

Finance Committee

The Scottish Rate of Income Tax

Submission from Lucy Hunter Blackburn

Summary

- The immediate priority should be making good the loss of tax revenue due to holding the council tax at the same cash level since 2007-08.
- The Scottish Government is providing £560m to councils in 2015-16 in lieu of lost council tax revenue (rising to £630m next year if the freeze continues). Something originally planned as short-term has grown into a large spending commitment in its own right.
- This is cash from the Scottish Block which is no longer available for spending on anything else, at a time when the Block as a whole is under considerable pressure.
- While the benefit of the freeze to individual council tax payers is clear, its cost is hidden. The Scottish Government's description of the freeze as being "fully funded" obscures that the policy carries a large cost in spending lost on other things. Citizens deserve a clearer account of the price paid for freezing council tax bills.
- The spending is likely to have been lost from a mixture of services outside local government and general funding to councils.
- The cost of the freeze in lost public spending is likely to be falling disproportionately on the poorest and most vulnerable, while the largest benefits fall disproportionately to the better off (the very poorest see no benefit, due to Council Tax Reduction). This is unfair.
- Using additional income raised through the SRIT explicitly for the purpose of funding the cumulative effect of the council tax freeze would:
 - **immediately release £560-630m for additional spending on public services.**
 - recognise that there has been a loss to the total tax base, clarify the link between the freeze and its real long-term cost and mean that cost is borne more fairly.

- create an identifiable element of taxation which could be *reduced* at a future point, when local taxation has been put back on a workable long-term footing.
- This would do nothing to restore local accountability, but would provide a better starting point for an eventual shift back to a form of local taxation able to bear a reasonable share of local spending, set by local decision.

SCOTTISH RATE OF INCOME TAX (SRIT):

2016-17 BUDGET DECISIONS

1. The Committee's decision to stimulate debate about the use of the SRIT ahead of this autumn's budget is very welcome.

The cost of the council tax freeze

2. The council tax freeze has kept local tax revenue at the same cash level since 2007-08 (other than any revenue growth due to net new build and revaluations), so that the council tax take has been held [at around £2 billion](#) for almost a decade.
3. Central government has compensated local authorities for the tax revenue foregone with a payment which has increased by £70 million each year. In 2015-16, this stands at £560m and will rise to £630m if the same rules are applied next year.
4. Over time, what was initially intended as a short-term solution, under which the Scottish Block would take the strain of local tax increases foregone, has become instead a significant spending commitment in its own right, now accounting for more than £1 of every £50 spent from the non-capital budget. The cost of funding the freeze now exceeds the amount the Scottish Government budgeted in 2015-16 to spend on, among others:
 - the Scottish Prison Service (around £400m);
 - further education colleges (£530m);
 - NHS Highland (around £540);
 - free personal care for the elderly (actual spend reported as almost £500m in 2013-14, likely now to be higher).
5. Since 2010-11, Fiscal Resource DEL assigned to the Scottish Government [has fallen by over £2.2bn in real terms](#). The subsidy for the council tax

freeze is therefore now adding a further 25% to downward pressure on spending over that period. Further cuts to the Scottish Block are expected.

6. The cost of the freeze is being paid for by spending less on other Scottish Government responsibilities. It is not possible to identify what investment has been lost from which areas. However, such a large pressure could not be easily borne only by smaller programmes and is likely to have had some impact on the larger areas of spending. The need to fund the freeze may, for example, partly explain why spending on health in Scotland appears to have risen less quickly than in some other parts of in the UK.
7. Central government spending on local government is also likely to have been affected. Although councils have received a separately identified stream of funding to compensate for the tax freeze, their *total* funding from central government has fallen by 10% in real terms since 2009-10, [according to Fiscal Affairs Scotland](#). Meantime, demographic change and various other factors have increased demands on local authority budgets faster than inflation. Recent press reports have drawn attention to further significant pressure expected on council funding.
8. There is plenty of evidence that, in the absence of any ability to increase local taxation, local authorities are applying a combination of cuts and increased charges in order to cope. As various organisations have documented (for example, [UNISON](#)) poorer and more vulnerable citizens are disproportionately affected by reductions in services and increases in charges, as they tend to rely more on local authority services.

Who benefits from the freeze – and who doesn't?

9. The table below shows the average saving from the freeze by property band, before application of any liability for income-related Council Tax Reduction (CTR). The council tax figures are a rough estimate, based on the difference £560m makes to the average Band D figure for Scotland ([£1,149](#)). There will be more sophisticated ways of doing this calculation, but it still gives a good general estimate. The table also shows the share of properties in each band and how this compares to their share of the total benefit from the freeze.
10. Unsurprisingly, the highest absolute savings have been experienced by the households in the highest valued properties. As a result, households in the highest-valued 39% of properties have seen just over half (52%) of the cash benefit of the freeze, before taking into account the impact of CTR. Once the relief available under CTR is included, these differences will be wider, as [36%](#) of properties in the lowest two bands are entitled to a reduced payment

under CTR. Bands A and B accounted for almost three-quarters ([73%](#)) of all CTR cases. Only 4% of households in the top four bands (E to H) received CTR. The total amount of council tax forgone under CTR was substantial, at £346m in 2014-15. Households in Bands A and B must therefore represent an even smaller share of the tax actually paid, and therefore saved as a result of the freeze, than the table below suggests.

