

LGiU

Local Government
Information Unit

Making it fair

Council Tax
Benefit and
working
households

np
ew policy institute

MAYOR OF LONDON

Association of
London Government

UNISON
the public service union

pcs
Public and
Commercial
Services Union

IPPRV
INSTITUTE OF REVENUE
AND TAXATION

This report was commissioned by the Local Government Information Unit and written by Peter Kenway and Guy Palmer of the New Policy Institute.

The LGIU is unique among the local government family in providing an independent intelligence service to local authorities, built up over 20 years. Free from political constraints, our analysts quickly interpret policy changes and legislation and provide practical advice on the implications for individual authorities. All our policy analysts are recruited for their knowledge, experience and contacts across government and have worked extensively at senior level in local authorities, both as officers and councillors.

Contents

	PAGE
Summary	1
Introduction	2
Council tax with CTB: a hybrid property/income tax	4
The meanness of CTB	6
Anomalies, inconsistencies and disincentives to work	11
Directions for reform	13
The timetable of possible reform	15

Summary

Council Tax Benefit (CTB) is very important – but it is also badly flawed. **Above all, it is really mean for working-age households.**

The starkest evidence of this is that some two thirds of children in poverty in the UK live in households that receive either no CTB, or partial CTB only. This is because most households have to pay some council tax well before they become liable to income tax and when they are still below the poverty line. Reform of CTB could have a major impact on meeting government targets to reduce child poverty and worklessness.

CTB creates disincentives to work for low income households who are hit by council tax payments before they can get the boost from Working Tax Credit (WTC). A fifth of WTC disappears immediately it is awarded because CTB is reduced as a result. CTB is not properly integrated with the tax credit system and with WTC in particular.

CTB suffers from anomalies and inconsistencies. Working-age households, both singles and couples, start paying council tax at levels of income that are little more than half the levels at which pensioners start paying. Low-income adults aged under 25, in particular, suffer from the inconsistencies of the CTB system.

Finally, the elements of the benefit system aimed at extending and easing entitlement to CTB for those moving into work are poorly designed. Combined with the way the system works, this adds to the risks associated with moving into work, undermining other incentives.

Three basic reforms are required:

- The primary reform is to make CTB much more generous for working-age households. This will both strengthen incentives to work and contribute to reducing poverty.
- The anomalies and inconsistencies within CTB need to be eliminated by basing it on clear principles that conform more closely with those in the income tax and tax credit system.
- The administration of CTB should be altered to make it easier for working-age households to claim it. Consideration should be given to whether the tax credit system might have a role to play here.

Introduction

This paper is a sequel to *Council Tax: the answer?*, published last year by the Local Government Information Unit (LGIU), which set out a series of proposals to reform the council tax in April 2007, at the same time as the revaluation of all properties for council tax purposes takes effect across England.

That paper, which made the case for retaining council tax, also recognised that the differential rise in house prices across England combined with higher tax rates and generally rising house prices meant that there was no acceptable way forward to revaluation within the confines of the current national eight band system. It, therefore, argued for a reform of the tax through the addition of new bands at the top and the bottom, coupled with the introduction of some regional banding. It also argued for a reform of the administration of Council Tax Benefit (CTB), which would be of particular value to pensioners.

The subject of this paper is narrower, namely the problems that **low income, working-age households** face with council tax and the means-tested CTB that is meant to help them.

Since the political sensitivities on council tax are usually seen as being related to pensioners, this focus on working-age households needs some explanation. The problems for pensioners with council tax have been a political issue since the protests that were sparked by the average 13 per cent rise in the tax across England in 2003.

In theory, CTB means that single pensioners with incomes up to £105 a week and pensioner couples with incomes up to £160 should pay no council tax at all, while those with incomes up to twice those levels should see annual increases in council tax that are no bigger than the annual increase in their pensions. In practice, CTB works badly, partly because many pensioners fail to claim the benefit they are entitled to and partly because the restrictive rules about savings disqualify others.

Council Tax: the answer? argued that the protection provided on paper by CTB could be achieved in practice by changing both its appearance and administration, such that it could be administered centrally (for example, by the Pension Service). This idea has received support from others¹ and we understand that something similar is being examined by government.

