



Institute for
Fiscal Studies

Taxation: principles and devolved powers

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Main objectives of taxation

1. Raise revenue to finance public spending
 2. Redistribute from the better-off to the needy
- We make no judgement as to the appropriate extent of these
 - What matters is how well the system as a whole achieves them
 - Not individual taxes

Characteristics of a good tax system

For a given revenue yield and distributional outcome, what matter are:

- Economic efficiency
 - Operational efficiency
 - Minimise admin and compliance costs
 - Transparency
 - Fairness
 - Due process, non-discrimination, respect legitimate expectations, etc
- “proportionality”
- “efficiency”
- “convenience”
- “certainty”
-
- ```
graph TD; P["proportionality"] --> E["Economic efficiency"]; E --> EF["efficiency"]; O["Operational efficiency"] --> EF; C["convenience"] --> MC["Minimise admin and compliance costs"]; T["Transparency"] --> CE["certainty"]; F["Fairness"] --> CE;
```

# Characteristics of a good tax system

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- Economic efficiency
  - Operational efficiency
    - Minimise admin and compliance costs
  - Transparency
  - Fairness
    - Due process, non-discrimination, respect legitimate expectations, etc
- } Simplicity

# Two rules of thumb

- Stability. Helps to avoid:
  - Change-related distortions (forestalling, off-putting uncertainty, etc)
  - Operational costs of transition
  - Having to learn about new system
  - Disappointing legitimate expectations
  - But upheaval sometimes justified if existing system costly
  - Don't introduce ill-thought-through policies in the first place!
- Neutrality, i.e. treating similar activities similarly
  - Tends to be simpler, fairer and less distortionary
  - Not always – but should have a high hurdle to justify exceptions

# What this presentation isn't about

- How to reform the UK tax system in line with these principles
    - See [www.ifs.org.uk/mirrleesReview](http://www.ifs.org.uk/mirrleesReview)
  - How an independent Scotland's tax system should differ from that
    - See [www.ifs.org.uk/publications/6912](http://www.ifs.org.uk/publications/6912)
- Instead, look at options for devolved tax powers
- Only limited powers → hard to consider the system as a whole

# Varying income tax rates

- Scottish Rate of Income Tax stronger tool than Scottish Variable Rate
  - Not just basic rate; not just  $\pm 3$  percentage points
- Can only move all rates together (on unchanged tax base)
  - Limits ability to tailor preferred degree of redistribution
  - Limits tax competition with rUK
- Practical advantages to keeping same rates as rUK
- Old powers not used – suggests extra powers of limited value?
  - Unless particularly keen to include higher-rate taxpayers

