Council Tax: the answer?

Centre for Council Tax Reform

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Published by the Local Government Information Unit
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This publication is also supported by the trade unions PCS and Unison

Introduction

Compared with the poll tax, the council tax is widely accepted and understood. There are relatively few complaints from taxpayers about the structure of the tax; it is the 'experts' who mostly make the criticisms.[1]

We first looked at the council tax in 1998, when the LGIU and PCS asked us to review the tax in the wake of the government s decision that year to leave it unchanged for the time being. The conclusion we reached then was that the tax could and should be reformed. Since then, working both with local government and the voluntary sector, we have examined the whole thing in exhaustive detail and from various angles. This has not changed our basic view that reform is necessary, but it has greatly influenced our thinking about exactly how reform should be done.

The purpose of this paper is to set out our conclusions on how the council tax system in England should be reformed from 2007 when the government is anyway committed to making changes to bring the tax up to date. It builds upon a paper that we presented in January 2004 to the government s Balance of Funding Review which has council tax as part of its remit.

The future of the council tax is now a hot subject. But this is not because people have come to believe passionately in the need for reform. Rather, it is because council tax has been rising faster even than earnings, never mind prices. So over the first 10 years of its life, to April 2003, council tax for Britain as a whole had almost doubled. By contrast, average earnings were up by a half, while prices were up by around one third.

It is quite understandable that pensioners should be at the forefront of recent protests. Individual pensioners see council tax taking an ever greater proportion of their income, a proportion that is around double that for the working age population. In a time of low inflation, when most items of expenditure are either steady, or at least a result of decisions people themselves have made, rises in council tax stand out. They happen even when neither income nor expenditure

[1] Local Government White Paper, (Strong local leadership, quality public services), December 2001, p102.

has changed. Relentlessly rising costs that are out of control inevitably cause anxiety to people on fixed incomes.

The underlying cause of the big rises in council tax in recent years lies in what has happened to public expenditure and the share of it that councils have to raise locally. It is not actually the fault of council tax itself. Since this paper does not offer a total solution to local government finance, the reforms we propose here to the structure of the tax do not directly address this issue.

But one part of the council tax system, namely council tax benefit, does have the potential to ameliorate the effects of rising council tax for many people, especially pensioners, on lower incomes. Though usually thought of as just a minor element of the system, this so-called benefit actually has the potential to directly address the most sensitive of all the concerns about council tax, namely the impact that it has on people in large homes but with low incomes.

The trouble is, though, that the council tax benefit system is not working properly, with a woeful failure to reach the people it is supposed to protect. Reform of council tax benefit is an integral part of the reform of the council tax.

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The case for retaining council tax

With the increasing number of calls for the replacement of the council tax by a local income tax, we have to begin (in a way that used not to be necessary) by re-stating the arguments in favour of the council tax.

To begin with, it is entirely right that one of our many taxes should be a tax on property. Almost everything else apart from food is taxed. To do away with council tax would leave housing in a uniquely privileged position. This privilege would be quite unjustified, for as a scarce resource, there are strong economic arguments for taxing housing.

It is also a reasonable idea that the tax which is paid to the local authority should be based on housing since it is absolutely clear why any particular council is taxing any particular individual. Council tax is also relatively simple and easy to collect: for most taxpayers, the only information required to work out how much is owed is the band that the property is in and the number of adults living there. As a result, local authorities can predict how much money they will receive overall with considerable confidence and will know where to collect the money.

It is often argued that local income tax would be more closely related to the ability to pay than the council tax. But the simple fact of how much it costs to bring up children, or to pay for a house with a mortgage, means that it is quite wrong to assume that income measures ability to pay.

Furthermore, criticisms of council tax overlook the way in which one part of it, namely council tax benefit, does take income into account in a big way, providing full or partial relief from council tax for four million homes on the basis that their income is low.

In defending council tax like this, we are not arguing against a local income tax under any circumstances. We are, however, arguing, that while council tax certainly has its faults, it is not so obviously unfair, extraordinary or inflexible as to merit dismissal.

