

The Commission on Local Tax Reform
 Scottish Parliament

By email to: evidence@localtaxcommission.scot

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Review of local taxation

Introduction

1. ICAS welcomes the subject of this consultation and the opportunity to comment. We are a leading professional body for chartered accountants with over 20,000 members working across the UK and internationally. Our members work across the private and not for profit sectors.
2. ICAS's Charter requires its committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

Key messages

3. Changing local taxation is a complex and sensitive task. The objectives and timescale of this exercise are challenging and the problems to be grappled with to achieve a workable and fair alternative, significant and multi-dimensional.
4. The financial challenges facing councils and the prospect of increasingly challenging budgets is well-documented. It is therefore important that a review, or any resultant changes, do not affect the relative certainty of the £2 billion¹ of revenue currently generated by the existing council tax arrangements. Moreover, this background needs to be carefully considered as part of a risk and impact assessment as the capacity of the current system to implement change and bear any shocks or associated risks is likely to be more limited.
5. Scotland is in a period of unprecedented change around the devolution of powers, including taxation to Scotland and community empowerment. We believe that a review of local taxation should form part of a more holistic exercise that considers the wider context of strategic change, local government funding and tax to give a clearer perspective of current and projected priorities, needs and challenges.
6. Overall, we suggest that the Commission pursues a more holistic and long term view which takes into account this multi-dimensional and evolving context. A useful step would be for the Commission to take the time to establish a robust and wide ranging evidence base for recommendations on a direction of travel which ensures that there is room in any conclusions to adapt to different circumstances arising from the Smith Commission and other reforms.
7. The statutory powers and purpose of local taxation need to be defined and clear principles articulated to provide a framework for setting direction and assessing options.
8. There is need for, and potential to improve, the transparency and accountability of local authorities in terms of how resources (including council tax) are used and how well the authority performs. There is a complicated landscape of funding, services and responsibilities split

¹ http://www.audit-scotland.gov.uk/docs/local/2015/nr_150305_local_government_overview.pdf page

between central and local government. Tax payers need a clearer picture of what they are paying for. This includes improved clarity on where councils are complying with statutory levels of service and where they exercise discretion.

9. We are concerned that local authority financial statements do not give a clear picture of the true cost of providing services. This is not in the public interest. We recommend that the statutory framework which conflates the council tax calculation and accounting purpose of financial statements is amended to remove this barrier to simpler and more understandable accounts. This would help to increase the transparency of the performance of local government.
10. In terms of options for local taxation, this is an area of judgement and different ideological perspectives, so rather than being able to conclude on an objective basis at this point, we hope the Commission sees its role as investing in the groundwork to enable a more objective assessment to be formed. It would be useful to be informed by international comparisons of what works elsewhere. Any change, regardless of preference, will require robust evidence and modelling of impacts as well as a suitable transition period to minimise the extent of any potential negative consequences for taxpayers, particularly in the current economic climate.

Current arrangements

11. Council tax has a high and increasing collection rate² as well as a low administration cost³. It is easy to understand and has a transparent charging system. It reliably raises around £2 billion (representing 95.2% of total billed in 2014) which demonstrates a level of acceptability by tax payers. However, bandings and valuations are significantly out of date, having not been updated since 1991. Over time, differing levels of property valuations may distort the fairness between bandings. An evaluation would need to assess the impact of this and identify what can be managed by updating the valuations, what can be achieved by incremental reform, what needs radical overhaul, short and long term actions and appropriate timings. A key consideration is to minimise the risk of financial loss for local authorities at a time when they are facing increasing budgetary challenges.
12. Scottish Government figures⁴ show year-on-year above inflation rises in council tax charges, before the freeze from 2008-09. Moreover, these increases were happening at a time when the economy and public finances were in a very different position to where they are now, particularly in the context of further austerity. This has created some adverse publicity for council tax and will need to be considered as part of any reform and communications to taxpayers.
13. Application of above inflation increases is likely to reduce correlation between the level of taxation and ability to pay. It is important to also consider the impact and role of increases over time on affordability and fairness. Modelling the impact of any tax changes is crucial to reduce the negative consequences of significant increases and differences.

