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Financial Scrutiny Unit Briefing

Tax progressivity and the Scottish Rate of Income Tax

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The Scottish Rate of Income Tax (SRIT) will be introduced in April 2016 and will apply equally to the three main income tax rates. In Scotland's Spending Plans and Draft Budget 2016-17 the Scottish Government proposed to set SRIT at 10p for 2016-17, which would leave income tax rates in Scotland the same as in the rest of the UK. In January 2016 the Scottish Liberal Democrats proposed a 1p increase in SRIT. In February 2016 the Scottish Labour Party also proposed a 1p increase in SRIT, combined with a £100 annual rebate for low income taxpayers.

This briefing explains the concept of progressivity and summarises the recent debate around "progressivity" and SRIT using illustrative examples. Whether increasing SRIT would be a "fair" move depends on the way in which this term is understood as it has no strict definition.

The Scottish Parliament
Pàrlamaid na h-Alba

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EXECUTIVE SUMMARY

The Scottish Rate of Income Tax (SRIT) will be introduced in April 2016. All income tax rates on non-savings and non-dividend income will be reduced by 10p for Scottish taxpayers. The Scottish Parliament will then be able to set SRIT, which will apply equally across the three main rates of income tax. In Scotland's Spending Plans and Draft Budget 2016-17 the Scottish Government proposed to set SRIT at 10p for 2016-17 (Scottish Government 2015), which would leave income tax rates in Scotland the same as in the rest of the UK. If SRIT is set at 10p, it is forecast to raise £4,900m in 2016-17 (OBR 2015).

Both the Scottish Liberal Democrats and the Scottish Labour Party have proposed a 1p increase in SRIT: this would take the basic, higher and additional rates of income tax for Scottish taxpayers to 21p, 41p and 46p respectively. Table 1 shows the estimated increase in revenue if SRIT is increased by 1p in the next three years.

Table 1 Estimated increase in tax receipts if SRIT is increased by 1p, 2016-17, 2017-18 and 2018-19 (£m)

2016-17	2017-18	2018-19
475	495	520

Source: HMRC 2015a

According to the strict economic definition of progressivity, a tax is progressive when the average tax rate rises as the tax base rises. A flat tax is progressive as long as there is a tax-free personal allowance. In 2016-17, this means SRIT is progressive for incomes under £122,000. However, the term "progressive" is sometimes used in ways that relate more closely to the concept of tax "fairness", which is open to interpretation. In addition, it is more meaningful to consider SRIT as part of income tax as a whole as it cannot be separated from the rest of income tax.

SPICe has a Scottish Rate of Income tax Calculator that allows users to set SRIT at different rates for 2016-17. Table 2 shows the effect of setting SRIT at 11p in 2016-17 for taxpayers with an income of £20,000 and £200,000.

Table 2 Effect of setting SRIT at 11p on incomes of £20,000 and £200,000, 2016-17

	£20,000	£200,000
Change in tax:		
£ per year	£90	£2,000
As % of total income	0.450%	1.000%
As % of taxable income	1.000%	1.000%
As % of initial tax bill	5.000%	2.628%
Change in post-tax income as % of initial post-tax income	-0.495%	-1.614%

Source: Scottish Rate of Income tax Calculator

INTRODUCTION

Under the Scotland Act 2012, the Scottish Rate of Income Tax (SRIT) is set to be introduced in April 2016. This will apply to the non-savings and non-dividend (NSND) income of Scottish taxpayers.[1] The basic rate will be reduced to 10p in the pound, the higher rate to 30p and the additional rate to 35p. The Scottish Parliament will have the power to set a Scottish rate that will apply equally to these three income tax rates.

Table 3 shows the forecast for SRIT receipts if SRIT is set at 10p from 2016-17 to 2020-21.

Table 3 Forecast of SRIT receipts if SRIT is set at 10p, 2016-17 to 2020-21 (£m)

2016-17	2017-18	2018-19	2019-20	2020-21
4,900	5,226	5,521	5,802	6,148

Source: OBR 2015

Revenues from SRIT will accrue to the Scottish Government and no longer to HM Treasury although the whole of income tax will continue to be administered and collected by HMRC. The Scottish block grant will be reduced to reflect this loss for the UK Government. The Command Paper, Strengthening Scotland's Future ("Command Paper"), set out a transitional period for the Scottish rate during which the block grant will be notionally reduced by the forecast for SRIT (at 10p) receipts, and the Scottish Government will receive payment to the same amount. This will not be adjusted against the outturn amount of SRIT collected by HMRC (UK Government 2010). The net effect on the Scottish budget during the transition period will be 0 if the Scottish Parliament chooses to set SRIT at 10p (UK Government 2010). In 2016-17 the block grant will be notionally reduced by £4,900m and this will automatically be added on to the Scottish budget (Scottish Government 2015).

After the transition period, SRIT outturn receipts will be reconciled with the amounts forecast and paid to the Scottish budget with a corresponding transfer either to or from the Scottish budget to the UK Consolidated Fund. This reconciliation will be when nearly all of the outturn receipts are known and no later than 12 months after the end of the financial year (UK Government 2010).

The Scottish Parliament must set a Scottish rate each year. The Command Paper states that:

> "The new Scottish rate will need to be set every year by the Scottish Parliament, with a resolution passed in such time as to allow the taxes to be collected at the start of each tax year. In order to allow the necessary administrative and compliance measures around the collection of a Scottish income tax to be taken by HMRC and by those paying and remitting income tax in Scotland, the rate to apply in a particular tax year will need to be formally communicated to the UK Government by the end of December in the preceding calendar year. This timetable will allow taxpayer compliance burdens to be minimised. The rate will then need to be passed by resolution in the Scottish Parliament by 5 April at the latest, to provide the statutory basis for the collection of receipts from the start of the tax year. Once this date has passed the resolution will not be able to be cancelled or amended." (UK Government 2010)

In Scotland's Spending Plans and Draft Budget 2016-17 (Scottish Government 2015) the Scottish Government proposed a SRIT of 10p that will apply from 6 April 2016. This will leave

[1] This is earnings, pension income and property income.

income tax rates for Scottish taxpayers at the same level as the rest of the UK. The Scottish Parliament Finance Committee ("Finance Committee") has supported the Scottish Government's proposal to set SRIT at 10p (Scottish Parliament 2016) whilst recommending a wide ranging debate across Scotland on taxation policy once the new financial powers arising from the Smith Commission are introduced.

