

7

Household taxation and local charges

Summary

This chapter assesses the merits of different forms of household taxation and charging, and the role that they should play in local government finance in England. It argues that council tax is not 'broken', and should be retained as a local tax either on its own, or alongside other local taxes. However, improvements to council tax benefit are crucial in the short-term, to improve the perceived fairness and sustainability of council tax. This should happen alongside measures to increase local flexibility over spending described in Chapter 4, to help take the pressure off council tax.

There also remain a number of options, including a local income tax and assignment of national taxation, which could be used to supplement, or fully or partially replace council tax, and thus further help to reduce the pressure on it over time. While these are not likely to be realistic options for the immediate term, they have a number of advantages and remain possibilities for the future.

In detail, the chapter argues that:

Council tax remains a broadly sound tax, though it has become overloaded within the present system. In the short term, action is needed to both improve the perceived fairness of council tax by improving the take-up and design of council tax benefit, and to take the pressure off council tax through greater local flexibility over spending.

'Fairness' means different things to different people; however the most common concerns about the perceived unfairness of council tax relate to 'ability to pay', or income, particularly with regard to older people. Other important dimensions of 'fairness' in this context include the link between tax and property value, and the perceived benefits of local services to taxpayers.

There are limits on the extent to which reform of the council tax bands can make it less regressive to income. Nonetheless, there are advantages to revaluation and reform of council tax to make it a better property tax. Revaluation of properties is an important part of maintaining a viable and up-to-date local tax base, and should go ahead in the medium term. At that point the Government should create new bands at the top and bottom of the existing structure.

Council tax benefit (CTB) has the potential to significantly reduce the burden of council tax on the poorest households. In practice, however, up to £1.8 billion in CTB entitlement was left unclaimed in 2004-05, much of it by older people.

Since the primary purpose of CTB is to adjust households' liability for council tax, it should be renamed 'council tax rebate'. Moreover, the Government should urgently pursue measures to simplify the claims process, as well as more ambitious work towards automated, proactive delivery of entitlements to taxpayers, with a view to achieving a step-change in take-up.

Some pensioner households pay a relatively high proportion of their income in council tax but are not eligible for CTB. The government should increase the upper savings limit for pensioner households, and eventually abolish it, in line with savings thresholds for Pension Credits. These reforms would address some of the main problems with council tax. Other problems, such as its lack of buoyancy, would require more fundamental changes.

Local income taxes were discussed in many submissions to the Inquiry, and are a possible option for inclusion in the local government finance system in the future.

Local income taxes are more progressive than council tax (even with full take-up of CTB) and popularly seen as fair, but some people may underestimate the amount they would pay under a local income tax compared with council tax. A local income tax would be naturally buoyant in that revenues would rise in line with earnings growth, but it would still be crucial to manage the pressures placed on local taxes if rate increases were to be avoided.

It would be feasible to implement a local income tax in England, but further detailed work would be needed to resolve complex questions around its precise design and operation. It is likely that the process of implementing a local income tax would take approximately six to seven years from the point at which the government decided to work towards it. There are some similarities with assignment of national taxation to local government, which I discuss in Chapter 9.

Charges for services are already a significant source of revenue for local authorities. New flexibilities to charge and trade were introduced for some authorities in 2003, but appear not yet to have been widely used. Local authorities need to develop confidence in taking a strategic approach to charging and trading, and should seek to engage their communities in a wider debate about the role for user charges in pursuing policy objectives and in meeting service costs, including as an alternative to council tax.

I do not at present see a case for a further extension of general charging powers, though the charging and trading powers in the 2003 Act should be made available to all local authorities.

There are significant emerging pressures on waste services as the UK aims to reduce its dependence on cheap landfill in the face of growing waste volumes. The Government should create powers for local authorities to charge for domestic waste collection, as a means by which incentives can be created to reduce household waste and manage costs, and to help ensure that the remaining costs may be shared in a way that is perceived as fair.

INTRODUCTION

7.1 Local residents are substantial contributors to local authority revenues, through council tax and through a range of fees and charges for local services. The financial dimension to local government's relationship with its citizens is crucial and, unsurprisingly, often fraught with tension. I will consider how the current system lends itself to supporting local choice and engagement whilst having regard to concerns about fairness in local taxation, and will make recommendations on:

- the role of domestic property taxes in local government finance, and the future of council tax and council tax benefit;
- the potential for a local income tax to be implemented in England; and
- the part played in the finance system by local service charges.

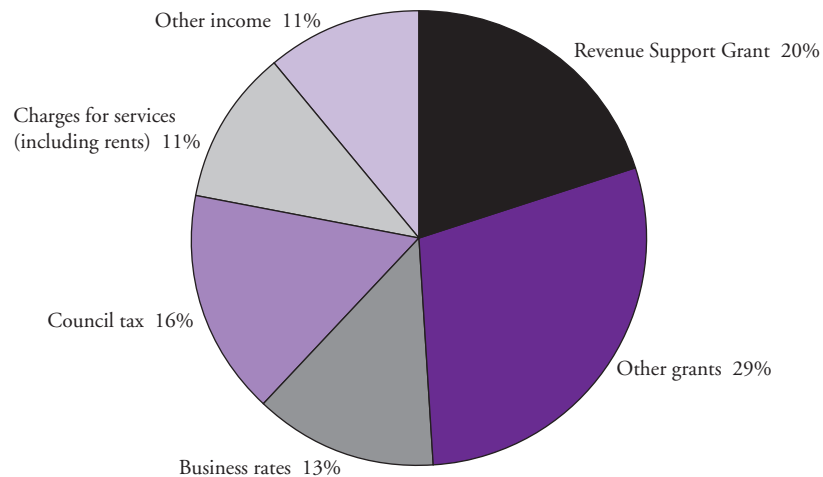
COUNCIL TAX

A hybrid property tax and service charge

7.2 Since its inception in 1993, council tax has been the only locally levied tax on households in England, and the only tax whose rate is decided by local authorities. With a total yield of over

£22 billion in 2006-07, council tax makes a significant contribution to the funding of local public services: chart 7.1 below shows that on average, around 16 per cent of local authorities' total budgets are funded from council tax. While council tax payers also contribute to the costs of local services through other taxes, redistributed as grant by central government, survey evidence shows that council tax is particularly well known, with public awareness of the tax at 99 per cent.¹

Chart 7.1: Total gross local authority income by source, 2003-04²



Source: Local Government Financial Statistics, England, CLG.

7.3 This chart represents gross local authority income, making it possible to take into account charges for services (other definitions often show revenue and expenditure net of this income). However, it should be noted that the latest available data on this definition relates to 2003-04 and so does not take into account the changes to schools funding. A similar chart for 2006-07 would be expected to show a larger proportion of income from “other grants”, including Dedicated Schools Grant, and a smaller proportion from the unhypothecated Revenue Support Grant.

¹ BMG Research, *Lyons Inquiry survey*, 2007

² Chart 7.1 shows gross local authority income as published in *Local Government Finance Statistics no.16*, 2005 (latest published data). Previous discussion on local government funding, for example the Balance of Funding Review, have focused on local authority revenue income, and more frequently refer to the ‘balance of funding’ in terms of revenue expenditure, which includes Revenue Support Grant, business rates and council tax. Under this definition, council tax provides around 25 per cent of net revenue expenditure.

Council Tax

Council tax was introduced in England, Wales and Scotland in 1993. It replaced the community charge (commonly known as the poll tax), which had in turn replaced domestic rates in 1990.

Residential properties were assigned to one of eight council tax bands, from A to H, according to their assessed capital value in 1991. Properties built since 1993 are assigned an estimated value at 1991 prices to put them in a council tax band.

Billing authorities decide each year on the level at which band D bills will be set in their area, with bills for all other bands then charged at a fixed proportion of the Band D amount.

Average council tax in 2006-07

A	B	C	band D	E	F	G	H
£846	£987	£1,128	£1,268	£1,551	£1,833	£2,115	£2,538
or							
£16.27 per week	£18.98 per week	£21.69 per week	£24.38 per week	£29.83 per week	£35.25 per week	£40.67 per week	£48.81 per week

Because more properties are in the lower bands than the higher ones, the average bill per dwelling is lower than the band D average, at £1,056.

Where there is more than one local authority in an area, one of them acts as the billing authority for council tax (for example, District Councils in two-tier county areas) and is responsible for tax collection, though the council tax revenues are shared between those authorities.

All residential properties are liable for council tax, but some discounts and exemptions apply, including:

- a 25 per cent discount for households with only one liable resident;
- exemptions for certain classes of unoccupied dwelling; and
- exemptions for certain groups of people including students.

Full details on council tax in England, including discounts and exemptions, can be found at www.communities.gov.uk, and on local authority websites.

7.4 Council tax is an unusual hybrid: both a property-based tax, and a charge on local service users. An individual household’s bills do not perfectly reflect the value of their home, but neither do they pay a flat charge for services. Households with only one liable resident receive a 25 per cent discount on their bill, partly reflecting the expectation that they will have lower service needs.

7.5 Council tax benefit (CTB) was designed as part of the council tax system to protect those on low incomes. In effect, it means that for eligible households on low incomes, council tax also acts as a hybrid property and income tax, as changes in earnings alter benefit entitlement. I will discuss this point in more detail later in this chapter. The idea of offering income-related reliefs against property tax is not new and the Layfield Commission noted in 1976 that the rebates used to adjust the property tax liability of the poorest under the old domestic rates were “a necessary feature of rating”.³

7.6 As a hybrid of this kind, council tax is unique among local taxes. There is nothing inevitable about the design of council tax – in fact it is in many ways a very pragmatic compromise between a property tax and a service charge. In considering whether council tax should be reformed, I have looked at whether this particular hybrid remains the right model for England’s main local tax, and compared the advantages and disadvantages of a range of alternatives.

³ HMSO, *Local Government Finance: Report of the Committee of Inquiry*, 1976.

The problem with council tax

7.7 When I was first asked to conduct this Inquiry, my remit was clearly focused on local government funding and, in particular, building on the findings of the Balance of Funding Review and preparing for a revaluation of all residential properties.⁴ Also at that time, in 2004, England had just been through a round of particularly steep average increases in council tax, and the Government would soon resume use of ‘capping’ powers to restrict the rate of increase in bills. My remit therefore has its origins in a period of increasing sensitivity about council tax: its overall size, the rate at which it was increasing, and its sustainability into the future.

7.8 I suggested in Chapter 6 that property taxes have a number of things to recommend them. Since council tax incorporates a property tax element, it shares many of these advantages. It is relatively easy to collect and difficult to evade; collection rates have risen steadily to their 2005-06 levels of nearly 97 per cent. Since properties do not move, tax bases are stable and revenues relatively predictable, allowing local authorities a degree of certainty in their financial planning. Property taxes are widely used around the world as a source of finance for local government, reflecting the crucial link between residents of an area and the services that are provided there.

7.9 These factors lead me to the view that council tax remains broadly sound, and should be retained as a local tax. It does however have some important shortcomings, some of which can be mitigated through reform in the short term, and others which may require more radical or longer-term reforms.

7.10 Concerns about council tax have several dimensions, all of which are exacerbated by the highly visible nature of the tax. A solution to “the council tax problem” must address:

- the perceived fairness of the way council tax distributes the tax burden, particularly in relation to people on low and fixed incomes, and especially older people;
- the burden of expectation and spending pressures that have been placed on council tax, with consequences for the rate of increase in bills; and
- concerns about the continued reliance on a single local tax which is not naturally buoyant.

7.11 Not all of these problems will respond to reforms which look at local tax in isolation. Tax reform alone will fail to take the pressure off local budgets unless it is accompanied with reform of the spending side of the equation. Chapter 4 set out recommendations to introduce greater local flexibility to manage pressures, by ensuring that resources can follow priorities in the most efficient way possible.

7.12 The chapters that follow focus on the options for reform of local government’s revenues. In the short term, the fairness and sustainability of council tax could be improved through reform of council tax and council tax benefit. There are, however, underlying concerns about the lack of natural buoyancy and whether popular support for council tax can be improved adequately through these and other short-term reforms. In the longer term, therefore, there are a number of possible options, including a local income tax, which could be used to supplement, or fully or partially replace council tax, and thus further help to reduce the pressure on it over time.

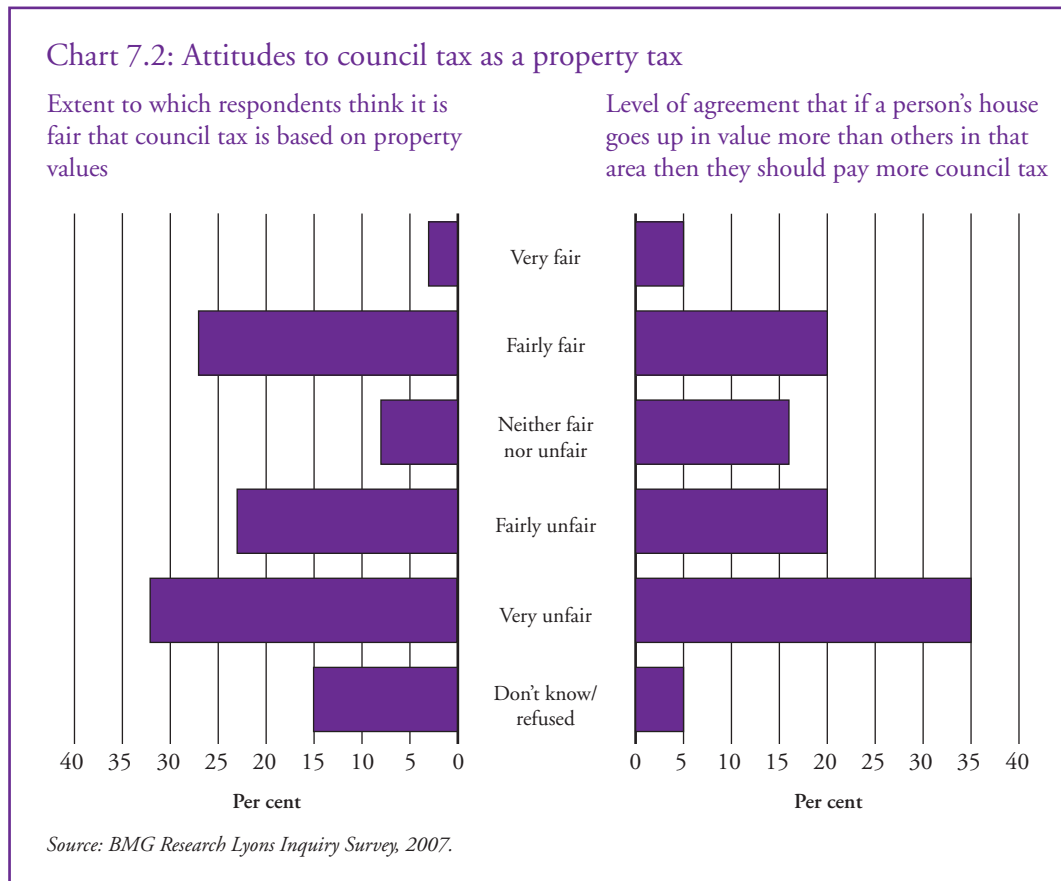
7.13 This chapter considers the options for reform of local taxes and charges on households. Chapter 9 will go on to consider wider options for central government’s funding of local services, including through assigned national taxes.

⁴ ODPM, *Balance of Funding Review – Report*, 2004.

Fairness and property taxes

7.14 I suggested in Chapter 6 that there is a strong economic case for retaining a local property tax in some form. Council tax has some great advantages, not least that it is a predictable source of revenue for local authorities, with high and rising collection rates.

7.15 Nonetheless, during the course of my Inquiry I have been struck by the strength of feeling that residential property taxes provoke. My research found real resistance to the idea that tax bills should reflect property values, and to the idea that they should rise when property values rise, as shown in chart 7.2 below. When homeowners benefit from growth in the equity in their property, it appears that this is often seen as a ‘reward; for their diligence as investors, rather than the product of housing market conditions, including constraints on the supply of new housing.’⁵ This is often expressed in the idea that ‘an Englishman’s home is his castle’ and as such, treating it as a taxable asset is something of an affront to privacy – though this phenomenon is by no means confined to England; property taxes have also been controversial in other countries at various times.



7.16 Concerns about fairness most commonly centre on the relationship between property taxes and ability to pay, generally measured in terms of household income. In this context there is particular concern about the impact of property taxes on those households who are asset-rich but income-poor, and may find it difficult to pay a tax based on the value of their home rather than their income. I will go on to look in some detail at the relationship between property value and income, and the impact of different reform options on ‘fairness’ in terms of progressiveness to income.

⁵ For detailed discussion of housing supply, see Barker Review of Housing Supply *Delivering Stability: securing our future housing needs* 2004.

7.17 However, income is not the only measure of fairness. Arguably, fairness in relation to income could in fact be the wrong question to ask of a property tax, since some property taxes by nature aim to tax the consumption or return on property. Taxes should therefore reflect the value of the good – in this case property – rather than the overall income of those consuming it. Fairness in these terms would mean that those in the most valuable properties would pay the most tax, and vice versa. It is worth remembering that the community charge was unpopular not just because it was regressive to income, but also because it did not reflect the type or value of home being occupied – one MP observing in 1989 that “under the poll tax two pensioners living in a flat will be paying more than a millionaire living in a mansion”.⁶

7.18 In assessing the scope for reform of council tax it is therefore worth considering both these dimensions of fairness. Reform might be used to achieve greater progressiveness to income, or to property value, or a combination of both.

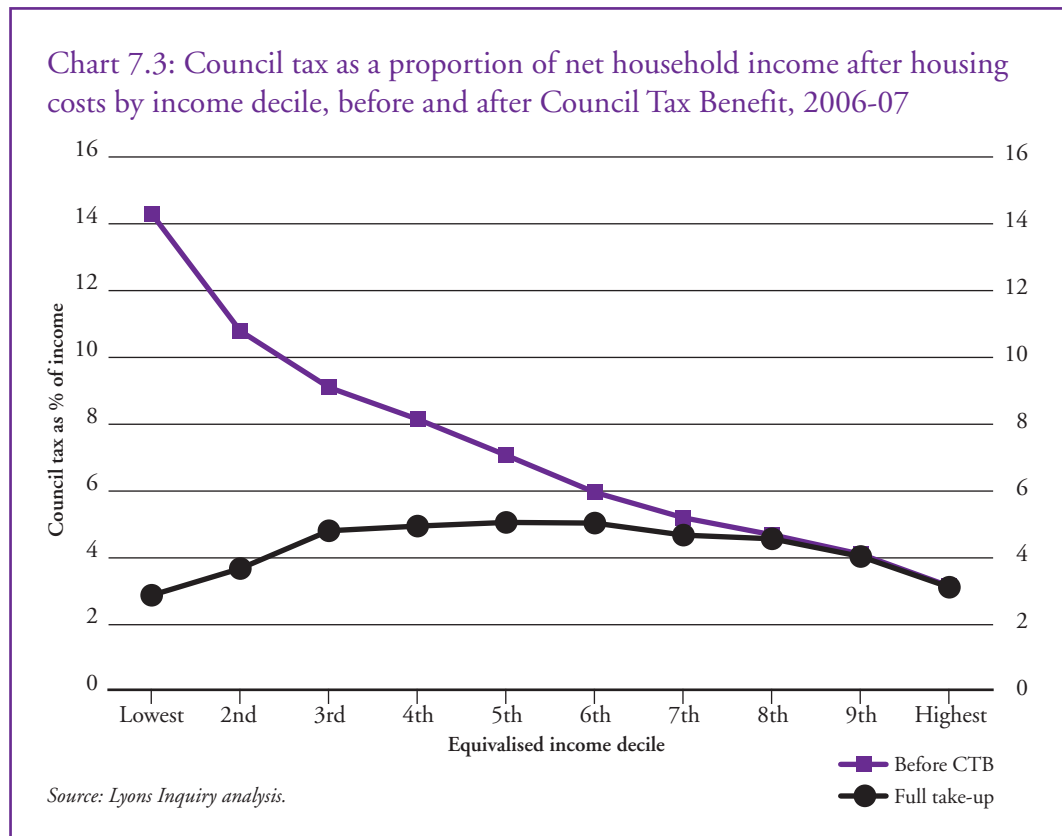
Property taxes and household income

7.19 I will return to the question of income taxes later in this chapter, but first want to consider the extent to which it is possible or desirable for property-based taxes to be designed to be progressive (or avoid being regressive) in relation to income.

7.20 Chart 7.3 overleaf shows that council tax, as it is designed at the moment, is regressive to income before council tax benefit is applied. That is, in terms of the pure structure of the tax itself, the highest-income households are liable to pay the lowest proportion of their income in tax, while lower-income households are liable to pay greater proportions of their total income in tax before CTB.

7.21 Once eligibility for council tax benefit is taken into account, council tax liability appears to be a relatively constant proportion of people’s incomes throughout the income distribution, becoming relatively progressive to income for those on the lowest incomes, and regressive only in the top three income deciles. However, the current system of CTB does not achieve this result in practice – something I will discuss later in this chapter.

⁶ Hansard, 19 January 1989.



