

Prime Minister

~~At the last time~~  
in the  
the Treasury

Awaiting Tony  
comments

TJ

Mr Carlisle has a  
few minor comments on  
the draft outline; the findings  
are content.

~~Letters yet committed.~~

I think we can say that  
officials should proceed to  
draft, ~~subject to any points~~  
~~the Chamber may raise.~~

Prime Minister

RATING - LONG TERM STRATEGY

When we discussed this at E Committee on 25 June we agreed to have a further meeting to consider the issues involved. As you know, we have announced to the House that a Green Paper will be issued in the autumn. We have now prepared the attached outline of such a paper (Annex A). Officials have largely agreed this skeleton and I understand that no real differences of view about what should be included have emerged. If colleagues would like to discuss the outline at this stage, I would be happy for us to do so, but I wonder if this is really necessary? If you and others agree, I would suggest we authorise officials to fill out the skeleton and provide us with a draft in September on which we could discuss all the points which concern us.

Agree?

TJ

31/7

Agreed not

At the same time, however, we ought to be clear what work can be done to support and illustrate the Green Paper both before and after issue. A note has been prepared of the work proposed (Annex B) and unless you or other colleagues wish to suggest changes to that programme I suggest work proceeds along these lines.

Copies of this go to all members of E Committee and to Sir Robert Armstrong.

TOM KING

27 July 1981

Second Draft FrameworkGREEN PAPER ON ALTERNATIVES TO DOMESTIC RATINGPreface:

Layfield; earlier Green Papers; Manifesto; the recent review.  
Consultation arrangements and timetable.

Section 1: Introduction and Context

Criticism of domestic rates; the need for change  
Present sources of LA revenue; relate to expenditure  
Central - local relations in matters of expenditure levels  
Importance of "accountability"

Problem of tiers and LG structure (touched on)

Fiscal dimensions:

- central government's use of income tax, VAT, etc;
- + potential yields
- yield of domestic rates in proportion to these

Economic effects:

- on housing (including the effect on house prices, and on levels of investment in housing as opposed to other consumption or savings; also including public sector housing);
- on poverty trap
- on RPI/TPI

Importance of distribution effects: between households, income groups, regions

LA budgeting (significance of looking for total replacement of domestic rates: ie total dependence of LA on the bouyancy, predictability and especially "lumpiness" of the yield of new tax).

Section 2: Alternative Taxes and Criteria for Assessing them

Eight taxes listed, plus assigned revenues and domestic rates in modified form. Six criteria explained. Five taxes can be rejected, ie:

- local duties on petrol, tobacco or alcohol;
- local vehicle excise duty;
- charges for licences for sale of alcohol or petrol;
- local payroll tax;
- local development land tax.

These are discussed in Annex A.

Section 3: Local Sales Tax

Rule out VAT in preference to retail sales tax

Two possible models of retail sales tax:

- I in conjunction with national VAT system
- II separate system run by LAs.

Discuss against each of the six criteria (with emphasis upon model I)

- i) Practicability, including:
  - European Community position;
  - problems of definition of tax base (eg so as to limit impact on business purchases);
  - timetable (need for extra computer capacity linked to VAT computers);
  - cost of administration.
- ii) Perceptibility and accountability (proportion of local electorate affected)
- iii) Financial control: predictability, buoyancy, "lumpiness" of its yield
- iv) Equity:
  - cover distribution by households and regions
- v) Compatibility with Government's fiscal strategy
- vi) Suitability for all tiers of local government.

Section 4: Local Income Tax

Most straightforward course to integrate LIT with existing IT (as proposed by Layfield). Practicable but complicated for all concerned, since National IT not easily adaptable for a local variation. Also, limited range of LIT rates: hence suitable only for major spending authorities.

Wider variation in LIT rates requires -

- either prior changes in national tax system with year-end assessment for all
- or collection of LIT separately from national IT: in principle could be done either by local authorities on tax information supplied by IR, or with a completely separate LA system. But latter very costly, because it duplicates IR.

Discuss against each of the criteria:

- i) Practicability, cost and time-table (interaction with tax computerisation): refer to each variant
- ii) Perceptibility and accountability (proportion of local electorate affected)
- iii) Financial control
- iv) Equity:  
cover distribution by households and regions
- v) Compatibility with Government's fiscal strategy
- vi) Suitability for all tiers of local government.

#### Section 5: Poll Tax

- i) Practicability and cost:  
cover enforcement problems
- ii) Perceptibility and accountability (whole local electorate affected)
- iii) Financial control
- iv) Equity:  
cover distribution by household and region
- v) Compatibility with Government's fiscal policy
- vi) Suitability for all tiers of local government.

#### Section 6: Assigned Revenues

A different approach: fixed share of a national tax or taxes assigned to local government <sup>; the distinction from exchequer grant,</sup> which is redetermined annually, may be difficult to preserve in practice; needs assessment and distribution system; central-local relations; implications for fiscal management.

#### Section 7: Exchequer Grant in Support of New Taxes

Functions of an exchequer grant:

- a) revenue support for local government - new options for the level of support grant emerge with potentially high-yielding new taxes; option of transferring part or whole of education service to central government is dealt with in annex B;
- b) equalisation of needs and resources of authorities - continuing requirement whatever the new taxes.

Technical considerations in creating a grant to combine with new taxes (features of tax yield - especially "lumpiness"; combination of grant with more than one local tax).

