How better tax policy can reduce poverty and inequality: Recommendations for an effective and accountable Scotland

16 October 2023

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Acknowledgements

The Commission is very grateful to members of its tax working group who have contributed their time and expertise to its work on tax:

- Shona Stephen & Alex Cobham, Commissioners at the Poverty and Inequality Commission and tax working group Chairs
- Bill Scott, Chair of the Poverty and Inequality Commission
- Joanne Walker, Technical Officer, Low Incomes Tax Reform Group
- Professor Mike Danson, Heriot-Watt University
- Sasha Saben Callaghan, Poverty and Inequality Commission Experts by Experience Panel member
- PM*, Poverty and Inequality Commission Experts by Experience Panel member

The Commission also wants to extend its thanks to the following contributors whom the tax working group has engaged with to discuss tax policy in Scotland over the course of its work:

- Martin Davidson, Scottish Government
- Professor Mairi Spowage, Director, Fraser of Allander Institute
- Howard Reed, Director, Landman Economics
- Professor Mark Stephens, University of Glasgow
- Rebekah Cameron-Berry, COSLA
- Jonathan Sharma, COSLA
- James MacKessack-Leitch, Scottish Land Commission
- Clare Blake, Welsh Government
- Debra Carter, Welsh Government
- Anna Adams, Welsh Government
- Andy Wightman, writer & researcher on land rights and democracy, former MSP
- Arun Advani, Associate Professor at the University of Warwick and co-chair of Discover Economics
- David Phillips, Associate Director, Institute for Fiscal Studies

The Commission thanks all of the above for their valued contributions and expertise. This report and the recommendations it contains represent the views of the Poverty and Inequality Commission.

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Summary

We all pay tax in a variety of forms – be they direct taxes like those on income, or indirect tax included in the cost of goods and services like VAT. Funding from taxation helps provide the services that people in Scotland rely on. Tax is an important part of the way society can reduce inequality through the redistribution of resources from one group to another. But in addition to this, taxes are also an important part of the relationship between each of us and our democratic structures. Taxation creates a connection between each citizen and their fellows, and between each citizen and our various levels of government. Tax is strongly linked to political representation, quality of governance, and how much citizens feel part of society.

The financial situation facing the government and public services in Scotland is challenging in the extreme, both in the immediate here-and-now, and in terms of the level of spend projected to be required in the longer-term to maintain, let alone improve, the quality of services. As a consequence, some of the recent public discourse in Scotland has appeared to focus on how to make tweaks to existing levers and raise taxes to plug short-term fiscal gaps. While this is understandable given the context, it is an inadequate response to the scale of the challenges facing public finances. It also ignores the benefits of looking more fundamentally at what we want taxation in Scotland to do and what it could achieve.

When we began our work on tax we started by considering to what extent current arrangements for taxation in Scotland are "progressive" overall – that is, a tax system in which those with higher income or wealth pay higher taxes – and also the degree to which they can reduce poverty and inequality. We have concluded that the overall taxation system in Scotland is indeed progressive, both as a result of the changes made to devolved taxes in recent years – such as changes to the Scottish rates and bands of income tax – and also as a consequence of how revenue raised by tax in Scotland tends to be spent on priorities related to the reduction of poverty and inequality.

We believe that people in Scotland value fairness in our taxation system and wider society, and want to see an end to poverty. Because of this, we have concluded that the changes to date are relatively modest compared to what could be achieved in terms of reducing poverty and inequality if we set our sights higher. Changes around the edges of some existing devolved taxes (such as further increases to the Scottish higher or top rates of income tax) under the current devolution settlement are not likely to be an adequate long-term response to the fiscal challenges faced. The Scottish Government must have the ambition to look at fundamentally reformed and better designed taxation policies – not just slightly tweaked levels of existing taxes – in order to address the public finance challenges that the country faces, and to achieve the ambitions it has around poverty reduction.

We acknowledge that some of these recommendations face barriers in delivery including those relating to the current devolution framework, and a range of other practical challenges. In this report and its recommendations we have set out our understanding of some of these issues. Some of these challenges have also been documented by others and we repeat some of their messages in this report. However, the recommendations we make include things that could be started now (or indeed relate to previously made commitments that are overdue for completion). Overall, they represent our best understanding of a package of measures that need to be taken as a whole if Scotland is to make best use of taxation in order to reduce poverty and inequality.

We recommend that, in order to reform taxation to reduce poverty and inequality, the Scottish Government and its partners must:

Recommendation 1: Ensure all land and property in Scotland is registered with a current and accurate valuation.

- **Why:** Accurate and timely information on the value and ownership of property and land is fundamental to understanding both patterns of ownership and the potential value of the tax base. Scotland has various systems for recording land and property ownership and value, but they are incomplete and/or out of date despite many years passing since original commitments for reform were made. This results in a fragmented and incomplete picture, which is an inadequate basis for any serious attempts to reform how we tax land and property – for example, by moving towards greater taxation on wealth held in property and land, rather than a reliance mostly on taxation of earned income.
- **How:** Collect and bring together the necessary data in a comprehensive fashion and create a mechanism (e.g. a website) where all land and property information is brought together and made available for authorities to, among other things, design effective taxation policy for property and land in both business and domestic usage. This platform should use open data principles and to the greatest extent possible be open for the public, organisations, and independent researchers to examine, use and reuse.
- **When:** There are multiple components to this work, some of which are necessary pre-requisites for redesign of local taxation in Scotland. As a priority, domestic property revaluation is needed in relation to Council Tax. Work on this should start now to be in place no later than 2026 (with a 2024 or 2025 date of valuation). On land information, a commitment to developing a system to comprehensively register land has been made since at least as far back as 2015, and the design of any future replacement to Council Tax that has a land component will require it. The original scope of Scotland's Land Information System (ScotLIS) had a two year timeframe, and expert observers have noted that not all of this scope has been fulfilled, and have proposed that a two year timeframe from now to bring it to its potential remains achievable. The Commission supports this call.

Recommendation 2: Revalue properties subject to the current council tax, and immediately start work to design its replacement.

- **Why:** Council tax is widely acknowledged as a fundamentally flawed and regressive tax, in part because valuations date from 1991, over 30 years ago. Recent consultation proposals presented as making it "fairer" through making small adjustments to band multipliers are not sufficient to address the core limitations of its current design. Making changes to band multipliers without revaluation means these changes will not impact all of the properties that they should, and will impact some that they should not.
- **How:** There should be a package of reform measures that begins with immediate revaluation (as has already been the case in Wales) and has the clear end point of creating a long-term replacement for Council Tax. Plans should be put in place for regular future cycles of valuation.
- **When:** Work on revaluation should commence immediately to the timetable in Recommendation 1. Design of a longer term replacement that sets rates proportionate to property value and potentially with a land component should also commence immediately. The Scottish Government should be in a position to begin consultation on the proposed new design for a long-term replacement to Council Tax by the end of 2026.

Recommendation 3: Seek to devolve the necessary powers to set rates and bands of income tax for savings and dividend income for Scottish taxpayers.

- **Why:** This provides an opportunity for the Scottish Government to set the rates and bands of income tax on savings and dividend income at the same rates and bands as for Scottish Income Tax for non-savings and non-dividend income. This would ensure that more income in Scotland is taxed at the same rate no matter its source (whether earnings from work or income from savings and dividends). This can reduce the impact of one important route of income tax avoidance where people who have the ability to do so will arrange to receive their income in a way that attracts lower rates of tax.
- **How:** The Scottish Government needs to seek and reach agreement with the UK Government on this or any other new tax power to be devolved. While this is progressing the Scottish Government can carry out analysis to allow setting the right rates and bands for savings and dividends income from the moment the powers are secured. This should include analysis of the option to set the rates and bands for income from savings and dividends to the same, or higher, rates and bands as Scottish Income Tax for non-savings and non-dividend income and consideration of the degree of revenue raised and the potential for cross-border effects between Scotland and the rest of the UK in such circumstances. It should appraise options in a way that also identifies and quantifies the risks of a "race to the bottom" in terms of competition and pressure to lower tax rates between Scotland and the rest of the UK on this matter.
- **When:** The Welsh Government has sought to engage with the UK Government on a similar request to gain competency for a new vacant land tax, formally requesting a new tax power in early 2020. This process is still ongoing at the present time. Because of the need to seek agreement with the UK Government and the timeline required implied from the Welsh experience, the work should start immediately to ensure the power is in place at the earliest opportunity.

Recommendation 4: Improve public understanding of, and compliance with, devolved taxation.

- **Why:** Devolved taxation and its interaction with reserved taxes can be complex, and some elements are poorly understood by taxpayers. This should be addressed by actions to improve understanding of and connection with the tax system among Scottish taxpayers (including explanation of the fiscal framework), and also actions on tax compliance and audit work.
- **How:** In its next tax publication, the Scottish Government should set out specific actions as to how it will advance the "engagement" principle from its 2021 Framework for Tax publication. This should include preparing and communicating analysis that summarises in as simplified a manner as possible what happens to each pound in Scotland raised by taxation after the effects of the fiscal framework between the Scottish Government and the UK Government have taken effect. It should agree with the UK Government a means through which the Scottish Government can produce and disseminate its own version of HMRC's Annual Tax Summary, that highlights how the Scottish Government spends tax revenue raised, emphasising the benefits to society and particularly how it enables the reduction of poverty and inequality. It should review the statutory and guidance definitions of a Scottish taxpayer, ensuring it is as tight and objective as possible and limits the possibility for individuals to move away from Scotland "on paper" to avoid devolved taxes. It should create and agree a process with the UK Government by which Scottish Ministers can invest further in tax compliance and audit, ensuring resulting revenues from work in Scotland accrue to Scotland.
- **When:** This work can commence now, with an objective to complete it by the end of the current Scottish Parliament session in 2026.

Recommendation 5: Broaden the tax base in Scotland by doing the work required to bring wealth into scope for future tax policy, and implement transparency measures on the profits of multinational companies.

- **Why:** To properly address the longer-term public finance challenges facing Scotland and to make meaningful progress on Scottish Government ambitions to reduce poverty and inequality, it will be necessary to broaden the tax base beyond a reliance on taxing earned income. This will take time and faces a range of practical and political barriers. However if this work is not done (and commenced now), it is extremely difficult to see how public finances will be on a sustainable footing in the future if service levels are to be maintained and improved, and if the Scottish Government is to stand a chance of realising its poverty reduction ambitions and meeting its statutory child poverty targets.

- **How:** The Scottish Government should appraise and publish, for public scrutiny, different scenarios and options for the introduction of taxation on wealth in Scotland (for example, securing new national wealth tax powers in agreement with UK Government, or introduction of a local wealth tax under current powers). Alongside our Recommendation 1 on the creation of a comprehensive registration system for land and property, it should determine the feasibility of extending this to enable wealth assets to be registered for the purposes of assessing the tax base. Scotland should seek agreement with the UK Government to introduce public country by country reporting for multinational companies to ensure transparency of companies who shift profits for the purposes of avoiding tax liability.