The Scottish Liberal Democrats have proposed a 1p increase in SRIT (The Scotsman 2016). The Scottish Labour Party has also proposed a 1p increase in SRIT, combined with a £100 rebate for taxpayers earning less than £20,000 a year (The Guardian 2016).

The Scotland Bill 2015-16 provides for the devolution of income tax on NSND income for Scottish taxpayers. This power would supersede SRIT and would allow the Scottish Government to set bands and rates for income tax. Decisions on the personal allowance would remain reserved to the UK Government. The Secretary of State for Scotland David Mundell supports the introduction of these powers in 2017. For example in the House of Commons on 6 January 2016, he stated: "I would like the tax powers in place by April 2017" (UK Parliament 2016). Although the Scotland Bill 2015-16 was passed by the House of Commons, the House of Lords Select Committee on Economic Affairs recommended that it not proceed to the Committee stage (Lords) until Scotland's fiscal framework is published (UK Parliament 2015). Negotiations on the fiscal framework between the Scottish and UK Governments are on-going, with the Joint Exchequer Committee meeting most recently on 8 February 2016 (Scottish Government 2016).

CONCEPTS OF TAX

Average rates of tax, which are linked to marginal rates of tax, are central to the concept of progressivity.

MARGINAL RATE OF TAX

The marginal rate of income tax is the proportion of an extra pound earned that is paid in income tax. An individual's marginal rate of tax is the highest rate at which they pay tax.

Income tax has three main marginal rates: basic, higher and additional. Table 4 shows the income tax rates and thresholds for 2016-17.

Table 4 Income tax rates, bands and personal allowance, 2016-17

	2016-17
Personal allowance	£11,000
Basic rate	20%
Higher rate	40%
Additional rate	45%
Basic rate band	£0-£32,000
Higher rate band	£32,001 - £150,000
Additional rate band	Over £150,000

Source: HMRC 2015b

People with incomes up to £100,000 receive full personal allowance, which is a tax-free allowance before tax starts being payable. Personal allowance tapers off for earnings over £100,000 at a rate of £1 for every £2. In 2016-17 personal allowance is £11,000 so the allowance is zero for incomes £122,000 or above.

For example, Table 5 shows the tax paid by a higher rate taxpayer with an income of £50,000.

Table 5 Income tax for a taxpayer with an income of £50,000, 2016-17

	Income and tax
Total income	£50,000
Personal allowance	£11,000
Taxable income	£39,000
Tax paid at basic rate	20% * £32,000 = £6,400
Tax paid at higher rate	40% * (£39,000 - £32,000) = £2,800
Total tax paid	£9,200

Source: SPICe calculations using the Scottish Rate of income Tax calculator

Marginal tax rates are related to but different from effective marginal tax rates.

EFFECTIVE MARGINAL TAX RATE

The effective marginal tax rate (EMTR) is the proportion of each extra pound lost due to tax and takes into account income tax, tax credits, benefits and reliefs. EMTRs vary from individual to individual (Berthier 2014). National insurance contributions (NICs) can be included in this calculation on the basis that, as argued by Paul Johnson from the IFS:

> "It is now a common view, accepted by virtually all tax experts outside of HMRC and HM Treasury, that NICs are no more than an additional tax on earnings. There is just the slightest relationship between whether they are paid and rights to some benefits. There is almost no relationship at all between how much is paid and rights to anything. They are a tax." (Bell & Eiser 2015)

Because national insurance rates decrease as incomes increase,[2] EMTRs are not as different between low income taxpayers and higher income taxpayers as marginal tax rates would make it seem. Furthermore, the withdrawal of low-income benefits means the low income taxpayers can face high EMTRs.

Marginal tax rates and EMTRs are also different from average tax rates, which also vary across individuals.