The reason why this paper looks at the issue from the point of view of low income, working-age households is precisely because this group has received inadequate attention. Does this mean that they do not really face any problems? Or, if they do, that they are not that big? If problems do exist, are they essentially the same as those faced by pensioners and thus amenable to the same sort of solutions? By contrast, if they are both big and different from those faced by pensioners, what could be done about them? This paper provides answers to each of these questions².

¹See for example, *Reforming Council Tax, the Case for Change*, Local Government Association, January 2005.

²This paper itself is based on a much longer working paper, *Council Tax Benefit for Working-Age Households: a Review of the Problems and Some Options for Reform*, which is available on the NPI and LGIU websites (www.npi.org.uk and www.lgiu.org.uk).

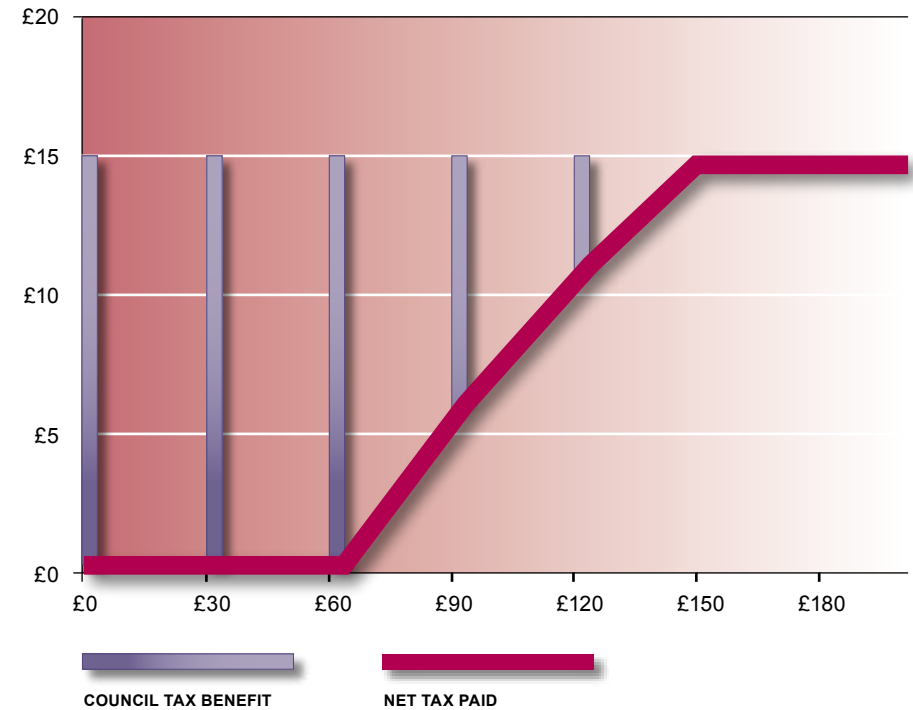
Council tax with CTB: a hybrid property/income tax

The crucial point to understand about CTB is that it is an integral part of the council tax system. It is not a sum of money (like Income Support or Pension Credit) which is paid over to a household to boost its income. Instead, CTB reduces the amount of council tax that the household is required to pay. Most discussions of the council tax system, including those that are critical of it, ignore CTB. With more than a fifth of households in Britain entitled to CTB, this neglect is thoroughly misleading; indeed, more people are entitled to CTB than any other means-tested benefit. More importantly, though, CTB changes the very nature of the council tax system, transforming it into a hybrid tax – a combination of a property-based tax for most households and an income-based tax for the rest.

Graph 1 illustrates how this works for a single non-pensioner adult aged 25 or over, living alone, whose normal liability to council tax (that is, the tax based purely on the home they occupy) is £15 a week. The graph shows how the actual liability to council tax starts to rise as their earnings increase. Liability is calculated on net income, that is, after tax credits have been included and after income tax and National Insurance have been deducted (which explains the slight curvature of the line). Liability begins at a level of income related to what the person would get by way of Income Support (or, if they were a pensioner, by way of the guaranteed part of Pension Credit). Thus:

- with weekly earnings of less than about £60 a week, the person is entitled to full CTB (worth £15) and therefore pays no council tax
- as weekly earnings rise above £60, CTB falls by about 20 pence for each extra £1 of income, so the amount of tax to be paid rises correspondingly
- at weekly earnings of £150, CTB falls to zero and the person pays the full amount of council tax (£15).