- **When:** Taking forward a package of options to allow wealth to be brought into the tax base in the future will be a longer-term, but necessary, goal. Depending on the options selected to pursue from the appraisal exercise, it may also require agreement with the UK Government on devolving new tax powers. But some aspects can commence immediately, such as beginning work on public country by country reporting for multinationals, and the Scottish Government appraising and publishing options on the benefits and costs of different ways a taxation on wealth could be introduced in Scotland. Given the public finance challenges present in longer term forecasts, we think the Scottish Government should set an aim to be in the position to bring forward a package of proposals to tax wealth by the end of the current Scottish Parliament session in 2026.

1 Introduction

Why focus on tax?

The Poverty and Inequality Commission is an advisory non-departmental public body. It exists to provide independent advice to Scottish Ministers on poverty and inequality. The Commission has a particular statutory focus on child poverty as part of the Child Poverty (Scotland) Act 2017, and also a range of broader functions on monitoring progress and proposing solutions to reduce poverty and inequality in Scotland.

Tax policy in Scotland has become increasingly important over time with the devolution of further tax powers as a result of the Scotland Act 2012 and 2016, including the powers to allow the setting of Scottish rates and bands for Income Tax. Since these tax powers have been devolved, the annual Scottish Government budget has increasingly been funded from revenues raised from devolved taxation, with the largest share of this coming from income tax.[1] As a result, the Scottish Government has increasingly moved from a government restricted to making spending choices based on a pre-set grant (the block grant it receives from the UK Government), to one that has choices on how to raise revenue, as well as how to spend it.

Debate on tax policy – who pays what tax and how much of it they pay – can be contentious, but is essential.

Tax can be presented as a technical subject, on which only proven "experts" can offer valid opinions. But tax affects us all, and determines much about the society we live in - including through its central role in funding public services in Scotland, and the importance of tax in political representation and democratic engagement. It is vital, then, that tax policy decisions are opened up for debate across our whole society.

Scotland faces an extremely challenging fiscal position both in the here-and-now, and looking to the longer term. The Scottish Government has high ambitions in terms of tackling poverty – "in all its forms" as stated in the First Minister's recent policy prospectus[2] – including meeting statutory child poverty targets. Based on progress and plans to date the Commission has taken the view that there is a very high likelihood that the Scottish Government will miss its 2030 child poverty targets.[3] Insufficient or delayed funding for delivery of existing poverty-reduction commitments and apparent lack of available or committed funding to deliver on future aspirations is one of the main reasons for this concern.

To achieve long term fiscal sustainability for Scotland, and for the Scottish Government to realise its ambitions on tackling poverty and inequality, substantive action on the design and operation of tax will be required.

Scotland's fiscal challenges

The Scottish Government's Medium-Term Financial Strategy[4], published earlier this year alongside forecasts from the Scottish Fiscal Commission[5], set out the scale of the challenge. The medium-term financial strategy estimates that the Scottish Government's resource spending (the part of the budget for day-to-day spending required to run public services) could exceed funding projections by around £1 billion in 2024-25, increasing to around £1.9 billion by 2027-28.

For perspective, around £1 billion is more than that allocated in the 2023-24 Scottish Government Budget[6] for NHS Tayside, or more than double that allocated for the Scottish Child Payment[i]. These are profoundly challenging fiscal projections that cannot be allowed to manifest in reality.

The Scottish Fiscal Commission highlight some of the reasons behind the way spending is projected to outstrip resources. They expect[5] social security spend in Scotland to increase from £5.3 billion in 2023-24 to £7.8 billion in 2028-29, and by 2027-28 they expect the Scottish Government to be spending £1.3 billion more on social security than the funding it receives after the UK Government block grant adjustments. This is particularly as a result of an expected higher spend on disability social security payments in the coming years.

Separately, the Scottish Fiscal Commission have published an indicative longer term assessment[7] of

[i] The Scottish Child Payment is a devolved benefit available only in Scotland that pays £25 per child per week to eligible families with children under 16. The Scottish Child Payment is expected to drive the majority of the reduction in child poverty we hope to see by the time data on the interim target year of 2023-24 becomes available.

Scotland's fiscal sustainability. It shows that, while both Scotland and the rest of the UK will have an increasingly older population in the coming decades, the Scottish population is projected to fall while the UK population will grow. Partly as a consequence, spend on health is projected to increase to around 50% of devolved spending over the next 50 years to 2072-73 (from around 35% in 2027-28). The Scottish Fiscal Commission also estimate that, in these circumstances, Scottish Government spending would exceed the estimated funding available (if public services continued to be delivered as they are today) by an average of 1.7% each year, rising to upwards of 10% each year depending on the way the UK Government responds to similar fiscal pressures.

These modelling exercises all come with substantial uncertainty, particularly as they project far into the future and they are not intended to be predictions as to what will happen. However, they show the serious and enduring nature of the fiscal challenge. This is not something that will go away with small tweaks to existing systems and structures.

What it will take to tackle poverty in "all its forms"

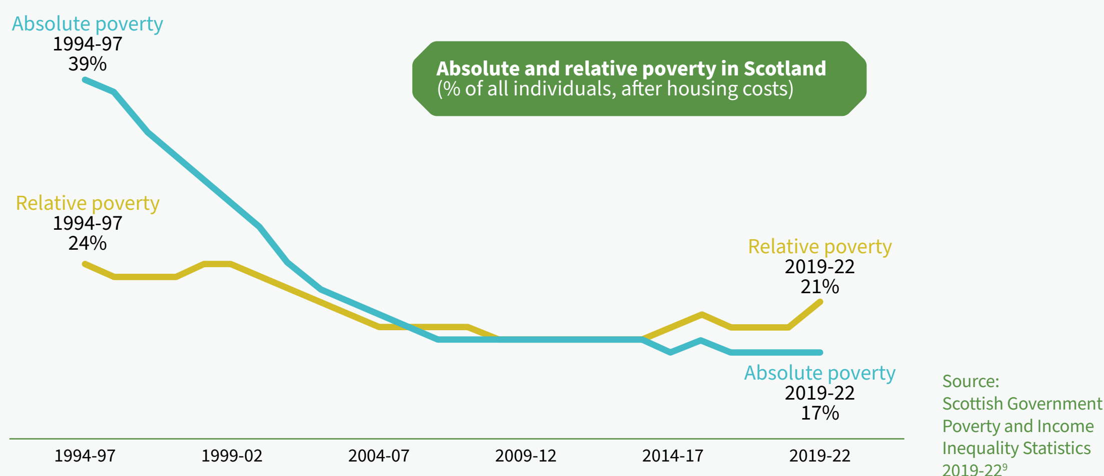
In recent years the Scottish Government has made strong commitments on tackling poverty, including the introduction of statutory child poverty reduction targets. In April the First Minister reiterated in his policy prospectus[2] the Scottish Government's commitment to tackle poverty in "all its forms" and to "use our fixed budget and all the powers we have to reach our targets of substantially reducing child poverty".

The policy prospectus includes outcomes the Scottish Government wants to see and some actions it will take over the course to 2026, when the current Scottish Parliamentary session ends. On poverty reduction, it makes reference to reducing child poverty rates; investment in social security; and actions and legislation on housing, human rights and other areas. Separately, on tax, the policy prospectus says that the Scottish Government will use its powers to deliver the "most progressive tax system in the UK", make tax policy choices informed by engagement and ensure revenue generated is used to achieve the Government's missions (which include the "equality" mission of tackling poverty and protecting people from harm).

This policy prospectus timeframe takes us up to 2026. By the time we are there, it will be a decade since Naomi Eisenstadt published her first report on poverty, Shifting the Curve[8], as the Independent Advisor on Poverty and Inequality, at the request of the former First Minister Nicola Sturgeon. By "shifting the curve" Naomi Eisenstadt meant significantly reducing the number of people living in poverty. Despite efforts over the intervening years, between then and now, Scotland has not yet been successful in shifting this curve.

Scotland has not yet "shifted the curve" on poverty

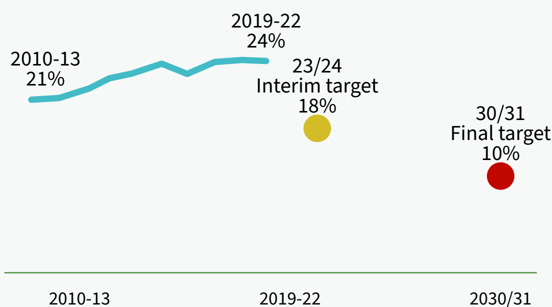
There are a number of different measures of poverty. This section summarises some of the main measures.



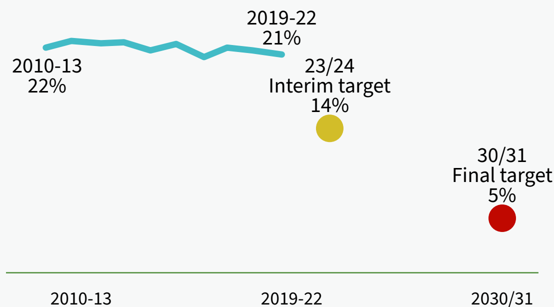
Source: Scottish Government Poverty and Income Inequality Statistics 2019-22[9]

The headline after housing costs relative poverty rate (for all people) in Scotland was estimated to be 21% in the most recent years of available data 2019-22. This equates to over one million people. For absolute poverty – a measure of whether the incomes of the poorest households are keeping pace with inflation – the figure for the same period was 17%. These poverty rates are described by the Scottish Government as "stable" in its official poverty statistics publication.

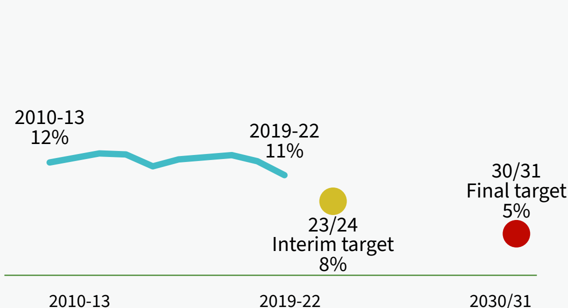
Relative child poverty
(% of children, after housing costs)



Absolute child poverty
(% of children, after housing costs)



Combined low income and material deprivation
(% of children, after housing costs)



Persistent poverty
(% of children, after housing costs)

Source: Scottish Government Poverty and Income Inequality 2019-22 and Persistent Poverty statistics[10]

In its most recent child poverty scrutiny report the Commission concluded that Scotland is not on track to meet its statutory child poverty targets; thinks it is unlikely that the Scottish Government will meet the interim targets in 2023-24; and believes that there is a very high likelihood the Scottish Government will miss the final 2030 targets as things stand. The Scottish Government's most recent modelling[11] on child poverty supports this conclusion. It estimates that the policies it modelled will contribute to reducing relative child poverty by 9 percentage points, to a level of 19% by 2023-24 (the interim target for that year is 18%), and absolute poverty to 16% by 2023-24 (the respective interim target is 14%).