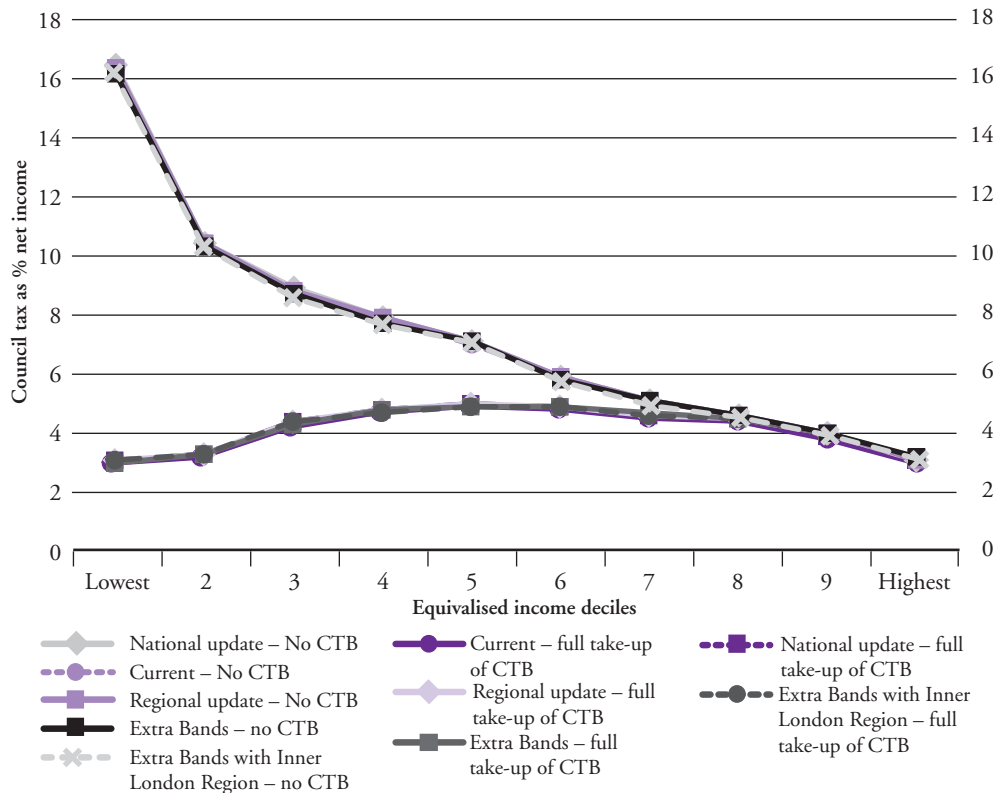
7.22 In December 2005 I published some analysis of options for redesigning the council tax band structure alongside revaluation of properties. This included options such as regional bands, and adding extra bands at the top and bottom of the present band structure, which had been suggested in a number of submissions to the Inquiry. There was a strong view in many submissions that council tax should be made fairer in relation to ability to pay; I was therefore particularly interested in the impact of these sorts of changes on households in terms of the tax burden relative to their income.

7.23 The results of that analysis, as I said in my Interim Report, were somewhat surprising.⁷ As shown in Chart 7.4 overleaf, this demonstrates that even options which significantly improved the link between property value and tax paid (such as adding extra bands at either end of the scale) did not have a significant impact on the overall relationship between council tax bills and household income. It remained the case that those on the lowest incomes paid the greatest proportion of their incomes in tax (before CTB) and vice versa. This regressiveness was not noticeably altered by any of the reform options examined (either before or after CTB).

7.24 I concluded that this unexpected result reflects the fact that people living in houses within a specific band tend to have widely different income levels, so changes to bands do not have a clear impact on the overall progressiveness of council tax to income. The options modelled, though not of course exhaustive, point towards the conclusion that structural change to council tax as a property tax will have very limited success in delivering greater 'fairness' to income.

⁷ Lyons Inquiry into Local Government, *Consultation Paper and Interim Report*, 2005.

Chart 7.4: Gross and net council tax as a proportion of net household income after housing costs by income decile, under the current system and after revaluation and reform, 2005-06⁸



Source: Lyons Inquiry analysis.

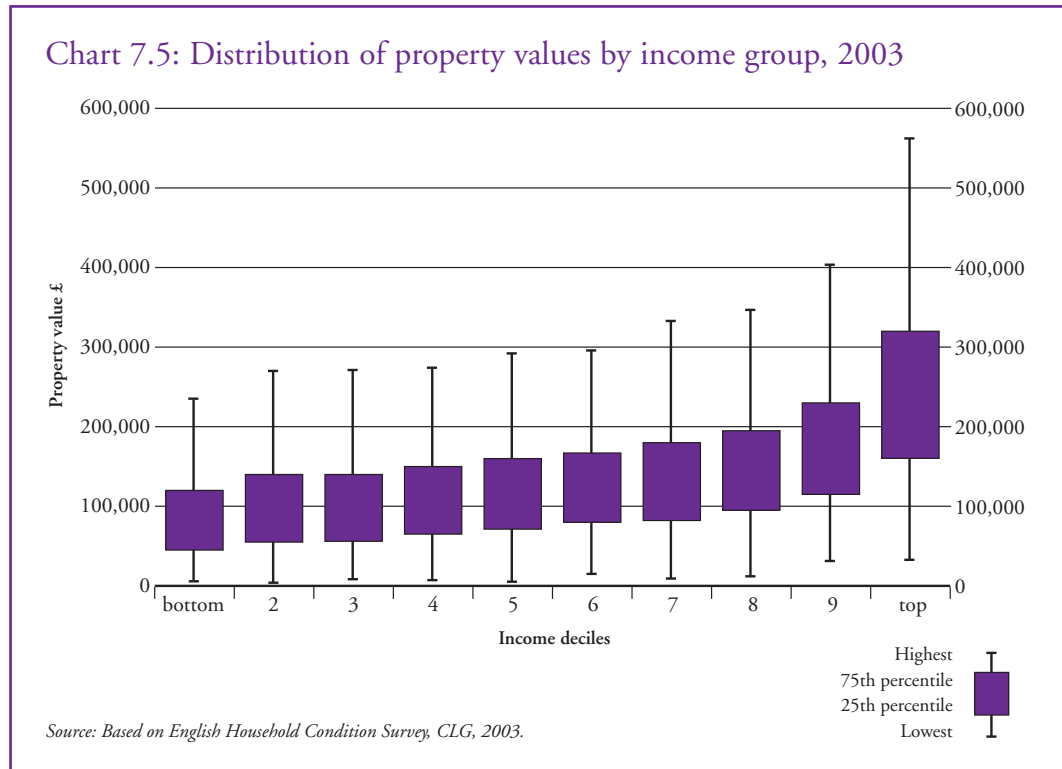
7.25 Since the Interim Report I have undertaken further work to test that conclusion. For example, some commentators have argued that perhaps more radical reform options would have greater success in making council tax 'fairer'.⁹ I have therefore looked closely at the relationship between property values and income in England, and some key trends emerge.

7.26 Chart 7.5 overleaf shows the range of values of properties occupied by households in each income group. This demonstrates a positive and statistically significant correlation between income and property value.¹⁰ However, there is also substantial overlap in the value of property occupied by all but the top income decile.

⁸ This chart shows a slightly higher average proportion of income paid in council tax in the lowest income group compared with other similar charts in this chapter (approximately 16 per cent compared to approximately 14 per cent in charts 7.3, 7.9 and 7.14). This reflects methodological changes in the treatment of outlying values in the modelling.

⁹ I am grateful to the New Policy Institute and the Local Government Information Unit for their valuable challenges on this point, and their help in examining the scope for council tax reform.

¹⁰ English Household Condition Survey data gives an overall correlation between income and property value of 0.4.

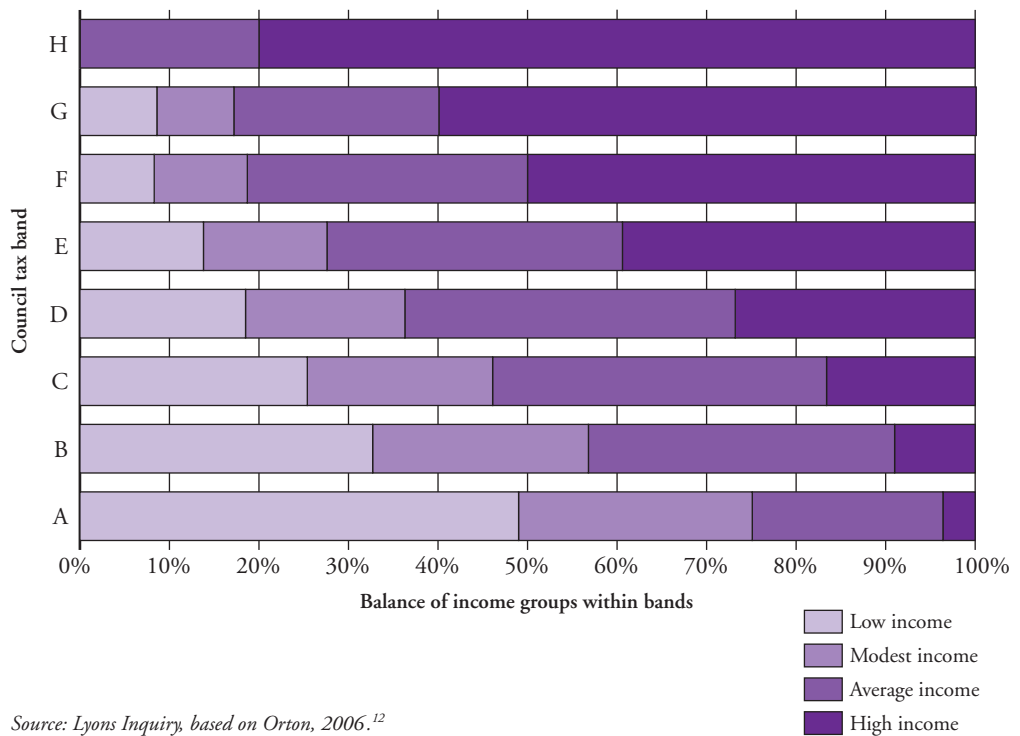


7.27 Chart 7.6 explores the relationship between property value and income by looking at the range of income groups in each council tax band, based on work by Michael Orton for the Joseph Rowntree Foundation.¹¹ This further demonstrates that the correlation between income and value is strongest at the top end of the scale, with nearly all band H households having high or above average incomes. Low and modest-income households are generally concentrated in the lower bands. However all bands also contain significant numbers of households with above average incomes, weakening the overall correlation between income and property band. A small but significant minority of low-income households are in bands F, G and H, of which over half are pensioner households.

7.28 Orton rightly points out, however, that these asset-rich, income-poor households are a minority in the population overall. The total numbers of households in the top bands are relatively small: over 80 per cent of all households in England are in bands A to D, including over 90 per cent of all low-income households. Nonetheless the mix of income groups in each band suggests that the burden of council tax in relation to income will vary widely between households.

¹¹ Orton, M *Struggling to pay council tax: new perspectives on the local taxation debate* Joseph Rowntree Foundation, 2006.

Chart 7.6: Income mix by council tax band



7.29 The evidence indicates that the nature of property markets in this country, and the complex factors influencing people's choice of home mean that there is not a simple relationship between a household's income and the value of their home, beyond the trends outlined above. I therefore remain of the view that while changes to the design of council tax can have some impact on its overall progressiveness, it is likely that a property tax will remain regressive to income overall, before council tax benefit is applied.

7.30 This is not to say that I consider property taxes to be inherently 'unfair', or that I see no point in reforming council tax. While the reforms I have examined do not produce the kind of income-related "fairness" that many hoped would emerge, they may still have advantages in terms of improving the link between council tax and property value, and may in some circumstances reduce, though not eliminate, the regressiveness to income of council tax as a property tax.

Options for reform of council tax

7.31 I have suggested that council tax should be retained, but that there may be a case for reforms of the tax aimed at improving its perceived fairness. In the short term, the key problems for council tax fairness relate to its impact on those with low incomes. Given the weak overall correlation between income and property value, it is likely that the main solution to this lies outside the design of council tax itself, in council tax benefit.

¹² Data from the Family Resources Survey. Income groups defined as: low Income – less than 60 per cent of median income; modest income – between 60 per cent of median income and median; above average – between median and twice median income; high income – more than twice median income.

7.32 However, it is within the scope of this Inquiry to consider not just how to resolve those immediate issues, but to look at how to make council tax a sensible and sustainable tax in the future. Solving its short term problems may create the space for a wider look at council tax in the medium term, and I consider elsewhere options for other local taxes and for assignment of national taxation which could play a role in the future.

7.33 This section summarises the options examined for reform of council tax as a property tax. It includes options examined in my Interim Report in 2005, as well as further analysis conducted since then.

Reforming the council tax bands at revaluation

7.34 I first looked at the options for council tax reform in the context of a planned revaluation exercise. Revaluation of properties presents an opportunity for reform by redefining the council tax bands, and then allocating properties to bands based on their current values. In my Interim Report, I published the results of modelling on a range of options of this kind.

Extra bands at top and bottom

7.35 Council tax bills are bounded by the current banding structure, which sets an effective floor and ceiling on the amount a household will pay, before benefits. Adding one or more extra bands at the top and bottom of the band structure would move that floor and ceiling, and widen the variance in bills.

7.36 This has the advantage of focusing reform on the very top of the band structure, where the correlation between property value and income is strongest, and on the bottom band, where many of the poorest households are concentrated. So while adding extra bands might not dramatically alter the overall link between tax bills and income, it would reduce council tax (before CTB) for many of the poorest while ensuring that the increased bills for the new higher bands are largely targeted at those with above-average or high incomes.

7.37 I have assumed that a reform of this nature would be revenue-neutral, so that the same amount of council tax (gross of CTB) is raised overall, but with the tax burden distributed differently between households. The bills for some taxpayers would therefore be increased, allowing others to pay less. The effect on individual households is complicated somewhat by CTB. Significant numbers of households who would, in principle, enjoy lower bills might not feel a change in practice since their bills are already paid wholly or partially by CTB. In that case, some of the benefit from a reduction in bills would accrue to the Government, rather than to the taxpayer, through a reduction in the costs of paying CTB to those households. Adding extra bands at revaluation would be expected to reduce total CTB costs, assuming full take-up, by approximately £130 million.

7.38 Since not all entitlement for CTB is taken up, in practice the savings to the Government would be less than this gross figure, and the savings to households slightly greater.¹³ None the less, if the Government so chose, it could use any savings to pay for measures to help those still paying a large proportion of their income in council tax, for example through changes to the eligibility criteria for CTB.

¹³ The statistical model used by the Inquiry is not adapted to forecast actual take-up levels after policy change. Broadly speaking however, if take-up of CTB entitlements remained at around 65-71 per cent (on an expenditure basis), cashable savings after reform might be around the same percentage of the gross figure given above.

Regional bands 7.39 The modelling around revaluation did however expose that the impact of such reforms would vary around the country. In particular, revaluation would be likely to generate significant, ‘turbulence’, with around half of all households changing band under the Extra Bands option (and about 36 per cent even under revaluation without reform). Properties in London and the southern regions, where house prices had, on average, risen the fastest since 1991, were most likely to move up at least one band.

7.40 In response to this I considered whether there might be lower turbulence if different band margins were applied to the nine English regions, reflecting different average property values around the country. This option had been suggested to the Balance of Funding Inquiry, and was modelled to consider the case for a sub-national banding scheme.

7.41 In fact, about as many properties changed bands under the regional option as under the national one. Furthermore, the regional option created a number of sub-regional ‘hotspots’ where property values had grown faster than average for the region, meaning that a large proportion of homes would be likely to move up one or more bands. It therefore appears that regional bands would not be an attractive option under the current distribution of house prices.

Separate bands for Inner London 7.42 A further variant of this approach would be to operate a distinct set of regional bands for Inner London, where properties were most likely to move up the bands under national and regional reform options. The number of Inner London households moving up at least one band was more than halved by the introduction of special bands for Inner London, without creating significant impacts on band movements in the rest of the country. The Government should consider introducing special bands for Inner London at the next revaluation, to reflect the unique circumstances of the Inner London property market relative to the rest of the country and to reduce the turbulence associated with revaluation there.

Limited upward band movement 7.43 Under the different options modelled, up to 11 million households would have been expected to move to a different council tax band (around half of all households in England). The majority of these would have moved by only one council tax band, with a minority of up to 400,000 households (two per cent of the total) expected to move up two or more bands, and a similar number moving down two or more bands. Given that most of the benefits of revaluation, in terms of a more up-to-date property tax base, can be achieved by properties moving only one band in either direction, there may be a case for limiting upward band movements to avoid sharp increases in individual households’ bills. The Inquiry modelled an option in which properties’ upward movement was limited to only one band, which would have resulted in approximately 370,000 households (two per cent of all properties) being held down one or more bands. The Government could consider implementing a limitation of this kind at the time of any revaluation.

The case for revaluation

7.44 The Government decided in 2005 to postpone revaluation of properties for council tax, for at least the life of this Parliament. While I understand the Government’s reasons for postponing the revaluation exercise, it is my view that there are advantages to revaluing the property base that have not been adequately explained so far. It is also worth noting that postponement itself created ‘winners’ and ‘losers’ – 3.7 million households (or 17 per cent of all households in England) that would have been moved down the bands by revaluation are arguably paying too much council tax, subsidising those who would be paying more because their properties had grown in value more quickly.¹⁴

¹⁴ Lyons Inquiry into Local Government, *Consultation Paper and Interim Report*, 2005, figures refer to national update option.

7.45 Revaluation would have two significant benefits: it can help underpin the credibility of a property tax by maintaining a meaningful relationship between relative property values and bills; and it creates an opportunity to make structural changes to council tax of the kind outlined above and later in this section. It is a matter for the government whether they are sufficiently attracted by any reform options to look at revaluation as an opportunity for change. However it is clear that significant reform is impossible without updating the tax base.

7.46 As for credibility, evidence from elsewhere does show that it is possible to use very outdated valuations as a tax base. The domestic rates in England lasted from 1973 to 1990 without revaluation, and Northern Ireland's rates have been, until this year, based on a 1976 valuation exercise that used rental data from the 1960s.

7.47 However, other successful property taxes are based on frequent revaluations. For example, property taxes in Washington DC are based on market valuations updated for all properties on an annual basis. These taxes are different from council tax in that bills represent a certain percentage of values, so revaluation allows public authorities to capture any increases in property values (which can itself be contentious). Revaluation has also happened closer to home. While England's revaluation exercise has been postponed; the Welsh Assembly Government went ahead with revaluation in Wales, demonstrating that revaluation, while difficult, is possible without undermining the sustainability of council tax. Moving to more frequent revaluations would promote stronger public understanding of the importance of accurate valuations, and introduce greater clarity to the system.

7.48 Substantial work was done in preparation for a 2007 revaluation in England (based on 2005 values), including the development of new valuations software in the Valuation Office Agency (VOA). This technology provides the opportunity to undertake a revaluation exercise, should the Government choose to go ahead, more cost-effectively than was possible in the past with manual valuations. It is also likely that subsequent revaluations would become more cost-effective over time if such exercises were fairly regular, as each revaluation would improve the accuracy of information on which properties are valued. More regular revaluations could also reduce the need for, and cost of, transitional schemes to phase in changes in tax bills.

7.49 In making the judgement about whether and when to revalue, government must weigh the risks to council tax from a turbulent or painful revaluation, against the risks of allowing the tax base to fall further into disrepair. There is no doubt that a first revaluation, some distance from the original valuation exercise, would be a challenging exercise, and some form of transitional arrangements might well be appropriate to ensure that any significant changes in liability for individual households – for example upward movements of more than one band – can be implemented in stages.

7.50 Even so, it is my view that the Government has a responsibility for maintaining the foundations of such an important revenue stream, since an out of date tax base will mean that the credibility of council tax as a property tax will gradually be eroded. There is a real risk that failure to revalue only makes it more difficult ever to do so, whereas an expectation of regular revaluations (as is already the norm in business rates) would contribute to the long-term sustainability of a property tax.

Revaluation of properties for council tax

Some submissions to the Inquiry have raised concerns about what a revaluation exercise might mean in practice. There are some common misconceptions about how revaluation would take place, and what might happen to the tax paid by people living in properties that have increased in value.

Assessment of properties by the Valuation Office Agency

Some people have been concerned that the valuation process might be intrusive, or that valuers might be given new and wider-reaching powers in order to conduct a revaluation of properties for council tax. In fact:

- the Valuation Office Agency (VOA) is a central government agency responsible for valuing homes for council tax purposes. It has the same powers now as it did when council tax was introduced in 1993;
- the VOA has a duty to maintain up-to-date information on properties in order to ensure they are in the right band for council tax. It only takes into account features of a property which affect its overall value. It does not collect any personal information about the residents of properties;
- in the minority of cases where the VOA need to visit a property, they will generally gather the information they need from outside. Valuers may only enter properties with the permission of the householder – the VOA has no powers to forcibly enter homes;
- fewer than one per cent of all homeowners are visited by VOA staff each year, and then often at the householder's request: for example when they have challenged the council tax banding of their property and have asked for a review.

A general revaluation of properties for council tax would not imply any new powers for the VOA.

Growth in property prices and revaluation

Most properties in England have increased in value since the date of the last valuation in 1991. The Government's stated aim, when revaluation was being considered, was that it should not increase the overall amount of money raised from council tax in England. There is no presumption that because house prices have gone up, tax should go up too. This means that revaluation would simply change the way the council tax burden is shared out across the country.

Which band a property is assigned to after revaluation would depend on its relative growth in value since 1991. Homes that have grown in value more quickly than the average would tend to move up the bands, while those whose value has grown more slowly than average would tend to move down. Since the current bands are relatively wide, a large number would stay in the same band as now.

The Government has stated that revaluation of properties for council tax will not take place within the life of the current Parliament.

Further options for reform

7.51 The postponement of revaluation obviously restricts the scope for reform of the council tax bands in the short term. I have therefore considered the options for reform in the absence of a revaluation exercise, as well as some more radical options for reform of council tax as a property tax.

Reform of Band H 7.52 The existing design of council tax contains a number of elements of judgement, some of which might reasonably be revisited. One such element is the current cap on council tax liability that is imposed by the ceiling on band H. Under the current system, the top band contains all properties worth at least £320,000 in 1991 (equivalent to approximately £900,000 in 2005 prices), right up to the most expensive property in the country at that time. Because of the way band ratios are set at present, the most valuable properties can only pay twice the tax paid by a band D home, and only three times as much as the least valuable home in band A, despite being at least eight times more valuable than band A homes in 1991.

7.53 There may therefore be a case for raising the ceiling on council tax liability by adding new top bands. This would be possible in theory without revaluation; properties could be assigned to the new higher bands based on their assumed value in 1991. This is the method already applied to any homes built since 1993, for which an estimated 1991 value is calculated to assign them to a council tax band.

