

A Scottish approach to taxation

A submission by the Poverty Alliance and the New Policy Institute

Introduction and summary

1. The Poverty Alliance is the national anti-poverty network in Scotland, formally established in 1992. It is an independent organisation with over 230 members drawn from the voluntary and public sectors, trade unions, researchers, faith groups and individuals with direct experience of poverty. The New Policy Institute (NPI) is an independent, think tank with a track record of analysis stretching over 20 years on matters to do with poverty, taxation and the economy.
2. The two organisations have worked together for many years. Much of this collaboration has been around the Poverty Alliance’s advisory input to NPI’s long running *Monitoring Poverty and Social Exclusion* series of reports.¹ In turn, NPI has provided expert input to the Alliance’s *Scottish Assembly for Tackling Poverty* series of conferences. An area of mutual concern is the labour market dimensions of the experience of poverty – ‘in-work poverty’.
3. In summary, we make three main points:
 - Given the emphasis on a “Fairer Scotland” over recent years, it is surprising that the principles suggested for Scottish taxation do not mention fairness. As they stand, the four principles set out are insufficient as a basis on which to design a Scottish tax system. Introducing a principle of fairness would help fill this gap.
 - We propose that the principle of fairness should be applied to *household* income. Household income is the measure by which both poverty and inequality are assessed. It is household income that determines living standards. Introducing a principle of fairness would move consideration of the tax system, and in particular income tax, beyond the framework of individual taxation.
 - Making this shift beyond the individual to the household would allow the Scottish tax system to be designed with an eye to other Scottish government goals, notably the Solidarity Target (to do with the share of income going to the bottom 30 per cent of the population) and reducing in-work poverty. We would also like to see it used to help reduce income inequality.

¹ See P. Kenway et al (2015) *Monitoring Poverty and Social Exclusion in Scotland 2015*, <http://npi.org.uk/publications/income-and-poverty/mpse-scotland-2015/>

A Scottish approach to taxation: a role for the principle of fairness

4. We welcome this inquiry by the Finance Committee and look forward to an informed debate on what is meant by a Scottish approach to taxation.² With new powers on the way there has never been a better time to think about the type of Scotland we want to live in, and how we achieve this. For us, this means tackling poverty and inequality and we believe that a fairer tax system is part of this. The recent poverty and income inequality statistics published by the Scottish Government show that in 2014/15 income inequality increased in Scotland with the top one tenth of the population having 15 per cent more income than the bottom four tenths combined.³
5. It is disappointing that none of the principles outlined by the Scottish government mention fairness, especially given the emphasis that has been put on creating a 'Fairer Scotland' in recent years. Like many other organisations, the Poverty Alliance supported the devolution of taxation powers so that they could be used for this reason. There is scope for a fundamentally different taxation system in Scotland, but it will take radical action to achieve this.
6. As it stands, there is very little in the principles outlined that would lead us to believe that taxation powers will be used more progressively in Scotland than they currently are by the UK Government. Almost any system of income taxation that could conceivably be implemented in Scotland would be "progressive", in the sense that higher incomes would attract a higher marginal rate of tax than lower ones. Any such system could therefore reasonably be said to conform to the principle of ability to pay. But progressivity and ability to pay in this sense is no more than a minimum. How progressive – and why – are the questions that have to be answered before a distinctive Scottish approach can be identified. In order to answer these two questions we propose that a fifth principle should be added, namely, that in designing the system, account should be taken of the role that tax can play in achieving greater fairness.

The principle of fairness to be applied to household income

7. In order to turn the idea of fairness into a practical principle, we propose that it should be applied to household income. Household income is the measure by which both poverty and inequality are assessed. Household income is a post-tax measure which takes account of all post-tax earned and unearned income, tax credits and social security benefits including both housing benefit and disability benefits intended to defray the higher cost of long term sickness or disability. Household income is also the frame through which inequalities in earnings between men and women can be seen. Although different from the usual focus of

² <http://www.parliament.scot/parliamentarybusiness/CurrentCommittees/100254.aspx>

³ The Scottish Government (2016) Poverty and Income Inequality Statistics
<http://www.gov.scot/Resource/0050/00502180.pdf>

the tax system on individual earnings, official data on household incomes and their distribution in Scotland have long been very closely scrutinised.

