
LOCAL GOVERNMENT FUNDING REVIEW

COSLA Resources & Capacity Executive Group



COSLA
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Executive Summary

Scope

Given the constitutional debate and the new powers to Scotland provided through the Scotland Act 2012, it is considered an important juncture for Scottish local government to have a clear statement of its ambition for Scotland. This ambition must include the framework in which local government is funded. The purpose of this review therefore is to provide a clear statement from COSLA on the structure of local government funding.

This review has been led by COSLA's Resources and Capacity Executive Group and the approach taken has been to identify and develop principles which should form the basis of any local government funding arrangement. Specifically the scope of the review is to:

Develop a set of principles that would underpin the funding framework for local government going forward, with specific reference to: the balance of funding; local taxation; and non-domestic rates.

The focus of the review is on structures for local government funding rather than the quantum of local government funding. Past reviews undertaken by COSLA have focussed on overall level of resources and therefore this review does not attempt to duplicate that work.

Summary of Recommendations

In line with the scope, the recommendations of the review are summarised below:

Recommendation 1	<p>The local government funding framework in Scotland should meet the 7 overarching principles as follows:</p> <ul style="list-style-type: none">• 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
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	<p>intervention agenda.</p> <ul style="list-style-type: none"> • Overarching Principle 7: For the purposes of borrowing, local authorities should continue to work within the principles of the Prudential Code.
Recommendation 2	Localisation of non-domestic rates is the only realistic means, in the short term, of addressing the current imbalance of funding.
Recommendation 3	<p>The system of local taxation in Scotland, be it domestic or non-domestic should meet the 6 local taxation principles:</p> <ul style="list-style-type: none"> • LT Principle 1: Local taxation should be fair and easy to understand. • LT Principle 2: Local taxation should be administratively efficient and difficult to avoid. • LT Principle 3: Local taxation should have regard to the stability and buoyancy of the underlying tax base. • LT Principle 4: Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the local setting of rates. • LT Principle 5: Local government should have the discretion to determine whether rates and reliefs are set nationally or locally. • LT Principle 6: 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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.
Recommendation 4	In terms of council tax, there should be a wholesale revaluation with regular revaluations thereafter.
Recommendation 5	The council tax current bands should be extended at both the top and bottom ends including a restructuring of the bands widths.
Recommendation 6	The current exemption to pay council tax for garages and lock ups should be reviewed to assess the appropriateness of this policy today.
Recommendation 7	Non-domestic rates should to be returned, in full, to local control.
Recommendation 8	<p>If full localisation cannot be met in the shorter term, then it is recommended that measures are introduced which seek to retain as much of the benefits of full localisation as possible, whilst providing sufficient safeguards for both local and Scottish Government. As a minimum these measures should have the following characteristics:</p> <ul style="list-style-type: none"> • Allow Councils the ability to vary the rates poundage, albeit within agreed parameters. These parameters should be subject to agreement between the Scottish Government and

	<p>local government.</p> <ul style="list-style-type: none"> • Allow Councils greater power to set reliefs and discounts locally, building on the Government's proposal for local powers over NDR reliefs. • Crucially local government would not be required to seek approval from Scottish Government for implementing the above measures, within the agreed parameters. • Should local authorities wish to explore the opportunity for cross boundary measures then local government would be empowered to do so without explicit approval from the Scottish Government, again within mutually agreed parameters.
Recommendation 9	<p>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, occupants, property owners or visitors in the Local Authority or within a discrete area of the Local Authority.</p> <ul style="list-style-type: none"> • 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.

Chapter 1:

Introduction and Scope of Review

Reason for undertaking the review

- 1.1 The Calman Commission on Scottish Devolution in 2009 understandably focussed on strengthening devolution from the UK Parliament to the Scottish Parliament. The Scotland Act 2012 has subsequently 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 in the next two to three years. Clearly there are changes happening to the funding structures for the Scottish Government and, in turn, this has some bearing on the current funding landscape for local government.
- 1.2 In line with this COSLA's response to the Scottish Government's Tax Management Consultation earlier in 2013, 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.
- 1.3 This is an opportune time therefore for COSLA to develop its thinking in this area and to look at the funding landscape for local government. In doing so it is important to have a clear statement of what COSLA stands for in relation to the framework of local government funding. This review, led by COSLA's Resources and Capacity Executive Group, therefore attempts to do that.
- 1.4 In line with the broad statement of greater local revenue raising powers for local government, the focus of the review has been to embody and further COSLA's Vision for local government and particularly the four main principles of the Vision as set out below:
 - Empowering local democracy: giving local decision making an unequivocal place in Scotland's constitutional future.
 - Integration not centralisation: bringing power closer to communities not centralising it.
 - Outcomes not inputs: flexibility to focus on what makes the biggest difference locally.
 - Local choice and accountability: protecting local democratic decision making and making sure that services reflect what communities want.

Scope of the review

- 1.5 The focus of this review has been to consider the structures of local government funding and whether they sufficiently empower local government and meet the principles of the COSLA Vision. In doing so there are a number of key areas for the review to address including consideration of the balance of funding between central and local government.

- 1.6 The review does not look at, or offer views on, the quantum of local government funding. A review of the quantum of funding, at the present time and into the future, was carried out in detail in 2010, when COSLA, in conjunction with the Scottish Government, undertook a comprehensive evidence based piece of work on the financial landscape. This work outlined the scale of the funding gap facing local government over the coming years. This work was used to support COSLA's responses to both the Scottish Government's Independent Budget Review (IBR) and the Christie Commission on the Future Delivery of Public Services in 2010. More recently this work was used to support evidence to the Scottish Parliament's Finance Committee on demographic change. This review does not intend to repeat any of that work as it still very valid today and as such COSLA continues to use it as a strong piece of evidence.
- 1.7 Given the purpose of this review is to provide a clear statement from COSLA on the structure of local government funding, the Executive Group has approached this review on the basis of identifying and developing principles which should form the basis of any local government funding arrangement. In line with this the specific scope of this review is to:
- Develop a set of principles that would underpin the funding framework for local government going forward, with specific reference to: the balance of funding; local taxation; and non-domestic rates.***
- 1.8 This review, led by COSLA's Resources and Capacity Executive Group, has been supported by officers from local government, including representatives from SOLACE (Society of Local Authority Chief Executives), Directors of Finance and Revenue practitioners.

Chapter 2: Overarching principles

Introduction

2.1 The purpose of this chapter is to develop and set out the overarching principles. 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 the COSLA Vision at their core and their aim is to act as a baseline in which any funding framework can be tested against.

Areas considered in developing the overarching principles

2.2 In addition to the Vision a range of other areas were referenced in order to develop the overarching principles, summarised as follows:

- The European Charter of Local Self-Government
- 'Place' and the reform agenda
- Prevention and early intervention
- National funding versus local funding
- Expenditure of resource
- Fairness
- Capital

2.3 These areas, and how they impact on a funding framework, are discussed in more detail below.

The European Charter of Local Self-Government

2.4 The European Charter of Local Self-Government was considered as a starting point for developing the overarching principles. 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 and a full copy of Article 9 is attached at Annex 1.

2.5 Whilst all principles set out in the Charter are absolutely pertinent to what should be sought from a funding framework, the first two principles in particular articulate 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. Were these principles to be adopted then it was recognised that this would need to be bolstered by stating that resources also need to be sustainable. Principles 3 and 4 cover the structure of a framework and articulate that local government should operate in a framework where they have a level of control over their resources and are not wholly reliant on another sphere of government.

The reform agenda

2.6 It could be argued that the EU Charter is too focussed on local government as an institution. The current reform agenda, as described in the Vision, is about how services

are delivered to improve outcomes for communities. It would be easy to define principles based on local government now but it was felt that the principles should be more ambitious and support the future direction of local government services in light of the reform agenda. 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.

- 2.7 With the above in mind, it was considered necessary to strike a balance between being detailed enough so that principles are meaningful but not so detailed that they are too prescriptive and inhibit the reform agenda. For example a focus could be on a principle that local government should maintain at least a third share of the Scottish Block Grant, but this is a subjective and arbitrary number as it does not reflect the principles in the COSLA Vision and could in fact be counter to them focussing on outcomes and delivery of more services locally.
- 2.8 A key advantage of having an explicit principle about public service reform and the strengthening of community planning, would be to put an onus on other public sector partners to bring resources to the table to enable joint priorities to be met at the local level. As part of the Scottish Government budget 2013, an agreement on joint working on community planning and resourcing has been signed and this places clear expectations on local government, the NHS and public bodies to share budget and resource planning assumptions with each other, at an early stage, and to work together through Community Planning Partnerships (CPPs) to deploy resources towards the jointly agreed priorities set out in each CPP's Single Outcome Agreement. This agreement has been signed by the Cabinet Secretary for Finance and Sustainable Growth, the Cabinet Secretary for Health and Wellbeing, the COSLA President and the Chair of the National Community Planning Group. Given this joint agreement it is important that this is recognised in the principles.

Prevention and early intervention

- 2.9 Integral to the reform agenda, is the principle of prevention and early intervention. Both Christie and the IBR highlighted the need to shift to a framework that supports this agenda. Again there should be reference to this agenda in the principles, or at very least to ensure that any framework allows for a shift in the focus to prevention and early intervention.

National versus local funding

- 2.10 A question that should be asked in the debate around local government funding and, in particular the balance of funding, is whether there is a need for central government funding at all? The alternative would be 100% funding from local taxation. COSLA carried out a detailed review of local government finance back in 2001 called: 'Putting the Local into Local Government Finance', which considered this question and concluded that there is a case for national funding. That report concluded that it would not be appropriate to expect the whole cost of providing local authority services in each area to be met solely by the local tax payers of that area. This reflects continuing policy that services that are national in character should be provided at an acceptable standard country-wide whether or not the tax payers of a particular area can afford to pay for them. Furthermore, where national government places statutory and legislative requirements on local government, then these should be paid for. Specifically the report concluded that there are three main arguments for national funding:
- Compensating for differences in expenditure needs between local authorities;
 - Compensating for variations on local authorities taxable resources
 - Appropriateness of paying a proportion of expenditure out of national taxation,

given that many of the main local authority services reflect national policy such as minimum standards of service.