Council tax band	Estimated annual benefit from subsidy for freeze 2015-16 £	Share of properties in band: all Scotland	Share of proceeds ignoring CTR ¹
A	200	21.0%	14.5%
B	233	23.5%	19.0%
C	267	16.1%	14.9%
D	300	13.2%	13.7%
E	367	13.3%	16.9%
F	433	7.5%	11.3%
G	500	4.9%	8.4%
H	600	0.5%	1.1%

(1) This is equal to the share of total council tax receipts due from each band, taking account of the band weightings and the number of properties in each band.

11. Nationwide, the highest absolute savings (around £660 a year) have been for those living in Band H properties in Aberdeen, which has [the highest rate of council tax](#), closely followed by Glasgow, Dundee and Midlothian (all saving just over £650). The least benefit (just over £180 a year) for those not on CTR has been for households in Band A properties in Eilean Siar, which has the lowest council tax, closely followed by the other island councils and Dumfries and Galloway (all under £190).

12. Those entitled to 100% CTR, mainly those on income-based JSA or ESA, Income Support or Pension Credit, have seen no gain. Partial entitlement to CTR, available at some low incomes, also reduces savings from the policy. According to [official statistics released on 16 June 2015](#), in March 2015:

- 1 in 5 chargeable dwellings in Scotland received a reduction in their Council Tax liability through Council Tax Reduction
- 55.6 per cent of recipients were in one of the 30 per cent most deprived areas in Scotland
- 38.2 per cent of recipients were aged 65 or over

- 16.5 per cent of recipients were single with at least one child dependant.

13. Taken together, all these figures strongly suggest that in absolute terms the benefit of the freeze to the least well-off households has been much more limited than for the better-off.

Funding the freeze through the SRIT

14. The council tax freeze has caused a hole to develop in the Scottish budget at a time of mounting pressure on public spending. A dedicated levy on the SRIT to fund the council tax freeze offers a way to fill that hole which no longer adds to the squeeze on public spending, while a longer-term solution to local taxation is found.

15. In particular, the SRIT offers a mechanism (income tax) which allows the cost of the freeze to be borne more fairly than at present.

16. A charge through income tax is likely to mean the highest cost is borne more than now by those who have made the largest savings from the freeze, even in the absence of an exact correlation between income and property value.

17. The table below shows the impact of the SRIT at an additional 1.5p (see paragraph 24 below) and how the cost is shared between low and high incomes.

Taxable income	Cost of additional SRIT @1.5p ¹		Monthly post-tax income after SRIT rise	% of post-tax income paid as additional SRIT
	Annual	Monthly		
£	£	£	£	%
15000	66.00	5.5	1171	0.5
25000	216.00	18.0	1825	1.0
35000	366.00	30.5	2480	1.2
45000	516.00	43.0	3090	1.4
55000	666.00	55.5	3578	1.5
65000	816.00	68.0	4065	1.6
95000	1266.00	105.5	5528	1.9
125000	1875.00	156.25	6624	2.3

(1) Single income tax payer household: figures will be lower for households with same income, but more than one income tax payer, due to the effect of additional personal allowances: each extra £1000 of personal allowance used in a household, over the first £10,600, reduces the annual cost by £15 (at incomes over £100,000 the personal allowance is reduced by £500 for every

£1000). Income tax figures based on [the Scottish Parliament SRIT calculator](#). Post-tax figure is after income tax only: no account taken of NI.

18. According to the most recent issue of [Poverty and Income Inequality in Scotland](#) the median net household income in Scotland in 2012-13 was £23,000. The majority of households in Scotland should therefore fall easily into the first three lines of the table above.

The role of the SRIT in moving to a new system of local taxation

19. Advocates of the freeze often argue that the council tax is flawed as a basis for raising local tax. However, although the council tax has been deemed too problematic to *increase*, it has not yet been deemed problematic enough to *cease using* as a basis for revenue-raising. Since 2007 there has therefore been no substantial progress in devising a replacement: none will be in place for 2016-17. The Commission on Local Tax Reform is due to report this autumn, but that makes any change unlikely before 2017 or 2018, at the earliest.
20. The transition from the existing tax base to any new one is likely to be hard, particularly if it involves returning the real-terms value of local taxation to something closer to, or even higher than, the position a decade ago. A temporary increase in the SRIT could provide a bridge between the present position and any new long-term settlement.
21. This element of the SRIT could then be wound down, as the local tax base is reformed and restored. The greater visibility of the SRIT than the present system of behind-the-scenes spending reductions, and the clearer link between any temporary increase and covering the cost of the council tax freeze, might help make the reform of local taxation more politically urgent.
22. If local taxation is instead held for the long-term round the existing level of the council tax, the SRIT could not be reduced. In that case, however, the link between the decisions on different taxes would at least be clear and the long-term effect would be fairer than now.
23. If the council tax freeze is lifted in 2016-17, these arguments would still stand. The percentage increase in the council tax already required to restore it to its real terms value in 2007-08 would be politically impossible to implement, certainly in one go. The funding gap built up since 2007-08 would remain.