Housing in Scotland is more affordable on average when compared to the rest of the UK, this has contributed to lower "after housing costs" measures of poverty in Scotland,[12] though the relative affordability of housing varies across the country. Interventions targeted at households with children, particularly the Scottish Child Payment, are also expected to make substantial contributions to reducing poverty among these types of household.

However, a recent report by the Joseph Rowntree Foundation[13] shows that, while some measures of poverty in Scotland have fallen (particularly among children), the proportion and number of people in very deep poverty has risen. Over the course of around twenty years, the number of people in very deep poverty (i.e. with very low incomes) in Scotland has risen from around 310,000 people to 460,000. In addition, the relative level of incomes of those that live in very deep poverty have has also fallen at the same time. This means that, for a couple without children in very deep poverty, they are more than £8,000 a year short of the poverty line let alone a decent standard of living.

The actions that the Scottish Government and others have taken have made a contribution to reducing poverty and inequality, for some groups – such as households with children – in particular. But it has not yet been enough to change the trajectory of poverty in Scotland. To genuinely match action to the ambition of tackling poverty in "all its forms" will require substantially more scale and impact than actions to date have been able to achieve, welcome as some of those have been to the Commission.

The Commission has noted that, in order to meet the ambitions, transformative action will be needed. It is difficult to see how this can be achieved without substantially increased investment. For example, the Minimum Income Guarantee[14] currently being considered and worked on by the Scottish Government and partners seems like it must come with a significant price tag attached, for both its design, and to ensure its sustainable delivery, if the Scottish Government agrees to implement it. Tax policy design must be an integrated part of the process to ensure potentially transformative ideas to reduce poverty can become more than just ideas.

Tax and representation

Tax can be looked at in terms of 4 “Rs”[15]. The first three Rs are often where debates on taxation focus:

- Revenues that arise from tax and how they are used to fund public services.
- Redistribution and the potential for tax to reduce inequalities between individuals and groups.
- Repricing and the use of taxation to reduce, for example, consumption of harmful goods like cigarettes, or to compensate society for external environmental costs resulting from the activity of polluting industries.

The fourth R of taxation, **representation**, can often be overlooked, but it has an important role in strengthening the “social contract” (something the Scottish Government placed significant emphasis on in its last budget[16]); the accountability of governments; and the strength of the relationship states have with their citizens. Some cross-country international economic evidence suggests[17] a positive relationship between tax and democratic accountability, and there are sound reasons to believe that such a relationship exists. How visible or noticeable a tax is can drive a sense that governments are spending money provided by citizens, and, along with that, a desire among citizens to hold governments accountable for such spending. When people think of the idea of the “Scottish taxpayer”, this is often assumed to be people who pay income tax – and it is this assumption that implicitly (and wrongly) defines who gets a say in spending and policy decisions. But tax is something that we all pay, whether we pay income tax or not.

The most visible or noticeable taxes are normally “direct” taxes (for example, tax on incomes or profits), while indirect taxes (such as those included in the cost of goods like VAT) tend to be less noticeable, and so less likely to produce a sense of “tax citizenship” – the sense of a right to hold governments to account for their spend.[18] This has particular consequence for the democratic engagement of lower income households and households in poverty, as a greater share of the tax they pay comes in the form of indirect tax like VAT rather than direct taxes like income tax.[19] As a result it is conceivable that households and individuals who experience poverty also experience a democratic deficit that results from the design of our taxation policies.

Looking at the effect of tax on democratic participation from a different perspective, Scotland was the first to see the effect of the poll tax when it was implemented in Scotland in 1989, one year ahead of the rest of Britain. The immediate public reaction and opposition to the poll tax, including the “can’t pay, won’t pay” campaign which focussed on non-compliance, saw tens of thousands in Scotland and the rest of the UK protest against an unfair and regressive tax, which ultimately contributed to the decline of the UK government of the day.

Though we might like to believe that policy decisions like the introduction of the poll tax are now part of history (albeit recent history), there remain echoes of the negative relationships that tax can have with democracy that are important to be aware of. In particular the Commission has heard from its Experts by Experience Panel about the negative impact on the relationship between the citizen and the state that can result from the heavy-handed pursuance of public debt, including debt from the replacement to poll tax – council tax.

Recent research by the Robertson Trust[20] highlights the scale of this issue in Scotland, with around one in ten of the lowest income households researched being behind on council tax bills. The Commission has previously published[21] on the punitive way that council tax and other forms of public debt are pursued, operating to standards that appear lower than would be accepted in the collection of private debt. Related research[22] from Aberlour highlights the negative impact on households of such practices, both on material living standards and the mental health issues and anxiety that these practices induce.

Because of the impact that tax can have on democratic engagement – both the positive and the negative – the Commission has chosen to explore tax representation as an additional aspect of its work on tax.

How the Commission has worked on tax

The Commission agreed to form a working group on tax to look in more detail at how devolved taxation could address poverty and inequality in Scotland. Over the course of 2023, the tax working group – composed of Commissioners, Experts by Experience Panel members with lived experience of poverty, and external contributors – invited expert speakers to discuss challenges and opportunities for tax in Scotland with the group; reviewed evidence and commissioned survey research[ii]; and came to conclusions and recommendations on what opportunities the Scottish Government should pursue on tax, for the endorsement of the wider Poverty and Inequality Commission.

There is no shortage of reviews looking at redesign of the tax system, either in whole or in part. At the UK level this has included the 2011 Mirrlees[23] Review, and there have been multiple attempts in Scotland to review the evidence and make recommendations on local tax, including the 2006 Burt (Local Government Finance Review Committee) report[24] and the 2015 Commission on Local Tax Reform[25]. More recently the Resolution Foundation published a report earlier in 2023 on what a good tax strategy would look like at the UK level,[26] while Reform Scotland published a report covering similar topics for Scotland in 2022.[27]

There are many other reports and analyses on tax reform, including technical papers informed by detailed analysis comparing various tax policy alternatives. The Commission's work on tax is not an attempt to provide a comprehensive technical analysis of tax options for Scotland. Instead the Commission sought to look at the existing evidence and provide recommendations on the principles of what a tax system should look like to meet the Scottish Government's aims of reducing poverty and inequality.

The tax working group focussed its efforts around a set of questions:

- To what extent are current arrangements for taxation in Scotland progressive?
- How could existing taxes be made more progressive in order to reduce poverty and inequality?
- What opportunities are there to raise additional revenue through existing or new taxation in order to reduce poverty and inequality?
- How can the representation aspect of taxation be promoted and understood, as a way of reducing inequality?

After discussing options with expert witnesses and reviewing published evidence, the tax working group created a set of assessment criteria[iii] for modified or new tax policies, and considered a range of potential tax policy options against these criteria. The outcomes from this process have been endorsed by the Poverty and Inequality Commission. The minutes of the meetings of the tax working group are published on the Commission's website.

The Commission thanks all of the above for their valued contributions and expertise. This report and the recommendations it contains represent the views of the Poverty and Inequality Commission.

[ii] This polling work was conducted by Survation on behalf of the Poverty and Inequality Commission in March/April 2023 and is available on the Commission's website at: https://povertyinequality.scot/about/our-working-groups/
[iii] See Annex published on the Commission's website for more detail on this criteria: https://povertyinequality.scot/about/our-working-groups/

2 Recommendations for reducing poverty and inequality using tax

Background: Arrangements for tax in Scotland

Scotland's tax powers have increased over the years since devolution, and are currently a mix of taxes that are fully or partially devolved to the Scottish Government, those that remain reserved to the UK Government, and taxes that are implemented locally.

The Scottish Government provides an overview of the taxes devolved to Scotland, which summarises the taxes it has responsibility for the design or collection of, and sets out the principles and objectives it has for tax system design. Earlier this year it announced a further new advisory group on tax strategy[28] that will provide advice to it, both for the 2024-25 budget and over the longer term.

This report by the Commission will not go into full detail of each currently devolved or reserved tax: these are set out by the organisations that design and administer these taxes including: the Scottish Government; Revenue Scotland (Scotland's tax authority who collect and manage Scotland's devolved taxes); and HMRC.

Key points around the nature of devolved taxes in Scotland and their interactions with areas of tax policy or operations reserved to the UK Government will be introduced as needed to aid understanding and provide context to the Commission's recommendations. However, the following general points are useful to bear in mind to help understand the environment in which these recommendations are made:

Taxes paid by people in Scotland include:

- those set by the Scottish Parliament and collected in Scotland by the Scottish Government's tax authority, Revenue Scotland (e.g. Land and Buildings Transaction Tax – the Scottish equivalent of Stamp Duty Land Tax – is an example of this "fully devolved" kind of tax).
- those where some aspects of policy are set in Scotland but their collection is administered at the UK level (like Income Tax, where there are Scottish rates and bands that are agreed by the Scottish Parliament, but where the revenues from Scottish taxpayers are collected by HMRC. Other aspects of income tax policy are set at a UK level).
- reserved taxes that currently remain under the control of the UK Government for both policy design and operational revenue collection and administration (such as VAT, Corporation Tax, or Capital Gains Tax).
- local taxes set and / or administered by local authorities, in alignment with the agreement of the Scottish Parliament (Council Tax and Non-Domestic Rates).

As a result, for the Scottish taxpayer, there exists a complex range of taxes that may have different rates, reliefs or exemptions when compared to taxpayers in the rest of the UK. These different types of tax are set by different governments and authorities, who can also have differing objectives and policy priorities.

This picture is further complicated by the fact that the funding arrangements for the Scottish Government are set by the "Fiscal Framework"[29] – an agreement between the Scottish Government and the UK Government that determines how the Scottish Government is funded and, in particular, how the block grant the Scottish Government receives from the UK Government is adjusted to reflect the expanded tax and social security powers Scotland now has.

A key feature of this block grant adjustment process is that it links the budget the Scottish Government receives into the relative performance of the Scottish tax base compared to the rest of the UK. If, all else being equal, earnings in Scotland and the Scottish tax base grow relatively less quickly than in the rest of the UK, it will cause the level of Scottish tax revenues raised to be less than the amount deducted from the block grant – i.e. the Scottish budget would end up with less than it would otherwise have had if tax powers were not devolved.

Scotland has existing powers to introduce new local taxes to "fund local authority expenditure" as part of an exception in the Scotland Act,[30] and it can also – with the agreement of the UK Parliament – create new devolved taxes as part of a further, as yet unused, section of the Scotland Act.[31]

Are current tax arrangements in Scotland progressive?

The Commission believes it is important to look at the overall cumulative impact of all taxes and redistributive mechanisms when answering the question of whether current tax arrangements in Scotland are progressive.

It is clear from a range of evidence and analysis that current arrangements for tax in Scotland are progressive, and more so than in the rest of the United Kingdom. This has been achieved both through actions the Scottish Government has taken using its devolved tax powers, supported by an overall policy direction of spending that has a focus on ensuring lower-income households benefit, combined with some flagship redistributive social security policies. Some of these changes have been of substantial material benefit to low income households, some appear more marginal and designed to allow the Scottish Government to make favourable comparative claims around low tax/competition versus the rest of the UK (e.g. the very modest £20 per year lower liability for lower income Scottish taxpayers as a result of Scotland's 19% income tax starter rate).

