The Scottish Parliament
Pàrlamaid na h-Alba

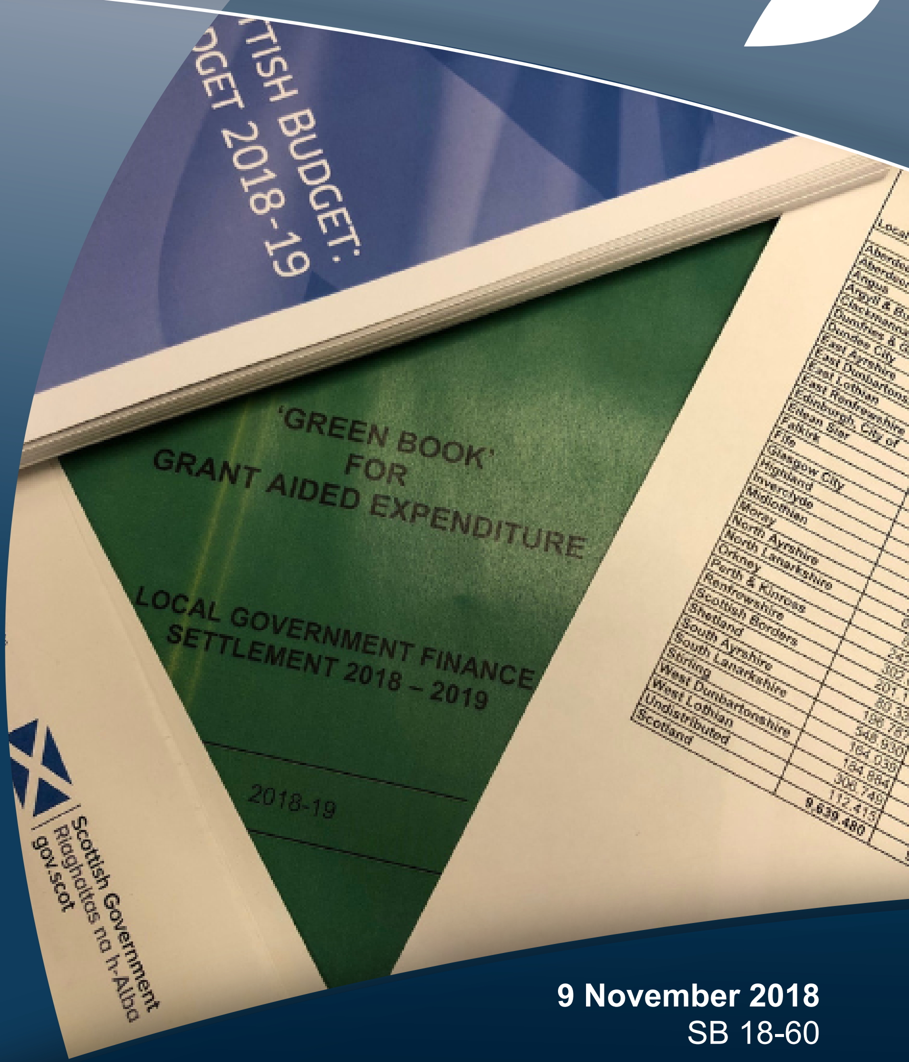
SPICe The Information Centre
An t-Ionad Fiosrachaidh

SPICe Briefing
Pàipear-ullachaidh SPICe

Local Government finance: the Funding Formula and local taxation income

Anouk Berthier, Ailsa Burn-Murdoch, Andrew Aiton and Kayleigh Finnigan

This briefing provides an overview of how local government in Scotland is funded. This includes detail on how the Scottish Government distributes the local government finance settlement, and detail of locally raised income from Non-Domestic Rates and Council Tax.



9 November 2018
SB 18-60

Contents

Executive Summary

In this briefing, the primary sources of funding for local government in Scotland are set out. The focus is on the sources of funding which contribute to the delivery of core services, so Capital funding, which is reserved for the delivery of Capital investment projects, has not been included, nor has borrowing.

Figure 1 shows the breakdown of the overall revenue funding that local government in Scotland used to deliver core services in 2017-18. In this instance, outturn data has been used to give the most accurate picture of final funding. Note, however, that the most recent data on Fees and Charges for services is from 2016-17. As this represents a fairly small and consistent amount of funding in the context of local government funding overall, this figure has been used as an illustration of its contribution.

Figure 1 - Sources of local government funding in 2017-18.

Scottish Government, 2018[1]

- The General Resource Grant (GRG) from the Scottish Government makes up the majority of local authority revenue expenditure. This is negotiated in discussions between Scottish Government and COSLA. Individual local authority allocations are calculated using Estimated Service Expenditure and Total Estimated Expenditure, before 'funding floors' are applied to ensure no councils are disproportionately disadvantaged. A key component of Estimated Service Expenditure is Grant Aided Expenditure (GAE), which is a 'needs-based' methodology used to allocate total revenue funding, pre-determined by the Scottish Government, equitably amongst local authorities on the basis of relative need.

- Estimated Service Expenditure combines GAE with the Special Islands Needs Allowance, which compensates local authorities which are partly or wholly comprised of islands, for the additional costs of island communities which are not already accommodated for, or only partially accommodated for, in the needs-based assessments. This is additional funding and does not impact on the funding for other local authorities.

- There are two taxes that directly fund local government - Non-Domestic Rates (NDR), levied on non-domestic properties, and Council Tax, levied on domestic properties. Both of these taxes are taken into account when calculating the GRG, which means that those local authorities which receive a higher income from NDR and Council Tax receive a smaller proportion of their Revenue funding through the Scottish Government's Resource Grant.

- The Scottish Government guarantees the combined GRG and distributable NDRI figure, approved by Parliament, to each local authority. If NDRI is lower than forecast, this is compensated for by an increase in GRG and vice versa. Therefore, to calculate Local Government's Revenue settlement, the combined GRG + NDRI figure is used.

- Non-domestic rates are also known as business rates, though this is misleading as NDR is also levied on public buildings such as schools and hospitals and on charities. NDR are charged on non-exempt, non-domestic premises. NDR is set nationally, and collected and retained locally. The key elements of NDR are:

  - The rate, or poundage, is based on a premise's "rateable value" (RV). The poundage has generally been increased annually by the Retail Price Index (RPI) outside of revaluation years. In 2018-19 however the Scottish Government increased it by the Consumer Price Index (CPI).[2] It is not known whether this will become the norm. There is also a Large Business Supplement for premises with a RV over £51,000 of 2.6p.

  - Rateable values are set by independent Assessors on the basis of market value every five years, except the 2017 revaluation, which was seven years after the last one. The methodology for doing so is set out in Scottish Assessors Association (SAA) Practice Notes.[3] After 2020, revaluations will occur every three years.

- Council Tax was introduced in 1993 to replace the Community Charge (known as the “poll tax”) and remained relatively unchanged until 2017. Key elements of the current Council Tax are:

  - The rate of tax payable is based on the value of residential property in 1991, and the amount that households pay depends on their band (A to H).

  - Local authorities set the Band D rate, and other bands are calculated as a set ratio to the Band D rate.

  - Councils collect Council Tax directly, and retain all income collected.

  - Between 2008-09 and 2016-17, the Council Tax was frozen at 2007-08 levels.

- Various exemptions and discounts apply and people on low incomes may be eligible for Council Tax Reduction, which replaced Council Tax Benefit in 2013.

Introduction

This briefing explains how local government Revenue funding works, its different sources, and the allocation methodologies for each local authority.

Local government is funded by the Scottish Government, as well as through income from taxes and fees and charges (Figure 2).

Figure 2: Sources of local government funding

Revenue funding supports the day-to-day running costs of a local authority and its services, and typically has an economic benefit of one year or less. Revenue funding goes to cover things like salaries and utilities. Council Tax income, and in most cases income from fees and charges, contributes to Revenue funding.

Funding for local authorities in Scotland

The Scottish Government estimates how much local government needs to fund the services it provides. It then applies a needs-based formula to allocate the total available funding. Once these initial allocations are calculated, the Scottish Government adjusts these initial figures using the Main Funding Floor, to ensure that no council is disproportionately disadvantaged in its year-on-year funding allocations. This provides those local authorities with reducing need an opportunity to reduce their spending to match their reducing funding. From this total, Council Tax income, Distributable Non-Domestic Rates income, and specific revenue grants are deducted to obtain the General Resource Grant (GRG), which together with the Distributable Non-Domestic Rates income makes up the guaranteed non-ring-fenced funding the Scottish Government provides to local government. A further funding floor is applied to ensure that no local authority receives less than 85% of the Scottish average of per head Revenue funding, and finally, a figure for Distributable revenue funding is reached.

