Scottish Parliament

Finance Committee

Call for evidence on a Scottish approach to taxation

A submission by:-

Aberdeen City Council

Date:- **September 2016**

Further information about Aberdeen City Council can be obtained at www.aberdeencity.gov.uk

Any questions arising from this submission, including requests to attend the committee, should be directed to:

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The Aberdeen City Context

Aberdeen is a unique place in Scotland. Though the City has benefited from the prosperity brought by the oil and gas industry, now that the rest of the UK economy is recovering from recession, Aberdeen is experiencing a decline due to the drop in the price of oil. This is compounded by pressures on infrastructure, connectivity, housing and skills. The effects of this include job losses, falling property prices and loss of custom.

Despite this decline, Aberdeen City continues to make a significant exchequer contribution to Scotland and the UK and this is expected to continue into the future. At a Scottish level, for example, almost 8% of Non-Domestic Rates was raised within Aberdeen in 2015/16.

Through our Regional Economic Strategy the City / Region is continuing to support the oil & gas industry, but also taking a more sustainable, diversified approach by attracting non-oil business. The City Council is also leading the largest regeneration programme ever seen in Aberdeen to support vastly improved transport, connectivity and investment in the city centre.

Q1. How can the Scottish Government's four principles to underpin Scottish taxation policy best be achieved?

By undertaking a review of all current taxes to ensure that they meet the four principles, and to test all future proposals to implement or amend taxes in Scotland against the four principles to ensure compliance. This may best be achieved by creating a Scottish Tax Commission to undertake the reviews and give expert independent advice to the Scottish Government.

The principles, particularly the first principle regarding ability to pay, are to some extent subjective and, therefore, will be open to interpretations as to whether or not a particular tax meets the criteria.

Q2. How does the current taxation regime and proposals for newly devolved taxes align against these four principles?

See table in Appendix.

Q3. Is there scope for a fundamentally different approach to taxation in Scotland?

Yes.

Aberdeen City Council supports the principles outlined in the Scottish Cities Alliance statement on "Empowering Scotland's Cities" June 2016. Of particular relevance to this enquiry is the approach outlined in the statement to setting a diverse tax system across Scotland; the relationship between the various tiers of government over the setting and use of fiscal levers; and the power to adopt local taxes and fiscal levers designed to help drive local economies.

In particular, the statement highlights the relatively limited levels of control that local government currently has over taxation in comparison with other cities internationally – 12% of local tax compared to local expenditure in the UK compared to almost 70% in Iceland. Cities simply do not currently have the fiscal levers to create sustainable public finances and sufficient flexibility to invest in local growth, because the benefits of investment often accrue to other bodies and authorities.

Changes to tax policy in Scotland and greater devolution of tax powers to local authorities are a natural next step following the Scotland Act 2016. Further changes in tax policy should be developed collaboratively between the Scottish Government, UK Government and local authorities, involving greater consultation and representation on the setting of local taxes, the adoption of appropriate local taxes and levies to drive local economies; and transparency on the impact of changes to tax policy on the overall funding package presented to local authorities, in particular the impact on government grant.

It is recognised that not all fiscal levers are best delivered at a local level, and that the debate on devolution of taxes overlaps with the significant changes being implemented as a result of the Scotland Act. Discussions around potential freedoms that could be explored, therefore, need to focus on enabling the specific conditions for success.

The Empowering Scotland's Cities statement outlines a menu of local taxes and levies that Cities would wish to discuss with the Scottish and UK Governments in order to consider the conditions for successful cities of the future. Aberdeen City Council, at its meeting on 17th August, 2016, considered potential additional powers and is continuing to assess the potential financial implications if such priority fiscal levers were to be devolved.

The devolution of taxes to local authorities could bring a series of benefits and risks to both local and central government. Primarily, the localisation of taxes will provide local authorities with the opportunity to create more sustainable public finances. By controlling more fiscal levers locally, they can better align revenue generation and local public expenditure. Potential ring-fenced fiscal revenue could be directed to meet local needs. This would enable local authorities to make local taxes more accountable to citizens and local businesses. Allowing local authorities the freedom to raise and spend taxes in a way that meets the needs and expectations of their residents and businesses most closely, can result in more attractive and responsive towns and cities that can attract people, business and capital. The current proposals to apply a multiplier to Council Tax Bands E to H and to retain the additional income for national distribution, does not support this relationship of accountability between councils and local communities.

Clearly localising tax would have a direct impact on tax revenue generated at a central treasury level for Scottish Government and UK Government. The relationship, therefore, between localising tax and consequent changes to local government grant is fundamental if public finances are to remain sustainable and the risks associated with raising local taxes are to be mitigated. The impact of localised taxes on both Scottish Government grant through devolved taxes and UK Government block grant and the Barnett formula, through changes to proposed reserved taxes, will need to be considered carefully as part of transparent and detailed analysis on the impact of any future taxes devolved to local authorities.