Tax arrangements in Scotland are progressive. However, there is scope to go significantly further, and to address issues where the existing tax system could already be more progressive and better designed, but the required actions have not yet been taken.

Since the introduction of expanded tax powers in Scotland, the Scottish Government has made use of the tax levers it has to differentiate itself from the tax structure in the rest of the United Kingdom. On tax policy, this has included:

- **Income tax** – one of the most notably distinct tax policies implemented by the Scottish Government was the introduction of the five-band income tax structure in the 2018/19 Scottish Government Budget. This introduced two new "starter" and "intermediate" rates and increased the rates for higher and top income taxpayers. Most recently, further changes were made to the Scottish income tax structure in the 2023/24 budget, with additional increases to the top two rates. Changes to the rates have also been accompanied in some years by freezing of the thresholds at which the higher band rate becomes payable; this has the effect of bringing more people into the higher tax bands and increasing revenue raised.
- **Council tax** – from 2007 till 2022, council tax was either frozen or capped at 3%. This changed in the 2022-23 Scottish Government Budget where councils were given full flexibility to set rates. In 2022-23, around two thirds of councils increased their rates by 3%[32] while in 2023-24 most councils chose to increase their council tax rates by at least 5%.[33] In 2017, the Scottish Government also increased the multipliers for higher value properties (bands E to H) and has recently consulted[34] on repeating similar changes. Council tax reduction is a means-tested scheme administered in Scotland that results in around half a million recipients[35] paying less council tax.
- **Non-domestic Rates** – the Scottish Government accepted most of the findings and recommendations of a 2017 review (the Barclay Review[36]) into non-domestic rates and has implemented a number of these.[37] The Scottish Government has set a slightly lower basic property rate than that which applies in the rest of the UK, and also has a relatively more generous rate relief policy, including the Small Business Bonus Scheme.
- **Land and Buildings Transaction Tax** – LBTT replaced Stamp Duty Land Tax in Scotland. The Scottish Government has made changes in the past to differentiate LBTT from its equivalents elsewhere in the UK, including historically having a more generous nil rate band for residential transactions of up to £145,000 (compared to £125,000 in England or Northern Ireland). However, this is now no longer the case with the UK Government's temporary increase in the nil rate band up to £250,000 till March 2025. The Scottish Government has also recently increased the Additional Dwelling Supplement, which is an extra charge due when additional residential property is purchased (for example a second or holiday home) from 4% to 6% in December 2022.

- **Landfill Tax, Air Departure Tax, VAT** – Landfill tax is devolved and currently the same rate in Scotland as it is in the rest of the UK, to address concerns over cross-border effects and "waste tourism" that could result from one part of the UK having lower rates. Air Departure Tax is the intended replacement in Scotland for UK Air Passenger Duty, but its introduction has been delayed pending the resolution of an issue in relation to an exemption for the Highlands and Islands. The Scottish Government has had a long-standing intent to assign a portion of VAT raised in Scotland to its budget. However, this intention has not been possible to implement due to the lack of a methodology to do this adequately – it is unclear when or even if this will ever be possible.

What have these changes achieved? When looking at the outcome of tax policies, it is important to look at the cumulative and holistic effect. Individual tax policies may be progressive, regressive or neutral, but what is most important is the overall combined effect of all tax (and also, redistributive spend) policies.

Earlier this year the Institute for Fiscal Studies published an analysis looking at the overall impact of the tax and benefit reforms made by the Scottish Government.[38] This finds that, while on average devolved income tax and benefit policy measures introduced since 2017 were estimated to decrease average Scottish household incomes by 0.5% (equivalent to £210), the poorest ten percent of Scottish households will have incomes 4.6% (£580) higher as a result, while higher taxes reduce the incomes of the richest ten percent by 2.1% (£2,590).

The Scottish Government's own evaluation[39] of its income tax policy changes in 2018-19 and more recently published distributional analysis of its most recent income tax changes in 2023-24[40] gives its own analysis of its income tax policy changes. In general the Scottish Government concludes that its 2018-19 income tax changes were progressive across large parts of the income distribution and its most recent 2023-24 income tax policy decisions were progressive in a similar fashion.

Scotland's income tax policy divergence from the rest of the UK tends to be a focus for the analysis that exists for Scotland, as it is by far the largest single tax revenue contributor to the Scottish Government's budget, and a very visible tax that attracts public and media attention. But it is important to look beyond income tax and consider analysis on wider tax policy and its strategic intent and purpose, not least as around 4 in 10 Scottish adults do not pay income tax.[41]

Analysis from the Fraser of Allander Institute on wider Scottish Government's tax policy (including, but not limited to, income tax) during the previous (2016 to 2021) parliamentary session[42] observes that some tax policy implemented during this period has indeed been progressive, but that tax policy overall appears to have two objectives: 1) to be able to claim that the majority of Scottish taxpayers are liable for less tax than they would be in the rest of the UK; and, simultaneously, 2) that the tax structure is more progressive in Scotland than it is in the rest of the UK. It also observes that in some cases the reduced liability for Scottish taxpayers is arguably marginal in size and impact, such as the around £20 reduced income tax liability for lower income Scottish taxpayers resulting from the narrow 19% starter rate band of Scottish income tax.

The Scottish Government under the new First Minister has signalled an intent to focus on taxation in order to fund the government's priorities. As there has yet to be a substantive publication on tax strategy or tax policy direction under the new administration (aside from content included in two recent consultations on council tax[43,44]), it is not yet clear whether any new policy direction will retain this feature of trying to emphasise both lower tax (than the rest of the UK) for the majority, alongside higher taxes for a minority of people in Scotland who have the highest incomes.

The Commission agrees with the broad conclusions of the analyses cited above in terms of the progressive nature of the changes to taxation policy made to date. These choices on tax have been coupled with spending policies that have particularly benefitted low-income households. These are driven by some flagship interventions such as the Scottish Child Payment and a differentiation in the assessment and award process for newly devolved disability benefits (which are anticipated to be a driver that will increase devolved spend in the future[45]), which have combined with taxation policy to increase the overall redistributive effect.

It is clear to the Commission that the Scottish Government has taken tax policy decisions that have differentiated itself from the policies that apply in the rest of the United Kingdom, and that these have been progressive as a whole. However there are also areas where more progress could have (and should have) been made, and an increasingly pressing need to do yet more.

A need for further change in the way Scotland approaches tax is clear. There is wide acknowledgement that the Scottish Government could both make greater use of the powers it already has, and seek opportunities for new tax powers. Doing so will not only be in alignment with the Scottish Government's stated ambitions and its mission of equality[46], but will provide a credible route to achieving these ambitions given the extremely challenging fiscal context.

This acknowledgement of the need for change does not seem confined to any one particular point of view. Last month, IPPR Scotland alongside a coalition of anti-poverty organisations advocated for greater use of devolved tax levers.[47] The views of a range of stakeholders consulted by the Scottish Government as part of its engagement for last year's budget process included the need to reform council tax, and discussion of other aspects of new taxation like wealth taxes.[48] The Scottish Trades Union Congress commissioned research from Landman Economics to look at the potential for a range of short and longer term major tax reforms to generate revenue for public services.[49] Reform Scotland has published an analysis arguing that the devolved tax system needs substantive redesign rather than continuing to follow past patterns of "tinkering" with the rates of existing taxes.[50] The Hunter Foundation published a report from Oxford Economics making the case that Scotland should seek to emulate Ireland's example, including by setting a low corporate tax rate and a focus on a small number of high value economic sectors.[51]

Different organisations with different preferences about the way that the economy should be organised will have differing recommendations on tax. However an area where there appears to be alignment of views is that substantive discussion and then action on the design of Scotland's tax system is necessary, and momentum on this appears to be building. The Commission comes to this issue with a perspective aligned to its remit of reducing poverty and inequality in Scotland.

Reducing poverty and inequality through existing and new taxes

Making the best recommendations for the Scottish context

The Commission and its tax working group has focussed on making recommendations on tax that we consider to have the greatest potential for reducing poverty and inequality in Scotland, looking at both changes that can be started now, and those that relate to longer-term thinking and reform. The recommendations in this report are made recognising the current constitutional arrangement between Scotland and the UK, and considering where there is the most potential for any new powers to work alongside existing ones.

Scotland is a devolved nation that is closely integrated with the UK when it comes to the majority of tax and revenue (64% of revenue in Scotland in 2022-23 was estimated to be reserved[52]). Integration with the UK economy and employment, freedom of movement and border policy, and geographic and social/cultural connections, all have important consequences for tax policy under present constitutional arrangements.

This context is often seen expressed in media discourse framed with the risk of divergent tax policy in Scotland encouraging "tax flight"; particularly the potential for those with a higher income to leave Scotland for other parts of the UK in order to pay less tax. However, these kind of responses to tax take a variety of forms, and not all relate to the movement of people, or active avoidance of tax in the manner often seen discussed.

Taxpayer response to diverging Scottish tax policy

It is well-established that taxpayers respond in a range of ways to changing tax rates, some of which can reduce revenue to a greater or lesser extent. These responses do matter, however these effects (called "behavioural responses" or "behavioural effects") are not always straightforward to predict, are very sensitive to context, and are subject to high uncertainty when attempts are made to estimate them. These can include avoidance activity like the movement of people between difference tax jurisdictions but also, importantly, include behaviours that would not be considered avoidance, such as people choosing not to take up higher paid roles, or not taking on more hours, due to the tax implications of doing so.

The Scottish Fiscal Commission (SFC) forecasts the revenue expected from tax as part of the process for the setting of the Scottish budget, income tax being the largest single source of tax revenue. SFC have outlined their approach to assessing behavioural responses (which includes consideration of aspects like migration, people choosing to work fewer hours or not taking up opportunities to work more hours, or changing at what point in time income is paid in order to attract less tax liability) in several publications.[53,54] In general, while acknowledging the high uncertainty and sensitivity to assumptions, the SFC judge that, in Scotland, the behavioural response to tax policy change is likely to be higher than that estimated for the rest of the UK. In their view this reflects the potential for migration and the opportunity for "income shifting" (i.e. Scottish income tax payers making arrangements to move their income outwith the scope of Scottish income tax and into dividends or capital gains which are taxed at different rates, set by the UK Government). These effects are expected to be most pronounced for higher bands of income tax, as higher income individuals have more opportunities and means to take such actions.

These assumptions have consequences for the Scottish Government's budget. The forecasts used by SFC as part of the Scottish Government's 2023-24 budget process estimate that factoring in the behavioural response resulting from the 1 pence increase in the highest income tax band (i.e. the increase that took the top rate from 46 pence to 47 pence) reduces the expected revenue raised from £32 million to £3 million. The behavioural response on the 1 pence increase to the higher rate (from 41 pence to 42 pence) is smaller, but still of consequence, reducing the expected revenue from £128 million to £92 million.