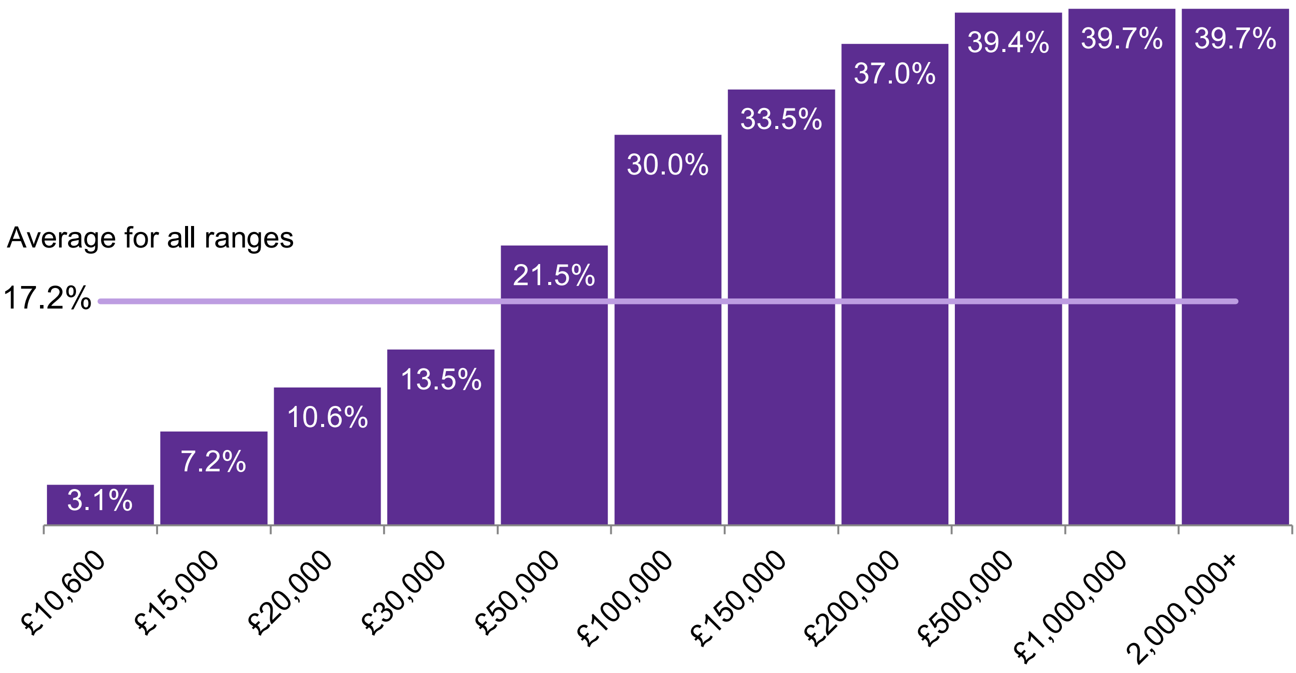
AVERAGE RATE OF TAX

The average rate of income tax is the ratio of income tax liability to total income, where income is measured before deductions, reliefs and allowances (HMRC 2015c). Unlike marginal tax rates, the average rate of tax may vary across individuals with the same earnings.

Figure 1 shows the average rate of tax for different income groups in the UK in 2015-16.

[2] For example, the employee rate is 12% for someone earning between £155 and £815 a week in 2015-16, but only 2% for someone earning above £815 (UK Government 2015).

Figure 1 Average rate of income tax for different income groups, UK, 2015-16



Source: HMRC 2015c

The progressivity of tax is defined in relation to the average rate of tax.

PROGRESSIVITY

Tax by Design, the final report from the Mirrlees Review notes that:

> "There is a strict economic definition of progressivity. A tax is said to be progressive when the average tax rate rises as the tax base rises. So an income tax is progressive when the average tax rate rises as income rises. (We usually think in terms of annual income, though lifetime income may be the better base against which to assess progressivity.) This is the case when the marginal tax rate (the proportion of an additional pound of income paid in tax) is higher than the average tax rate (the proportion of total income paid in tax). In effect, the higher marginal tax rate pulls the average rate up towards it.
>
> The simplest way to achieve progressivity in an income tax is to have a tax-free allowance before tax starts being payable." (Institute for Fiscal Studies 2011)

As shown in Figure 1, average rates of tax broadly rise as incomes rise, so income tax is progressive (HMRC 2015c).

FAIRNESS AND PROGRESSIVITY

While there is a strict definition of progressivity (Institute for Fiscal Studies 2011), when discussing SRIT the term "progressive" has sometimes been used in a sense that goes beyond its economic definition and seems to relate instead to the concept of "fairness." The Commission on Local Tax Reform (2015) notes that "[m]any people associate fairness with whether a tax is progressive or not. The House of Commons Treasury Committee noted in 2011 that "[t]here is little consensus about the detail of what constitutes fairness" and concluded that:

> "A tax system which is felt to be fundamentally unfair will quickly lose political support. However, judgements about the fairness of policy details are politically contested and a major way in which parties distinguish themselves from one another. This can obscure the fact there is a significant amount of consensus on fairness. The differences are often matters of degree and emphasis." (UK Parliament 2011)

The Commission on Local Tax Reform states that:

> "Sometimes, people use terms like regressiveness to describe how the tax rate changes as incomes change. That is why VAT is often called regressive. It is a 20% flat rate on the value of goods and services, but because lower income households spend relatively more of their income, on average they spend more proportionately on VAT. The same would be true of a proportionate, or flat rate, property tax because, on average, housing costs make up a larger proportion of a lower income household's expenditure. Some think that this interpretation of progressiveness and regressiveness is more important than how a tax relates to its tax base. That is why we look at both interpretations" (Commission on Local Tax Reform 2015).

The following section assesses SRIT and changes to SRIT in relation to progressivity in the strict sense of the term, but also in the more loose sense that the term progressivity is sometimes used and which relates more closely to notions of fairness.

THE SCOTTISH RATE OF INCOME TAX (SRIT)

SRIT can be considered in terms of tax progressivity from two perspectives:

- Statically, in other words at a specific point in time and a given rate e.g. SRIT at 10p.
- Dynamically, that is to say when considering a change in SRIT and whether this makes SRIT and/or income tax as a whole more or less progressive.

IS SRIT A PROGRESSIVE TAX?

The Mirrlees Review highlights that:

> "[A] *flat tax* - an income tax charged at a single constant rate above a tax-free allowance - is progressive, as long as there is a tax-free allowance." (Institute for Fiscal Studies 2011)

SRIT is a flat tax on all incomes above the personal allowance. Thus it is progressive for taxpayers receiving personal allowance, i.e. with incomes under £122,000. However, as SRIT is not a standalone tax, i.e. it is part of income tax, it is more meaningful to consider the income tax structure as a whole.

As SRIT is a flat tax, it is progressive if there is personal allowance i.e. for incomes under £122,000. However, in practice SRIT is best considered as part of income tax as a whole.

WHAT EFFECT DOES CHANGING SRIT HAVE ON INCOME TAX?

The Mirrlees Review notes that:

> "This income tax [charged at a single constant rate above a tax-free allowance] can be made more progressive by (i) increasing the tax-free allowance, (ii)

increasing the single rate of tax, or (iii) introducing one or more higher marginal tax rates on higher incomes. Progressivity does not, however, require that the marginal tax rate keeps on increasing as incomes rise." (Institute for Fiscal Studies 2011)

Changing SRIT will have an effect on the progressivity of income tax, but this cannot make income tax as a whole a regressive tax.