The Institute for Fiscal Studies describe this system as follows: [2]

> “ A very complex system of 'equalization' exists, giving larger grants to those local authorities with a more limited tax base - where properties are less valuable - to try and ensure that, if all local authorities spent at the level judged appropriate by local government, they would all levy the same tax rate on properties of a given value.”

As part of the Scottish Government's funding settlement, local authorities are expected to meet certain commitments in return for the full funding package. For 2017-18, for example, local government was expected to maintain the pupil:teacher ratio at 2016 levels, and to secure places for all probationers under the teacher induction scheme. These commitments can influence and have an effect on the total level of funding available to local authorities to deliver core services.

The SPICe briefing, Local Government Finance: Draft Budget 2018-19 and provisional allocations for local authorities [3] , sets out the 2018-19 priorities in detail.

Whilst the commitments around early years education and childcare are funded as ring-fenced specific grants, other commitments which local authorities must agree to meet are funded within the General Resource Grant plus distributable Non-Domestic Rates.

Public commentary on local government funding methods

Whilst the guaranteed current block model gives local authorities freedom over how to deliver the priorities agreed between COSLA and the Scottish Government, COSLA have argued that including commitments such as these within overall presentation of the headline change in the local government budget means that the core Revenue Budget is, in effect, lower than it might first appear. During the Local Government and Communities Committee's scrutiny of the Draft Budget 2018-19. COSLA submitted its proposals for what it called the 'fair funding of essential services" [4] . This did not call for a change to the Local Government Funding Formula. It did, however, imply that a more fundamental review of funding for local government is needed-

> “ We cannot keep going on like this, storing up problems for the future. Over the long term, linking in with the overall Scottish budget process, we need a fundamental review of Scottish priorities and how services are funded, ultimately with a view of improving outcomes.”

The Accounts Commission, in its report, Local government in Scotland: Challenges and performance 2018 [5] , looked further into population trends and reiterated a point made in other recent publications that "the Scottish Government and COSLA should assure themselves that the funding formula remains fit for purpose in a changing landscape for local government.".

It explained-

> “ In our 2017 local government financial overview report, we outlined how the Scottish Government funding formula is largely based on the size of council's populations, although under proposals to review funding for education, this may change. Currently, those councils with a projected decrease in population can expect to see greater reductions to their budgets compared to councils with increasing populations. However, all 11 councils which are expected to have reduced total populations are expected to have increases in the number of people of a pensionable age and over. These councils will therefore have a higher dependency ratio and a consequent increased demand for services at a time of reduced funding. Many of these councils are also rural which poses an additional challenge in delivering services as cost effectively as urban councils. ”

General Resource Grant/Non-Domestic Rate Income

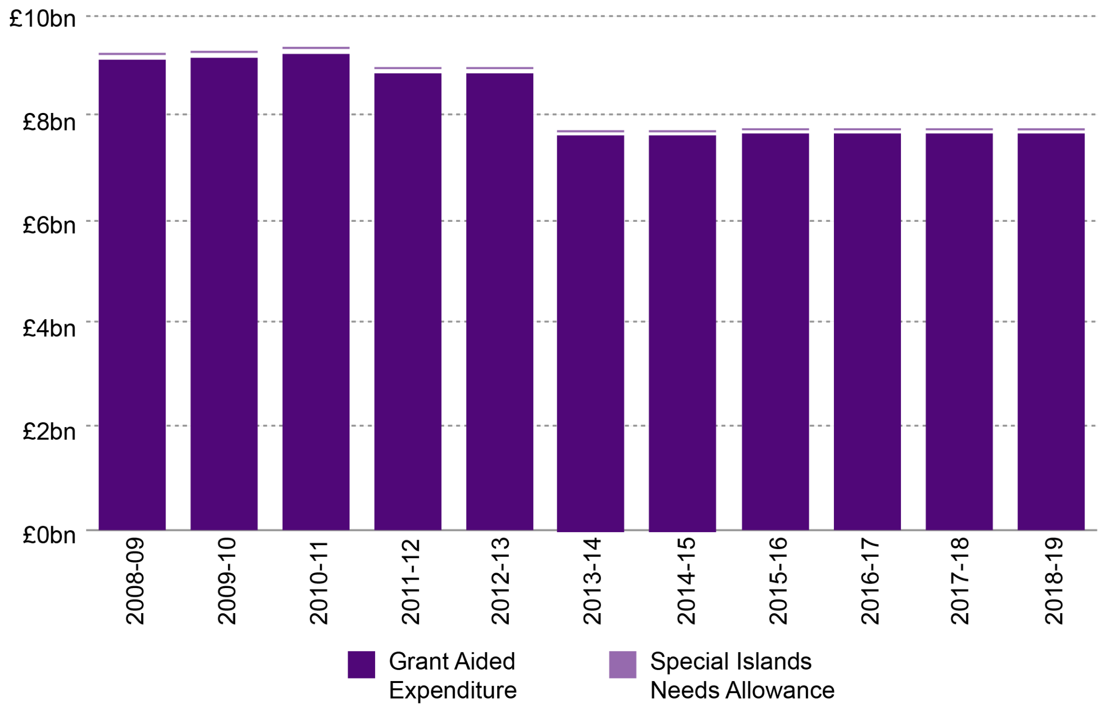
The Scottish Government provides local government with a General Resource Grant (GRG), which combined with the locally raised NDR, makes up the majority of local authority revenue expenditure. Each local authority's share of this guaranteed total is calculated using Estimated Service Expenditure and Total Estimated Expenditure , before 'funding floors' are applied to ensure no councils are disproportionately disadvantaged.

Estimated Service Expenditure

The key building blocks used to calculate each local local authority's calculation of the General Resource Grant are Grant Aided Expenditure (GAE), and a much smaller component, Special Islands Needs Allowance (SINA). These are combined to form an Estimated Service Expenditure (ESE).

Figure 4 shows a breakdown of ESE from 2008-09 to 2018-19.

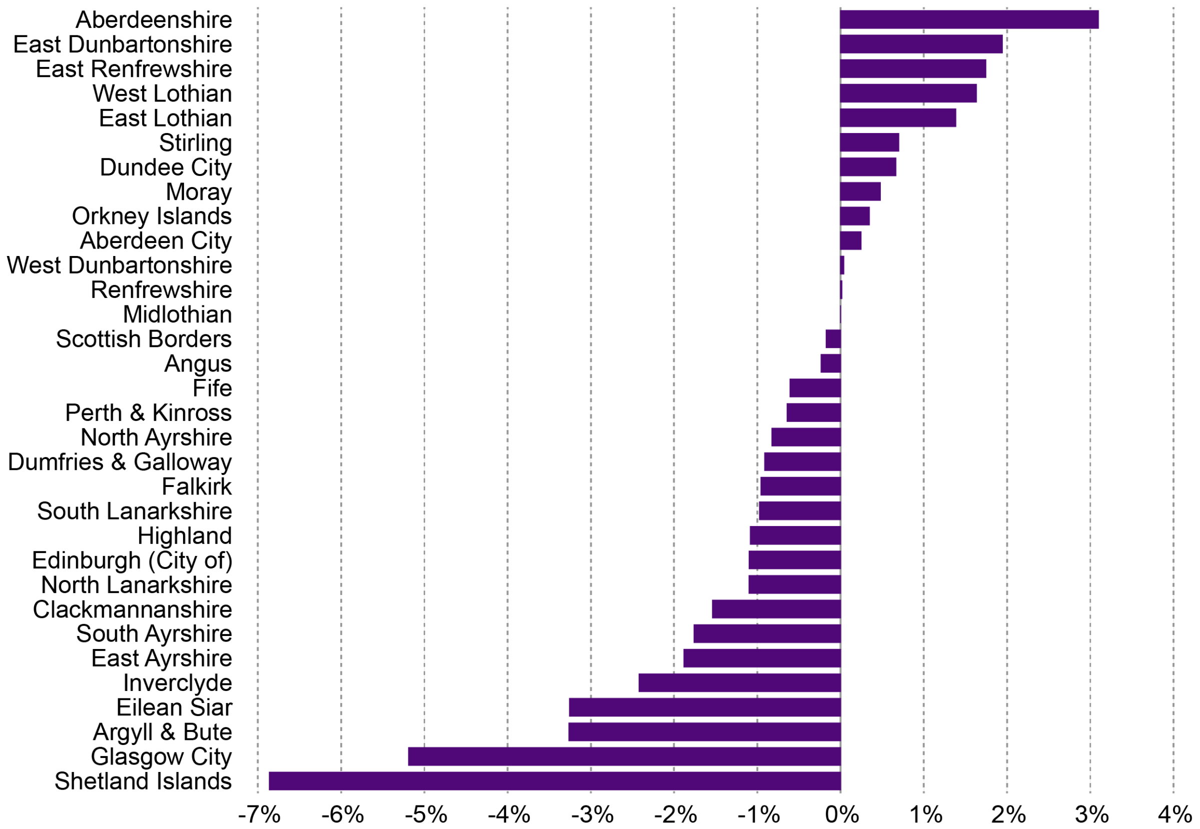
Figure 4 - Grant Aided Expenditure + Special Islands Needs Allowance, 2008-09 to 2018-19, cash.



