

## SNP Proposal for Scottish Local Income Tax

December 2007

### BACKGROUND

- As part of their agenda to create “a wealthier and fairer Scotland<sup>1</sup>”, the Scottish National Party (SNP) has set out proposals for replacing council tax (and council tax benefit) with a local income tax;
- The idea behind this is to introduce a regime which is based intrinsically on ability to pay.
- The local income tax (LIT) would apply at the starting, basic and higher rates, to all taxable income except savings income, and would be capped at 3%;
- The SNP would continue to levy a property tax on second and empty homes.
- They are also proposing a ‘freeze’ on council tax rates in the short term, to avoid interim increases.

### **Financial Implications:**

- Council tax in Scotland is forecasted to raise £2,131 million in 2006-07, of which around £45 million comes from second and/or empty homes. Council tax benefit is forecasted to cost £381 million;
- The Institute of Fiscal Studies (IFS) has estimated that, if the LIT were in place in 2006-07 and was set at its maximum level by all local authorities, it would raise around £1,250 million<sup>2</sup>;
- The reform would therefore constitute (at best) a £450 million tax cut and leave a corresponding revenue shortfall<sup>3</sup>;
- The SNP argue that this £450 million reduction in local authority spending could be absorbed with no loss of quality in public services, if councils make efficiency savings of 1½% p.a. for 3 years. However, precedent suggests this could be difficult, particularly since this would be in addition to any efficiency savings already implied for the UK<sup>4</sup>.

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<sup>1</sup> “Abolition of council tax – public domain statements by the Scottish Executive”, FMQs 7 June 2007

<sup>2</sup> This assumes that individuals’ behaviour did not change in response to the reform.

<sup>3</sup> This estimate assumes that the savings from not having to pay council tax benefit (which would accrue) centrally, would be returned to the Scottish local authorities – if this was not the case, the tax cut would be £830 million.

<sup>4</sup> “Analysis of the SNP proposal for a capped local income tax”, Institute for Fiscal Studies, March 07

**Net Income Implications:**

- The table below quantifies the estimated average effects upon net income, by income decile group (individuals are categorised into ten groups on the basis of income levels – 1 is the Poorest, 10 is the Richest).

**Effect across the Scottish income distribution of replacing council tax with a 3% local income tax, 2006–07**

Income decile group	Average change in net weekly income	% change in net income
Poorest	£0.83	1.23%
2 <sup>nd</sup>	£4.18	2.48%
3 <sup>rd</sup>	£6.72	3.05%
4 <sup>th</sup>	£6.84	2.82%
5 <sup>th</sup>	£6.38	2.26%
6 <sup>th</sup>	£6.83	2.07%
7 <sup>th</sup>	£5.57	1.42%
8 <sup>th</sup>	£4.97	1.04%
9 <sup>th</sup>	£2.19	0.37%
Richest	-£8.71	-0.95%
Overall, modelled	£3.58	0.97%
Overall, best estimate	£3.20	n/a

Note: Policy as described in the text: council tax abolished for main homes only, savings income excluded from LIT. The “best estimate” overall change (£3.20) is below the “modelled” overall change (£3.58) because the data on which our model is based under-record top incomes and our model therefore understates the losses from a local income tax. The average change shown for each decile group is therefore overestimated by an average of 38p, but this is concentrated in the higher income groups whose incomes are under-recorded. Income decile groups are derived by dividing all families in Scotland into 10 equal-sized groups according to income adjusted for family size using the McClements equivalence scale.

Source: Authors’ calculations using the IFS tax and benefit model, TAXBEN, run on updated data from the 2004–05 Family Resources Survey.

Source: *Institute for Fiscal Studies, March 2007*

- One of the potential shortcomings of a local income tax is that families (with multiple-earners) could be comparatively worse off. The next table quantifies net income effects, by ‘family type’:

**Effect for different family types of replacing council tax with a 3% local income tax in Scotland, 2006–07**

Family type	Average change in net weekly income	% change in net income
Single, not working	£1.07	0.98%
Single, working	£0.07	0.03%
Lone parent, not working	£0.50	0.21%
Lone parent, working	£7.63	2.16%
Non-working couple without children	£7.54	2.27%
Non-working couple with children	£8.34	2.55%
One-earner couple without children	£7.31	1.60%
One-earner couple with children	£6.04	1.11%
Two-earner couple without children	£1.63	0.25%
Two-earner couple with children	£2.79	0.40%
Single pensioner	£5.87	2.64%
Pensioner couple	£10.37	2.61%
Overall, modelled	£3.58	0.97%
<i>Overall, best estimate</i>	<i>£3.20</i>	<i>n/a</i>

Note: Policy as described in the text: council tax abolished for main homes only, savings income excluded from LIT. The “best estimate” overall change (£3.20) is below the “modelled” overall change (£3.58) because the data on which our model is based under-record top incomes and our model therefore understates the losses from a local income tax. The average change shown for each family type is therefore an overestimate, particularly for higher income groups.

Source: Authors’ calculations using the IFS tax and benefit model, TAXBEN, run on uprated data from the 2004–05 Family Resources Survey.

Source: *Institute for Fiscal Studies, March 2007*

### Some Criticisms of Proposed LIT

- **The exclusion of savings income**

The proposed LIT has been criticised on the basis that savings income is excluded, and the implications of this for “fairness”. For example, a wealthy, retired investor who earns dividend income would not be required to contribute under this system. However, savings income is excluded due to the enormous administrative costs which would be associated with charging investment income<sup>5</sup>.

- **Would reduce the importance of local government**

It is argued that local authorities’ reduced ability to raise revenue would constitute a significant reduction in the importance of local government within Scotland. Levels of local spending would be almost entirely determined by the level of grant received from the Scottish Executive, since local authorities would lose the ability to increase local taxes to fund expenditure. There are concerns that this could result in the accountability and efficiency of local government being undermined<sup>6</sup>.

- **Burden on Employers**

The proposed LIT could represent a considerable additional administrative burden on local employers.

<sup>5</sup> “Abolition of council tax – public domain statements by the Scottish Executive”, FMQs 31 May 2007

<sup>6</sup> “Local Income Tax Would be Holyrood’s Biggest Mistake”, Policy Institute Website, 20/09/07

- **Effect on families**

As mentioned above, it is argued that families consisting of multiple incomes would be comparatively worse-off under a LIT.

- **High Earners may leave Scotland**

It is argued that the introduction of a LIT would result in the economy suffering the flight of high earners. High earners are typically highly mobile; they often have more control over their terms and locations of work. They are also adept at arranging their tax affairs to maximum advantage.

- **Large companies may relocate**

Large UK companies with a presence on both sides of the border may recruit senior staff to offices outside Scotland if this tax is imposed. This argument implies that the tax could damage the economy doubly – by driving wealth creators away and diverting business to other parts of the UK.

- **Implications for Housing Market**

The current system of council tax provides some incentive to live in relatively smaller (low-value) properties. This alleviates some degree of pressure on the local housing market. This effect would be removed by the proposed LIT<sup>7</sup>.

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<sup>7</sup> “Why a local income tax would prove disastrous for Scotland”, Policy Institute Website, 25/09/2007