Scottish tax policy in the 2016 – 2021 session of parliament

David Eiser, Fraser of Allander Institute

Abstract. This paper reviews the tax policy changes that have been implemented in Scotland between the 2017/18 and 2021/22 budgets. It considers the motivation for policy changes, as well as their impacts on taxpayers and government revenues. The key thread linking the Scottish Government's main tax policy decisions this parliament is the aspiration to be able to claim that the majority of Scottish taxpayers are liable for less tax than they would be under the policy that prevails in the rest of the UK; but at the same time, to set tax policy structures that are more progressive than prevail in rUK. This theme is common to all major devolved taxes, including income tax, council tax, property transactions taxes, and business rates. The Scottish Government argues that the resulting tax system is 'fairer' and 'more competitive' than the rUK system.

Introduction: an unprecedented period of tax policy change

Tax has been at the forefront of policy debate throughout this parliament. Most noticeably have been the Scottish Parliament's new powers on income tax. These became operational in 2017, and paved the way for significant policy divergence to open up between Scotland and the rest of the UK (rUK).

But there have been significant policy changes in other areas too. Council tax has been subject to its first substantive reform since the parliament was established in 1999, and there has been a resounding break with the council tax freeze policy that applied during the nine years prior to this parliament, before the freeze was re-applied in 2021/22. A major review of Non-Domestic Rates has ushered in several changes to business rates. And the Scottish Government has continued to carve a distinctive policy on aspects of property transactions taxes. Box 1 outlines the devolved tax responsibilities.

On some of these taxes, policy change has gone well beyond what was envisaged in the 2016 Manifesto; but in other areas, commitments in the manifesto have remained unmet – for a mixture of reasons. And in some areas, policy reform has fallen short of what some might have hoped for.

This paper looks back at the tax policy choices that have been made in the five budgets of this parliament (2017/18 – 2021/22). It examines:

- What tax policy choices have been taken, and to what extent have they been justified by a coherent rationale, both individually and collectively?
- What are the likely impacts and implications of those policies, both for taxpayers and government revenues?
- To what extent have the 2016 Manifesto tax policy commitments been implemented?

The paper shows that the key thread linking tax policy decisions this parliament is the Scottish Government's aspiration to be able to make two points about its tax policy:

- First, that a large proportion – if not the majority – of Scottish taxpayers pay less tax than they would under the rUK policy.
- Second, that Scottish tax policy is more progressive than the policy that prevails in rUK. This often means that taxpayers towards the top of the distribution (by income or property value) face higher tax liabilities than under the rUK system – sometimes substantially so.

This approach is common not only to income tax, but also council tax, Land and Buildings Transactions Tax, and Non-Domestic Rates. In relation to personal taxes like income tax and council tax, these tax policy structures are framed by the Scottish Government as being 'fairer' than those in rUK; in relation to business rates, Scottish tax policy is argued to be more 'competitive'.

There have been a large number of tax changes in this parliament, particularly for LBTT and NDR. The boldest reforms have been made on income tax, where the distinct Scottish policy is set to raise around £500 million in 2021/22 from taxpayers in the top-half of the distribution of taxpayer income, relative to the policy that prevails in rUK. But whilst reforms to council tax bands in 2017/18 did go some way to addressing the issues raised by the Commission on Local Tax Reform, they fell short of what was required – and progress on local tax reform more generally has been slow.

There has been an at times fractious debate during this parliament about whether or not Scotland is the highest taxed part of the UK. Comparing the main personal taxes in combination – income tax and council tax – reveals that personal taxation in Scotland relative to rUK is best characterised as transferring tax liability from council taxpayers to (the highest income half of) income taxpayers. In combination, the Scottish policy differential across the two taxes represents a progressive transfer of tax liability, but is not revenue raising.

The remainder of this paper considers tax policy changes under each of the devolved tax responsibilities in turn.

Box 1: Which tax responsibilities have been, or are in the process of being, transferred to the Scottish Parliament?

Which taxes are we referring to in this paper? Table 1 summarises the tax responsibilities that have been transferred to, or are planned to be transferred to, the devolved institutions in Scotland, together with the latest estimates of revenues associated with each of those responsibilities.

Table 1: Tax responsibilities transferred, or planned to be transferred, to Scotland

Tax	Date of Scot Parl responsibility	Forecast revenue 2021/22 (£m)	Degree of devolved control
Council tax	1999	£2,122	Fully devolved; complete autonomy
Non-Domestic rates	1999	£2,139	Fully devolved; complete autonomy
Land and business transactions tax	2015	£586	Fully devolved; complete autonomy.
Landfill tax	2015	£88	Fully devolved; complete autonomy.
Income tax (on NSND income)	2017	£12,263	SG sets rates and bands; reliefs/ allowances set by UKG
Air Passenger Duty	tbc	£129	Fully devolved; complete autonomy
VAT: partial assignment	tbc	£5,727	Assigned revenues; no autonomy
Aggregates Levy	tbc	£62	Fully devolved; complete autonomy

Council tax and non-domestic rates (businesses rates) have been under the control of the Scottish Parliament since its inception in 1999. The revenues from both support local authority expenditure, but individual local authorities have very little autonomy to set tax policy, which is largely the responsibility of the Scottish Government.

Two taxes, Land and Buildings Transactions Tax (LBTT) and Landfill tax, were devolved to Scotland following the recommendations of the Calman Commission, and became operational in 2015. LBTT is a tax on property transactions, and landfill tax is a tax on waste disposed by landfill. Both taxes are fully devolved the Scottish Government has no restrictions on the way that tax policy is designed or revenues are collected.

In revenue terms, the major devolved tax is income tax. Income tax is not fully devolved. The Scottish Government can vary tax rates and thresholds, but the UK Government determines allowances and reliefs (including for example the Personal Allowance and reliefs on pensions contributions). HMRC is responsible for revenue collection in Scotland, as in the rest of the UK.

Two taxes recommended for devolution by the Smith Commission – Air Passenger Duty and Aggregates Levy – are yet to become operational. In both cases this has been due to issues relating to state aid.

The other tax responsibility that has not yet been operationalised is the Smith Commission recommendation that around half of VAT revenues raised in Scotland should be assigned to the Scottish Government. The transfer of this responsibility has been delayed due to technical challenges in its implementation. Nonetheless, even when operational, this responsibility does not grant the Scottish Government any policy autonomy – it merely aims to enhance the fiscal responsibility of the Scottish Government, by linking the size of the Scottish budget to the performance of Scottish VAT revenues overtime.

Income tax

The Scottish Parliament's new powers over income tax, as proposed by the Smith Commission and legislated for in the Scotland Act (2016) became operational in 2017/18, the first budget of this parliament.