We believe that council tax can be made into a much better tax for a fraction of the political energy that would have to be devoted to abolishing it and replacing it with any alternative, however intrinsically good that alternative may appear to be. Reform, rather than the third massive upheaval in 20 years to the way the local government raises its own revenue, seems to us to be the overwhelmingly sensible course of action.

Why a basic revaluation is not enough[2]

Although there seems to be increasing recognition within government that some change to the council tax system is required, it is still worth starting by looking at why change, beyond what we call basic revaluation , is actually needed.

Council tax is currently calculated based on a valuation of properties undertaken in 1991. These valuations are due to be updated in 2005 and come into effect in 2007. This process of updating the valuations is called revaluation.

By basic revaluation , we mean the rolling forward of the current, eight band council tax system, using new valuations and increasing the band limits in line with average house price inflation across England as a whole since 1991. The multipliers, which relate the amount paid in any particular band to the amount paid in the reference band, band D, remain unchanged. Such a revaluation is effectively the do minimum option and we have to be clear about what is wrong with it before proceeding to develop an argument for exactly how it should be changed.[3]

There are two things that make basic revaluation an attractive option. First, being unchanged in all details bar the level at which the council tax bands are set, it has the merit of being familiar to the public.

Second, its effects would be reasonably transparent, with a clear explanation about changes in council tax levels. Around 12 million households would remain in the same council tax band as now and would see an unchanged council tax (before the usual annual increase). Around five million would go down a band, and thus see a fall in their council tax, because the value of their home has gone up since 1991 by significantly less than the national average. And 3 million would go up a band, and thus see a rise in their council tax, because the value of their home has gone up by more than the national average.

[2] This section is based directly on the New Policy Institute submission to the Balance of Funding Review.
[3] All our analyses assume that the total amount of council tax to be raised nationally will remain unchanged from what it would be if there were to be no revaluation.

This, though, is looking at the overall outcomes. Beneath this fairly benign, overall picture, the detailed pattern of results across the country and between bands is far from acceptable.

Because house price inflation has been higher across the South than the North and the Midlands, there would be huge variation after revaluation in the distribution of homes across the different bands in different parts of the country. In the North West, for example, 75 per cent of homes would be in bands A or B, compared with just under 40 per cent in the South West and just 6 per cent in London. These geographical variations would be much greater than they are at the moment.

As a result of these shifts, revaluation would cause council tax bills to fall on average across the north, and to rise across the south, including London.

This may sound good for the north and bad for the south. But it is actually much worse than that because, although bills would fall on average across the north, they would not fall for homes already in band A. It is obvious why this happens: to get a reduction in your bill your home has to go down a band — and homes already in the bottom band clearly cannot do that. So in general, the gainers in the north would be limited to those who live in the bigger homes outside of band A.

Across the south, the opposite happens: bills rise for homes in the low and middle bands, but do not do so for those already in the top band because for a bill to rise, a home has to go up a band, and a band H home cannot do that. So while the south on average pays more, the most affluent do not.

These simple points about the detailed pattern of winner and losers mean that basic revaluation is impossible to defend. Obviously, arguments can be put that bills should on average be lower in the north and higher in the south. But it is impossible to imagine anybody arguing that the half of the people in the North who live in smaller homes should not share in those lower bills, nor that the most expensive homes in the South should not have to carry any share of those regions increased overall burden.

The conclusion is clear: there is no acceptable way forward within the confines of a national, eight band system. In essence, the problem is that more expensive properties in low inflation areas are the ones who gain most from basic revaluation while less expensive properties in high inflation areas are the ones who lose the most. Some reform is therefore necessary: the question is, exactly what?

Reforming the council tax by increasing the bands

Our answer is that change is needed at both the top and bottom of the council structure, to increase the number of bands, that is, the current bands A, G and H. By contrast, apart from the uplifting necessary to take account of house price inflation since 1991, bands B through F can be left alone.

At the bottom end, it is widely argued that the current band A should be split into two bands.[4] One reason for splitting it is its size: band A currently has the greatest number of homes in it nationally and dominates in the three northern and two midland regions.