Note that since 2008-09 total GAE, GAE for each service and GAE for each sub-service have been maintained at the same levels, hence the relative consistency in levels shown here. The exception to this is where policy changes have had an impact, for instance the removal of Police and Fire GAE following the removal of these services from the local government settlement in 2013-14

Figure 5 shows the change in ESE per capita from 2015-16 to 2018-19. The Shetlands saw the biggest decrease in ESE per capita over that time, followed by Inverclyde and Eilean Siar. East Dunbartonshire, Aberdeenshire and Midlothian saw the biggest increases.

Figure 5 - change in Estimated Service Expenditure per capita, 2015-16 to 2018-19.



Total Estimated Expenditure

Estimated Service Expenditure is combined with additional elements of expenditure and grants to form the Total Estimated Expenditure (TEE). It's important to note that, since 2008-09, the total funding settlement for local authorities has been decided first, which dictates a level of TEE. GAE does not decide the total of TEE, rather the proportions within it.

TEE is currently calculated based on -

- Grant-Aided Expenditure plus the Special Islands Needs Allowance together make up the bulk of local authorities' total estimated revenue spending - 'Estimated Service Expenditure' (ESE).

- All the additional funding allocations for the Scottish Government's policy commitments that have been added since 2007-08 including former-ring-fenced grants.

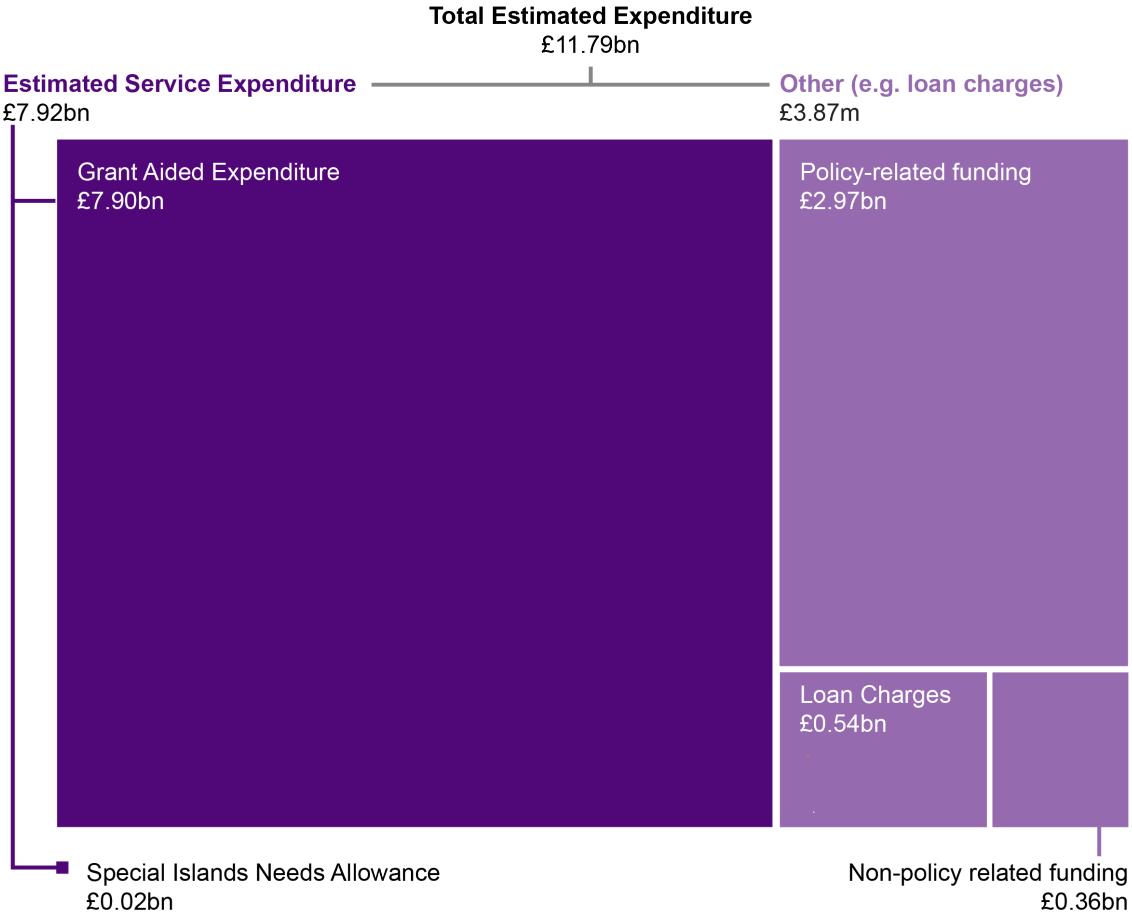
- case-by-case allocation of policy-related ring-fenced funding like Early-Learning and Childcare, Gaelic and Pupil Equity funding. .

- a further total of non-specific changes to grant allocations, the allocation of which is based on local authorities' shares of GAE + SINA; and,

- local authorities' commitments in respect of certain historic loan charges.

Figure 3 shows a breakdown of Total Estimated Expenditure for 2018-19.

Figure 3 - Total Estimated Expenditure, 2018-19



Main funding floor

An important part of the Local Government Finance Settlement is the Main floor calculation, which is a self financing mechanism that ensures a local authority's funding allocation will not fall by more than a set amount from the previous year. The floor works by reallocating some of the initial needs-based funding between local authorities. Those authorities with grant changes which fall above an agreed minimum contribute to the floor (in proportion to the quantum of their total grant), and those below the minimum receive this money to raise them to the agreed floor level.

85% Funding Floor

The final calculation in the funding of local authorities comes in the form of the application of a second funding floor, the 85% funding floor calculation. As part of the 2012-15 Local Government Finance Settlement, the Scottish Government made the commitment that no local authority will receive less than 85% of the Scottish average per head in terms of Revenue support. This has continued to apply for all subsequent settlements. This basis for this calculation has changed over recent years, but now also includes funding from

Council Tax income. The "85% floor" is calculated by taking these revenue allocations and the assumed Council Tax income figures, and then adjusting for any outliers.

This means that, for this calculation, councils with very high per head allocations (in effect the island local authorities and Argyll and Bute) have their allocations adjusted down. This does not mean their actual allocations are reduced - it is only for the purposes of this calculation. These adjustments are made, and then a new set of per head allocations are calculated. The "cap" for 2018-19 was set at 115% of the combined total Revenue + Council Tax income average. Once this calculation was made, only Aberdeen City Council came out as being below the 85% floor. The revised calculations in January 2018 resulted in Aberdeen receiving an additional £8.7m, which rounded its total allocation to 85% of the Scottish average. The calculation for the 85% floor in 2018-19 was detailed in the SPICe briefing, Local Government Finance: Facts and Figures 2013-14 to 2018-19 [6] .

Historically, the floors have been calculated at the time of the original consultation Finance Circular in December (which accompanies the Draft Budget), and only re-opened if any adjustments are required as a result of the consultation period.