2017/18: dipping the toe into tax reform

In its 2016 Manifesto, the SNP had committed to use the new income tax powers, in the first year of parliament, to 'freeze the higher rate threshold in 2017/18', and to increase the threshold by no more than inflation over the course of the parliament. This represented a divergence from wider UK policy which had proposed a real terms increase in the higher rate threshold to £50,000 over the course of the parliament.

Whilst the 2017/18 draft budget initially proposed a 1% increase in the threshold, the threshold was ultimately frozen in cash terms following budget negotiations with the Green Party. 2017/18 thus saw the first divergence in Scottish and UK income tax policy, with a higher rate threshold of £43,000 in Scotland compared to £45,000 in the rest of the UK. The decision to freeze the higher rate threshold was anticipated to raise £108, relative to the UK policy[1].

[1] Source: p.86 of Scottish Government Medium Term Financial Strategy 2021

2018/19: a bold new five-band system

Having dipped its toe into income tax policy change in 2017/18, 2018/19 saw the more substantial move to a new five-band tax system in Scotland. A 19% starter rate was introduced on the first £2000 of taxable income, an intermediate rate of 21% was introduced on income above £24,000, and the higher and additional rates were each increased by one percentage point. Perhaps most significantly from the perspective of individual liabilities, the higher rate threshold was increased by one per cent to £43,430, whilst in rUK it increased three per cent to £46,350.

This was a bold move by Finance Minister at the time, Derek Mackay. It meant that Scottish income taxpayers in the upper half of the income distribution faced higher liabilities than equivalent taxpayers in rUK. This difference was modest at incomes below £43,000. But taxpayers with incomes of £46,350 faced an annual tax liability almost £800 higher than they would in rUK, a difference in average tax rate of 1.7%[2].

The 19% starter rate, whilst somewhat gimmicky, ensured that Scottish taxpayers earning less than Scottish median income faced slightly lower liabilities than they would down south. Whilst the difference in liability for these taxpayers was extremely marginal (a maximum of £20 per annum), it formed an important part of the government's narrative – only those taxpayers in the top-half of the income distribution were being asked to contribute to the revenue raising effort, and only higher rate taxpayers were being asked to contribute substantively more than in rUK.

The government has estimated that the policy would raise 'around £300m' in additional revenue compared to the outlook if UK rates had been applied[3]. This estimate includes the SFC's forecasts of likely behavioural responses by Scottish taxpayers to the different rates, around which there is substantial uncertainty.

The government's justification for the policy, as set out in the 2018/19 budget, was that it raised additional revenues to 'support public services and maintain the social contract' in Scotland, doing so in a 'fair and progressive' way – with only the top half of Scottish income taxpayers facing higher liabilities, and only higher and additional rate taxpayers, (thought at the time to represent 14% of taxpayers but subsequently revealed to be 13% of taxpayers) facing liabilities substantively higher than they would face under UK policy. Criticism of the policy tended to focus on the risks that the policy might damage competitiveness or economic performance – although there is as yet insufficient outturn data to empirically test these concerns.

2019/20: a widening of the divergence in income tax liability

The broad structure of the Scottish five-band system has remained unchanged in subsequent years, although the difference in tax liability for higher rate taxpayers grew further in 2019/20, when the UK higher rate threshold was increased to £50,000 but was again frozen in Scotland.

2020/21 and 2021/22: a settled structure

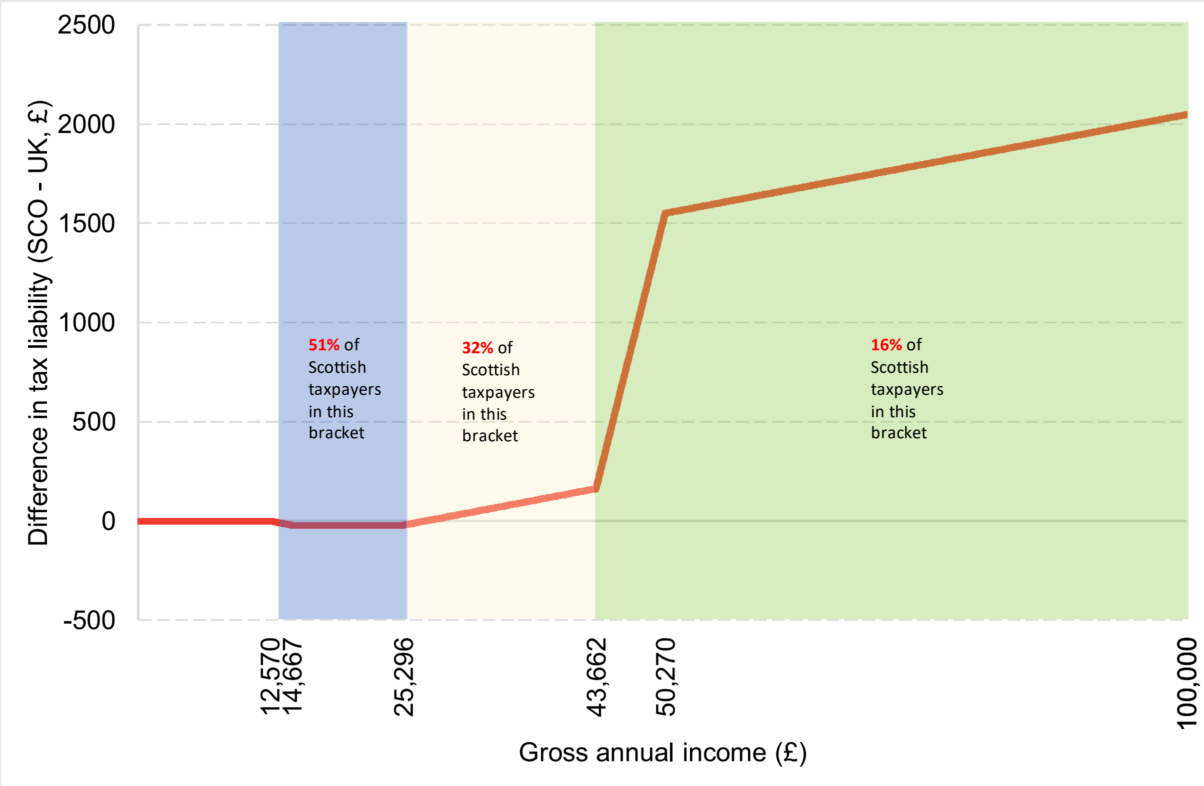
In the final two budgets of parliament, there were only small changes to the structure of Scottish and rUK income tax. The difference in tax liability for Scottish taxpayers compared to equivalent taxpayers in rUK is shown in Chart 1. The Scottish Government is able to say that the lowest income half of Scottish income taxpayers pay less than they would do elsewhere in the UK. But taxpayers with above median income face higher liabilities. As a percentage of income, this difference peaks at

[2] The average tax rate is tax liabilities expressed as a percentage of pre-tax income.
[3] See page 87 of the 2021 Medium Term Financial Strategy.

