Celtic Academies Alliance

Unlocking fiscal autonomy

The evolution of devolved taxation

The Learned Society of Wales
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Knowledge Made Useful

Summary

The Celtic Academies Alliance facilitated a discussion on the origins of devolved taxes and the extent to which new fiscal powers have been deployed by each administration. This report summarises the discussion that assessed the effectiveness of devolved taxes in Scotland, Wales, and Northern Ireland, reflects on the unique challenges facing each administration, and considers potential solutions through a variety of measures, including new taxes and further devolution.

In the Scottish context, the report acknowledges warnings from the Scottish Fiscal Commission that Scotland's public finances are unsustainable. The report suggests the Scottish Government faces a pincer movement, where putting up tax rates is not generating much more revenue due to poor economic performance. Wales and Northern Ireland face unique geographical challenges, with highly permeable borders playing an outsized role vis a vis Scotland. It was noted that income and excise taxes in Wales were unlikely to generate the same result as in other devolved nations due to the high proportion of the population living close to the border. This issue limits the discretion of any Northern Ireland Government too, as excises need to align (at least partly) with the Republic of Ireland. Additionally, Northern Ireland faces competitiveness issues with the Republic, which has a corporation tax set lower at 12.5%.

The report considers a number of policy solutions for each administration, emphasising tools useful for all three devolved governments. This discussion covers the further devolution of fiscal levers, such as corporation tax and VAT, as well as proposing new taxes, such as the green land value tax (GLVT), which is considered at length in the report.

The Celtic Academies Alliance report identifies the issue at the heart of devolved taxation in the UK as all three devolved governments spending considerably more than they raise in taxation. The report concludes by arguing that a more mature tax-and-spending regime in each case requires the devolved administration to take responsibility for each marginal £ it spends and each marginal £ it raises in tax, so that it can make the trade-offs that a mature democracy requires between taxing and spending. Moreover, the devolved administrations should all consider more innovative approaches to property taxations so that property taxes are less regressive, do not discourage transactions, and fall most on the shoulders of those who can most afford to pay them.

The position within this summary reflects the discussion and views of the roundtable attendees and not necessarily the views of the Learned Society of Wales, Royal Irish Academy, and the Royal Society of Edinburgh.

Introduction

1. Following the Celtic Academies Alliance taxation conference in November 2022, a further roundtable was facilitated to discuss the recommendations covered during the first conference as well as rarely considered tax options within the devolution settlements. Experts from the Celtic Academies and policymakers were invited to discuss what the best possible tax options are for the devolved administrations. The points from the discussion can be used to inform policymakers on key issues within the current devolved administration's tax policies and highlight key considerations on the implementation of further tax policy levers.

2. The Celtic Academies Alliance is an alliance between the Learned Society of Wales (LSW), the Royal Irish Academy (RIA), and the Royal Society of Edinburgh (RSE). Its purpose is to inform public policy developments at both the UK level and within the devolved nations.

3. The evidence below reflects the discussion and views of the roundtable attendees and not necessarily the views of the LSW, RIA, and RSE.

Scotland

4. The discussion began by highlighting the key issues in relation to the process of tax devolution. It was argued that there was disappointment in some of the developments that have taken place. It was noted that one reason for this is the consequences of UK government policies, which impose either legal or political constraints on what Scottish Government can do. Notwithstanding the 2011 Mirrlees Review,[1] the UK tax system is difficult to reform due to inertia, lack of public understanding, and lack of political willingness. Other shortcomings have been a result of successive Scottish governments, failing to act with what has been described as a paralysis at the UK level infecting Scotland. With recent constitutional debates, it seems everything in Scotland is interpreted through the lens of its constitutional future, and this has made serious political debate of taxation options difficult.

Policy issue: Fiscal drag

5. It was noted that the proportion of UK taxpayers being brought into the higher rate of income tax is increasing year on year. The consequent increased tax take is known as 'fiscal drag.'

Rather than having a coherent direction for tax policy, it was argued that fiscal drag is now the main policy instrument of both the UK and Scottish Governments. The Scottish Fiscal Commission has warned that Scotland's public finances are unsustainable, just as the Office for Budget Responsibility has been doing for the UK for many years.[2] This never seems to register in political debate. Levels of public services are not sustainable at present levels of taxation. One of the reasons for that is adverse demographics.

What is devolved taxation supposed to achieve?

McIntyre et al.[3] identified three logics that have framed calls for greater Scottish tax devolution

1) "Accumulate more competencies regardless of how such competencies are used."

2) "Accumulate more competencies as a means of pursuing objectives that cannot be achieved or are inhibited by existing competencies."

3) "Accumulate tax powers to balance the Parliament's powers to spend public money, thus bringing more fiscal responsibility and making decision-making more accountable."