- 2.11 Whilst the public sector has moved on since 2001, the arguments presented in favour of national funding are still very much valid today. The Vision does not argue against national government setting national policy, rather it argues that policies are outcome focussed and that local government has the flexibility to deliver these services in a way that achieves these better outcomes.
- 2.12 The question that then needs to be answered is why is there a need for local funding? The European Charter states that part of resources should be derived locally and that local government should have the power to determine the rate. For local government's principles to carry currency it is important to argue the case for why local taxation is important.
- 2.13 The Vision argues that services are better if delivered locally. There needs to be a greater link between local democratic accountability and local financial accountability and, in recognition of the place local government has, it should not be in a position where another sphere of government holds all the financial levers. If we are arguing that local democracy and service delivery are better, it can also be argued that local taxation can and should play a key part in encouraging greater local self-determination and should foster an environment where resources are controlled close to communities. Fundamentally local government should have the ability to easily vary its total spending. With that in mind the current local revenue base is simply too small.
- 2.14 Another argument against the existing balance of the local revenue base centres around the arguments of gearing, whereby a small percentage in spending, if not matched by an equal increase in grant, leads to a disproportionate increase in council tax.
- 2.15 The question therefore remains, what is the appropriate balance between national funding and local funding? To solely focus on a number would be misleading, as the key objective is to have local control over the ability to raise and expend resource. Without these freedoms, the balance of funding discussion is rendered redundant. On the basis that there is a principle that reinforces the need for local control over the raising and expenditure of funds, the debate does return to the balance of funding.
- 2.16 The fourth Principle in the European Charter also states that resources available to local authorities should be sufficiently diversified and buoyant to enable them to keep pace with the real costs of carrying out tasks. This therefore articulates the need to have a mix of funding resource to balance the risk of being too heavily reliant on one source.
- 2.17 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. The current position is clearly not one that sits well with the Vision, but it is also difficult to arrive at a definitive position, numerically, of where the balance should lie that stands up to scrutiny. There are strong arguments for retaining a centrally funded share of local expenditure and there are strong arguments for local taxation. In order to move the debate on from an exact figure it was felt that the principle should focus on the assertion that there should be a fair and reasonable balance between resources provided centrally and those raised locally. This should be the aim if there is to real accountability between a Council and its electorate and an effective relationship with central government.

Risk

- 2.18 Fundamentally risk should feature in the principles and a recognition that a funding

framework must be based on an appropriate level of risk for local government. This appropriate level must acknowledge the ability of local government to absorb and respond to risk.

Expenditure of resource

2.19 Any funding system must allow local government to raise its own resource. It must also allow it to have freedom over how it expends its resources. Again this is covered in the European Charter under the Principles 1 and 7 and this fundamental principle is articulated in the overarching principles.

Fairness

2.20 Whilst issues like distribution are out with the scope of this piece of work, it is appropriate to state that a funding framework must recognise the variation across local government and individual council's ability to raise resource. This has been covered, to an extent, above under the arguments for central government funding, but it is worthwhile considering the concept of fairness as an explicit principle on which local government funding should be based.

2.21 Principle 5 of the EU Charter covers this concept as well as the issue of additionality of local resource. It was considered however that these are two separate and explicit principles.

Capital

2.22 The focus must be on local government funding as a whole, and it should be highlighted that the principles relate to both revenue and capital in terms of freedom and flexibility to raise and expend resource.

2.23 At present, with the introduction of the Prudential Code and the removal of ring-fencing for capital there is a framework around capital that meets a number of core tests. Local Government would not want to see this framework eroded and therefore it was considered important to include a principle relating to capital and the flexibility afforded by the Prudential Code.

Overarching Principles

2.24 Taking account of the Vision for local government and drawing from the areas considered above, the Executive Group identified the overarching (O) principles as follows:

- **O Principle 1: For both revenue and capital funding, local government must be funded on an adequate and sustainable basis;**
- **O 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.**
- **O Principle 3: A local taxation system must have the freedom to raise additional resource in a way that recognises the local needs of communities.**
- **O 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.**
- **O Principle 5: Local government funding should create an environment where Community Planning can thrive.**

- **O Principle 6: Local government should be funded in a way that drives forward the prevention and early intervention agenda.**
- **O Principle 7: For the purposes of borrowing, local authorities should continue to work within the principles of the Prudential Code.**

2.25 It is intended that these overarching principles inform local government's view on any form of proposed or current local government funding and will provide a strong guiding framework to assist local government in formulating and asserting their position regarding the funding of local government.

Chapter 3: Balance of funding

Introduction

- 3.1 A key strand of the funding review, as defined explicitly in the scope, is to look at the balance of funding between central and local government. The right balance between the two featured as a key area in the development of the overarching principles and Overarching Principle 2 states that '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'. To reiterate, the focus in the balance of funding debate is not therefore about a number but on an appropriate balance. It is important to focus on the principle of local control and flexibility rather than ratios and explicit figures.
- 3.2 This review therefore needs to focus on whether the current system does have a reasonable balance and if not how that can be addressed.

Current situation

- 3.3 Over recent years the balance of funding has moved to 85% central government, 15% local government (a move from 78% Scottish Government and 22% local government in 2001). In 2013/14 the balance was readjusted to 80% central government, 20% local government due to the removal of police and fire. Overall, local government's dependency upon Scottish Government is increasing, particularly given the current council tax freeze, and in reality this means that local authorities have little financial leverage over its resources. What can be concluded from this is that the current system does not offer an appropriate balance. The focus therefore needs to be on how the funding structure can be changed to achieve a more appropriate balance of funding.

Options to address the balance of funding

- 3.4 COSLA looked in some depth at this area in 2001 as part of the 'Putting Local into Local Government Finance Review'. This review recommended that moving closer to a 60:40 relationship seemed a more principled position. Whilst the current review is consciously not focusing in on an exact number, the 2001 review did highlight that in reality, and certainly in the short term, the only way to alter the existing balance of funding would be to either: significantly increase domestic local taxation (which would then require a readjustment to the Scottish block grant if the overall quantum of funding was not to increase); or transfer non-domestic rates to local control.
- 3.5 Another obvious option is to remove a service from local government with the corresponding grant funding being removed. This could move towards addressing the balance of funding, by reducing the share of central grant funding but, as can be demonstrated by the removal of police and fire from the local government settlement, this only manipulates the numbers and does nothing to financially empower local government. Therefore removal of a service is clearly and fundamentally counter to the Vision and this therefore again emphasises why the sole focus cannot be on addressing the numbers.
- 3.6 It is also considered unlikely that there is sufficient political appetite, at this time, to significantly increase the quantum that domestic taxation can raise and therefore the only realistic option, in the short term, to address the balance of funding, is the

localisation of non-domestic rates.

- 3.7 Whilst emphasising again that numbers should not be the main focus, the control of non-domestic rates at a local level plus the current level of local domestic taxation (council tax) could see the balance of funding change to approximately 62% central government and 38% local government. The localisation of non-domestic rates is considered further in chapter 5.

Chapter 4: Local Taxation Principles

Introduction

- 4.1 The seven overarching principles, detailed in chapter 2, set out the baseline for a local government funding framework. Given local taxation forms a key part of the funding framework, it needs explicit consideration as part of this review and this is reflected in the review's scope. Past reviews have focussed on looking at the various options for local taxation and compared these against each other with a view to identifying a preferred option. This review does not attempt or indeed intend to do that as there are differing political views on what is a preferred option for local taxation. The focus therefore is on the development of a set of principles against which any form of local taxation can be 'tested' against.
- 4.2 As mentioned, the constitutional landscape in Scotland is at a key juncture and in recognition of this it is important that local government has a clear statement of what it would like from a local taxation system. The aim of having local taxation principles is to set out what local government wants from a local taxation system. This allows local government to have a clear position on any future debate on local taxation without being drawn into selecting a particular model.
- 4.3 The principles are drawn from the overarching principles and in determining these, there is no attempt to distinguish between domestic and non-domestic tax as it is deemed appropriate that both types of taxation should meet the principles. Further chapters will aim to critique both the current forms of domestic and non-domestic taxation schemes against these principles and offer recommendations on how the current systems can be better aligned to the principles.
- 4.4 The section below highlights the key areas the local taxation principles should encompass.

Fair and easy to understand

- 4.5 As a starting point, any local taxation system must be fair and related to a person's ability to pay. Local taxation systems should be impartial as taxpayers want a system which is fair and equitable and not subject to discretion.
- 4.6 The system as a whole and the resulting tax bills must be easily understood by those required to pay the tax. In addition to this, and importantly, those paying the tax must understand the reason and need for the tax and the benefit the tax confers. Both these aspects of understanding are critical to ensuring the credibility of the tax system.

Efficient and difficult to avoid

- 4.7 Any system of local taxation should be administratively efficient. The system should enable straightforward collection at a relatively low cost to ensure that the income generated from the tax is available to fund core services.
- 4.8 Local taxation systems should be developed and set up to ensure that it is difficult for tax payers to evade and avoid. If it is seen that there is scope to avoid and evade pay the tax then this can reduce the credibility and fairness of the tax system.

Stability and buoyancy of the underlying tax base

4.9 Crucially, a local taxation system must provide local government with a degree of certainty around current and future funding levels. Therefore, the system must be stable and buoyant to provide this certainty. In terms of the arguments around the balance of funding and the objective to have a reasonable balance between central and local government funding, local taxation, as a significant source of funding, must not expose local government to an unmanageable degree of financial risk. Therefore having these elements included as a principle is considered essential.

Determined locally

4.10 In determining the overarching principles it was highlighted that there needs to be a clear link between local accountability and financial accountability within the funding framework for local government. Fundamentally, local authorities need to be accountable for local taxes. If local government is to respond to local needs and be effective it needs a significant base of responsibility for its finance. There needs to be democratic accountability to the local electorate as per Overarching Principle 3 and 4. Ultimately autonomy over local taxation affords local authorities the ability to respond to communities.

4.11 There are two elements to this autonomy: local authorities must be able to set the rates of a local taxation system; but must also be able to influence the corresponding reliefs system too. Therefore, to be truly local, local government needs to have ownership of local taxation from the setting of rates to control of any reliefs or discounts. Without ownership the local authority loses its democratic accountability and fails to take account of differences between local authorities as referenced in Overarching Principle 7.