£50,270, where liabilities are £1,550 in Scotland than under the rUK system – a difference in average tax rate of 3.1%.

The policy differential was estimated by the Scottish Government to raise around £460 million for the Scottish budget in 2020/21, compared to the position if UK rates and bands were implemented[4]. In 2021/22, the policy differential is expected to raise around £500m relative to following rUK rates and bands.

Chart 1: Difference in annual income tax liability, Scotland v. rUK 2021/22



Source: Analysis of Scottish Government data

[4] Latest revenue forecasts imply that income tax will contribute somewhat less than this to the Scottish budget in 2020/21. This is because the impact of income tax on the Scottish budget depends on two things: differences in tax policy, and differences in growth of the underlying tax base (i.e. incomes) in Scotland compared to rUK. Under the latest forecasts, Scottish incomes are forecast to growth slightly more slowly than in rUK. But when it comes to understanding the revenue impacts of Scottish tax policy on its own then what matter is the comparison of the revenues raised in Scotland under current Scottish tax policy, compared with revenues that would be raised in Scotland if UK policy applied - i.e. ignoring any differential growth in the underlying tax base. In this sense, it is correct to say that the Scottish budget will be around £460m higher in 2020/21 than would have been the case if the Scottish Government had applied the same tax policy as prevails in the UK – even though this number does not appear anywhere in the budget document itself.

Council tax

The SNP's 2016 Manifesto made two major commitments in respect of council tax:

- First, that after nine years, the council tax freeze would end in 2017/18;
- Second, that the ratios between council tax bands would be revised so that higher-banded properties paid more tax relative to band D than they had previously.

In the 2017/18 budget, councils were permitted to increase council tax rates by up to 3%. Whilst this wouldn't normally be considered news, it marked a significant policy change, coming on the back of a nine-year freeze in rates. As a result of the freeze, the average band D tax rate in Scotland in 2016/17 was £1,149, some £265 *below* where it would have been had rates kept pace with inflation since 2007/8.

Whilst a council tax freeze protects household incomes, for a government running a balanced budget, this protection for households necessarily comes at the expense of the government's overall resource budget[5].

Partly to ward off claims that a council tax increase would be regressive (i.e. hit low income households proportionately harder than high income households), the ending of the freeze in 2017/18 coincided with a restructuring of council tax bands. This increased the tax liabilities of houses in bands E, F, G and H relative to those in bands A-D (see Table 2).

Table 2: Council tax bands in Scotland: the effect of the 2017/18 change in ratios between bands on council tax liabilities in 2021/22

	Pre 17/18 system	New system	Difference %	Difference £
band E	£1,596	£1,713	7%	£118
band F	£1,884	£2,132	13%	£249
band G	£2,184	£2,564	17%	£379
band H	£2,616	£3,205	23%	£589

Notes: table estimates the average council tax liabilities by band for properties in Scotland in 2021/22, assuming an average band D tax of £1,308. The table compares the liabilities that would be due under the old ratio system, with the actual liabilities under the 'new' banding system

This band ratio reform was forecast by the government to raise about £110m annually, compared to the previous policy. In principle it represented the government's response to the report of the Commission on Local Tax Reform, which had reported at the end of 2015. In reality however, the banding reform didn't really engage with the substantive points of the Commission. The government made no attempt to address the report's argument for revaluation, and no attempt to get to grips with the main failing of council tax – that it is neither well related to property value, nor progressive with respect to income.

Nonetheless, the band ratio reform enabled the government to argue that the tax system was fairer than the council tax system in other parts of the UK, in the sense that the tax is marginally more progressive with respect to tax band in Scotland than elsewhere.

[5] The Scottish Government has allocated additional resources to local authorities to compensate them for the effects of the freeze; but ultimately the loss of tax revenues has to have an 'opportunity cost' in terms of reduced resources for the devolved public sector more widely.

Since that first budget, council tax rates have generally increased faster than inflation. Councils were allowed to increase rates by up to 3%, 4.79% and 4.84% in 2018/19, 2019/20 and 2020/21 respectively, before the freeze was reimposed in 2021/22. As a result, the average council tax bill is on course to be around 4% higher in real terms by the end of this parliament than it was at the start (equivalent to an additional £28 a year for a typical band D compared to an inflationary uplift).

Whilst this session of parliament has clearly been revenue raising in respect of personal taxation in Scotland – as a result of above inflationary increases in council tax, the council tax band ratio reform, and changes introduced to income tax – a comparison of the burden of personal taxation in Scotland compared to England tells a slightly different picture, as described in Box 2.

Box 2: Comparing rates of personal taxation in Scotland and rUK – implications for revenues and household incomes

Throughout this parliament, a debate about the extent to which Scots pay more or less in tax than they would had they lived in rUK has circulated – and what the impacts of this are for the public finances.

As discussed above, the income tax policy is forecast to raise around £500 million for the Scottish public finances, relative to the situation where UK policy were implemented. This additional revenue is largely raised from the 400,000 Scottish taxpayers who have income above the £43,662 higher rate threshold; Scottish income taxpayers with income below £27,000 pay less in income tax than they would if they lived elsewhere in the UK.

However, if the discussion incorporates council tax, then the argument is more complex.

Council tax rates in Scotland have diverged from those in England and Wales over the past 15 years or so (Chart 2). Most of that divergence happened between 2008 and 2016, during which Scotland implemented a council tax freeze for longer than in other parts of the UK. In this parliament, council tax rates in Scotland have increased in real terms, and largely kept pace with elsewhere in the UK, but the effects of the previous freeze remain 'baked in' to differences in rates. As a result, band D council tax is now on course to be £600 higher in England and £400 higher in Wales than in Scotland next year[6].