Rate of the SRIT

24. Recent estimates have suggested the SRIT will raise £330m/1p, while a 2012 paper prepared for the Parliament appeared to imply a sum closer to £500m/1p, and one further recent report suggested £440m/1p. This suggests that an increase in the SRIT of something between 1p and 2p would be needed to make up for accumulated lost council tax revenue.

	Total spending	SRIT @ £330m/1p	SRIT @ £440m/1p	SRIT @ £500m/1p
Cost of freeze to	£m	Rate (pence)		
2015-16	560	1.7	1.3	1.1
2016-17 (est)	630	1.9	1.4	1.3

Potential areas of spending

25. The Committee's attention is drawn here to two areas of public spending.

Local services

26. Given the evidence of particular pressures on local budgets, affecting schools, social work services, early years provision, social care at home, day centres and libraries, among other things, a significant amount of the £560-630m should be recycled back into local government funding from central government, to off-set some of the impact of local service reductions and charges already visited on the most vulnerable.

Student grants

27. [My research](#) concentrates on student funding in higher education. In 2013-14, the Scottish Government reduced spending on student grants from £100m to £65m. If they wished to avoid a drop in support, low-income students were obliged to take out additional student loan to compensate. This followed several years in which the value of grants had been frozen: spending on grants is now just over half what it was in real terms at the time the council tax was first frozen. A recent announcement of an increase of £125 a year in grant will increase spending by around £7m, reversing only around 20% of the cut made in 2013-14.
28. Scotland now has the lowest rate of grant in Western Europe. It is unique in the UK in expecting poorer students to borrow more than their contemporaries from better-off homes. The maximum grant for a young student in 2015-16 will be £1,875 a year, falling to £1,125 immediately

household income reaches £19,000 a year. Mature students will be entitled to a lower grant of £875: Scotland is exceptional in the UK in putting mature students on a lower rate.

29. Although the Scottish Government has made available a “minimum income” for low income students which will be worth £7,625 in 2015-16, this is 75-90% loan based. [Government figures](#) suggest that around one-quarter of young low-income students are not prepared to borrow anything, for whatever reason, and attempt to manage on their grant alone, which is likely to mean facing considerable hardship while they study. Those who do borrow the amount required to achieve the minimum income will face a debt on graduation of between £23,000 and £27,000 after four years.

30. For around £100m, it would be possible:

- to increase spending on grants for young students in full-time higher education enough that the debt facing young students from lower-income backgrounds would no longer be higher than that expected for their better-off peers, reducing the long-term financial inequality which the current system in Scotland creates (+£35-40m); and
- to do the same for mature students, by bringing them back into the main grant scheme, costing a similar amount; and
- to use grant to provide some additional help with living costs for some students from incomes between £17,000 and £45,000 who live away from home (+£10-20m). Most of this group receives relatively low total support compared to other parts of the mainland UK, making a greater demand on these households' ability to pay towards immediate costs.

31. The links between particular aspects of student funding and access remain too little understood. However, grant increases *may* aid recruitment and retention among the quarter or so of poorer young students who are not willing to borrow. There is [some tentative evidence](#) that additional grant may increase participation rates.

32. An increase in spending on grants for poorer students on this sort of scale would give these a priority closer to that already enjoyed by universal free tuition, although spending on the latter would remain much higher. Every £1,000 of fee subsidy per student per year costs around £130m: the full cost of tuition in higher education, met through the Students Awards Agency for Scotland and the Scottish Funding Council, is somewhere over £7,500 per student on average, or £1bn in total.

33. If we can afford the existing investment in fees, we ought to be able to afford the increased, but still much smaller, investment in grants proposed here, either as one use for cash released from the subsidy of the council tax freeze or as a new cost on the SRIT. The proposal here for an increase in grant is illustrated below, expressed in cash terms and in terms of equivalence with a charge on the SRIT. Existing spending on grants and fees is provided for comparison.

		Total spending	SRIT @ £330m/1p	SRIT @ £440m/1p	SRIT @ £500m/1p
		£m	Equivalent rate (pence)		
Student grants in higher education	Existing	65	0.20	0.15	0.13
	Proposed increase	100	0.30	0.23	0.20
	New total	165	0.50	0.38	0.33
Tuition in higher education	£1,000 a year per student	130	0.39	0.30	0.26
	Total cost	1,000	3.03	2.27	2.00

Lucy Hunter Blackburn

Freelance researcher and policy analyst: between 1995 and 1999, I was Head of Local Government Finance Distribution in the then Scottish Office; and between 2000 and 2004, Head of Higher Education in the Scottish Executive.

June 2015