A second reason is that, in proportional terms, it spans a very large range of property values from under £10,000 to £40,000 at 1991 prices. This is a larger range than is to be found in any other band, except H. By contrast, the normal range, in bands B to F is one where the top of the band is about one third more than the bottom of the band.[5]

At the top, band G, too, should be split. Stretching at the moment from £160,000 to £320,000, it is in effect a double band. Splitting it into two would create two bands of equal proportional size which more or less continue the regular progression already present in bands B to F.

Finally, band H, too, should be split. At the moment, properties worth £200,000 pay nearly 40 per cent more in council tax than properties worth £100,000. There is no reason why properties worth £2m should not pay 40 per cent more than those worth £1m. Exactly how many parts the current band H needs to be split into will depend on how high the very top property prices go. Four or even five parts may not be too many.

What about the multipliers, which relate the amount paid in any particular band to the amount of council tax paid by a property in the reference band D? At the moment, those in band A pay two thirds of what those in band D pay while those in band H pay twice as much as those in band D. Taken together, this means that band H pays three times as much as band A, even though some band H properties can easily be worth 20 times what some band A properties are worth.

Clearly, each of the new, split bands requires a multiplier to be set for it. Just as the band limits for bands B through F proceed in a fairly orderly fashion, so too do their multipliers. Taking any two adjacent bands, property values in the higher one are about one third more than in the lower one, while their council tax bills are about one sixth higher. Applying this to the split bands in A, G and H would produce a system in which those in the very top band could be paying perhaps 10 times as much as those in the very bottom band, compared with just three times as much at the moment.

This approach to the setting of new bands and multipliers draws on the regularity at the core of the council tax system and extends it towards both ends. It introduces no new principles, simply extending the principle that already applies to the majority of properties (namely, that the more valuable your home, the more you should pay in council tax) to both the cheapest and the most expensive homes. A pragmatic approach to a rather dull but important and sensitive tax seems like a good idea in view of the troubled history of this tax and its forebears in the 1980s and early 1990s.

As it turns out, however, there is one other piece of evidence that supports an approach which at its heart leaves the bands and multipliers that apply to bands B through F as they are at the moment. An examination of the average income of households in each council tax band shows that the ratio of average household income to council tax is roughly the same for each of the bands B through F. Put another way, band by band, from B to F, average household income rises roughly in line with the rise in council tax.

This result should not be taken too precisely — it could not, for example, be used to argue against small changes in the multipliers for these bands — and indeed, as we have already observed, there is no single, indisputably right measure of income . Nevertheless, the pattern we observe here does suggest that, when measured against an income yardstick, there is nothing obviously wrong with the way in which council tax currently rises with property value in these middle bands.

[4] There may even be an argument for splitting band A into three.
[5] For example, the current band F, ranging from £120,000 to £160,000

Regional variation in the council tax system

Detailed forecasting of what is likely to happen, however, reveals one basic problem that neither the creation of additional bands nor adjustments to multipliers really affects. That problem is that the cheaper properties in high inflation areas face double digit percentage increases in their council tax bill after revaluation, irrespective of whether or not there is reform along the lines we suggest above.

Homes currently in band C in inner London exemplify this problem. The fact that half of these homes are rented shows that this band includes a substantial amount of social housing. A big tax rise on this group at the same time that similar properties in other parts of the country (thanks to the reforms to band A) may even be enjoying a significant fall in their bills would be nigh on impossible to justify.

There are, as ever with the council tax, a variety of ways that this could be addressed. Because of its transparency, we favour the introduction of regional bands, that is, council tax bands that differ by region. More complex schemes, for example using bands that differ within regions, are also possible. In this scheme, those regions that have seen higher house price inflation since 1991 have their band limits scaled up by more. So, for example, whereas band C spans the range £100,000 to £130,000 in the northern regions, it spans the range £155,000 to £200,000 in London. Raising the band limits in this ways means that far fewer properties in high inflation areas would go up a band, and therefore face a rise in council tax.

Besides protecting key workers in London and the south, some form of regionalisation would have the effect of preserving another rather important feature of the present council tax system, namely, its inter-regional equity .