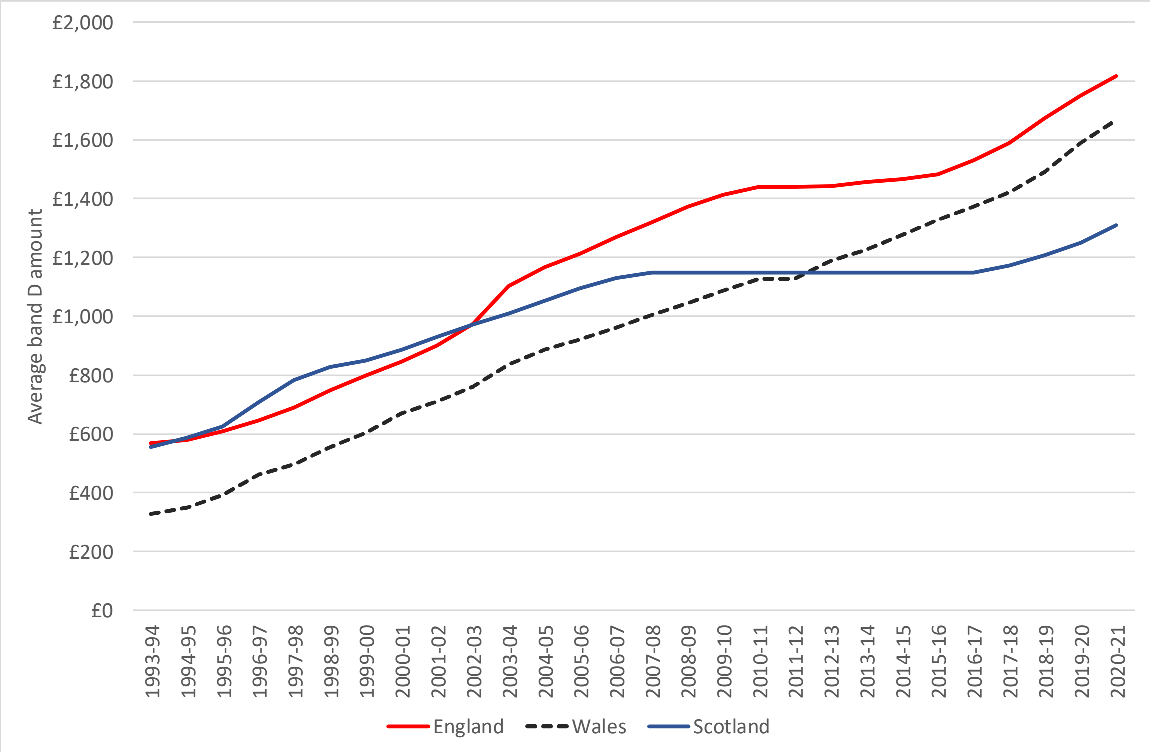
Those 2021/22 tax rate differentials represent a significant annual saving for Scottish households. But there are of course implications for devolved public finances.

Council tax revenue in Scotland will be over £500 million less in 2021/22 than if Welsh rates applied (the revenue gap compared to English rates is even greater). This calculation includes the effect of the change to the ratios between bands that the Scottish Government introduced in 2017/18.

In purely revenue terms therefore, the Scottish income tax policy offsets, but not quite in full, the lower band D council tax rates in Scotland.

[6] Note that Wales also introduced two reforms to council tax since 1999. First, a rebanding exercise was undertaken in 2003. Thus homes in Wales are placed into council tax bands based on a valuation exercise that is only 18 years old, as opposed to the 30-year old (1991) valuation that is used in Scotland and England. Second, a new, ninth band of council tax (band I) was introduced at the top of the other brackets, with a ratio of 233% compared to band D.

Chart 2: Average band D council tax, Scotland, Wales and England



Source: IFS Fiscal Facts, FAI analysis

In this perspective, it is too simplistic to say that the burden of personal taxation is higher in Scotland than rUK. Scottish tax policy relative to England/Wales is better described as transferring tax liability from council taxpayers to (the highest income half of) income taxpayers.

The effect of this policy differentiation on household incomes will clearly depend on the specific circumstances of households and the individuals within them. But in general, the tax policy differential between Scotland and rUK transfers tax liability from households in the bottom four fifths of the distribution to those in the top fifth.

Chart 3 divides the Scottish population into 10 deciles of net household income, and compares the average impact on household income of the Scottish relative to rUK policy on personal taxation. Lower council tax rates in Scotland raise net incomes in Scotland in all parts of the distribution[7] – although the impact is less towards the top of the distribution, given the rebanding reforms introduced in Scotland in 2017/18[8].

Differential income tax policy reduces net incomes at the top of the distribution in Scotland, relative to the case where rUK policy was implemented.

The overall impacts of this policy – a largely revenue neutral transfer of tax liabilities from council tax to higher income income taxpayers – could be justified if one cares a lot about progressivity

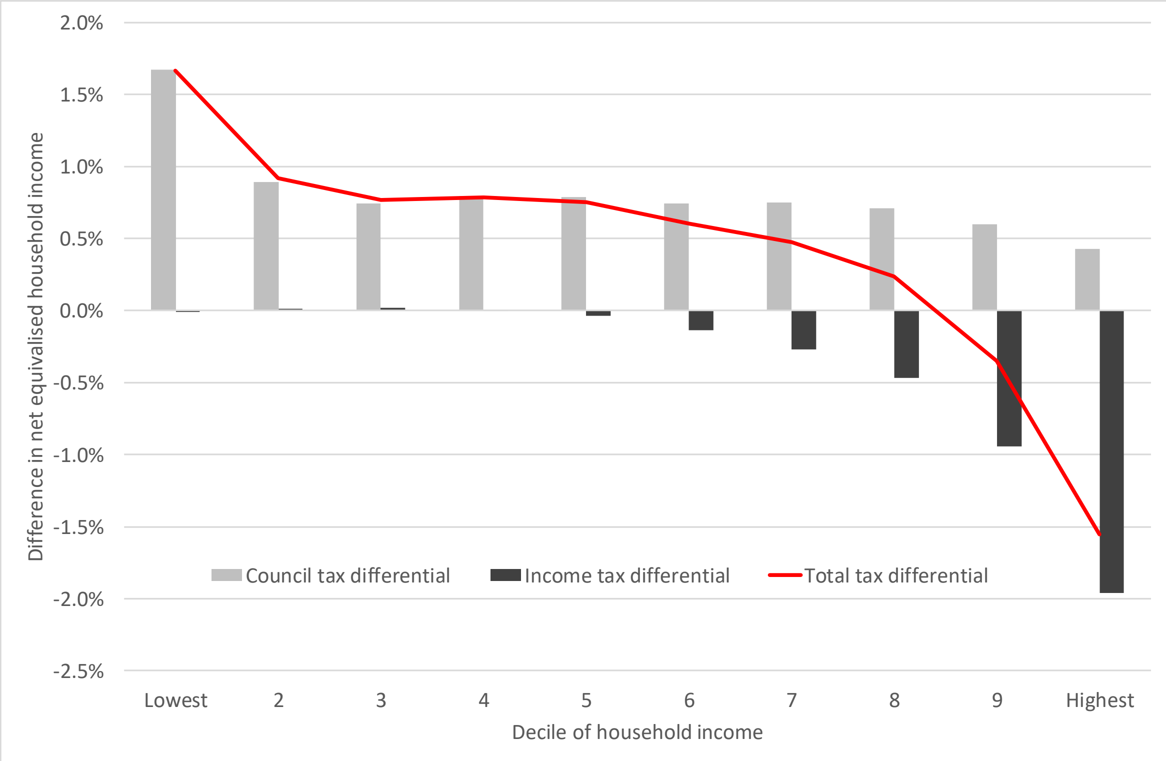
[7] There is a small caveat here. Council tax band thresholds are slightly lower in Scotland than England. So a property of similar value in Scotland and England could be valued in band C in England but band D in Scotland. Strictly speaking, the tax differential between England and Scotland cannot be inferred from looking at the band D rate alone. In practice however this point is likely to have a relatively small impact on the conclusions – and is essentially impossible to account for in modelling (we would need to know the 1991 values of households in Scotland to adjust for it!)