7.54 Such reform would have the advantage of producing a stronger link between property value and tax bills for the most valuable homes, who currently pay a relatively small proportion of their value in tax. While the majority of households would not be affected, as a first step to reform improving this link at the very top of the scale could send an important signal that reform of the property tax element of council tax could be viable, and be a first step away from treating the current banding structure as inevitable and fixed. It would also, as noted above, be consistent with a definition of fairness based on ability to pay, since it would target those households where the correlation between income and property value is strongest.

7.55 The financial impact of raising or removing the ceiling on band H would depend on the new structure introduced at the top of the scale. The Inquiry modelled a scenario based on introducing several new top bands, including one for properties worth more than £1 million in 1991 (it is estimated that the latter would contain only around 800 homes).¹⁵ It was estimated that this option would raise approximately £75 million in additional revenue compared with the current council tax bands. Again this extra revenue, while modest, could conceivably be used to offset the costs of other measures aimed at those paying a high proportion of their income in council tax.

7.56 Less than 0.6 per cent of all households in England are in the top band, so in practice, reform of band H would only affect a very small minority of properties. However, most band H properties are concentrated in a relatively small number of authority areas – almost a quarter of all band H properties are in Kensington and Chelsea or Westminster – so implementing such a change might be challenging in those areas. Any extra yield would also be highly concentrated in a handful of authorities, though under the present system of grant equalisation the gain would be redistributed through grant to other areas.

¹⁵ See Annex C for full details of the options modelled.

- Extra bands at 1991 values** 7.57 A more far-reaching reform in the absence of revaluation would be to alter both the floor and the ceiling on council tax by creating new bands at both the top and the bottom of the scale, again by allocating properties to bands based on their assumed value in 1991.
- 7.58 The advantage of this option is that it allows for some relatively significant reform of council tax as a property tax, introducing a stronger link between bills and property value (albeit 1991 values) at either end of the scale, but without creating the large-scale turbulence of a full revaluation exercise. Approximately 2.5 million households would move into the new lower band and see their tax reduced, but the vast majority – over 85 per cent of all households – would not change bands.
- 7.59 The Valuation Office Agency advise that measures of this kind would be possible without a full revaluation, but practically challenging in some respects. For example, it would be difficult to re-band properties consistently in areas whose relative desirability had radically altered since 1991, and it would be necessary to decide how to take account of improvements made to properties since 1993. There are also drawbacks to a method which does not allow those properties which, at revaluation, would have moved down into band A, or up into band H, to do so. Ultimately it may be better to implement reform alongside revaluation.
- 7.60 None the less, even an imperfect reform of this kind would be expected to increase the overall progressiveness of council tax to property value at either end. This would increase bills for some households, and reduce them for others, including for many low-income households in band A. Since many of those households receive full or partial CTB, some of the reduction in bills would translate into reduced costs in the CTB bill for government. It is estimated that adding new bands in this way could reduce total CTB costs by around £110 million (assuming full take-up).
- Widening the band ratios** 7.61 Another alternative would be to leave the band structure unchanged, but alter the ratios applied to each band. This would effectively redistribute the tax burden by requiring the higher bands to pay more, and the lower bands less than now as a proportion of band D bills.
- 7.62 Widening the band ratios would have the advantage of reforming council tax to strengthen the link between bills and property values, without any properties having to move bands. Reform would therefore be possible without revaluation of any kind, if it were decided that this was the best way forward in the short term.
- 7.63 Again, this would be expected to reduce council tax bills (before CTB) for a large number of low-income households. As before, part of that saving would accrue to the Government through reductions in the costs of paying CTB to those households. Total CTB costs could be reduced by up to £570 million, based on the band ratios in the options modelled and full take-up of CTB.
- 7.64 However, this would be a significant reform affecting bills for nearly all households, albeit without their having to change bands. It would therefore only be attractive in the context of a wider commitment to fairer, or at least more progressive, property taxes in relation to value.
- Point value property tax** 7.65 Finally, I said in my Interim report in 2005 that I was interested in looking at the experience of other parts of the UK and international examples of different local taxes.¹⁶ In that context I have considered what the impact might be of eventually replacing council tax with a so-called ‘point value tax’, under which bills would be based on a set percentage of property value each year.

¹⁶ Lyons Inquiry into Local Government, *Consultation Paper and Interim Report*, 2005.

7.66 Property taxes in many other jurisdictions are directly related to property value in this way. For example, Northern Ireland's domestic rates are to be replaced by a point value tax this year, with bills based on capital value as determined by the Valuation and Lands Agency. The Northern Ireland context is of course very different to that in England, and decisions about local taxes there are entirely separate from decisions about reform in England. It is, however, an interesting example of a property tax very different to council tax. Many US states also operate 'real' property taxes, based on annually updated capital values.

7.67 Analysis by the Inquiry shows that based on 2005 values (the most recent detailed data available to the Inquiry), a point value tax would need to be levied at approximately 0.64 per cent of capital value in order to raise the same amount as council tax (before CTB). More households would gain than would lose under this reform option, with almost 60 per cent of households paying at least £1 per week less than now. Around 40 per cent would pay at least £3 per week (or £156 per year) less than now. However more than a quarter of all households would pay at least £1 per week more than now, and around 18 per cent would pay more than £3 per week more than now.

7.68 A point value tax has some theoretical attractions in the longer term. As Sir Peter Burt's Committee noted last year, a tax of this kind would have the potential to act as a more effective stabiliser of the property market than council tax.¹⁷ If properties were regularly revalued, it could even be a source of buoyant revenue for local government, as yield from a particular multiplier would rise (or fall) with house prices, and embed incentives for local authorities to invest in the desirability of their area for residents, in terms of the service quality and wider well-being which can be reflected in property prices.

7.69 Applying a fixed multiplier to property value would be the logical extension of the idea that fair property taxes should not tax expensive homes more lightly than cheaper ones. It would also result in significantly greater progressiveness in relation to income, though a point value property tax would remain regressive overall before benefits are taken into account. Compared with the current system, this would significantly reduce the costs of council tax benefit. Analysis by the Inquiry suggests that a point value tax might reduce the average burden of tax as a proportion of income for the poorest by around 15 per cent, and so could also reduce total CTB costs by up to £1 billion (assuming full take up).

7.70 However, this would be a radical change and could not be contemplated in the short term, or until such time as public support for such reform could be established. There is also a tension between on the one hand achieving a perfect relationship between tax and property value, and on the other allowing for local variability, which is an important part of the system at present. In light of these drawbacks, I am not recommending point value tax as a replacement for council tax, but it remains a viable option for future governments.

Weighing the case for reform

It must be considered that there is nothing more difficult to carry out, nor more doubtful of success, nor more dangerous to handle, than to initiate a new order of things. For the reformer has enemies in all those who profit by the old order, and only lukewarm defenders in all those who would profit by the new order. (Niccolo Machiavelli)¹⁸

¹⁷ Local Government Finance Review Committee, Scotland, *A Fairer Way*, 2006.

¹⁸ Machiavelli, N., *The Prince*, 1513, with thanks to Peter Watt, University of Birmingham.

- Winners and losers** 7.71 My work on options for reform of council tax further exposes that there is no ‘golden key’ that will make it a perfect tax, or universally accepted as fair. There are advantages to reforming the property tax element of council tax, but these must be weighed against its drawbacks, not least that any redistribution of the tax burden inevitably creates ‘winners and losers’.
- Impact on local tax bases** 7.72 Reforming the property element of council tax also has implications for local authorities’ tax-raising capacity. The current council tax bands limit the amount that bills can vary by compressing properties towards band D, rather than reflecting the full range and variability of house prices within and between areas. If local taxes more closely reflected real property values, and the relative desirability of areas, this would mean that the grant system might have to work much harder to equalise for the differences between authorities’ local tax-raising capacity. The extent of this impact would, however, vary over time, as relative property prices between regions may diverge at some times and converge at others. The extent to which reform made tax bases more variable would partly depend on the point in the housing cycle at which revaluation took place.
- 7.73 Some authorities might also find that their tax bases shrink after reform, shifting their balance of funding towards greater dependence on central revenues. The government would therefore want to consider the implications of reform for authorities, while recognising that reform might still be justified in terms of its impact on taxpayers.
- Ability to pay, and CTB costs** 7.74 There are arguments in favour of some reform of the current design of council tax, in the medium term. Reform of the property tax element can help make council tax less regressive to income, though it would still be regressive overall, before benefits. Such reforms are particularly successful in reducing the burden on many low-income households, creating consequent savings in council tax benefit. The Government would have to decide how to spend any such savings, but they could help contribute to the long-term sustainability of council tax and CTB, for instance if used to strengthen the ability of council tax benefit to reach those paying a high proportion of their income in tax.
- ‘Fair’ property taxes** 7.75 Strengthening the link between property value and tax can also be justified in its own right. Some submissions to the Inquiry express fairness not just in terms of income but also in relation to property value.
- Council tax is not even a fair property tax. It was oversimplified... this ensures that the richest people in the biggest houses pay proportionately much less.* (Bristol Older People’s Forum)
- 7.76 There is a case for altering the bands in recognition of the fact that the present, very compressed, bands impose a lower effective rate of tax on expensive homes than on cheaper ones, not least with a view to the potential for property taxes to stabilise house prices in theory, as discussed in Chapter 6. I do not have detailed evidence on which to judge the likely macroeconomic impact of the reforms outlined above. However, it is clear that the current design of council tax does not lend itself to acting as a stabiliser of property prices, and that reform could in theory improve it in this respect.
- 7.77 In particular, reform should recognise that the current band structure is the product of judgement rather than natural law. The floor and ceiling on current eligibility are the products of a series of choices in the early 1990s, and might reasonably be revisited now. Adjusting the relationship between bills and value at either end of the scale would go some way to capturing the benefits outlined above.

Recommendation 7.1

Council Tax should be retained as a source of revenue for local government. The option of change in the longer term to shift the balance towards other taxes and charges remains open.

Recommendation 7.2

While not the most urgent priority, the Government should conduct a revaluation of all domestic properties for council tax. Transitional arrangements to ensure households do not face steep tax increases from one year to the next should be considered at the point of revaluation.

Recommendation 7.3

Subsequent revaluations should take place regularly and automatically at intervals of no more than five years.

Recommendation 7.4

At the revaluation the Government should introduce new property bands at the top and bottom of the current structure. It could also consider the introduction of separate bands for Inner London to reflect the unique shape of the property market in that region and to reduce turbulence there.

The fairness of a service charge

7.78 While income or ability to pay is often the focus of discussions around council tax fairness, other submissions to the Inquiry have focused on the fairness of charging occupiers of property, based on their status as service users. Council tax liability currently applies mainly to occupiers rather than owners, partly reflecting its roots in the community charge, under which all residents of an area were asked to make a contribution to the funding of local services. For some, fairness means paying according to the benefits received from services, perhaps on an individual rather than household basis.

What do you get for it? I have lived in London ten years and it has gone up by about 200 per cent. In ten years there hasn't been a 200 per cent increase in services... that is the thing that I think is unfair. (Focus group participant)¹⁹

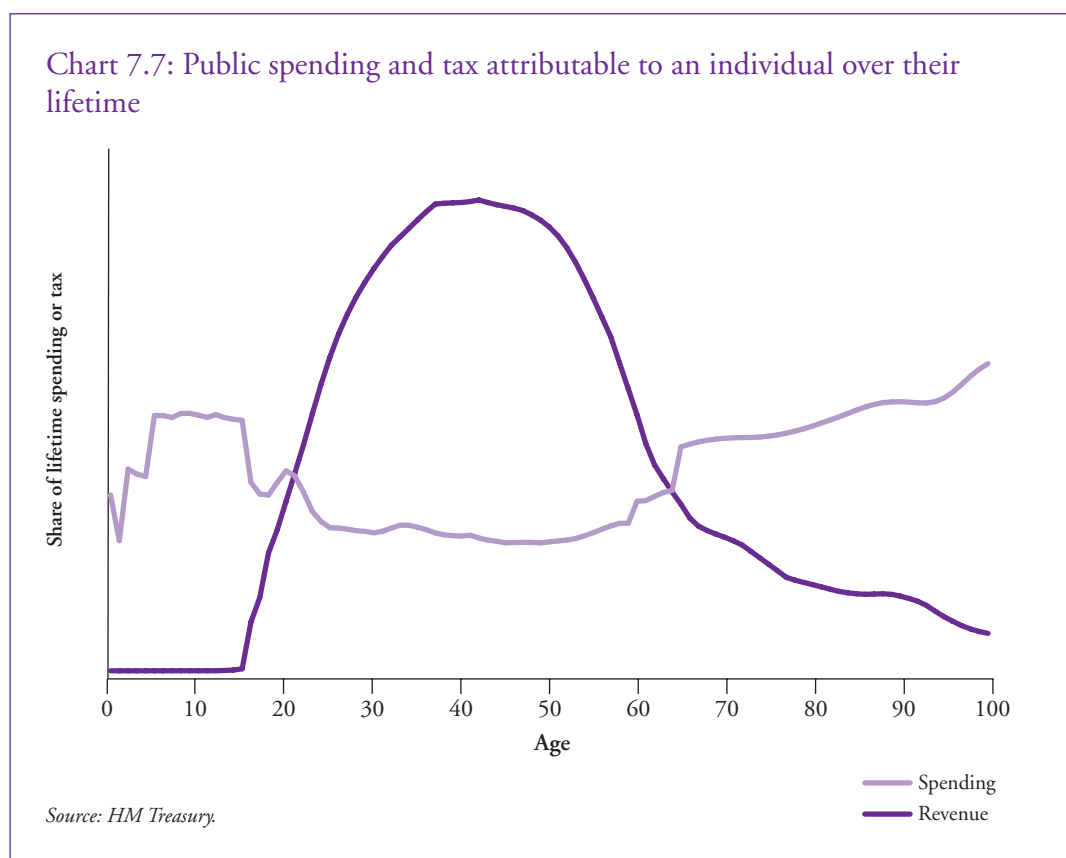
[An] anomaly exists where a household of two old aged pensioners have to provide say £600 per head to pay Council Tax of £1,200 and the household next door which is occupied by four tax payers who only have to provide £300 per head to fund Council Tax of £1,200. (T.R. Troughton)

7.79 It appears that the emphasis on the service-charge element of the council tax may have contributed to the expectations people have of a very direct return on their payment for local services. When we pay VAT, or even income tax, we are aware that we are contributing to the pool of 'general taxation'. We do not calculate the fairness of our VAT payments (if we are aware of them) in terms of how many times we have used the local hospital that year, nor do we expect to pay more income tax during the years when our children are at school. Council tax, on the other hand, is often described as unfair to those who do not make heavy use of local services.

¹⁹ GfK NOP Social Research, Qualitative Research on Public Attitudes to Taxation and Public Services, 2005, Lyons Inquiry.

7.80 In practice, an expectation of a direct return from local services is unrealistic. For example, local government provides social and care services which are by nature likely to directly benefit a particular group of people, with many of the benefits to the wider community being indirect. There is perhaps a need for a more open debate about how we fund such services, so that people’s expectations of what local government provides, and what council tax pays for, can be more realistic.

7.81 It is worth noting that the balance between the tax people pay and the services they use will vary over time. Chart 7.7 below shows how, on average, people consume most services when they are young and when they are old, and pay most tax during their working lives. So, while council tax functions partly as a service charge, it is clear that not every taxpayer will use services in proportion to their payment every year – if they did, then all services could be provided simply by charging at the point of use.



7.82 In practice, public services are more complex than that sort of simple transaction; the costs of services extend beyond the product ‘used’ on the day to include longer-term investment in provision, often with large overheads that do not obviously relate to individual service users. By providing services through taxation, we must accept a degree of shared responsibility for financing them as distinct from our personal use of those services. In my view, it is important to be clear that this holds true for local services financed partly by council tax as much as for national services financed by other taxes.

7.83 Different kinds of ‘service charge’ also speak to different sorts of fairness. For example, pure service charges might mean direct payments in proportion to the services used by each individual. The community charge is often discussed in the language of a service charge, because it represented a shift away from a local tax on households towards one on adult individuals, thus reflecting an assumption about per-head service use. However this made it a broadly flat universal charge, rather

than one which varied according to the actual amount of services consumed by each person. These complexities show that taxes introduced as service charges, like property taxes (and indeed most other forms of tax), are subject to some debate about how ‘fairness’ ought to be defined.

7.84 I believe it is right that council tax should continue in the short to medium term to incorporate elements of both a property tax and a service charge. The service charge element of council tax is well understood by the public, and reflects an important link between residence in an area and a household’s interest in local services and local prosperity. However, retaining a hybrid model, which also reflects the different value of people’s homes, ensures that the service charge element is balanced by a reflection of households’ different circumstances. A move towards local taxes based solely on service use would not address concerns about fairness in relation to ability to pay, and might in fact worsen them.

7.85 Nonetheless, there is room for a debate about the balance between taxes and user charges in paying for local public services. Charges already operate across a wide range of services, from parking to social care. Local authorities already make decisions about whether council tax increases or charges are the best outlet for a spending pressure, particularly at a time when the ability to increase council tax is restricted by capping. I will return to the issue of charging later in this chapter, and consider how charges can be used alongside local taxes to spread the costs of services in a way that is perceived as fair.

Fairness to older people

7.86 Submissions to my Inquiry, and other evidence, suggest that there is particular concern about the impact of council tax on pensioners, linked particularly to concerns about the council tax burden on households who are asset-rich but income-poor. Many retired and older people wrote to the Inquiry, often expressing deep concerns about the impact of council tax on them, and about the likely impact of tax increases in the future.

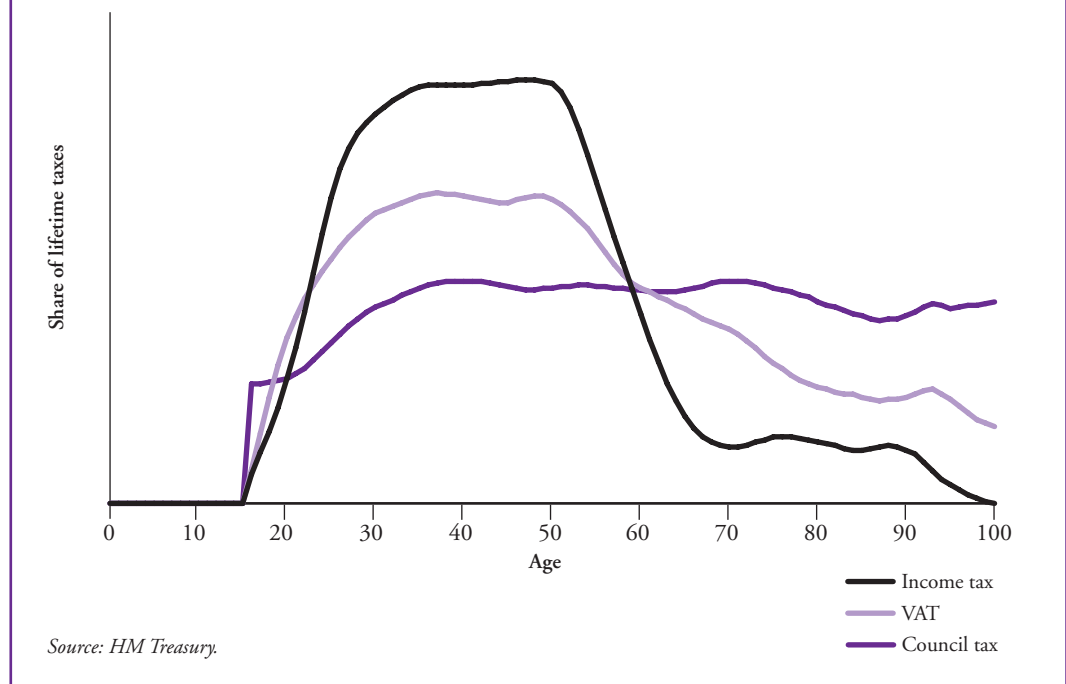
Many older people inhabit homes which might have been in their family for, in some cases, generations. These homes do not necessarily reflect their present circumstances, but there is no need for them to move, other than the cost of “running” that home. Therefore, relating local taxation to size of home is unfair. (Mr M Napier)

7.87 Concerns about fairness to older people are perceived by many as central to the council tax debate. In surveys conducted for the Inquiry, three quarters of all respondents agreed that the elderly should automatically pay less council tax even if they own a property without a mortgage. There was substantial though lower support for the idea that elderly people should pay less even if they have a lot of savings, pensions or investments. However, up to a quarter of respondents thought it would be unfair for other households to pay more to relieve the burden on pensioners or retired people, expressing concern that working people should not have to pay more tax, or suggesting that a degree of means-testing would be fairer.

7.88 These issues speak to our wider expectations about the tax we will pay and the benefit we will take from public services over our lifetimes. Survey respondents prepared to pay more so that pensioners paid less were likely to cite the fact that older people “have paid into the system and are entitled to help”.²⁰ As shown above, it is already true that on average, people are net beneficiaries of public services when they are older (and when they are young), and net contributors during their working lives. Older people benefit substantially from public expenditure, and overall pay less tax as they get older. Chart 7.8 shows that council tax is, however, an exception to this rule, with most people continuing to be liable for the same council tax (before benefits) in retirement as when they worked. Nonetheless the overall picture is one of declining tax contributions into old age.

²⁰ BMG Research, Lyons Inquiry Survey, 2007.

Chart 7.8: Income tax, VAT and council tax attributable to an individual over their lifetime



7.89 One of the tensions facing the Government in reforming local taxation is addressing people's concerns about the unfairness of council tax to older people, within a tax system that already puts much of the burden of taxation on working-age taxpayers. With an ageing population, transferring the burden of council tax towards younger households might become unaffordable in the future. I will explore these issues further in looking at the role of council tax benefit, and the arguments around a local income tax.