[1] Adam, S. et al., *Tax by Design*, London, Institute for Fiscal Studies, 2011, available from https://ifs.org.uk/books/tax-design

[2] Scottish Fiscal Commission, *Fiscal Sustainability Report,* Edinburgh, 2023

[3] McIntyre, S., Mitchell, J. and Roy, G. (2022) 'Careful what you wish for? Risk and reward with Scottish tax devolution', *Political Quarterly,* 93(3), 392-400

The presenter provided brief comments in relation to the above logics:

- In Scotland, those favouring independence have seen more tax powers as important in making Scotland seem closer to an independent state.
- There is, however, limited divergence the Scottish Government can adopt whilst remaining part of the Union.
- In terms of accountable decision-making, the complexities of block grant adjustments have made Scotland's public finances even more unintelligible to most people.
- Scotland has taken on much more fiscal risk since the implementation of the Scotland Acts 2012 and 2016, due to the extent and form of tax devolution.

The financing of the Scottish Government

6. Currently, Scottish income tax (as proposed in 2014 by Lord Smith of Kelvin)[4] finances £15,810 million (37%) of the 2023-24 Scottish budget's fiscal resource of £41,944 million.[5] The other devolved taxes, finance 2%. These have been smoothly administered by Revenue Scotland, but land and building transactions tax (like stamp duty land tax in England), it was argued, discourages housing moves and damages labour mobility.

7. It was noted that the Smith Commission's partial assignment of VAT revenues seems to have been quietly abandoned. The speaker regarded this Smith proposal as misguided and insisted the lack of movement allows the UK Government to accuse the Scottish Parliament of not making use of its available powers.

8. Council Tax plays a significant role in financing public expenditure in Scotland, with strong support for having a residential property tax. However, reliance on 1991 valuations is inefficient and inequitable, and the immediate rejection of the 2006 Burt Report[6] recommendations was disappointing for reform possibilities.

Scottish income tax and national insurance contributions

9. It was argued that the UK tax system produces high marginal rates for moderate earners because national insurance contributions (NICs) are a second income tax. The public seems to favour NICs as opposed to income tax, but perhaps this is due to a lack of understanding of the relationship between income tax and NICs.

10. In Scotland, some argue that there is an issue with the current definition of a higher-income earner. Someone earning more than £43,666 should not necessarily be considered a high earner. This matters because there is a combination of a big increase in income tax from roughly 20% to 40% and the interaction with NICs resulting in very high marginal rates. There is also a peak in marginal rates caused by the withdrawal of personal allowance for incomes over £100,000.

11. To demonstrate the above point about definitions of high earners. Due to the withdrawal of child benefits, someone with an income over £50,000 with two children faces a combined income tax and NICs rate of 64.7%.[7] Given that one of the drivers of fiscal unsustainability is that the demographic structure is ageing fast, we need to do more to support families.

Claim: Scottish taxpayers are better off than rUK taxpayers

12. It is sometimes claimed that Scottish taxpayers are better off than rUK taxpayers. However, this is not for the reason people seem to believe. In reality, it is because of the high concentration of Scottish incomes lower down on the income distribution. However, as the Scottish Fiscal Commission has highlighted, the policy of fiscal drag has already dragged more Scottish taxpayers into the higher rate.[8]

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[4] Lord Smith of Kelvin (chair), *Report of the Smith Commission for Further Devolution of Powers to the Scottish Parliament*, Edinburgh, Smith Commission, 2014.

[5] Scottish Government, *Scottish Budget: 2023-24*, Annex A

[6] Burt, P., *A Fairer Way: Report of the Local Government Finance Review Committee*, Edinburgh, Local Government Finance Review Committee, 2006

[7] Heald, D., 'The politics of Scotland's public finances', in Keating, M. (ed.) *The Oxford Handbook of Scottish Politics*, Oxford, Oxford University Press, 2020, Chapter 28, pp. 512-42, Figure 28.5

[8] Scottish Fiscal Commission, *Scotland's Economic and Fiscal Forecasts: December 2022* (revised version February 2023), Edinburgh, Scottish Fiscal Commission, Figures A.2 and A.3

13. What the Scottish Government can spend depends, in part, on what the Scottish Fiscal Commission say that the tax system will yield. Looking at recent changes to income tax in Scotland, where the additional rate threshold was lowered whilst the additional rate itself was increased to 47%, the Scottish Fiscal Commission can forecast the impact these changes will have on the resources available for public spending:

    - Assuming nobody changes their behaviour, the static costing of the revenue increase in 2026-27 from the reduction in the additional rate threshold is £40 million.
    - However, in the financial year 2026-27, forecasts suggest that Scotland will have lost about two-thirds of the increased tax revenue, leaving it with £15 million after taking into account behavioural effects.[9]
    - Looking at the increase in the additional rate to 47%, this should produce £37 million in 2026-27 on the static costing, but the post-behavioural change forecast is only £3 million.[10]

14. Therefore, this can be perceived as tax policy making for political ends. It was argued the Scottish Government felt it had to put the additional rate up when increasing the higher rate, but this hardly increases tax revenue. Roughly 40% of Scottish income tax revenues come from the top 5% of income taxpayers. If those people work less, organise their taxes in a different way, or get themselves classified as a rUK taxpayer, this could substantially reduce Scottish income tax revenue.