Without this, London homes in any particular band would find themselves paying a greater share of their income in council tax than homes in that band elsewhere in the country. Yet at the moment — although with one important exception — this is not the case. Rather, when we look across the regions, the ratio of council tax to income in any given band and in any particular region is usually very close to the national average for that band.

While it would be wrong to attach too much precision to this finding, it does suggest that when measured against an income yardstick, council tax is reasonably fair as between different parts of the country. Regional bands or something similar can preserve this parity, more or less.

The one exception is the South-West, where the ratio of council tax to income is about 10 per cent higher than the national average across almost all bands. Regional banding could allow something to be done about that.

The arithmetic of council tax reform: an example

Any discussion of council tax reform has to be supported by analysis of the likely effects. What we do here is set out both the details of our proposed reforms together with their key financial effects.

In essence, our proposal is for a system built on the core of the present system, but extended to both its ends much more thoroughly and with a system of regional bands to reflect, and thereby nullify, the worst of the effects of differential regional house price inflation since 1991.

Before looking at the results, some qualifications need to be made. First, the details of the reform itself are illustrative only since they use house prices for 2002. The financial effects show what would have happened if the reforms had been introduced in 2003/4 (after the increases that took place in April 2003). The calculations also assume that every property in a local authority area has gone up by the same percentage amount, which is unlikely to be the case. So these are not forecasts of what will happen in 2007.

Second, there is always more than one way of achieving a particular effect. For example, we implement the regionalisation of the council tax by combining regional council tax bands with national council tax multipliers. But the same effect could be achieved the other way round (national bands, regional multipliers) as well as by using the central government grant system to achieve regional or local variation. Each approach has its pros and cons.

Third, average results at any level are often a poor guide to what would happen to most individual households in the group in question. For example, the results show that London properties now in band C will, on average, see a 2 per cent rise in their council tax bill. This 2 per cent is itself an average of inner London, where the average rise is around 6 per cent, and outer London, where the fall is between 1 per cent and 2 per cent.

Finally, these figures do not include the effects of the (seemingly inevitable) annual increase in council tax overall. In that sense, they refer, exclusively, to the effects of revaluation and reform alone.

Tables 1 and 3 present the basic details of a possible new, regionalised system while tables 2 and 4 present the principal results.

Table 1 gives an illustrative proposal for the upper limits of a revised 14+ band system after revaluation, in which bands A and G have each been split into two while band H has been split into 4 (or more, if required to accommodate the very highest house prices). The bands are highest in London and lowest in the three northern regions. Whether the three northern regions should be treated identically is a matter of detail where there are arguments both ways. So too is the treatment of the South West, where higher band limits could be justified on the grounds that the income to house prices ratio is already higher in that region than elsewhere. An argument could also be made to treat inner London differently from outer London.

Table 1: Upper Limits for New Bands, by Region, After Revaluation (£000's)

	A1	A2	B	C	D	E	F	G1	G2	H1	H2	H3	H4
NE, NW, Yorks	45	60	80	100	130	180	240	340	500	700	950	1,350	1,900
E. & W. Mids	50	70	90	115	150	205	270	380	550	750	1,100	1,550	2,200
Eastern, SE, SW	50	70	90	115	150	205	270	380	550	750	1,100	1,550	2,200
London	70	90	120	155	200	275	370	520	750	1,050	1,450	2,100	3,000
Current band limits (all regions)	n/a	40	52	68	88	120	160	n/a	320	n/a	n/a	n/a	n/a

Table 2 shows our estimates of what the distribution of properties by band would look like after revaluation if the band limits from table 1 were adopted. The distribution is certainly far from uniform; for example, 63 per cent of properties in the northern regions are in bands A or B, compared with 15 per cent in London. This 63 per cent is, however, much lower than the 75 per cent which would be the case under basic revaluation. In essence, the band limit scheme in table 1 more or less reproduces the current distribution of properties by band within each region.