Empowering local government

4.12 In the context of the Vision and the overarching principles, the local taxation principles need to go beyond consideration of the administrative aspect and end user perspectives. The principles need to fundamentally consider and articulate the empowerment of local government. The emphasis on accountability and the need for rates and reliefs to be determined locally offer a good starting point, but this needs to be bolstered.

4.13 Fundamentally each local Authority area has different needs and priorities. Empowerment for local government requires a flexible system of local taxation which allows local authorities to raise additional funding for local projects, if required, as explicitly stated in Overarching Principle 3. Specifically, individual local authorities should be empowered to introduce additional local taxes, at their discretion, to raise additional resource. Such taxes would be truly local and developed by individual authorities.

Local taxation principles

4.14 In consolidating the points raised above, the following sets out the principles of a local taxation system:

- **LT Principle 1: Local taxation should be fair and easy to understand.**
- **LT Principle 2: Local taxation should be administratively efficient and difficult to avoid.**
- **LT Principle 3: Local taxation should have regard to the stability and buoyancy of the underlying tax base.**
- **LT Principle 4: Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the local setting of rates.**

- **LT Principle 5: Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.**
- **LT Principle 6: 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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.**

Chapter 5: Critique of Council Tax System

Introduction

- 5.1 This chapter looks at the current council tax system and undertakes a critique of council tax against the local taxation principles. As part of the critique, opportunities for better alignment with the principles are identified.
- 5.2 It is important to note that the scope of this review and critique is not to offer detailed commentary on council tax or make a case for or against council tax compared to other forms of local domestic taxation, either property or income related. Any Government would need significant time and consultation to make fundamental changes to the current tax system and therefore the focus of this chapter is to look at how the current system can be better aligned to the local taxation principles.

Overview of Council tax system

- 5.3 The Council Tax system was introduced in 1993 and replaced the community charge, which in turn replaced domestic rates. The council tax raises around £1.9 billion every year across Scotland. The amount that households pay in council tax depends on their band (A to H) which is based on the value of the property in 1991, and is worked out from the Band D rate. Billing authorities decide each year on the level at which band D bills will be set in their area, with bills for all other bands then charged at a fixed proportion of the Band D amount. The band values are nationally set.
- 5.4 Special provisions, including those for single person households, disabled persons and students exist, which may allow people in those groups a discount on their council tax. In addition to these discounts, people with low incomes may be eligible for assistance through Council Tax Reduction, which is a means tested system, and is administered by local authorities. The Council Tax Reduction Scheme replaced the Council Tax Benefit Scheme in April 2013.

Council tax critique

- 5.5 The critique of the current council tax system against the principles for local taxation (LT) is set out below.

LT Principle 1: Local taxation should be fair and easy to understand

- 5.6 The first principle includes both the subject of fairness and ease of understanding under the one heading. However the analysis below considers these under two separate areas given that the issues pertinent to their critique are quite distinct.

Fairness

- 5.7 Fairness is a principle that has been looked at widely in relation to council tax and other forms of taxation over the years. The 2007 Lyons Inquiry into Local Government in England highlighted that fairness is generally accepted as meaning 'ability to pay' but also highlighted that other important dimensions of 'fairness' include the link between tax and property value and the perceived benefits of local services to taxpayers.
- 5.8 In terms of ability to pay, the Executive Group agreed that for the majority of households,

property values are deemed to be a reasonable reflection of ability to pay. There is however recognition that for some households with the lowest incomes, they are liable to pay a higher amount of tax in relation to their income. This is offset to a significant degree by the Council Tax Reduction System which replaced the benefits system. It has been argued that any property related tax is regressive in nature but in the case of council tax, the reduction scheme is there to adjust a household's liability to pay.

- 5.9 As stated, the council tax reduction scheme was introduced in April 2013, replacing the council tax benefits system. The reduction system was designed to ensure that the council tax payer would receive a similar level of assistance to that under the benefits system. One of the key principles used to develop the new scheme was ability to pay and it was felt that the reduction scheme, as it is, offered the strong link with ability to pay. Like its benefit predecessor, council tax reductions are available to households on low incomes and may reduce all or part of a household's bill. There are around half a million household recipients of Council Tax reduction in Scotland, accounting for around 25% of households. Of these, around three quarters receive 100% benefit and therefore have no net council tax bill to pay.
- 5.10 Table 5.1 below shows that in 2010, the majority of benefit (as it was in 2010/11) was paid out to those in bands A and B. This also strengthens the assertion that property values are a reasonable reflection of ability to pay as those in bands F and above receive very little benefit.

Table 5.1: Spread of Council Tax Benefit Recipients by tax band (2010)

Council Tax Band	A	B	C	D	E	F
Share of Households in Band	47%	31%	12%	5%	3%	1%

- 5.11 A further point in relation to fairness is that Council tax liability applies to occupiers of property rather than owners. This relates to the principle that all residents in an area should contribute to the funding of local services. Some argue that council tax is not fair as they do not directly use all local services and particularly those in single households use less than a household of multiple occupants. The single persons discount has been introduced to reduce this concern whereby households of single occupancy receive a 25% discount. In 2012 there were 948,208 dwellings in receipt of the single person's discount.

Easy to understand

- 5.12 In terms of ease of understanding, the structure of the council tax is relatively straightforward. Each household is issued with a single bill that reflects both the banded value and the effect of any reduction arrangements. The council tax system has strong collection rates and this can be viewed as an indicator that households are aware of their tax and what they are required to pay.
- 5.13 Councils do however jointly bill council tax and water and sewage charges on behalf of Scottish Water. This can sometimes make the billing process, not the system itself, subject to an element of confusion where there are different increases to the individual elements. For example, water charges have recently risen and council tax bills have not. What individual households will see is that their overall bill has increased. This may be confusing when they are told that there has been a council tax freeze.

LT Principle 2: Local taxation should be administratively efficient and difficult to avoid

- 5.14 The council tax system has been in place for over 20 years and is fully operational. The system is relatively straight forward to collect and high collection levels are reported

annually as can be demonstrated in the table 5.2 below.

Table 5.2: In year collection rates for Council Tax in Scotland (1998-2013)

Year	1998/99	2003/04	2006/07	2009/10	2012/13
Collection rate	87.2%	91.7%	93.8%	94.4%	95.2%

- 5.15 An element of evasion can exist in the form of reductions or discounts, under false pretences. Councils do however have anti-fraud campaigns in place and there is increased data sharing to identify potential fraudulent claims.
- 5.16 The system is also considered to be administratively efficient. In the absence of revaluations, the maintenance of the council tax valuation list involves only very modest levels of expenditure. In summary therefore it is considered that the council tax performs strongly against this principle.

LT Principle 3: Local taxation should have regard to the stability and buoyancy of the underlying tax base

- 5.17 The underlying tax base of the council tax system is considered to be stable. The system is based on allocating a bill to each household (or more accurately chargeable dwelling) within a local authority area. Local authorities can therefore reasonably predict their expected income from council tax as the number of chargeable dwellings varying only relatively modestly year to year to reflect new houses and deleted properties.
- 5.18 The system is also considered to be buoyant as the tax base is growing each year. Both the areas of stability and buoyancy are demonstrated in table 5.3 below which shows that the tax base has steadily grown over the 16 years from 1996 to 2012 by 12%, with steady movement year on year.

Table 5.3: Council Tax - Number of Band D Equivalent dwellings - 1996 to 2012

Year	1996	2000	2004	2008	2012
Number of dwellings	1,793,759	1,851,169	1,921,528	2,005,947	2,060,964

- 5.19 In summary it is considered that the council tax system performs strongly against this principle.

LT Principle 4: Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the local setting of taxes.

- 5.20 When it was introduced, the intent was that the council tax would be set and collected locally. The system has therefore been developed to allow each individual local authority to set their band D rate on an annual basis. Therefore in principle there is a strong link with democratic accountability.

[However since 2007, it can be argued that the council tax has not been operating at a local level with the introduction of the council tax freeze. Whilst each individual council still sets the council tax, the financial penalties in place mean that councils would only get a financial benefit if the council tax is increased in excess of 3%. The freeze does not sit well with Principle 4 or the overarching principles of how local government should be funded. It is however a political issue for Scottish Government and local government to

determine and not something that is structurally wrong with the council tax system in principle.]

- 5.21 It is however important to note that, out with the freeze, the Scottish Government does have the power to cap council tax increases. Whilst this power has not been used, its existence does not sit well with principle 4.
- 5.22 The current Council Tax Reduction Scheme is a nationally set scheme without local discretion. This was however the preferred position of both Scottish and local government as there was the option, and still is to an extent, to replicate the position in England and introduce local schemes.
- 5.23 In summary, the intent of the council tax system is that it is set locally.

LT Principle 5: Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.

- 5.24 At present there is little local discretion over rates and reliefs and where there is, these relate to discounts which can vary between 0% and 100% in relation to empty properties (unoccupied and unfurnished up to 6 months) and properties undergoing major repair. The Local Government Finance Act 2012 does not allow local authorities to vary any other discount rates and there is no discretion over the large discounts and reliefs relating to single person's discount, disabled persons and students etc.
- 5.25 Whilst the current system does not meet this principle, the Executive Group are of the view that local variation in this area may not be desirable at the current time. Both COSLA and the Scottish Government agreed that the Council Tax Reduction Scheme should be a nationally set scheme and that local schemes would not be an efficient course at this time.

LT Principle 6: 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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.

- 5.26 This principle does not directly link to the core local taxation system and is more directed at the ability to introduce local discretionary taxes, which is considered separately at Chapter 7. It is however important to acknowledge that the current council tax system would not act as any barrier to such local discretionary taxes being introduced.

Summary of critique

- 5.27 The table below aims to summarise the critique as discussed above. **In line with this it is concluded that the council tax system is sound overall, against the local taxation principles. There are however anomalies in the system that require to be addressed and these anomalies are detailed further in the section below.**

Table 5.4: Summary of critique

	Principles	Yes	No	Partial
1	Local taxation should be: <ul style="list-style-type: none"> Fair; Easy to understand. 	Y		P
2	Local taxation should be administratively efficient and difficult to avoid/evade.	Y		
3	Local taxation should have regard to the stability and buoyancy of the underlying tax base.	Y		
4	Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the local setting of rates.	Y		
5	Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.		N	
	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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.		N	

Anomalies of the current council tax system

5.28 In critiquing the council tax system, anomalies were identified which do not negate the conclusions of the critique, but if addressed, could improve the robustness of the council tax system against the principles and in particular Principle 1 relating to fairness and ease of understanding. The anomalies are set out below along with recommendations as to how these anomalies could be addressed.