Conclusions

15. The Scottish Government faces a pincer movement. It is clear from the Scottish Fiscal Commission that putting tax rates up is not generating much more revenue.

16. The Scottish Fiscal Commission forecasts that by 2027-28 social security spending will be £1.4 billion more than what the UK Treasury provides in terms of positive block grant adjustments.

17. Stephen Smith highlighted the conflict between neutrality (as few economic distortions as possible, subject to the desired revenue yield) and subsidiarity (holding sub-national governments accountable).[11] When there is more than one level of government with tax-raising powers, then horizontal equity in tax payments only occurs within each jurisdiction, not across jurisdictions. With a long history of fiscal centralism, there can co-exist public approval for devolved tax powers but disapproval of emerging differences. This is a familiar phenomenon known as the 'devolution paradox.'

18. The tax system should be as neutral as possible so that it does not distort individual behavior, except where that is an explicit policy objective.

Positive reflections on tax devolution in Scotland

- The Scottish Government deserves credit for using the Scottish income tax powers. There was a great danger that the Smith Commission powers would atrophy.
- The work of the Scottish Fiscal Commission has brought greater transparency to the ways in which Scotland's public finances operate.
- There is an opportunity to develop a cross-party political debate about devoting more attention to the performance of the Scottish economy, on which the Scottish budget now partly depends. One of the reasons the Scottish Fiscal Commission considers that Scottish tax revenues are doing relatively badly is because the Scottish economy is not performing as well as the UK economy. However, in relative economic performance, there are two big factors involved: the importance of the financial sector in London and falling North Sea oil activity.

What is the view of the Scottish Government on partial assignments of VAT?

19. The fiscal framework review has just been published and assignment VAT has been postponed once again.[12] It was noted that the reason for this is that there is concern that the policy does not increase

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[9] *Ibid* Figure A.2

[10] *ibid* Figure A.3

[11] Smith, S., 'Subsidiarity and neutrality in European tax policy: economic considerations', in Smith, S. and Barents, R., *Neutrality and Subsidiarity in Taxation*, London, Kluwer Law International, 1996, pp. 7-25

[12] Fraser of Allander Institute (2023). Fiscal Framework Review Finally Published – What Does It Mean For Scotland? https://fraserofallander.org/fiscal-framework-review-finally-published-what-does-it-mean-for-scotland/

fiscal powers but does involve an element of volatility. After almost 10 years, it has become clear that there is no way to estimate VAT yield in Scotland that is precise enough to calculate exact budgetary implications. As the Fraser of Allander Institute highlights, it is a large amount of money (more than £5 billion) so even small fluctuations in how it is estimated can mean changes of hundreds of millions of pounds.[13] It was suggested that this links to the question of how much fiscal risk can be taken.

Wales

20. Following the Wales Acts 2014 and 2017, the Welsh Government have the powers to implement tax policy on taxation areas, such as:

    - The full devolution of non-domestic business rates.
    - They replaced the stamp duty with a devolved land transaction tax in 2018.
    - Landfill tax was also replaced with landfill disposal tax in 2018.
    - In 2019, the Welsh rates of income tax (WRIT) replaced 10 pence in each band of the UK Governments income tax. This was essentially the same system as Scotland's 2012 system, with the exception of the Welsh Government having the ability to change each rate of income tax separately by any amount.

    Together these make up about 20% of revenue collected in Wales.

21. The Holtham Report also looked at the pros and cons of the different taxes that could be devolved to Wales and the possibility of new taxes in Wales. However, certain areas of taxation in Wales were unlikely to generate the same result as in other devolved nations. It was noted that 150,000 people cross the border every day, and nearly 50% of the Welsh population live within 25 miles of the border, which means that putting up higher rates of taxes in Wales would unlikely have a significant impact on revenue. For example, increasing departure taxes at Welsh airports would likely precipitate a behavioural response where people choose to fly from English airports to avoid the additional costs due to the long populous border Wales shares with England, particularly for those who currently fly from Cardiff, perhaps choosing to fly from Bristol instead.[14]

22. So far, they have made extensive use of the business, land transaction and landfill tax but are yet to use the Welsh income tax options available. Below is a summary of the use of tax powers to date:

    - The Welsh Government has made the old stamp duty more progressive: higher property transaction taxes on more expensive properties (range from 0-12 percent) and on second home purchases (4-16 per cent).[15] No discount for first-time buyers.
    - It has reformed the council tax (which was described as a positive step). It had a revaluation of properties for council tax in 2005 and introduced an additional band – band I – to make the tax somewhat less regressive. Councils can charge up to 300% premium on second homes from April 2023 (previously 100 percent) (In North West Wales 10% of the total housing stock is second homes).[16]
    - It has conducted a consultation with a view to further Council Tax reforms and proposes another revaluation as a prelude to reform. The goal is "a fairer system for all."[17]

23. Regarding a suggestion that if council tax in Wales was considered as a property tax and charged at a single rate rate proportional to capital values, research by the Institution of Welsh Affairs in 2014 outlined this would need to be over 1% of the median house value in each band to be neutral.[18] This could double taxes on the most expensive homes and halve taxes on the cheapest properties.