GRAPH 1: At low levels of income, it is income itself rather than the 'normal' council tax applicable to the home that determines how much council tax a person actually pays³



Whether or not the combined CT/CTB system is administered explicitly as a hybrid tax, it is highly desirable that it should be thought about in these terms by politicians, policy makers and commentators. This is because the hybrid tax is what the low income household actually experiences – and how it pays.

³Source: NPI calculations assuming one worker in the household is paid at £5 an hour. This graph, and all others like it, assume that household savings are below the limit at which they affect entitlement to CTB.

The meanness of CTB

Although a sixth of working-age households that are estimated as being entitled to CTB do not claim it, this is lower than the comparable official figure for pensioners of two-fifths⁴. So, although low take-up is a problem for working-age households, it is not as big a problem as it is for pensioners. It is also not, in our view, the main problem. Rather, our analysis suggests that there are three basic problems with CTB as it affects working-age households:

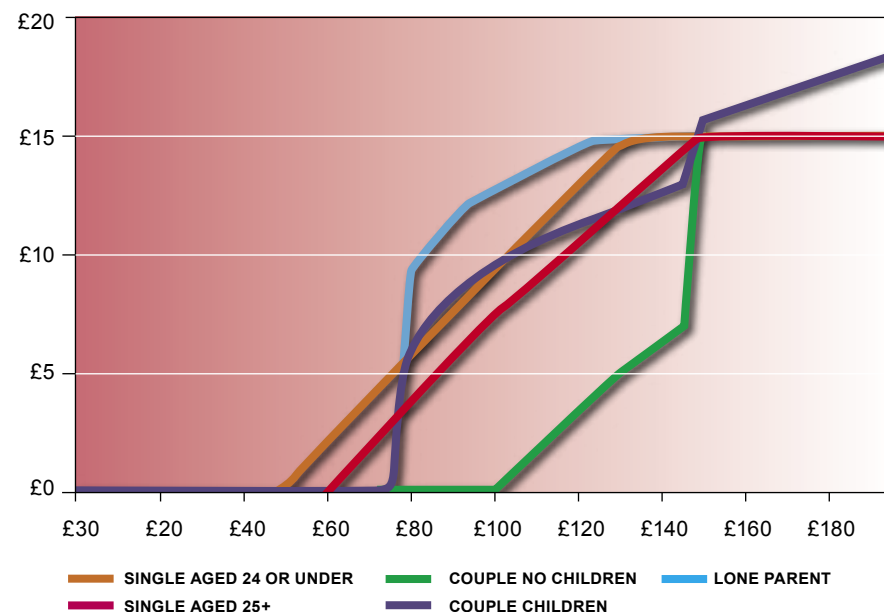
- it is mean
- it is full of anomalies, and
- its administration is deficient.

Of these three, the most important is the meanness.

Graph 2, which is a development of Graph 1 (the red line here is the line in Graph 1), shows the weekly amount of council tax paid by various low-income, working-age households depending on their level of weekly gross earnings. This graph is drawn on the assumptions that the household's normal liability to council tax (that is, the tax based purely on the home they occupy) is £15/£20 a week for singles/couples and that just one adult within each household is working (at a wage rate of £5 an hour). Different assumptions about the wage rate and the number of people working in each household would alter the details of the picture but not the basic pattern.

⁴Source: *Income Related Benefits Estimates of Take-Up in 2002/2003*, DWP, February 2005.

GRAPH 2: The relationship between income and council tax for low income households is greatly complicated by the presence of Working Tax Credit⁵



There is much to see in this graph. First, the various lines have very different shapes with no obvious pattern. This illustrates the complexity of the CTB calculations and how they affect different family types differently. The main reason for this complexity is the interaction between the amount of Working Tax Credit (WTC) being received and the amount of CTB due.

Second, the point at which each curve leaves the horizontal axis (the *lower earnings threshold*) corresponds to the weekly earnings at which CTB starts to fall below its maximum, meaning that the household has to start paying some council tax. These thresholds vary greatly, from between £50 and £60 a week for single adults to around £100 a week for couples without children. Two things stand out here, both of which are testimony to the meanness of CTB for working-age households:

⁵Source: NPI calculations

- how much lower they are than the comparable thresholds for pensioners, namely £105 for a single pensioner and £160 for a pensioner couple
- the fact that, except for the couple without children, households start paying council tax well before they start paying income tax or National Insurance, liability for which begins when gross weekly earnings reach about £90.