The uncertainties around the degree of behavioural response we might expect as a result of changes in tax policy are highlighted in reviews of domestic and international evidence.[56,57,58] What is more certain from the evidence that exists on the subject is that people make decisions about where to live and work based on a variety of factors, and tax is only one of these. The quality of public services, governance, and wider culture and environment all factor strongly in individual decisions.

For income tax in Scotland, Scottish Income Tax rates and bands are set by the Scottish Parliament, but are collected and administered by HMRC at a cost of around £0.6m per year (for 2021-22[59]). A service level agreement[60] is the basis for this relationship, and HMRC's administration of Scottish Income Tax is audited annually by the National Audit Office[61] and Audit Scotland.[62] This audit work notes that, to date, HMRC assess the risk of non-compliance (for example, taxpayers changing their address to reduce tax liability) as currently being low. Earlier this year, Scottish Government and HMRC officials gave evidence to the Scottish Parliament's Public Audit Committee[63] and were questioned by MSPs on similar topics, confirming that there was limited evidence of income tax divergence to date inducing large responses of this type from Scottish taxpayers.

Considering the evidence available, the Commission considers that:

- Taxpayer behavioural responses to changes in policy exist, and they can take effect across the income distribution, but are particularly pronounced for higher income/wealthy individuals.
- The size of any given response to changing tax policy is highly uncertain, and is subject to a range of other contextual factors.
- The size of the overall tax gap relating to avoidance (that is, operating within the letter but not the spirit of the law) is not trivial – HMRC estimates it to be around £1.4 billion at the UK level in 2021-22.[64]

- To date there is not strong evidence to indicate that the existing level of divergence in income tax rates between Scotland the rest of the UK has resulted in behavioural changes like significant levels of migration, or non-compliance by declaring residence outside of Scotland, however there is a need to keep this under review.

Next steps the Scottish Government should take on tax

The Commission believes that the potential for behavioural responses and the context of Scotland as a devolved nation as part of the wider United Kingdom have important consequences for making recommendations on tax policy that can – in practice, not just in theory – contribute towards the reduction of poverty and inequality.

While to date there is limited evidence of significant migration or non-compliance as a result of Scottish tax policy, the possibility of such effects in the future as policy diverges further needs to taken into consideration. The next steps for the Scottish Government on tax must also recognise both the scale of the fiscal challenge in the future, and the substantial distance to travel between current performance on reducing poverty and inequality and what the Scottish Government aspires to.

The Scottish Government has published "ready reckoner" figures on tax[65] that indicate how tweaking the existing system will be inadequate. These figures suggest that increasing further (i.e. over and above the income tax increases in the last 2023-24 Scottish Government Budget) the higher rate and top rates of income tax by 1 pence could result in an addition £88 million and £5 million of revenue, respectively. Reducing the higher rate threshold (i.e. bringing more taxpayers into the higher band) could result in £108 million of revenue. Changes outside of income tax are smaller – e.g. increasing the basic property rate for Non-Domestic Rates by 1 pence could result in £61 million, or increasing the Additional Dwelling Supplement by 1% could result in £13 million of revenue.

These would be significant revenue raising measures. And if done together, they could provide a substantial additional stream of revenue going into some hundreds of millions, with the potential to build on the progressive credentials of previous changes and reduce income inequality.

However, even this would be short of what will be required in order to ensure fiscal sustainability. The anticipated gap between revenue and expenditure in Scotland stretches into billions well before the end of this decade, even before the additional expenditure that will be required to meet poverty reduction ambitions and statutory child poverty targets is accounted for.

It is also important to note that reform of tax with the aim of reducing poverty and inequality is not just reform for the sake of avoiding something we do not want to happen, it is making an active, positive, choice. IPPR Scotland have recently documented[66] the scale of the economic and health impacts of poverty and show how action on poverty has the potential not only to improve individual living standards, but to increase the prosperity of Scotland overall.

Because of this, the Commission considers that significantly further-reaching reform of tax policy in Scotland is required. This must go beyond the scope of the changes seen over the course of the last (2016-2021) Scottish Parliament, and the direction of travel indicated during the present one, where the focus appears to be more on adjustments rather than fundamental reform.

The recommendations that follow are the ones that the Commission and its tax working group believes are the priority areas that the Scottish Government must act on. The Commission thinks these actions are:

- **Complementary** – they build on each other with short, medium, and longer term actions to reform Scotland's tax policy environment and the data that underpins it.
- **Practical** – they can be done under existing powers in Scotland, or areas where there is already a route to secure further powers and a strong case can be made to do so.
- **Effective** – in terms of their potential to raise revenue, strengthen democratic tax representation, and in the contribution they can make to reducing poverty and inequality.

Recommendation 1. Ensure all land and property in Scotland is registered with a current and accurate valuation

The previous section of this report has set out a case for why further-reaching reform on taxation in Scotland is necessary. The Commission believes that a pre-requisite for this reform is better data on both land and property ownership and value in Scotland. The main opportunities the Commission sees to broaden Scotland's tax base (see Recommendations 2 and 5) in the manner required are dependent on an evidence base that has up-to-date and sufficiently accurate valuations for both land and property ownership. These developments will be necessary in order to design any new property or land taxes, or simply to update existing ones with more timely valuation data.

On land, Scotland has had a commitment to have a "one-stop-digital database for land and information services" from the Scottish Government since at least 2015.[67] Some progress has been made on this commitment, chiefly through Scotland's Land Information Service (ScotLIS),[68] however it is still incomplete in several important ways (including in terms of what development would be required to inform tax design). As of July 2023, 51.6% of Scotland's land mass is covered by the land register, with a further around 35% of "indicative ownership" available through the sasine register[69] and the unlocking sasine project.[70]

In its 2022 advice to Scottish Ministers on land reform and taxation[71] the Scottish Land Commission emphasised that better data on land value is "an important underlying system improvement to maintain transparency and relevance in the application of tax to land, and to be able to target tax measures appropriately in future." The Land Commission recommended that the Scottish Government commences a programme to bring all land onto the valuation roll. It also recommended that the Scottish Government should develop and use a "consistent and comprehensive cadastral [a register or collection of land surveys containing details of ownership and value] approach" to allow the integration of information on land ownership use and value.

In February 2023, the David Hume Institute and Built Environment Forum Scotland published a report commissioned from Andy Wightman on Scotland's land information services.[72] This report gives the recent history behind Scotland's attempts to create a national land information system, and draws the conclusion that, while projects like ScotLIS have been important steps and have improved the availability of land data in Scotland, ScotLIS currently falls short of what was promised at the outset and it does not yet contain everything it should (or needs to). The report reiterates the point that the "overarching improvement needed is to construct a portal where all the land and property information can be examined for any particular site and downloaded for analysis via one single online portal."

In relation to property values, for domestic properties subject to Council Tax, the values used to put properties into Council Tax bands in Scotland are still based on their 1991 values. Some properties have grown in value at much higher rates compared to others that were in the same band in 1991. This means many properties are in the wrong band for their current value, and properties that should be in the same band are in different ones. The 2015 Commission on Local Tax Reform[73] showed that 57% of properties in areas they modelled would change band if revaluation had been conducted in 2014. Around half of those were currently in a higher band than they would be after revaluation (and so would pay less Council Tax if such a revaluation was conducted), and around half would pay more as a consequence of revaluation.

Valuation data from 1991 is not a sound basis for reforming local taxation or making Council Tax fairer, and so domestic property revaluation must be addressed as a priority for the Scottish Government. A continued failure to do so results in Council Tax bills paid by citizens that continue to diverge from the actual value of their properties, and will ultimately frustrate any other attempts to amend the system (for example, by further adjusting band modifiers in Scotland as has recently been consulted on).[74] This risks decreasing trust in, and credibility of, devolved taxes as a whole.

The lack of process for revaluing domestic properties can be contrasted with that which applies to business properties. Non-domestic rates (or business rates) are a local property tax, where the amount liable from each ratepayer is determined by the rated value of the property, after any reliefs apply. There has been a recent non-domestic rates revaluation published in 2023[75] (based on market values from April 2022), updating the previous valuation rolls from April 2017 (based on property value as of April 2015). The Non-Domestic Rates (Scotland) Act 2020[76] now requires revaluation for the

purposes of non-domestic rates to be carried out every three years, rather than the previous five. This process applies to around a quarter of a million non-domestic properties in Scotland. As mentioned previously, a substantial degree of rates relief applies to properties in relation to non-domestic rates. In 2022, 145,370 properties (57% of all properties) received 100% relief at a total value of £539 million.[77] In that year, three reliefs (the Small Business Bonus Scheme, Charity, and Empty Property) accounted for 93% of the number of reliefs and 79% of the value of reliefs.

It appears to the Commission that there are open questions over the value of aspects of Scotland's non-domestic rates and relief schemes. The total relief value of the Small Business Bonus Scheme in mid 2022 was £275 million, however a previous evaluation of the Small Business Bonus scheme from the Fraser of Allander Institute was not able to draw any conclusions in relation to enhanced business outcomes as a result of such a scheme.[78]

These questions aside, Scotland's approach to non-domestic rates is one that does feature a regular process of revaluation, with a statutory backing, which is notably absent from the approach taken to the around 2.5 million domestic households[79] in Scotland. There exists a further contrast with Wales where Council Tax is currently based on 2003 valuations (updating the 1991 valuations that remain in use in both Scotland and England). The Welsh Government has also recently consulted[80] on a "Fairer Council Tax" proposal as part of a package of reform that includes rolling revaluation cycles, among other measures.

When looking at the data that should support and inform policies that can serve to reduce poverty and inequality and improve public understanding of land and property ownership and value in Scotland, the incompleteness and inaccuracy of land and property data is a serious stumbling block. The difficulties that follow as a consequence of this – for example the challenge of linking information on household incomes to land or property values – will continue to frustrate progress on designing alternatives to the status quo.

Hence the Commission believes that a comprehensive system of both land and property ownership, use, and value is the outcome the Scottish Government and its agencies should be working towards with urgency. Existing information on land has been mostly gathered at public expense, so the system should be open for the public, organisations and independent researchers to examine, use and reuse, to the greatest extent possible.

The Commission recognises that this will not be without practical and other challenges in terms of the systems required and operational capacity. But the Commission believes that these challenges are not insurmountable, and that one of the most important conditions for successful reform in this area appears to be the degree of leadership and commitment to reform that a government can show.