Direct effect on taxpayers of increasing SRIT by 1p in 2016-17

The data used in this section for different income levels are taken from the Scottish Rate of income Tax calculator with detailed figures available online on the same page as the briefing.

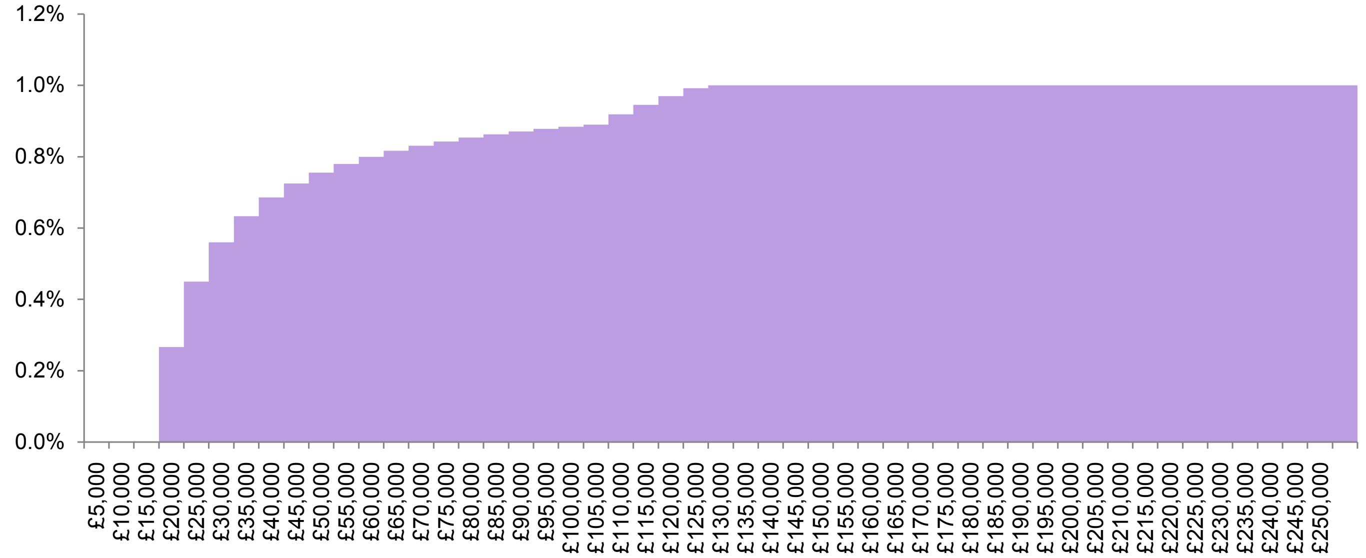
The following section shows the direct effect of setting SRIT at 11p in 2016-17 on individual taxpayers with incomes between £0 and £250,000 (rising by increments of £5,000).

Please note the stacked appearance of the graphs that follow is due to the fact that the illustrative incomes used increase by increments of £5,000. The smaller these increments, the smoother the results would appear.

Tax increase as a share of total income

Figure 2 shows the increase in tax liability when SRIT is increased by 1p as a percentage of total income for different incomes between £0 and £250,000.

Figure 2 Increase in tax liability as a share of total income (%) for different incomes, when setting SRIT at 11p, 2016-17



Source: SPICe calculations using the Scottish Rate of income Tax calculator

The increase steepness of the curve for incomes between £100,000 and £122,000 is due to the tapering off of personal allowance for incomes over £100,000.

Figure 2 shows that setting SRIT at 11p leads to:

- An increase in tax as a share of total income that is greater the higher the income for incomes above £11,000 (standard personal allowance) and under £122,000 (the income at which there is no personal allowance).
- An increase in tax as a share of total income of 1% for incomes equal to or £122,000 or above.

As a share of total income, increasing SRIT leads to:

- For incomes above £11,000 and under £122,000, a bigger increase in tax the higher the income.
- For incomes equal to or above £122,000, the same increase in tax whatever the income.

Tax increase as a share of taxable income

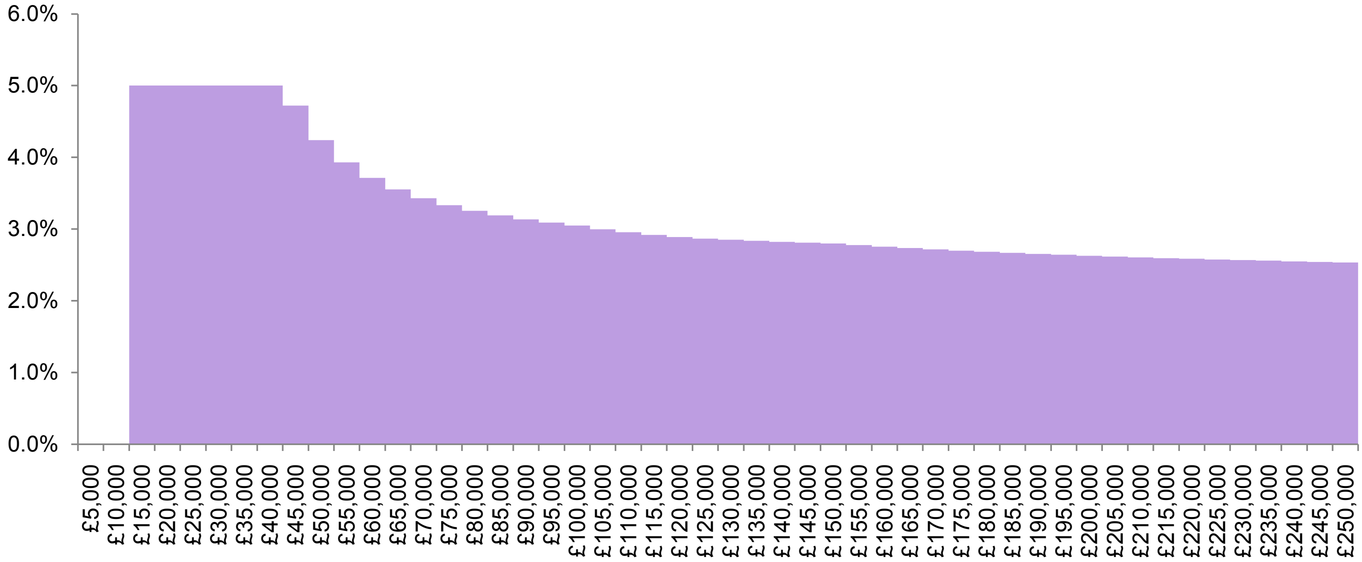
Increasing SRIT by 1p, from 10p to 11p leads to a 1% increase in tax as a share of taxable income for all incomes above £11,000.