Council tax liability: ownership, occupation, discounts and exemptions

7.90 My view is that it is right in principle that all residents of an area should contribute in some way to the cost of local services (though I recognise that council tax benefit meets up to 100 per cent of some households' bills in practice). I am however interested in whether the tax system can also reflect the fact that non-resident property owners have a stake in the desirability and wellbeing of an area, and will benefit from place-shaping and local services which contribute to the value of their property. It is interesting that some other countries levy separate taxes on occupation and ownership; for example, in France the occupier of a property pays a locally-set "taxe d'habitation", while the owner pays a separate tax based on the value of their property and land, which is assessed annually.

7.91 Council tax effectively combines these elements in one hybrid tax, so that liability falls either to the owner or the occupier. In the case of rented accommodation, tenants will generally pay council tax, with liability reverting to the landlord if the property is empty. While I am not making a general recommendation in this area, a number of submissions to the Inquiry have suggested that the Government might look again at the tax liability of particular groups of owners and occupiers, particularly students, owners of properties let to students, and second home-owners.

Students' exemption from council tax 7.92 Full-time students are currently exempt from paying council tax for the duration of their course of study. Some submissions to the Inquiry have questioned whether this exemption is fair, given that students are likely to make substantial use of local services but do not currently make a contribution to the costs of providing them.

7.93 Some submissions have also raised wider concerns about the impact on communities of having a high concentration of student accommodation.

Every student conversion brings with it increased costs to refuse collections, street cleaning and the administration of residents parking schemes. All of these costs are paid for by the remaining council tax payers. It is a source of massive grievance and aggravation as well as of financial loss to the local authority. (Alan Simpson MP)

7.94 However other submissions, including from the National Union of Students, have argued for the retention of the exemption, pointing out that unlike other households, students are not usually eligible for benefits and so could not claim CTB.

7.95 There might be a case for bringing students into liability for council tax, reflecting their interest in local services and their stake in the community. However, such a move would need to be accompanied by making council tax benefit available to students on low incomes. A large proportion of the student population would be likely to be eligible for CTB, and processing their claims would be a significant addition to local authorities' CTB caseload in some areas.

7.96 I am attracted to the principle that students should make some financial contribution to the services provided in the area in which they study. However, on balance I am not convinced that the benefits of bringing students into the council tax and CTB system would be enough to outweigh the administrative costs involved. I therefore am not recommending a change to the student exemption.

7.97 Another possibility might be that liability for council tax should revert to the landlord when all tenants are exempt students. At present, the student exemption covers the dwelling itself, so the landlord does not become liable to pay tax. I am attracted in principle to the idea that owners of such properties, which in some areas represent a large section of the total community, might make a contribution to the costs of services in those areas. However, in practice this would put treatment of student landlords out of line with that of other landlords, and might have perverse consequences, potentially driving up rents or creating disincentives to let to students. I am therefore not recommending a change to the student exemption, but have looked for other ways that the impact of highly concentrated student populations might be reflected through the local government finance system.

Student populations and local tax base numbers 7.98 Formula grant to local authorities reflects, among other things, the number of council tax-paying households in the area in a given year (the tax base). Authorities submit information on tax base to the department for Communities and Local Government (CLG), including the number of households subject to discounts or exemptions, providing a snapshot of the tax base on a given day once a year.

7.99 At present the timing of the grants settlement means that a snapshot is taken in September. For authorities with student populations beginning courses at that time, many student households may not yet have registered for an exemption, meaning that authorities may overestimate their tax base in the data they provide to CLG. In some cases authorities may therefore receive a lower grant settlement than would have been the case had the snapshot been taken at a different time of year, possibly leaving some of the costs associated with student populations to fall on council tax.²¹

7.100 I recommend that the system be adapted to allow authorities to submit more realistic data on student numbers to inform the grant settlement. This could be done either by taking a snapshot of student numbers on a different date (for example, six months earlier) or by submitting data based on outturn figures from the previous year. Data submitted in 2007 will be particularly important as they will inform grant settlements for three years going forward. The Government should seek to resolve this issue before then.

Recommendation 7.5

The Government should ensure the grant system reflects realistic data on the number of student households exempt from council tax in their areas. This should be done in time to inform the forthcoming negotiations on three-year settlements.

Second homes 7.101 Other submissions to my Inquiry have raised questions about the tax treatment of second homes, particularly in rural communities. At present, second homes are eligible for a discount on their council tax of up to 50 per cent, although since 2002 billing authorities have had the power to reduce the discount in their areas to a minimum of 10 per cent and locally retain any revenues over the 50 per cent amount.

7.102 The availability of a discount for second homes is based in the service charge element of council tax, and reflects their assumed lower consumption of local services. However the new flexibility indicates that the discount can also be seen in the wider context of local authorities' place-shaping role, and the fact that second homes can have a variable impact on local communities, particularly where they represent a large proportion of the total housing stock.

7.103 The report of Elinor Goodman's Affordable Rural Housing Commission last year suggested I consider whether local authorities should have the power to levy a 'second homes impact tax', particularly in areas in which the concentration of second homes had become "disproportionate".²² I am attracted to the idea that in their place-shaping role local authorities should have the power to decide whether any discount should be available, and indeed whether a supplementary levy might be an appropriate way of coping with high-concentrations of second homes in their areas, which may have implications for community cohesion and prosperity.

7.104 I am aware however that there may be some practical barriers to implementing such a power. At present, second home-owners identify themselves to councils to register for a discount – if that discount were removed, or a supplementary tax imposed, their incentives to do so would be weak. This in turn might make it harder to identify the part of any revenues that should be locally retained. Nonetheless, if local solutions could be found to this problem, greater flexibility over tax rates for second homes could be a valuable policy tool for rural and some other communities, and I would urge the Government to consult local authorities on these issues.

²¹ The relationship between student numbers and grant levels is not a straightforward one: final settlements will be affected by a range of relative needs and resource measures, and any 'floors' applied to grant increases. See Annex A for full details on the grant system. However the numbers of exempt households is a component of authorities' grant allocations.

²² Defra, *Affordable Rural Housing Commission – final report*, 2006.

Symbolic contributions for all local residents

7.105 It has been suggested to me that council tax benefit might be adjusted so that no household receives 100 per cent relief against their tax bill. Advocates of this idea argue that it would ensure that every household makes at least a symbolic contribution to the cost of local services, and might create stronger democratic pressure for low council tax and efficient services by avoiding there being a constituency of people unaffected by rate increases.

Everyone in the community should pay [the] local tax... This would mean everyone has an interest in how efficiently the community is run. So when someone drops some litter they cannot only say, "someone is paid to pick it up" but also "and I help to pay his wages". (Mr A Coulthurst)

7.106 I am attracted to this idea for its accountability benefits, and on the principled basis that all citizens have a stake in the community that might properly be reflected in local taxes. The same argument might equally apply to groups currently exempt from council tax, such as students. However, I am concerned that the costs of collecting small amounts of council tax from households currently receiving full CTB – and of prosecuting non-payment of those small amounts – might outweigh the benefits of its collection. I would also be concerned that such a move should not lead to an unfair burden on the very poorest households. I am therefore not recommending it.

Not broken but overloaded

7.107 This chapter has outlined a range of options for reform of the way council tax is designed, particularly with a view to addressing the perceived fairness of the tax. Any reform carries significant difficulties and redistributing the tax burden inevitably creates winners and losers. However the prize, if reform were successful, might be a tax that is more widely perceived as broadly fair, and potentially a better property tax. I will go on to explore the role of council tax benefit in achieving the link to income that is clearly crucial to perceptions of fairness.

7.108 However, as outlined at the beginning of this chapter, the sustainability of council tax also depends not just on its inherent fairness as a tax, but on its relationship with the rest of the local government finance system. I have argued that giving local authorities the tools to manage pressures more effectively is a key element of addressing the rate of increase in council tax.

Better management of pressures to contain council tax increases

7.109 I have suggested that the key to controlling the rate of increase in council tax bills is equipping local authorities to better manage spending pressures. Doing so will require central and local government to promote more realistic public expectations of local services, engaging with the public on making realistic trade-offs between the services people want and the taxes or charges they are willing to pay. I have also argued that management of pressures would be facilitated by more transparent financial settlements from central government, which most of all fully fund those mandates which are central government priorities, both to avoid unfunded burdens on local authorities and to incentivise a more mature relationship between central and local government.

7.110 Above all it is my view that the solution to the rate of increase in council tax lies not in constraining local authorities' powers to raise revenue, for example through capping, but in providing real flexibility to set spending plans in a way that reflects local choice about service provision and tax rates. Chapter 4 set out a range of recommendations to increase local authorities' financial flexibility, by reducing ring-fencing and making room for reprioritisation within budgets, to enable authorities to pursue not just managerial efficiencies but a more efficient use of public funds across their service responsibilities by tailoring spending plans to local preferences and circumstances.

7.111 A further dimension to these concerns about council tax relates to its overall size, and the type and proportion of local services it is asked to support. Many council taxpayers perceive the tax primarily as a charge for services, with their views on ‘value for money’ in council tax informed by the perceived benefit they take from those services. There is evidence to suggest that people are most conscious – and accepting – of local spending on services which visibly relate to their property or the physical area such as waste collection, parks, street cleaning and physical regeneration.

7.112 This is not unique to England; for example a recent study of attitudes to local property taxes in New Zealand showed that people see services such as waste collection and town planning as essentials which should be paid for by local ratepayers, but place social services, and arts and cultural services in the category of “luxuries” which should not be paid for through local rates.²³

7.113 It appears that property taxes in particular may hit an ‘acceptability threshold’ beyond which they generate public resistance. The high visibility of property taxes, perhaps combined with their overall regressiveness to income, may make it difficult for property taxes to support very ambitious spending programmes, particularly where tax increases are not perceived to deliver benefits in the most visible service areas or those of direct benefit to residents, and homeowners in particular.²⁴ The threshold of acceptability may not be a fixed cash amount, so much as the point beyond which service improvements are not perceived to have significant benefits to local property.

7.114 This has implications for the way in which pressures impact on council tax and its public perception. For example, it may be right that pressures on waste services are met by council taxpayers, since most households make use of, and contribute to the cost of running waste services. By contrast, social care services are used by a minority of local citizens, making pressures on, or improvements to those services, less visible to taxpayers.

7.115 In this context, I have considered the options for reducing the overall size of council tax as a source of revenue, either through a one-off measure (by increasing funding from another source) or over time (by introducing greater buoyancy into another element of local revenues). I will explore in this chapter whether a local income tax might be an attractive option for introducing natural buoyancy to local revenues, or as an alternative source of revenue for local authorities. In Chapter 9 I will consider a range of wider options for ensuring the contribution made by central government to funding local services is sustainable.

Conclusions

7.116 It is my judgement that council tax is not broken, and remains a broadly sound tax. Council tax benefit is, in my view the key to ensuring the burden of council tax on the lowest-income households is appropriately reduced. If fully taken up, CTB can have a substantial impact on ‘fairness’ in terms of the link between council tax and ability to pay. I will look at the current impact of CTB in practice, and whether reforms in that area may be called for.

7.117 The rate of increase in council tax has placed a growing burden on many households and could put at risk the sustainability of council tax in the long term. Capping of local authority budgets fails to address the underlying causes of high tax increases. I suggest in Chapter 3 that council tax tends to bear the strain of pressures in the whole local government finance system. Its acceptability therefore rests not just on the way council tax is designed, but on whether service expectations can be managed and met in a way that does not continue to put council tax under unsustainable pressure.

²³ Commissioned by Local Government New Zealand, *Improving the Reputation of Local Government a survey of Perceptions of Rates*, 2006.

²⁴ Fischel, W *The Homevoter Hypothesis* 2001.

7.118 Reform of council tax, and council tax benefit, are a key part of the picture and should be the priority in the short term. There are also wider possibilities for change in the future. In that light I will look further at whether, in the medium term, other taxes and charges including a local income tax, or assigned national taxes, could be an alternative or additional source of revenue for local authorities. I will also consider the interaction between local taxes and central government support for services, which is important in understanding how pressures on council tax might best be managed in future

7.119 While council tax is broadly sound, reform of its structure could be desirable in order that the relationship between bills and property value be brought out more strongly, and to deliver some greater progressiveness to income. In the medium term, revaluation combined with reform to add extra bands at the top and bottom would remove the distorting effect of the current ceiling on council tax, as well as reducing bills for many low-income households and cutting the overall cost of CTB.

COUNCIL TAX BENEFIT

7.120 As shown above, my analysis suggests that while council tax could be reformed to make it a better property tax, it is the nature of the relationship between property and income in England that no property tax could deliver a close enough relationship between bills and household income to satisfy those most concerned with income as a measure of ability to pay. This does not, in my view, mean that council tax is ‘broken’: however, it does suggest that a mechanism for dealing with inability to pay for those on the lowest incomes is important for the perceived “fairness” and therefore the continued acceptability of the tax.

The key to fairness? 7.121 Council tax benefit (CTB) has been designed specifically for this purpose, and if council tax is retained, I believe that reform and more effective delivery of CTB is the key to dealing with council tax ‘unfairness’ for the poorest households.

Council tax benefit

Council tax benefit is available to some households on low incomes, and may cover all or part of their council tax bill. It is administered by local authorities, but can also be accessed through agencies including the Pension Service.

Eligibility for CTB depends on the circumstances of each household, and takes into account:

- household income including earnings, occupational pensions and some benefits and tax credits;
- income from savings above £6,000 (the lower capital limit); and
- the composition of the household (for example eligibility thresholds are different for lone parents, pensioners and other groups, in line with other parts of the benefit system such as Income Support and Pension Credit).

Savings above £16,000 (the upper capital limit) mean that a household will not usually be eligible for CTB.

Rebate, not benefit 7.122 It has been suggested to me, including by the IsItfair? campaign group, that a tax which must be accompanied by a benefit must be flawed. I disagree; there is no difference in principle between a tax against which a benefit is paid in certain circumstances, and a tax against which rebates or discounts are available. I tend to agree with those who argue that it is particularly the term ‘benefit’ which is unwelcome to some taxpayers, with the result that CTB is perceived differently to the single person discount, for example. The term has a particular resonance which may prevent some people (many of whom might be sure to claim an income tax rebate owed by the Inland Revenue) from taking up their entitlements. Similar issues have also been identified by a joint working group on council tax benefit in Wales. A paper shared with the Inquiry by the Welsh Assembly Government observes that among other barriers to claiming CTB, “pensioners were sometimes averse to claiming because of pride – ‘I’ve never claimed benefits in my life and I’m not about to start now’.”

7.123 It is noteworthy that take-up of the rebate available against the old domestic rates was higher than that for council tax benefit, at around 75 per cent. Pensioners were then the group most likely to claim, with take-up rates at around 90 per cent.²⁵ It is possible that among other things, the rebranding of what had been a rebate as a benefit has impacted on its ability to reach certain groups.

7.124 I am strongly of the view that CTB’s primary purpose is not to provide income support per se, but rather to adjust each household’s liability for council tax according to their ability to pay. In that light, I suggest that the Government should address the perception problem around CTB by explicitly recognising it as a rebate, and re-naming it ‘Council Tax Rebate’, to reflect its unique place within the tax and welfare system.

Recommendation 7.6

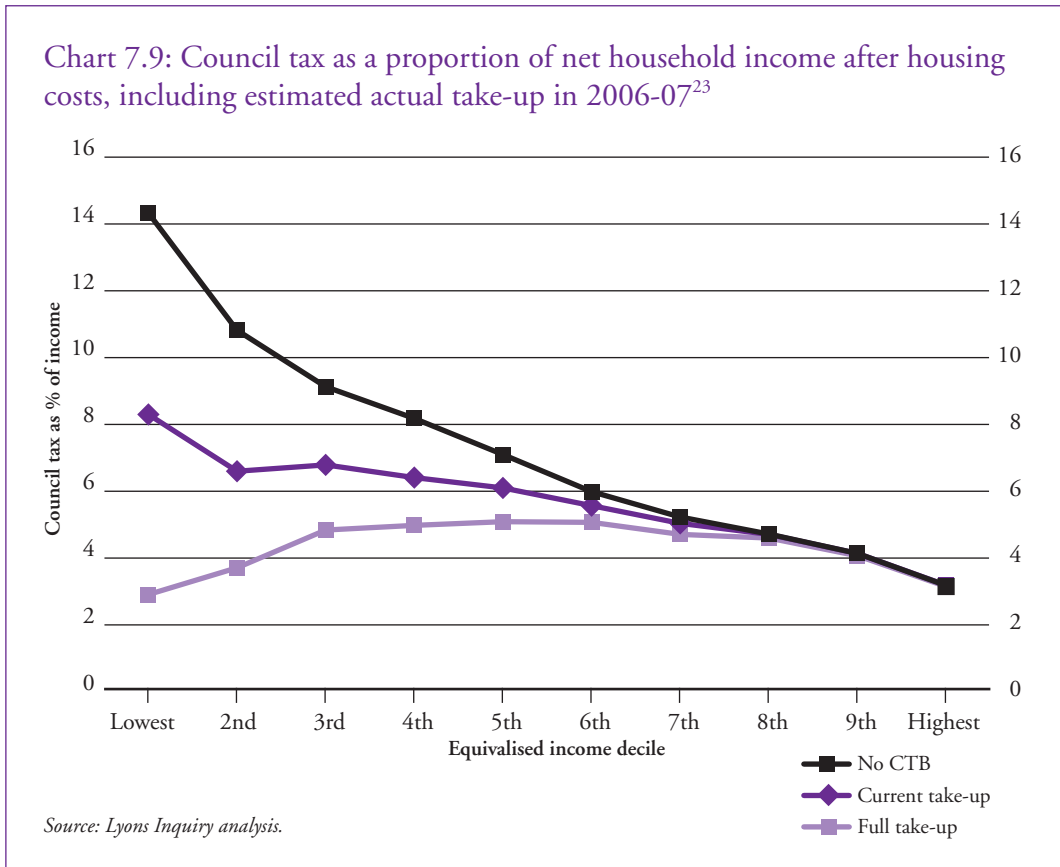
Council tax benefit should be recognised as a rebate rather than a benefit, and re-named ‘council tax rebate’, to properly reflect its main purpose: adjusting households’ liability to council tax.

Take up of council tax rebates

7.125 I believe that renaming CTB is justified in its own right, given the particular links between council tax benefit and council tax, which already give it a somewhat different purpose to other income-related benefits. However renaming CTB is not purely a question of presentation, but implies a wider recognition that steps should be taken to ensure rebates reach those households who are entitled to them. Ideally, CTB would therefore be renamed alongside the announcement of measures to improve take-up and delivery of entitlements.

7.126 Chart 7.9 demonstrates that council tax rebates have the potential to fulfil what is, in my view, their main aim: alleviating the burden of council tax for low income households. If current entitlement to rebates were fully taken up, council tax would be progressive to income overall for the poorest households. However this graph also shows that CTB is not yet fully achieving that aim in practice, because not all entitlement is being claimed. In particular, for the poorest ten per cent of households council tax remains a large average burden relative to income.

²⁵ HMSO, *Local Government Finance: Report of the Committee of Inquiry*, 1976.



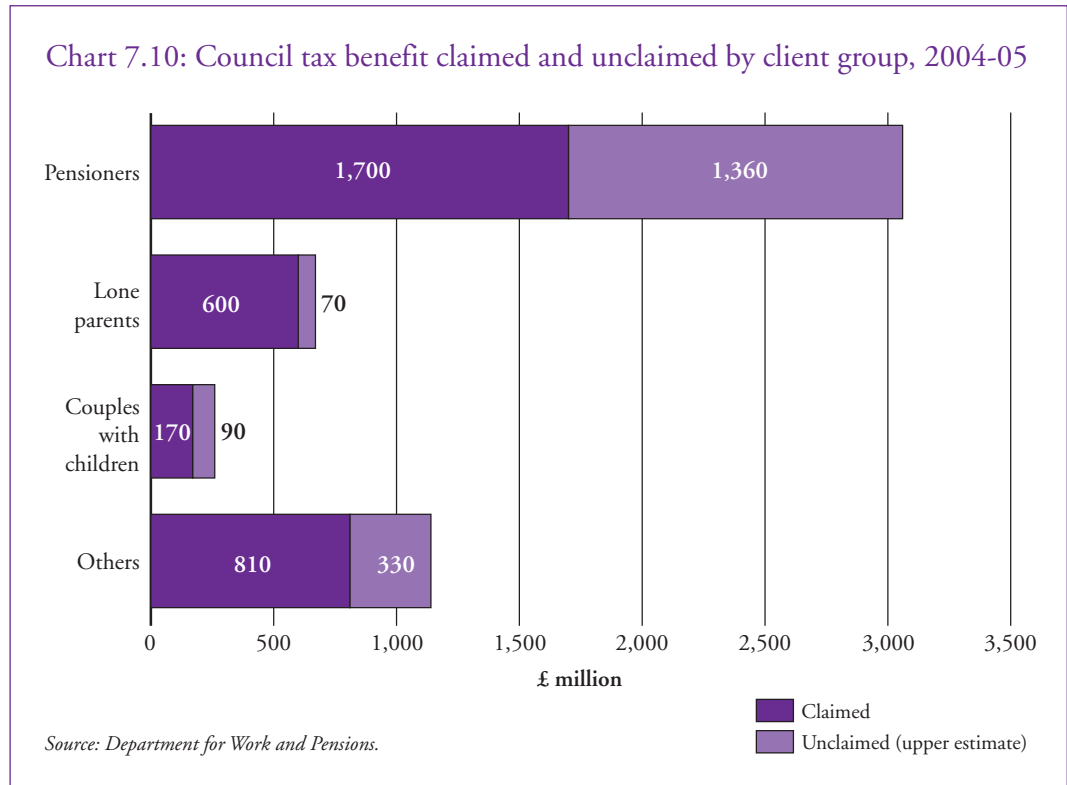
7.127 CTB is the means-tested benefit with the highest number of claimants, but the lowest level of take-up. Overall take-up of CTB in 2004-05 was between 62-68 per cent, and has been falling in recent years, down 8-10 percentage points since 1997.²⁶

7.128 Take-up is lower than average among pensioner households at 53-58 per cent, which represents an 11 percentage point drop since 1997. The National Audit Office has estimated that a ten per cent increase in pensioner take-up of CTB would lift approximately 47,000 pensioners out of poverty. Crucially, it appears that most of the money unclaimed is owed to pensioners; the Department for Work and Pensions (DWP) estimate that up to £1.36 billion in CTB entitlement is left unclaimed by older people each year.²⁷

²⁶ Estimates of current take-up are based on latest published figures (which relate to the year 2004-05) as against income and council tax data for 2006-07.