Relating current property values to 1991 prices

5.29 There is a degree of difficulty for tax payers to see how their council tax liability relates to the current value of a property. The current banding structure of 8 bands is based on the value of a property as it would have been in 1991. Assessors do not have a straight forward methodology for linking the value of a property today with its value in 1991, and valuation can be particularly complex where regeneration has taken place or where new housing estates have been developed since 1991. New types of housing also exist now which did not in 1991. Furthermore, when a property is improved (e.g. an extension is built), legislation prevents the revaluation of that property until a relevant transaction, which is essentially a sale, has taken place. Once a sale has taken place then Assessors have a statutory power to revalue the property. This means that two houses of quite different values (due to the added value from the extension) can be paying the same in council tax before any sale transaction.

5.30 The council tax regulations do not have a requirement of a regular revaluation and therefore positive action is required to introduce this, whereas non-domestic rates have in place a 5 year revaluation cycle and positive action is required to prevent this. It is also worth noting that no revaluation has taken place in England, however a revaluation was carried out in Wales in 2005 and Northern Ireland carried out a revaluation in 2007

Banding structure

- 5.31 Not only are house values considerably higher than they were in 1991, the range of prices has also significantly broadened. The current banding structure of 8 bands, which has been nationally set since 1993, effectively introduces a ceiling and floor to the amount of council tax a household will pay. The research undertaken has not been able to identify why 8 bands were initially chosen but what is clear twenty years on is that there is a large range of property values, even at today's prices, in the highest band H. Further, the research from the 2007 Lyons review shows that before council tax benefit, the correlation between property value and ability to pay is strongest at the higher bands, suggesting that there is scope for broadening this band.
- 5.32 As can be seen in table 5.5 below, properties in band H only pay twice the amount of households in band D and three times the amount in band A. In addition there is disproportionately a greater number of households in bands A and B. Many reviews of the council tax system, including the 2007 Lyons review, have recognised these issues and recommend that they should be resolved.

Table 5.5: Council tax bands and values

Band	Value (£) (as at 1991)	Rate of Band D	Percentage
A	Up to 27,000	6/9	67%
B	27,001 to 35,000	7/9	78%
C	35,001 to 45,000	8/9	89%
D	45,001 to 58,000	9/9	100%
E	58,001 to 80,000	11/9	122%
F	80,001 to 106,000	13/9	144%
G	106,001 to 212,000	15/9	167%
H	212,001 and over	18/9	200%

- 5.33 In addressing the anomalies identified above, the updating of the tax base, with a regular revaluation cycle, and an extension on the banding structure at both the lower and upper ends could promote stronger understanding and fairness of the system. Without these actions, there is a risk that the credibility and integrity of the council tax system could be eroded. There are a number of ways of doing this, as set out below, and the advantages and disadvantages of each have been explored.

Revaluation

- 5.34 Three types of revaluation have been explored: automatic revaluation; partial revaluation and wholesale revaluation.

Automatic Revaluation

- 5.35 Northern Ireland has implemented a computer assisted appraisal system to help implement revaluations. The tax system uses discrete property values rather than bandings and the charging mechanism is considered to create a more progressive taxation. This is broadly accepted by taxpayers who are able to understand the level of charge as it relates to the value of their property. Property values are however capped at £400k which is quite low and negates the progressive nature intended. Whilst such a system could be introduced in Scotland this could be an expensive option if significant changes to current systems were required. This would also mean a move away from a

banded system, which is the basis of the council tax, to a discrete value system more closely aligned to a domestic tax.

Partial revaluation

- 5.36 A partial revaluation would require defining as it would introduce certain parameters on which the revaluation would focus. This in itself could reduce the integrity of the system. A partial revaluation could look at properties where there have been significant improvements undertaken which have increased the value. Currently, unless they have been sold, such properties remain in the band they were originally valued in which could go against the fairness principle. New properties could also be looked at under a partial revaluation. New properties have to be referred back to 1991 valuations regardless of their current value and this affects the ease of understanding and opens up the risk of appeals, given that the Assessor has had to make a judgement on which banding the property should reside in.
- 5.37 The disadvantage of partial revaluation is that it creates a twin track system which would have the effect of generating more 'losers', as the properties affected would most likely be valued upwards. There is also the question of maintaining a revenue neutral system and how this could be made to work. Partial revaluation – difficult to define as parameters would need to be introduced that would reduce integrity of the system. This would also result in significant cost.
- 5.38 Further, partial revaluation would require virtually all of the overheads of updating survey data without achieving the same degree of benefit of a full revaluation.

Wholesale revaluation

- 5.39 The ethos of fairness in property taxation exists by the establishment of a single point in time at which all valuations are set. Any other arrangement such as partial or automatic would not achieve this. A wholesale revaluation is considered to be the best option for ensuring credibility and integrity in the system whilst improving fairness and ease of understanding. In taking forward a wholesale revaluation the following points would need to be considered:
- an initial revaluation should be followed by regular revaluations thereafter. These would encourage a better understanding of the value of a property and would lead to more stability in the longer term.
 - a wholesale revaluation would also enable the introduction of more bands. It would not be possible to introduce a restructuring of the bands without a wholesale revaluation.
 - In terms of timing, a first revaluation would need time and would have significant resource implications, particularly in surveying properties and reference work.
 - The mechanism for appeals might also need to be looked at given that this is currently undertaken through Valuation Appeal Committees whose members are lay volunteers. The appeal system for non-domestic rating is being reconsidered at present by the Scottish Government and it may therefore be appropriate to consider both in tandem.
 - It is estimated that for any revaluation, at least 2 years is needed for preparation and then up to 3 years to address appeals. The timing of appeals could be looked at with a view to making the time for submission of appeals tighter (currently it is 6 months and at the last Revaluation all appeals had to be submitted by 30th November from a 1st April introduction).
 - It is recommended that a regular revaluation cycle is introduced. The exact timing of this should be subject to further consideration but should recognise that stability and integrity of the system need to be considered in determining the cycle duration.

- In terms of resources, it is estimated that a revaluation would cost in the region of £7m to £10m for an initial revaluation. The cost of revaluation includes costs of survey work (which is estimated to account for at least half), the cost of appeals and any associated costs to local authorities. A cost benefit analysis would need to be undertaken but in relative terms the amounts seem relatively modest split over 5 years compared to an annual income generation of £1.9bn. If revaluations were undertaken on a regular basis then this would also reduce the resource implications of subsequent cycles.

5.40 In summary, it is recommended that a wholesale revaluation should be undertaken to address the anomalies in the council tax system and that after an initial revaluation, a regular revaluation cycle should be introduced.

Restructuring of the bands

5.41 It has been stated that an extension of the bands at both the lower and upper ends would improve the fairness and integrity of the council tax system. A restructuring of the bands and both ends would result in a redistribution of the tax burden with those in higher valued properties paying more and those in the lowest valued properties paying less. Since many of the households in the lowest bands received either full or partial council tax reduction, it could also translate into reduced costs of the Council Tax Reduction Scheme which has been devolved to Scotland with a 10% funding reduction.

5.42 Whilst the Lyons report suggested that an extension of the bands and the upper and lower ends could be undertaken without a full scale revaluation it was deemed to be practically challenging. The conclusion in this review is that it would be very difficult to decouple a revaluation from a restructuring of the bands as the two are so closely linked and it would mitigate the impact to do one without the other.

5.43 Modelling work was undertaken with councils to determine the impact of a rebanding exercise. The model was developed in one council area and then tested in 3 others. This initial modelling highlighted that:

- It is difficult to add on extra bands without restructuring the existing bands widths.
- The outcome and impact of the extension and rebanding is dependent on the number and width of bands chosen.
- The impact will vary between local authority areas depending on the number of properties councils have in each of the bands.
- It may be the case that an initial survey would be required before setting the bands to determine the desired outcome and impact.
- The impact on the tax base of individual authorities would also vary across the country and therefore there would need to be some form of equalisation with the settlement.
- Transitional relief would need to be a consideration.
- Any revaluation would require a legislative change. A revaluation would only require secondary legislation but any changes to the band widths or number would require primary legislation. The revaluation and rebanding could be more smoothly introduced if people know their proposed bands well in advance of the changes being effected through billing.

5.44 This is by no means a definitive list of observations and issues to consider and there are potentially other areas that the officer group has not identified that would require to be looked at on further examination and modelling. If the recommendation to undertake a

revaluation and rebanding is pursued, then detailed modelling work would be required to determine both the number and width of the bands. What is clear however, from the initial modelling, is that there is considerable scope to build in desired policy objectives when determining the number and width of bands.

- 5.45 **In summary, it is recommended that there is an extension of the number of bands and a restructuring of the bands widths to improve the fairness of the council tax system. This would require further modelling work before setting out the number and widths.**

Potential to raise additional income

- 5.46 In terms of improving the integrity of the system, revaluation and rebanding have been looked at on an income neutral basis so that the same amount of council tax is raised overall, but with the tax burden distributed differently between households. There would be scope to do this on an income generation basis should that be the desired result. This could also be looked at in terms of covering the costs of the system alongside raising additional revenue for local government to spend on services. A greater proportion of income generated through the council tax could also make moves in the right direction towards addressing, although not significantly, the balance of funding.

Impact on water and sewage charges

- 5.47 It is also important to acknowledge that any rebanding would need to consider the impact on the current arrangements with Scottish Water. The current charging arrangements and formula in place to calculate the level income collected relating to water charges, and therefore the amount to be passed over to Scottish Water, are based on the current system and specifically are dependant on the existing banding structure.

Garages and stores

- 5.48 Another anomaly in the system that has been highlighted is that garages and stores are currently exempt from paying council tax. There are currently 106,000 garages/stores in the council tax list as exempt properties. It is recommended that this is something that needs reviewed to assess whether this exemption is still relevant today.