- **Why:** Accurate and timely information on the value and ownership of property and land is fundamental to understanding both patterns of ownership and the potential value of the tax base. Scotland has various systems for recording land and property ownership and value, but they are incomplete and/or out of date despite many years passing since original commitments for reform were made. This results in a fragmented and incomplete picture, which is an inadequate basis for any serious attempts to reform how we tax land and property – for example, by moving towards greater taxation on wealth held in property and land, rather than a reliance mostly on taxation of earned income.
- **How:** Collect and bring together the necessary data in a comprehensive fashion and create a mechanism (e.g. a website) where all land and property information is brought together and made available for authorities to, among other things, design effective taxation policy for property and land in both business and domestic usage. This platform should use open data principles and to the greatest extent possible be open for the public, organisations, and independent researchers to examine, use and reuse.
- **When:** There are multiple components to this work, some of which are necessary pre-requisites for redesign of local taxation in Scotland. As a priority, domestic property revaluation is needed in relation to Council Tax. Work on this should start now to be in place no later than 2026 (with a 2024 or 2025 date of valuation). On land information, a commitment to developing a system to comprehensively register land has been made since at least as far back as 2015, and the design of any future replacement to Council Tax that has a land component will require it. The original scope of Scotland's Land Information System (ScotLIS) had a two year timeframe, and expert observers have noted that not all of this scope has been fulfilled, and have proposed that a two year timeframe from now to bring it to its potential remains achievable. The Commission supports this call.

Recommendation 2. Revalue properties subject to the current council tax, and immediately start work to design its replacement.

In Recommendation 1, arguments were set out that provide the Commission's rationale for why revaluation of the 1991 property values for Council Tax is a priority first step, as part of a wider programme of improvement of the data that is held on Scotland's property and land. The revaluation of domestic property is also a necessary step in designing a longer-term sustainable replacement to Council Tax.

Council Tax is a badly outdated and regressive tax requiring fundamental reform. Research we commissioned from the Resolution Foundation in 2019 highlighted that Council Tax remained almost as regressive as the Poll Tax it replaced.[81] More recently, IPPR Scotland have shown that around three quarters of all homes are in bands A-D (and because of a lack of revaluation, many should not be), including more than a third of homes occupied by the 10% of highest income households. Similarly, while higher income households are more likely to live in higher band (i.e. band E to H) properties, a substantial proportion of lower income households do also.[82] While there are some measures in the system to help those on the lowest incomes (principally Council Tax Reduction), the amount of Council Tax paid is not strongly linked to household income and ability to pay. Failure to revalue properties as previously described means that actual property value has diverged from the band properties are assigned to. Together, these and other flaws mean that measures like further increasing the "band modifiers" (i.e. the amount of Council Tax paid) in higher value properties, as is currently being consulted on by the Scottish Government, still result in those with the highest 10% of incomes paying on average a lower proportion of their income as a result of the additional charge than the next few income groups down.[83] The way the system is designed "resists attempts to make it more progressive" (as IPPR Scotland have put it).

These flaws appear to be widely acknowledged in public debate surrounding tax in Scotland, and defenders of the present Council Tax system seem to be few in number. Yet, at the same time, the Commission's tax working group has heard about the difficulties of reform, as evidenced by numerous, unsuccessful (in securing change) advisory and expert groups running over many years.[84]

A persistent theme in evidence that the Commission's tax working group heard was that the failure to secure reform in relation to replacing Council Tax with one of its potential replacements (e.g. replacing it with a proportional property tax, a land value tax, or a local income tax) was not principally one relating to technical gaps in evidence or operational capability. Such gaps do exist (some of which relate to the data on land value and ownership that was the subject of the previous recommendation). However, the principle reason identified for failure to properly design and implement a replacement to Council Tax was largely thought to be one of political leadership and the will required to drive change. Council Tax has persisted in its present, flawed, form for a long time. It has persisted in this state largely impervious to the findings of various reviews over many years with changes that appear at best minor corrections and mitigations to address its fundamental problems.

Hence there appears to be a risk that these past failings have resulted in a situation where Council Tax reform is too readily written off as something too difficult to do, and a problem best left for another time (or for somebody else) to deal with.

Limited progress has been made since the 2015 Commission on Local Tax Reform. Proposed cross-party talks following the 2019-20 Budget around a Council Tax replacement did not result in progress. The August 2021 Bute House Agreement[85] includes the commitment to establish a working group along with COSLA to "develop effective deliberative engagement on sources of local government funding, including Council Tax, that culminate in a citizens' assembly." To date this working group – the Joint Working Group on Sources of Local Government Funding and Council Tax Reform[86] – has taken forward two recent consultations on Council Tax: one on premiums for second and empty homes[87], and one on increasing the band modifiers for higher value properties (bands E to H).[88]

The Bute House Agreement states the commitment to take forward this work and complete it within the current parliamentary session (i.e. by 2026). However, this commitment can be read as being fulfilled by the conclusion of a citizens' assembly or other deliberative process designed to further inform, rather than conclude, a process for designing a replacement to Council Tax.

The Commission welcomes the principle of citizen deliberative engagement on policy design, and an argument can be made that local tax reform is sufficiently contentious as to be a good candidate for these kinds of methods. But given the history of many attempts over the years to meaningfully reform Council Tax with little progress to show for it, there is also a clear risk that the present exercise and Bute House Agreement commitment becomes a further report of recommendations and options, left without the impetus to implement change. The timescales for this work must be brought forward and begin with (not end with) deliberative citizen engagement. The Commission believes that the 2026 end point should see the Scottish Government in a position to begin consultation on the proposed design of a long-term replacement to Council Tax.

Options for replacement have been set out in detail by others over the years. These typically include:

- A more substantially reformed version of the current Council Tax.
- A land value tax.
- A proportional local property tax.
- A local income tax.
- A hybrid tax involving, multiple components of the above.

Each of these options has its own design and operational requirements. Some would bring new questions to be addressed such as the need for some kind of equalisation or redistribution mechanism (e.g. in the case of a local income tax) between areas of Scotland that have differing levels of income. Design of a land value tax would have data and information requirements that are not currently met in Scotland, as discussed in the previous recommendation.

Practically, it would appear that a new, proportional, local property tax is potentially the most feasible option to proceed with in the medium term – as the data and operational requirements would be expected to be similar to those called for in the previous recommendation (i.e. accurate information on property value and a process to ensure this remains accurate over time). However, the data and information requirements for a land value tax have value in themselves – to definitively answer the public question of "who owns Scotland?" – and work on this should continue to be a priority.

It appears from the present direction of travel that, regrettably, Council Tax in its present form – potentially subject to some further modifications such as those currently being consulted on – will continue to be the primary domestic local tax for some years. The Commission believes that this should be the case only as long as absolutely necessary until the design of a replacement can be introduced and formally consulted on. Letting the Council Tax status quo drift on for yet longer risks further eroding public trust and confidence in local democracy and the social contract. This is particularly the case given the concerns the Commission has over the way Council Tax debt is managed and pursued, which will be discussed further in Recommendation 4.

- **Why:** Council tax is widely acknowledged as a fundamentally flawed and regressive tax, in part because valuations date from 1991, over 30 years ago. Recent consultation proposals presented as making it "fairer" through making small adjustments to band multipliers are not sufficient to address the core limitations of its current design. Making changes to band multipliers without revaluation means these changes will not impact all of the properties that they should, and will impact some that they should not.
- **How:** There should be a package of reform measures that begins with immediate revaluation (as has already been the case in Wales) and has the clear end point of creating a long-term replacement for Council Tax. Plans should be put in place for regular future cycles of valuation.
- **When:** Work on revaluation should commence immediately to the timetable in Recommendation 1. Design of a longer term replacement that sets rates proportionate to property value and potentially with a land component should also commence immediately. The Scottish Government should be in a position to begin consultation on the proposed new design for a long-term replacement to Council Tax by the end of 2026.

Recommendation 3. Seek to devolve the necessary powers to set income tax for savings and dividend income for Scottish taxpayers.

The Scottish Income Tax rates and bands set by the Scottish Parliament at present apply to Scottish taxpayers' "non-savings, non-dividend" (NSND) income. NSND income to which Scottish Income Tax rates and bands currently apply is the large majority of income tax revenue, however it also has important interactions with the smaller share of income tax that arises from taxing savings and dividend income, arrangements for which are currently entirely reserved to the UK Government.

Individuals who have income from savings and dividends need to refer to, separately, the UK Government's dividends allowance[89] and personal savings allowance.[90] An important feature of this is that there is a separate dividend allowance (below which tax is not paid – in 2023-24 this was set at £1,000) and also a three band structure that applies to the dividend income above the allowance, depending on the individual's Income Tax band. The tax rates applied to dividend income over the allowance are lower than those applied to NSND income tax at the UK level, and also lower still than would be the case in Scotland were the higher rates of Scottish Income Tax to NSND income to apply to dividend income.

This creates an incentive, for those with the means to do so, to shift income from NSND income tax to dividend income to attract a lower tax liability. In particular, those with the means to make these kinds of arrangements tend to be higher income individuals, who have opportunities available such as incorporating a company (creating a company with a legal entity separate from those who own or run it). It is well-established that business income (either from self-employment or owning and running a company) is much more important for higher income taxpayers. Business income in the UK accounts for around 21% of the income of the top 1%, compared to 9% of those below the top 1%.[91] It is routine for advisers providing advice to individuals who have owner-managed businesses to investigate options around incorporation. One of the advantages of incorporation is the ability to pay oneself in dividends, and indeed leave money in the company (corporation tax is also lower than higher and top rate income tax). However, it should be noted that there are other reasons why businesses incorporate too, for example, to obtain the limited liability a company offers. In addition, some businesses have to operate as companies in order to gain contracts from engagers.

In Scotland, with a divergent, and higher, income tax structure than the rest of the UK, this situation creates stronger incentives for individuals to arrange incomes in a way that reduces exposure to the Scottish Income Tax rates and bands. In addition to revenue loss, this is also likely to increase the complexity of the system for some individuals who, for example, are Scottish taxpayers but who do not pay any (or very little) Scottish Income Tax because their income arises from dividend and saving income only (or in large part).

The Commission's view is that that there are advantages for the Scottish Government in securing the ability to set tax rates and bands for income from more sources, and that this should be a priority when making decisions on what further tax devolution can help to address both fiscal challenges, realising poverty and inequality reduction ambitions, and making strategic decisions about the future direction, simplicity, and cohesiveness of Scottish tax policy.

Devolving the powers to set Scottish rates and bands for savings and dividend income would allow the Scottish Government to make decisions on the totality of income tax where options available to them include both revenue-raising and revenue neutral choices. The Scottish Government could, post-devolution of these powers, decide to apply the same rates of tax to income from savings and dividends as it currently does to NSND income. The Commission would expect that to be modestly revenue raising and reduce the incentive to participate in one important route of tax avoidance, but also (and as importantly) start the implementation in Scotland of an important tax design principle: to tax all income at the same rate, regardless of the source of that income. This would be a further divergence of tax policy between Scotland and the rest of the UK, and would have to be assessed against the likelihood of behavioural responses.

This is not a power the Scottish Government currently has, and to secure it would require agreement from the UK Government. The Commission's tax working group heard the experience of the Welsh Government in their attempts to gain new tax competence in relation to a vacant land tax, in agreement with the UK Government. This process was formally begun in 2020, and has yet to reach a resolution.

