

IS THE COUNCIL TAX DEAD?

QUESTIONS OF PRINCIPLE FOR THE GOVERNMENT AND FOR THE LYONS INQUIRY

A DISCUSSION PAPER BY THE CENTRE FOR COUNCIL TAX REFORM

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The Centre for Council Tax Reform set up by NPI, LGiU, PCS and Unison Local Government has produced two pamphlets on council tax that have had a major influence on the debate on local government finance and provided a backdrop to the Lyons Inquiry.

The first pamphlet, *Council Tax: the answer?*, argued that that council tax was basically a sound tax and should be retained. Reform, however, was urgently required to turn it from the second most regressive tax after tobacco tax into a fairer tax, and that regional banding might need to be introduced to deal with the issue of the regional imbalances between incomes and house prices. The pamphlet also drew attention to the fact that only two thirds of eligible pensioners take up council tax benefit. To address this, it suggested that the presentation and administration of council tax benefit for pensioners should be changed, with a ‘maximum liability’ set, based on income, and with the household only billed for the tax net of benefit.

The second pamphlet, *Making it fair: council tax benefit for working households*, published in June 2005 focussed on council tax benefit (CTB) for those of working age. It addressed the ungenerous nature of the benefit which meant that some two thirds of children in poverty in the UK live in households that receive no CTB, or partial CTB only. The pamphlet pointed out that reform of CTB for working age households would reduce workless households and children in poverty.

Introduction and summary

In September 2005, the Government announced that it was cancelling the exercise already underway to create a new valuation list for all homes in England and to postpone any change to the basis on which council tax is levied until after the next General Election at the earliest. As a result of this cancellation, the council tax will still be based on 1991 values for the conceivable future, and will be increasingly perceived as unfair.

The argument of this paper is that, at a stroke, this cancellation changes the nature of the fundamental challenge facing the Lyons Inquiry as far as council tax is concerned. Previously, its remit was to advise Government on exactly how council tax should be brought up-to-date. Now, by contrast, its first task is to explain *why* it should be brought up-to-date, rather than being left to rely on the original 1991 valuations indefinitely. This is a question of principle.¹

It is in this new context that we believe it is important to reflect on the issues of principle that should underpin the long term reform of local government finance. Revaluation will not happen before the next election, but the direction of reform and the principles underlying reform can usefully be set out by the Lyons Inquiry, discussed by all the political parties and used to inform any forthcoming government proposals.

Three other arbitrary aspects of the council tax system also demand a principled answer, one concerning a new element that has just been introduced and the others about arbitrary elements that have long been present. They are:

- ***A national council tax***: should the principle on which central government grant has long been distributed, namely that wherever they are in the country, properties in the same council tax band are expected by central government to pay the same tax, continue or not?
- ***Council Tax Benefit (CTB)***: why should people start paying council tax even though their income is too low to have to pay income tax? And why should working-age households start paying council tax on much lower incomes than pensioner households?
- ***Council tax bands***: why should the relationship between house value and council tax that applies fairly uniformly to most homes (from around £75,000 to £600,000), not apply in the same way both to very cheap ones and very expensive ones?

We hope that the final report of the Lyons Inquiry will provide its answers to these questions and, in so doing, oblige Government, in its response to that report, to do the same.

Background: revaluation “mañana?”

Council tax came into force in England, Wales and Scotland in 1993, based on the value that each home was estimated to have had in 1991.

Labour came to power in 1997. At the start of each of its three terms in office, Labour has asked itself whether or not the property values underlying council tax in England should be updated, that is, whether there should be a ‘revaluation’.² Each time, they have reached the same conclusion, namely “revaluation not in this term but (maybe) in the next”.