A key risk associated with devolving taxes to cities and regions is the potential for a divide to be created between those areas that are able to grow income and those that face a decreasing tax base. A specific concern in response to the Scottish Government announcement on the potential to ring fence a proportion of locally raised income tax is the potential for the policy to exacerbate existing issues in some areas where high unemployment and low productivity could contribute to declining income tax receipts.

Q4. Should future tax changes be ring-fenced and if so, how? If not, why?

Ring-fencing on a national scale reduces the opportunity for local choice and discretion. The Concordat between the Scottish Government and Local Government, agreed in 2007, established the principle that in implementing the Single Outcome Agreement it would seek to remove the ring-fencing of grants in the Local Government funding settlement and the principles behind that agreement remain true today; particularly that it gave authorities increased scope to re-deploy their resources to meet the funding pressures they face, and that the Scottish Government would stand back from micro-managing what authorities do - authorities being expected to take responsibility for their own decisions and to be answerable for them.

Locally, ring-fencing local tax revenues could be directed to meet local needs, enabling local authorities to make local taxes more accountable to citizens and local businesses, and make their areas more attractive to people, businesses and investors.

Q5. To what extent do potential behavioural responses limit options for tax changes in Scotland?

All taxation systems will to some extent affect the behaviour of the potential tax payers. Indeed a fundamental aim of some taxes will be to affect behaviours, for example in respect of health issues e.g. tobacco taxes; or environmental issues e.g. landfill tax. It will be for governments in Scotland to determine what behaviours they may wish to affect by the use of fiscal policy, and equally importantly those behaviours they would not wish to encourage via taxation policy, particularly around economic factors if perceived tax differentials between Scotland and the rest of the UK may lead to businesses relocating outside Scotland.

The impact of changes in taxation on citizens and businesses must be considered. One of the most fundamental considerations relating to the devolution of taxes or creation of new taxes will be whether the taxes are projected to create additional revenue. A careful balance must be struck between tax rises and dis-incentivising business and voters. In a competitive global environment, where people and businesses are able to move and relocate with more ease than ever before, the offering of public services must be proportionate and not demand cumbersome levels of taxation. Only by striking this balance, will cities be able to meet the needs of existing stakeholders, and attract others to cities to grow the tax base. Population or business migration as a result of increased taxes poses a risk. A migration of significant proportions of people or the migration of a single major employer could have a material impact on the local economy.

Q6. To what extent do the mechanisms for administering the Scottish income tax system via HMRC limit the scope for a different tax system in Scotland to develop?

Presumably it is possible for HMRC to administer Scottish variances to standard UK taxes, though there may be an additional cost of administration for such variables, which would need to be considered alongside the potential impact of establishing separate arrangements for the collection of Scottish taxes. Potentially local authority tax collection systems could be used to administer some Scottish taxes.

If greater divergence in Scottish taxation policy is to be pursued then the fundamental question that would need to be considered, in accordance with the principles of ease of payment/be efficient, would be the trade-off between the tax to be collected and the cost of administration. Achievement of Best Value should be a guiding principle in determining the most cost effective method of collection, be it to pay HMRC to administer Scottish taxes or setting up a separate body to administer Scottish taxes.

The risk of disproportionately high administration and collection costs will also be significant when considering the potential devolvement of taxes and levies to the local level.

Q7. Are there any other administrative limitations to the emergence of a Scottish tax system?

Determining the extent to which individuals or businesses are liable for Scottish taxes as opposed to UK taxes may be an issue.

Appendix

Tax	Proportionate to ability to pay?	Certainty to taxpayer?	Ease of payment?	Efficient?
Income Tax Proposal to consult on further devolution of part of income tax take to local authorities	Tax has the capability to be proportionate, via use of tax bands and allowances. Ultimately it is a political judgement as to whether or not the current banding levels and allowances achieve that. No impact on tax paid by earners unless the devolution extends to an ability to vary the rate locally.	Tax rates/bands clearly defined in advance. Subject to change year on year. No impact on tax paid by earners unless the devolution extends to an ability to vary the rate locally.	Straightforward for most, particularly employees via PAYE. More challenging for self-employed. No impact on tax paid by earners unless the devolution extends to an ability to vary the rate locally.	The PAYE element tends to be very efficient. Much less so, in terms of the proportion of tax due being collected by other methods. No impact on tax paid by earners unless the devolution extends to an ability to vary the rate locally.
Capital Gains Tax	Tax has the capability to be proportionate, via use of tax bands and allowances. Ultimately it is a political judgement as to whether or not the current banding levels and allowances achieve that.	Tax rates/bands clearly defined in advance. Subject to change year on year.	Relatively complex, paid via self-assessment tax returns	No - difficult to ensure that all CGT due is collected.
Council Tax	Although Council Tax has some cognisance of ability to pay in that the bandings lead to higher payments by those in more valuable properties it is inherently regressive in nature. Property is not always an accurate proxy for income. The lack of property revaluations may also contribute to	The tax bandings of all properties are known and each Council's tax rates are fixed in advance each year. Rates subject to change year on year. Potential revaluation of properties would reduce certainty over the tax banding of the	Payment by annual invoice is relatively straightforward	Yes. Collection rates generally in region of 97% of tax due.