24. When discussing such a tax, there is often the argument that there may be homeowners that have low-incomes who live in high-value properties.

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[13] *ibid*

[14] Independent Commission on Funding and Finance for Wales (2010) *Fairness and accountability: a new funding settlement for Wales* [online] Available at: https://gov.wales/sites/default/files/publications/2018-10/fairness-and-accountability.pdf

[15] Welsh Government (Updated 2022). 'Land Transaction Tax Rates and Bands. https://www.gov.wales/land-transaction-tax-rates-and-bands

[16] Welsh Government (Updated 2022). New Tax Rules for Second Homes. https://www.gov.wales/new-tax-rules-second-homes

[17] Welsh Government (2021). *Tax Policy Work Plan 2021 to 2026*. https://www.gov.wales/tax-policy-work-plan-2021-to-2026-html

[18] Institute of Welsh Affairs. Senedd Papers #2. 2014. Taxation in Wales https://www.iwa.wales/wp-content/media/2016/03/seneddpaper-2-2.pdf

However, the correlation between income and the value of a property is very high, meaning that depending on how we define people on low incomes, the proportion of people who would fall into that category would be very low,[19] and this could be resolved by the government offering a type of rollover relief.

New taxes – a chance to innovate or a dead letter?

25. The devolution settlement allows the Welsh government to introduce new taxes, with the consent of the UK Government. The Welsh Government considered several possibilities to propose as a new tax, including a levy to finance social care, however, a vacant land tax was selected after two years' preparation. The choice to do this has been questioned, because vacant land hoarded by property developers is not a significant problem in Wales. And if a valuation and collection agency were to be set up, it would make sense to use it for a more general land tax.

26. The experience of the Welsh Government has been that it is difficult to reach an agreement with HM Treasury (HMT), concluding that "it has become clear the agreed process for devolution of tax competence to Wales is not fit for purpose."[20] HMT has called for more information and has generally been reticent to the point of obstruction, meaning they've not been able to agree on anything. Therefore, there is an open question whether the new tax provision isn't a dead letter.

27. The other initiatives being considered are air passenger duty, tourism tax (which is likely to go ahead) and non-domestic rates. The Welsh Government has been considering Land Taxation, however, it has not suggested putting non-domestic rates on a site value basis, where there's a precedent in many countries, and would arguably remove the distortion that penalises commercial development.

Corporation tax – not just an Irish option.

28. Concern was raised about why so much of the discussion around "levelling up" has been about funds for regional authorities when increased regional tax expenditures, as opposed to financial handouts, have advantages.

29. The Holtham Commission discussed a controlled devolution of corporation tax which has not yet been considered for implementation. The tax could be reduced to the extent that the devolved territory had a lower GDP per head than the National average. Wales and Northern Ireland, which have GDP per head at 70% of the UK average, could reduce corporation tax by 30%.[21] The advantage of this approach is that it is self-limiting and indeed self-abolishing if the devolved territory grows faster and narrows the GDP gap.

30. Potential regional objections in England could be reduced by extending the scheme to the regions. It was argued that instead of just using this mechanism to make Northern Ireland as competitive versus the Republic of Ireland, there should be a general UK scheme in which the devolved territories consent to a lower corporation tax dependent on their GDP.

Desirable development: The backstop

31. It was argued that tax devolution has two main aims:

    a) To give devolved authorities and our elected representatives more power and responsibility for outcomes.

    b) Within the United Kingdom; to maintain a broadly equitable provision of public services in all parts of the country.

    These goals are currently in conflict. The first is privileged, and no backstop is in place, so poor decisions or elements outside government control, like different rates of population growth, could result in a cumulative divergence in levels of public services.[22] A solution could be a lengthy period between rebalances when block grants are adjusted for different relative income levels. The adjustment would not be retrospective so past losses would not be recouped. And the rebalances would occur beyond any plausible political horizon – say once every 15 years. These objectives would perhaps be more compatible if a lengthy period between rebounds was in place.