In 1998, in its first White Paper on local government, Labour decided against a revaluation on the grounds that things had not changed that much since 1991:

*The Government has concluded that the current valuation base remains broadly acceptable, and is likely to remain so for the next few years. In these circumstances it does not propose to carry out a revaluation in the course of the current Parliament.*³

Although this response disappointed some, including the LGiU, the White Paper made it clear that the question was one of ‘when’ not ‘if’; that when it came, the scope would include reform of the council tax system as well as revaluation; and that the ‘when’ might well come during the second term:

*In time there will be a need for a revaluation, although it is difficult to predict when this will become essential. The Government recognises that a general revaluation gives an opportunity to re-examine the number and width of the property bands, as many council respondents have asked it to do. It will keep the fairness of the system under review, and carry out the first revaluation during the next Parliament if it proves necessary.*⁴

At the start of its second term in office, the Government returned to the question. This time, its 2001 White Paper was explicit in its acceptance of the need for revaluation:

*Government fully recognises the importance of keeping property values up to date. This was not done under the domestic rates, which caused the tax to fall into disrepute and was one factor behind the introduction of the poll tax.*⁵

However, for both practical reasons and because Government thought it unwise to combine revaluation with changes to the system for allocating central government grant to local authorities, revaluation would not come into effect until 2007: in other words, until the next term. But both the date, and the requirement to revalue again every ten years, would be written into legislation.

The White Paper, and the subsequent legislation, launched a stream of activity by both local and central government to examine how both revaluation and reform should proceed. This culminated in 2004 with the appointment of Sir Michael Lyons to head an independent inquiry to provide the Government with answers to the balance of funding issue and council tax reform.

Yet in September 2005, at the start of its third term, the Government suddenly announced its intention to revoke this legislation, discarding the preparatory work already done by the Valuation Office Agency (at a cost £60 million⁶), replacing it with a power for the Secretary of State to announce the date of revaluation when he or she saw fit.

When asked during the parliamentary debate on the bill overturning the previous legislation, the then minister, David Miliband, confirmed that the Government had rejected the advice of Sir Michael Lyons that revaluation should be delayed by just a year,⁷ meaning that:

*The Government have made it clear that we do not anticipate revaluation occurring during this Parliament, and that is a clear statement of affairs.*⁸

So, as in 1998 and 2001, revaluation is put off again “until the next term” – at the earliest.

Mr. Miliband went on to explain why the Government had concluded that revaluation in 2007 would not be sensible. “*We need*”, he said:

*the flexibility to revalue as part of a fully developed package of funding reforms, rather than as a precursor to them, and at a moment of greater financial stability for local authorities.*⁹

In 2001, by contrast, the White Paper had used precisely the opposite argument to explain the delay in revaluation to the next term, namely:

*It would be unacceptably disruptive to conduct a council tax revaluation in parallel with reform of the revenue grant system.*¹⁰

The Government can change the funding arrangements at will. As a result, its readiness to postpone revaluation, both because it would coincide with such changes (2001) and because it would not (2005), means that it will *always* be able to argue for postponement if it wants.

A principled case for revaluation

The purpose of this long introduction has been to show that the terms on which Sir Michael Lyons' current Inquiry is based have shifted radically. This is because one of the fundamental assumptions on which the Inquiry was originally based no longer holds. This assumption, expressed in the 2001 White Paper and given force in the 2003 Local Government Act, was that a revaluation both *should* and *would* take place. The questions after 2001 therefore all concerned 'how?', including what else should change too (e.g. reform as well as revaluation).

These questions have not gone away. Now, in the face of the Government's decision to postpone, the final report of the Sir Michael Lyons inquiry also needs to set out the answer to the fundamental question of *why* it is necessary to revalue at all. This means going further than in the interim report, which expressed the opinion that "*revaluation will be necessary if council tax is to remain credible as a property based tax in the long term*".¹¹

Part of that argument is that, over time, the value of properties relative to one-another change, sometimes by a considerable amount. Indices of average prices suggest that this may be so. For example, the average sale price of detached houses in Kent in spring 2006 was 204% higher than those sold there ten years earlier. By contrast, the average sale price of price of flats and maisonettes in Kent was 272% higher.¹² The size of this difference is enough to suggest that the bands these types of property occupy relative to one another are no longer correct. For example, Wales undertook its own revaluation in 2004 - 30% of properties moved to higher valuation bands; 8% fell to lower valuation bands and over 60% remained in the same band.¹³

Over time, as one former local government minister has observed, places change:

*Some areas of my constituency were entirely void industrial wastelands 15 years ago, and anything built there would have had no value at all, so, now, it is slightly odd to create notional 1991 values for properties built as a result of that area's regeneration. That pattern is replicated all over the country.*¹⁴

Another former local government minister noted that properties can already be revalued if they are sold and undergo some material change.¹⁵ Furthermore, a local government leader we spoke to said that, in his view, new properties tended to be put in higher bands than existing ones. Current valuations are therefore ridden with anomalies, which increase as time goes by.