²⁷ Department for Work and Pensions, *Income Related Benefits, Estimates of Take-Up in 2004/2005* (table 4.2), 2006. Take-up figures shown here relate to caseload, not expenditure. Decreases in headline take-up partly reflect the fact that some recent policy changes have increased the number of eligible households, not all of whom have claimed, which reduces headline take-up. Even after adjusting for this however, the Department for Work and Pensions estimates that overall CTB take-up has dropped by up to five percentage points since 1997.

²⁵ All figures from DWP, above.



Barriers to claiming 7.129 Low take-up has a number of causes: people may be unsure whether they are entitled to a rebate, or may have an aversion to becoming a benefit claimant. The effort involved in filling in application forms and pursuing claims is itself a barrier for many, despite efforts at simplification.

7.130 Help the Aged have done extensive work to identify the barriers to pensioners' claiming their CTB entitlements. Their work suggests that while for some older people the barrier may be aversion to benefits or uncertainty about whether they are entitled, for a significant number the barriers are more practical, and in many cases:

...the individual knows they ought to find out whether they could get council tax benefit but does not get round to actually claiming. This group may include people who have been sent the forms to fill in but who have left these languishing among other paperwork. (Help the Aged)

7.131 Help the Aged suggest that the effort involved in making a claim (filling in a 28 page form, providing proof of income, savings and other relevant information) may put older people off applying for CTB. They call for a redesign of the system so that CTB is much more proactively delivered to entitled taxpayers. Age Concern have also expressed interest in measures to make CTB delivery more automatic, including in the context of wider efforts to join up services and benefits for older people.

7.132 Local authorities administer CTB, and Government statistics show significant variation in, for instance, average time to process new claims and percentage of claims decided within 14 days. In part this will reflect local circumstances. But local authorities have also worked in many instances to improve take-up of entitlements within their communities, often as part of wider efforts to make services more joined-up and accessible. Local action in this area can make a valuable contribution to ensuring CTB is successfully delivered.

7.133 Improving take-up is not straight-forward. For example, home visits, while very effective in improving take-up in some cases, may be perceived as intrusive in others. Local action in this area

reveals some good examples of client-friendly services, which can help to ensure people receive any rebates they are eligible for. The box below gives some examples of this.

Local action to improve take-up of council tax benefit

Halton Borough Council's 'Benefits Express' is a high-tech, mobile, door-step service dealing with benefits claims which helps to greatly reduce the time it takes to apply for benefit.

The purpose of the service is to:

- reduce the time it takes to process benefits claims;
- simplify the application process for claiming benefit through face to face contact with the customer;
- make information available about other benefits to residents;
- maximise benefits up-take within the borough; and
- work with other key partners in the borough to add value to the services offered via the Benefits Express.

The Benefits Express operates as a mobile office connected to the Council's computer systems and tours the borough offering a range of services.

Since the service began in 2004, processing time for claims has reduced from an average of eight weeks to less than 48 hours for customers using the service. The service works through officers visiting customers at home, collecting all the necessary information and processing the claim on-line, thereby giving the customer an instant decision on their claim. Lengthy delays associated with dealing with customers via postal correspondence are now avoided, thereby reducing frustration for both customers and staff.

Milton Keynes Council has worked to achieve a customer-focused and friendly approach to delivery of benefits, by training staff to put customer needs first and to resolve the customer's demands at that first point of contact wherever possible. This involves the whole service being focused on customers' individual needs rather than on bulk or batch processing.

This approach has been backed up by changes within the organisation that allow the council to focus more staff on dealing with claims, and fewer on back office functions, for example by reducing unnecessary paperwork.

The council succeeded in reducing the average time for dealing with benefit claims from 63 to 25 days within a six-month period, moving from the bottom quartile to the top quartile of local authorities in the country on this measure.

7.134 In Wales, many authorities are also taking innovative steps to ensure entitlements are taken up, including a joint project by four authorities, in conjunction with their software supplier, to telephone taxpayers and proactively offer them a benefit eligibility check. Others are working with the voluntary sector to reach groups such as pensioners or ethnic minority groups, among whom take-up of council tax benefit is low. There is scope for more action at the local level in England, in particular for some authorities to learn from the experience of the best performers.

7.135 Nonetheless, with up to £1.8 billion per year in CTB entitlement going unclaimed, it is clear to me that low take-up is a systemic as well as a local issue, and as such requires a structural change in the way rebates are administered.²⁸ Local authorities will always have an important role to play in reaching their citizens and connecting them with services and other entitlements, but

²⁸ Department for Work and Pensions, *Income Related Benefits, Estimates of Take-Up in 2004/2005*, (table 4.2), 2006. Amounts unclaimed are published in ranges: estimated at £1.33 billion – £1.80 billion in 2004-05. Includes Scotland and Wales.

they cannot be solely responsible for the successful delivery of CTB; central government has a prior responsibility for getting the framework right.

A joined-up approach to delivery through the Pension Service

7.136 Some steps have already been taken to simplify the claims process and improve take-up. The Pension Service already aims to ensure that callers to its telephone line are means-tested for CTB and housing benefit alongside pension credit. Details of callers' circumstances are entered into a short form, which is then posted to the caller to sign and forward to their local authority. This removes the need for claimants to enter the same information into a separate form for CTB.

7.137 This is a welcome innovation: it avoids people having to provide the same information several times, and moves towards the kind of joined-up services that the Government is pressing for and that the public increasingly expects. Last year, over 120,000 pension credit claimants received a pre-completed CTB form from the Pension Service in this way.

7.138 However these measures do not at present simplify the claims process for up to 1.2 million pensioners who are not eligible for pension credit but are entitled to, and not claiming, CTB. At present those people cannot claim CTB via the Pension Service, since calls end at the point pension credit eligibility is ruled out. Although many of the personal details needed for a council tax benefit claim have been given during the course of the call, if no pension credit claim goes forward those details are not currently retained by the Pension Service's systems, and cannot be entered into the simplified forms for CTB.

7.139 I agree with Help the Aged that this represents a missed opportunity to deliver CTB more effectively, and I understand that the barriers to change are partly technical, and could be solved through the adaptation of the software used to log calls. In that case the Government and the Pension Service should work together to adapt their systems so that all callers can be assessed for all three benefits at once, regardless of whether they qualify for Pension Credit.

7.140 These are positive measures, which can and should be implemented in the short term. However, it is likely that while the onus remains on taxpayers to activate claims, the government will continue to face some difficulty in dramatically improving take-up. For example, of those pensioners who received a completed form from the Pension Service, around half still failed to forward their claim to their local authority for processing.

7.141 I understand that the Department for Work and Pensions is considering whether this claims process could be further simplified by The Pension Service passing CTB information directly to local authorities, instead of sending a short claim form to the taxpayer to forward. This seems a sensible step and, given that the Pension Service will have verified callers' personal details and satisfied themselves that pension credit can be paid, there seems little value in claimants having to re-sign a form to verify the same details for CTB.

Recommendation 7.7

The Government should build on recent efforts to streamline delivery of council tax rebates by adapting IT systems so that the Pension Service can act as a portal to rebates for all callers, regardless of pension credit eligibility.

Recommendation 7.8

Further improvements to the claims process should be pursued to allow the Pension Service to liaise directly with local authorities in processing rebate claims.

7.142 It is right that the Government should take steps within the current system to ensure that rebate entitlements are delivered as effectively and as fully as possible. However, given the particularly low take-up of CTB compared with other benefits, and the very significant barriers to take-up identified above, I believe there is also a need to look at a more radical overhaul of the way council tax rebates are delivered, in the medium-term.

**Automated
delivery of
entitlements**

7.143 In 2006, a joint team of DWP and local authority officials began a ‘blue skies’ project to look at the scope for automated delivery of CTB. They envisaged a model in which government agencies would share data, including some currently held by HM Revenue and Customs, to assess households’ eligibility for CTB and initiate claims on that basis. Instead of individuals being required actively to apply for benefits, they would be asked to verify their assessed details after which benefits would be paid. Requirements to provide proof of circumstances would be minimised through a risk-based approach to claims, so that full verification would only be carried out where people were on the borderline of eligibility, or there was greater uncertainty about their status.

7.144 DWP officials are now working on a project with the Pension Service to consider the possibilities for gathering data and using it in CTB, pension credit and housing benefit claims processes. The ultimate extension of this approach would be that in theory households could be billed for council tax net of any rebate entitlement, but with a responsibility to inform the Government if the details on which it was calculated were incorrect.

7.145 More automatic delivery of entitlements would not be without risk. More streamlined checks of people’s status as claimants might expose the Government to some increased risk of fraud, including if similar processes were applied more widely than to council tax benefit alone, for example to housing benefit. The Government would want to weigh these risks carefully given its responsibility for ensuring benefit fraud is not tolerated.

7.146 Nonetheless, there is a balance to be struck between concerns about preventing fraud, and equally valid concerns about the system failing genuinely entitled households. The current system appears to favour 100 per cent precision over easy accessibility for taxpayers, which may be the wrong balance to strike in the case of CTB, given its importance for the sustainability of council tax. An automated and risk-based system would be more user-friendly, and though a risk-based approach might allow for error in some cases, it would help to achieve the step-change in take-up that is in my view necessary for council tax rebates to successfully underpin a local property tax.

7.147 I strongly endorse the direction of this early work on automation, and urge the Government to pursue it as a matter of urgency. I recognise that this would also represent a philosophical change in the Government’s treatment of CTB. Instead of it being an elective benefit with the onus on the claimant (as is appropriate in other benefits such as Jobseekers’ Allowance) CTB would become an automatic entitlement. I believe that this shift is justified and necessary: as an elective benefit CTB is currently failing to reach a large number of entitled people, which undermines the perceived fairness of council tax itself.

7.148 Increasing take-up in this way would also not be without costs to the Government. The amounts currently unclaimed are large (up to £1.8 billion in 2004-05) and additional money spent on increased CTB take-up would clearly reduce the amount of money available to spend elsewhere. Nonetheless, I am clear that the success of the system of council tax rebates – and particularly its success in reaching entitled pensioners – is critical to the sustainability of council tax, and should be considered a priority.

Recommendation 7.9

Ministers should examine the scope for data sharing between agencies to proactively deliver council tax rebates to those who are entitled, with a view to achieving a step-change in the take-up of council tax benefit.

CTB eligibility criteria: options for reform

7.149 Achieving high levels of take-up would be a real step forward. However, even with full take-up of current entitlements, some households would still face a relatively high council tax burden as a proportion of income. Estimates for the Inquiry suggest that a significant number of ineligible pensioner households face a high council tax burden. Around 200,000 pay more than 10 per cent of their net household income in council tax but do not qualify for benefits. Of those households, 70 per cent are in the bottom two income deciles, of which a quarter of have savings under £25,000.

7.150 Work by Michael Orton's work for the Joseph Rowntree Foundation²⁹ has suggested that two million households are struggling to pay council tax. These are mostly low-income households in bands A-C. However, low-income households do exist in all bands, including a small but significant minority of band F-H households who have below-average incomes and may struggle to pay. Orton's estimate is based on the number of households receiving a council tax summons, which is only one possible indicator that households find it difficult to pay council tax. This approach will necessarily exclude those who struggled to pay but nonetheless did so by some means, and may include some who are able to pay but choose not to. Nonetheless it suggests that at present the burden of council tax may still be too high for some households.

7.151 There is, in my view, a strong case for more generous CTB eligibility criteria for some groups. It is clear that council tax can be a relatively large burden on households that fall outside the current thresholds for CTB, either because their income is over the 'applicable amount', or because their savings exceed the CTB 'capital limit'.

7.152 I have considered a number of options for reform of the current eligibility thresholds, including:

- **Increasing or abolishing the upper capital limit for pensioners**, to reduce the number of pensioner households excluded from eligibility for a rebate by their savings. This could also help reduce the extent to which benefit eligibility may act as a disincentive to save for retirement by ensuring that the capital thresholds do not penalise those who have saved;
- **Increasing the lower capital limit**, so that the first £10,000 in savings, and any income from it, would be disregarded for the purposes of benefit entitlement; and
- **Increasing the 'applicable amounts' or income thresholds** for both pensioners and working age households, so that liability for council tax would begin at a slightly higher level of income. The examples modelled increase applicable amounts by five per cent and ten per cent.³⁰

²⁹ Orton, 2006.

³⁰ The cash value of "applicable amounts" varies between different groups; see Annex C for details.

Alignment with other benefits 7.153 In implementing any changes to CTB eligibility criteria, the Government would need to consider the knock-on implications for the other income-related benefits. At present CTB is considered part of a wider suite of policies aimed at tackling poverty, and in that context thresholds for housing benefit, income support and pension credit are mostly aligned with those for CTB. However there is already some difference between the thresholds applied to different benefits: notably, pension credit where no upper capital threshold exists.

7.154 Keeping eligibility criteria aligned has the advantage of providing a degree of consistency across the benefits system. There could be a risk that moving to different criteria for different benefits might be confusing for claimants, which could act against attempts to simplify the system to improve take-up. In practice however, increasing the thresholds for all benefits together would be much more expensive than reforming council tax rebate criteria separately. The Government would have a very pragmatic choice to make about balancing the financial costs of continued alignment against the risk of added complexity. The example of capital thresholds for Pension Credit also shows that in some cases policy considerations, such as providing incentives to save for retirement, may outweigh concerns about keeping thresholds perfectly aligned.

7.155 I am primarily concerned with CTB as a specific mechanism to alleviate the burden of council tax. Recognised as a rebate, rather than a benefit, it could legitimately be detached from the rest of the suite of income-related benefits though it is currently administered alongside Housing Benefit by local authorities. The fact that other mechanisms can be used to address poverty among specific groups should not become a brake on any reform of CTB – I believe reform here is justified in its own right, to improve the sustainability of council tax.

Savings thresholds and pensioners 7.156 My primary focus in considering changes to eligibility criteria has been on pensioners, as the group most likely to be on fixed incomes, and about whom I have received by far the greatest number of submissions expressing concern. Evidence from survey and public deliberation work carried out for the Inquiry also supports a focus on older people as the group around whom concerns about council tax fairness are strongest.

7.157 Changes to capital limits have the potential to deliver benefits to significant numbers of pensioner households. Table 7.1 shows the likely costs of altering capital thresholds in different ways, and the amounts by which households would be expected to gain, on average, as a result. The options shown here concentrate on savings limits for pensioners, as modelling showed that since older people hold the majority of all savings, only a very small number of working-age households would benefit from changes to capital thresholds. Full details of this modelling, including on other options considered are provided in Annex C.

Table 7.1: Cost and impact of reform of CTB savings thresholds for pensioners³¹

	CTB costs:	Likely to benefit:	Average weekly gain:	
			households already entitled to full or partial CTB	newly-entitled households
Increase upper capital limit to £50,000 for pensioners	£195 million	370,000 pensioner households	n/a	£10.10
Increase upper capital limit to £50,000 and increase lower limit to £10,000 for pensioners	£260 million	1,040,000 pensioner households	£1.20	£10.00
Abolish upper capital limit for pensioners	£220 million	420,000 pensioner households	n/a	£10.00

7.158 The evidence suggests that raising the upper savings limit to £50,000 could have a significant impact for many pensioner households whose savings currently make them ineligible for CTB, who would gain rebates of around £10 per week on average. Around 370,000 pensioner households would be brought into eligibility for CTB by such a change, including 135,000 of the poorest pensioner households. Abolishing the threshold brings approximately a further 50,000 pensioner households into eligibility for a rebate worth similar amounts on average. Adjusting the lower limit makes a small difference to a large number of households who are already entitled to a partial rebate on their bills. Approximately three times as many households' gain by this measure compared with altering only the upper limit; however the benefits to many of them are small, at just £1.20 per week on average, suggesting that the extra costs of moving the lower limit might not be justified in terms of the impact on individual households.

7.159 The costs of these changes would be significant, though the extent to which they are realised would depend on take-up rates. However they would target significant support to households currently bearing a relatively large council tax burden, and would cost much less in any one year than the £800 million devoted to a £200 one-off payment to pensioner households in the 2005 Budget.

Income thresholds and working age households

7.160 Some submissions to the Inquiry suggested that reform should also look at the impact of council tax and benefit eligibility criteria on working age households. For working age households, the income thresholds on rebate entitlement are most important, with council tax liability beginning at a relatively low level of income.³² Some measures for working age households have been modelled in this light. Again, full details of this modelling can be found in Annex C, including some options not pursued here.

³¹ All costs based on full take-up of new entitlement compared with full take-up of current entitlement (see Annex C). Costings on a Great Britain basis since CTB changes would also affect eligibility in Scotland and Wales.

³² The level of income at which council tax liability begins will vary depending on the composition of the household. For example, the income threshold for a single person under 25 is approximately £45 per week; for a pensioner couple, approximately £175 per week; and for a couple with two children, approximately £200 per week.

Table 7.2: Cost and impact of reform of CTB income thresholds for working age households³³

	CTB costs:	Likely to benefit:	Average weekly gain:	
			households already entitled to full or partial CTB	newly-entitled households
Increase applicable amounts for working age households by 5 per cent	£60 million	980,000 working age households	£1.20	£0.90
Increase applicable amounts for working age households by 10 per cent	£130 million	1,100,000 working age households	£2.30	£1.70

7.161 The options shown above represent a one-off increase in the level of income at which council tax liability begins. Changes of this nature have the potential to reach large numbers of households, though the amounts gained by each would be very small. It may be more important that the thresholds are uprated in a way that ensures eligibility for rebates keeps pace with earnings growth. Pensioners and lone parents have seen particularly generous uprating of income thresholds in recent years.

7.162 It may also be that council tax rebates is not the best vehicle for addressing poverty and work incentives in working age households. These are issues that go much wider than council tax and are beyond the scope of this Inquiry, so are likely to be best considered in the context of wider welfare policy including the tax credits system. I am therefore not recommending changes to the applicable amounts.

Recommendation 7.10

The Government should increase the savings limit on council tax rebate eligibility to £50,000 for pensioners.

Recommendation 7.11

The Government should, over time, abolish the savings limit in CTB for pensioners, so aligning council tax rebate thresholds with the criteria for eligibility to the pension credit.

Other options for relieving the burden of council tax

7.163 CTB is the primary mechanism by which households' liability for council tax can be adjusted to take into account their circumstances, making reform of CTB the option of first-resort for dealing with council tax-related hardship. However the government could also consider other options to help those struggling to pay council tax. If the costs of benefit reform proved a barrier to implementation, these other options might deserve serious consideration.

Rebates linked to income

7.164 For instance some US states use a "circuit breaker" rebate to ensure no household pays more than a set proportion of their income in property tax. I have considered whether a similar scheme might be possible in England. A rebate of this kind would probably have to operate similarly to income tax reconciliations, with the taxpayer applying for a rebate after the end of the financial year once total income was known. It would probably have to apply to gross household income,

³³ All costs based on full take-up of new entitlement compared with full take-up of current entitlement (see Annex C). Costings on a Great Britain basis since CTB changes would also affect eligibility in Scotland and Wales.

since taking into account housing costs and other factors would make the scheme extremely complex and perhaps open to abuse. In the US such schemes tend not to exist alongside a CTB-type mechanism. However in England it could be available as a supplement to council tax benefit, so that a household would first have to claim any CTB entitlement. This in itself could be an advantage of a ‘circuit breaker’ scheme, which would be reasonably explicable to the public and could be used as a lever to encourage take-up existing entitlements.

7.165 A rebate of all council tax above 10 per cent of gross household income would cost approximately £100 million in 2006-07 and benefit over 350,000 households, of which 70 per cent are in the bottom two income deciles. Around 55 per cent of households receiving a rebate would be pensioners. If council tax continued to rise faster than average earnings, one would expect the costs of a rebate also to rise over time.

Deferred payment for pensioner homeowners

7.166 Deferred payment schemes are used in some countries to allow pensioners with equity in their homes to postpone property tax liability until their property is sold. For example, the Canadian province of British Columbia has operated a deferral scheme for over-60s and some other homeowners since 1974, with 11,000 households currently making use of the option to defer tax. Householders must have at least 25 per cent equity against the property’s assessed value, and pay interest on the amount deferred when the property is sold.

7.167 Equity release products are already available from a range of private sector lenders in this country and could in theory be used to pay council tax or for any other purpose. The Financial Services Authority regulates equity release products, providing assurance to those who take this option up. However commentators have raised concerns about the suitability of those schemes to older people, particularly if the amounts to be released are relatively small, in which case transaction costs might outweigh the benefit of equity release. The Institute for Public Policy Research suggests that in some cases the quality of advice from providers on equity release can be poor, creating a risk of mis-selling.³⁴ There is some doubt over whether markets are currently able to provide the right opportunities for equity release for low-income homeowners struggling with council tax.

7.168 Equity release might not be the right option for all households, and should be a matter of individual choice on take-up. However the Joseph Rowntree Foundation suggest that attitudes to inheritances are changing, and that people are increasingly prepared to draw down wealth for spending during their lifetime.³⁵ For some, releasing housing equity might be an attractive way of coping with tax liabilities in old age.

7.169 Equity release schemes linked to council tax could in theory be operated locally, but there might be economies of scale in running a national scheme, perhaps in collaboration with the financial services industry. There are modest precedents for this, including in existing provisions to allow homeowners moving into residential care to defer some fees until their property is sold. It would be important that equity release for council tax were considered carefully alongside government policy on social care, charges for which are partially determined by a person’s assets including housing equity.

