

Call for evidence: A Scottish Approach to Taxation – COSLA response

Key Messages:

- **A Scottish approach to taxation should look at both national and local taxation.**
- **The principles proposed to underpin a Scottish approach to taxation should go beyond implementation and should reflect the objectives of taxation, including accountability and the balance of risk.**
- **The Committee should consider using COSLA's taxation principles to underpin a Scottish approach to taxation.**
- **A funding framework for taxation in Scotland needs to respect each sphere of government and not erode local discretion by directing spend.**
- **Local discretionary taxation should be included in any Scottish approach to taxation.**

Introduction

1. COSLA welcomes the opportunity to submit written evidence to the Scottish Parliament's Finance Committee regarding a Scottish Approach to Taxation. Scotland is amidst a changing taxation environment and COSLA agrees that this is an opportune time to consider how taxation is approached in Scotland. The Scotland Act 2012 has brought in a range of new devolved powers to the Scottish Parliament, including a Scottish Rate of Income Tax, new borrowing powers for the Scottish Government and powers over a number of former UK taxes, all of which will bring changes to the funding landscape in Scotland over the next few years. Further to this the recent Commission on Local Tax Reform and the resulting changes to Council Tax and the proposed changes around the assignation of Income Tax shows that while changes are happening to the funding structures for the Scottish Government, there are also changes happening to the current funding landscape for Scottish local government. Recognising this, our response seeks to focus on the underlying principles that COSLA feel should underpin any system of taxation in Scotland, **and we think it is important that a Scottish approach to taxation should look at both national and local taxation.**
2. This is not a new area of consideration for COSLA. The Committee will be aware that we have submitted a body of evidence to numerous Commissions, Scottish Government consultations and Scottish Parliamentary Committees stretching back some years. In formulating our response to this inquiry, COSLA has drawn upon a number of key politically endorsed positions of our members. In particular, the Local Government Funding Review, the Commission on Strengthening Local Democracy, our Fiscal Empowerment Agenda and the evidence we submitted to the Commission on Local Taxation. The Committee will also wish to note that our response has been developed with input from CIPFA Directors of Finance and Local Authority Chief Executives via SOLACE.
3. Crucially, we recognise that the Committee is conducting this inquiry to initiate debate on the approach which should be followed in developing a Scottish approach to taxation and that its deliberations have the potential to inform the formation of the system going forward. We believe that any Scottish approach to taxation must be taken forward in close dialogue

with communities across Scotland and consider the taxation system as a whole, which includes local taxation. As a distinct layer of governance, local government is a key stakeholder in that process and we look forward to discussing these opportunities with the Committee.

Principles for a System of Taxation

4. In calling for evidence the Committee has stated that it is seeking views on the approach to developing a Scottish approach to taxation and states that Scottish Government suggest that four principles should underpin this approach;
 - Be proportionate to the ability to pay,
 - Provide certainty to the taxpayer,
 - Provide convenience/ease of payment; and
 - Be efficient.
5. While COSLA does not disagree that these four principles are important, they are very practical in nature. We suggest that the committee should be considering a more robust set of overarching principles that could be applied to a Scottish system of taxation which go beyond just looking at implementation and also clearly reflect the objectives of taxation, accountability and balance of risk.
6. Furthermore, COSLA argues that a Scottish approach to taxation should not only look to address taxation at the national level but also consider local taxation. As such, **any principles relating to a system of taxation should be developed with a view to being applicable across all forms of taxation, both at a national and a local level and extend beyond practicalities.**
7. Expanding on this point, COSLA argues that the Scottish approach to taxation needs to clearly reflect that Scottish National fiscal policy should be cognisant of local democracy, community empowerment and local taxes.

COSLA's Position on taxation

8. In 2013 COSLA's response to the Scottish Government's Tax Management Consultation, which asked for views on the creation of a new body (Revenues Scotland) to oversee taxation in Scotland, highlighted that it would not want to see an erosion of local taxation powers. COSLA argued that rather than diminish local powers this should be an opportunity to look again at what works best locally and nationally. Whilst not going into a detail at that time, the response set down a marker that there is a case for greater local revenue raising powers for local government, which could encompass new taxation powers, as well as other approaches to raising revenue.
9. COSLA therefore took the time to further develop its thinking in this area and to look at the funding landscape for local government, which saw the publication of COSLA's Local Government Funding Review. This review specifically looked at the structure of funding rather than the quantum of funding and established a set of principles by which all forms of taxation, local and national, should be tested and is therefore particularly relevant to the committee's inquiry. While the Review was published in 2013, given the changing taxation landscape facing Scotland and the scope of the Finance Committee's Inquiry, COSLA believes that the Local Government Funding Review remains highly relevant today.
10. It was from this body of work that COSLA developed its Fiscal Empowerment Agenda, which argues that effective local taxation is a fundamental component of democratic renewal in Scotland. In the international context, we know that accountability tends to be strongest, and reflect local preferences most clearly, when local decisions are funded locally. In the Scottish context, this link appears to be less strong. Across Europe the