8. At this stage, we are not proposing that the Scottish tax system should be applied to household incomes as opposed to individual incomes. Such a conclusion could only be reached after a proper consideration of the likely consequences and practicalities. Instead, what we are proposing is that in designing the new Scottish tax system, account should be taken of the implications for three statistics all of which are measured using household income. They are:
 - The Solidarity Target, introduced in 2007, to increase the share of income going to the bottom three tenths of the population as measured by the income distribution.
 - In-work poverty, which is the name given to those people whose family or household contains working members but whose household income is nevertheless still below the poverty line. In the three years to 2014/15, 45 per cent of people in poverty in Scotland were in working families.
 - Income inequality in Scotland which is always measured using the distribution of household income. In this way, tackling inequality could become one of the goals of the new Scottish tax system.
9. In each case, we propose that any candidate for the new Scottish system of taxation should be assessed for its implications on solidarity, in-work poverty and inequality. It is not possible in advance to assess how far or in what ways this might make a difference to the design of the tax system. But given the prominence of household income to other aspects of the Scottish government's goals, it must be right to consider the design from this point of view.
10. Besides the practical implications, a tax system built explicitly on the principle of fairness could also increase public confidence in both tax and public spending. If we are to convince people that some should pay more tax then we will need to convince them that their taxes are being raised fairly and spent in a way that has social value. Concerns around spending include, but are not limited to, both how benefits are spent and the real cost of benefit fraud. For example, a poll in 2013 found that the general public thought that 24 per cent of benefits were fraudulently claimed, compared with the reality which is approximately 0.7 per cent.⁴ Changing attitudes towards public spending, creating a sense in which public spending is useful and beneficial for society as a whole will be necessary if we are to develop an approach to taxation that has fairness at its heart.

⁴ Ipsos Mori (2013) <https://www.ipsos-mori.com/researchpublications/researcharchive/3188/Perceptions-are-not-reality-the-top-10-we-get-wrong.aspx>

A fairer Scotland: two specific proposals

11. The lowest earning 40 per cent of adults (and almost 20 per cent of the lowest paid workers) currently pay no tax.⁵ We therefore need to look beyond raising the personal tax threshold to help those on the lowest incomes. The Scottish Government should give consideration to increasing the higher rates of income tax once it has the power to do so. While doing this alone may not dramatically increase revenue, due to the small rate of higher rate tax payers in Scotland, it would 'be proportionate to the ability to pay'. We note research by David Eiser which calculated that for an individual earning £300,000, a 5p rise in the Additional Rate would cost around £7,500.⁶ While not an inconsiderate amount of money it seems unlikely that people would leave their homes, families, and friends, and uproot their lives for such a sum – particularly if their job is based in Scotland.
12. Too often we think of taxation only in terms of income tax but Scotland has powers over taxation which go beyond this. One area which has long been under Scottish Government control is council tax. The current system is regressive, particularly for certain groups such as those on a low income, and it is in need of a radical overhaul. While some promises have been made with regards to lifting the freeze and increasing rates for higher bands, this falls short of what is needed. The current council tax system does not fit with the principle of being proportionate to the ability to pay. While this is not the only principle that might shape council tax, if the Scottish government is serious about it, it should give a green light to radical council tax reform.

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⁵ Eiser, D. (2016) *Poverty Alliance briefing 23 Devolved Taxation in Scotland*
http://www.povertyalliance.org/article/tax_briefing

⁶ Eiser, D. (2016) Centre for constitutional change *Taxing times*
<http://www.centreonconstitutionalchange.ac.uk/blog/taxing-times>