

Finance Committee

The Scottish Rate of Income Tax

Submission from Ben Thomson

Response

For the first time, taxpayers living in Scotland will next year be identified as Scottish on their tax code for the purpose of paying the Scottish Rate of Income Tax (SRIT). As this is something of a defining moment it would be good to think of how we could lower this tax rather than increase it, particularly as increases in the SRIT are regressive and will hit lower rate tax payers harder than higher rate tax payers.

The way in which the SRIT works is that the change is implemented across all income tax payers across all bands and hits rich and poor alike. In fact it hits lower rate tax payers proportionally harder than top rate payers, as a 2p increase in SRIT is a 10 per cent increase to a lower rate tax payer but only a five per cent increase for a 40 per cent higher rate tax payer and four per cent for a top rate taxpayer; i.e. to raise the SRIT is a regressive progressive tax proposal.

The Treasury figures show that an increase of 1p in SRIT would raise about £330million. Therefore it would be logical to assume that a reduction in the SRIT would be a progressive tax proposal favouring lower tax payers and that if there was a 2p reduction for example this would reduce the tax burden on all Scottish Income Tax payers by £660mn and in particular benefit lower rate tax payers by reducing their income tax by 10%. Help lower income tax payers would be particularly appreciated by lower tax payers at this difficult economic time.

There are two additional advantages of lowering the SRIT. First, for who are on the line between being Scottish or English income tax payers with two properties across the border, a lower SRIT might help them to organise themselves to pay their income taxes in Scotland, which would result in higher than expected income tax receipts for Scottish revenue. Second, it would signal the Scottish Governments commitment to economic growth in Scotland through good fiscal management.

The question then is how could an income tax reduction be funded so that Scotland did not carry a greater deficit as a consequence of lowering SRIT? If Scotland had other tax powers it would have greater flexibility but as proposals for further powers are not yet clear any balance would either need to come from reducing costs or raising other taxes already devolved to Scottish Government. Given the Scottish Governments commitment to ending austerity, spending cuts are unlikely so raising revenue through other taxes would seem the most probable option.

The most obvious tax to raise is council tax and at the same time give responsibility for setting the tax fully back to local government. The advantage of council tax is that it is already devolved to Scottish Government and therefore it has the power to change. In addition Council Tax is a regressive tax as those in lower valued houses pay proportionately more on the value of their house than those in high value houses. Those in the top band (H) pay four times more council tax than homes in the

lowest band (A) but the houses in the top band are worth at least 10 times more, and some more than 50 times, than those in the lowest band. In addition the top band is set at homes over a nominal value of homes set in 1991 at £220,000 so makes no allowance for changes in the relative value of homes and very high value homes pay the same as any in the top band.

Council Tax is in long need of an overhaul. For the last seven years it has been capped and control effectively taken away from local government. The bands are not realistic with current pricing and rebasing property values back to 1991 makes no sense. Therefore in order to raise addition tax revenue why not give back control over council tax to local government, releasing them from the council tax cap and allowing them to re-base the tax bands. Local government could then adjust council tax after the seven year freeze and bring council tax bands in line with increased house prices. The banding could also be adjusted to reflect more properly the differential between high end properties and those in economically disadvantaged areas. It could also address some of the existing rebates such as the discount for second homes. As council tax revenue in Scotland is £2bn an increase in 33% would be needed to match the 2p reduction in income tax. However the burden of this could be directed at those in higher valued homes making this a progressive tax proposal.

A benefit of this approach is that it could provide the right timing to give council tax control back to local government, which is part of the trend to decentralise government. All political parties in Scotland have expressed the desire to give more responsibility to local government and giving them control over more of their finances to meet their expenditure would be a good start. Allowing more to be raised from council tax would allow the Scottish Government to reduce income tax, which should be a popular move and also one that demonstrates to Westminster that Scotland can take a different approach.

I hope the committee will seriously review how Scotland might use the tax powers it has, including the SRIT, to make them less regressive and might make more people and businesses receptive to more fiscal powers being transferred, such as those proposed by the Smith Commission. I would recommend a reduction of SRIT from 10p to 8p to be funded through passing council tax back to local government, removing the cap and rebasing the bands to reflect current property values.

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