Grant Aided Expenditure (GAE) and the Special Islands Needs Allowance (SINA) in detail

Grant Aided Expenditure (GAE)

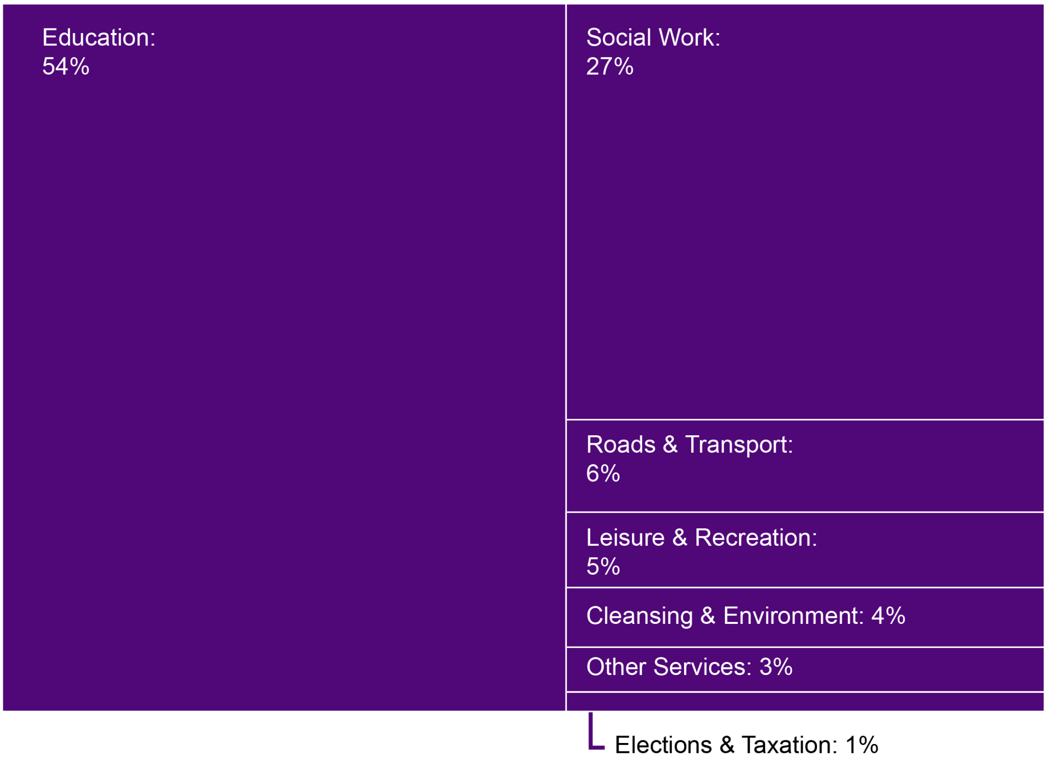
Grant Aided Expenditure (GAE) is a 'needs-based' methodology used to allocate total revenue funding, pre-determined by the Scottish Government, equitably amongst local authorities on the basis of relative need. The funding totals which GAE is used to distribute used to be set on a multi-year basis , however in recent years (since 2015-16) they have been set annually. The full GAE methodology, along with all the data used in the calculations, is published at each Spending Review in the ‘Green Book’ for Grant Aided Expenditure [7] .

GAE is divided into services, which are then divided into sub-services. For instance, 'education' is a service of which 'secondary school teaching staff' is a sub-service. Total GAE is currently split into seven services and 89 individual sub-services. The services are:

- education
- social work
- roads and transport
- leisure and recreation
- cleansing and environment
- election and taxation
- other services.

Figure 6 shows the proportion of funding each service-level GAE represented in 2018-19. With the exception of the removal of Police and Fire services when these were centralised in 2013-14 (not shown here), this breakdown has remained relatively stable since 2008-09. The only change has been to Building Control GAE, (which was adjusted downwards in 2018-19 following increased building warrant fees being collected by local authorities), however this change is proportionately small enough to have not affected the rounded percentage spread amongst service-level GAEs shown here.

Figure 6 - Service-Level GAEs in 2018-19



Sub-service totals, referred to as GAE 'lines', each have a different allocation formula, but all formulas follow the same principles. They are all based on an assessment of need for that sub-service using the Client Group Approach.

This does not determine the level of provision in absolute terms, nor its allocation between different GAE services, but rather the allocation between different GAE sub-services.

The way in which Total GAE is divided between services and sub-services has changed over time. Service and sub-service GAEs used to be compared with Local Authorities' budgeted expenditure at a service and sub-service level and the average of the two became the following year's revised base GAE figures. In the late 1980s/1990s, Ministers decided where the Government's key priorities lay, and the revised GAE sub service totals reflected those priorities. This method remained in place until the 2007 Spending Review when it was agreed that GAE levels would be frozen.

Since 2008-09 total GAE, GAE for each service and GAE for each sub-service have been maintained at the same levels (except Police and Fire GAE following the removal of these services from the local government settlement). This does not mean that what individual councils have received has stayed the same, as the latest indicators (e,g, population, deprivation, road length and such) will still affect the proportion or distribution of GAE allocations across council.

GAE totals for each local authority are used to distribute any additional changes in funding resulting from subsequent Spending Reviews. The full details behind the calculation of the 2018-19 allocations are set out in Local Government Finance Circular No 4/2018 [1] .

The Client Group Approach

A Client Group Approach is used to divide GAE assessments for each subservice between the 32 Local Authorities. This Client Group Approach is an evidence-based method used to estimate relative proportions for Local Authorities of individual GAE lines.

In some cases, the name 'client group' is clear. For instance, the 'clients' for the sub-service 'secondary school teaching staff' are secondary school pupils.

However, despite what the name would suggest, in a small number of instances the service will not have a sufficiently defined client group or data to enable allocation. For example, ‘Trading Services’ and ‘Coast Protection’. In these instances, the average past expenditure of local authorities is used to allocate the funding. This is done only as a last resort when a client group cannot be identified as there is a strong presumption against the use of past expenditure to allocate funding.

The Client Group Approach does not determine the level of provision in absolute terms, nor its allocation between different GAE services. GAEs are not targets, and are not ring-fenced. For example, Aberdeen City does not have to spend its ‘Nursery School Teaching Staff’ GAE or even ‘Education’ GAE on that sub-service or service.

Each sub-service has its own needs-based allocation formula. The method aims to take into account variations in the demands for services, the costs of providing them to a similar standard, and with a similar degree of efficiency.

Once all GAE lines have been calculated, the lines are added up to give GAE service totals for each local authority. [7]

The freeze on GAE levels agreed in 2007 means that a local authority's GAE can only increase at the expense of one or more other local authorities GAE. It also means that the share of total revenue funding that is distributed on the basis of relative need has decreased over time, at the expense of local taxes.

Primary and secondary indicators in the Client Group Approach

The calculation of relative GAEs for individual services, using the Client Group Approach as described, involves distributing between authorities a sum of funding related to a primary indicator and, where found to be justified, redistributing this funding on the basis of one or more secondary indicators. All primary indicators feed into the distribution formula of each sub-service in the same way.

The primary indicator is considered to be the most significant single determinant of expenditure on a service. Composite primary indicators are single indicator expressions which encompass a number of factors, each considered to be plausibly associated with inter-authority variation in expenditure.

For instance, the Scottish Government allocates an amount to fund secondary school teaching staff for all local government, and GAE ensures that every (non-island) secondary school student receives the same level of funding per head for secondary school teachers. Note that this does not mean that local authorities have to spend a set amount on secondary school teachers - these are not ring-fenced allocations. [7] Other formulas may be less obvious and be reliant on other indicators. For instance, "road administration" is based on the GAEs for "road maintainance", "winter maintainance" and "road lighting", which in turn are dependent on the measures "KMs of local authority road length", and for the former two, the "number of vehicle licenses".

Case study - Teaching Staff

For Secondary School Teaching Staff, there is only only primary indicator (number of secondary school pupils) and no secondary indicator.

If there is only one Primary indicator for a sub-service, a local authority's GAE share would be a simple pro-rata share of the total GAE for that sub-service and every "client" would receive the same in each (non-island) local authority.

Where there is more than one primary, or secondary indicator, each indicator in that class has a share of the sub-service total. For instance, the sub-service School Security has two primary indicators, Number of Pupils, and Number of Establishments, and they each count for half of the total.

Secondary indicators are demand and cost factors that are outside of the control of Local Authorities, which offer plausible explanation for, and which can be shown to be associated with, inter-authority expenditure variation. This includes indicators of population dispersion (i.e. rurality) and deprivation. For instance, Primary School Teaching Staff has one primary indicator (primary sector pupils), and a secondary indicator (percentage of pupils in small schools).

