

# WHY SCOTLAND NEEDS A FAIR PROPERTY TAX

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## Summary

- The Council Tax was designed to be unfair.
- The cost of freezing the Council Tax grows each year and this year will cost £560 million.
- Ending the freeze would allow us to build the social housing we need, reverse the Housing Benefit cuts *and* have money left over.
- Local income tax would drive up house prices and could be avoided by the rich and mobile.
- A fair system of property tax is essential to combat poverty and austerity – as well as putting local government finance on a secure footing.

## Introduction

The Council Tax was introduced in 1993 as a replacement for the Poll Tax. Properties are divided into one of eight bands, based on their 1991 value. It raises £2 billion every year, and funds about 12% of councils' total gross revenue income.<sup>1</sup> The Council Tax has been frozen since 2008-09 and in Autumn 2014 the Scottish Government announced the establishment of a [Commission on Local Tax Reform](#) to find a fairer system.

### The Council Tax is designed to be unfair

The bands are designed to tax more valuable properties less heavily than cheaper ones. Because people who live in more expensive and higher banded houses generally have higher incomes, this also means that people on higher incomes are taxed proportionately less heavily than people on low incomes. Introducing more bands can reduce this unfairness. But they cannot remove it.

### The Council Tax freeze is expensive

The Council Tax has been frozen for eight years. Every year the Scottish Government has to set aside more money to pay for the freeze. Each year the freeze requires the cumulative sum of previous years' freeze *plus* another £70 million per annum. This year, in total, the annual cost of maintaining the freeze is £560 million (8 times £70m), bringing the cumulative cost to £2.5 billion.<sup>2</sup>

### Unfreezing the Council Tax could pay for the social housing we need....

Just one quarter of the £560 million that it costs to pay for the Council Tax freeze this year could help to increase the output of new social rented homes by more than 3,000 units a year – bringing the total to the 7,000 the Commission on Housing and Wellbeing<sup>3</sup> says we need.

### ... and reverse all of the Housing Benefit cuts...

A further £40 million of the freeze would be enough to reverse the main cuts to Housing Benefit since 2010<sup>4</sup>... **and still leave £375 million left over.** That's £375 million which could be used to reduce the impacts of austerity arising from cuts in the block grant from Westminster.

## **We can't afford the freeze, but we need a fairer local tax**

However, the Scottish Government does not want to increase the Council Tax because it is unfair. So we need to find a new tax for local government which is fair.

## **Wouldn't a local income tax be fairer?**

Local income tax sounds like a fairer option because it is based on the ability to pay. But there are compelling reasons why abolishing the Council Tax in favour of an income tax would be a poor decision.

## **Abolishing the Council Tax would make buying or privately renting a house more expensive...**

The Council Tax taxes property values – albeit imperfectly. If the Council Tax were abolished and not replaced with a fair property tax, it would lead to higher house prices and higher private rents. This is because property taxes reduce the price of property due to the liability to make ongoing annual payments. If this liability is removed potential owners and investors will be able to bid more for property, and house prices will increase.<sup>5</sup> Higher house prices would hit first time buyers and private renters, and would make the housing crisis worse.

## **...and people would pay more income tax!**

What's more, income tax revenues would have to rise by 17% to make up for the loss of current Council Tax revenues and by 22% to bring back revenues to their 2008-09 value.<sup>6</sup> In 2006, the Burt Review estimated that a revenue neutral local income tax would require an additional tax rate of between 5.7 and 7.9 pence in the pound (depending how broadly it was applied and at different tax rates) on top of the prevailing rate of general income tax.<sup>7</sup>

## **Income tax has other disadvantages**

Income tax has other disadvantages. One of the most important of these is that unlike properties, people can move, so if income tax is higher in one council area compared to another, people can move to avoid it. Self-employed people could convert their income into dividends to avoid it. People with more than one home can juggle where they live. There is a growing international consensus that broadening the income-based tax base and increasing our reliance for revenue on it can have negative economic consequences such as 'fiscal flight', compared to widening and diversifying the tax base to other less productive sectors such as property.<sup>8</sup>

## **This is why we need a reformed property tax**

Property has been used as a basis for taxation across the world for centuries because it is a fair and reliable way to raise revenue. A fair property tax is one which reflects the value of the property, and is revalued automatically and frequently.

## **What about the 'asset rich but income poor'?**

There are many ways that people with low current incomes, but who live in relatively expensive properties, can be protected. In Scotland, rebate systems have operated since the 1960s. Other options include allowing owners to defer payments, combining property tax with income tax, or even introducing a hybrid property and income tax.

## **Conclusion**

A fair system of property taxation is essential – not only to replace the unfair Council Tax, but to combat poverty and austerity.

## References

- 1 Commission on Local Tax Reform, *Council Tax Facts*
- 2 Don Peebles (Head of CIPFA Scotland) [Council Tax in the Context of Local Government Finance](#)
- 3 Commission on Housing and Wellbeing (2015) [A Blueprint for Scotland's Future](#)
- 4 Based on Scottish Government impact assessments.
- 5 The last time property tax was abolished – when the rates were replaced by the poll tax – four separate studies found that long run house prices would rise by 5% (Department of the Environment, 1986, *Paying for Local Government*, Cmnd 9714), between 13-23% (Hughes, G, 1987 *Rates Reform and the Housing Market*. University of Edinburgh Discussion Paper – medium run figures), by 7-30% (Spencer, P, 1988 *The Community Charge and its Likely Effects on the UK Economy*, CSFB Economics. London: First Boston) or 10-17% (Rosenthal, L, 1999, 'House prices and local taxes in the UK', *Fiscal Studies*, 20(1)). In the event these effects were outweighed by the collapse in the housing market caused by the doubling of interest rates.
- 6 Calculated from [GERS](#), Table 3.1
- 7 Sir Peter Burt (chair) (2006) [A Fairer Way: Report of the Local Government Finance Review Committee](#), p. 98
- 8 See Burt (2006); Steven Smith (2015) *Taxation: A Very Short Introduction* (OUP); also raised by Gibb, K and Christie, L (2015) [International Literature Review for the Commission on Local Taxation](#).