The devolution arrangements for Scotland and Wales are different, but the Commission understands that a broadly similar process of agreement with the UK Government would also need to be the case in Scotland. The Commission believes that a strong case can be made by the Scottish Government to the UK Government on devolving the competencies required to tax income from savings and dividends. From the Welsh experience, as this may take some time to reach agreement, work to negotiate agreement with the UK Government should commence immediately.

- **Why:** This provides an opportunity for the Scottish Government to set the rates and bands of income tax on savings and dividend income at the same rates and bands as for Scottish Income Tax for non-savings and non-dividend income. This would ensure that more income in Scotland is taxed at the same rate no matter its source (whether earnings from work or income from savings and dividends). This can reduce the impact of one important route of income tax avoidance where people who have the ability to do so will arrange to receive their income in a way that attracts lower rates of tax.
- **How:** The Scottish Government needs to seek and reach agreement with the UK Government on this or any other new tax power to be devolved. While this is progressing the Scottish Government can carry out analysis to allow setting the right rates and bands for savings and dividends income from the moment the powers are secured. This should include analysis of the option to set the rates and bands for income from savings and dividends to the same, or higher, rates and bands as Scottish Income Tax for non-savings and non-dividend income and consideration of the degree of revenue raised and the potential for cross-border effects between Scotland and the rest of the UK in such circumstances. It should appraise options in a way that also identifies and quantifies the risks of a "race to the bottom" in terms of competition and pressure to lower tax rates between Scotland and the rest of the UK on this matter.
- **When:** The Welsh Government has sought to engage with the UK Government on a similar request to gain competency for a new vacant land tax, formally requesting a new tax power in early 2020. This process is still ongoing at the present time. Because of the need to seek agreement with the UK Government and the timeline required implied from the Welsh experience, the work should start immediately to ensure the power is in place at the earliest opportunity.

Recommendation 4. Improve public understanding of, and compliance with, devolved taxation.

As has already been discussed in this report, tax arrangements for citizens in Scotland are perceived to be complex, due to the nature of different tax policies implemented by differing governments, and the fiscal agreements between them. The Commission believes that an important principle of tax design is citizen understanding of the taxes they pay, and how they connect to the democracy and society they are part of. The Scottish Government has reflected some of this in its "engagement" principle in its 2021 Framework for Tax publication.[92]

The nature of the current devolution arrangements means that the benefits that arise from being able to set, in general, more progressive tax policy in Scotland comes at the cost of some additional level of complexity. IFS have argued that some of this progressivity has been unnecessarily complex, particularly in relation to the five band Scottish Income Tax structure and the range of targeted business rates relief the Scottish Government has devised.[93] While the Commission considers that, in general terms, the complexity is a cost worth paying in order to improve the circumstances of low-income households, it is also clear to the Commission that more can be done to improve understanding of, and citizen engagement with, devolved taxes.

This is something that the Commission views as going hand-in-hand with improved tax compliance efforts, which are well-evidenced as a revenue raising measure. Understanding and trust in the tax system helps to build compliance, while poor practices in compliance cause trust to deteriorate and risk becoming self-defeating.

Public attitude survey work has suggested there is at least some level of a gap in understanding of taxes in Scotland, including around which government has the responsibility for income tax.[94] Given the complexity and perceived technical nature of tax, these figures are understandable. However, in other polling[95] (this time in the UK as a whole) people do appear to have some strengths in their tax knowledge – particularly around identifying what additional sources of income (e.g. such as income from letting out properties) are taxable, and are in favour of tax education work.

Polling work conducted for the Commission[iv] in Scotland supports similar conclusions, 38% of respondents believing their knowledge of "how the tax system in Scotland works" was good, 21% poor, and 39% neither good nor poor, with higher income households more likely to rate their knowledge as good. Respondents were more likely to believe that the tax system in Scotland is progressive (50%) compared to the tax system in the UK as a whole (26%). Around two-thirds (67%) of survey respondents agreed that the taxes they pay make the Scottish Government accountable to them for how it spends money (only 10% disagreeing).

The Commission's view is that the Scottish Government should, as part of its current focus on tax, create a clearer programme of work on the "engagement" strand of its tax strategy. This should include a wider review of how it currently communicates with the public on devolved tax and specifically how it communicates the implications of the fiscal framework on the revenue for devolved taxes and on the Scottish Government's Budget process. The Commission believes that the Scottish Government should produce a communications product for public engagement that is as simple as possible and that summarises what happens to each pound of taxation raised in Scotland, after the operation of the fiscal framework.

HM Revenue and Customs produces an "Annual Tax Summary"[96] for taxpayers, in which HMRC summarises, among other things, a breakdown of how the UK Government spends revenue raised from taxation. The Scottish Government should discuss and agree with the UK Government a means through which it can produce and disseminate its own version of this, which should emphasise the societal benefits of devolved tax and associated spend, particularly focussing on how it contributes to reducing poverty and inequality in Scotland.

Public communications from authorities is one aspect of how people develop an understanding of the tax system. A more important one is how they experience it. The Commission has previously highlighted the punitive approach to the management and pursuance of public debt (including Council Tax debt) in advice to the Scottish Government.[97] When Commissioners have spoken to front line services struggling to support those that rely on them through the cost of living crisis, they have emphasised the damaging impact this practice has.[98,99]

The way that public debt is managed and pursued requires reform, and if this is not done alongside wider communications and compliance activity, the Commission believes it will erode public trust and engagement. Gateshead council has shown how, through a novel approach,[100] it used council tax arrears as a signal for help, rather than punitive action. This is an approach that should be learned from in Scotland.

The Commission believes that ensuring that the public has as clear as possible an understanding of devolved taxation, and reforming harmful practices in public debt management are actions that will, in themselves, build trust and tax compliance in Scotland.

This is an important next step in Scotland's tax strategy and one where evidence suggests that there are substantial gains to made. At the UK level HMRC estimates the "tax gap" – the difference between the tax that should be paid in theory to HMRC and that actually paid – was £32 billion in 2020-21. During the same period HMRC generated £30.8 billion from its compliance activities. For every £1 that HMRC spends on compliance activities it recovered £18 in additional tax revenue.[101]

While the figures above are for all taxes for which UK HMRC has responsibility, there appears to the Commission to be potential for compliance work also to have significant potential in Scotland, particularly in relation to audits of self-assessed tax returns. Research suggests that, while tax non-compliance is common in self-assessed tax returns (with a third of taxpayers underpaying by some degree), half of the total of under-reporting is done by 2% of taxpayers.[102] Further, audits at a single point in time appear to cause longer-running changes in behaviour, improving compliance for years after the audit takes place.[103]

Although the Commission is not aware of research being conducted on tax audit and compliance in Scotland, evidence the Commission's tax working group has heard[104] suggested that the return on investment that may be expected from such work in Scotland is likely to be around £6 to £8 for every £1 invested.

[iv] This polling work was conducted by Survation on behalf of the Poverty and Inequality Commission in March/April 2023 and is available on the Commission's website at: https://povertyinequality.scot/about/our-working-groups/

As previously mentioned, the collection and administration of income tax in Scotland is conducted by HMRC, who apply a risk-based approach to their compliance work. That is, more intensive audit and compliance work is conducted where there is believed to be risk of non-compliance specifically related to Scottish taxpayer status. To date, the Commission understands that there has not been specific compliance work in Scotland. The Commission believes that, to further develop its agreement with HMRC and realise benefits from tax compliance work, the Scottish Government should:

- Review the statutory and guidance definitions of a Scottish taxpayer, ensuring it is as tight and objective as possible and limits the possibility for individuals to move away from Scotland "on paper" to avoid devolved taxes.
- Create and agree a process with the UK Government by which Scottish Ministers can invest further in tax compliance and audit, ensuring resulting revenues from work in Scotland accrue to Scotland.

However, this must be done in the right way, with the principles of treating Scottish taxpayers fairly, and with dignity and respect. The Scottish Government should use the formal channels it has with HMRC to ensure tax compliance work in Scotland is conducted fairly and to the highest standard. As discussed previously in this report, while there is not strong evidence to date that suggests the existing level of divergence in tax policy between Scotland and the rest of the UK has resulted in behavioural changes like migration or non-compliance (e.g. by declaring residence outside of Scotland), this is something that should be kept under close review.

- **Why:** Devolved taxation and its interaction with reserved taxes can be complex, and some elements are poorly understood by taxpayers. This should be addressed by actions to improve understanding of and connection with the tax system among Scottish taxpayers (including explanation of the fiscal framework), and also actions on tax compliance and audit work.
- **How:** In its next tax publication, the Scottish Government should set out specific actions as to how it will advance the "engagement" principle from its 2021 Framework for Tax publication. This should include preparing and communicating analysis that summarises in as simplified a manner as possible what happens to each pound in Scotland raised by taxation after the effects of the fiscal framework between the Scottish Government and the UK Government have taken effect. It should agree with the UK Government a means through which the Scottish Government can produce and disseminate its own version of HMRC's Annual Tax Summary, that highlights how the Scottish Government spends tax revenue raised, emphasising the benefits to society and particularly how it enables the reduction of poverty and inequality. It should review the statutory and guidance definitions of a Scottish taxpayer, ensuring it is as tight and objective as possible and limits the possibility for individuals to move away from Scotland "on paper" to avoid devolved taxes. It should create and agree a process with the UK Government by which Scottish Ministers can invest further in tax compliance and audit, ensuring resulting revenues from work in Scotland accrue to Scotland.
- **When:** This work can commence now, with an objective to complete it by the end of the current Scottish Parliament session in 2026.

Recommendation 5. Broaden the tax base in Scotland by doing the work required to bring wealth into scope for future tax policy, and implement transparency measures on the profits of multinational companies.

Recommendations so far have focussed on reforming or extending existing devolved taxes, and related operational processes. Finally, the Commission considers it necessary for the Scottish Government to start to develop options on bringing wealth into scope for tax policy in Scotland, and for Scotland to take action on transparent reporting to drive wider improvements to reduce profit shifting internationally.

This recommendation will focus on two aspects: 1) the case for the Scottish Government to do the work required to determine the best way of bringing wealth into the tax base in Scotland, in order to reduce the current reliance on taxing income from labour; and 2) the case for the Scottish Government introducing a transparency measure that will put multinational companies on an even footing with domestic companies to drive improvements in their tax behaviours.

Firstly, there are several key reasons why the Commission recommends the Scottish Government commence the necessary work to bring wealth into the tax base in the future:

- Wealth (e.g. financial, property and assets, and pension) is more unequally distributed than income.[105]
- Wealth has been growing much faster than income, so it is becoming harder for those without wealth to climb up the wealth distribution.[106]
- Earned income is typically taxed more heavily than wealth, which creates a distorted system of incentives within the tax system, advantaging particular groups over others.
- In the absence of a functioning system of taxation of wealth, wealth will tend to continue to accumulate to already high-wealth individuals, and other taxation or redistributive levers will be unable to compensate for this.

The Wealth Tax Commission[107] has studied, in-depth, the applicability of a wealth tax to the United Kingdom as a whole, recommending in its final report a one-off wealth tax to raise substantial revenue, and discussing merits of other proposals.