Conclusions and recommendations

- 5.49 In summary, the conclusion of the council tax critique against the local taxation principles is that the council tax system, in conjunction with the reduction and discount systems in place, can be viewed as reasonably fair and easy to understand. The council tax system performed well against the other principles with the exception of the ability to set rates and reliefs locally. However it is considered that this is something there is currently little appetite for in local government.
- 5.50 That being said, there are anomalies in the system that if addressed could improve the robustness of the council tax system against the local taxation principles and particularly in relation to LT Principle one. Specifically it is concluded that fairness and ease of understanding could be improved by updating the base data of the system and restructuring the banding arrangements. Specifically it is recommended that:
- **A wholesale revaluation is undertaken with regular revaluations introduced thereafter;**
 - **The current bands are extended at both the top and bottom ends including a restructuring of the bands widths.**
 - **The current exemption for garages and lock ups is reviewed to assess the appropriateness of this policy today.**

Chapter 6: Localisation of Non-Domestic Rates

Introduction

- 6.1 Non-domestic rates (NDR) forms a core element of the funding for local government. NDR income for 2013/14 is budgeted at £2.44bn which accounts for around one fifth of local government funding (including Council Tax). Since 1990 the non-domestic rates poundage has been set nationally by the Government (the Scottish Government since devolution), but prior to this each local authority set its own rate. Therefore it has now been over two decades since local government last had substantial control over NDR.
- 6.2 As highlighted in Chapter 3, in the short term, the return of non-domestic rates (NDR) to local control is considered to be the only realistic way to address the balance of funding and meeting the aims of the Vision of greater powers for local government. However, whilst full localisation of NDR is viewed as the only option, there is a need to consider further the implications of having local government control of non-domestic rates, specifically, considering what the risks would be and how these risks could be mitigated.
- 6.3 Encompassing this is a recognition that empowerment comes through local government engaging more effectively with local businesses to bring about economic development. This is in line with the view from the Lyons Inquiry.¹ Localisation should not therefore be considered in isolation of the need for local authorities to have a greater say over wider local economic development in their areas.
- 6.4 A critique of the current non-domestic rates system and the implications of returning NDR to local control has therefore been undertaken. This involved assessing the merits and weaknesses of the current NDR system and the benefits and the risks of moving to full localisation, against the local taxation principles. By critiquing both the current NDR and full localisation against the local taxation principles, this determined the extent of local control and thereby the extent of the balance of funding. This then also allowed the related risks and benefits to be drawn out. The critique then considered how any risks of full localisation could be mitigated.
- 6.5 It is important to note that the critique is of the NDR system of taxation and local control of NDR. The intention of the local government funding review is not to propose, for example, an alternative property tax. It is worth highlighting however that such a debate was raised at the time of the Burt Review in 2006 which proposed an alternative property tax based on a percentage of property value, this being a position supported by the Institute of Revenues, Rating and Revaluation (IRRV) at the time.
- 6.6 This chapter therefore looks at the following sections in line with the scope of the review:
- Section A: A critique of the current NDR system.
 - Section B: A critique of full localisation of NDR.
 - Section C: Summary comparison of current NDR and full localisation

¹ The Lyons Inquiry into Local Government in 2007 concluded that, whilst localisation in principle should not be ruled out, there would need to be a different relationship between local authorities and businesses built on mutual trust and shared objectives. Lyons was in favour of a local business supplement.

- Section D: Measures to mitigate the risks of full localisation of NDR.
- Section E: Conclusion and recommendations.

Section A: Current non-domestic rates system

- 6.7 NDR (often referred to as business rates) is a property tax for which owners or occupiers of most non-domestic properties are liable. This normally covers shops, factories and offices as well as public buildings and other amenities. There are exemptions for areas such as agricultural land and places of religious worship.
- 6.8 Each property has a rateable value based largely on the annual market rent for the property as assessed by professional valuers. Property revaluations normally take place every five years, though it is worth noting that the revaluation due in 2015 has been delayed by the Scottish Government for two years to 2017, following a similar delay applied in England.
- 6.9 The rates liability for each property is determined by taking the rateable value and multiplying by a rates poundage. The table below provides the non-domestic rates income over the past few years; the poundage rate; and the total rateable value for each year. The poundage for 2013/14 is 46.2p which is in line with the Scottish Government's commitment to match the English poundage.

Table 6.1 - Non-Domestic Rates Income, Total Rateable Values and Poundage Rate
(source Scottish Government)

	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14 Budgeted
Non Domestic Rates Income (£m)	1,924	2,010	2,138	2,252	2,362	2,435
Total Rateable Value (£m)	5,296	5,299	6,612	6,678	6,718	-
Poundage Rate (pence)	45.8	48.1	40.7	42.6	45.0	46.2

- 6.10 The table shows that rates income and rateable value have been increasing year on year and, over the years since 2008/09 it is worth noting that total rateable value has increased by 27% (with the rates income slightly lower due to the variations in poundage over the time). Even in real terms this suggests that there has been substantial growth in the business rates base in recent years.

Reliefs and discounts

- 6.11 Various reliefs and discounts are available to those liable to pay NDR. The main relief is the Small Business Bonus Scheme which is aimed at supporting small to medium enterprises and business start-ups. The Scottish Government introduced additional empty property reliefs from 2013/14 to assist new occupants of empty properties and for new builds which are empty for a period of time, in order to encourage empty properties back into use and encourage speculative developments. Other reliefs include reliefs for charitable properties and properties in rural areas. The Scottish Government has also introduced a large business supplement from 2013/14 of 0.9p and is continuing to apply a public health supplement to certain business, such as tobacco related, of 13p. Agricultural land is generally exempt from NDR and the Government has signalled its intention to continue with this practice.
- 6.12 In its recent response to the consultation on business rates (Supporting Business Promoting Growth), the Scottish Government indicated that it intends to allow local

government to introduce local reliefs and will develop this in partnership with local government. This intention has recently been re-stated in the Government's consultation on the Community Empowerment (Scotland) Bill.

NDR pooling

- 6.13 Currently the total rates income in Scotland is pooled on an annual basis and funding is distributed by the Scottish Government to each local authority as part of the local government settlement. The Scottish Government forecasts the total rates pool and determines the income "target" for each local authority. Within this is an assumed level of buoyancy. If an individual Council does not reach its share of the targeted income level then the Government will compensate for this through general revenue grant. Similarly if a Council exceeds the targeted income level then this will balance against the general revenue grant provided. If the overall target is exceeded then the Scottish Government retains the additional income (buoyancy). If the overall total is not reached then the Government bears the risk, though it is worth noting that the target has exceeded year on year (as noted above the rates base has been growing substantially) and the Government has not had to step in to cover an overall shortfall.
- 6.14 Whilst this has been the arrangement a change to this was agreed from 2013/14 onwards under the Business Rates Incentivisation scheme (BRIS). BRIS allows a Council to keep 50% of any rates growth above its share of an agreed National Target, with the Government retaining the remaining 50%. If a Council fails to reach its target then Government will step in to cover this in full. The current BRIS is due to be reviewed in 2015.
- 6.15 The recent Scottish Government commissioned External Advisory Group report "Community and Enterprise in Scotland's Town Centres" has put forward recommendations for a BRIS+ scheme. This would entail 100% of NDR collected in town centres being retained for re-investment into town centres. Such a recommendation would need to be considered in light of the recommendations set out in this chapter.

Tax Increment Financing

- 6.16 In recent years there have also been moves to look at ways to use additional rates income in more flexible ways to meet local requirements. Notably Tax Increment Financing projects (TIF) are being piloted on a limited basis in 6 local authority areas. TIFs allow local authorities to designate areas of development, whereby the rates income can be retained to help repay the cost of the development for a period of years, as agreed with the Scottish Government. In recent years the concept of TIF and other innovations for funding development have fallen within the wider concept of Enterprise Areas (15 of which have now been set up across Scotland) which look more thematically at ways to bring about development, for example in the low carbon sector. These are however restricted to quite specific large-scale developments and do not confer wider powers to local government to control NDR. Crucially all TIF pilots required the agreement of the Scottish Government.

Critique of current non-domestic rates system

- 6.17 The current non-domestic rates system has been critiqued against the local taxation principles and this is set out below.

Principle 1: Local taxation should be fair and easy to understand.

- 6.18 As with the critique for Council Tax the critique for NDR considers fairness and easy to understand under two separate areas.

Fairness

6.19 The liability to pay NDR is entirely linked to discrete property values and therefore broadly reflects ability to pay. A uniform poundage across the country ensures that businesses should not feel disadvantaged by their location. Reliefs ensure that there are supports available for example to small businesses and charitable organisations.

Easy to understand

6.20 NDR is generally understood and accepted by the Scottish business community and the concepts of rateable value and rates poundage to determine liability are well established.

6.21 The current NDR system therefore meets this principle quite strongly and this is one of its advantages.

Principle 2: Local taxation should be administratively efficient and difficult to avoid.

6.22 NDR is administratively straightforward and easy to collect. Collection rates are high, suggesting that the tax is not easy to avoid/ evade.

6.23 This principle is well met by the current NDR system.

Principle 3: Local taxation should have regard to the stability and buoyancy of the underlying tax base.

6.24 The underlying tax base is broadly stable and buoyant as is demonstrated in Table 1 above. This is a key feature of the current NDR system. Periodic revaluations ensure that the link between liability and property value is maintained. However the buoyancy of the underlying tax base is only partially recognised at the local level through the Business Rates Incentivisation Scheme (BRIS).

Principle 4: Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the setting of local taxes.

6.25 The current system of NDR does not facilitate democratic local accountability as it is a centrally set tax, with no scope for local authorities to determine the taxation locally. Councils act solely as a collection agency and there is no link between businesses and local democratic decision making as a result of the NDR system.

6.26 Lack of local democratic accountability is therefore a fundamental weakness of the current system of NDR, which does not meet this principle.

Principle 5: Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.

6.27 Currently local authorities have no power to introduce local taxes under the current NDR system and only have highly limited powers to vary the relief on charitable organisations. This may change, to some extent at least for reliefs, with the Scottish Government's proposal for more local control of reliefs, though the detail and extent of this is as yet undetermined.

6.28 This principle is not met by the current NDR system.

Principle 6: 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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.

6.29 Whilst this principle is focussed on local discretionary taxation and therefore does not apply to NDR as a core form of taxation, it is worth noting that local government does not have power to raise funding for local priorities under NDR. However, as with Council Tax, this does not prevent discretionary taxes from being implemented.