Secondary indicators must be factors which plausibly affect either the demand for services or the unit cost of meeting that demand. They are selected after discussions with local authorities and other service specialists. In addition, the secondary indicator must be shown to be clearly correlated with inter-authority variations in expenditure. The size of the allowance made for a secondary indicator is derived mathematically from the relationship between past expenditure and the secondary indicator, and results in some redistribution of relative GAE. For instance, GAE for primary school teaching staff is adjusted by a secondary indicator which takes account of the higher ratio of staff to pupils in rural areas.

The Teacher Remoteness and Distant Island Allowance (TRDIA) funding is a completely separate calculation, detailed in Annex 4 of the Green Book. TRDIA funding is based on the estimated expenditure on these allowances by councils with remote/island communities. The ‘Island LA Adjustment’ made in the Secondary Schools Teaching Staff line is an historic adjustment. The adjustment works in the same way as other secondary indicators however, unlike the other secondary indicators, the allowance remains the same for every settlement. This historic adjustment is the only one of its type used in the settlement and was agreed for continued use as part of the SINA review.

Like secondary indicators, the monetary value of the Island LA Adjustment is zero, meaning that the total sum attributed to the three wholly island Local Authorities is exactly made up for by taking the equivalent sum away from the other Local Authorities.

Special Islands Needs Allowances (SINA)

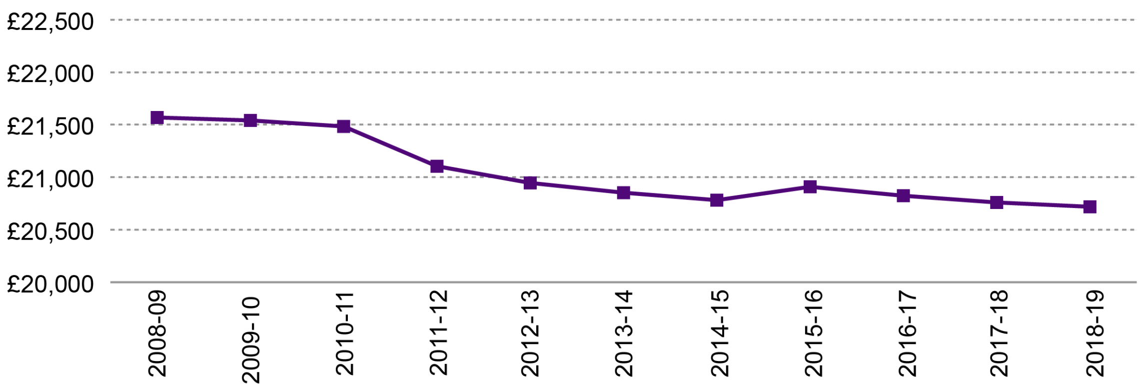
The Scottish Government also calculates Special Islands Needs Allowance (SINA) for the three wholly island Local authorities (Eilean Siar, Orkney Islands and Shetland Islands) and the three Local Authorities with important island communities (Argyll and Bute, Highland and North Ayrshire).

The purpose of the SINA is to compensate authorities for the additional costs of island communities which are not already accommodated for or only partially accommodated for in the needs-based assessments. In 2000 SINA was reviewed and extended to all Local Authorities with significant island communities instead of applying only to three wholly islands ones.

Contrary to GAE assessments which are fixed amounts, there is no cap on SINA and it is not a zero-sum category. In other words, SINA funding is separate to GAE, and as a result an increase in SINA for one Local Authority does not imply a decrease for other local authorities. This differs from the Teacher Remoteness & Distant Islands Allowances, which are part of GAE, meaning that any increase in funding for the three island authorities on these indicators will decrease the funding available to the remaining 28 local authorities.

Figure 7 shows that SINA has gone down by 0.6% since 2013-14 in cash terms. This represents a steeper fall of 7.8% in real terms.

Figure 7 - Special Islands Needs Allowance, 2008-09 to 2018-19, cash.



Taxes

Introduction

The two taxes that directly fund local government are Non-Domestic Rates (NDR), levied on non-domestic properties, and Council Tax, levied on domestic properties. Council Tax is set, administered, collected and retained by local government, whereas NDR is a national tax which is set by the Scottish Government, with all receipts flowing to Government, but is administered, collected and retained by local authorities.

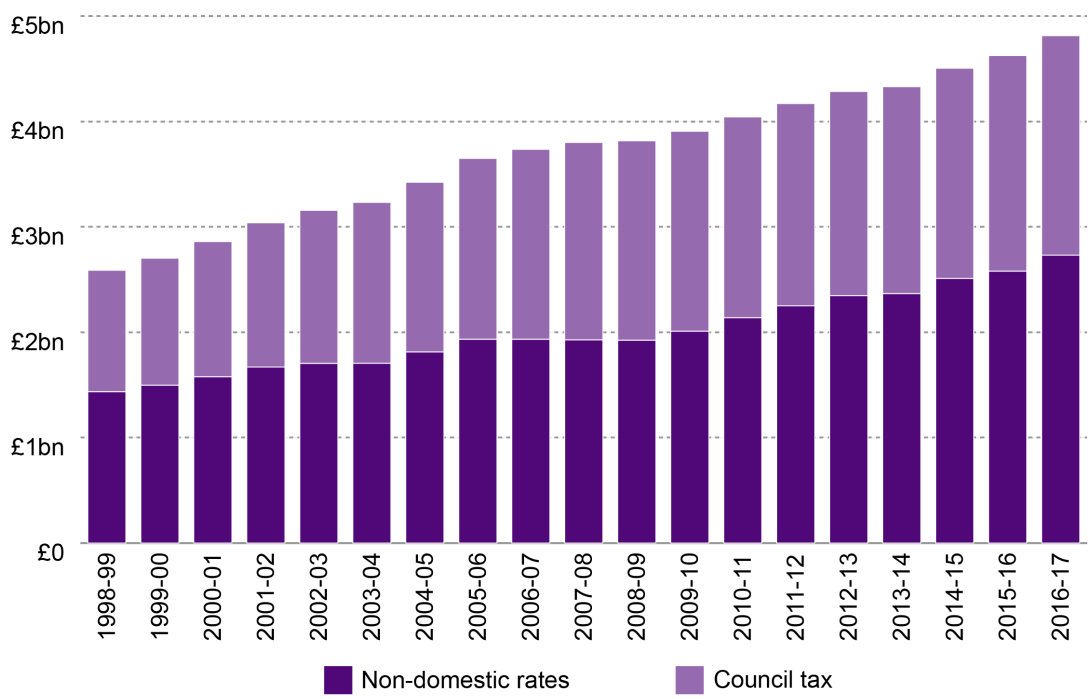
In 2016-17, Non-Domestic Rates was worth £2.7bn - just over 5% of all onshore tax revenue in Scotland and was the fifth largest onshore tax (after income tax, national insurance contributions, value added tax and onshore corporation tax). [8] Council Tax came seventh, at £2.1bn, made up 4.0% of total onshore taxes (after Fuel duties).

The value of local tax revenue

Non-domestic rates income (NDRI) increased by 90% in cash terms between 1998-99 and 2016-17 (similar to income tax, at 94%), whilst Council Tax Income rose by 81%. The value of both NDRI and Council Tax revenue vary year on year based on the current tax base (i.e. the number of business and properties contributing).

Figure 8 shows the relative valued of NDRI and Council Tax revenue.

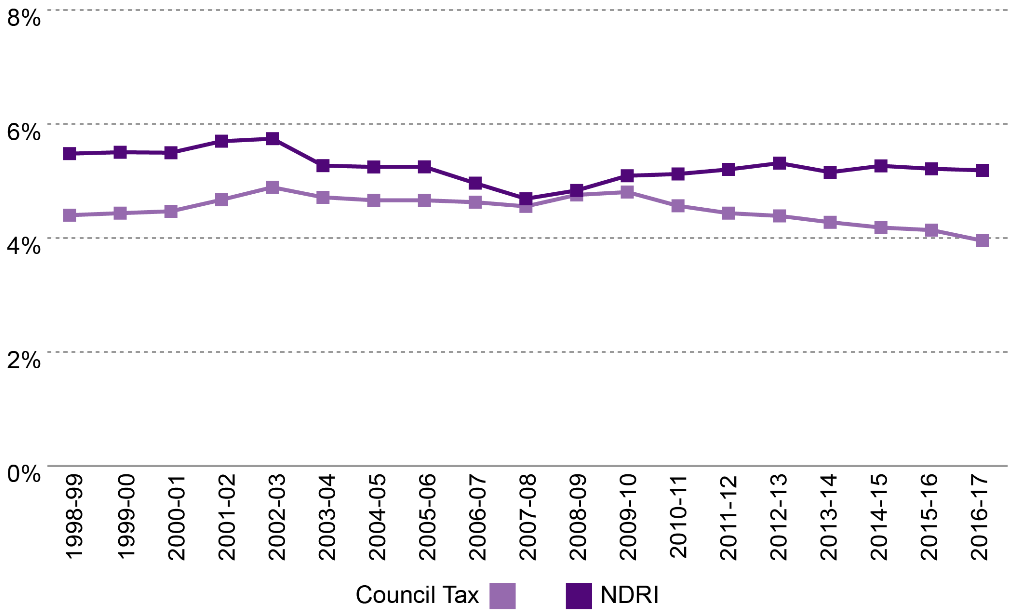
Figure 8 - Non-Domestic Rates Income and Council Tax, 1998-99 to 2016-17, cash.