As a share of taxable income, for incomes above £11,000, increasing SRIT leads to the same increase in tax for all incomes.

Tax increase as a share of previous tax bill

Figure 3 shows the increase in tax liability when SRIT is set at 11p, as a percentage of the tax bill if SRIT was set at 10p, for different incomes between £0 and £250,000.

Figure 3 Increase in tax liability (%) for different incomes when setting SRIT at 11p, 2016-17



Source: SPICe calculations using the Scottish Rate of income Tax calculator

Figure 3 shows that setting SRIT at 11p leads to:

- An increase in tax of 5% for incomes above £11,000 and up to or equal to £43,000 (the higher rate threshold).
- An increase in tax that is lower the higher the income for incomes above £43,000.

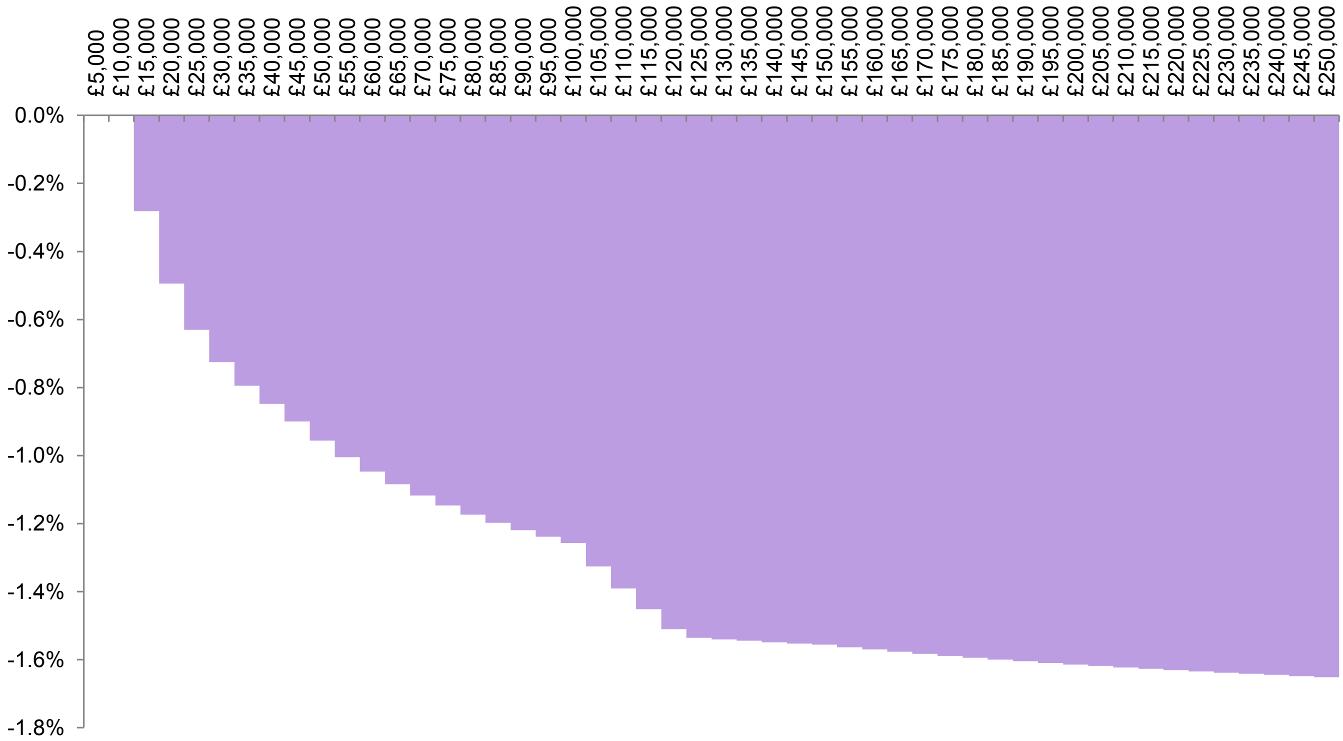
Increasing SRIT leads to a relative change in the tax bill that is:

- **For incomes above personal allowance and up to or equal to the higher rate threshold, the same whatever the income.**
- **For incomes above the higher rate threshold, smaller the bigger the income.**

Post-tax income decrease as a share of previous post-tax income

Figure 4 shows the decrease in post-tax income when SRIT is set at 11p as a share of post-tax income if SRIT was set at 10p, for different incomes between £0 and £250,000.

Figure 4 Decrease in post-tax income (%) for different incomes when setting SRIT at 11p, 2016-17



Source: SPICe calculations using the [Scottish Rate of income Tax calculator]

Figure 4 shows that increasing SRIT by 1p, from 10p to 11p leads to a decrease in post-tax income that is higher the higher the income for incomes above £11,000.

Increasing SRIT leads to a relative change in post-tax income that is bigger the higher the income

- For incomes above £11,000 and up to or equal to £43,000, the same whatever the income.
- For income above £43,000, smaller the bigger the income.

Summary

Table 6 compares the direct effect of setting SRIT at 11p for incomes of £20,000 and £200,000.