most empowered local governments can raise more than 50% of their own income, and in many systems local government raises 40% - 50% of total public income. In Scotland 50 years ago the figure was over 50%, but has now fallen to notionally 18%, and local government instead has a high dependency on grants from national government. Indeed, with the current Council Tax freeze, it can be argued that 100% of resource is controlled centrally and that, other than through fees and charges, local government has no income raising levers at its discretion. While lifting the freeze to replace it with a 3% cap starts to provide some room for manoeuvre, this would still only see very limited local discretion. From a citizen's perspective, we believe that this makes democracy a complex and opaque business which sits awkwardly with the burgeoning community empowerment agenda in Scotland.

11. We have consistently argued that devolution should flow through to local communities and not only stop at the door of the Scottish Parliament. Indeed, with further devolution of fiscal powers to Scotland now becoming a reality, our view is that there has therefore never been a better time to focus on devolution of fiscal powers within Scotland too.
12. This aspiration is embodied in the Local Government Funding Review and the Commission on Strengthening Local Democracy, and in our submission to the Smith Commission. Further devolution of fiscal powers from the UK to Scotland, starting with those being implemented from the Scotland Act 2012 and those subsequently set out in the Smith Commission recommendations, open up an opportunity for a wider system of local government finance which could potentially look significantly different from the one we have now. That said, any proposals for change need to be clearly defined and deliver true change and not just be displacement of funds. This is one of COSLA's main concerns when it comes to the proposals around income tax assignment.

COSLA's Principles

13. In the Local Government Funding Review, COSLA established an overarching set of principles which should be applied to the formulation of any funding framework or system of taxation. COSLA strongly advocates that, overall, the funding framework should enable local government to achieve better outcomes for communities and improve lives of citizens. The principles have therefore been developed with this vision at their core and their aim is to act as a baseline in which any funding framework can be tested against. These overarching principles can be found at ANNEX 1 for the Committee's reference.
14. It is important to stress that we understand the consultation by the Committee is not about local government funding, however we simply cannot ignore the concept of local taxation in a Scotland wide review of taxation.
15. COSLA's Convention had already opened up discussions on the proposal to place a duty on Scottish Government Ministers, while exercising their functions, to observe and promote the European Charter of Local Self-Government. Article 9 of the Charter sets out principles of how local government should be resourced. It articulates the basic, but fundamental, premise that in order to deliver services, local government must be adequately funded and should have the freedom to dispose of their resources. It is key that any framework for a Scottish system of taxation should articulate that both national and local government should have a level of control over their own resources and not be wholly reliant on another sphere of government.
16. It would be easy to formulate the Scottish approach to taxation based on how things are today. However, we are currently in a climate of ambitious reform, which seeks to deliver improved outcomes for communities. Therefore, government should be ambitious around the system of taxation and use this to support the future direction of local government

services in light of the reform agenda. Certainly, there is a need to consider what funding should look like where local government is seeking to drive forward radical change to the way services are prioritised and what type of services are delivered locally by all public sector partners.

17. The analysis of European countries highlights that Scotland is heavily reliant on central government resource and with the current council tax freeze, it can be argued that 100% of resource is controlled centrally and that local government has no income raising levers to use at its discretion. We recognise that this could potentially change in 2017/18, but this is subject to Spending Review discussions. The current position is clearly not one that sits well with the COSLA Vision, but it is also difficult to arrive at a definitive position, numerically, of where the balance should lie that stands up to scrutiny.

Local Government's Fiscal Deficit

18. COSLA remains concerned by the current balance of funding and was dissatisfied with the government's response to the Commission on Local Taxation. While we are disappointed that government did not adopt our specific proposals, we strongly feel that their response was not far reaching enough.
19. What we were arguing for with a modernised Council Tax was to address the current fiscal deficit whereby 80% of Council funding is provided centrally. We have an aspiration to ensure that at least 50% is raised locally, as the Commission for Strengthening Local Democracy argued in its report. Whilst the Government has proposed to assign a proportion of income tax to local government, there is nothing yet to suggest that this would give local government greater control over its funding. Strengthening Council Tax in our view was a key means to secure local revenue raising for local spending decisions and, coupled with a return of business rates to local control, would achieve the 50% aspiration.
20. As the Committee will be aware there has been a Council Tax freeze in place for the last seven years as a requirement of the Local Government Settlement. Whilst the proposals will enable Councils once again to raise Council Tax, a cap is to be applied such that increases are capped at a maximum of 3%. It is COSLA's strongly held view that such a cap retains central direction of Council Tax and goes against local democratic decision making and local control of Council Tax. In that respect it is no different to the Council Tax freeze.
21. COSLA believes that local government must be able to raise its own revenue, in the form of taxation, without a cap or restriction, so that there is true local discretion on how to expend resource for communities. It is vital for local democratic accountability that there remains a strong link between local communities and local spend.