Conclusions

7.170 I concluded above that council tax is not broken. While it has some significant weaknesses, it also has some important strengths and should be retained, either alone or, in the longer term, alongside other local taxes and charges. To an extent, that conclusion rests on the premise that CTB

³⁴ Maxwell, D and Sodha, S, ippr, *Housing Wealth: first timers to old timers*, 2006.

³⁵ Joseph Rowntree Foundation, *Attitudes to Inheritance in Britain*, 2005.

can be used to achieve an acceptable link between tax liability and ability to pay for the lowest income households.

7.171 CTB is only partly succeeding in that role at present, mainly because of low take-up, with take-up among pensioners a particular concern. A new approach to the delivery and presentation of council tax benefit is therefore required. The Department for Work and Pensions, working with local authorities and the Pension Service, has made a promising start on work in this area, but this must now be pursued further and implemented as rapidly as possible.

7.172 There is also a case for some reform of CTB eligibility criteria. As a first priority the government should act to increase savings limits for pensioners, which are currently set at modest levels and may penalise those who have saved for their retirement.

7.173 Both increased take-up and an extension of eligibility would carry costs to the government (and hence taxpayers). However, I see these as necessary if the problem of perceived unfairness in council tax is to be addressed. In the medium term, reform of council tax as discussed earlier could produce offsetting savings in the benefit bill by reducing the liability of many low-income households.

LOCAL INCOME TAX

Local income taxes in other countries

7.174 I have argued in this chapter that council tax remains a sound local tax and should be retained, though it should be reformed and valuations updated in the medium term. This does not rule out further reform of the local government finance system, in the longer term. While the immediate focus should be on council tax benefit and management of pressures to stabilise council tax, it may be that in future, a developmental approach to reform could allow for a wider look at the balance of local taxation.

7.175 It is part of my remit to consider both alternatives to council tax and possible sources of supplementary revenue for local government. In respect of both these questions, local income tax (LIT) has been a prominent feature of the debate about local government finance, as part of formal submissions and in focus groups and survey responses. I have therefore explored in some detail the potential for a local income tax to be deployed in England, either alongside council tax or as a full or partial replacement to it.

7.176 In this section I will:

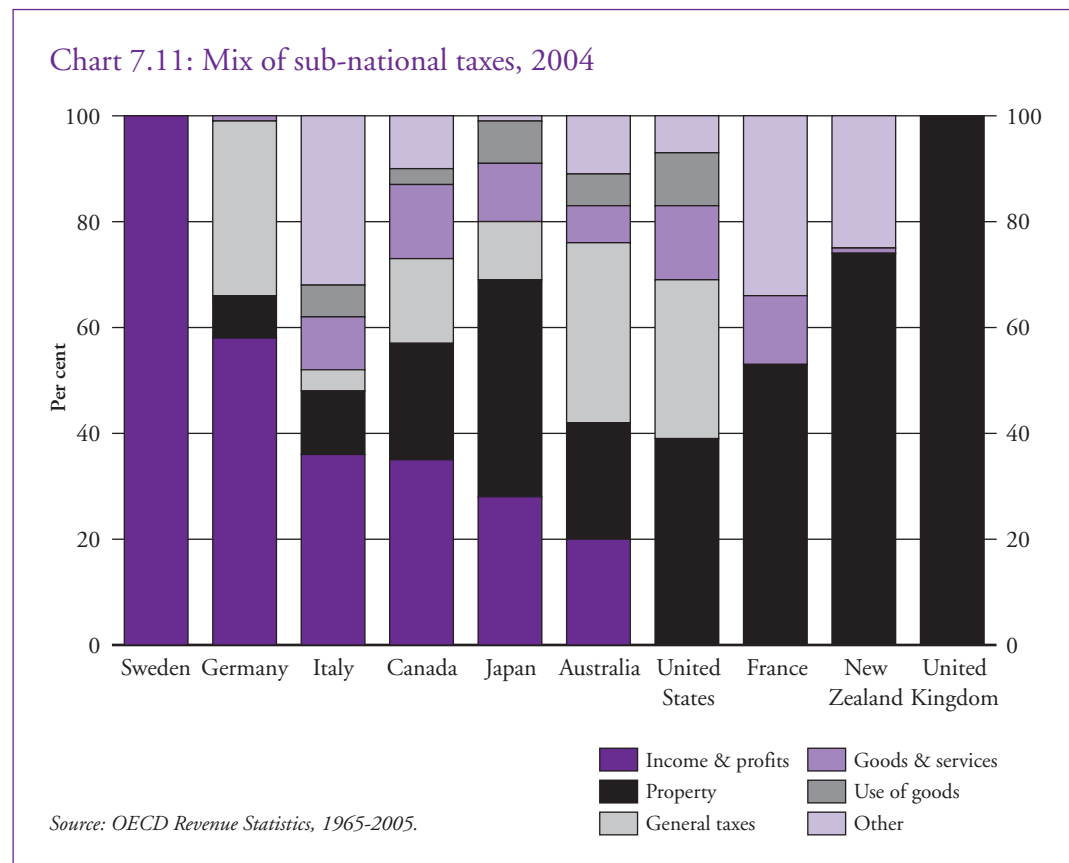
- consider the high level implications of a shift from property to income taxes, in terms of both the impact on taxpayers, particularly with regard to public perceptions of fairness, and the implications for local revenues and the local government finance system;
- discuss a number of questions around the detailed design of a local income tax, and explore some of the complexity of designing such a tax;
- present the outcomes of some modelling work on a local income tax in England, including the likely rate needed to fully or partially replace council tax; and
- address questions around the practical implementation of a LIT, including likely costs and timescales.

7.177 This chapter will focus on the potential for introducing a locally-variable income tax, with rate-setting powers for local authorities. However it would be possible to design a model in which income tax revenues contributed to financing local government without going as far as the locally-

variable model described below. I will consider other options in Chapter 9, as part of a wider look at central government’s financing of local services.

Background to the local income tax debate

7.178 Local income taxes are a relatively widely-used source of local government funding in other countries, and were present in two thirds of the EU’s then fifteen member countries in 2004, as well as Japan, Canada and all but seven US states. As chart 7.11 demonstrates below, it is also relatively uncommon for local government to be entirely dependent on a single local tax, whether property-based as in the UK or income-based as in Sweden.



Local income tax in the UK 7.179 The Layfield Committee considered the case for a local income tax in 1976, and concluded that it was “the only feasible major new source of income” for local authorities, should the government judge that a new source of local revenue was necessary. Prior to Layfield, such taxes had been under consideration at various points during the 20th century, but had been rejected by previous bodies such as the Royal Commission on Local Taxation of 1901 and the Kempe Committee of 1914.

7.180 The Balance of Funding Review also pointed to LIT as the chief option, besides localisation of business rates, for achieving a shift in the balance of funding towards local revenues. Both Layfield and the Balance of Funding Review saw advantages in using a local income tax as a new local tax, on top of property taxes, so that more money could be both raised and spent locally, giving councils more direct accountability for their finances. In a sense there is nothing special about a local income tax for creating accountability (in fact, if administered via the PAYE system LIT might be less visible than council tax and so would arguably have less impact in terms of accountability); but it could be implemented in a way that could have some accountability benefits.

7.181 Other studies have raised doubts about the application of a local income tax, either for practical or principled reasons. Local income tax was considered again by the 1981 Green Paper on local taxation, which suggested that administering a local income tax through the national income tax system might be costly and highly complex.³⁶ More recently, Sir Peter Burt's independent committee in Scotland concluded that it would not be appropriate to introduce a LIT there because of concerns including the impact on incentives to work, and in light of the fact that taxes on income already contribute a relatively large share of total UK tax revenues.³⁷

7.182 Supporters of local income taxes have tended to highlight three potential benefits of introducing them into the local government finance system. Firstly, it has been suggested that income taxes would be 'fairer' than property taxes in that liability should more closely reflect ability to pay. Secondly, those interested in achieving better local accountability and flexibility through a shift in the balance of funding have argued that introducing local income taxes alongside property taxes would be a positive step towards making local authorities less dependent on central grant. Thirdly, it has been suggested that introducing a naturally buoyant local tax would help make local government finance more sustainable in the long term.

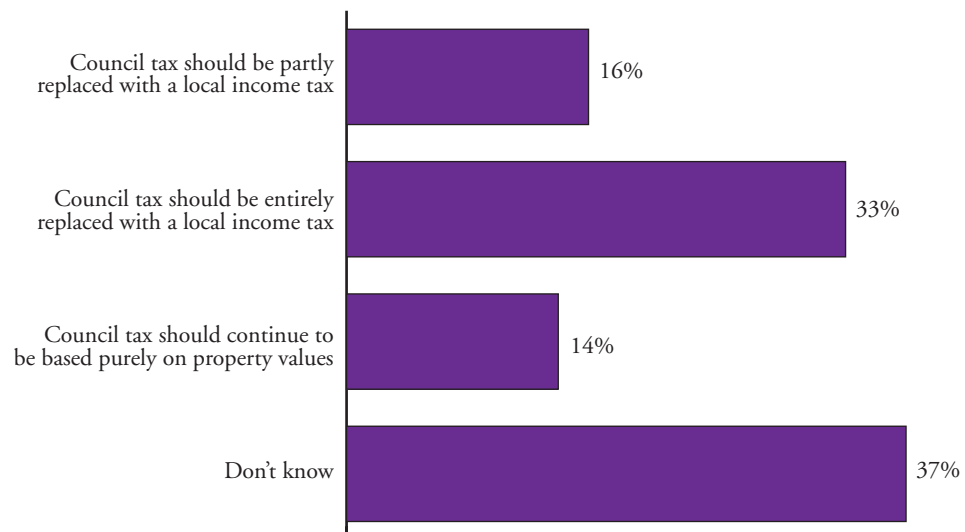
7.183 I have considered all these high-level arguments, as well as some of the detailed practical questions around how a local income tax might operate in this country.

Fairness and the implications of a LIT for taxpayers

Public opinion on local income tax

7.184 Survey evidence suggests that, in principle, many people like the idea that council tax should be replaced with a local income tax, with nearly half of all respondents to an Inquiry-commissioned survey saying that council tax should be partly or fully replaced by LIT. However it may be that this support is not based on a true understanding of what local income tax would mean for respondents' own bills. Almost four in ten respondents did not have a view on local income taxes, suggesting the arguments around it are not widely familiar to people. And, while people recognise that pensioners would probably do well from a move to income-based taxation, relatively few (just 13 per cent) think that they would pay more themselves.

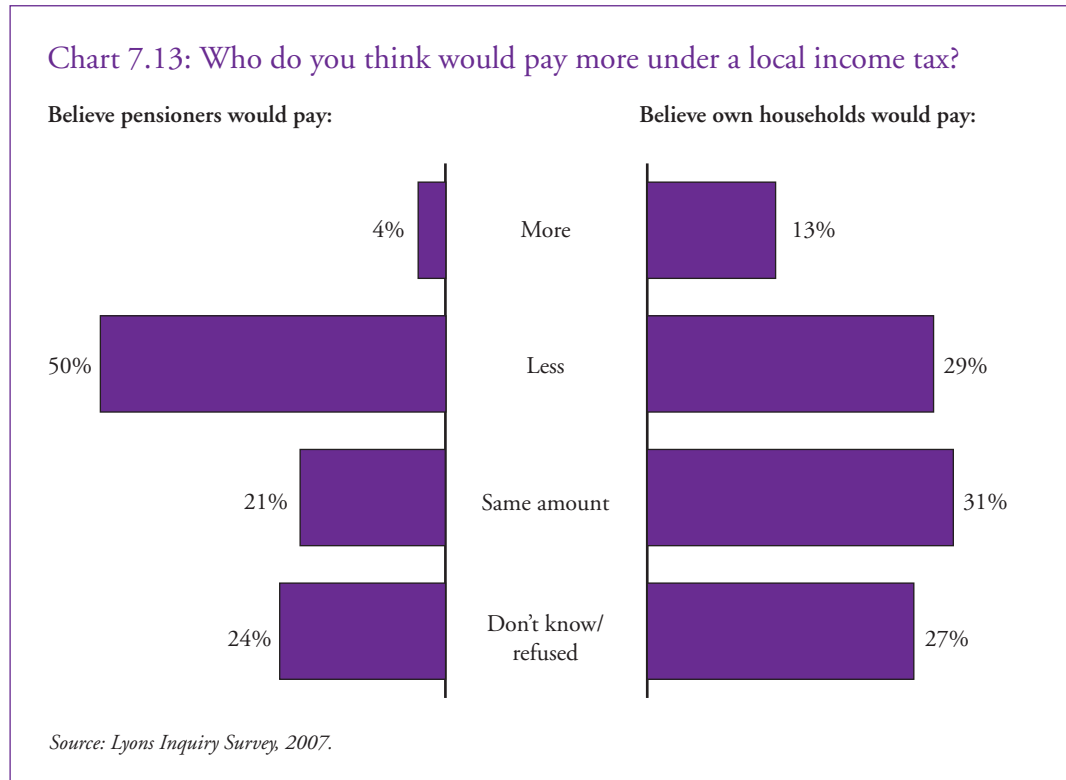
Chart 7.12: Attitudes to local income tax



Source: Lyons Inquiry Survey, 2007.

³⁶ *Alternatives to Domestic Rates*, HM Stationery Office, 1981.

³⁷ Local Government Finance Review Committee, *A Fairer Way*, 2006.



Fairness 7.185 In fact, moving away from a property-based tax to an income tax would mean a significant rebalancing of the tax burden away from retired households and onto the working-age population. As shown earlier in this chapter, council tax liability is spread throughout adult life, while an individual's income tax and VAT liability is typically concentrated during their working life. Any decision to replace council tax with income taxes would therefore require a political judgement that retired households should, on average, pay a reduced burden, and younger working households a larger one.

7.186 Again, the crucial issue is what definition of fairness, or 'ability to pay' is applied. If income were the only measure of ability to pay then this shift would arguably be a fair one. However, I am concerned that this would neglect other relevant factors. I am not convinced, for example, that a pensioner household with a relatively modest income but significant savings or housing equity, is less able to pay than a young family with a larger income but no other assets. In this light I have some concerns about whether abandoning property taxes for income taxes would be fair; in practice this might simply replace one sort of perceived unfairness with another.

Convenience of collection versus visibility 7.187 Participants in focus groups for the Inquiry also raised issues around the practical experience of paying income taxes compared with council tax. Some felt collecting tax at source would be simpler than the present system of council tax, which required individuals to actively decide and organise the most appropriate method of payment for them. The way that income tax is paid made it less perceptible as a call on people's weekly or monthly resources than council tax:

I don't consider it [income tax] an outgoing because you do your outgoings after your net pay... so everyone forgets the tax. You know you are not getting it, so it is not like an outgoing. (Focus group participant)

7.188 Others were concerned that a LIT might operate as a 'stealth tax', particularly if introduced alongside council tax. Nonetheless, the fairness of income and property taxes was the overriding theme in these discussions.

Implications of a LIT for local government finance

A buoyant local tax? 7.189 Moving from a property tax to an income-based tax could have profound implications for local government finance. Firstly, income tax yield could introduce natural buoyancy into the system, potentially removing the need for rate increases each year: instead yield would grow as people earned more, or if more people moved into work. However this would, by the same token, expose authorities to more uncertainty than in the past – tax income might go down in the bad times. To capture the benefits of buoyancy, authorities would also be exposed to risk.

7.190 If a LIT were introduced, the government of the day would want to consider the scope for measures to allow local authorities to budget sensibly around this risk, including embedding full end-year flexibility, and multi-year grant settlements. Other countries manage this risk successfully: for example in Denmark the annual negotiations around grants from central government take into account the expected growth in local revenues, with an expectation that the government may provide ‘top up’ resources during downturns.

7.191 It is important also not to overstate the extent to which a local income tax would be buoyant. My research indicates that while the natural buoyancy of an income-based tax would be an advantage, it would not make a local income tax immune to the pressures that are felt in council tax. Modelling for the Inquiry suggests that in fact the revenues from basic rate income tax may even tend to grow more slowly than council tax.³⁸ If spending requirements outstripped the amount of yield produced by this natural buoyancy, the rate of local income tax would come under pressure to increase.

7.192 It might therefore be unrealistic to expect a local income tax to support the kind of spending growth that has been supported by council tax in recent years, since doing so would be likely to require successive rate increases. Upward pressure on LIT rates would no doubt be just as controversial as increases in council tax bills, so it would still be crucial that the overall finance system were managed in a way that did not put the local tax under unsustainable pressure, whether based on income or property.

7.193 Revenues from all income tax as well as the individual higher and starting rates of tax, do tend to grow more strongly than revenues from the basic rate alone. Income tax revenues could potentially be assigned to local authorities as a buoyant income stream. This possibility is explored more fully in Chapter 9.

Adapting the grant system to a LIT 7.194 Moving from council tax to income taxes, or a combination of the two, would have consequences for the amounts of money different authorities could expect to raise in tax. For example areas with many retired or low-income households might have a smaller-than-average income tax base, while those with many low-banded homes might find income a stronger tax base than property. Any change in local taxes will tend to change the pattern of authorities’ tax-raising capacity. This could have implications for the amount of grant equalisation that might be required if central government wished to continue compensating for tax base disparities.

7.195 The Balance of Funding Review suggested that income tax bases were less evenly distributed between areas than the council tax base, and that equalisation grant might therefore be expected to work harder if local taxes were based on income. Moreover, because authorities with high council tax bases also tend to be those with high income tax bases, if a LIT were introduced in a way that shifted the balance of funding towards local revenues, one might expect the differences between local authorities’ tax bases to be amplified.

³⁸ See Annex C for full details of this modelling.

Designing a local income tax

7.196 As well as considering the theoretical case for a local income tax, I have also looked in some detail at whether it could be made to work in practice. In this context, there are a number of key issues to consider. While I have not sought to exhaustively cover every element of the design of a new local income tax, nor definitively solve all the elements discussed below, this section aims to draw out the complexity of these issues, and highlights some of the key questions that would need to be answered in order for a local income tax to be implemented.

Constraints 7.197 In introducing the power to raise local taxes on income, it would be necessary to decide how those powers might be appropriately defined and what limits might be placed on them. For example, the Scottish Executive has a limited power over the basic rate of income tax, which it can choose to vary by up to three pence above or below the UK basic rate.

7.198 A locally-variable LIT might appropriately be subject to similar constraints, to ensure a minimum level of revenues and prevent unfair tax competition between areas, or to reassure taxpayers that rate increases would not be excessive. For example, local authorities might be given powers to vary either side of a standard local rate, or could be given a limited menu of local rates to choose from. Central government would however retain the powers to set certain variables nationally, such as thresholds and allowances, which could affect the actual revenues raised by a given rate of LIT.

Level of the rate-setting authority 7.199 It would also be necessary to decide which authorities would have rate-setting powers, particularly in two-tier areas. I am inclined to the view that upper tier authorities, which are responsible for most local spending, should hold rate-setting powers: not least because a system in which around 150 authorities set income tax rates would certainly be less complex than one in which around 350 did so, which could be particularly important for employers if they were to administer the new tax through payrolls.³⁹ However this would alter the current role of district councils as the billing authority for local tax, and a mechanism for ensuring they would still be able to influence rate-setting decisions would be important. It would also be necessary to consider whether precepting authorities should have a claim on the revenues from a new tax, and if so, how this would operate.

Place of taxation 7.200 Property taxes are clearly applicable to a given authority area, based on the location of taxable property. In taxing income and particularly wages, it would be necessary to decide whether liability would apply according to the taxpayer's residence, or their place of work. My analysis is based on the presumption that taxpayers would be liable for LIT at the rate set by the authority in which they live. Since the options modelled assume that a local income tax would replace all or part of council tax, they also assume that local income tax might aim to retain one of the benefits of that tax: a strong link between tax paid and services delivered in the area in which people live and vote. I recognise that some authorities might feel disadvantaged by this – particularly those with large numbers of commuters coming into the area to work. This is, however, a criticism that could be levelled at any residence-based local tax, including council tax, so need not undermine the case for a local income tax based on residence as such.

³⁹ Shire Counties, Metropolitan Districts, Unitary Authorities and London Boroughs = 150 authorities in total ('Upper tier refers to County Councils in two-tier areas, not in this case the Greater London Authority). Shire Districts, Metropolitan Districts, Unitary Authorities and London Boroughs = 354 authorities in total.

Defining taxable income 7.201 Income tax is levied on a number of different forms of income, the most obvious being wages from employment. However, national income tax also applies to a variety of other sources, including self-employment income, pensions, some benefits, income from savings and dividends and income from renting out property. It would be necessary to decide which of these types of income would be subject to a new local income tax. It would also be important to consider the impact this could have on incentivising tax-motivated incorporation.

7.202 In the present system, income from savings and dividends is dealt with through deduction at source by financial institutions, so that for the majority of taxpayers the process happens automatically. Higher rate taxpayers pay any additional amount due through self-assessment. However, to deduct a variable amount according to local rates would either require financial institutions to have variable deduction systems, which would be extremely complex, or would need taxpayers to fill in individual tax returns. CIPFA concluded in 2004 that the only way to tax income from savings and dividends would be to introduce universal tax returns, which would be a significant change to our current system of deduction at source for most taxpayers.⁴⁰ CIPFA further concluded that the additional revenue to be raised from taxing savings and dividends would probably be outweighed by the additional cost of moving to universal tax returns, and I have seen no evidence to contradict this.

IT bracket to which LIT would apply 7.203 Different commentators have made various suggestions about the element of income tax which might be increased by a LIT. Some assume an increase in both the basic and higher rates of tax locally; others focus on the basic rate only. Both approaches have some merits: in particular increasing the higher rate might be a way of introducing some progressiveness to income at the top end of the scale, which is arguably a weakness of the council tax at present.