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[19] Appleyard, L. and Rowlingson, K. (2010) 'Home-ownership and the distribution of personal wealth' [online] Available at: https://www.jrf.org.uk/report/home-ownership-and-distribution-personal-wealth-review-evidence

[20] Welsh Government (2021). *Tax Policy Work Plan 2021 to 2026*. https://www.gov.wales/tax-policy-work-plan-2021-to-2026-html

[21] Independent Commission on Funding and Finance for Wales (2012). https://commonslibrary.parliament.uk/research-briefings/sn06288/ Discussed devolution of corporation tax in chapter 7 of the final report

[22] Independent Commission on Funding and Finance for Wales (2012). https://commonslibrary.parliament.uk/research-briefings/sn06288/ The need for a backstop concludes the discussion on integrating tax devolution and expenditure equalisation in Chapter 5

Fiscal devolution lessons from Northern Ireland

32. The Northern Ireland Fiscal Commission's report was given to the finance minister in May 2022, when there was no sitting Assembly, which is still the case—meaning the recommendations have not been considered for implementation. However, the report also contained useful lessons for both Scotland and Wales. The below section reflects the NI Fiscal Commission report.[23]

Scotland and Wales have been on a long journey to fiscal devolution - overview.

33. Scotland and Wales have been on a long journey to fiscal devolution - overview.

A) They have both had two commissions, one technical and one political.

B) Scotland has had some tax-varying powers since devolution in 1999. It now has powers over Scottish income tax (partially devolved) rates and bands (non-savings and non-dividend), Scottish land and buildings transaction tax, Scottish landfill tax and council tax and non-domestic rates.

C) Wales has powers over, income tax – partial (though not as extensive as Scotland), land transaction tax, landfills disposals tax, council tax and non-domestic rates.

D) It was noted that, like other devolved nations, Northern Ireland has relatively poor areas requiring high public expenditure. For example, GDP per head in NI is about 25% lower than that of the UK as of 2019, and identifiable public spending is about 20% higher on a per-person basis than the UK average.

NI has substantial powers over spending but not over tax.

34. As with Wales and Scotland before the devolution process started, NI has, by international standards, remarkably high control over expenditure decisions, combined with deficient taxation powers.

35. The report found that nearly 90% of the NI Executive department expenditure limit (DEL) budget comes from Block Grants. The DEL budget is the programme budget of the Scottish, Welsh and NI governments and the Barnett formula determines changes. The only NI Executive tax resource comes from Rates (domestic and business), less than £1 in every £20 of tax revenue is raised by the NI Executive.

36. One advantage for NI is that the poll tax was never introduced in Northern Ireland, and it maintained its domestic and business rates. NI has a better terrier/land Geographical Information System that enables policymakers to easily identify who is or isn't liable for tax on any patch of land in NI.

37. One constraint that is relevant to NI now, but also Scotland in the event of independence and Wales with its very permeable border, is the freedom of movement and the impact of excise taxes. Excise taxes are restricted because people can drive across the border and minimise such taxes. This limits the discretion of any NI government, as excises need to align (at least partly) with the Republic of Ireland. There would be a similar scenario for Scotland and Wales. However, Scotland may have a slight advantage as there is a relatively low population on the borders compared to the other nations.

Conclusions

38. There is no reason in principle why, in the long term, a substantial fraction of current taxes could not be devolved. However, this should be done slowly, considering one major tax at a time, starting with income tax. It was concluded that devolving national insurance would be a big a challenge. However, it was noted that this is something that should be looked at in all devolved nations. Arguably, Northern Ireland should look to pursue smaller taxes in the first instance.

39. The report looked at 20 of the different tax options and considered the following taxes:

a) For fuel duty and other excises, the difficulty would be the ability to get taxes resources such as petrol from over the border.

b) There is a powerful tax argument to place taxes on goods such as tobacco and alcohol.

c) Land tax should be easier to do in NI due to its good Land Registry system.

d) Air passenger duty appeals to politicians in NI, as it wanted to entice/retain long-haul carriers. When they pulled out, this resulted in a hole in the budget because they were no longer receiving the tax income.

[23] The Independent Fiscal Commission NI (2021) 'More Fiscal Devolution for Northern Ireland?' [Online] Available at: https://www.fiscalcommissionni.org/files/fiscalcommissionni/documents/2021-12/fcni-additional-exec-summary-with-charts-accessible_1.pdf

e) Corporation tax powers were already devolved in statute but have never commenced. The politicians in NI were then pressing hard for this due to the low corporation tax in the Republic but were less keen in their evidence to the NI Fiscal Commission. This is currently on pause due to the UK Treasury insisting that it would not consider corporation tax devolution until the NI Executive can demonstrate that it can maintain the sustainability of its finances.

Principles for implementing fiscal devolution.

40. The commission looked at both the Welsh and Scottish models and summarised that the Scottish model is higher risk and potentially higher reward than the Welsh model. It was added that all the previous discussions have highlighted the conflict between devolving tax and the various safeguards. The question was left whether the two Smith Principles are consistent with one and another and, if not, which is preferable:

41. *Smith Principle: (3) No detriment as a result of the decision to devolve further power: the Scottish and UK Governments' budgets should be no larger or smaller simply as a result of the initial transfer of tax and/or spending powers, before considering how these are used.*

42. *Smith Principle: (2) Economic responsibility: the revised funding framework should result in the devolved Scottish budget benefiting in full from policy decisions by the Scottish Government that increase revenues or reduce expenditure (or bear the full costs of policy decisions that reduce revenues or increase expenditure).*

Further points

Is devolving national insurance too much to the UK's devolved administrations?