Table 6 Effect of setting SRIT at 11p, incomes of £20,000 and £200,000, 2016-17

	£20,000	£200,000
Change in tax:		
£ per year	£90	£2,000
As % of total income	0.450%	1.000%
As % of taxable income	1.000%	1.000%
As % of initial tax bill	5.000%	2.628%
Change in post-tax income as % of initial post-tax income	-0.495%	-1.614%

Effect of changing SRIT on marginal income tax rates

Changing SRIT will change the marginal rates of taxation. David Eiser from the Centre on Constitutional Change notes that, if SRIT is set at 11p:

> "A basic rate taxpayer sees their tax rate increase from 20p to 21p, an increase of 5%, whereas an upper rate taxpayer sees their marginal tax rate increase from 40 to 41p, an increase of 2.5%. This means that, following a 1p increase in SRIT, basic rate taxpayers see the amount of tax they pay increase by 5%, whereas those earning above the upper rate face a smaller percentage increase in the amount of tax they pay." (Eiser 2016)

As stated by David Eiser, because a change in SRIT leads to a change in the marginal rates of taxation, "[t]he SRIT is sometimes said to be regressive." (Eiser 2016). However, this is not accurate according to the strict definition of progressivity.

Changes in the marginal rates of taxation change the rates in relation to one another. For example, if SRIT is set at 10p, the higher rate is twice the value of the basic rate. If SRIT is set at 11p, the higher rate is only 1.952 times the value of the basic rate.

Increasing SRIT decreases the differences between each marginal tax rate. However this does not mean SRIT is regressive.

Distributional impact on households of increasing SRIT by 1p in 2016-17

This briefing has focused so far on impact of changes in SRIT and has not looked at the interaction between the tax and welfare system. One way of starting to explore this aspect is through micro-economic modelling. This can allow data to be factored in on the composition of households and income from all sources (not just earnings) as well as capital (savings, investments and property). It can also include changes in means-tested benefits as a result of changes in tax liability.

Using the tax-benefit micros-simulation model Euromod (developed by the University of Essex), SPICe has published an online tool Who gains and loses from changes to the new Scottish Rate of Income Tax? which allows users to see the impact of changing SRIT on disposable household income by income decile. This tool gives a broad picture of changes to household disposable income following changes in SRIT. However, caution must be taken when interpreting the results. For example, income deciles under different scenarios (e.g. SRIT at 10p and SRIT at 11p) are not directly comparable.[3] In particular, changes in aggregate disposable income for different income decile brackets may be caused by the way the deciles are constituted, as well as by 'real world' changes in entitlement to benefits for individual households.

Comerford and Eiser (2014) considered the redistributive effects of an increase in SRIT and showed that raising the basic rate to 21p would reduce the Gini coefficient[4] by less than a fifth of one percent, while raising the higher rate to 41p would reduce the Gini by less than a tenth of one percent. The poorest fifth of Scottish households would experience a fall in net income of slightly less than 0.2%, whereas the richest fifth of households would experience income falls greater than 1%. On this basis, they concluded that a rise in the SRIT is slightly progressive.

[3] Although the majority of households in a given income decile will remain in that same decile under different Scottish rates of income tax, some households may shift into a contiguous decile as a result for example of changing their eligibility to certain benefits which could affect their disposable income in a counter-intuitive direction. For example, if SRIT is increased, post-tax income may go down which may lead to an increase in benefits and a rise in disposable income if the net effect of the tax and benefit changes at a household level is positive.

[4] The Gini index "measures the extent to which the distribution of income (or, in some cases, consumption expenditure) among individuals or households within an economy deviates from a perfectly equal distribution (…) a Gini index of 0 represents perfect equality, while an index of 100 implies perfect inequality" (World Bank 2016).

FINANCE COMMITTEE CALL FOR EVIDENCE AND ENQUIRY ON SRIT

In 2015 the Finance Committee issued a call for evidence seeking views on the rate for SRIT; how any additional resource should be allocated or reduction funded; and how well the introduction of SRIT had been publicised to employers and tax payers (Scottish Parliament 2015a). The consultation closed on Friday 28 August 2015 with 24 submissions. These are summarised in the Finance Committee adviser briefing published on 18 September 2015 (Scottish Parliament 2015b).

A large number of respondents, mostly individuals, favoured a reduction in SRIT. For example, the Scottish Retail Consortium stated that any move leading to those working in Scotland having to pay higher taxes than elsewhere in the UK “could affect the ability of retailers to retain or attract talent - either on a permanent or temporary basis - especially when compared to other parts of the UK. If Parliament was determined to vary tax rates then we would prefer it to fall rather than rise” (Scottish Parliament 2015b). The Scottish Building Federation also stated:

> “If the Scottish Parliament were to seek to generate additional tax revenues by setting the SRIT at a level higher than 10%, we have grave concerns about the impact this could have on the Scottish construction industry given the relatively high level of basic rate income tax payers working within the [building] sector.” (Scottish Parliament 2015b)

Most business respondents argued SRIT should be set at 10p. For example, Johnston Carmichael Chartered Accountants stated that:

> “Until a full budget and spending plan is prepared for Scotland, we recommend that SRIT is retained at 10% for the first year, 2016/17. This will provide time for the people of Scotland to become more aware of what SRIT means in practice and for HMRC to establish and stabilise the administrative procedures necessary to operate SRIT.” (Scottish Parliament 2015b)

The Scottish Trades Union Congress (STUC) also argued that SRIT should remain at 10p for 2016-17, for two reasons:

