comparatively small amount of additional revenue forecast (£176 million before any additional reliefs to Council Taxpayers or compensatory funding for councils which gain little extra revenue), the resulting controversies would be unhelpful.

The way ahead

23. As noted in paragraphs seven and eight, reform of local authority taxation in Scotland requires a consensus among the major parties on how the deficiencies should be addressed. Policymakers should work together to resolve the issues within Scotland's tax system and create new approaches to property taxation. The RSE draws attention to the proposals by John Muellbauer of Oxford University for a property tax which incentivises households to contribute to the climate change agenda.[6]

24. A significant difference from 30 years ago is that there are now better data on house values and some of these are easily accessible to households. This would make regular revaluations, or indeed rolling valuations easier, so that they never became seriously out of date. Up-to-date valuations would avoid people facing steep hikes in their Council Tax, though the required catch-up following the first revaluation may require a longer transitional period which would have to be funded either by the Scottish Government or implicitly by those councils whose valuations have not increased as much as those of other councils.

25. Rather than go ahead with changing the multipliers, the Scottish Government should commission a survey to establish just how inaccurate the 1991 banding now is, paying attention to the expectation that there will be geographic differences in house price changes as well as relative price changes by property type. Another issue to address would be to examine how social housing should be valued for Council Tax purposes, particularly in rural locations where construction costs can be high and market values may be influenced by greater second home demand than was the case in 1991. A similar issue might arise in high-pressured locations in the cities. The RSE believes that the CTR scheme should be expanded to protect those on lower incomes from any post-revaluation changes to property valuations and to the multipliers applicable to higher bands.

Broader issues for consideration

26. This Consultation may have put back on the Scottish policy agenda the financially vulnerable position of local authorities and the enfeebled condition of the Scottish local government finance system. There used to be a very full resources equalisation as part of the grant distribution in which the central government stepped in as a proxy taxpayer, bringing revenues per capita up close to those of the most affluent council. Resources equalisation is now less extensive. The Consultation Paper states that the Scotland-average Band D is £1,417, with a range of £1,261 to £1,515. It also states that: "We assume a standard Band D rate of about £911. Individual councils are currently able to keep all of their receipts in excess of this". This illustrates how Council Tax interacts with the distribution of Scottish Government grants. In grant distribution, the Scottish Government is, in effect, assuming a level of council spending lower than occurs: this puts greater pressure on those councils with a weak tax base.

27. The Council Tax consultation gave the impression of a desperate search for more cash from Council Tax, albeit a relatively small amount, required in part because of the cumulative effects of the nine-year Council Tax freeze. What is required instead is securing the research and data underpinning for a programme of local taxation reform which might take 10 years to complete. The information should be available so that political parties can adopt well-informed policy positions ahead of the 2026 Holyrood election and so that a measure of political consensus might be developed. Undoubtedly reform is politically difficult, which is why it has never happened since relevant powers were fully devolved from 1999. Mismanaging those parts of the tax system in Scotland which are devolved reflects badly on the Scottish Parliament.

[6] J. Muellbauer, *Why We Need a Green Land Value Tax and How to Design It*, Oxford, 2023.

28. Whereas some English councils have entered quasi-bankruptcy, issuing Section 114 notices under the *Local Government Finance Act 1988*, Scotland has fortunately averted such chaos. Nevertheless, financial pressure on the 32 Scottish local councils is now extreme, with more proposed service cutbacks a routine media event. Local government has been starved of local autonomy and finance for more than a decade. In part this stems from UK Government squeezes on the funds received by the Scottish Government through Barnett Formula consequentials. In part it stems from the spending and tax priorities of Scottish Governments. Moreover, the way in which the grant distribution to local authorities has been managed means that almost all distribution principles have been fudged. There are issues of principle to address, including the extent to which individual local authorities should be compensated for lower resources and higher needs.

29. In order to navigate this condition, there needs to be more data collection and more analysis, and more research on local authority taxation, particularly on what would happen in the event of a revaluation. The obstacles to data access that have prevented the Institute for Fiscal Studies from extending to Scotland its analysis of properties now in the wrong Council Tax banding should be removed. Research should also include consideration of how Council Tax and LBTT interact as property taxes, and of the merits and demerits of possible deferral schemes in the context of a revaluation.[7]

30. Finally, it is important to reiterate that a local residential property tax has a useful role to play in the overall tax system. The problem is that Council Tax has been mismanaged since 1991. Such taxes are widespread across the world as one element in local government funding; they are useful as a local accountability mechanism whereby councils have direct responsibility for raising some of the money they spend; they raise substantial amounts of money and are difficult to avoid; and they are a tax which focuses on one measure of wealth as opposed to income. Banding has proved useful as a means of reducing appeals against valuations. There is scope for political choice about the extent to which the tax charge increases with property values. This is a tax that needs to be properly managed and that has not been done, as is evidenced by this Advice Paper.

Additional Information

31. The RSE welcomes the opportunity to further support the Scottish Government with tax policy development and actively seeks engagement with it, public bodies, MSPs and other interested parties. If you have any enquiries about this Advice Paper or if you wish to engage with the RSE, contact Stephanie Webb, Policy Advice Officer (swebb@therse.org.uk).

[7] International research on existing deferral schemes shows that there has been low take-up, Northern Ireland providing one example. Eligibility restrictions, ignorance, complexity and concern about high interest rates are possible reasons. A. Munnell, W. Hou and A. Walters (2022), 'Property Tax Deferral: Can a Public-Private Partnership Help Provide Lifetime Income', Chapter 12 in O. Mitchell (ed.), *New Models for Managing Longevity Risk: Public-Private Partnerships*. https://academic.oup.com/book/41445/chapter/352801667

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