Assignment of Income Tax Proposals

22. While we remain concerned by the current balance of funding, we are interested to hear the government's proposals regarding assignment of income tax. It is clear that this is not in a position to happen in 2017/18, however we urge government to progress joint working with COSLA on the options around the assignment of income tax to local government.

Ring-fencing of taxation

23. The ability to set and collect local taxation is a key component of an effective local democracy, and is central to the relationship of accountability between councils and the communities that they serve. This relationship has been slowly eroded over the decades, and whilst new local approaches are beginning to emerge, not least of all through the

successes of the Our Islands Our Future campaign, Cities Deals, and the Community Empowerment (Scotland) Act, more needs to be done. Our overall objective is to strengthen at a greater pace this new local approach to improving outcomes right across the country, and with it, rebuild trust and participation in democracy much more widely.

24. The Committee in their call for evidence specifically ask if future tax changes should be ring-fenced. As the committee will be aware, COSLA does not advocate ring-fencing of local government funding to be expended in a specific manner. This fetters local discretion and is confusing in terms of democratic accountability for communities and voters. In terms of the ring-fencing of future taxation, COSLA is currently exploring the allocation of a portion of income tax to local government, however we do not see this resource as being ring-fenced for a specific area of spend.
25. COSLA is particularly concerned with the Scottish Government's proposals around the reform of Council Tax. COSLA's position remains that local taxation is a cornerstone of local democracy and the proposed reforms are in direct contradiction to this position. We are disappointed that the government did not adopt our recommendations or those of the Commission on Local taxation, instead focusing very narrowly on changing the multiplier to the upper bands.
26. COSLA does not accept that the new proposals for council tax reform go anyway towards constituting a proper reform of taxation. Moreover, COSLA has **two key concerns with the new proposals - firstly that a local tax is being used for central priorities, and secondly there is erosion of the link between local taxation and the local electorate.**

Central Policy Direction of Local Taxation

27. Fundamentally COSLA is deeply concerned about the intention to use local taxation to pay for centrally determined policies. This is not the role or indeed the purpose of local taxation. The decision to re-direct £100m of revenues raised by the changes to the Council Tax multiplier for Band E – H properties, to fund educational attainment, breaks the link between local democracy, local taxation and accountability to local communities for spending in their local area. For the first time in its history and, indeed, the history of local taxation in Scotland, Council Tax is to be used to fund expenditure by central government.
28. The Government had a range of options at its disposal, including its own substantial tax raising powers, and could have drawn on these in order to raise funds for raising educational attainment instead of using local taxation.

Breaking the Link to Local Spending

29. The link between raising revenue and expenditure in the same locality is the cornerstone of local taxation and the Government's proposed changes breaks this link. For the first time ever, Council Tax revenues from one Council could be diverted elsewhere through central policy direction.

Devolution downwards of taxation

30. In the call for evidence, the Committee specifically asks if there is scope for a fundamentally different approach to taxation in Scotland. In response, COSLA suggests that there should be devolution downwards of taxation with Local government being best placed to deliver that. Again, this argument is not new and the Committee will be aware that COSLA has called on Scottish Government and Scottish Parliamentary Committees to consider local discretionary taxation before. Indeed, COSLA has consistently argued that devolution should flow through to local communities and not only stop at the door of the Scottish Parliament. With further devolution of fiscal powers to Scotland now becoming a reality, our view is that there has therefore never been a better time to focus on devolution

of fiscal powers within Scotland and **local discretionary taxation should be included in any Scottish approach to taxation.**