7.204 However, for the purposes of the Inquiry's own analysis local income tax is applied only to the basic rate of income tax. This reflects a judgement that since higher-rate taxpayers are not evenly distributed throughout the country, local authorities' ability to benefit from higher rate revenues would be highly variable. If LIT rates were not to vary too greatly, the grant system would need to adjust for those differences, implying quite ambitious equalisation between areas. Basic rate income taxpayers are distributed much more evenly across the country, creating fewer disparities between areas' tax-raising capacity and therefore making it a better local tax base.

7.205 The advantages of a local stake in higher rate income tax might be realised without local rate-setting powers through assignment of national revenues to local government, as discussed in Chapter 9.

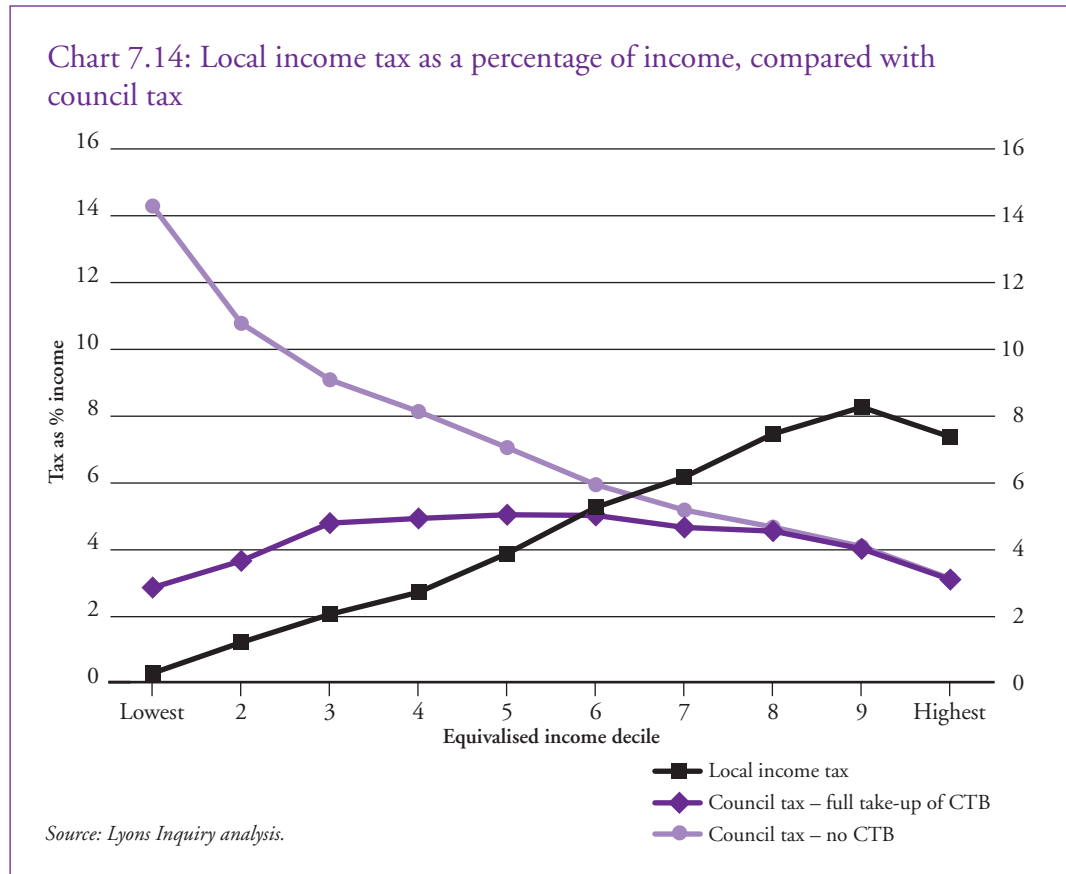
Modelling a local income tax

7.206 The options explored below apply a LIT as an addition to the current 22 pence basic rate. Two scenarios were modelled:

- **full replacement LIT**, which would take the place of council tax, raising the full £22 billion raised in council tax (gross of council tax benefit) in 2006-07. An average local rate of 7.7 pence on the basic rate of income tax would raise the full amount necessary to replace council tax; and
- **partial replacement LIT**, which would replace approximately half of council tax. Council tax would be retained but reduced so that it raised approximately £11 billion (gross of council tax benefit) in 2006-07. An average local rate of 3.9 pence on the basic rate of income tax would replace half the current yield from council tax, and allow band D council tax to be reduced to an average of £629.

⁴⁰ CIPFA, *Reviewing the case for a Local Income Tax* Balance of Funding Review Paper 19, 2004.

Impact by income group 7.207 A local income tax would be more progressive to income overall than council tax, even with full take-up of benefits. Chart 7.14 shows some reduction in the average burden on the bottom half of the income distribution, with the burden remaining progressive for all but the top income group. This reflects the fact that the top income decile contains many higher-rate taxpayers. The modelling also confirmed that, on average, pensioners and one-parent households would pay less under a local income tax than under council tax, with other working-age households paying more.



The impact of CTB savings on LIT rates 7.208 These rates of local income tax are based on the assumption that the new tax would replace council tax, including the element of council tax that is paid by the Government as council tax benefit. If local income tax were to replace both of these there would, on the face of it, be a saving to the Government, which would no longer have to pay council tax benefit in the case of a full replacement LIT, or would pay less under a partial replacement LIT.

7.209 It would be a matter for the Government to decide how best to use those savings, but it could choose to use them to hold down overall rates of tax. If council tax benefit savings were paid back to local government as grant, the overall amount of local tax necessary would be lower. A full replacement LIT offset by the £3.15 billion currently paid in CTB (at current levels of take-up) could be set at 6.6 pence on the basic rate. A partial replacement LIT could in theory be set at 3.3 pence.

7.210 In practice it is likely that CTB savings would be somewhat lower than these headline figures. By increasing income tax rates, households’ net income would be reduced and they might become eligible for new or increased support through tax credits or other benefits. In that case, the extra social security expenditure would to some extent offset the savings made in council tax benefit; however without detailed data it is not possible to test the precise impact of these effects.

LIT as a supplement to council tax

7.211 A further element of my remit was to consider whether Local Income Tax might have a role as a source of supplementary revenue for local government. Key questions are the scale of revenues that might be raised through a supplementary tax on income, and the public acceptability of such a levy.

7.212 A supplement levied at 1 pence on the basic rate of income tax would raise £2.87 billion in 2006-07.⁴¹ A supplement of this size would therefore be a substantial new source of revenue, roughly equivalent to total budgets across the country for cultural services.

7.213 The yield from a one pence supplement would be equivalent to, on average, about 13 per cent of the average authority's budgeted council tax yield for 2006-07. This proportion would vary widely across the country, with the supplement raising an amount equivalent to just 7.6 per cent of the council tax take in West Somerset, up to 28.8 per cent in Wandsworth and 47.8 per cent in the City of London. This variation in the amounts raised by authorities partly reflects the differences in incomes between areas, as well as the proportion of the population in work. The national average amount levied per head of population would be £57, varying from £33 (Barrow-in-Furness) to £88 (Surrey Heath).⁴² The Government would need to consider how far this unevenness would be compensated for by the grant system.

7.214 However, focus group work conducted on behalf of the Inquiry has suggested a lack of public appetite for LIT as a supplement to council tax, because of a concern among respondents that they might be paying twice for the same services.

Having it alongside [council tax] is too much. To us it would just seem like another tax. (Focus group participant)

7.215 If the motivation for introducing an income tax supplement were to relieve the pressure on council tax, strong public support for such a move would be essential. While I have made no presumption in my work about what the revenues from a supplement might be used for, I am clear that local authorities would need to communicate its purpose to their communities, and be able to reassure citizens that the new tax would deliver tangible benefits according to local preferences. Under those circumstances, a supplementary LIT might be an option for the medium term.

Implementation

7.216 For a local income tax to be adopted in England, the Government would need to be satisfied that it was not only desirable in principle but achievable in practice. Introducing any new tax throws up a raft of complex and often minutely detailed problems, and while it is beyond the scope of this Inquiry to resolve them all, it is worth exposing some of those complexities and understanding their implications for how, and how soon, a new tax might realistically be implemented.

Collection mechanisms

7.217 Most income tax is collected at the time wages are paid via the Pay-As-You-Earn (PAYE) system. Unlike in many other countries where local income taxes exist, UK taxpayers do not, in the majority of cases, fill in annual tax returns. A LIT which required a move towards tax returns for all would be unattractive to the Government and more complex for many taxpayers, whereas a system which integrated a LIT with PAYE would retain the convenience of that system for taxpayers.

⁴¹ Based on data from HM Revenue and Customs. See Annex C for more details.

⁴² Excludes City of London.

7.218 I have explored two specific options for the collection of locally-variable income taxes:

- The “**Tax tables**” approach seeks to use the present system of employers withholding tax from pay. At present employers use a set of tax tables (which are published by the Government) to calculate how much of each employee’s pay to withhold and pay to HM Revenue and Customs (HMRC). A local income tax could be implemented by creating new tax tables for the new local rates of tax. Employers would then need to be told by HMRC which set of tables to use, depending on which authority area the employee lived in.
- The “**Coding adjustments**” approach (suggested by CIPFA in one of their later proposals on this topic) uses adjustments to each person’s tax free allowance to collect the local element of income tax. In this option we assume that HMRC would need to use data on earnings to calculate each person’s expected local tax liability and subtract this from their tax free allowance for the year, so that over the year they should pay the right amount of local and national tax.⁴³

7.219 For the self employed, higher rate taxpayers and people with more complex tax affairs the self assessment system would continue to operate and could be used to collect local tax liability.

7.220 These two approaches have different advantages and disadvantages. The tax tables approach would be the most consistent with the current principles of the PAYE system. Employees would pay their local tax over the course of the year as they do with their national tax, and most people should have paid the right amount of tax by the end of the year, in most cases avoiding the need for adjustments at year-end. That would reduce the complexity of the system for individuals, and for HMRC (for whom a large number of end-year adjustments would be a substantial additional burden).

7.221 However, the tax tables approach does have some disadvantages. While convenient for taxpayers (and thus potentially less visible and painful than council tax), taxes collected in this way might lack transparency. Separate itemisation of local taxes on payslips would help, though this would require legislation to make it possible.

7.222 Crucially, the tax tables approach would be likely to impose a substantial administrative burden on employers. Variable rates would make the operation of payroll systems much more complicated, and the greater the variance permitted, the greater the complexity. It should be possible to design software to cope with much of the practical work of processing variable tax rates; however there would be initial costs associated with buying in that software and adapting systems to it. For small businesses, and particularly those without computerised payroll systems, the burden of implementing the new tax would be particularly heavy.

7.223 Operating the alternative system of coding adjustments would not impose that administrative burden on employers, who would continue to operate the system as they do now. Local tax would be collected via the national income tax system by altering each employee’s tax code in HMRC. There are some limited precedents for this: coding adjustments are used for some taxpayers at present to collect small amounts of underpaid tax from previous years.

⁴³ A variant on this option has been suggested by the Liberal Democratic Party, which would involve deducting local income tax at a standard rate from all taxpayers and settling up at the end of year, depending on the actual LIT rate that a taxpayer should have faced.

7.224 However, this approach has some substantial drawbacks. Individuals' tax codes are calculated some months in advance of the beginning of the tax year, and to use them to collect LIT in this way HMRC would have to make estimates of individual incomes for the forthcoming tax year at that point. Any change in an individual's income, or the local tax rate to which they were subject (for example if they moved to an authority area with a different rate), during the course of the year would mean that they paid the wrong amount of tax. It is therefore likely that a very large number of taxpayers would pay the wrong amount of tax during the year, and would have to enter a process of end-year reconciliation with HMRC, creating a substantial new administrative burden for them. Some taxpayers already have to engage in such reconciliation, but the number is fairly small. It could also create confusion and difficulties for taxpayers, including the possibility of unexpectedly owing tax at the end of the year.

7.225 On balance, I consider that of the two systems, the tax tables approach is the better, as it would be much easier for taxpayers to understand, require fewer end-year corrections (which can also create hardship for those on modest incomes) and less burdensome to operate overall. However, I recognise that there would be potentially significant new burdens on employers. Should the Government wish to implement a local income tax in the future, further detailed work would be needed to assess the costs to business of running such a system, and what steps might be taken to minimise that burden.

Timing of local budget decisions

7.226 Council tax increases are decided as part of authorities' annual budgeting process, which generally takes place in February and March. Once rates have been decided, bills can be sent out, with all the effort of collection being handled locally. The collection mechanisms for local income taxes would necessitate big changes to the timetable for local decision-making about tax rates.

7.227 For example, the tax tables approach would require HMRC to have full information about local income tax rates in every authority by the Autumn, when tax tables are published. The coding adjustment approach would require several months' work on calculating tax liabilities ahead of the start of each financial year. Either method would bring forward local decision-making by about six months compared to now, which could in turn require a radical change to the timing of grant settlement decisions. The Government would need to consider how this could be accommodated, perhaps by building on the practice of three-year settlements.

Costs of implementation: HM Revenue and Customs

7.228 There would undoubtedly be significant costs involved in moving to a new system of taxation. The scenarios above assume that HMRC would remain the body with responsibility for income tax collection, so many of those costs would fall to them. It is not possible to arrive at precise estimates of the costs of collecting a LIT without specifying in much greater detail how it would operate, and any costings would be highly susceptible to change according to decisions about some of the complex issues outlined above, and many other operational questions.

7.229 However, a preliminary and indicative estimate of possible costs to HMRC suggest a range of £125 – 200 million for set up costs, with ongoing costs potentially in the order of £10 million per year, for the tax tables option, and a range of £340 – 520 million for set up costs, with ongoing costs of £30 – 45 million per year, for the coding adjustments approach.⁴⁴ Given the broad range of new activities that it would be necessary for HMRC to design and implement – including additional staffing, new IT systems, enforcement activity, and establishing processes with both local authorities and businesses – in order to support the introduction of a LIT, these estimates clearly remain subject to significant variation.

⁴⁴ HMRC, based on Lyons Inquiry specifications; not indicative of Government policy.

- Costs to employers** 7.230 It is important to recognise that the costs of implementing a LIT might not be confined to government. It is difficult to estimate the likely costs to employers of administering a LIT, not least because the available technology at the time of implementation will have a big impact on the initial costs of changing to a new system. The government of the day would of course be expected to conduct a full assessment of the likely impact on business of the new tax. Work for the Balance of Funding Review by CIPFA suggested start-up costs to business in the order of £100 million and this remains a reasonable estimate, though it would obviously be affected by the timing and detailed implementation of any changes. As noted above, it is likely that small and medium-sized enterprises would be particularly affected, and the government might wish to consider schemes to mitigate initial costs for small businesses.
- Costs to local authorities** 7.231 Separately from these costs there would also be financial implications for local authorities. If LIT were to be introduced as a full replacement for council tax it could generate significant savings to local authorities, who currently bear the costs of council tax collection and enforcement, of around £340 million per year, and to central government who bear the costs of most council tax benefit administration through a grant to authorities of around £280 million per year.⁴⁵ There would be a role for local authorities to assist HMRC in collecting and enforcing payments of a LIT, and this would have cost implications for authorities.
- 7.232 At present the responsibility for collecting council tax (and consequent revenue risk) is local. Local and central government would also need to reach an understanding on who would bear the risks of default on local income taxes, and who would prosecute non-payment.
- Timetable for implementation** 7.233 Preparing for the implementation of a new local income tax would be a complex process, and as such would require a long-enough lead time to ensure the tax were robust and sustainable once introduced. Preparations would be expected to include:
- a policy design phase, including consultation with the public and with businesses, to explore detailed questions around the type of scheme that could be supported;
 - passage of legislation providing for the tax change;
 - development of new IT software for tax collection. It is likely that IT development could not be progressed until after policy had been fixed and legislation passed; and
 - roll-out to business payroll systems if required, and integration with the local government finance settlement process.
- 7.234 Initial views from HMRC suggest a total lead time, depending on the complexity of the scheme being introduced, of approximately six to seven years from the point at which the government decided to work towards a LIT.
- Implications of a LIT for the devolved countries** 7.235 If a local income tax were introduced in England this might also have implications also for the devolved countries, where I know these issues have attracted some political interest. Council tax does at present exist in Scotland and Wales; and Northern Ireland has a system of local and regional rates, on which the Government has implemented a separate review. Local taxation is devolved in Scotland, although Wales is governed by the same system of primary legislation as England. Since I am not recommending that a local income tax be implemented in England in the short or medium term, it would be speculative to go any further into the possible implications for the devolved countries of a future LIT. If the Government were attracted to a local income tax in future, it would need to consult the devolved administrations in Scotland, Wales and Northern Ireland on any consequences for them of such a change.

⁴⁵ CLG, figures for 2005-06.

Conclusions

7.236 Local income taxes were seen as a positive option in many submissions to the inquiry, demonstrating the resonance of the idea that ‘fair’ taxation is based on ability to pay, or income. Income-based taxes could introduce greater progressiveness to income both for the poorest households and at the top of the income scale, in a way that council tax presently cannot, even with full take-up of council tax benefit. They could significantly reduce the burden of local taxes on those groups with the lowest average incomes, notably pensioners and lone parents.

7.237 However, it is important to recognise the limitations of local income taxes. A LIT would be progressive to income but might mean substantial increases in tax for the working population. There is evidence that the public may have unrealistic expectations of what a local income tax would mean for them, so it is not clear that in-principle support for taxes based on income would translate into support for a local income tax in practice.

7.238 Local income taxes are naturally buoyant, though not infinitely so. In practice a LIT on the basic rate might deliver less buoyant funding than the existing streams of revenue to local government, while introducing a risk that local tax revenues could go down as well as up. It would therefore be wrong to assume that income taxes could withstand pressures that property taxes cannot: managing pressures effectively will be essential if any local tax is to remain sustainable in the long term, and requires discipline from both central and local government.

7.239 I am satisfied that a local income tax could be feasible in England and could viably replace all or part of council tax, or operate alongside it. Implementation of a LIT would however require thorough preparation to ensure that it could be properly integrated with existing PAYE and Self-Assessment systems, and that local authorities and HMRC were given adequate time to prepare for a transition.

7.240 Particular attention should be given to the likely costs to employers, and particularly small business, of administering locally-variable income tax rates. The Government might wish to consider options for providing financial support to help businesses meet the initial costs of administering the new tax. If a LIT were introduced as a full or partial replacement for council tax, savings in council tax benefit might be a source of funding for such a scheme.

7.241 The desirability of a LIT is a matter of political judgement, particularly in view of the substantial lead times involved in implementing a new local tax. The Government would also want to consider broader questions about the overall balance of the tax system, the load on different tax bases and overall incentives, in considering the implementation of a LIT. My analysis suggests that a preparatory period of more than one parliamentary term should be assumed, making a LIT a significant undertaking and an option for the medium to long term.

LOCAL SERVICE CHARGES

7.242 While council tax is the largest revenue stream controlled by local authorities, other sources of income are available in the form of fees and charges for some local services. While not all charges are locally set, and a variety of conditions apply to their use, charging nevertheless represents a key financial flexibility for local authorities.

7.243 I have argued that greater flexibility is a key part of equipping local authorities to deal with pressure on budgets. Equally, it is right that if local communities wish to invest in the improvement of their area, or in improving a service, they should have the means to do so. While council tax provides one option for raising funds in support of local ambitions, in many cases a charge on the users of a particular service may be an appropriate and more popular way of financing those choices.

7.244 Charges also have the potential to be a significant policy tool, if used strategically. Place-shaping in an area should include the judicious use of charges; for example, to pay for improvements which directly benefit services users who are willing to pay for them, to subsidise services for a particular group such as children or older people, and to support wider policy objectives such as changing behaviours or moderating demand for a particular service.

7.245 I will consider how far the current framework for charging allows for financial flexibilities to support local choice and place-shaping. My recommendations will focus on the general use of charging and on any specific areas where new powers might be called for.

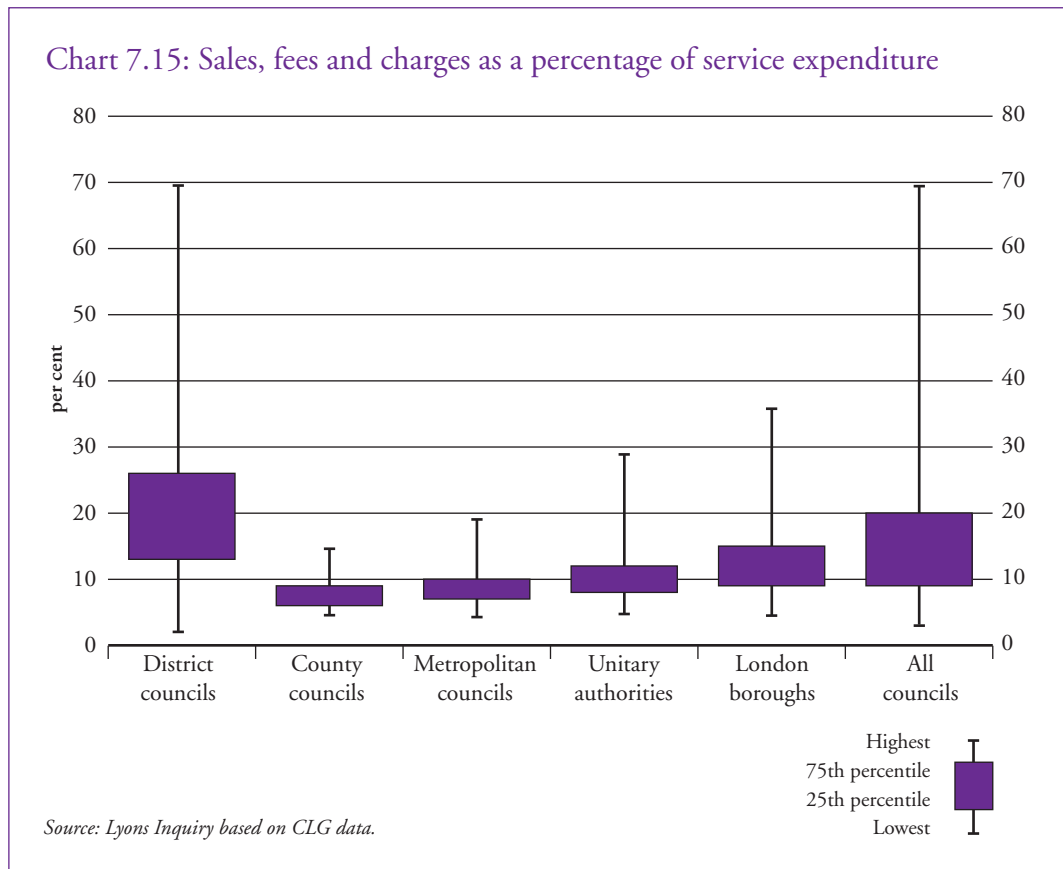
The current picture

7.246 Income from charges already represents a significant part of local authorities' revenues. In 2003-04 (the latest year for which published data in this form is available), local authorities received approximately £10.2 billion from sales, fees and charges, which comprised 8.5 per cent of all income.⁴⁶ Over a quarter of all councils raised more income from sales fees and charges than from council tax. The amount of money raised from fees and charges has grown steadily and in line with total spending, making charging income a relatively stable proportion of local revenues.