43. The devolution of national insurance would be a UK-wide issue. National Insurance is more of a social security contribution than people realise. But across the world, social security contributions are rarely (or possibly never) devolved.

Do you need to engage the whole public in tax policy changes, and if so, what are the best ways to engage the public?

44. The big problem is fiscal psychology. For example, the public has a different attitude to national insurance than they do towards income tax. As people wrongly associate national insurance with pensions and assume that it contributes to a fund that pays for their pension. However, the fund was closed in 1911 and has never reopened.

Why the devolved regions need a green land value tax - and how to design it.

45. This section includes the arguments made for a green land value tax, and outlines what this tax would mean, its benefits, obstacles and how it should be designed.

Overview

46. Green land value tax (GLVT) could resolve conflicts between meeting climate goals, equity, and housing affordability. Land prices, reflected in house prices, relative to incomes, are near all-time records, pricing younger citizens out of home ownership and affordable rents. This is an issue facing much of Northern Europe. The OECD confirms that annual property taxes linked to current market values improve macroeconomic stability, efficiency and long-run growth rates.

47. It was proposed that a GLVT could help resolve the conflicts noted above; it would effectively be a split-rate property tax and would consist of a charge on the land plus a charge on the building minus a discount (depending on energy usage)—regular revaluations to discourage speculation and avoid cliff-edge changes.

48. To protect cash-poor but land-rich households, everyone would have the right to defer the tax. Deferral, initially for the over 65s, is crucial to the political acceptability of the GLVT to avoid complex interest charges, the tax authority would register a proportionate interest at the Land Registry equal to the unpaid tax for each year deferred, settled following the property's transfer or sale at the then prevailing price.

49. A GLVT would have multiple benefits for Wales and Scotland.

Criteria for property tax design.

50. The basic criteria for property tax design are to raise revenue, incentivise the green transition, improve equity, help stabilise the economy and financial system, reduce housing supply constraints, simplicity (if easy to understand and administer- helps compliance, reduce collection costs and reduces tax avoidance), maintain a balance between localism, subsidiarity and democratic accountability, and national objectives. And finally, public acceptability, which is a key element of any tax reform.

Raising revenue

51. Property taxes are difficult to avoid as property is a fixed asset. The cost of collecting property tax is low, and the revenue from property tax can potentially be considerable. The OECD has argued that 'many countries are underutilising the current property taxes and have substantial scope for increasing these levies.'[24]

52. The devolved regions have lower average incomes than England, which limits the scope for raising tax rates on economic activity above rates in England. However, Scotland probably has more concentrated patterns of private land ownership than any other country.[25] And much of this private land is owned by large businesses and non-locals. Therefore, a GLVT has the potential to raise more revenue in Scotland whilst, to some extent, avoiding overburdening locals with taxes on economic activity in order to increase tax revenue.

53. For any tax reform, extending the Land Registry data should be a high priority.

Incentives for economic growth and good resource-use

54. Generically, economists have long regarded land value tax (LVT) as the most efficient type of tax. The OECD argues that 'as the supply of land is highly inelastic, taxes on the unimproved value of land are economically efficient and therefore contrast with taxes on improvements (i.e., buildings), which may affect investment.'[26]

55. LVT captures more precisely than other property taxes an increase in value stemming from infrastructure investment and improvements in the quality of local schools or the environment and, of course, from planning gains. LVT helps land value capture, where the general public shares in land value gains from shifts in planning or zoning permission.[27]

56. The point is that the generic incentive arguments for the poor region are on steroids for Scotland and Wales. The UK's high relative price of land and cumbersome planning system have long impeded UK competitiveness. If we consider what attracts highly productive people and businesses to a region, it's usually low costs of doing business, relatively low taxes and high-value public services, infrastructure, and a high level of education in the local workforce and culture. It, then perhaps makes particular sense in the devolved regions to lower the taxes on productive economic activity and transactions but increase the taxes on land.

The distributional aspect of green policies

57. The green aspect of this proposal is essential. Green policies can potentially weigh most heavily on the poor, worsening housing affordability and fuel poverty. Hence, public acceptance of green policies requires that the distributional issues are front and centre of policy design. Targeted subsidies and progressive green taxes and finance must compensate for higher short-run costs due to green taxes and tougher building regulations. Green property tax could resolve the conflict between affordability, equity and meeting climate goals. Indeed, the OECD has also noted the potential for green property tax.[28]

58. The proposed GLVT would apply a discount on buildings depending on their energy usage, with a maximum discount for energy-neutral buildings and gardens. Give every household the right to defer the tax, offering a small discount for cash payers choosing not to defer to avoid subsidising the deferments.