Creating the right conditions for reform

14. We note the various reviews and abortive attempts to reform local taxation which underlines the complexity, sensitivity and challenge of achieving a fairer system. At this point in time, council tax in Scotland may also be a less prominent issue in the minds of taxpayers given the council tax freeze since 2007.
15. There is a need to create the right conditions for reform including a communication exercise to help the public understand the background, context and need for reform. Publication of a discussion paper supported by research which collates up to date evidence, key projections, international comparatives and models the impact of alternatives is essential to inform next steps. We would welcome further clarity of the vision for reform and intended outcome of the

² <http://www.gov.scot/Publications/2014/06/3066>

³ <http://www.irrvscotland.org.uk/documents/robin%20haynes.pdf>

⁴ See Annex 2

review. We would also welcome more open communication on government responses to previous reviews, such as [A Fairer Way \(2006\)](#), to inform the debate.

Principles, powers and objectives of local taxation

16. Revenue Scotland has identified 4 [principles of the Scottish approach to tax](#). We ask the Commission to clarify its intentions as to whether these principles for national tax will also be adopted for local taxation or if new principles will be articulated.
17. The [remit of the Commission](#) identifies the objective of a fairer system of local taxation. Further articulation of what the Scottish Government means by 'fairer' would help to base a future assessment of options. Revenue Scotland has identified its fourth principle as 'proportionate to the ability to pay'⁵. The term 'ability to pay' is subjective, so the Commission would need to define what it means by this i.e. whether it would reflect gross income only, disposable income or income less essential expenditure (e.g. number of dependents and taxpayers in a household), capital or a combination of income and capital.
18. In our view the following could support key principles to assess options:
 - Proportionate, reflecting ability to pay;
 - Simple to understand and transparent;
 - High collection rates, predictable revenues and difficult to avoid;
 - Clear accountability which connects decision making and spending of public funds with taxes raised;
 - Cost effective to administer;
 - A broad but balanced tax base. This builds on:
 - Making a contribution to the costs of government (which expands on the principle attributed to Adam Smith in paragraph 5(d): "*The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities*"⁶;
 - Supporting broad accountability and voter representation to avoid the negative consequences of focusing on a narrow tax base which can create a more risky dependency for revenue and unhealthy level of influence in a smaller, less representative group;
 - Value for money & best value – "*every tax ought to be so contrived as both to take out and to keep out of the pockets of the people as little as possible, over and above what it brings into the public treasury of the state...*" (Adam Smith⁷). If we expect value for money from expenditure on public services then this principle could be usefully applied to raising revenue to fund those services i.e. a duty to be neither profligate in the spending of public funds nor in the raising of tax revenues;
 - Stable and predictable revenues;
 - Aligned with current, not historic, needs and priorities;
 - A basket of taxes to minimise overloading one form with the risk that it can reduce incentive to pay, as identified by the Laffer Curve⁸.

⁵ Proportionate to the taxpayer's ability to pay: The subjects of every state ought to contribute towards the support of the government, as nearly as possible, in proportion to their respective abilities" The Wealth of Nations, Book V Chapter II Pt II, P.825 para 3.

⁶ [The Wealth of Nations, Book V Chapter II Pt II, P.825 para 3 - Adam Smith](#)

⁷ The Wealth of Nations, Book V Chapter II Pt II, p. 826, para. 6

⁸ [Laffer curve and modelling of increase in tax rate on revenue](#)