Summary of critique of current NDR system

6.30 Table 2 summarises the critique by answering whether the principle is met or not or whether it is partially met.

Table 6.2: Summary of critique of current NDR system

	Principles	Yes	No	Partial
1	Local taxation should be <ul style="list-style-type: none"> • Fair. • Easy to understand. 	Y Y		
2	Local taxation should be administratively efficient and difficult to avoid.	Y		
3	Local taxation should have regard to the stability and buoyancy of the underlying tax base.	Y		
4	Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the local setting of rates.		N	
5	Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.		N	
6	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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.		N	

Conclusion on the current NDR system

6.31 In overall terms, whilst the current system of NDR may meet some of the more administrative principles for local taxation, fundamentally this does not address principles around ownership by local government and local democratic control which are at the core of the balance of funding and Vision local government. NDR is a centrally controlled tax and local government's powers are limited to collecting and administering the tax.

Section B: Critique of full localisation of NDR

- 6.32 In order to meet the vision for local government and address the balance of funding, which are found to be deficient in the current system of non-domestic rates, full localisation of NDR is the option which needs to be considered. However, in undertaking the critique, it is important to define what full localisation means.
- 6.33 Full localisation of NDR means that local authorities have the power to set the rates poundage locally. This is an important point because, in the past, the debate about returning control of non-domestic rates locally has tended to focus on tax buoyancy. The arguments previously focussed on Councils' ability to retain additional rates within their local area by growing their rates base. The last time this was debated in 2008, this led to the introduction of the Business Rates Incentivisation Scheme (BRIS). Fundamentally however, in order to be able to state that NDR is truly controlled locally, the setting of business rates must be at the core, along with the ability to set reliefs and exemptions. This is the only way in which local government would have full control and ownership of the system.
- 6.34 With this in mind the critique of full localisation of NDR against the local taxation principles is set out below.

Principle 1: Local taxation should be fair and easy to understand.

Fairness

- 6.35 As the nature of the taxation system would not change there is no reason to suggest that localisation of NDR would be any less fair. However there is a risk that localisation would not be as easily accepted by local businesses where, for example, neighbouring authorities were setting radically different rates. Nonetheless, whilst the local business communities may be reluctant to support local variation of rates, this would offer the scope for them to be able to influence the rate which could be seen as improving fairness. This point is re-iterated under Principle 4 below.

Easy to understand

- 6.36 Equally, as the tax system itself is not changing, then it should be no less understandable. There is an added benefit that the body collecting rates is also then responsible for the tax which should strengthen this principle. Clearly a change from a national scheme to a local one would require explanation, particularly around variations in rates across the country.

Principle 2: Local taxation should be administratively efficient and difficult to avoid.

- 6.37 Again as the tax system would not be changing the benefits should follow the current system in being straightforwardly administered and effectively collected. The possibility arises that businesses' perception of Councils having power over setting rates may impact on collection, as well as businesses seeking tax efficiency potentially by relocating to a neighbouring lower charging authority.
- 6.38 Nonetheless it is not considered that there would be collection issues and therefore it is considered that this principle is met by full localisation.

Principle 3: Local taxation should have regard to the stability and buoyancy of the underlying tax base.

- 6.39 There would be benefits in terms of this principle that buoyancy is recognised where it is generated. The stability principle carries the highest risk if full localisation is applied.

Whereas, at a local government level, it could be argued that stability would follow the current scheme in that the system of taxation, which is relatively stable, would not change, at an individual Council level it is likely that there would be significant instability in the tax base. The current pooling of NDR at the national level ensures that stability is protected for individual Councils by re-distributing rates from those Councils who can grow their tax base to those who are unable to do so as readily.

- 6.40 If Councils are not able to reach a targeted level of NDR then the Scottish Government will adjust this by increasing general revenue funding under the pooling arrangements. If this is removed, as would be the case with full localisation, then each Council would need to fully absorb the risk for their area. Trends in total rateable value over the last 5 years indicate that the majority of Councils are either below or in line with the average rateable value growth for Scotland, with some Councils well below the average. Whilst total rateable value only gives one indication and could change over time, it is clear that different Councils would be exposed to varying levels of risk, with the potential that many could lose potentially significant income, if there is a move to full localisation.
- 6.41 An additional factor is that there are different industries across different Council areas, with some areas being highly dependent on one industry. Changes to those industries, for example a major closure, could have a significantly disproportionate financial impact on the affected Councils. There is a question therefore of whether local government has sufficient capacity to be exposed to risk in this way and whether full localisation carries too high a risk.
- 6.42 A good example of the national impact of NDR occurred recently with the threatened closure of Grangemouth, which would have had substantial implications for the viability of the NDR funding pool. It is unlikely that such an impact, had it happened, could have been contained by the local authority concerned or, for that matter local government as a whole, under full localisation.
- 6.43 Equally consideration would need to be given to those Council areas where NDR is currently collected for one company or industry sector which operates nationwide, for example utility or telecom companies. Full localisation could imply that the NDR income falls to that one Council, in contrast to the current arrangements whereby NDR targets are adjusted to reflect this position.
- 6.44 For the reasons outlined above this principle is only considered to be partially met and, importantly, the risk that there could be significant instability for individual Councils needs to be highlighted.

Principle 4: Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the setting of local taxes.

- 6.45 Localisation of NDR would achieve this principle by placing the decisions for setting rates closer to local business communities. This should open up the opportunity for businesses to engage more effectively on how NDR impacts on them locally and for local authorities to be able to respond to the needs of local business communities. This would also allow for NDR decisions to be taken alongside economic development decisions within a local authority area.

Principle 5: Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.

- 6.46 Localisation would meet this principle by enabling Councils to raise their rates locally and consequently raise additional revenue, as well as varying the reliefs provided in accordance with local priorities.

Principle 6: 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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.

6.47 Whilst recognising that this principle is focussed on local discretionary taxation and therefore does not apply to NDR as a core form of taxation, this principle would be met insofar as local government would have power to raise funding for local priorities under full localisation of NDR.

6.48 Table 6.3 summarises the critique of full localisation and demonstrates that full localisation largely meets the local taxation principles.

Table 6.3: Summary of critique of full localisation of NDR

	Principles	Yes	No	Partial
1	<ul style="list-style-type: none"> • Local taxation should be • Fair. • Easy to understand. 	Y Y		
2	Local taxation should be administratively efficient and difficult to avoid.	Y		
3	Local taxation should have regard to the stability and buoyancy of the underlying tax base.			P
4	Local taxation should be determined locally in order to establish/maintain democratic local accountability. This includes the local setting of rates.	Y		
5	Local government should have the discretion to determine whether rates and reliefs are set nationally or locally.	Y		
6	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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax.		N	

Section C: Summary comparison of current NDR and full localisation

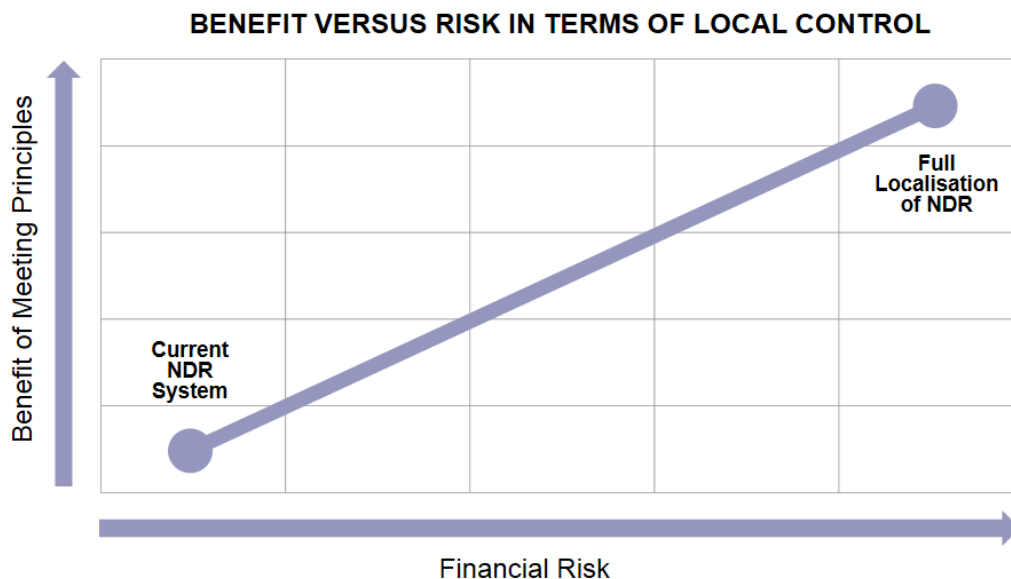
6.49 In overall terms, full localisation of NDR meets the local taxation principles. Fundamentally it gives local government more control over its share of total resource and in doing so empowers local government to have greater choice over its income base. As highlighted it also creates a closer link with local economic development. Whilst not undermining these significant benefits, it is important to note two significant issues:

Issue 1: risk to local government

6.50 The first of these is the potential risk that partial alignment with Principle 3 represents. Stability and buoyancy of the underlying tax base is a fundamental principle. It is not to say that this carries more weight than the other principles but it is important to consider whether local government, as a whole, or at individual council level, has the capacity to manage the exposure to risk that full localisation represents. Particularly in relation to some Councils' exposure to changes to industries, such as a major business closures.

6.51 In terms of risk, Chart 6.1 summarises the current NDR system with full localisation showing how the two systems compare in terms of principle versus risk. This spells out that on the one hand the current NDR system is low on risk but also does not confer the benefits of meeting the local taxation principles. On the other hand, full localisation is better aligned to the Vision and principles but is high on financial risk for local government.

Chart 6.1: Chart of risk against principles of full localisation of NDR compared with the current NDR system



Issue 2: Willingness of national government to localisation NDR

6.52 The second issue which must also be considered is the likelihood of the Scottish Government's willingness to give up national control of NDR, given its significant influence over economic development at the macro level. It is likely that full localisation, certainly in the immediate term, would be a significant ask of the Scottish Government, regardless of which political party is in power.

6.53 In recognition of these issues, options to mitigate these were explored and are set out in the next section. Mitigation focuses on reducing the financial risk for local government but as Chart 6.1 demonstrates, the more risk is reduced, the further you move from the benefits of meeting the principles.

