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
- Transparency
- Fairness

- Minimise admin and compliance costs
- Due process, non-discrimination, respect legitimate expectations, etc

- “proportionality”
- “efficiency”
- “convenience”
- “certainty”
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
  
  - Simplicity

• Transparency

• Fairness
  – Due process, non-discrimination, respect legitimate expectations, etc
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

• How an independent Scotland’s tax system should differ from that
  – See 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 ± 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

- £700
- £800
- £900
- £1,000
- £1,100
- £1,200
- £1,300
- £1,400


Scotland
England

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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

Average tax rate

- Wales
- England (outside London)
- Scotland

Note: assumes outside London

Estimated market rental value of premises

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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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