Accountability and balance of funding

19. One of the intentions of council tax was to provide local authorities with discretion for raising and setting tax and to provide direct accountability with the taxpayer for its spending decisions. A direct link between tax and spend is a part of the system of local democracy. Although evidence of the effectiveness of council tax as a tool to encourage stewardship and discourage profligacy is uncertain, the issue of an invoice by a local authority bearing its decision on council tax increases is a clear message which can and does trigger comment.
20. A local tax is only one part of a wider framework of accountability and engagement which has evolved significantly since 1990. The complexity of local authorities, variety of accountability mechanisms and range of public performance reporting can make it difficult for taxpayers to get a holistic picture of their performance and financial stewardship.
21. The structure of funding, control and therefore accountability over local public services is complicated. It is not clear exactly what services the council tax is directly paying for and where councils are exercising their discretion as opposed to acting as an agent of central government or implementing centrally set statutory requirements. There are various examples:
 - Education is provided locally but the strategy and curriculum is set centrally;
 - The ability of local authorities to set fees is variable. For example, licensing and planning fees are based on legislation so local authorities do not have the same level of discretion, they may have for swimming pool charges (although they must still operate within certain parameters which restrict the ability to make a profit);
 - Council tax funds less than 20% of local services with central government providing the majority of funding (in turn allocated through tax collected by the UK government).
22. The result is that it is not sufficiently clear to the public what decisions on local services are made by the local authority alone and which are driven nationally. Effective accountability needs to be able to link responsibilities and decision making powers with performance. Taxpayers need a clearer picture of what they are paying for. This should include local authorities being transparent about where they are complying with statutory levels and where they are exercising discretion.
23. Effective accountability needs to include financial performance as well as the longer term financial position, borrowing and alternative financing of capital expenditure. One of the principal publications which is used to understand any organisation, its objectives, performance and stewardship of funds is its' annual report and accounts. Public performance reporting may be varied for local authorities yet the regulatory framework is still quite light touch so there is not a consistent approach and it can be difficult for taxpayers to get a succinct, holistic picture of performance. Local authorities have no statutory requirement to produce an annual report (although some may do so on a voluntary basis) so a crucial document to show how well they have spent public funds and met their responsibilities is the financial statements.
24. ICAS is concerned that the financial statements of local authorities do not communicate the true cost of providing services clearly enough for a public audience. The statutory framework which governs the council tax calculation has created a conflict with accounting practice which is managed by a series of material adjustments in the accounts. This has created specialism and complexity in local authority accounts which obfuscates the true financial position of the local authority. It creates a significant barrier to transparency and simplification of the published financial statements and considerably weakens the ability of the taxpayer to hold their authority to account for financial performance. This is not in the public interest. It is important to fully support and publicly justify decisions to increase council tax, particularly in the context of year on year above inflation increases as shown in Annex 2.
25. The root cause of much of the accounting specialisms is the [Local Government Finance Act 1992](#) (Section 93) which combines the purpose of accounts with the council tax calculation (and housing rent setting). We would encourage the legislation to be updated to remove the dual purpose of local authority accounts. Further explanation is provided in Annex 1.

26. The declining proportion of council tax as a contribution to local authority funding (currently around 20%) means that it has become increasingly marginal so it becomes more difficult to relate to locally controlled areas. It is unlikely to be perceived as fair by taxpayers if local authorities were to increase local taxes to fill spending gaps which may be beyond their control or to express discontent with central policies. This is one reason why reform of council tax should not be undertaken in isolation from the wider issue of local government funding, a strategy for addressing financial challenges and the interaction with central government.
27. There is a trend for both centralisation and localism as exemplified by reorganisation of local authority services including the introduction of national fire and police services which were previously 49% funded by local authorities. There is also greater focus on community engagement e.g. The Community Empowerment Bill as well as increasing the devolution of powers at jurisdiction level. This suggests we are in a period of some fluctuation, so consideration of the impact of these changes at a local level and communication of the vision for service delivery across central and local government would be an area to consider as part of this review.
28. The proportion of council tax funding for local authorities is also affected by policy changes. As an example, around 40% of local government expenditure relates to social services and education, so any changes to how these major services are organised would have a significant impact on the proportion of council tax as part of local government funding.
29. In Scotland, water is billed by local authorities on the same invoice as council tax, on behalf of Scottish Water. Scottish Water also pays the local authority a fee for debt collection. This may offer convenience and efficiency for water billing and collection, however, it risks obscuring the accountability of Scottish Water and creating confusion for some customers as to whether water is a separate charge, unrelated to council tax.
30. We suggest that the impact of this arrangement on accountability should be reviewed. We also suggest greater transparency of the costs and income received by local authorities for this arrangement and further clarification of any differences between commercial and householder contributors.