Section D: Measures to mitigate the financial risk of full localisation of NDR

6.54 A range of measures which could mitigate the financial risk of full localisation of NDR have been identified and, for each measure, the benefits and risks are highlighted. In setting these measures out it needs to be recognised that there could also be a number of variations, in addition to or even between the identified measures. This is not to say therefore that they are necessarily mutually exclusive, or that one measure would stand out as being preferred compared with another.

Localise NDR but local government collectively agrees the national rate poundage and reliefs.

- 6.55 This would see local government coming together to agree the national rates poundage and reliefs for NDR collectively, with no local variation, rather than the Scottish Government having control over this. There would be scope for local government, for example, to agree a different incentivisation scheme from the current BRIS; to develop more flexible TIF arrangements; or to develop different reliefs than those currently in operation. This measure would not give power to individual Councils to set their own local rates and the economic and financial benefits this could confer locally would not be offered by this measure, although local government as a whole would have the power to determine a national rate. There would need to be collaborative arrangements in place between Councils and a means for local government to make decisions collectively.
- 6.56 Such a measure would give greater power to local government and would go some way to address the balance of funding, whilst offering similar protection to Councils as with the current pooling arrangement.
- 6.57 The key risk is that the ability of local government to reach collective agreement could be highly challenging, particularly as this could be perceived as just a replication of the existing arrangements, without the current protections offered by Scottish Government over the total NDR funding pot.

Fix the level of NDR at a point in time, so that Councils receive a guaranteed allocation.

- 6.58 With this measure the level of NDR within the local government settlement would be fixed at a point in time, such that all Councils would receive their share of NDR within the settlement, thus offering the degree of protection afforded by the settlement at that point. All Councils could then vary their rates and grow their rates base beyond the fixed point.
- 6.59 This would protect the share of NDR income for Councils, based on a given historic position, and would then give Councils complete control over setting rates beyond the fixed point and to take advantage of future buoyancy. There is however no guarantee of future buoyancy which, in any case, would not apply to all Councils evenly, with some councils less able to grow their tax base than others. Future growth in the NDR pool is factored in to the Local Government Settlement so there would need to be recognition that the Settlement would be lower than with the NDR pool in operation and those Councils less able to grow their rates base would need to make up the difference locally.
- 6.60 Importantly, whilst moving closer to full localisation over time, in the short term this approach would differ from full localisation in that the level of buoyancy already factored into each Council's share of NDR would remain with them. Under full localisation those Councils which are more likely to generate buoyancy would retain this in their local area whilst others who are less able to generate buoyancy would need to make up any shortfall locally. Therefore this approach would afford a degree of protection to those Councils which would not be available under full localisation.

Allow Councils to group together to operate local NDR pooling.

- 6.61 A measure could be to localise NDR but allow Councils themselves to group together to have local pooling arrangements. Councils would have the choice whether to join with other Councils or go it alone.
- 6.62 This would offer control of the NDR pool to Councils locally ie full localisation. Those Councils who were then looking for protections offered by pooling could then agree collectively with other Councils how best to operate pooling arrangements.
- 6.63 The key risk would be how easy it would be for those Councils seeking protection to be able to come together with other Councils, who are more likely to benefit from localisation, and to define and agree the pooling arrangements.

Retain the existing pooling arrangements but allow Councils to opt out if they wish.

- 6.64 This measure would retain the existing pooling arrangements but, for those Councils who wish to have greater control, they would have the option to opt out and control their own NDR. Any Council opting out would have their NDR allocation fixed, but would then have flexibility to vary their rates/ grow their rates base beyond the fixed point, whilst accepting the risks around local control.
- 6.65 This would retain protections for those Councils preferring the safety net afforded by the current pooling arrangements, whilst offering greater control of NDR to those Councils who want it.
- 6.66 The risk under this measure is that this could lead to significant disparity between those Councils who are able to take advantage of opting out and those who are not. This would only result in shifting the balance of funding for some Councils and would not meet the vision for local government as a whole.

Keep the national scheme but allow Councils to vary rates within set parameters.

- 6.67 Under this measure NDR would be retained as a national scheme however the Scottish Government would set parameters within which Councils could vary their rates locally. For example a parameter could be 3p in the pound above or below a nationally set poundage. There would be a pooling arrangement with a nationally set rates poundage, and Councils would be required to absorb the financial risk for the equivalent movement from this.
- 6.68 This measure could be attractive as it could allow local flexibility over setting of rates which could be coupled with other local flexibilities such as reliefs, BRIS and TIF. However fundamentally this would not address the issue of full local control over NDR.
- 6.69 There is a risk that displacement could occur as some Councils may be better able to influence their rate locally than others.

Keep the national scheme but look to enhance existing measures locally.

- 6.70 This measure would be the furthest away from full localisation but may offer some scope to increase powers for local government over NDR in some areas.
- 6.71 The Scottish Government has signalled that it is looking to introduce local rates reliefs in conjunction with local government, as a result of its review of business rates consultation. This therefore offers some increased flexibility from the current NDR system which will need to be explored further. An extension of this could be for local government to have powers to introduce local supplements. Business Improvement Districts (BIDs) whereby local businesses pay an additional rate to support town centre improvements perhaps sets a precedent for this.

- 6.72 There could also be scope to look again at flexibilities around the current BRIS and TIF schemes, to give far greater control of these to local government. This would offer the opportunity to draw from some of the benefits of these existing measures and to build on them with a much greater local dimension.
- 6.73 It would however need to be recognised that this measure could only offer some additional control at the margin, whilst protecting the safeguards in the current NDR system, and fundamentally this would not confer significantly greater power over NDR for local government.

Conclusion on approaches to mitigate the risks of full localisation of NDR

- 6.74 The measures outlined above offer a range of mitigations against the risks of full localisation but most of these measures also carry many of the risks of full localisation, particularly around the different levels of risk exposure between Councils. Whilst some Councils would be able to take better advantage of these mitigations, local government would need to collectively afford protection to some Councils and protect the overall rates base, without the intervention of the Scottish Government, and this could be highly challenging.

Section E: Conclusion and recommendations

- 6.75 The overall conclusion of this chapter is that the full localisation of NDR would realise a number of significant benefits for local government. Full localisation largely meets the local taxation principles and could substantively readdress the balance of funding. In meeting these key objectives, the outcome is greater empowerment of local government. **It is therefore the primary recommendation that non-domestic rates be returned, in full, to local control.**
- 6.76 This Chapter has however also identified that full localisation could present significant financial risk for local government, as a whole and/or at individual council level, by exposing the stability and buoyancy of the underlying tax base. There may be measures which can mitigate some of the risks, whilst seeking to retain as much of the benefits of full localisation as possible. A number of options have been set out. This is not an exhaustive list of options but what is clear from identifying and critiquing these options is that the further the move to mitigate risks, the further this moves away from the local taxation principles and ultimately the Vision for local government. It was also highlighted that any Scottish Government may be unwilling to relinquish control of non-domestic rates in its entirety.
- 6.77 To some extent these risks are greater if an immediate move to full localisation was taken. Therefore in recognition of this, but without wanting to lose the benefits of greater empowerment for local government, the following is offered as a pragmatic solution, in the shorter term, that could allow local government to move forward on a partnership basis with the Scottish Government. The recommendation below builds on the benefits local government would wish to see from full localisation but recognises that pragmatically there needs to be space to negotiate with Scottish Government. This however is not to negate the longer term ambition of full localisation.
- 6.78 If full localisation cannot be met in the shorter term, then it is recommended that measures are introduced which seek to retain as much of the benefits of full localisation as possible, whilst providing sufficient safeguards for both local and Scottish Government. As a minimum these measures should have the following characteristics:
- **Allow Councils the ability to vary the rates poundage, albeit within agreed parameters. These parameters should be subject to agreement between the Scottish Government and local government.**
 - **Allow Councils greater power to set reliefs and discounts locally, building on the Government's proposal for local powers over NDR reliefs.**
 - **Crucially local government would not be required to seek approval from Scottish Government for implementing the above measures, within the agreed parameters.**
 - **Should local authorities wish to explore the opportunity for cross boundary measures then local government would be empowered to do so without explicit approval from the Scottish Government, again within mutually agreed parameters.**
- 6.79 Importantly this package would need to be worked up in partnership with the Scottish Government and would need to have regard to issues such as State Aid rules². Equally recognition would need to be given to the issue that certain Councils collect rates, for example for all utility or telecoms companies nationwide.

² Article 107(1) of the Treaty of the Functioning of the European Union (TFEU) lays down general prohibition on the provision of State aid by Member States. Tests would be required to see if any proposed measure on NDR benefits the economy generally or would confer advantage to one part of the market over another, this being prohibited.

Chapter 7: Local Discretionary Taxation

Introduction

7.1 The overarching principles state that individual local authorities should be empowered to introduce local taxes, at their discretion, to raise additional resource. In line with this, an explicit principle was created under the local taxation principles.

7.2 Local Taxation Principle 6 states:

‘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. Individual local authorities should have discretion over the rate and discount and relief arrangements for this tax’

7.3 In terms of revenue raised, local discretionary taxation will not have a major impact upon the balance of funding. However, regardless of the revenue raised, 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.

Current Taxation Powers in Scottish Legislation

7.4 A review of the current legislation available to local authorities in Scotland was undertaken to assess whether local government had an existing power to meet this principle. The section below sets out the legislation that was looked at.

The Power to Advance Wellbeing

7.5 In the main, the most significant power for raising revenue independently available to local authorities is through the power to advance wellbeing. The power to advance wellbeing is contained in The Local Government in Scotland Act 2003 and allows a local authority to impose a charge, so long as it is reasonable, in return for services provided.

7.6 Section 22 of the Local Government in Scotland Act 2003 stipulates the limitations on the power to advance wellbeing. The power to advance wellbeing does not enable a local authority to raise tax. Section 22(7) of the Local Government in Scotland Act 2003 specifically prohibits local authorities from levying any tax other than council tax. In order for local authorities to raise discretionary taxes under the power to advance wellbeing, section 22 would need to be repealed or amended.

The Difference between Taxes and Charges

7.7 In this context, it is important to note the differences between taxes and charges. **A charge is a fee, toll or other type of assessment in exchange of particular goods, services, or use of property.** These are generally not considered taxes, as long as they are levied as payment for a direct benefit to the individual paying. It is clear therefore that local authorities have several avenues under which they can levy charges. However, this funding review is specifically concerned with the ability of local authorities to raise taxes.