Improving progressivity and efficiency

59. Property taxes can be made more progressive, for example, by imposing a surcharge on the most expensive properties and/or giving a tax allowance of, say, the first £50,000 of each property's value. The tax allowance could be linked to regional house prices to make the tax less onerous in the highest-priced regions. And to improve efficiency, it could cut transaction taxes (stamp duty), given the higher revenue from recurrent property tax. Lower transaction taxes increase the flexibility

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[24] OECD (2021). 'Brick by Brick: Building Better Housing Policies.' https://www.oecd.org/social/brick-by-brick-b453b043-en.htm

[25] Scottish Government (2014). 'The land of Scotland and the common good: report.' https://www.gov.scot/publications/land-reform-review-group-final-report-land-scotland-common-good/pages/61/

[26] OECD (2022). 'Housing Taxation in OECD Countries.' https://www.oecd-ilibrary.org/taxation/housing-taxation-in-oecd-countries_03dfe007-en

[27] OECD (2022). 'Global Compendium of Land Value Capture Policies.' https://www.oecd-ilibrary.org/urban-rural-and-regional-development/global-compendium-of-land-value-capture-policies_4f9559ee-en

[28] OECD (2021). Making Property Tax Reform Happen in China. https://www.oecd-ilibrary.org/taxation/making-property-tax-reform-happen-in-china_bd0fbae3-en

of labour and housing markets and adaption to shifts in the economic environment. Adaptation to shifts in the economic environment with climate change is becoming increasingly important. For example, people may increasingly need to relocate due to adverse weather events, such as floods.

Other criteria GLVT meets for property tax design.

60. The GLVT could also meet other criteria for property tax design as it incentivises supply and affordability. Housing supply restrictions resulting from planning systems, zoning regulations and costs of supplying new infrastructure are significant problems in many countries, especially UK.[29] This is a key reason why NIMBYS tend to reject new developments. Good property tax design can help fund new infrastructure.

61. Supply can also include the existing stock. Well-designed market value-linked property taxes, avoiding single-person and second-home discounts, improve the efficient use of the stock. For example, they encourage downsizing by retired households.

62. Well-designed taxes could also help resolve the affordability issues for locals in tourist destinations. Higher tax rates on second homes and international investors (not domestic taxpayers or pensioners) discourage foreign speculation and increase utilisation rates.

Designing property tax deferral

63. Deferral is critical as it is a key element of public acceptance. An equity-based referral is where the proportion of interest is registered on the Land Registry and is settled when the property is sold or transferred. This would help protect cash-poor but property-rich taxpayers. International research on existing deferral schemes shows that there has been a remarkably low take-up. Northern Ireland is one example. Eligibility restrictions, ignorance, complexity and concern about high-interest rates are possible reasons.[30]

64. In contrast, the proposal's proportion of equity deferral is easy to understand. It would only involve ticking a box on the property tax form requesting deferral without submitting to a means test, complex form-filling and compound interest rate calculations. In most OECD countries, house prices have risen more than incomes in the long run, which should ensure solid long-run revenue flows. This type of deferral is also helpful to stabilise the economy, as in boom periods when house prices are expected to increase, the incentive to pay cash increases, taking money out of the economy.

Tax and agricultural land

65. For Scotland, this is a critical issue. Tax privileges (e.g., for estate duty) apply to UK agricultural and forest land. In the low-interest rate environment of the last 20 years, extensive portfolio flows from international investors searching for yield have driven up prices.[31] This has had negative consequences. It has increased barriers to entry into farming, contributed to the exit of family farms and increased the riskiness of agriculture for those without significant capital behind them. As towns and cities have expanded, the rising prices of nearby agricultural land have worsened the housing affordability problem.

66. There is, therefore, a need to include agricultural land in the tax system. While use-based exemptions for national parks and areas of outstanding natural beauty make sense, it is better for general principles to govern tax criteria. On distributional grounds, agricultural and vacant land should be included in a broad-based property tax regime, but for tax allowances to apply. For example, if you exempt the first £15,000 per hectare of value, then much of the rural land in Scotland and, indeed, Wales would be tax-exempt.

67. This system could give positive incentives for the extension of national parks and conservation because some landowners can reduce their tax bill by switching parts of their land to a national park.

Public acceptability and ease of transition

68. It was understood that across the political spectrum raising taxes, even with politicians who would traditionally support tax rises, is difficult because there is often public backlash. As Thomas Piketty pointed out, in a stable economic arrangement, capital accumulates.[32]

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[29] C. Hilber & W. Vermeulen (2014). 'The Impact of Supply Constraints on House Prices in England.' *The Economic Journal*. https://onlinelibrary.wiley.com/doi/full/10.1111/ecoj.12213

[30] A. Munnell et al. (2022). Chapter 12: 'Property Tax Deferral: Can a Public-Private Partnership Help Provide Lifetime Income' in *New Models for Managing Longevity Risk: Public-Private Partnerships*. O. Mitchell (ed.). https://academic.oup.com/book/41445/chapter/352801667

[31] Savills (2020). 'Global Farmland Index.' https://pdf.euro.savills.co.uk/uk/rural---other/spotlight-global-farmland-index---sep-2020.pdf

[32] Thomas Picketty (2013) *Capital in the Twenty-First Century.* Harvard: Harvard University Press.