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	inconsistencies in the relationship between property values and ability to pay. The reforms currently proposed by the Scottish Government to increase the share paid by those in the highest bandings will reduce the extent to which the tax is regressive.	property.		
Property Tax (Land & Building Transactions Tax (LBTT)	Progressive tax in nature due to the tax bandings applied.	Tax rates/bands clearly defined in advance. Subject to future changes.	Collected as part of the transaction cost of property sales	Yes, in that the tax is collected and paid by those involved in the conveyancing process.
Non-Domestic Rates	A proportionate tax on the basis that the rate poundage applies to all business properties, with the actual payment due being based on the assessed value of each property. However, property valuations may not be current and reflect current levels of a business's profitability.	Property values defined and rate poundage set annually. Property values subject to revaluation and rate poundage may change year on year.	Payment by annual invoice is relatively straightforward	Yes. Collection rates generally in region of 98% of tax due
Climate Change Levy	Use of fuel will not be an indicator of a company's wealth or ability to pay, but it may be considered that this principle is not a primary consideration in relation to this type of tax. To the extent that the charge is then passed on to the consumer	Tax rates clearly defined in advance.	Payment by invoice received from energy supplier.	Yes

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	the tax only takes account of ability to pay to the extent that the use of fuel reflects ability to pay, making it a very regressive tax.			
Airport Passenger Duty	Progressive to the extent that lower classes of travel are set at lower rates of tax.	Tax rates clearly defined in advance, and included in total cost of flights.	Included within booking cost of travel.	Yes
VAT	Not proportionate to the extent that VAT payable on a given purchase is the same regardless of income. Exemption for "non-luxury" goods takes account of ability to pay to some extent. Regressive overall in nature.	VAT rates are set in advance, and only change occasionally. VAT element of the cost of purchase may be less visible on some purchases	For consumer the VAT is usually included in the price and it would usually be clear if VAT was to be added. More complex system for businesses that collect and pay the tax.	No, European Court of Auditors recently reported on significant VAT losses across EU countries due to fraud and inefficiency.
Aggregates levy	No, same rate applies regardless of a company's wealth or ability to pay, but it may be considered that this principle is not a primary consideration in relation to this type of tax. To the extent that the charge is then passed on to the consumer the tax only takes account of ability to pay to the extent that the use of aggregates reflects ability to pay.	Tax rates clearly defined in advance.	Payment by invoice received from supplier.	No comment
Betting & Gaming	Amount of tax paid is dependent upon the extent to which an individual gambles. It is difficult to say if this relates to ability to pay,	Tax rate set in advance	Paid within cost of transaction	No comment

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	but it should help to discourage people from gambling irresponsibly.			
Corporation Tax	Payable only on company profits generated. Can be made more progressive by use of bands and rates, subject to political judgement.	Tax rates and bands set in advance.	Complexity of relief systems, means that professional guidance will usually be required	No - difficult to ensure that all CT due is collected.
North Sea Oil Tax	Corporation Tax supplementary charge is only payable on profitable business and at the same rate on all profits. PRT reduced to 0% effectively abolishing this element of tax.	Rates set in advance	Via corporation tax assessment	No comment
Fuel Duties	No – regressive in nature	Although fuel duty rates are fixed and available to view, most consumers will not be aware of the extent of fuel duty they pay.	Paid within cost of transaction	No comment
Inheritance Tax	Not payable on smaller estates	Tax rates set in advance but complex system of reliefs etc.	Can be difficult to quantify the sum due and may require professional help.	No comment
Insurance Premium Tax	No – regressive in nature	Tax rate set in advance	Paid within cost of transaction	No comment
National Insurance	Tax has the capability to be proportionate, via use of tax bands and allowances. Ultimately it is a	Tax rates/bands clearly defined in advance.	Straightforward for most, particularly employees via PAYE. More challenging for	The PAYE element tends to be very efficient. Much less so, in terms of the

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	political judgement as to whether or not the current banding levels and allowances achieve that. Currently regressive once you exceed the upper earnings threshold and tax reduces from 12% to 2%, but maybe needs to be considered in the context of Income Tax rates and bands.	Subject to change year on year.	self-employed.	proportion of tax due being collected by other methods.
Tobacco & Alcohol	Given that levels of consumption will not correlate to income earned then these taxes are regressive in nature. On average those in lower income brackets will spend a larger proportion of income on such products. Recognise though that other factors may be more important than proportionality in relation to this type of tax.	Tax included within sales price of product and actual extent of tax unknown to most consumers.	Yes, included within sales price of product.	No comment
Vehicle Excise Duty	No – regressive in nature. Recognise though that other factors may be more important than proportionality in relation to this type of tax.	Yes – tax bands set in advance and updated annually.	Relatively straightforward range of payment methods but all require specific action to be taken by taxpayer.	No comment