	Table 2: Percentage of Properties by Band, After Revaluation									
	A1	***A2***	***B***	***C***	***D***	***E***	***F***	***G1***	***G2***	***H1-4***
NE, NW, Yorks	32%	15%	16%	16%	10%	6%	3%	1.2%	0.8%	0.4%
E. & W. Mids	23%	12%	21%	19%	11%	7%	4%	1.3%	1.1%	0.4%
Eastern, SE, SW	8%	6%	19%	24%	18%	12%	7%	2.3%	2.8%	0.8%
London	2%	2%	11%	25%	26%	17%	8%	3.4%	3.4%	2.3%
England	17%	9%	17%	21%	16%	10%	5%	2.0%	2.0%	0.8%

Table 3 shows the multipliers, expressed (as they are now) as a number of ninths of the amount of tax paid in the reference band, band D. Multipliers for bands B through F remain as they are now. Those for both parts of band A are reduced , those for both parts of G are increased and those for what was H are simply a continuation of the pattern in the other bands.[6]

	Table 3: Current and New Multipliers by Band (as the number of 9ths of band D)												
	A1	***A2***	***B***	***C***	***D***	***E***	***F***	***G1***	***G2***	***H1***	***H2***	***H3***	***H4***
Current	6	6	7	8	9	11	13	15	15	18	18	18	18
New	4.5	5.5	7	8	9	11	13	16	20	25	31	38	45

[6] For the purposes of our analysis, we treat H as currently a single band with an average multiplier of 27/9.

The overall effect of this is to leave the average level of council tax as determined by the government — ANCT or Assumed National Council Tax — unchanged. Table 4 shows the changes in bills for a selection of regions, with the average percentage changes shown by the current band. For those in bands B through F, the changes in the council tax bill reflect movements in bands. For those in A, G or H, however, the changes also reflect changes in the multipliers. While few figures in this table are actually zero, the overwhelming feature is the fall of more than 15 per cent for those now in band A, and the rises of 25 per cent and 50 per cent on average for those in bands G and H respectively.

	Table 4: Average Percentage Change in Bills by Band and Selected Region							
	A	***B***	***C***	***D***	***E***	***F***	***G***	***H***
North West	-18%	1%	2%	5%	3%	6%	33%	50%
East. Midlands	-18%	1%	1%	3%	2%	3%	27%	50%
South East	-17%	0%	0%	2%	1%	1%	25%	49%
London	-13%	3%	2%	2%	1%	2%	28%	51%

Because of the skewed geographical distribution of properties, this pattern of bill changes results in a diversion of central government grant from the London and the South East to the North and the Midlands. However — and this is a vital point — this in effect represents a transfer from the most valuable properties in London and the South East to the least valuable in the North and the Midlands. This is completely different from what would happen under basic revaluation, when the losers in the South would be all but those in the biggest properties, and the gainers in the North would be all those except those in the smallest properties.

Finally, these calculations take no account of council tax benefit. If we were to take it into account, it would show that a revenue-neutral scheme like this actually saves the government money. This is because those in receipt of council tax benefit are concentrated in the lowest council tax bands. Cutting the council tax for these people, therefore, does not really cost anything because central government is in effect paying the tax for them, in the form of council tax benefit. A complete analysis that took this benefit into account would therefore produce more favourable arithmetic for government than the figures presented above suggest.

Reforming council tax benefit

Despite being the means-tested benefit with the highest number of claimants, Council Tax Benefit (CTB) receives little attention from policy makers. This is a mistake. CTB is essential to the acceptability of the council tax system as a whole because it provides a solution to the problem of the poor person living in the large house, who has a high council tax bill which they cannot afford.

This is a very sensitive problem that should be taken seriously. Yet provided their savings are not too high and depending upon their exact level of income, such a person s council tax bill should be met, in full or in part, by CTB. Perhaps even more importantly, when the council tax goes up each April, CTB will take the strain.

Furthermore, entitlement to CTB already extends far beyond those in receipt of Housing Benefit. Especially for pensioners, there will be an entitlement to some CTB on incomes way above the minimum guarantee level. For example, a pensioner couple with a net weekly income of £250 would be entitled to at least some CTB provided their council tax bill was above £780. A pensioner couple with a net weekly income of £300 would get some help provided their bill was above £1,300. These levels of income are well above those that count as poverty. At the least, it is now a substantial minority of pensioners who are entitled to CTB.

