Delivering his Draft Budget in December, Derek MacKay argued that Scotland was the 'fairest taxed part of the UK'. As the dust settles on the 2019/20 Scottish Budget, it's a good time to reflect on the Scottish Government's approach to taxation, and to examine that claim.

Devolved tax policy in Scotland and the claim to fairness

Looking across each of the taxes controlled by Holyrood, the common thread underpinning policy decisions is the Scottish Government's desire to make two claims.

First, that Scottish tax policy is more progressive than the equivalent policy in other parts of the UK. Second, that those with the lowest incomes, or living in the lowest value properties, pay relatively less tax in Scotland than they would do in rUK.

- On income tax – 55% of the lowest income Scottish income taxpayers will pay less than they would do elsewhere in the UK in 2019/20 (although the maximum saving equates to just £20), whilst the average tax rate for the top half of Scottish income taxpayersis as much as three percentage points higher than for people with the same income in rUK;
- On LBTT – the rates schedule is also more progressive with respect to property value than the equivalent Stamp Duty in England, with properties transacting for less than £333,000 (which account for the majority of Scottish properties) paying somewhat less tax in Scotland than they would in England and those above paying more; and,
- The Council Tax system is more progressive than in England in the sense that the ratio of tax paid by properties in bands E-H compared to bands A – D is higher in Scotland, whilst the typical band D tax in Scotland is less than it is in England so the majority of Scottish households face a lower council tax bill.

The objective to secure a more progressive tax schedule also extends to non-domestic rates, where progressivity relates to the tax liability as a function of rateable value. In Scotland, businesses occupying premises with a rateable value of less than £15,000 qualify for 100% NDR relief, against a threshold of £12,000 in England. Scotland also has a 'large business supplement' which charges a 2.6 pence supplement on the poundage of businesses occupying premises with a rateable value in excess of £51,000. This structure, together with a lower than inflationary increase in the business rates poundage in 2019/20, enabled the Scottish Government to say that 90% of Scottish business pay a lower rate of NDR than a business occupying premises of equivalent value in England.

A consistency of approach?

But the pursuit of this objective for individual taxes can create contradictions when looking at the tax system as a whole.

What about the consistency across taxes in the government's approach to revenue raising?

The Scottish Government's income tax policy is projected to raise £500m more in revenues than would be the case if the UK Government's tax policy was followed. This policy helps to achieve the government's objectives of raising additional revenue and supporting public investment as part of the 'social contract'. But against this, the Budget also boasts of the fact that Scotland has the most generous package of non-domestic rates relief in the UK. This takes out from the budget around £750m in 2019/20.

Similarly, the freeze of the income tax higher rate threshold is forecast to raise £68m in 2019/20, but this is partly offset by the below inflationary increase in the NDR poundage, forecast to cost £35m in lost revenues. There was a similar story in 2018/19, when additional revenues of just over £200m from income tax were offset by an over £90m cut in NDR income from more generous reliefs.

The juxtaposition of revenue raising measures in income tax with tax cuts in NDR is arguably hard to square. Now the Scottish Government may argue that it needs to balance revenue raising objectives with the objective to creating a 'competitive business environment'. But whilst reductions in NDR are generally justified by reference to the need for a 'competitive regime', the evidence suggests that the beneficiaries of NDR reductions tend to be landlords rather than the occupying businesses. Moreover, whilst reliefs for charities and places of worship are no doubt justifiable, the government is yet to produce an evidenced justification of the Small Business Scheme, which accounts for the lion's share of reliefs.

What about the consistency in terms of the claims to protect those on the lowest incomes? Here again there are issues.

For example, the below inflationary (2.1%) increase in NDR, and the real-terms freezing of the starter and basic rate thresholds on income tax, contrasts with the 4.8% cap for council tax increases in 2019/20. It is true that the nine years of council tax freeze has mean that council tax bills are lower in real terms than in 2007. But if the freeze was previously justified by the need to 'protect family budgets' (as per the SNP's 2011 Manifesto), and if income tax thresholds in 2019/20 have been set 'to protect our lowest and middle earning taxpayers', the case for above inflationary increases in council tax is less clear. Council tax increases are generally regressive, even when the provision of Council Tax Reduction for less well-off households is considered*.

Conclusions

Looking at each tax in isolation, there is a case for saying that Scotland is more fairly taxed than rUK, if 'fair' is assumed to mean a tax system that is more progressive.

But this does not necessarily mean that the tax system as a whole is fair or could not be fairer. The council tax system is manifestly unfair, being poorly related to both income and property value. Pledges to develop a fairer system were once again kicked into the long grass. One of the government's arguments for not undertaking more fundamental reform following the recommendations of the Commission on Local Tax Reform in 2015 was that reform would result in dramatic changes in the amount of tax that some households pay – which is of course the point!

The claim to fairness also becomes more difficult to make when looking at policies in combination. Efforts to protect lower paid earners by increasing lower and basic rate income tax bands are juxtaposed against higher than inflationary caps on council tax increases. Efforts to raise additional revenue to invest in public services by increasing income tax rates on higher earners are offset by below inflationary increases in business rates and an expansion of business rates relief in order to enhance competitiveness.

Some of these apparent inconsistencies result from the government's objective to frame fairness in a narrow sense of being more progressive than rUK. In fact a cynic might say that Scottish tax policy is motivated entirely by this objective. But there is a clear risk in benchmarking oneself to a tax system that is in itself flawed, rather than considering a bigger picture.

The question of what constitutes a fair tax system will no doubt continue.

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* Of course it is well known that council tax liability is not well related to income, so that increases tend to be regressive. But the tax is not well related to property value either. And whilst it is true that most Scottish households pay less council tax than those in other parts of the UK, it is also true that, as a percentage of property value, most Scottish households actually pay relatively more tax. This provides an interesting perspective on fairness for those who think that council tax should be more closely related to property value.