Third, the points at which each curve reaches its maximum, corresponds to the point at which all entitlement to CTB has disappeared, **leaving the low income household paying full council tax**. These upper earnings thresholds also vary a lot, ranging between £130 a week gross earnings for a lone parent and £225 a week for couples. Yet these levels of earnings are still very low, reached in fewer than 30 hours a week at the minimum wage for the lone parent or 35 hours a week at £6.50 for one adult in a two adult household.

Just quite how low these upper earnings thresholds are becomes apparent in table 1: with the exception of the lone parent household, all the households are paying full council tax on levels of income that are below the income poverty line by up to £50 a week.

Table 1: Most working-age households lose all entitlement to CTB at earnings levels that mean they are still in poverty⁶

Household	Gross weekly earnings at which CTB is zero	Net weekly income after deducting housing costs ⁷	'Poverty line' ⁸	Amount by which net weekly income falls short of poverty line
Single under 25	£135	£60	£105	£45
Single 25 or over	£150	£95	£105	£10
Lone parent	£130	£205	£195	n/a
Couple	£225	£140	£190	£50
Parent couple	£225	£240	£280	£40

⁶Gross weekly earnings at which CTB is zero' and 'net weekly income after housing costs': source – NPI calculations

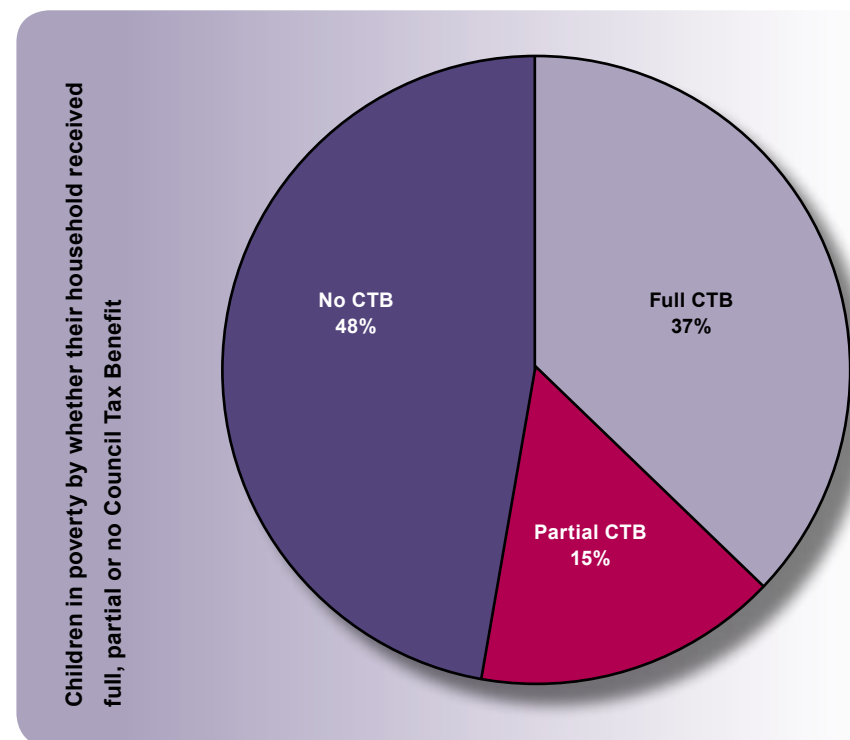
⁷It is the receipt of tax credits which allows net weekly income after housing costs to be higher than gross earnings.

⁸A 'poverty' income is defined here (and subsequently) as one that is below 60 per cent of median household income, after deducting housing cost. The precise values, which vary according to the composition of the household, are sourced from the Government's annual publication *Households Below Average Income 2003/04*, uplifted by 5 per cent as an estimate for 2004/05.

The effect of all this is to be seen in the official child poverty numbers. Graph 3 classifies the 3.5 million children whose household income fell below the low income threshold in 2003/04 according to whether the household received full, partial or no CTB. It shows that:

- barely more than a third of children in poverty were in households receiving full CTB
- another sixth were in households receiving partial CTB
- the remainder – **just under a half of children in poverty** – were in households that received no CTB whatsoever.