N.B. Council Tax figures represent gross revenue calculated taking account of all discounts and exemptions, and the collection rate, but do not take account of Council Tax Reduction (CTR). They are therefore on the basis of the assumed Council Tax income element of the local government finance settlement. 2018-19 estimated figures are based on 2017-18 outturn figures, with the 3% increase in the Band D rate applied by all local authorities taken into account.

Figure 9 shows NDRI and Council Tax revenue as a share of the onshore tax total (i.e. excluding North Sea tax revenue) for Scotland. This has has decreased slightly from 1998-99, from 5.5% to 5.2% for NDRI, and 4.4% to 4.0% for Council Tax Income; with a noticeable dip in 2007-08 for NDRI.

Figure 9 - Non-Domestic Rates and Council Tax as a share of Scotland's on-shore tax revenue, 1998-99 to 2018-19.

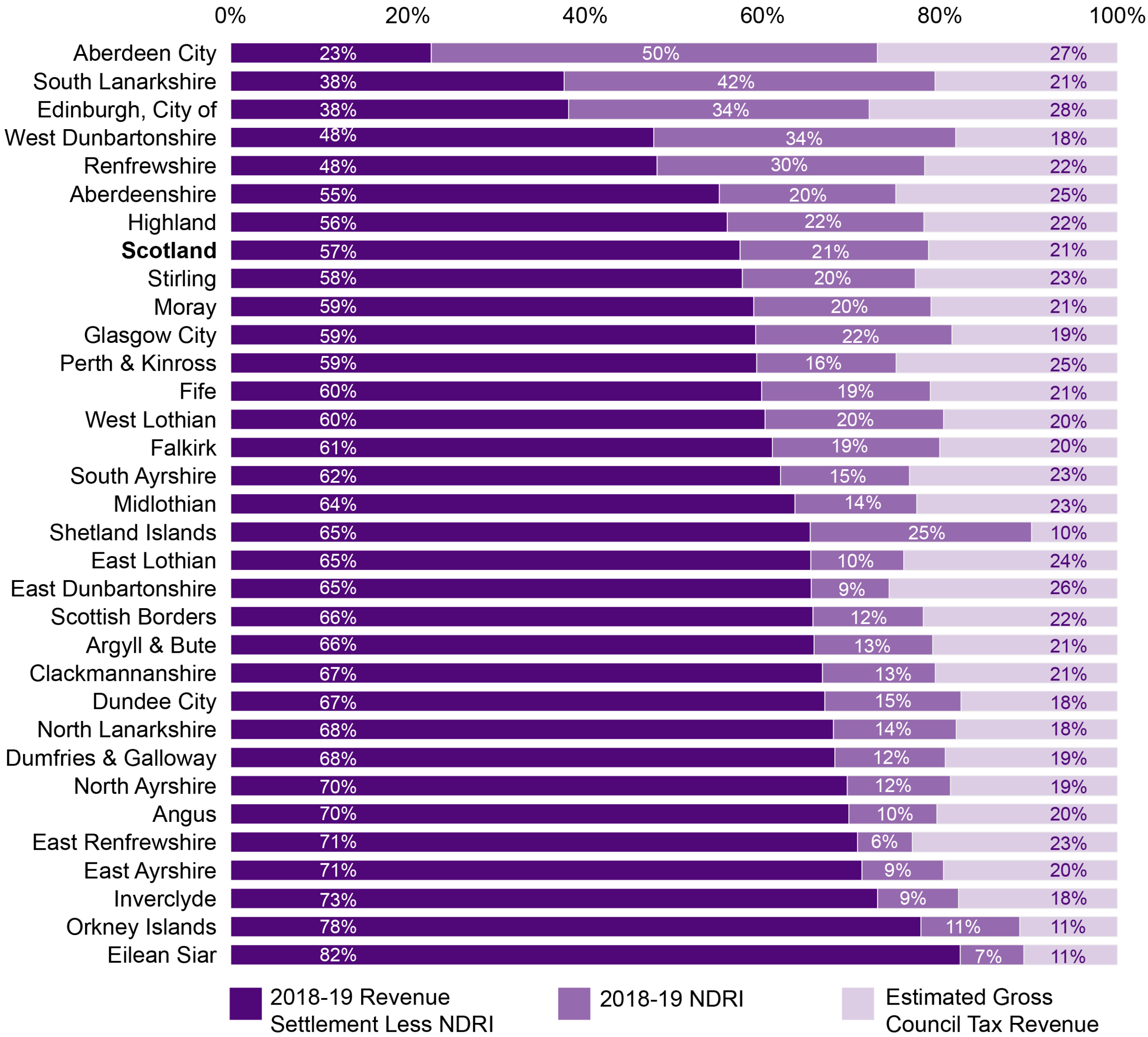


The role of local taxation in local government income

The Scottish Government guarantees the combined General Resource Grant and distributable NDRI figure, approved by Parliament, to each local authority. If NDRI is lower than forecast, this is compensated for by an increase in GRG and vice versa. Therefore, to calculate Local Government's Revenue settlement, the combined GRG + NDRI figure is used.

Figure 10 looks at the relative proportion of total funding that Revenue grants provided by the Scottish Government, Non-Domestic Rates income and Council Tax income represent - in this case NDRI and GRG have been separated out to give an indication of expected proportions. Figures can be found in the Annex. It's important to note that this does not represent the total amount of funding available for local authorities - it does not include, for instance, income collected directly by councils through fees and charges for services, or any funding delivered to councils which is not set out in the Local Government Finance Circulars (for instance funding for Health and Social Care Integration).

Figure 10 - Council Tax, NDRI and Revenue grant funding allocations as a proportion of total funding, 2018-19.



In 2018-19, Non-Domestic Rates Income will make up 21% of the funding for local authorities across Scotland. Council Tax will also make up an estimated 21% of the funding available, which, as can be expected following the end of the Council Tax freeze (see Council Tax), is a slight increase on the 2016-17 figures of 20%. It's important to note, however, that the figures for individual councils vary widely:

- Aberdeen City and South Lanarkshire see a higher proportion of income coming from NDRI than the Scottish Government's Revenue Grant.
- On Council Tax, those councils with a high proportion of Band E-H properties (Edinburgh, Aberdeen City and East Dunbartonshire) receive a much greater proportion of total income from Council Tax than areas which typically have few higher band properties, particularly the island authorities.
- When Council Tax and Non-Domestic Rates income is combined, five councils (Aberdeen City, Renfrewshire, Edinburgh, South Lanarkshire and West Dunbartonshire) receive more money through local taxation than through the Scottish Government's revenue grant.

N.B. Revenue figures represent the Revenue settlement set out in the Local Government Finance Circular 4/2018 [1] (including £34.5m of additional funding for 2018-19 which was paid in 2017-18). These figures differ from outturn figures, which will not be available until late-2018 at the earliest, and will take into account any additional allocations made in-year.

Non-domestic rates

Non-domestic rates (NDR), also known as business rates (though this is misleading as it is also levied on public buildings such as schools and hospitals and on charities), is one of two local taxes that part-funds local authorities. NDR are charged on non-exempt, non-domestic premises.

The Lands Valuation (Scotland) Act 1854 established the basis of the current NDR system and required that each county or burgh keep a "roll" (updated annually) with the details of the yearly rental or value of all land and heritages. [9] The Act also provided for a new type of officer, the Assessor, whose role it was to calculate "rental", according to the notion of market value. There are 14 Assessors in Scotland.