- “Economic circumstances: the recovery from the recession precipitated by the banking crisis and prolonged period of stagnation that followed is far from complete: unemployment is still some 40% above its 2008 level, underemployment remains high and the prevalence of precarious low wage[s] has increased. The global economic outlook is highly uncertain as is the impact of raising interest rates on (still) highly indebted households. Although, in global terms, it is clearly a significant boost to demand the low oil price raises specific concerns for Scotland; and,
- Fairness/distributional consequences: while there is a very strong case for seeking to increase revenues from those currently in the higher and additional rate brackets, this cannot be achieved through the SRIT. The STUC is concerned at the impact of a tax increase on lower wage workers – particularly those in precarious employment - when wages, which experienced a historically unprecedented collapse between 2009-14, have barely started to recover. The STUC will continue to press the case for tax to be increased at UK level in a progressive fashion Low wage workers should, at least for the time being, be insulated from increases with the responsibility placed firmly on those in the higher and additional rate brackets.” (Scottish Parliament 2015b)

The least represented view amongst the respondents was that SRIT should be increased above 10p. NHS Health Scotland supported the introduction of SRIT at a rate greater than 10% on the basis of modelling that suggests that increasing SRIT by 1p would reduce the relative index of inequalities in all-cause mortality by approximately 0.5%, assuming the resultant increased revenue be used for redistribution or to fund effective public services for it to generate a positive impact on mean population mortality (Scottish Parliament 2015b). Lucy Hunter Blackburn also proposed an increase in SRIT, to the value of 1.5% in order to tackle a funding gap resulting from the Council Tax Freeze. She argued that:

> "[T]he highest absolute savings have been experienced by the households in the highest valued properties (…) A charge through income tax is likely to mean the highest cost is borne more than now by those who have made the largest savings from the freeze, even in the absence of an exact correlation between income and property value" (Scottish Parliament 2015b).

On 23 September 2015 Ben Thomson and Lucy Hunter Blackburn gave evidence to the Finance Committee. Lucky Hunter Blackburn stated:

> "I differ with Ben Thomson on the progressive-regressive argument. It is an important point on which the committee will want to take a view. When Ben Thomson talks about the impact by income, he is looking at how much a person's tax goes up. It is absolutely right to say that, under the Scottish rate, as a percentage of the current tax, the extra penny will be more for those on lower incomes. However, that argument does not pick up the point that, at lower incomes, people pay much less of their income as tax full stop." (Scottish Parliament 2015c)

Asked whether SRIT is progressive in the Finance Committee on 30 September 2015, Stephen Boyd from the Scottish Trades Union Congress stated:

> "I do not think that the SRIT is progressive in and of itself, but that is not to say that the funds that could be raised through increasing it could not be used in progressive ways. I mentioned earlier that we can use "progressive" and "regressive" in narrow and simplistic ways (…) Lucy Hunter Blackburn makes a reasonable case, but I cannot agree with her on the fundamental point of whether the SRIT is in and of itself progressive. It is clearly a regressive instrument." (Scottish Parliament 2015d)

In response, Dr Gerry McCartney from NHS Health Scotland explained that:

> "The argument about whether the SRIT itself is regressive depends a lot on whether the tax is measured in relative or absolute terms. Stephen Boyd [of the Scottish Trades Union Congress] is right that normally it is measured in relative terms, which is why it is normally judged to be regressive. Clearly any increase would take in a greater amount of tax, so it could be argued that it is progressive in absolute terms." (Scottish Parliament 2015d)

SCOTTISH GOVERNMENT PROPOSAL TO MAINTAIN SRIT AT 10P FOR 2016-17

In Scotland's Spending Plans and Draft Budget 2016-17 (Scottish Government 2015) the Scottish Government justified setting SRIT at 10p on the basis that:

> "As the same rate is added to the existing UK rates minus 10 percentage points, any increase above a 10 per cent rate would have a disproportionate effect on the amount of tax paid by people on very low taxable incomes against their current tax bill, and any decrease would disproportionately benefit those people with high incomes."

On 16 December 2015 the Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy (John Swinney MSP) stated in Parliament:

> "[A]ny rate set above 10 pence would increase the tax paid by all Scottish taxpayers. By its nature, exercising that power would have a disproportionate effect on the amount of tax paid by the taxpayers on the lowest incomes. Likewise, although any rate below 10 pence would cut the tax bill paid by all taxpayers, those on the highest incomes would see the greatest benefit" (Scottish Parliament 2015e).

On 16 December 2016 the Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy on BBC's Scotland 2015 explained that increasing SRIT by 1p would have double the impact on the taxable income of low income individuals compared to high income individuals. As highlighted by David Eiser, it is correct to say that increasing SRIT would have a disproportionate effect in the amount of tax paid by taxpayers on the lowest incomes, "as long as, by 'taxpayers on the lowest incomes' [the Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy] is referring to anyone earning less than the Upper Rate threshold, i.e. £43,000" (Eiser 2016).

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy gave evidence to the Finance Committee on Wednesday 13 January 2016 on the effect of changing SRIT. John Mason MSP highlighted an example of someone with an annual income of £25,000 and someone who is on £125,000 a year, noting that a witness had stated that adding 1.5p on the SRIT would mean that the person on the lower wage would pay £216 extra, while the one on the higher wage would pay £1,875, which is eight times more. John Mason commented: "That shows that, although the tax is not extremely progressive, when the income goes up five times, the tax that is paid goes up eight times, which strikes me as progressive" (Scottish Parliament 2016b).

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy responded:

> **"**I view the Scottish rate of income tax as a progressive power, on the basis of the sort of analysis that Mr Mason has outlined, although I do not have that particular example in front of me. Clearly, people on higher incomes will pay comparatively more than people on lower incomes. Two issues were on my mind and influenced my decision. The first was that the lockstep would involve increasing tax for people on low incomes. I take the view of the STUC that this is not the moment to do that, as people are finding things hard enough. The second point was that, if I had increased the Scottish rate of income tax beyond 10p, as a percentage of current income tax, the increase in individuals' tax bills would have been greater for those on lower incomes than it would have been for those on higher incomes. On those two grounds, I felt that it was not an appropriate step to take" (Scottish Parliament 2016b).