In summary, the basic case for revaluation is that, without it, the Council Tax becomes ever more an arbitrary tax, based in the end on what can be got away with, rather than principle. Principled, rather than arbitrary, taxation is the cause that we hope the final report of Lyon Inquiry will champion.

The principle of a national system of council tax

Starting this year, Government has introduced a new set of rules for allocating grant to local authorities. Although grant is the other side of the local government coin from the council tax, they are intimately connected. What needs to be understood is that the new rules threaten what has been the very cornerstone of the council tax system since it first appeared in 1993, namely that central government makes its decision about grant allocation in away that requires all households in the same council tax band, wherever they are, to pay the same rate of council tax.¹⁶ In essence, central government set a national rate of council tax to meet a nationally determined level of need.

Hitherto, this principle of a national council tax to meet a nationally-determined level of need was not in doubt because it was built in to the grant rules. From now on, however, that is no longer true. The question therefore for the Lyons final report is whether this principle, of equal treatment of households in the same band by *central* government, should continue to hold?

Without this principle – and this appears to now be the situation – the actual distribution of billions of pounds of grant a year depends on the value of two numbers in the central government’s computer model which are set, according to a one line statement in the 346 page consultation report published by the Government in 2005, ‘by judgement’. In this situation everyone, from ministers downward, are in the dark.

Principles for Council Tax Benefit reform

In other areas of the Inquiry’s remit, principle rather than just practical proposals also need to be at the fore.

One such area in need of a clear enunciation of the principles that should guide it is Council Tax Benefit (CTB). The Interim Report’s recognition of the importance of CTB in reducing the burden of council tax among lower income households is very welcome. In the introduction to this paper we highlighted that two thirds of children in poverty in the UK live in households that receive no CTB, or partial CTB only. There is increasing concern that CTB and housing benefit combine to create a poverty trap that stops the unemployed moving into jobs, particularly insecure jobs. And the current system of CTB is shot through with anomalies so a low income young man on reaching the age of 25 will suddenly receive more CTB. But, before approaching the details of reform, there are two questions of principle which should be answered.

First, should people start paying council tax at a rate of 20 pence for every pound they earn at very low levels of income and well before they have to pay income tax? Put another way, why is the threshold at which liability to council tax begins lower than the one at which liability to income tax begins?

Second, the thresholds for working-age households are much lower than those for pensioners. As a result, working-age households pay council tax on much lower incomes than pensioner ones. Is that right?

The answers to these two questions are matters of values and politics. For our part, we would answer ‘no’ to both of them.¹⁷ Hitherto, these questions have not been asked because CTB, being a benefit, is anchored in the social security system and takes its thresholds from there. But by asking and answering these questions, the Lyons Inquiry will have a basis for reform of CTB and its recommendations could make a significant difference to millions of workless households and children in poverty.

Principles for Council Tax bands

One of the virtues of the Interim Report is that, by arguing that the income-related issues are confined to lower income households (and so addressable by reforms to CTB), the way is cleared to look at the Council Tax as a tax based on the value of the home being occupied.

Here too, there is one, simple issue of principle. In order to see it, it is helpful to imagine that all the Council Tax bands have been uplifted (following revaluation) by a factor of two and a half. The bands and their multipliers then become:

Band	A	B	C	D	E	F	G	H
Band limits (000's)	Up to £100	£100-£130	£130-£170	£170-£220	£220-£300	£300-£400	£400-£800	£800+
Multiplier	6/9	7/9	8/9	1	11/9	13/9	15/9	18/9