The key elements of NDR are:

- The rate, or poundage, which is set by the Scottish Government and is based on the rateable values of the premises. In 2018-19 however the Scottish Government increased it by the Consumer Price Index (CPI). [10] It is not known whether this will become the norm. There is also a Large Business Supplement for premises with a RV over £51,000 of 2.6p.
- Rateable values (RV) are set by independent Assessors on the basis of market value every five years, except the 2017 revaluation, which was seven years after the last one. The methodology for doing so is set out in Scottish Assessors Association (SAA) Practice Notes. [11] Scotland will move to a 3 year revaluation cycle from 2022.
- Non-exempt non-domestic premises are listed alongside their RV on the Valuation Roll, which is maintained by the SAA and can be searched online. [12]
- Revaluations have historically incurred a decrease in poundage so as to be broadly revenue-neutral. This is a policy commitment, whereas in England it is a legal requirement.
- Rates liability can be reduced or removed in three ways: exemption from the Roll (e.g. agricultural land), exemption from rates (derating) (e.g. livestock or fishing), or receipt of relief (e.g. the Small Business Bonus Scheme).

Councils collect NDR directly and now retain all the NDRI collected within their council areas. It is however accounted for at the end of each year when balances between what local authorities have collected and the Scottish Government are notionally distributed are settled. The Scottish Government sets an annual "distributable amount" (DA), based on forecast collected revenue and on policy choice. Since 2018-19 the collectable amounts have been set by the Scottish Fiscal Commission. The distributable amount distributed to councils on the basis of their share of the previous year's mod-year estimated income. In 2018-19 the Scottish Government set a DA that would have brought the NDR Account back into balance had the collected amount equalled the forecast. [10] It's important to note that if NDR receipts within a local authority are higher than forecast, the General Resource Grant for that authority will be adjusted accordingly.

There is a Business Rates Incentivisation Scheme which allows local authorities to retain 50% of extra NDRI they receive if it grows above a certain 'buoyancy target' set by the Scottish Government. The other 50% is retained by Government given the Scottish Government guarantees the combined GRG/NDRI total and as a result carries 100% of the risk in the case of a fall in NDRI.

In 2016 the Scottish Government set up the independent Barclay Review with a remit to make recommendations on NDR to help "better support business growth and long term investment and reflect changing marketplaces, whilst still retaining the same level of income to deliver local services upon which businesses rely." It reported in August 2017 [13] and made a number of recommendations, the majority of which were accepted by the Scottish Government and which will be implemented according to a timescale set out in the report.

A full list of the legislation related to NDR is available here. [14]

Council Tax

Council Tax is the second form of locally administered taxation that is used to part-fund local authorities. It was introduced in 1993 to replace the Community Charge (known as the “poll tax”) and remained relatively unchanged until 2017.

Key elements of the current Council Tax are:

- The rate of tax payable is based on the value of residential property in 1991, and the amount that households pay depends on their band (A to H).
- Local authorities set the Band D rate, and other bands are calculated as a set ratio to the Band D rate.
- Councils collect Council Tax directly, and retain all income collected.
- Between 2008-09 and 2016-17, the Council Tax was frozen at 2007-08 levels.
- Various exemptions and discounts apply and people on low incomes may be eligible for Council Tax Reduction, which replaced Council Tax Benefit in 1991.

In 2015, following a recommendation by the Parliament's Local Government and Regeneration Committee [15] , the Scottish Government and COSLA established the Commission on Local Tax Reform (“the Commission”). The Commission reported in December 2015 [16] .

In March 2016, the Scottish Government published its proposals for reform of the Council Tax [17] , in response to the Commission's report. These proposals focused primarily on adjusting the ratio to Band D of Bands E-H. The Scottish Government estimated that this would generate an additional £100m a year (net of consequential impacts to the Council

Tax Reduction Scheme) in direct revenue for councils (not taking into account other proposed changes to Council Tax). The Council Tax (Substitution of Proportion) (Scotland) Order 2016 [18] , which also included provisions on ending the Council Tax freeze, was agreed to by Parliament on 3 November 2016.

In addition to the changes to multipliers, upon the end of the Council Tax freeze in 2017-18, the 2017-18 Local Government Finance settlement included an agreement between the Scottish Government and local government for locally determined Council Tax increases to be capped at 3%. At this point, 21 councils opted to increase the Band D rate of Council Tax (against which all other Bands are set) by the full 3%. Three councils chose increases of 2% or 2.5%, and eight councils opted to apply no increase.

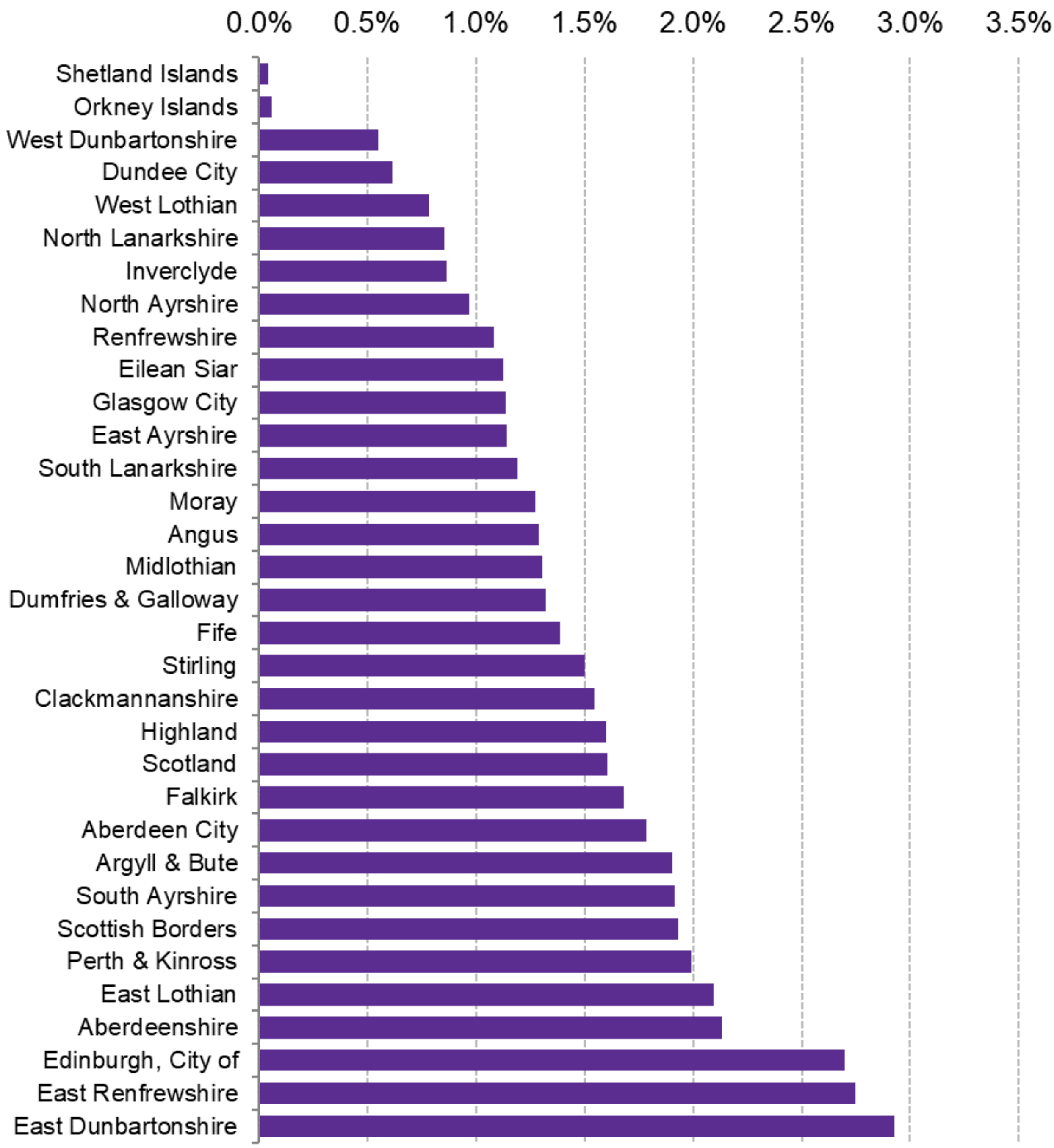
The 3% cap on locally determined Council Tax increases was again agreed for 2018-19, and all 32 local authorities opted to increase Council Tax by the full 3%.