[8] Strictly speaking, Chart 3 compares Scottish council tax policy to Welsh council tax policy; if comparing to England, the shape of the distributional impacts would be similar, but the council tax differential (grey bars) would show a relatively greater degree of impact.

and ability to pay. Council tax is regressive, hitting poorer households relatively more as a proportion of income than richer households. And whilst Council Tax Reduction does support many low-income households, it does not protect all of them.

But viewing the two policies in combination reveals that the story of whether the burden of personal taxation is higher in Scotland than elsewhere in the UK is more complex than the public debate sometimes allows.

Chart 3: Impacts on household income of tax policy differentials between Scotland and rUK



Source: FAI analysis of Family Resources Survey

Land and Buildings Transactions Tax

On residential LBTT, the Scottish Government has set rates in line with its core policy themes of fairness and progressivity with respect to rUK – or more specifically, England and NI (property transactions taxes were devolved to Wales in 2018/19).

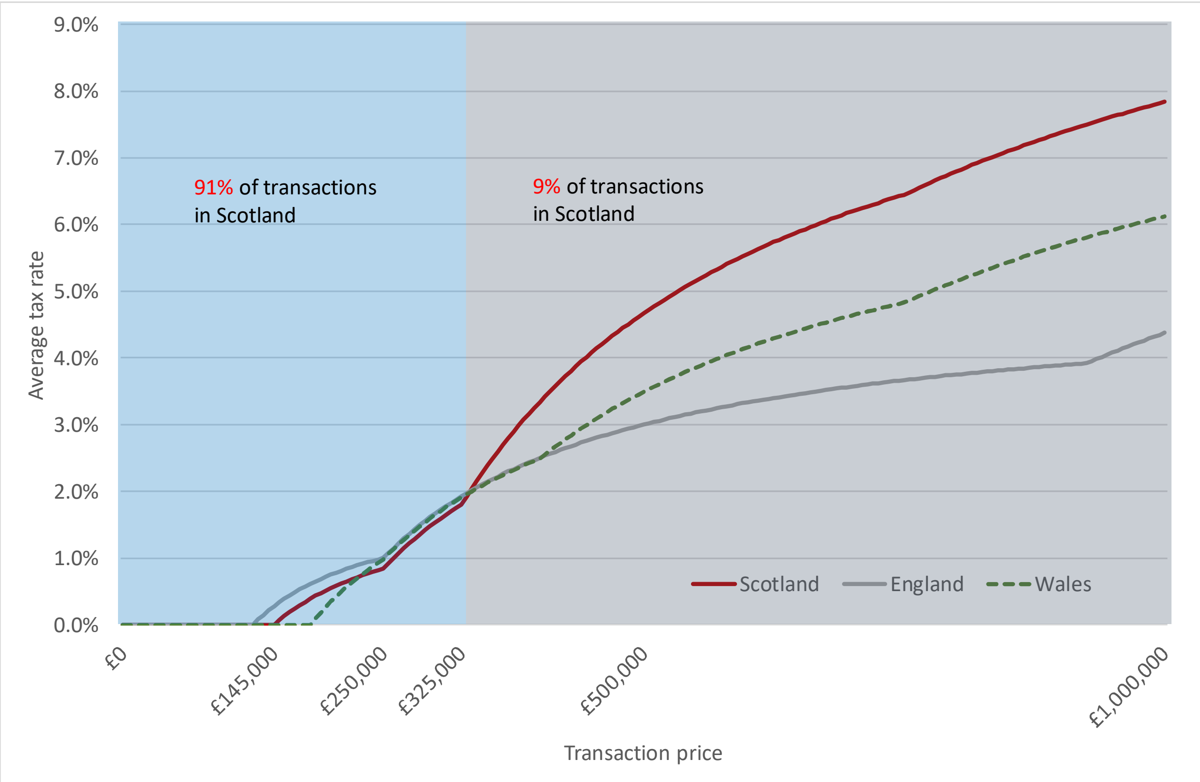
The nil rate band of tax (below which no liabilities are due) extends to £145,000 in Scotland, compared to £125,000 for the equivalent Stamp Duty Land Tax in England (and Northern Ireland). This difference is enough to ensure that most properties transacted in Scotland are liable for slightly lower rates of property transactions tax than they would face in England/NI. A house selling for £200,000 for example would be liable for tax of £1,100 in Scotland compared to £1,500 in England (an average tax rate of 0.6% and 0.8% respectively).

However, the 5% tax band extends to only £325,000 in Scotland before the 10% rate kicks in; in England the 5% band extends to £925,000. This means that properties transacting for more than £333,000 pay more tax in Scotland than they would in England/NI. The differential becomes quite substantial. Someone lucky enough to contemplate buying a £1 million property would face a tax bill of £78,350 in Scotland but £43,750 in England/NI.

The rate structure thus enables the Scottish Government to make a similar line of argument as it did with income tax. The majority of residential property transactions, 91% in 2019/20, will face liabilities somewhat less than they would in England/NI. Only the top 9% of property transactions by value (which account for around three quarters of residential LBTT revenues) will face higher liabilities than they would in England (Chart 4). Note that Wales operates a different policy, with slightly lower liabilities than Scotland for transactions in both the lower and upper parts of the distribution (Chart 4).

The tax rate differential is sufficient to ensure that Scottish residential LBTT revenues are around £50m higher than they would be if English rates prevailed[9].

Chart 4: Average residential property transaction tax rate, Scotland, England and Wales (2021/22)



Note: the rates shown here are the 'normal' tax rates and thresholds, excluding any temporary tax reliefs or holidays associated with Covid. Distribution of transactions by value is based on 2019/20 outturn data. Source: FAI analysis of Revenue Scotland data

The Scottish Government's emphasis on fairness extends to the Additional Dwelling Supplement. The ADS rate was extended from 3% to 4% in the 2019/20 budget, despite remaining at 3% in England. The higher rate of ADS is, according to the Scottish Government, an 'important element of the Scottish Government's drive to protect opportunities for first-time buyers in Scotland, reinforcing the progressive approach in place for LBTT rates and bands'. This increase in the ADS was forecast to raise £27 million in the year it was introduced.