# Scottish landfill tax

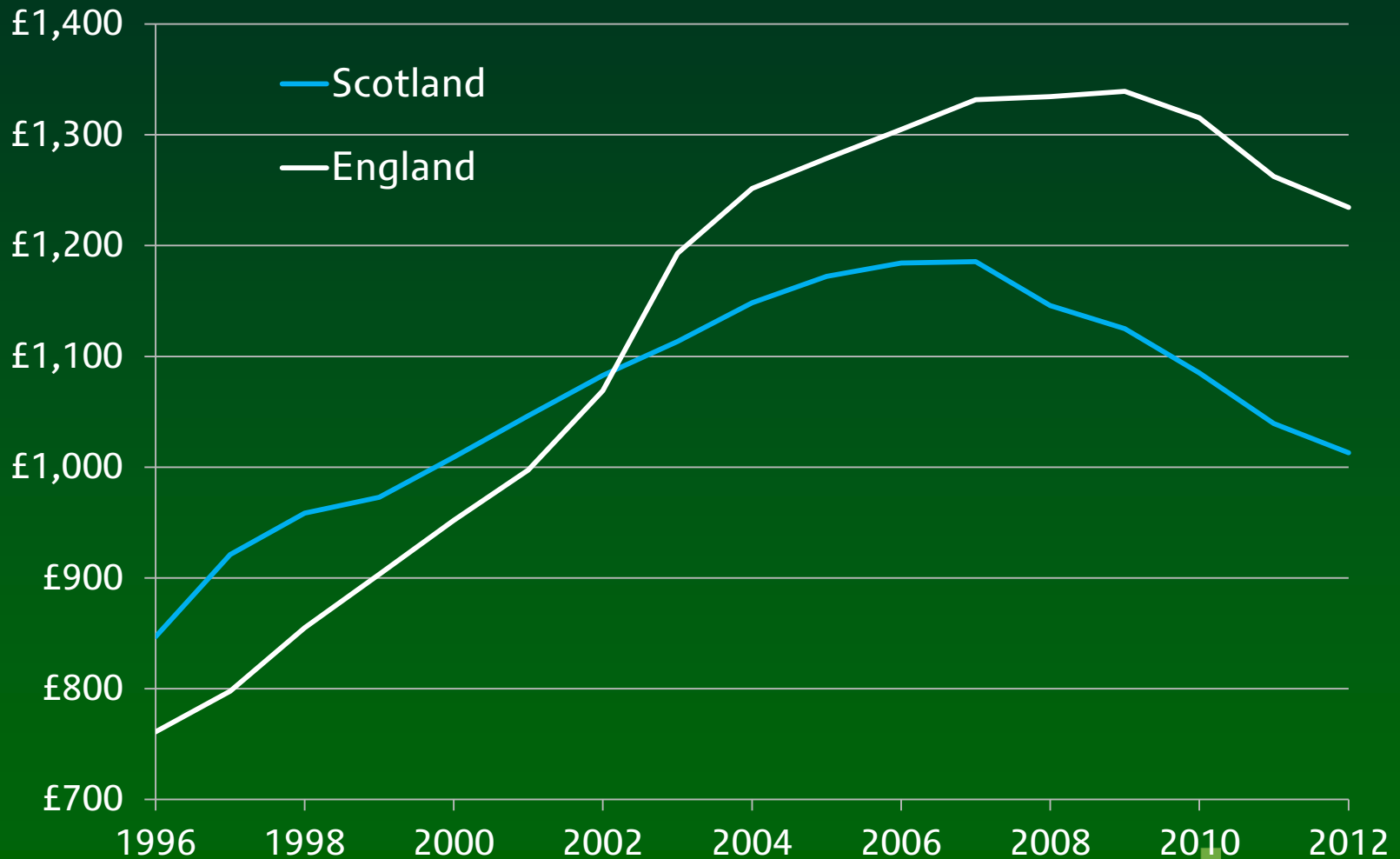
- Scottish government says rates here will at least match UK rates
- Guiding principle should be to set tax = value of environmental damage from additional landfill
- £2.50 / tonne for inactive waste roughly in line with this
- £80 / tonne for active waste far exceeds any reasonable estimate...
- ...but rate for active waste now looks unimportant, since...
- Waste (Scotland) Regulations 2012 ban all landfill of active waste from January 2021
  - Odd, since estimated harm from landfill is relatively modest



# Land and buildings transactions tax

- Improvement on 'slab' structure of stamp duty land tax
  - Absurd that £1 higher price could mean £40,000 higher tax bill
- But more fundamentally, transactions should not be taxed at all
  - Why impose heavier tax on properties that change hands more often?
  - Assets should be held by the people who value them most
  - Reduced labour mobility one symptom of this more fundamental problem
- Transaction taxes should not be part of the tax system
  - But don't want to give up revenue / give windfall gains to current owners
  - So look to replace with better taxes rather than simply abolish