Some aspects of wealth are already partly taxed in the United Kingdom. Current taxes that have aspects of wealth in Scotland and the UK are related to transfers (e.g. inheritance tax), the returns from wealth (e.g. capital gains tax) or property (e.g. council tax). The Commission recognises that designing a wealth tax to operate under a system of overlapping devolved and reserved taxes will come with some clear challenges. However, it also seems clear that the current approach where income is taxed heavily in comparison to wealth is one that has relatively limited additional room in which the Scottish Government can manoeuvre. Revenue will need to be raised to sustain and improve public services, and further changes to income tax and reform to other existing forms of taxation do not appear sufficient to meet this task.

Therefore the Commission recommends that the Scottish Government should use its expertise and those of its agencies and other delivery partners to conduct a detailed appraisal of options for the introduction of wealth taxation in Scotland. There are different routes by which a wealth tax may be operationalised in Scotland:

- Through the introduction of a local wealth tax, under existing devolved powers.
- Seeking to agree with the UK Government the powers to introduce a national wealth tax.

The Wealth Commission's 2020 report sets out a range of other considerations (and supporting evidence to aid policy design) that will need to be considered by the Scottish Government, including:

- How to define what would be within and outwith scope for a wealth tax in Scotland, with the principle of ensuring equal treatment for equal values of differing types of wealth, and avoiding as far as possible overlap with existing taxation.
- In practical terms, how to register and value the tax base for a wealth tax and whether the wealth tax would be one-off or recurring.

A less obvious way in which wealth is taken out of taxation is through profit shifting by multinational companies. A decade ago, the G20 group of leading countries - including the UK - agreed on a single goal for reform of international taxation: to reduce the misalignment between where companies report their profits for tax purposes, and the location of their real economic activity. This allows some companies to extract wealth from countries where they do business, and to channel it into low- or no-tax jurisdictions rather than pay a fair share of tax at the origin.

Data on multinationals headquartered in the United States shows how this misalignment grew from just 5% of their global profits in the early 1990s, to 25% by the early 2010s.[108] That increase in profit shifting, coupled with the financial crisis of the late 2000s and the subsequent fiscal pressures facing countries, explains the timing of the G20's efforts to address tax abuse. The latest analyses show that no progress has been made – rather, the problem has continued to worsen.[109]

A study of HMRC data showed that in the mid-2010s, 70% of all the assets on corporate balance sheets in the UK were held by subsidiaries of foreign multinationals which paid zero tax in the UK.[110] That is, the majority of the UK's corporate wealth was held by multinationals, but such was the degree

of profit shifting – or else the comprehensive failure of companies to manage those assets – that it yielded nothing in terms of a fiscal contribution to UK society.

In line with establishing transparency about the ownership of assets, an important element of the approach to profit shifting has been the rise of 'country by country reporting'. This is a simple transparency measure that puts multinationals on a level playing field with domestic businesses that publish accounts, by requiring each major multinational to detail the extent of its economic activity, profits declared and tax paid, in each jurisdiction of operation. Where this data has been made public, the disciplining effect of transparency has seen a reduction in tax haven use and an increase in the effective tax rates of reporting companies.[111]

The European Union will require a form of public country by country reporting from 2024, and Australia has published draft legislation for a more ambitious version. The UK moved first, and passed legislation in 2016 which allows HM Treasury to require full public reporting – but it has yet to do so. The Scottish Government could seek agreement from HM Treasury to enact the requirement for all multinationals operating in Scotland. In addition to the expected improvement in tax behaviour, and resulting revenues, this measure would immediately add substantially to citizens' confidence in fair taxation, and to public knowledge of the ownership of assets in the UK. Alternatively, or in addition, the Scottish Government could consider direct legislation, potentially including reporting of disaggregated data on Scotland-specific activity.

The need to look beyond existing domains of taxation in Scotland is pressing, and while some of the practical and political challenges of introducing a wealth tax will be significant, the Commission sees this work as necessary in order for the Scottish Government to achieve its objectives. It also provides an opportunity to redesign, as far as is possible in the devolved context, the existing system of incentives that result in the persistent accumulation of further wealth in those who are already wealthy.

The introduction of a functional wealth tax in Scotland is a longer-term goal, but if work does not begin on the initial phase of appraising and publishing options for debate and scrutiny, it is extremely difficult to see how the tax base in Scotland will be able to support what will be needed in the years ahead.

- **Why:** To properly address the longer-term public finance challenges facing Scotland and to make meaningful progress on Scottish Government ambitions to reduce poverty and inequality, it will be necessary to broaden the tax base beyond a reliance on taxing earned income. This will take time and faces a range of practical and political barriers. However if this work is not done (and commenced now), it is extremely difficult to see how public finances will be on a sustainable footing in the future if service levels are to be maintained and improved, and if the Scottish Government is to stand a chance of realising its poverty reduction ambitions and meeting its statutory child poverty targets.
- **How:** The Scottish Government should appraise and publish, for public scrutiny, different scenarios and options for the introduction of taxation on wealth in Scotland (for example, securing new national wealth tax powers in agreement with UK Government, or introduction of a local wealth tax under current powers). Alongside our Recommendation 1 on the creation of a comprehensive registration system for land and property, it should determine the feasibility of extending this to enable wealth assets to be registered for the purposes of assessing the tax base. Scotland should seek agreement with the UK Government to introduce public country by country reporting for multinational companies to ensure transparency of companies who shift profits for the purposes of avoiding tax liability.
- **When:** Taking forward a package of options to allow wealth to be brought into the tax base in the future will be a longer-term, but necessary, goal. Depending on the options selected to pursue from the appraisal exercise, it may also require agreement with the UK Government on devolving new tax powers. But some aspects can commence immediately, such as beginning work on public country by country reporting for multinationals, and the Scottish Government appraising and publishing options on the benefits and costs of different ways a taxation on wealth could be introduced in Scotland. Given the public finance challenges present in longer term forecasts, we think the Scottish Government should set an aim to be in the position to bring forward a package of proposals to tax wealth by the end of the current Scottish Parliament session in 2026.

Comment on other tax options

During the course of its work, the Commission's tax working group heard evidence on, and discussed other options on tax in Scotland aside from those in the recommendations above. The points below summarise the tax working group and Commission's headline views on other areas of potential future tax policy in Scotland:

- **New Scottish Income Tax bands/rates:** As mentioned earlier in the report, these have the potential to contribute to both Scotland's fiscal sustainability and raise revenue that could be spent on the reduction of poverty and inequality. Because Scotland already has a more progressive and divergent income tax structure from the rest of the UK, and because of the uncertainty related to the potential for increased behavioural response from further changes, the Commission has focussed on other aspects of reform in its main recommendations. It acknowledges that further changes to Scottish Income Tax rates and thresholds may also have a part to play.
- **Land and buildings transaction tax:** It appears widely accepted to the Commission that both LBTT and its equivalent in the rest of the UK, Stamp Duty Land Tax, are generally considered undesirable by economists and other experts, as they are a significant disincentive to mobility through their effect on property transactions. The Commission believes that these issues can best be considered in the context of the recommendation we have made around a longer-term wealth tax and council tax reform, moving towards an approach where the asset itself is taxed, not the transaction.
- **Devolution of Capital Gains Tax or Corporation Tax:** Both currently reserved, the Commission considers that under the current devolution settlement and the Scottish geographic and economic context, further work would have to be done to reduce the risk that devolution of these tax areas would have large behavioural responses that limit their potential. For example, a substantial proportion of those who currently pay capital gains tax do so as the result of single large realisation of gains (e.g. selling a business), which would be relatively easy to make arrangements not to pay in Scotland.
- **Tourist tax/visitor levies:** These are policy proposals that are already being taken forward and a Visitor Levy (Scotland) Bill is currently at Stage 1 in the Scottish Parliament. Applied appropriately, this has the potential to raise moderate revenue for local authorities in Scotland and bring some social and economic benefits.
- **VAT:** While the assignment of VAT to Scotland has been a long-standing topic of discussion between the Scottish and UK Governments, there appears to the Commission to be little prospect of a viable methodology to allow this to be further developed, and the Commission believes the Scottish Government should focus its efforts on other areas.
- **Inheritance tax:** Currently reserved, the Commission believes that the Scottish Government should best approach this in terms of a wider strategy to bring wealth into the tax base in Scotland.

3 Concluding remarks

This report sets out the Commission's views and recommendations on how tax policy in Scotland can make the best possible contribution to reducing poverty and inequality. The Commission believes that these recommendations will enable Scotland to make progress on its ambitions, while at the same time supporting fiscal sustainability and enhancing the accountability of local and national government to citizens. In concluding, the Commission would like to highlight some final overarching points it has considered over the course of its work on tax.

One perspective that the Commission has heard come through strongly from people who have experienced poverty is what it really means for system of tax and spend to be seen as "fair". People with lived experience of poverty have been clear to the Commission about their experience of going through the assessment processes for some means-tested benefits. They have told the Commission about their experiences of the high level of scrutiny adopted by authorities in relation to their income sources in order to determine their eligibility to receive support. For them, this stands in stark contrast to the relative ease with which individuals with high income or wealth appear to be able to make arrangements to avoid paying more tax. The Commission thinks that these kind of perceptions are damaging to the social contract that the Scottish Government seeks to create, particularly when it comes to the democratic engagement of people on lower incomes. The Commission hopes that some of the recommendations in this report will help address these challenges.

Over the course of several years of providing reports to the Scottish Government scrutinising its progress on tackling child poverty, the Commission has repeatedly made recommendations around better use of evidence to inform and explain policy-making in relation to reducing poverty. From its work on tax, there is a parallel area of improvement in relation to the formulation and public explanation of tax policy in Scotland. A recent Institute for Government report[112] highlights some challenges and shortcomings around how evidence is used and explained in terms of reserved UK Government tax policy. The Commission believes that there is also learning in this area for the Scottish Government – more can be done in future Scottish Government budgets and tax policy announcements to inform and explain how evidence has shaped tax policy decisions.

Over the course of its work on tax, the Commission has heard that the overall design of the tax system is seen in both the UK and Scotland (and the interactions between them) as complex, unpredictable, and inefficient to experts and citizens alike. Recent work by the Resolution Foundation at the UK level has highlighted this.[113] This status quo frustrates attempts to make the existing system fairer, or to build a stronger social contract.

Tax policy and spend choices in Scotland in recent years have made Scotland more progressive, and have overall been to the benefit of low income households. The Commission welcomes this. However, given the challenges faced, there appears to be limited further road for tweaks to the status quo. Seeking to do so without also tackling the more fundamental issues inherent in the system raised in this report – such as the poor design of the current system of council tax, and the need to expand the tax base to wealth and beyond its current reliance on taxing earned income – will both concentrate risks around fiscal sustainability and miss the opportunities offered by reform.

In order to meet both the poverty reduction ambitions the Scottish Government is committed to, and to ensure Scotland is fiscally sustainable in the future, substantial reform of tax policy in Scotland is required. This report is the Commission's contribution to the debate over what that reform should look like.

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