- 7.8 **A tax is defined as per accounting practice as a financial charge or levy imposed upon a taxpayer (an individual or legal entity) by a state or the functional equivalent of a state (in this case a local authority) such that failure to pay is punishable by law.**
- 7.9 **In practical terms, a tax offers local authorities more discretion than a charge with regard to how it is levied and that there need not be a direct link between the revenue raised and how it is spent. Taxation is therefore a more empowering financial lever for local government.**
- 7.10 In conclusion, 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. In fact exactly the opposite is true as taxation by local authorities, other than Council Tax, is specifically prohibited.
- 7.11 From this it is clear that local authorities in Scotland do not have the power through current Scottish legislation to raise local discretionary taxes. Given this, and the fact that Scotland is covered by additional legislating bodies, alternative legislatures were considered. In particular, the review considered UK and European legislation.

Current Taxation Powers in UK and EU Legislation

- 7.12 Currently, there is no UK or EU law which would enable local authorities in Scotland to raise charges or taxes where the power to advance wellbeing does not already do so.

English Comparisons

- 7.13 For reasons of comparison, the English Localism Act 2011 was considered in order to ascertain if this makes any powers of local discretionary taxation available to English local authorities. However, it can be concluded that the Localism Act 2011 has not provided a statutory basis for extending powers of taxation to local government in England, so while this is a useful starting point for possible charges that local authorities may wish to consider, it is not helpful at laying a foundation for discretionary taxation in Scotland.

Individual European State Comparisons

- 7.14 Again, for reasons of comparison, individual European state legislation was considered. Before comparing individual European states, it is important to clarify exactly what is being compared. The taxation systems across Europe are vastly different, and like for like comparison is extremely difficult. In this specific instance, the tax legislation of a number of states from within the European Union have been considered, while the system of government and the services that are provided have been set aside. This enabled the focus to be on the taxes that are levied at local government level and what exists to empower local government to do so. A detailed summary of the findings can be found at Annex 2.
- 7.15 European states can be loosely categorised into a number of different government models. For the purposes of taxation both the Scandinavian model and Civil Law model, which covers the bulk of states within the European Union, were considered. Broadly, Scandinavian models give a greater degree of taxation freedoms compared to other EU states. However, this tends to focus around the ability to collect and set rates of tax rather than a general power to levy a discretionary taxation. Civil law models give less freedom of taxation than the Scandinavian model. States following the civil law model tend toward national legislation which covers a list of 'acceptable' charges that local government can set up should they wish. It does contain an element of discretion, in that local government can chose whether or not to impose the charge, but this is very limited as the desired charge must be covered by the approved list. The key to this

model is that any list is sizeable and general, giving local government a large margin within which to work.

- 7.16 In the main, local government within Europe does not have a general power of taxation. Most forms of taxation are explicitly defined in national legislation, or at devolved level, and are uniform, so do not involve any element of local discretion, which is a key element of what this review is specifically interested in. In practical terms, it is clear that there is not an easy parallel for Scottish local government to draw on from within Europe.

The European 'Tourist Tax' Example

- 7.17 Initial expectations centred on drawing on some examples of specific local discretionary taxes from Europe. In particular, the concept of a tourist tax had been repeatedly referred to on an anecdotal basis. Research has shown that while a number of European countries do have a tourist tax in place, in each instance there exists a specific piece of legislation enabling the tax to be levied and that this legislation does not give rise to any further local discretionary taxation.
- 7.18 In summary, having examined the current powers available to local government in Scottish, UK and EU legislation it is clear that there is not currently a mechanism to enable local government in Scotland to levy local discretionary taxation. Furthermore, in practical terms, there is no easily identifiable equivalent to provide a blueprint for this, requiring local government to work up their request from scratch.

Moving Forward

- 7.19 In order to enable local government to raise local discretionary taxes there requires to be a change in legislation. On this basis a number of factors were considered, not least setting out exactly what local government's definition of what a local discretionary tax is. The explicit outline of how a power of local discretionary taxation should work for local government is set out below:

Permission

- 7.20 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. In line with Local Taxation Principle 6, local authorities would hold the power individually of each other so that it would be an entirely local decision.

Additionality

- 7.21 Any local discretionary tax levied should be entirely additional to other forms of taxation. The power to levy local discretionary taxation should remain, regardless of whether local authorities chose to use the power. Conversely, there is no limit to the number of local taxes that could be levied either at the same time or over a period of time.

General power

- 7.22 So as not to be prescriptive, or place limitations on the discretionary nature of the taxation power, a list of possible local discretionary taxes has not been developed. The power proposed is a general power and this is key to the empowerment of local government, enabling taxation to be used by local decision makers to address local issues in line with Local Taxation Principle 6. 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.
- 7.23 Given that the aim of local discretionary taxation is to empower local government to address local issues, 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 of Local Taxation Principle 1, that local taxation should be fair and easy to understand.

7.24 There would be no limitations on what local authorities choose to do with the revenue raised from a local discretionary tax. Unlike revenue raised via a charge, tax revenue does not require to be spent in a prescribed way that is directly related to what is being taxed. 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.

Rates and reliefs

7.25 The rate of tax would be decided and set at local level. Accordingly, the local authority would also be able to set any related discounts and reliefs. For local discretionary taxation to be a tool of empowerment for local government, they must have complete ownership of the tax. Given this complete ownership, local authorities would choose the area over which a tax was levied, be that the whole area or a defined area, adding another level of local control and affording them the flexibility to target or protect certain groups within their local boundary as set out in Principles 4 and 6.

Efficiency

7.26 As per Local Taxation Principle 2, the discretionary tax should be administratively efficient and difficult to avoid. When imposing and collecting a tax, local government needs to be mindful about the sanctions in place for those who chose not to pay. A key part of the definition of a tax is that failure to pay is punishable by law. There must therefore be a legal framework which ensures that people pay, written into the corresponding legislation.

7.27 The administration and collection of local discretionary taxes would obviously have an associated cost. 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.

Proposed Definition

7.28 In summary, encompassing all of the above, the 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.”**

Legislative Process

- 7.29 This recommendation seeks a specific piece of legislation that enables local authorities to levy local discretionary taxation. This would not require a significant change to the current legislation as set out below.
- 7.30 As stated, 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).**
- 7.31 **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.** While this review recognises that the decision over the legal terminology will lie with the Parliamentary draftsmen, this definition of local discretionary taxation seeks to demonstrate the broad intention for discretion and flexibility.

Conclusions and Recommendations

- 7.32 Local discretionary taxation presents a significant opportunity to empower local government in line with the COSLA vision for local government. Taxes offer local authorities more discretion than the charges currently available, with particular regard to how they are levied and how revenue is expended, and are therefore a powerful financial lever. Local discretionary taxation is not overly concerned with the revenue raised in terms of tipping the balance of funding, but instead empowering local government to address local issues at a local level, decided by locally democratically accountable elected members without requiring permission from national government.
- 7.33 On the basis, it is recommended that:

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, occupants, 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**

European Charter of Local Self-Government (Strasbourg, 15.X.1985)

Article 9 – Financial resources of local authorities

- 1) Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.
- 2) Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.
- 3) Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.
- 4) The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.
- 5) The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.
- 6) Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.
- 7) As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.
- 8) For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

EU Comparisons

Sweden

Local government has the right to levy taxes. Most of the tasks of the local government are regulated in legislation. They largely finance themselves through means of local taxes and fees paid by citizens for various services. Taxes are income based and local government can set their own rates. There is some national government grant. Overall the local taxation rate is approximately 30%.

Finland

While local government has some ability to levy taxes, they cannot levy taxes that are not previously legislated for on a national basis. While they have control of the tax rate, which varies from complete freedom for income tax to very limited ranges for property tax, national government decides the level of relief available. National government retains overall control.

Iceland*

While local government have the autonomy to determine fees and can set income tax between a nationally defined tax band, the constitution makes it clear that sources of revenue are defined by national law. Furthermore, there is a national equalisation fund, in the form of non-ring-fenced funds, to ensure parity between areas.

Netherlands

All taxation in the Netherlands is based on national legislation. While local authorities can determine the rate of real estate tax, the level of variation is so low, there is little additional revenue powers available in real terms.

There is a Tourist Tax in the Netherlands. This is found in national legislation and is specifically legislated for by national government.

France

French local authorities are able to set the rates of four taxes (built property, non-built property, inhabited property and professional taxes), but only within the proportional variance dictated by national law.

France does have a Tourist Tax. It is applicable in certain towns recognised as a tourist resort. It has been enshrined in national legislation since 1919, and the proceeds must reinvested in promoting tourism in the local area.

Italy

The Italian Constitution was changed to establish fiscal federalism. In Italy's case, this provides revenue and expenditure autonomy at all levels of government including independent financial resource. In order for this to work in practice, it is necessary to specify in legislation the means by which fiscal autonomy is secured, which will ultimately result in the abolition of national government grant. Many aspects are still to be implemented or developed, however in March 2011 there was a transfer to local government a portion of national taxes to

compensate for the removal of a national grant.

Italy also has a Tourist Tax, which was reintroduced in 2011, under the fiscal federalisation legislation. The tax is collected and passed onto the city authority by the Hotelier. The proceeds of this tax must be reinvested in local tourism and the protection of cultural and environmental heritage.

Spain

Spanish local authorities levy a number of taxes, including discretionary taxes. This ability to impose discretionary taxes is done through national legislation. In line with this, Spanish local authorities could choose to levy a Tourist Tax. In Catalonia there is a separate Tourist Tax that has been previously set up by the devolved governments of Catalonia and Balearic Islands. The devolved governments in Spain do, unlike Scotland, have some taxation powers, but this is at devolved government level, not local government level.

European Law

The European Court has no role in taxation unless there is discrimination proved on the grounds of nationality. In most continental countries local government has the right to judicial remedy in order to secure free exercise of their powers and respect for local self-governance as this is either enshrined in their constitution or domestic legislation. Taxation at local government level would be covered by this.

*Please note that we are aware that Iceland is currently only in accession negotiations to join the European Union and not yet a full member state. However, given that Iceland has been a member of The European Free Trade Association since 1970, has a bilateral Free Trade Agreement with the European Economic Community since 1972, two thirds of Iceland's foreign trade is with EU Member States and as the information was available to us, we felt it appropriate to include them here.