# Average council tax bill, 2013-14 prices



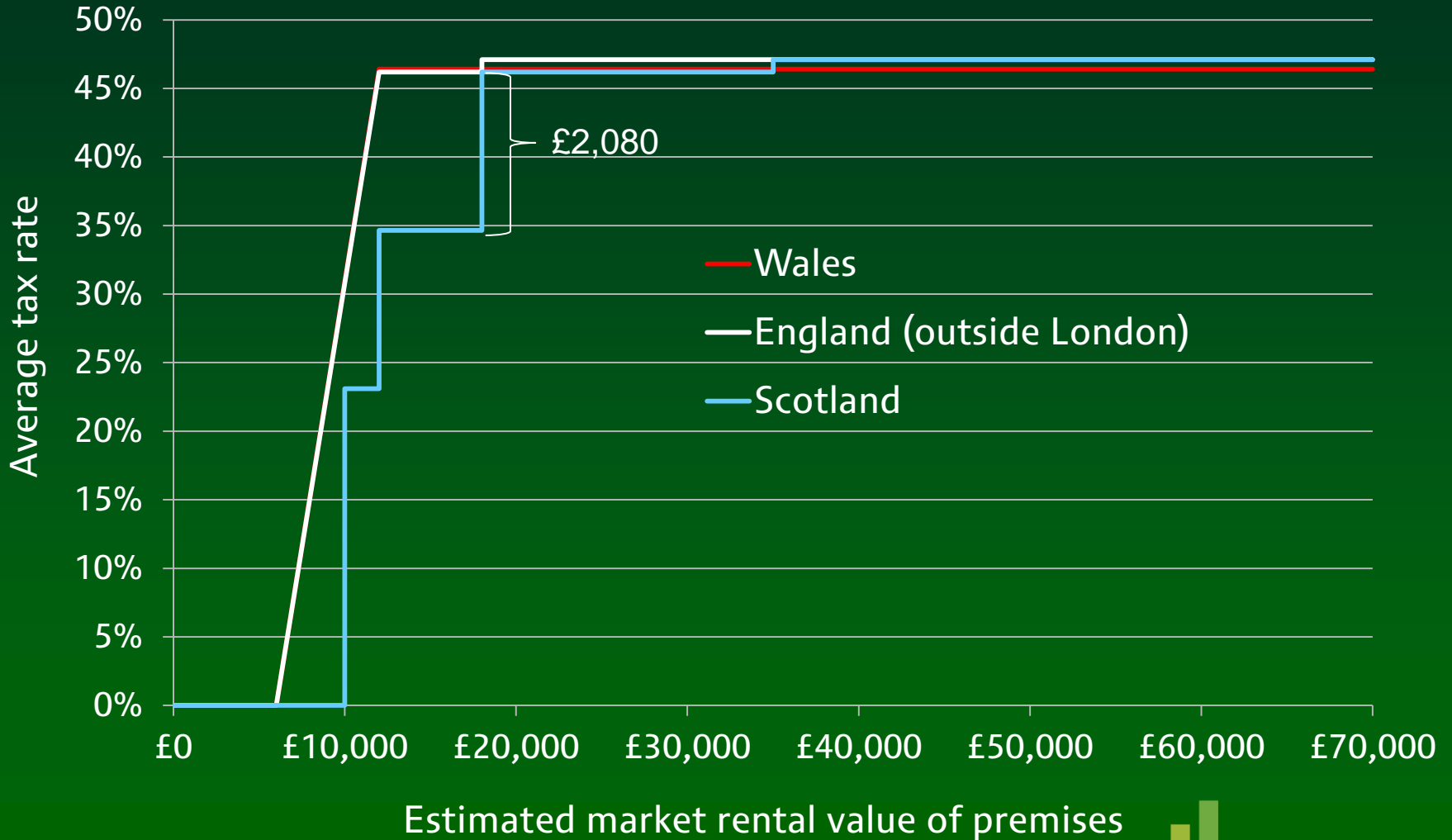
# Reforming council tax

Should be a simple percentage of up-to-date property values:

- Based on up-to-date valuations
  - rather than 1991 values
- Proportional to values
  - rather than pointlessly regressive and banded
- No discounts for single occupancy
  - rather than 25% discount
- Replace revenue from residential LBTT in the process



# Business rates, 2013-14



Estimated market rental value of premises



# Reforming business rates

- Eliminate jumps in rate schedule
- More frequent revaluations
  - Delay to 2017 is a move in wrong direction
- End exemption of agricultural land and property

But, like stamp duty, business rates are more fundamentally flawed...

# Replacing business rates

- Business property is an intermediate input to production
- Basic principle that intermediate inputs should not be taxed
  - Economy inefficiently skewed away from property-intensive production
- Taxing land value (excluding buildings) does not have this problem
  - Fixed supply of land – taxing it does not discourage any desirable activity
  - Windfall loss to land-owner on day tax is announced
  - But no disincentive to buy, develop or use land
- Replace business rates (and non-domestic LBTT) with land value tax?
  - Redistributes from owners of undeveloped land to owners of highly developed (and/or frequently traded) properties
- Subject to confirming practical feasibility
  - Valuing land and buildings separately is hard

# Conclusions

- Underlying principles being cited are broadly sensible
- Question is how far policy decisions reflect them
  - Big issue is property taxation
- LBTT is an improvement on SDLT
- More fundamental reform of property taxes needed
  - Make council tax proportional to up-to-date valuations
  - Reform business rates and ideally replace with land value tax
  - Abolish LBTT and replace revenue through these other taxes
- Limited use of powers to date suggests little appetite for radical reform



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