A more holistic exercise

31. Our understanding is that the remit of the Commission's review of local taxation has been tightly drawn around council tax. We are not convinced that effective reform of council tax can be achieved by looking at one element of local government finance in isolation.
32. There is a wider context which deserves consideration as part of a holistic exercise. Any changes to the current system of local taxation should reflect current needs and support wider developments. This includes:
- Local authority funding challenges, performance and accountability;
 - The package and implications of devolution of tax powers to the Scottish Parliament;
 - The impacts of the Welfare Reform Act 2012, which are not yet known;
 - The effect of a sustained period of house price inflation on affordability levels and perceptions of wealth taxes (a concept which is not currently part of the UK fiscal framework);
 - The changing policy context around centralisation and localisation of services as well as the development of community empowerment;
 - Changing household profiles;
 - The growth of an ageing population;
 - Current strategic priorities, needs and how well or otherwise, the existing council tax system, its exemptions and discounts aligns with these.

33. An example of strategic priorities could include assessing how well discounts help drive efficient use of housing stock to support the Scottish Government's Housing Strategy⁹. There are also findings from the Land Reform Group¹⁰ which raise the question of how well aligned historic exemptions for land based businesses are with current day needs and priorities, which has implications for local government funding.

Options and alternatives

34. ICAS does not have a view on a preferred option although we recognise various alternatives for local taxation exist. We suggest that the Commission seeks to identify options which have been applied successfully in different international jurisdictions and assess if these could apply in Scotland. If, after this initial consultation exercise, the Commission decides which options it will explore further, we would be pleased to offer our comments. Some of our initial comments include:

- The need for and extent of reform needs to be evidenced, articulated and assessed against the areas council tax performs well, along with implementation risks;
- Council tax to date suggests that the concept of a property base for the tax is supported by taxpayers and this forms part of the existing basket of taxes;
- A structure is now in place for the new Scottish Rate of Income Tax, administered by HMRC. Any further variables introduced through a local based income tax, which could potentially create up to 32 more variables, would add cost and administrative complexity (identification of the residence of the local tax payer adding a further layer);
- Council tax is based on valuations as a proxy. It is not a wealth tax as it is paid by occupiers, not just owners. It is also a hybrid of different tax concepts e.g. consumer based reductions for second homes/ single occupancy and income based for council tax reductions. The Commission needs to identify its purpose for a reformed local tax;
- A tax based purely on valuation would essentially be a wealth tax as it taxes unrealised gains, not cash income. This would therefore be a new concept in the UK fiscal framework. There are likely to be differing views on how fair and affordable a wealth tax based on sales valuations would be, especially after an extended period of house price inflation. A tax based directly on a percentage of current valuation is likely to pose affordability issues for those who have lived in the same property for many years and would not necessarily be able to afford to purchase the same property at the current market price. The selection of a multiple for the bands which meets affordability needs and transition is crucial;
- Reform will most likely need to be incremental (this will obviously be dependent on how radical the option chosen by Ministers is) and communicated well to stabilise transition and gain public support;
- Equitable redistribution – a mechanism to support areas with lower tax bases (capacity) by those with higher tax bases already exists through the formula-based central grant allocation. Any changes in local taxation would need to include this as part of an impact assessment.

35. We hope this is helpful and please do not hesitate to get in touch if we can be of further assistance.

Yours sincerely,

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⁹ [The Scottish Government's Strategy and Action Plan for Housing in the Next Decade: 2011-2020](#) (pg 2-4)

¹⁰ [Report of the Land Reform Review Group 2014 - The Land of Scotland and the Common Good](#) (pg 169)

ANNEX 1

Complexity of financial reporting

Local authority financial statements are specialist, complex and therefore difficult to understand. This is driven by legal requirements on council tax funding which conflict with the legal requirements to observe proper accounting practice. This does not support financial transparency and accountability.