Local Discretionary Taxation

31. COSLA argues that individual local authorities should be empowered to introduce local taxes, at their discretion, to raise additional resource. In particular, that local taxation should allow for local flexibility, empowering local authorities to raise local funding for local priorities. Specifically, individual local authorities should be empowered to introduce local taxes, at their discretion, to raise additional resource. Additionally, individual local authorities should have discretion over the rate and discount and relief arrangements for this tax. While local discretionary taxation will not have a major impact upon the balance of funding the power to levy local discretionary taxes will have a substantial impact, empowering local government by affording local authorities discretion at a local level to meet local needs. This would be a significant and positive change for local government in Scotland.
32. While some individual pieces of legislation confer specific powers of charging, such as road user charges under the Road Traffic Act, there is no existing legislation enabling local authorities to introduce local discretionary taxation, either at Scottish, UK or European level. In fact, apart from Council Tax, taxation by local authorities is specifically prohibited. In order to enable local government to raise local discretionary taxes there requires to be a change in legislation. Scottish local authorities should be able to levy a local tax without having to ask permission from Scottish Government. Ultimately this would be a political decision taken by elected members locally, with Local authorities holding the power individually of each other so that it would be an entirely local decision.
33. The power proposed is a general power which is key to the empowerment of local government, enabling taxation to be used by local decision makers to address local issues. Given this local discretion, it follows that any proposed taxes and associated political will to vary from local authority to local authority. A tax levied in one area may not be suitable for another, leading to variation across Scotland. Furthermore, local authorities would be able to apply local taxation both domestically and non-domestically. In terms of domestic tax, this encompasses residents and property owners within the local authority area. This power extends to incorporate visitors to the local authority. This would be a useful tool for councils that wish to raise additional revenue, but do not want to add to their resident's tax bill, instead taxing visitors or businesses in their area. Local government would remain mindful that local taxation should be fair and easy to understand.
34. There would be no limitations on or ring-fencing of what local authorities choose to do with the revenue raised from a local discretionary tax. Tax revenue does not require to be spent in a prescribed way, therefore a tax being levied to address a specific local issue could be used as a deterrent to a type of behaviour, or to raise funds for a specific project, or other local need. This is in stark contrast to any powers that local government currently hold.
35. The discretionary tax should be administratively efficient and difficult to avoid. The administration and collection of local discretionary taxes would obviously have an associated cost. This has been recognised in part by the four principles set out in the Committee's call for evidence, but as demonstrated above, the practical element is only one aspect that a funding framework should contain. This would be taken into consideration whenever a local discretionary tax was being considered. Councils already deal with the collection of a number of revenue streams such as council tax, water and sewerage charges and non-domestic rates. They have a good track record for high level

collection rates for these areas and already have the knowledge and ability to collect levies.

36. Legislation is required to enable local authorities to levy local discretionary taxation. This would not require a significant change to the current legislation. Under Section 22(7) of the Local Government in Scotland Act 2003, local authorities are explicitly prohibited from levying taxes other than council tax. Without this specific prohibition, local authorities would have the ability to levy local discretionary taxes under the power to advance wellbeing. On that basis the Scottish Government could simply repeal the relevant words in Section 22(7). Alternatively, the Scottish Government could amend Section 22(7) to explicitly enable local authorities to impose local discretionary taxation, using the definition of local discretionary taxation proposed above.

37. Encompassing all of the points considered above, COSLA's proposed definition of local discretionary taxation is:

***“Individual local authorities have the discretion to raise additional income by levying a tax, in addition to Council Tax and Non-Domestic Rates, on either residents, occupiers, property owners or visitors in the local authority or within a discrete area of the local authority.*”**

- **The power will enable local authorities to introduce tax(es) without the need to seek approval from Scottish Government.**
- **The rates and reliefs will be determined locally.**
- **The local authority will be granted powers to ensure that those on which the tax is levied have a legal obligation to pay.**
- **The local authority has the discretion to determine how the additional revenue is expended.”**

38. In conclusion, COSLA sees this inquiry as an opportunity for setting out a fundamentally different approach to taxation by establishing a set of principles for the Scottish system of taxation that apply to both national and local taxation which focus on more than just implementation. By doing so, this would ensure a robust framework which recognises and respects each sphere of government and look to redress the current local democratic deficit. COSLA welcomes the debate that the inquiry is encouraging and would be happy to speak to the committee further on this matter.

Annex 1

COSLA Overarching Principles for Taxation

- Overarching Principle 1: For both revenue and capital funding, local government must be funded on an adequate and sustainable basis.
- Overarching Principle 2: There should be a fair and reasonable balance between resources provided nationally and those raised locally which is based on an appropriate level of risk.
- Overarching Principle 3: A local taxation system must have the freedom to raise additional resource in a way that recognises the local needs of communities.
- Overarching Principle 4: Local government should have freedom to expend their resources in a way that recognises that local is better, with no direct restrictions imposed by central government other than those defined in statute.
- Overarching Principle 5: Local government funding should create an environment where Community Planning can thrive.
- Overarching Principle 6: Local government should be funded in a way that drives forward the prevention and early intervention agenda.
- Overarching Principle 7: For the purposes of borrowing, local authorities should continue to work within the principles of the Prudential Code.