69. Most citizens do not understand 'General Equilibrium' – the idea that many inter-relations, spillovers, feedbacks and unintended consequences exist. Any change creates uncertainty, generating resistance, and losers shout louder than winners, especially for redistribution with widely spread small gains and concentrated losses. So clearly, the transition would require a phased implementation.

How do we make this transition?

1. Extend coverage of the Land Registry.

2. Invest in robust systems and trained staff for generating energy performance certificates (EPCs).

3. Reconsider the harmonisation of local, regional and national tax regimes and the funding structure of local government.

4. **Concurrently**, update property valuations, assuming regular revaluations will continue, trial methods of separating building and land values.

5. Phase in new, non-regressive domestic and business property tax structures with green discounts and deferral.

6. At the next revaluation, separate building, and land values.

Phase in new split-rate property tax structure

Would this be a taxing exercise at the UK Government level, regional government level, or Local Government level?

70. As council taxes, council tax revenue in the current system, at least in principle, goes to local authorities, who have some discretion.

What kind of equalisation scheme would be in place?

71. Council tax is currently regressive at the local and regional levels. If we replaced council tax with something close to a proportional tax on property values, the more affluent areas would pay more than the less affluent areas. To equalise this, there would then have to be compensatory transfers from the devolved government budget to poorer local authorities to compensate for the difference in revenue being raised. One can envisage revenue sharing between local and central governments.

Would GLVT increase the taxable capacity of an area?

72. There was substantial agreement that land taxes could be developed, implemented better and used more effectively, especially in the devolved areas. However, the question was raised as to whether GLVT would increase the taxable capacity of an area.

73. With the GLVT, a person would pay the tax on land. However, it would be paid from their income. Therefore, it won't necessarily increase the amount of tax revenue by switching to land taxation, although it is possible. It can, however, improve economic efficiency and improve equity.

Is wealth tax an alternative to land tax?

74. Wealth tax is an alternative to land tax, but wealth is very mobile. What is not mobile is the ground underneath one's feet. In Scotland, property tax raises about 5 billion a year. Even an 10% inflationary increase is half a billion and far more than any income tax. And it was noted that with GLVT, the tax will be paid from income. The key point is to reduce the taxes on income and increase the taxes on land/capital – without necessarily increasing overall tax revenue (although it possibly could), whilst being more efficient and equitable in terms of outcomes).

How important is the green aspect of LVT, and how easy would it be to project tax revenue under the deferral scheme within a (G)LVT?

75. The green element is extremely important, as tackling climate change should remain a priority for the UK. But for the transition to GLVT, the green element is essential to avoid the scheme being known as a garden tax. Gardens don't produce greenhouse gas emissions, which must be considered and incorporated into the payments.

If there is a gap in tax revenue for the first few years that the tax scheme is introduced that could effectively be handled by borrowing, how would this impact Scotland/Wales/N. Ireland?

76. Since the wealth transfer from the people who have deferred to the tax authority is there in the government balance sheet, the markets should be happy with what looks like an increase in debt but leaves the net asset value of the government intact. In principle, HMT should be happy to allow devolved government debt to rise when balanced by a rise in its assets.

Would a simple means test be better than deferral?

77. The international data on deferral shows that the take-up of deferrals is extremely low and these onerous tests and the build-up of debt in existing deferral schemes tends to deter people from choosing the option.[33]

[33] A. Munnell et al. (2022). Chapter 12: 'Property Tax Deferral: Can a Public-Private Partnership Help Provide Lifetime Income' in *New Models for Managing Longevity Risk: Public-Private Partnerships*. O. Mitchell (ed.). https://academic.oup.com/book/41445/chapter/352801667

Chair's conclusion

78. All three devolved administrations still spend considerably more than they raise in taxation. This is true even in Scotland, because although almost the entire proceeds of income tax raised in Scotland are spent there, the Scottish Government has no control over allowances and reliefs, which are still under UK government control. Transfer of VAT raised on Scotland to the Scottish Government has not yet occurred and would not give the Scottish Government a policy lever even if transferred unless it had the power to alter the rates and/or coverage of VAT. Therefore, all 3 administrations remain dependent on block grant ('Barnett consequentials') to fund a proportion of the services they run. Block grant adjustments are both highly technical and controversial.

79. A more mature tax-and-spending regime in each case requires the devolved administrations to take responsibility for each marginal £ it spends and each marginal £ it raises in tax, so that it can make the trade-offs that a mature democracy requires between taxing and spending. The devolved administrations should all consider more innovative approaches to property taxations, so that property taxes are less regressive, do not discourage transactions, and fall most on the shoulders of those who can most afford to pay them.

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