The root cause of much of the accounting specialisms in local authority accounts is the Local Government Finance Act 1992 (Section 93) which requires local authorities when setting a budget to take into account *"any means by which those expenses may otherwise be met or provided for"* (paragraph 4). This includes 'reserves brought forward'. As a result the accounts contain both the IFRS-compliant numbers and the carried forward Reserves balance which is required under statute to be taken into account for the council tax calculation (and housing rent setting). This carried forward balance used in the council tax calculation is known as the General Fund.

Various statutory adjustments are made to the figures appearing in the IFRS accounts to transfer components to an Unusable Reserves balance to leave the identifiable General Fund. This dual purpose means that certain costs which one would expect to see in an Income and Expenditure Account such as depreciation and certain anticipated pensions costs, are removed using a series of statutory accounting adjustments so that they do not affect the bottom line, which is used to show the council tax funding requirement. The adjustments are recorded in the reserves statement and referred to as "adjustments between the accounting and funding basis".

These adjustments have accumulated over time. Currently around 18 statutory adjustments^[1] are available for local authorities to apply. These arise from items which do not have an immediate cash flow implication, to mitigate the impact on the setting of the council tax. Across councils the most common adjustments, and the most material, tend to relate to differences in the accounting for pension costs, depreciation charges, capital grants and capital charges. The adjustments are carried in the balance sheet under the heading "Unusable Reserves". In many instances the balance on this account is a material component of the balance sheet.

^[1] CIPFA Code 2015-16 Statutory Mitigation Disclosures para 3.4.2.40 (page 67)