[9] This estimate is approximate, based on a fairly crude analysis which involves multiplying the number of transactions by £5,000 band in Scotland in 2019/20 by the average tax rate applying to each of those bands in Scotland, and then in England respectively.

First time buyer relief on the other hand is slightly less generous in Scotland than England/NI. The nil rate band of LBTT extends to £175,000 for first time buyers in Scotland, compared to £300,000 for first time buyers in England/NI.

The decision to set a lower threshold for first-time buyers relief in Scotland seems fairly prudent given the strong likelihood that the policy generates significant 'deadweight'. When it was first introduced, the SFC estimated that it would lead only to an additional 150-200 first-time buyer transactions per year (out of 33,000 annual first-time buyer transactions in total). The main reason for this is that the tax cut largely feeds through to higher property prices, offsetting the impact of the tax cut on transactions – but costing the government an estimated £5-£7 million in lost revenue.

In terms of non-residential property, rates for both transactions and leases are lower in Scotland than in England at all property values. The difference in liability, as a percentage of property value, peaks at £250,000 where the difference in liability is £1,000, equivalent to an average tax rate of 0.4% in Scotland but 0.8% in England/NI.

There were of course temporary changes to residential LBTT during the pandemic. In Scotland, the nil-rate band was extended to £250,000 (from £145,000). These pandemic measures will cease in Scotland from April 2021, although in England the extension of the nil rate band to £500,000 will continue until June, returning to its 'normal' £125,000 by October. Stamp Duty holidays can be an effective way to stimulate housing market activity during a slump. But much of the effect results from the policy's impact on causing buyers and sellers to change the timing of the transactions to take advantage of the holiday, rather than creating a permanent change in the level of housing market activity. This is implicitly the justification for the decision not to extend the holiday in Scotland.

Non-domestic rates (Business rates)

Non-domestic rates (NDR) are the second most significant source of revenue for the Scottish Government after income tax, generating around £2.8 billion annually prior to the pandemic.

There have been policy changes to NDR throughout the parliament, largely reflecting the recommendations of the Barclay Review. The Barclay Review was established in the previous parliament and reported in August 2017, making 30 recommendations to enhance and reform the NDR system.

The Review's recommendations included making more regular valuations, reducing avoidance, and changes to rates reliefs for certain recipients, including arm's length external organisations (ALEOs), independent schools and accommodation by universities.

The government accepted most, or committed to consult further on, all but two of Barclay's recommendations (the two explicitly rejected were to put farms on the valuation role and levy rates on commercial agricultural processing). A significant number of the recommendations have been implemented[10].

[10] These include what is arguably the flagship policy, the introduction of the grandly titled Business Growth Accelerator, which provides rates reliefs for new or improved property, which was introduced in 2018/19 at an estimated cost of £42m, although this estimate was subsequently revised down. Various other reforms were also introduced in 2018/19 (relief for day care nurseries, an expansion of Fresh Start Relief, and relief for unoccupied new-build property). Subsequently, the Non-Domestic Rates (Scotland) Act 2020 makes provision for further policy amendments in response to the Barclay Review, some of which were implemented in Budget 2020/21 (changing eligibility or relief rules for student accommodation, independent schools, unoccupied

Beyond these specific reforms, the government's narrative has been to make the case that Scotland has the 'most competitive' business rates policy of any part of the UK. There are two elements to the government's claim that Scotland has the most competitive business rates system in the UK: the headline poundage or multiplier – the tax rate applied to a property's valuation; and the reliefs for lower valued properties.

The issue of the multiplier first emerged as an issue in the 2019/20 budget, when a slightly lower 'standard' rate was set in Scotland (levied on property with rateable value below £51,000) compared to the equivalent rate in England. This enabled the Scottish Government to state that '90% of Scottish business pay a lower rate of NDR than a business occupying premises of equivalent value in England', although for most businesses the difference was very marginal.

The reason that the remaining 10% of businesses do not face lower rates than equivalent English businesses is because Scotland has levied a 2.6p supplement on businesses occupying properties valued at more than £51,000. The Barclay Commission recommended that this supplement be reduced to 1.3p to bring tax rates for this group into line with those in England, at an estimated cost of some £60 million. In a compromise, the Scottish Government in 2020/21 reduced the supplement to 1.3p for properties valued at up to £95,000, but retained the 2.6p supplement for those in properties valued at £95,000 and above. The result is that, from 2020/21, 95% of Scottish premises face lower rates than they would in England[11]. The difference was extremely marginal in 2020/21, but widened to 0.9p in 2021/22, when Kate Forbes announced a cut in the Scottish poundage, despite it being frozen in England. The cut in poundage is estimated to cost £63 million in 2021/22.

There have of course been a number of policy measures in response to Covid. Notably this includes the 100% relief for businesses in the Retail, Hospitality and Leisure sector during 2020/21. This relief has been extended at 100% in Scotland throughout the 2021/22 year, despite only having been extended until at 66% in England after July 2021.

The second element of Scotland's relatively more generous business rates policy comes from the generosity of rates reliefs for businesses occupying lower valued premises. The so-called Small Business Bonus Scheme (SBBS) provides 100% rates reliefs for businesses occupying property with a rateable value of up to £15,000, and partial relief up to £18,000[12]. The equivalent scheme in England provides full reliefs only up to £12,000, with part-relief provided up to £15,000.

A significant number of businesses benefit from the SBBS – 126,000 in 2020 according to the government's analysis, up from 102,000 in 2016. The value of these reliefs, (i.e. the cost associated with the scheme) is £280 million in 2020, up from £180m in 2016.

The SBBS is a flagship policy of government, frequently lauded as contributing to job creation and enhancing productivity. On the one hand, it seems intuitive that a typical small, local independent convenience store in a property valued at £10,000 for example would benefit significantly in the £5,000 annual relief that the SBBS would provide. On the other hand, ascertaining the impact of the relief is empirically very challenging, and the government has limited evidence of its impact. It is possible that firms might in some cases employ fewer staff without the relief. But it is also feasible

properties, and commercial properties in parks), and some of which will be implemented over longer timescale (including a commitment to move to three-yearly revaluations).

[11] Scottish Budget 2021/22, p. 52

[12] In fact it is slight more complicated than this. Whether a property is eligible for SBBS and what level of relief it is eligible for depends on the cumulative RV of all the properties in Scotland of which a ratepayer is in rateable occupation. Currently, a ratepayer whose properties have a cumulative rateable value lower than £35,000 may be eligible for SBBS for each individual property with a RV of up to £18,000.

that the impacts of the scheme could include some combination of higher profits, lower prices, or even higher rents (benefitting landlords rather than the intended beneficiary firms). Without more evidence on impact, assessing whether the SBBS is worth its £280m cost is difficult.