As discussed, expected Council Tax income is taken into account in the calculation of the General Resource Grant - if a local authority sees an uplift in it's Council Tax income, it can, all other things being equal, consequently expect to see a reduction in its direct funding from the Scottish Government in future years. The exception to this was in 2017-18, when the additional income from changes to Council Tax multipliers was not taken into account for the calculation of the 2017-18 local government finance settlement.

The SPICe 'facts and figures' briefings on local government finance published in 2017 [19] and 2018 [6] explored the impacts of Council Tax reform income on individual local authorities. This highlighted the Council Tax 'landscape' of Scotland, in which certain local authorities have higher proportions of low-band properties, and greater numbers of Council Tax benefits claimants, whilst others tend to have higher levels of Band E-H properties.

Figures 11 shows the percentage point change in the amount of income each local authority received from Council Tax between 2016-17 and 2018-19.

Figure 11 - Proportion of income from Council Tax, 2016-17 to 2018-19, percentage point change



Compared to 2016-17 pre-reform figures, those local authorities which have a smaller proportionate income from Council Tax have seen a minimal increase in proportion of income coming from Council Tax, with both Shetland and Orkney seeing almost no increase. In contrast, the local authorities with higher proportions of high band properties have seen their proportion of income from Council Tax increase by up to almost 3 percentage points, with East Renfrewshire, East Dunbartonshire and City of Edinburgh seeing the greatest increase.

Annex

Council Tax, NDRI and Scottish Government Grant funding for local government, 2018, cash.

£m, Cash	2018-19 Revenue Funding, less NDRI	2018-19 NDRI income	Est Gross CT revenue 2018-19	Total
Aberdeen City	102.36	227.80	122.57	452.73
Aberdeenshire	306.51	110.71	139.05	556.27
Angus	176.33	25.10	51.50	252.93
Argyll & Bute	162.57	33.04	51.50	247.10
Clackmannanshire	80.33	15.33	24.72	120.37
Dumfries & Galloway	242.13	44.23	69.01	355.37
Dundee City	242.44	55.55	63.86	361.85
East Ayrshire	201.83	26.07	55.62	283.52
East Dunbartonshire	162.39	21.79	63.86	248.04
East Lothian	148.17	23.74	54.59	226.50
East Renfrewshire	163.70	14.32	53.56	231.58
Edinburgh, City of	382.84	340.47	281.19	1,004.51
Eilean Siar	88.28	7.70	11.33	107.31
Falkirk	213.53	65.96	70.04	349.53
Fife	485.27	154.14	170.98	810.38
Glasgow City	911.23	340.78	287.37	1,539.38
Highland	319.66	126.54	124.63	570.83
Inverclyde	146.73	18.36	36.05	201.14
Midlothian	130.29	28.12	46.35	204.75
Moray	118.47	40.15	42.23	200.85
North Ayrshire	235.80	39.47	63.86	339.13
North Lanarkshire	512.04	104.34	136.99	753.37
Orkney Islands	65.49	9.38	9.27	84.14
Perth & Kinross	195.82	51.95	82.40	330.17
Renfrewshire	191.35	120.11	86.52	397.97
Scottish Borders	172.92	32.79	57.68	263.39
Shetland Islands	62.48	23.85	9.27	95.61
South Ayrshire	163.37	38.30	61.80	263.47
South Lanarkshire	265.54	295.50	145.23	706.27
Stirling	125.05	42.27	49.44	216.77
West Dunbartonshire	110.45	78.81	42.23	231.49
West Lothian	237.41	79.33	77.25	393.99
Scotland	**7,122.75**	**2,636.00**	**2,641.77**	**12,400.52**

Abbreviations

COSLA - Convention of Scottish Local Authorities

CPI - Consumer Price Index

CT - Council Tax

CTR - Council Tax Reduction

DA - Distributable Amount

ESE - Estimated Service Expenditure

GRG - General Resource Grant

GAE - Grant Aided Expenditure

LA - Local Authority

NDR - Non-Domestic Rates

NDRI - Non-Domestic Rates Income

RPI - Retail Price Index

RV - Rateable Values

SAA - Scottish Assessors Association

SINA - Special Islands Needs Allowance

TEE - Total Estimated Expenditure

TRDIA - Teacher Remoteness and Distant Island Allowance

Bibliography

1 Scottish Government. (2018, March 6). Local Government Finance Circular 4/2018: settlements for 2018-2019. Retrieved from https://www.gov.scot/publications/local-government-finance-circular-42018/ [accessed 26 September 2018]

2 Adam, S., Besley, T., Blundell, R., Bond, S., Chote, R., Gammie, M., … Poterba, J. (2011). *Tax by Design: The Mirrlees Review*. Oxford University Press: New York.

3 Burn-Murdoch, A. (2017, December 18). Local Government Finance: Draft Budget 2018-19 and provisional allocations to local authorities. Retrieved from https://digitalpublications.parliament.scot/ResearchBriefings/Report/2017/12/18/Local-Government-Finance--Draft-Budget-2018-19-and-provisional-allocations-to-local-authorities [accessed 22 December 2017]

4 CoSLA. (2017, November). Submission to the Local Government and Communities Committee: Fair Funding for Essential Services. Retrieved from http://www.parliament.scot/S5_Local_Gov/Inquiries/20171113_Budget_COSLA.pdf [accessed 23 November 2017]

5 Accounts Commission. (2018, April 5). Local government in Scotland: Challenges and performance 2018. Retrieved from http://www.audit-scotland.gov.uk/report/local-government-in-scotland-challenges-and-performance-2018 [accessed 18 September 2018]

6 Burn-Murdoch, A. (2018, May 21). Local government finance: facts and figures 2013-14 to 2018-19. Retrieved from https://digitalpublications.parliament.scot/ResearchBriefings/Report/2018/5/21/Local-Government-Finance--facts-and-figures-2013-14-to-2018-19# [accessed 11 June 2018]

7 Scottish Government. (2018). 'Green Book' For Grant Aided Expenditure Local Government Finance Settlement 2018 – 2019. Retrieved from http://www.gov.scot/Resource/0053/00532605.pdf

8 Scottish Government. (2017). Government Expenditure and Revenue Statistics. Retrieved from http://www.gov.scot/Publications/2017/08/7201 [accessed 30 June 2018]

9 *History and Computing III. Historians, Computers and Data. Applications in Research and Teaching. Eds. Mawdsley et al.*. (1990). Manchester University Press: (n.p.).

10 Scottish Government. (2017). Scottish Draft Budget 2018-19. Retrieved from http://www.gov.scot/Publications/2017/12/8959 [accessed 2018]

11 Scottish Assessor's Association. (2017). 2017 Practice Notes. Retrieved from https://www.saa.gov.uk/non-domestic-valuation/2017-practice-notes/ [accessed 30 June 2018]

12 Scottish Assessors Association. (2018). Portal Advanced Search. Retrieved from https://www.saa.gov.uk/search/?ST=advanced [accessed 30 June 2018]

13 Scottish Government. (2017). Barclay Review Report. Retrieved from https://beta.gov.scot/publications/report-barclay-review-non-domestic-rates/ [accessed 30 June 2018]

14 Scottish Government. (2018). Non-domestic rates: legislation. Retrieved from https://beta.gov.scot/publications/non-domestic-rates-legislation/ [accessed 30 June 2018]

15 Scottish Parliament Local Government and Regeneration Committee. (2014, June 27). Flexibility and Autonomy in Local Government. Retrieved from http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/78987.aspx [accessed 27 April 2017]

16 The Commission on Local Tax Reform. (2015, December 15). Just Change: A New Approach to Local Taxation. Retrieved from http://localtaxcommission.scot/download-our-final-report/ [accessed 27 April 2017]

17 The Scottish Government. (2016, March 2). Council tax reform. Retrieved from https://news.gov.scot/news/council-tax-reform [accessed 27 April 2017]

18 The Scottish Government. (2016, September 7). The Council Tax (Substitution of Proportion) Order 2016. Retrieved from http://www.legislation.gov.uk/sdsi/2016/9780111032589/contents [accessed 27 April 2017]

19 Burn-Murdoch, A. (2017, June 21). Local Government finance: facts and figures 2011-12 to 2017-18. Retrieved from https://digitalpublications.parliament.scot/ResearchBriefings/Report/2017/6/21/Local-Government-Finance--facts-and-figures-2010-11-to-2017-18# [accessed 23 November 2017]