Council tax increases year on year

BAND D COUNCIL TAX 1996-97 TO 2015-16																					
	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	Council Tax Freeze								
	1996-97	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	
Scotland	708	10%	5%	3%	4%	5%	4%	4%	4%	4%	3%	2%	1,149	1,149	1,149	1,149	1,149	1,149	1,149	1,149	
Aberdeen City	648	9%	10%	4%	6%	6%	5%	4%	8%	5%	3%	2%	1,230	1,230	1,230	1,230	1,230	1,230	1,230	1,230	
Aberdeenshire	591	8%	7%	3%	7%	9%	7%	5%	5%	4%	2%	1,141	1,141	1,141	1,141	1,141	1,141	1,141	1,141	1,141	
Angus	659	3%	4%	3%	5%	6%	7%	6%	5%	5%	3%	0%	1,072	1,072	1,072	1,072	1,072	1,072	1,072	1,072	
Argyll & Bute	675	16%	9%	0%	6%	5%	2%	2%	4%	4%	3%	2%	1,178	1,178	1,178	1,178	1,178	1,178	1,178	1,178	
Clackmannanshire	692	8%	9%	5%	4%	4%	3%	2%	5%	3%	5%	2%	1,148	1,148	1,148	1,148	1,148	1,148	1,148	1,148	
Dumfries & Galloway	590	17%	2%	5%	6%	5%	5%	3%	3%	2%	3%	3%	1,049	1,049	1,049	1,049	1,049	1,049	1,049	1,049	
Dundee City	801	13%	7%	4%	2%	-1%	3%	1%	4%	4%	3%	0%	1,211	1,211	1,211	1,211	1,211	1,211	1,211	1,211	
East Ayrshire	714	8%	5%	3%	3%	5%	5%	5%	5%	5%	5%	2%	1,189	1,189	1,189	1,189	1,189	1,189	1,189	1,189	
East Dunbartonshire	668	13%	2%	5%	0%	5%	5%	5%	6%	4%	4%	2%	1,142	1,142	1,142	1,142	1,142	1,142	1,142	1,142	
East Lothian	670	7%	5%	4%	8%	6%	5%	4%	5%	2%	2%	2%	1,118	1,118	1,118	1,118	1,118	1,118	1,118	1,118	
East Renfrewshire	621	9%	6%	5%	6%	6%	6%	5%	5%	5%	5%	2%	1,126	1,126	1,126	1,126	1,126	1,126	1,126	1,126	
Edinburgh, City of	812	3%	3%	2%	3%	5%	4%	4%	4%	4%	2%	1%	1,169	1,169	1,169	1,169	1,169	1,169	1,169	1,169	
Eilean Siar	550	8%	9%	5%	5%	5%	6%	6%	5%	5%	4%	2%	1,024	1,024	1,024	1,024	1,024	1,024	1,024	1,024	
Falkirk	624	8%	3%	3%	5%	7%	6%	5%	5%	5%	4%	2%	1,070	1,070	1,070	1,070	1,070	1,070	1,070	1,070	
Fife	694	7%	3%	5%	5%	5%	5%	5%	5%	3%	3%	4%	1,118	1,118	1,118	1,118	1,118	1,118	1,118	1,118	
Glasgow City	805	18%	9%	0%	2%	2%	2%	2%	2%	2%	0%	0%	1,213	1,213	1,213	1,213	1,213	1,213	1,213	1,213	
Highland	659	8%	7%	3%	5%	6%	5%	5%	5%	4%	4%	2%	1,163	1,163	1,163	1,163	1,163	1,163	1,163	1,163	
Inverclyde	762	8%	4%	3%	5%	8%	5%	2%	5%	3%	2%	-1%	1,198	1,198	1,198	1,198	1,198	1,198	1,198	1,198	
Midlothian	718	16%	4%	5%	3%	4%	3%	3%	5%	4%	3%	0%	1,210	1,210	1,210	1,210	1,210	1,210	1,210	1,210	
Moray	608	7%	7%	3%	8%	5%	5%	5%	9%	5%	5%	3%	1,135	1,135	1,135	1,135	1,135	1,135	1,135	1,135	
North Ayrshire	660	8%	4%	5%	5%	6%	5%	5%	5%	5%	4%	2%	1,152	1,152	1,152	1,152	1,152	1,152	1,152	1,152	
North Lanarkshire	758	4%	3%	4%	4%	3%	3%	3%	3%	3%	3%	2%	1,098	1,098	1,098	1,098	1,098	1,098	1,098	1,098	
Orkney Islands	480	7%	13%	5%	10%	8%	8%	8%	4%	3%	3%	3%	1,037	1,037	1,037	1,037	1,037	1,037	1,037	1,037	
Perth & Kinross	699	5%	0%	3%	5%	9%	7%	5%	5%	5%	4%	2%	1,158	1,158	1,158	1,158	1,158	1,158	1,158	1,158	
Renfrewshire	738	6%	0%	0%	7%	6%	5%	5%	5%	5%	5%	2%	1,165	1,165	1,165	1,165	1,165	1,165	1,165	1,165	
Scottish Borders	558	9%	4%	5%	8%	8%	9%	8%	5%	3%	4%	2%	1,084	1,084	1,084	1,084	1,084	1,084	1,084	1,084	
Shetland Islands	443	9%	13%	10%	9%	8%	8%	7%	7%	5%	4%	3%	1,053	1,053	1,053	1,053	1,053	1,053	1,053	1,053	
South Ayrshire	731	4%	3%	0%	5%	5%	5%	5%	5%	5%	4%	4%	1,154	1,154	1,154	1,154	1,154	1,154	1,154	1,154	
South Lanarkshire	724	9%	8%	2%	2%	2%	2%	2%	3%	3%	3%	2%	1,101	1,101	1,101	1,101	1,101	1,101	1,101	1,101	
Stirling	678	17%	1%	5%	9%	6%	6%	5%	4%	4%	4%	2%	1,209	1,209	1,209	1,209	1,197	1,197	1,197	1,197	
West Dunbartonshire	812	13%	3%	-3%	2%	2%	2%	2%	2%	2%	2%	2%	1,163	1,163	1,163	1,163	1,163	1,163	1,163	1,163	
West Lothian	678	14%	4%	3%	3%	3%	3%	3%	4%	4%	2%	2%	1,128	1,128	1,128	1,128	1,128	1,128	1,128	1,128	

Source: As reported by local authorities on the statistical return Council Tax Assumptions for the respective years
Excludes Water and Sewerage

Source: <http://www.gov.scot/Topics/Statistics/Browse/Local-Government-Finance/DatasetsCouncilTax/BandDCouncilTax1516>

Colour coding

- Red = increase over 10%
- Amber = increase between 5% and 9%
- Green = increase between 1% and 4%