What this all means in practice is that, in 2021/22 a business with a rateable value of between £12,000 and £18,000 will pay markedly less NDR in Scotland than they would in England, due to differences in small business reliefs. For businesses with rateable value above £18,000 the difference is more marginal – the rates bill will be around 1.8% less in Scotland than it would be if the English poundage was applied. Businesses with a rateable value of over £95,000 will face a rates bill around 0.8% higher than would face if English rates applied.

It will be interesting to see whether the lower poundage for most businesses in Scotland in 2021/22 will persist into future years (baked-in to the future, as was the case following the council tax freeze), or whether the next Scottish Government will seek to undo the change with a relatively faster rates increase in future.

Landfill tax

Landfill Tax was devolved to the Scottish Parliament in 2015 following the recommendations of the Calman Commission. The Scottish Government matched UK Government policy on landfill tax to address concerns over the potential for 'waste tourism' should one part of the UK have a lower tax charge than another.

Air Passenger Duty

Whilst anticipated devolved powers over APD have not yet become operational, the policy intent of the Scottish Government with respect to APD has evolved substantially over the course of this parliament.

A long-running aspiration to cut Air Passenger Duty, once it was devolved, was formally abandoned in 2019. The ambition to cut and eventually abolish APD altogether had been included in the Independence White Paper of 2013, whilst the 2016 SNP Manifesto reiterated the commitment to halve the tax during the course of this parliament.

The case for cutting APD rested on an argument that it would boost economic activity – through increased business and tourism travel and consequent activity at Scottish airports – which would offset the direct loss of revenues as a result of the cut. But as explained in this blog by Daniel Borbely, the Government's economic modelling exercise was not particularly convincing.

This notwithstanding, it became increasingly clear that the policy aspiration to cut APD was going to be increasingly difficult to justify alongside the government's wider climate change aspirations; all the more so given the role of Green Party votes in supporting the Scottish budget through parliament. The abandonment of the policy was announced in May 2019, shortly after Nicola Sturgeon had declared a 'climate emergency' at the SNP Conference.

As it happens, APD has not yet in any case been devolved, having been snarled up by issues of EU State Aid. It emerged in the early part of the parliament that flights from the Highlands and Islands have been exempt from APD since 2001. However, a continuation of this exemption under what might technically be viewed as a 'new' tax would be subject to confirmation from the EU that the exemption is not in breach of State Aid rules. Whilst the UK's official exit from the EU may mean that the State Aid issue recedes, this is not necessarily a foregone conclusion given the nature of the UK-EU trade agreement.

Where does this leave prospects for devolution of APD? The Air Departure Tax (Scotland) Act 2017 puts in place the necessary legal arrangements for APD to be replaced by Air Departure Tax in Scotland. But whilst the government indicated in its January 2021 Medium Term Financial Strategy that it remained committed to devolution of the tax, it appears that some of the technical details remain to be resolved.

Local tax powers

We have already discussed developments in relation to the two main 'local' taxes, council tax and Non-Domestic Rates. In practice most policy decisions on these taxes are made by the Scottish Government; local authorities have little direct say either individually or collectively on policy decisions generally, or local discretion to vary specific elements of policy (other than scope to increase band D council tax rates within whatever bound is set by government). Moreover, individual local authorities tend not to face the fiscal benefits or costs of the growth of revenues in their areas, as these are equalised away in the grant allocation formulae.

In its 2016 Manifesto, the SNP had committed to assign a share of income tax to councils. This would, it was claimed 'increase the financial accountability of local authorities' and make council 'less reliant on central government funding, and incentivised to grow their local economies'. As far as we are aware, this manifesto pledge has not been taken anywhere.

However, the government has taken forward alternative proposals to enhance the taxation autonomy of local government. The Transport (Scotland) 2019 Act, passed by Parliament in October 2019, creates the power for councils to introduce a workplace parking levy should they wish to do so. In principle a workplace parking levy could act as a useful tool to manage traffic congestion and raise some additional revenues. The government also consulted, in late 2019, on the principles for a discretionary tourism visitor levy (tourist tax).

In practice, further progress and implementation on both of these taxes has been stymied by the arrival of Covid. Traffic congestion and tourist numbers are neither a major problem nor a useful source of revenue at the current time.

This notwithstanding, real progress on reforming local taxation to provide local government with meaningful revenue raising accountability has been slow this parliament, particularly in relation to the momentum created by the Commission on Local Tax Reform in 2015 and the commitments in the 2016 Manifesto.

Calls for further local tax reforms will likely be made during the upcoming election campaigns – but will we ever move from platitudes to meaningful action?

Tax responsibilities not yet transferred

Two of the taxes recommended for devolution/ assignment to the Scottish Parliament by the Smith Commission have not yet become operational:

- The Smith Commission recommended that half of VAT revenues raised in Scotland should be assigned to the Scottish budget. Revenue assignment does not offer any policy autonomy, but in theory can raise the accountability of the Scottish Government for performance of the Scottish economy. VAT assignment to Scotland has been repeatedly delayed because the UK and Scottish Governments cannot find a satisfactorily robust way to estimate Scotland's share of VAT revenues. The two governments agree that asking businesses to report the locations of their input purchases and/or sales would be unnecessarily complex and onerous; but estimating the VAT share through annual survey data exposes the budget to significant volatility through survey error. Whether VAT assignment goes ahead remains uncertain.
- The devolution of Aggregates Levy has been delayed by legal issues. The Aggregates Levy is intended to create incentives to promote recycled aggregate by increasing the cost of first used aggregate. The British Aggregates Association (BAA) has argued that some of the tax exemptions granted to recycled aggregates effectively create issues of State Aid, and the issue has been in the courts. Devolution of Aggregates Levy has been on hold while the legal issues are resolved at UK level. Given that the legal issues have now recently been concluded, this in principle paves the way for devolution of Aggregates Levy to take place.

Conclusions

The key thread linking the Scottish Government's main tax policy decisions this parliament is the aspiration for 'fairness'. Fairness in this context has a very specific meaning – it involves setting tax policy in such a way that taxpayers in the lower part of the distribution of the tax base (whether that is income, property value, council tax band, or rateable value) face lower tax liabilities than they would in rUK; but at the same time, setting tax policy to be more progressive than in the rest of the UK – so that those in the upper part of the distribution face relatively higher tax liabilities, compared to the median taxpayer, than is the case in rUK.

This approach is most obviously the case with income tax, where (very marginal) reductions in tax liabilities for the bottom half of taxpayers have been combined with more substantial increases in tax liability for those in the upper half.