GRAPH 3: 48 per cent of children in poverty in 2003/04 were living in households that got no CTB; a further 15 per cent were in households getting only partial CTB.⁹



⁹Source: *Households Below Average Income 2003-04* (NPI analysis). Percentages for England and Wales.

These figures are striking. They mean that, in 2003/04, 2.2 million children in Britain were in households with incomes below the income poverty line but which were paying some or full council tax. Of these, a quarter of a million were in households whose income fell below the poverty line by an amount less than they paid in council tax – in other words, the council tax they paid could be said to be the immediate cause of their being in poverty. Certainly, non take-up of CTB plays a part in explaining these figures. However, with two thirds of the children in households getting less than full CTB being in households where at least one person is working, it is the meanness of the CTB system that is the major factor.

Anomalies, inconsistencies and disincentives to work

CTB has always been treated as part of the benefits system and is therefore designed to 'fit' with it. This can be seen most clearly in the levels of income at which different types of household cease to be entitled to full CTB (that is, they have to start paying some council tax). In all cases, these levels are set in relation to the minimum guaranteed level of income available to each household, either via Income Support for working-age households or Pension Credit for pensioner households. However, what makes sense from a benefits point of view can produce some odd results for a hybrid income and property tax. For example:

- Single people under the age of 25 start paying some council tax on lower earnings than a single person aged 25 or over (as can be seen from the two lower earnings thresholds in Graph 2). As a result, a young single person receiving partial CTB (and therefore paying some council tax) on their 25th birthday would actually find their CTB going up and their council tax going down.
- Working-age households, both singles and couples, start paying council tax at levels of income which are little more than half the levels at which pensioners start paying. This reflects the big increases in the levels of means-tested support for low income pensioners over the past few years, delivered now via Pension Credit.
- Although single people get a 25 per cent discount on normal council tax, a single person receiving some but not full CTB will typically pay more council tax than a couple in an identical property and with the same income (again illustrated in Graph 2).

These results may or may not be judged to be desirable. The point is, though, that once CTB is recognised as part of a hybrid income and property tax, it is no longer obvious that conformity with the benefit system should be the overriding principle guiding its design.

A CTB rooted in the benefits system also creates disincentives to enter low paid work, which may be at odds with other reforms (eg tax credits) designed to boost incentives to work. For example:

- Because a liability for council tax usually arises before (ie at a lower income) than a liability to income tax, low income households may perceive council tax as a greater disincentive to work than income tax or National Insurance.
- Most households become liable to pay council tax before they become eligible for WTC. Prior to getting help from WTC – an incentive to make work pay – households therefore face a tax which reduces the degree to which work pays.
- The receipt of WTC (at 16 hours of work a week for those with children and 30 hours for those without) leads to an immediate fall in the amount of CTB, and a corresponding rise in the amount of council tax payable, of between £6 and £9 a week. It is this that accounts for the sharp jumps in some of the curves in Graph 2¹⁰. As a result, CTB further undermines the extent to which WTC actually helps make work pay. This does not happen with Child Tax Credit.¹¹

Another measure to help make work ‘pay’ is the arrangement to extend benefit for four weeks to some claimants who take up work and the arrangement to swiftly restore previous benefits if someone takes a job and then for some reason loses it or gives it up. Yet while demands for council tax are, quite rightly, despatched speedily when someone enters work, case study evidence presented in the technical report suggests that the complications in the system mean that there can often be long delays in the processing of extended payments and of new claims for CTB once a spell of work ends.

As a result, debts and arrears can build up, leading even to the threat of eviction from the home. That people should be averse to such outcomes is entirely understandable. Incentives to work are not just about helping people into work but also about giving them the reassurance that if, for some reason, they lose that work, they will not end up in debt. From that perspective, the administration of CTB is as important an incentive to someone to ‘risk’ work as measures that help make work ‘pay’ are, such as extended benefit or WTC.

¹⁰Although Graph 2 only shows sharp jumps for couples and for lone parents, it also applies to single adults aged 25 or over. As the graph uses a wage of £5 an hour, however, entitlement to WTC does not begin until all CTB entitlement has already disappeared.