The basic rule here is clear: the more your home is worth, the more you pay – and across most of the range, the link between the two is quite stable. For example, a home worth £150,000 is in band C pays one third more than one worth £75,000 in band A (i.e. 8/9 compared with 6/9). One worth £300,000 (band E) pays just over one third more than one worth £150,000 (11/9 compared with 8/9). Similarly, one worth £600,000 (in band G) pays just over a third more than one worth £300,000. It is this regularity – double the property value and the Council Tax payable goes up by about a third – that has led us to describe the Council Tax system as ‘sound at heart’.¹⁸

The question of principle is this: why does this regularity not extend all the way up and all the way down the scale of property values? At the moment, the house worth £1.2 million pays only one fifth more Council Tax than the one worth £600,000 while the ones worth £2.4 million, £4.8 million and so on pay no more at all. Is that right? Liability is not capped for either income tax or VAT so why should it be capped for Council Tax?

Similarly, why should any property worth less than £100,000 pay the same Council Tax whether it is worth £25,000, £50,000 or £100,000?

The question here does not relate to the rightness of banding, which is a rather good way of making the system more robust. Rather it concerns the way in which a perfectly serviceable set of bands is restricted at the top and the bottom. For a tax based on property values, this makes no sense. Why not, therefore, just do away with these limits and turn council tax into what members of the public will recognise is a fairer and more acceptable tax.

Conclusion: against an arbitrary tax

The heart of the argument in this paper is that an out-of-date tax becomes an inherently unfair and unacceptable tax. In addition, besides the passage of time, council tax has various arbitrary elements built in to it, especially the failure to treat both the cheapest and the most expensive properties consistently with those in the middle, as well as the rules which determine when a low income household has to start paying council tax, rules that are quite at odds with those for income tax.

In place of an arbitrary council tax, we need one that is based on principle. The final report of the Lyons Inquiry has the opportunity to set out what those principles should be.

End notes

- ¹ One way of seeing this is that the cancellation of revaluation means that we must retreat from answering “how” questions to answering “whether” ones instead. This retreat is reflected in the fact that the two earlier reports on Council Tax written by NPI and published by the LGIU – *Council Tax: the answer?* (2004) and *Making it fair: CTB and working households* (2005) dealt mainly with “how” questions.
- ² [draft note: add a two line history of the Welsh story]
- ³ Local Government White Paper, *Modern local government: in touch with the people*, 1998
- ⁴ Local Government White Paper, *Modern local government: in touch with the people*, 1998
- ⁵ Local Government White Paper, *Strong local leadership, quality public services*, December 2001, p101.
- ⁶ Hansard, Vol. 439, col. 36. 7 November 2005. £45m of that £60m was described by Mr Miliband as being “prudent investment in modern and efficient working practices”.
- ⁷ For the Conservatives, see the quote attributed to Michael Howard by David Miliband, Hansard, Vol. 439, cols. 38-39. 7 November 2005.
- ⁸ Hansard, Vol. 439, col. 37. 7 November 2005.
- ⁹ Hansard, Vol. 439, col. 34. 7 November 2005.
- ¹⁰ Local Government White Paper, *Strong local leadership, quality public services*, December 2001, p101.
- ¹¹ *Lyons Inquiry into Local Government: Consultation Paper and Interim Report*, December 2005, S.58.
- ¹² Source: Land Registry Property Prices (online). The quoted figures compare April to June 2006 (last updated 02/08/2006) with April to June 1996. The increases for the other two categories of home reported by the Land Registry were 217% for semi-detached and 236% for terraced.
- ¹³ With more properties going up a band than down, standard council tax in Wales should have come down, thereby meaning that even those remaining in the same band as before would have seen a reduction. Because the revaluation was not constrained to be revenue neutral, however, this did not happen.
- ¹⁴ Hansard, Vol. 439, col. 51. 7 November 2005.
- ¹⁵ Hansard, Vol. 439, col. 48. 7 November 2005.
- ¹⁶ Apart from the effect of the 25% single person discount.
- ¹⁷ Not least because they give rise to extraordinary statistic that of the 3 million or so children living in income poverty in England and Wales in 2004/05, fully half of them – 1.5million – were in households paying full council tax. Source: www.poverty.org.uk (indicator 3e).
- ¹⁸ *Council Tax: the answer?*, LGIU, 2004.