7.247 There is a high degree of variation between areas, and between services, in the use of charging. In cash terms, revenue from charges is highest from social services, education, and highways. As a proportion of all funding for different services, charging income is most significant in highways and transport spending.

7.248 Chart 7.15 shows that charging as a proportion of service expenditure varies significantly between types of authority, whose powers will differ, but also between authorities of the same type. Since authorities' spending levels also differ widely, this means that there is also significant variation in the level of charges raised per head of population in different authorities.

⁴⁶ Some outturn data on revenue from fees and charges is available for 2004-05 and 2005-06; however comparable data on the overall proportion of local authority income derived from charging is not available beyond 2003-04.



Legislative powers on charging

7.249 Local authorities have a variety of powers to charge for different services, many of them enacted as individual provisions attached to a particular local government function. The Audit Commission’s 1999 paper *The Price is Right* noted the wide variance in councils’ discretion to charge for different services, from those which could be charged for at levels set locally, to those which councils were required to provide and prohibited from charging for. At that time the Audit Commission recommended that government should undertake a review of the logic and consistency underpinning the framework of charging powers, and consider introducing a general power to charge for discretionary services, to encourage local innovation.

7.250 In 2003 the Government introduced such a charging power, and new powers to trade commercially (see box for more details). These changes were to some extent the financial corollary of the well-being power in the 2000 Local Government Act, which enables authorities to take any steps they consider likely to promote or improve the economic, social or environmental well-being of their communities but did not extend to raising taxes or charges. Following the 2003 Act, local authorities have been able to take innovative action in support of local well-being, alongside relatively widely-drawn charging powers around non-core services. Taken together these provisions represent significant new local flexibilities.

Charging and trading powers in the Local Government Act 2003

Section 93 of the 2003 Local Government Act conferred a new power on ‘best value authorities’ to charge for some services.⁴⁷ Certain conditions apply to this power:

- authorities may only use this power to charge for “discretionary services”. This excludes services that the authority has a statutory duty to provide, but covers improvements to statutory services that go beyond the level of provision required by law;
- authorities may only set charges up to the level that is deemed to “cover the cost of provision” – that is, they may not make a profit through the use of charges under this power; and
- if another legal power to charge already applies to a service, or an authority is expressly prohibited from charging for a service, this power may not be used.

Authorities can continue to charge for statutory services or charge at levels above cost-recovery where there were already legal powers to do so.

Section 95 of the 2003 Act makes provision for the Secretary of State to empower best value authorities to do for a commercial purpose anything that they are authorised to do to carry out their ordinary functions, by trading commercially through a company. This provision allows for such companies to trade at a profit, which may be returned to the local authority through dividends and shares. A local authority must prepare a business case and risk analysis before using trading powers.

Full details and guidance on the use of charging and trading powers under the 2003 Act may be found at www.communities.gov.uk

7.251 However, early evidence on use of these new powers suggests that take-up of these new flexibilities has been limited. A survey by the Local Government Association in 2004⁴⁸ showed that 77 per cent of councils were not using the new charging powers and had no plans to do so. Around 80 per cent were not using the new trading powers and had no plans to do so.

7.252 That survey was conducted when the new powers were still relatively new and untested; as yet there is not enough data to judge how far their use has since moved on. A recent CLG paper suggested that:

*trading and charging powers, while welcomed ‘in principle’ by some authorities and deployed by others, are perceived by most authorities to be having a marginal impact...; this is an area where a small number of ‘innovating authorities’ are keen... but where most authorities are reluctant to explore the limits of the powers available to them.*⁴⁹

7.253 It is disappointing that local authorities, many of whom lobbied strongly for the wellbeing power and for greater financial flexibility, have not embraced the new charging and trading powers more enthusiastically. It is therefore important to understand what barriers, either internal or external, might prevent local government from innovating in this area.

⁴⁷ Authorities in the top three categories in their Comprehensive Performance Assessment: ‘excellent’, ‘good’ or ‘fair’.

⁴⁸ LGA, *Loosening the reins: a survey of local authority approaches to prudential borrowing, charging and trading*, 2004.

⁴⁹ CLG, *Evaluation of Freedoms and Flexibilities in Local Government: Baseline study*, 2006.

Barriers to wider use of charging and trading powers

7.254 Early work by the Audit Commission to investigate the latest picture on use of powers suggests a number of possible barriers to charging and trading:⁵⁰

- public acceptance of charging schemes can be difficult to secure. The Audit Commission suggest that high quality engagement with the public is crucial to securing support for charging schemes, by providing clarity about the policy aims being pursued, and the likely benefits to service users. Poor engagement risks public suspicion that charges are in place only to raise revenue, and that they may be paying twice for the same services;
- political willingness to consider charging or trading is crucial. Some councils express a preference for taxation over user charges, seeing this as a fairer way of providing 'free' services. This is a legitimate debate and should be subject to local choice: however the Audit Commission suggest that this debate has some way to go in engaging local service users and taxpayers:

There would seem to be little public appetite to fund increasing proportions of council activity through direct charging. This may simply reflect the fact that no one has yet made a convincing case to the public for changing the balance of funding from taxation to charges. (Audit Commission)

- capacity constraints can be a problem, particularly in smaller councils for whom developing charging policies that take account of information about service costs, local markets and the likely impact of charges may be challenging. Trading is regarded by some councils as complex and risky, or peripheral to councils' core role as a provider of public services. There is also a perception that guidance from central government on local authority trading has been cautious, which does not encourage innovation or risk-taking;
- information on the cost of service provision may not be available or well understood. Some councils cite difficulty in discerning the true costs of services as a barrier to making use of the 2003 power, which requires that charges do not exceed cost-recovery; and
- European Union procurement rules may be a particular barrier to local authority trading, since they will impact on councils' ability to award contracts to their special-purpose trading companies. The complexity of the rules in this area may deter councils from entering the fray.

Local behaviours

7.255 It is striking that while some of these barriers are structural, such as the interaction between trading powers and EU legislation, the majority are linked to local government confidence and behaviours. I have not found evidence that central government has got the legal framework drastically wrong, nor that the powers conferred on authorities are too tightly drawn to permit action. However this apparent lack of capacity and confidence to innovate perhaps further demonstrates that local strategic decision-making has been 'crowded out' by local authorities' perceived core role as service deliverers against a centrally-allotted budget. There is perhaps a need to both make space for local action, and to create an appetite for it.

⁵⁰ Audit Commission, *Charging for local services: submission to the Lyons Inquiry based on scoping research for a national study*, 2006.

7.256 Some councils are making innovative use of charging to pursue policy objectives and help meet costs in a way that is perceived as fair. For example, Cornwall County Council has used charging powers to finance the investment needed to upgrade facilities at Newquay Airport. The council-owned airport encourages inward investment to the region and supports local tourism. Though unpopular with some airlines, the £5 per passenger charge ensures the Council's share of the £44 million improvement costs are borne largely by airport users and not local council taxpayers.

7.257 However, the general picture is one of reticence on the part of authorities to make wider use of charges. 'The Price is Right' suggested in 1999 that only 12 per cent of local decisions about charges were the result of tariff redesign or a wider review of charging policy. The vast majority of charges were simply increased with inflation or were not changed at all. This is a significant missed opportunity, since it suggests councils are not taking a strategic approach to making charges and services work together. The Audit Commission make the valid point that 'doing more' on charging need not always mean higher charges – one council in their study suggested that reducing charges could increase service use, which could mean greater efficiency against fixed overheads.

7.258 The Local Government Association (LGA) and Improvement and Development Agency (IDeA) published advice for councils on getting the best from charging and trading, including a checklist of key actions including:

- conducting an internal review of charging and trading activity;
- adopting a policy on charging and trading in line with the council's strategic aims;
- taking forward an appraisal of the options available to the council; and
- agreeing and implementing a business case and change programme that take into account both practical and cultural steps needed to charge or trade successfully.⁵¹

7.259 These seem to me the right tests of whether authorities have explored the possibilities that charging might offer, and I endorse them fully, but would add that significant changes must be informed by, and communicated through, effective engagement with the local community, including citizens, businesses and the voluntary sector, as appropriate.

The legal framework for charging

7.260 A wide range of legal powers to charge already exist, and I do not yet see a case for more widely drawn general powers than the 2003 Act provides, though the discretionary power in the 2003 Act should be made available to all local authorities. Powers to charge should be a means by which councils can exercise strategic management of local budgets, not a reward scheme for those who have already done so.

7.261 Some submissions argued that the removal of the 'cost recovery' restriction would free up local authorities to charge. However it is not clear that councils have yet exhausted the opportunities available to them within the cost-recovery restriction, and it may be appropriate to reflect on those powers after several years of use before judging them inadequate. Developing a good understanding of real service costs should in any case be part of sound financial management and should be part of the evidence underpinning decisions about charging for services.

⁵¹ IDeA, *Enterprising councils: getting the most from charging and trading*, 2005.

7.262 However there may be a case for a review of local authorities' scope to charge for statutory services, where provisions have evolved piecemeal and may not represent a coherent whole. As discussed in Chapter 3, it is not obvious why, for example, councils are permitted to charge (often significant amounts) for social care for the most vulnerable, but may not charge for other services such as waste collection or the lending of library books. Greater coherence across these powers might help provide greater clarity to both local authorities and to the public, though further detailed work, such as that being undertaken by the Audit Commission, will be needed to explore this more fully.

Recommendation 7.12

The powers to trade and charge conferred on 'best value' authorities in the Local Government Act 2003 should be extended to all local authorities.

Recommendation 7.13

The Government should carefully consider the wider framework of charging powers for statutory and discretionary services, including in the light of the Audit Commission's work when published later this year.

7.263 I am not recommending changes to the general framework of charging powers, but would encourage central government to make space for local innovation in this area, and to focus guidance in areas where central expertise can add value: for example in relation to EU procurement rules. There are however some specific areas in which new powers may be called for: particularly in relation to waste services, and around developing policy on congestion charging and road pricing.

Charging for waste services

7.264 Local authorities may not, at present, charge for the collection and disposal of household waste, with some exceptions, for example the collection of bulky items. Local authorities also have powers to fine residents if, for example, they contaminate recycling or do not comply with compulsory recycling schemes. Local authorities already have the right to charge businesses for the collection of waste.

7.265 As set out in Chapter 4, waste policy in future will have to meet the challenge of reducing the volume of biodegradable municipal waste sent to landfill, in line with EU legislation. Councils now have 'landfill allowances' which they can trade with other local authorities, but which they may not exceed. If excess waste goes to landfill, heavy fines can be imposed on the authority, creating a risk that council taxpayers might have to bear these punitive costs.

7.266 Increasing the amount of waste that is recycled is a key part of managing these challenges, as is action to reduce waste volumes 'upstream'. There is already evidence of significant local variation and innovation in this area.

Action by councils to encourage recycling

Blaby District Council is one of a large number of councils that provide an integrated refuse and recycling service. Residents are provided with two wheeled bins, one for refuse with a black lid, and the other for recycling paper and card with a green lid. Also provided are two smaller containers for recycling. Garden Waste is also collected separately.

The standard bins are both 140 litres and are of a slim line design to minimise the space required to store them. Bigger bins are available upon request, but larger refuse bins usually require an additional payment, except in medical circumstances. For households who only need extra capacity occasionally, 'Blaby District Council Extra waste sacks' can be purchased from local outlets.

The refuse bin is emptied on a weekly basis. The recycling containers are optional and are emptied every fortnight. Garden waste can be collected in either special garden waste wheeled bins, or 'Blaby District Council garden waste sacks' available from local outlets again for an additional charge.

Since the scheme became fully operational in January 2005 the recycling rate looks set to increase from 29 per cent to a projected recycling rate of 39 per cent in 2006/7. In addition, the chargeable bags/bins system has proved to be a substantial income generator for the Authority, which in turn keeps the overall costs of the service to an acceptable level. A further noticeable benefit is a 3 per cent reduction in the total amount of household waste generated.

Barnet, in London, has adopted an innovative approach to recycling – by making it compulsory. Under the Environmental Protection Act 1990, local authorities may require residents to use particular containers for different waste materials. In this new scheme, the council requires residents not to put glass, paper or cans, in the black wheeled bin for general waste but instead provides a black box for these items to be collected separately for recycling.

A trial compulsory recycling scheme ran in four wards from April 2004, and was expanded across the Borough from March 2005. The compulsory recycling scheme does not apply to those in households who have shared refuse facilities, such as flats.

Monitoring of compliance is based on the use of recycling boxes by households. Recycling assistants visit households who do not regularly recycle in order to further explain the scheme and encourage people to participate. Residents who persistently and deliberately fail to recycle receive warnings and formal notices. Only as a last resort will the council prosecute the most persistent offenders – this has not been necessary so far. As a result of the scheme, resident participation in recycling has risen from a low of 40 per cent to around 85 per cent and resulted in a 28 per cent increase in tonnage of waste recycled in 2005-06.

7.267 During the course of my Inquiry I have received a number of submissions – including from local authorities, environmental groups and waste management organisations – detailing the advantages and disadvantages of various waste charging schemes. A key theme through these submissions and at Inquiry engagement events has been that introducing a charging regime would act as a powerful incentive on householders to reduce the amount of waste they produce and encourage them to recycle and compost more of that waste. It might also be seen as a fairer way of spreading the costs of waste disposal, with the heaviest waste-producers contributing most.

You only have to look at a landfill to know that it's bad to continue in this way. (Shropshire resident engagement event)

In [another area] the size of your bill is set by the size of your bin. Small bin, small bill. I live alone so I don't throw away the equivalent weight of a small child every week, so why should I pay for people who do? (Barnet resident engagement event)

7.268 Given the severity of the pressures likely to arise in the waste system – both financial and environmental – I can see that a power to introduce variable charging for household waste could have a significant role to play in reducing the waste we produce and recycling more of that waste, and might be a sensible addition to councils' financial 'toolkit'.

7.269 Local authorities would need to ensure that any new scheme addressed a number of potential problems. The submissions I have received and the evidence I have gathered make it plain that a poorly thought out variable charging system would have the capacity to impact most harshly on those people least able to afford it, particularly young families. Some respondents also raised the issues of fly tipping and 'waste tourism', which would need to be addressed as part of a new system.

7.270 In addition, there would need to be clarity about the purpose of any new charge, and how it interacts with council tax. My public perceptions work clearly demonstrates that people consider waste management to be a key local authority activity, and that many feel they already pay for this service through their council tax bill.

Variable charging – if introduced – needs to be part of a greater system, not a solution in its own right. In particular, people will need to be able to avoid charges by being able to easily access recycling facilities. (Green Alliance, waste seminar)

Recycling should get you a discount off your council tax. We already pay for the bins and we shouldn't have to pay more for not recycling. (Shropshire resident)

Fining encourages you to do it, but it's a bit big brotherish – we don't want the bin police. (Essex resident)

7.271 These perceptions will have an impact on the design and development of any variable waste charging scheme, and its acceptability to local people. Public understanding of the principles behind a charging scheme is essential, putting a premium on effective public engagement to secure local support for new policies on waste.

7.272 There is evidence of emerging pressures on waste budgets as we reduce our dependence on landfill, in the face of an upward trend in waste volumes. Charging powers in this area would represent a significant new flexibility to manage pressures on budgets according to local preferences.

7.273 I am clear that charging should be a matter for local choice, and am not proposing that it be rolled out nationally or in a way that does not reflect community preferences. However if tailored to local circumstances, variable charging might be a means by which incentives can be created to reduce waste and thereby reduce costs – and could help ensure that the remaining costs are shared in a way that may be perceived as fair.

Recommendation 7.14

The Government should take new powers to allow local authorities to charge for domestic waste collection, developed in close consultation with residents and other key stakeholders.

Road pricing and congestion charging

7.274 Congestion charging and road pricing have been raised by a number of submissions to the Inquiry as a possible source of revenue for local authorities. Powers to operate congestion charging schemes were introduced for authorities outside London in the Transport Act 2000, in instances where charging would support the Local Transport Plan. These are still relatively new powers, and local authorities face a considerable challenge in building the public understanding of, and support for road pricing that would be necessary for schemes to go ahead. In light of that, and given the long-term nature of much transport investment it is perhaps not surprising that powers in this area are still largely untested, with the notable exception of London's congestion charge.⁵²

7.275 Road pricing therefore represents an area of developing policy, in response to congestion and associated concerns about the environmental impact of road travel. It is important, in my view, that the debate about road pricing can be taken forward in the communities that are affected by congestion and the citizens and businesses that would be affected by charging schemes.

A local role in road pricing

7.276 Many of the negative impacts of congestion are felt locally: while carbon emissions are obviously of wider significance, congestion also impacts on the local environment through air pollution, and on local homes and businesses, with consequences for the prosperity of local economies. Equally, many of the causes of, and solutions to congestion are local, making local knowledge a key advantage in designing charging schemes that can tackle congestion while avoiding perverse consequences.

7.277 On a more pragmatic level, local engagement and buy-in would be important to the wider road pricing agenda. Local councillors have a key responsibility in building public support for charging schemes through engagement with their communities, and would be held accountable for unpopular schemes.

7.278 Under the 2000 Act, it is likely that the difficult engagement necessary to get a road pricing scheme off the ground would be delivered locally. In that context, it is right that locally accountable bodies should also have the freedom to invest revenues according to the 'deal' communicated to and agreed with local citizens. Without this, councils' incentives to engage with road pricing and be locally accountable for its success would be undermined.

Retention of the revenue raised from road pricing is a major incentive towards using this as a demand management measure where this is an appropriate element of a local transport strategy... If local schemes become established, there will be a steady demand for spending the funds on transport schemes at a local level to meet local needs. (Norfolk County Council)

Hypothecation of congestion charging revenues

7.279 Under the 2000 Act, local authorities that introduce congestion charging schemes before 2011 can keep the revenues and must spend the revenues on improving transport in their areas for the first ten years of the scheme's operation. Similarly in London, congestion charging income has been used to support investment in public transport, particularly buses.

7.280 I have a general presumption against ring-fencing funds, which can restrict the scope for local choice and produce incentives to make priorities follow funds, rather than the other way around. Place-shaping local government requires room for manoeuvre; decisions about how to make use of congestion charging should properly be a matter of community choice. I recognise that in some circumstances hypothecation of funding streams can help build public support for a charging scheme by making the benefits of that new public investment appear more tangible or targeted. However when revenues are raised locally it is reasonable that responding to public

⁵² The London congestion charge is based in powers in the Greater London Authority Act 1999.

concerns about the benefits of charging schemes, including by deciding what the revenue should be spent on, should be a matter for local accountability.

7.281 In that light, the Government should consider removing restrictions on the use of road pricing revenues, and as a minimum should ensure that any hypothecation operates at a strategic level that allows local authorities to take a broad view of their investment priorities, and the views of their communities.

Developing national and local policy together

7.282 If national road pricing were to be rolled out in future, it would be important that the advantages of local schemes were not lost. Given the importance of transport policy for local authorities' place-shaping role, and in recognition of councillors' accountability for charging schemes in their areas, local government might properly have a role in national road pricing. While recognising that the government will want to consider these issues in the context of wider national policy on road pricing, ministers will need to continue to be mindful of the incentives for, and benefits of local action in this area.

Conclusions

7.283 Charges are a widely used and significant part of local authorities' financial landscape. While take-up of the new powers has been relatively limited, in time one would expect to see greater innovation under these new provisions, and indeed take-up of older powers is much more widespread. There is substantial variation between areas in their use of charging powers, and it seems likely that while some of that variation reflects local choice or circumstances, it also partly reflects the level of councils' willingness to engage with charging and take a strategic approach to its use.

7.284 Some councils are at the forefront of innovation in this area. Well-designed charging schemes can help to manage demand for services, influence behaviours, or build in equity by using charges on some users to subsidise others. As such they form an important part of local authorities' policy toolkit.

7.285 There is room for a much fuller conversation with local service users and taxpayers about the best way to fund local services. Stephen Bailey argues convincingly that public support for charges is unlikely to be secured if they are perceived as purely revenue-raising rather than as supporting a policy goal.⁵³ Equally however, many responses to the Inquiry's consultation on council tax expressed a perception of fairness in terms of the 'benefit principle', whereby those who use services would also pay for them.

7.286 I would suggest that given the pressures on council tax, a move towards services users meeting some costs directly, rather than allowing the costs to fall on council tax, might itself be a policy aim, and one which councils could legitimately open up for public debate. User charges have a valid place alongside local taxation, and in some contexts may be perceived as fairer. As a minimum, when local authorities face a choice between increasing charges or council tax, or reducing service provision, that trade-off should be made transparent to citizens, with charging presented as one of the options where available. I would encourage all local authorities to take a strategic approach to the use of charges, including as part of the range of levers available for managing pressures on budgets and on council tax.

⁵³ Bailey, S. published by CIPFA Technical Information Service, *User Charges for Services – a response to the Lyons Inquiry interim report*, 2006.