¹¹Although Child Tax Credit is counted as income for the purposes of calculating CTB, there is an offsetting ‘disregard’ in the CTB rules, which means that, in effect, it is ignored for CTB purposes.

Directions for reform

Reforms are needed to different aspects of CTB to address each of these groups of problems, namely its meanness, its anomalies and the defects in its administration.

In our view, the priority is to make CTB for working age households much more generous, both to strengthen incentives to work and as a direct contribution to reducing poverty. There are three basic possibilities:

- As a minimum, we can see no reason in principle why the lower earnings threshold at which CTB starts to fall below the maximum, and at which council tax therefore starts to be paid, should be lower than the income tax personal allowance (around £90 a week).
- A slightly more generous option would be to set the lower earnings threshold at the level at which a qualifying household is entitled to full WTC (closer to £100 a week).
- A third possibility would be to set the thresholds at the same level as those for pensioners (£105 for single pensioners and £160 for pensioner couples in 2004/05). While the principle here of inter generational equity is an attractive one, the pension credit and (working age) tax credit systems are sufficiently different as to make it unclear why the thresholds for CTB for working age and pensioners should be the same. These pensioner thresholds could therefore be seen as the maximum for the lower earnings thresholds.

Changes to WTC also offer ways of making the CTB system more generous. There are two basic possibilities here:

- The first would be to treat WTC like Child Tax Credit (CTC) and disregard it for the purposes of calculating CTB.
- Alternatively, WTC could be increased and then continued to be treated as income for the purposes of CTB. The argument for this approach would probably rest on the superiority of providing working households with all their financial support through the tax credit channel.

Such reforms are obviously not revenue-neutral for the government. As they would contribute to reducing child poverty, however, they should be judged against alternative ways of using public money to achieve that goal. Moreover, because these reforms would lower the barriers to work faced by working-age households, their net cost to the government would be lower than the gross cost, thanks to the higher income tax and National Insurance yield and lower overall benefit levels that will occur as a result of the shift from worklessness to work.

The key to eliminating the anomalies within CTB lies in regularising the thresholds at which different household types start paying council tax. This requires that the council tax system be seen by policy makers as a hybrid income and property tax, which is what low income households actually experience.

Options for improving the administration of CTB to make it easier to claim include:

- Making alterations to the onerous conditions that are attached to the potentially very useful Extended Payment Scheme, the Rapid Reclaim procedures and the Change of Circumstance procedures.
- Re-drawing the boundary between CTB and WTC so that, for those working 16 hours a week or more, CTB is replaced by a council tax credit element within a much more generous WTC, but with the household then having to pay full council tax to its local authority.

It is acknowledged that this last idea would constitute a radical change, involving a further extension of the tax credit system. There are certainly a number of concerns with the idea (for example, on the impact it might have on council tax collection rates), all of which would need to be examined in a full evaluation of the idea. It is, however, important to recognise that, whether intentionally or not, WTC already plays this role in part, giving households additional income but also increasing their liability to council tax at the same time. Ultimately, the merit of the idea will turn on the judgement about how well the tax credit system overall is performing. If the judgement is that performance is good, a radical idea of this kind may be what is needed to deal with the important yet intractable problem of how to make CTB 'work'.

The timetable of possible reform

The necessary policy levers to make CTB more generous already exist, both within CTB itself but also within the tax credit system, especially Working Tax Credit. There would, therefore, be no legislative barrier to these changes being made in time to coincide with the introduction of the updated council tax system due in April 2007. Likewise, most of the changes necessary to remove anomalies and inconsistencies could be handled in the same way.

Any reforms to the various arrangements within the benefit system, which help people moving into and out of work, would probably need legislation, but this is not a major barrier to reform.

By contrast, any major system reform, for example involving the tax credit system taking over some of the role currently played by CTB, would take longer to bring in. If the change is judged to be of a comparable scale to the reforms to tax credits introduced in 2003, then a lead-in time of some four years would probably be required. This would still allow real change to be delivered within the lifetime of this parliament.

The Local Government Information Unit

22 Upper Woburn Place, London WC1H 0TB

Tel 020 7554 2800

Fax 020 7554 2801

Email info@lgiu.org.uk

Web www.lgiu.gov.uk