The trouble is, however, that while this is all very well on paper, the benefit fails to work effectively in practice. Take-up of CTB is very low — around three-quarters overall, around two-thirds for pensioners and below 50 per cent for owner occupiers. These take-up rates are way below those for other benefits.

Any reform to the council tax, even basic revaluation, will leave hundreds of thousands of homes facing an increase in their bills as a result of going into a higher council tax band. Public acceptability of any change introduced in 2007 is likely to depend critically on CTB working far better than it does now. This is an administrative priority for central and local government alike.

But the problem is not just administration. Households can lose their entitlement to CTB if they have only modest amounts of savings. At the moment, it takes only an additional £10,000 of saving (above the first £6,000) to wipe out all entitlement to a benefit worth on average £1,000 a year. This is a punitive rate of taxation on small amounts of savings.

As part of the reform of council tax, and ideally before that, these savings limits need to be raised. From an economic point of view, a doubling or even a trebling of the limits would not be excessive.

Transforming council tax benefit

Reform of the details and administration of CTB is essential — but we think government should go further. Without altering its financial effects in any way, it is possible to change fundamentally both the appearance and administration of CTB which will make it both easier and more acceptable to those who are supposed to benefit from it.

CTB is that part of its council tax bill that a low income household does *not* have to pay. If instead, we look at that part of the council tax bill that the household in receipt of some CTB still *does* have to pay, what we find is something that is algebraically equivalent to a form of local income tax with a marginal tax rate of 20 per cent.

Looked at like this, the council tax system has two ways of determining a household s liability: either the normal council tax based on the property, or what we have called the maximum liability based on the household s income (and qualified by their savings). What the household actually pays is whichever is the lesser of these two amounts.

It should be stressed that this change would do nothing to alter the arithmetic of CTB or the amount of money that central government would have to pay to local government to make up for the fact that not everyone pays the full amount of council tax. We do, however, think that it has all kinds of advantages.

First, because maximum liability depends only on a household s income (and savings) and not on anything to do with where they live, it can be calculated nationally, for example, by the Inland Revenue or the Pensions Service. If this could be done automatically, as part of the normal assessment of income tax or pension credit, it would reach many of the low income owner occupiers who are the ones least likely at the moment to be taking up their entitlement to CTB.

National organisations, newspapers and radio programme would also be able to give clear, generally applicable guidance about what the maximum liability is for a particular level of income and household composition, in a way that they cannot with CTB. This is bound to improve understanding and to encourage people to apply.

Most importantly of all, it would do away with the fundamental problem with CTB, namely, that it is seen as demeaning. The maximum liability approach, by contrast, administers CTB as a tax. In so doing, individuals are turned from supplicants seeking relief, into taxpayers seeking an objective assessment of the maximum amount they have to pay. The algebra and the arithmetic are all the same — but the power relationship is subtly different, and people are left with their dignity intact.

Summary and conclusions

The argument advanced in this paper is a simple one, made up of four propositions.

First, although the council tax is flawed in some ways, it rests on some sensible principles and is capable of reform. The danger in the current furore about council tax is that opinion is moving from complacent acceptance to panic stricken rejection. Neither position is, or was, right: reform is the answer.

Second, there is a regularity as well as an external justification for the design of the core council tax system, that is bands B to F. Reform should rest upon the consistent application of this design to both ends of the distribution, namely bands A, G and H.

Third, some form of regional (or sub-national variation) has to be introduced into the system, to protect low and middle income households in high house price areas.

Fourth, council tax benefit should be transformed into an assessment based on income for limiting a household s liability to council tax. The resulting dual system, with households paying the lesser of their council tax and this income based maximum liability , should work better, increase take-up and command greater public support.

With the help of detailed computer-based models, we have analysed the detailed effects of these ideas and believe them to be financially sound, even prudent. Council tax is never going to be loved but it can be improved. Government should make these improvements in an open way. If it gets it right — and we think it can — council tax will return to its proper place in our public life: grudging acceptance and decent obscurity.

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DK/2K/0304

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£5 for pamphlet

ISBN 1-902080-21-1