The Convenor of the Finance Committee (Kenneth Gibson MSP) also asked the Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy to comment on the Scottish Trades Union Congress (STUC) view that the SRIT is regressive. The STUC had noted that if the basic rate of tax goes up from 20p to 22p, that is a marginal rate of 10 per cent whereas, for higher taxpayers, an increase from 45p to 47p is a marginal rate of 4.4 per cent.

The Deputy First Minister and Cabinet Secretary for Finance, Constitution and Economy responded:

> “Those factors are absolutely correct, convener, but I cannot deny that the Scottish rate of income tax as it stands is progressive. We have to be careful that, in the decisions that we take, we maintain that progressivity” (Scottish Parliament 2016b)

In its Report on the Draft Budget 2016-17 the Finance Committee stated:

> “The Committee supports the Scottish Government‘s proposal to set SRIT at 10p for 2016-17. However, the Committee also notes some of the innovative proposals from witnesses for tax changes and recommends the need for a wide ranging debate across Scotland on taxation policy once the new financial powers arising from the Smith Commission are introduced. The Committee will consider this as part of its legacy paper” (Scottish Parliament 2016a).

OTHER PROPOSALS FOR SRIT

In January 2016 the Scottish Liberal Democrats proposed a 1p increase in SRIT, stating it would put the expected £475m in extra revenue towards education (The Scotsman 2016). Liam McArthur (MSP) stated:

> “By committing to raising income tax by 1p, we would be able to spend £475 million more on education next year alone. That would be the biggest investment in education since devolution.” (Scottish Parliament 2016c)

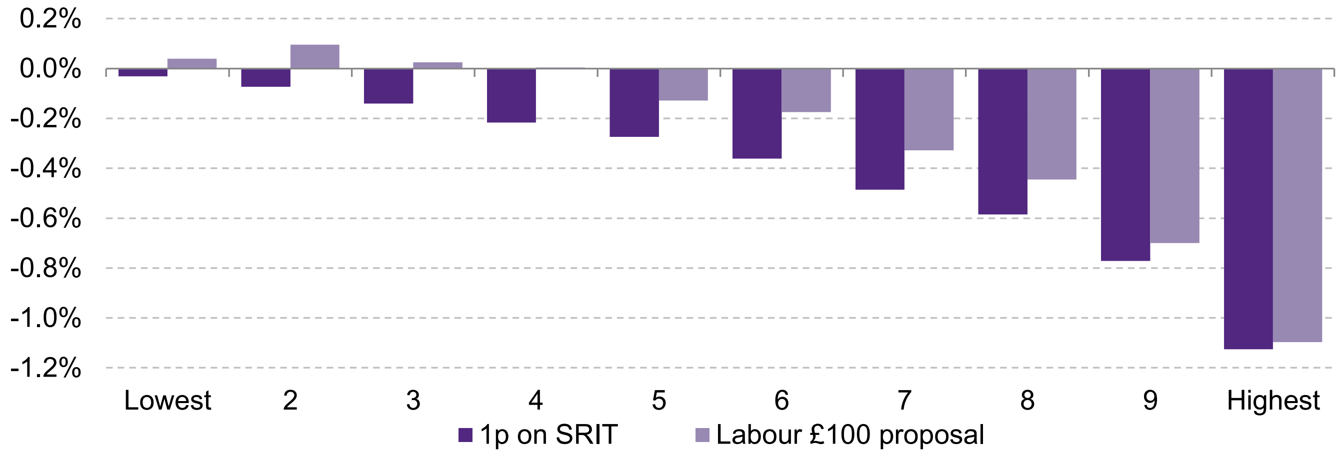
Willie Rennie (MSP) explained that the money would be invested in the pupil premium (Scottish Parliament 2016c).

On 1 February 2016 the Scottish Labour Party also proposed a 1p increase in SRIT, combined with a system to give a rebate for low income taxpayers, earning less than £20,000 a year (The Guardian 2016). Kezia Dugdale (MSP) noted:

> “We would establish, with local authorities, a £100 annual rebate for low income taxpayers. This workers rebate will account for just £50 million of the £500 million this change will raise but will mean that we can boost the incomes of low paid workers (…) I can also reassure low income pensioners who pay tax that they will also be protected by a £25 million rebate” (Scottish Labour 2016).

Using the Stirling Economics micro-simulation model, Bell and Eiser (2016) also assess the distributional impact at a household level of the Scottish Labour Party’s proposal as shown in Figure 5.

Figure 5 Changes in household net equalised income by household net income decile



Source: Bell and Eiser (2016)

Figure 5 shows that the £100 payment compensates households in the bottom four deciles completely from the tax increase while it also mitigates the effects of the tax increase for a large number of households in the middle and upper-middle of the income distribution, because many individuals who earn less than £20,000 live in households that are close to, or above, median income.

Using the IPPR tax-benefit model, Torsten Bell from the Resolution Foundation assesses the distributional impact of setting SRIT at 11p in 2016-17 but also of the Scottish Labour Party's proposal, setting SRIT at 11p and giving a £100 annual rebate to taxpayers earning under £20,000. He concludes:

> "For the bottom half of the distribution, 15 per cent of families actually gain overall while over half are unaffected. The remainder lose, for example a single earner family on £25,000 pays £140 more tax." (Bell 2016)

Using the IPPR tax-benefit model, Russell Gunsson (2016) from IPPR Scotland considers a number of proposal proposals against a baseline scenario in which the personal allowance rises to £12,500 and the gap between the higher-rate threshold and the personal allowance increases with inflation (CPI). He compares the average change in annual disposable household income in 2020-21 by equivalised household income decile (before housing costs) and notes:

- The proposal to raise SRIT by 1p "produces a large increase in taxes for the richest – the top-earning households would pay £1,050 extra per year – and at least marginal tax increases for all but the poorest 10 per cent of households."
- The proposal to raise SRIT by 1p and offer a £100 rebate for those earning £20,000 or less leads to an increase in income for the poorest 30% of households, "with the richest paying significantly more than now (up to an additional £1,040 per year in the wealthiest 10 per cent of households)."

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