But the aspiration to set more progressive tax policy is also seen in terms of residential LBTT (where the Scottish Government can argue that 90% of Scottish residential properties pay less transactions tax than an equivalent property in rUK), council tax (where the distribution of ratios between tax bands is more pronounced than in rUK) and Non-Domestic Rates (where the supplement on high valued properties is relatively more than in England, and reliefs for low-valued properties extend slightly further up the distribution).

In relation to personal taxes like income tax and council tax, these tax policy structures are framed by the Scottish Government as being 'fairer' than those in rUK; in relation to business rates, Scottish tax policy is argued to be more 'competitive'. The result is a set of policies that can be argued to be more progressive in Scotland than in rUK; but fairness is of course in the eye of the beholder.

A cynic would argue that in some cases, the reduction in liabilities for some Scottish taxpayers relative to equivalent taxpayers in rUK is too marginal to make any meaningful difference to the taxpayers affected. In these cases, aspects of policy have arguably been designed with a slogan in mind. The £21 reduction in annual income tax liabilities for income taxpayers with below median incomes being the obvious example, but aspects of LBTT and NDR policy could also be included here.

In some cases however, the differences in tax policy that have opened up between Scotland and rUK have been substantial. Scottish tax policy has diverged substantively from prevailing rUK policy for higher rate income taxpayers and higher value residential property transactions. Council tax rates are substantially lower in Scotland than rUK.

This parliament has seen extensive and at times fractious debate about whether Scotland is the highest taxed or most fairly taxed part of the UK. Taking the two major personal taxes in combination – income tax and council tax – the picture is slightly nuanced. Scottish tax policy relative to rUK is best characterised as transferring liability from council taxpayers to (higher income) income taxpayers. In this sense, Scottish tax policy can be viewed as progressive although not necessarily revenue raising.

Most of the SNP's 2016 Manifesto commitments on tax have been met. Where Manifesto tax commitments have not been met, the case for the change of course has generally been well justified. For example, although devolution of APD has been delayed, the rationale for the proposed cut was always difficult to justify given wider environmental policy aspirations and evidence on the likely economic benefits.

In some cases however, the justification seems in part to undermine the rationale for the original commitment. The proposed rise in the tax free amount of income tax to £12,750 in 2021/22 would have been an expensive way to support household incomes, benefiting those a long way up the income distribution as well as those at the lower end – and not doing anything to support those with income too low to be liable for tax. The commitment to assign a share of income tax revenues to local authorities lacked a well-evidenced rationale. The idea that it would, as claimed in the manifesto, incentivise councils to grow their economies seems doubtful in the context of local government economic levers. Annex A sets out 2016 Manifesto commitments on tax, and the extent to which those have been met.

Whilst Scottish Government income tax changes have been bold and gone well beyond manifesto commitments, there has been a relative lack of progress on reforming local taxation, particularly with regards to council tax.

Changes to the ratios between council tax bands in 2017/18 did respect the manifesto commitment, but in reality represented a very partial attempt to get to grips with the recommendations of the Commission on Local Tax Reform. Local tax reform feels like unfinished business for the next parliament.

Tax policy priorities for the next parliament remain slightly uncertain, at least until the publication of manifestos. The future of business rates in a post-covid world may need to be reviewed, given permanent erosion of the tax base. And it remains unclear what the government's aspirations are for Air Departure Tax, now that its previous policy aspiration has been abandoned.

But what can we expect for tax policy beyond 2021/22? The only concrete policy commitment we know about so far is the UK Government's recently announced proposal to freeze the income tax Personal Allowance and thresholds in cash terms from 2022/23 until 2025/26 – a real terms tax increase. The likelihood is that Scottish thresholds will remain similarly unchanged, as following a different threshold uprating policy would have revenue implications – but it will be interesting to see what the manifestos say in this regard.

More broadly, it will be interesting too to consider the extent to which 2021 Manifesto plans make the case for further changes to the balance of tax powers devolved. The Scottish Government's Medium Term Financial Strategy, published earlier this year, begins to make the case for full devolution of income tax (including ability to set reliefs and allowances, and to tax savings and dividends), National Insurance Contributions, and Capital Gains Tax, as well as to devolve rather than assign VAT revenues.

The detail of tax policy is unlikely to play a major role in the upcoming election campaign. But the next session of parliament is likely to be at least as busy on tax policy as this parliament has been.

Annex A: SNP 2016 Manifesto Commitments on tax

Reduce Air Passenger Duty by 50 per cent during the course of the next Parliament

Commitment abandoned in 2019. Devolved APD has not yet become operational, but the commitment to cut the rate was abandoned on the well justified grounds that a cut would not be consistent with wider climate objectives

Expand the Small Business Bonus, increase the number of small businesses that pay no rates and carry out a wider review of business rates to ensure that we maintain Scotland's competitive business rates environment

Commitments achieved through an increase in the threshold qualifying rateable value threshold for the SBBS in 2017/18, and the Barclay Review.

We will increase the amount of income exempt from Income Tax to £12,750 by the end of the next parliament.

Commitment not met. The Scottish Government does not determine the Personal Allowance, but it can set a higher tax free amount than prevails in the rest of the UK by setting a zero-rate band of tax between the PA and whatever level of income the Scottish Government wants the tax free amount to end at. Thus although the UK Government set the Personal Allowance at £12,570 in 2021/22, the Scottish Government could have met its manifesto commitment by establishing a zero-rate band applying to income from £12,570 to £12,750. This policy decision would have cost around £90m in lost revenues, with the tax giveaway benefitting those with incomes of £90,000 by the same cash amount as those with incomes of £15,000. The case for implementing this policy is not therefore particularly obvious – although this goes for the pre-covid as well as post-covid world.

Freeze the basic rate of Income Tax to help low and middle income earners, but not implement the tax cut for higher rate earners proposed by the Tories. Instead, we will freeze the higher rate threshold in 2017/18 and ensure that it will rise by a maximum of inflation until 2021/22.

Commitment met. The Scottish higher rate threshold has increased by just 1.5% in cash terms in this parliament, compared to the 17% increase in rUK.

From next year, we will cap any increase made by councils [to council tax] to a maximum of 3 per cent a year.

Whether or not this commitment was achieved depends on whether the commitment relates to cash or real terms increases. Councils were allowed to increase bills by almost 5% in 18/19 and 19/20, although this is 3% in real terms.

We will reform local taxation by asking those living in the highest banded houses to pay more and reducing tax for low income families with children.

Commitment me through the 2017/18 change to ratios between bands, and a 25% to the child element of council tax reduction.

We will increase the financial accountability of local authorities. By assigning a share of Income Tax to councils, they will be less reliant on central government funding, and incentivised to grow their local economies

Not met.