Section 8 - Domestic Rates in Modified Form

- i) Facts and figures of domestic rating at present
- ii) To enable other taxes, and reforms, to be compared with a base position, show:
  - a) administration costs and practicability
  - b) perceptibility and accountability
  - c) financial control
  - d) problem of inequity:
    - distribution by household
    - regressively (reduced by rebate scheme)
  - e) suitability for all tiers of local government
- iii) Possible reforms or modifications, especially:-
  - a) making rate poundages (or expenditure) subject to absolute limits imposed by central government, accompanied by provisions to apply in cases of default. Discuss and leave as open question.
  - b) list possible reforms to modify the distribution of rate burden: eg discounts for households with one adult or one earner, setting rates against income tax; charges in valuation methods. No assessment to be attempted in Green Paper.

Section 9: Non-domestic rates

- i) Facts and figures
  - ii) Protection of non-domestic ratepayer from excessive poundage; options include:
    - a) central government regulation of poundages, including making non-domestic rates a national tax, with yield distribution to local authorities
    - b) linking non-domestic poundages in each area with tax rates of new domestic taxDiscuss but leave these as open question.
  - iii) Wider question of whether there continues to be a case for a local property tax on non-domestic properties.
  - iv) Recent pressures for rate relief for businesses (de-rating non-domestic rate relief, mothballing relief, etc)
  - v) Revaluation
- Note that ideas at (iii), (iv) and (v) are for consideration at future dates.

ANNEXES TO GREEN PAPER

Annex A - The Rejected Tax Options

(As in section 3 of earlier report)

Local duties on petrol, tobacco and alcohol

Local vehicle excise duty

Charges for licences for sale of alcohol or petrol

Local payroll tax

Local development land tax

Annex B - Financing the Education Service

Around a half of local government's total current expenditure is on the education service. It follows that new ideas for funding that service might widen the range of options for dealing with the problem of rates, and conversely that rating reform might provide new opportunities for funding education expenditure. Suggestions that are sometimes made include:

- transferring the cost of the local education service to central government
- transferring only the cost of teachers' salaries.

∟Discuss pros and cons in relation to the objectives of the Green Paper. Query: leave as open question?∟

∟Do DES wish to raise further suggestions?∟

Annex C - Contingent Problems

Parishes

Water charges

Precepts for other purposes (eg land drainage, police, local conservators).

Section 10: Fees and Charges

Size of fees and charges

Little scope for significant extra yield

Role of charges in marginal adjustments of income (to help mitigate "lumpiness").

Section 11: Combination of taxes

The jigsaw to be fitted together comprises:

- different tiers
- different taxes
- several variants or models of each tax
- different quantities of grant for combination with taxes
- non-domestic rates

From this can be derived several leading schemes (as in Table 7 on page 61 of earlier report).

Appraisal of schemes against the original criteria (done briefly on pages 62-65 of earlier report).

Section 12 - Concluding passage ]

A Proposed Programme of Work

A Report from the interdepartmental official group  
on alternatives to domestic rates

1. The Secretary of State for the Environment announced on 2 June that the Government would publish a consultation document on alternatives to domestic rates in the autumn. To carry forward the development of Government policy on this topic there are now two parallel and related tasks:-

- (i) preparation of an autumn consultation document (possibly a Green Paper);
- (ii) further examination of topics that require greater study before decisions can be taken by Ministers early in 1982.

Work on (ii) has been set in hand immediately. Some of it will feed into (i) but the work would continue throughout the period of public consultation following the Green Paper.

Preparation of a Green Paper

2. The Green Paper being prepared will need to show something of the distributional effects of moving to new taxes. The report by officials in June 1980 was, of necessity, very thin on this, and fresh analytic work has now been started. To be complete in time for publication in October, the analysis must be strictly limited. The work now being done will aim to show distributional effects in the following ways:-

- (i) A single variant will be illustrated for each of LIT, LST and a poll tax. In each case only the total replacement of domestic rates (together with their rebates) by the new tax will be shown. With a poll tax, however, it may also be possible to show the effects of a poll tax with a yield of a quarter or a fifth of domestic rates (ie in conjunction with other, unspecified, revenue: because the effect of a large



poll tax would be very severe for the poor). No combinations of taxes will be illustrated at this stage.

- (ii) The options would be illustrated with likely changes in disposable income of a few types of household, showing for each household type some broad bands of income level and of amounts of rates paid. Fuller studies - of the range of the effects for each sub group - are planned to be produced after publication.
- (iii) Results would be differentiated between London-and-the-South-East, the rest of England, Wales and Scotland. For these illustrations it will be assumed that in each of England, Wales and Scotland the rate payments for those counties are replaced by an identical yield of the new tax. (This working assumption implies that the average tax rate in each country will be a consequential of the yield and tax base - in which case there may be wide variation between countries in the average rate of tax. However, Ministers will be able to consider the balance of tax yields between countries as a separate issue later.) Within England the incidence of tax is expected to shift between London-and-the-South-East and the rest.
- (iv) It will be assumed that the new tax replaces domestic rates yield with no change in the sum of exchequer support grant.

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3. The June 1980 report by officials had little evidence of the likely cost to PAYE employers or to traders of operating local income tax (LIT) or local sales tax (LST). It is important that the Green Paper should draw attention to the fact that these costs will exist but no information is available, or can be obtained at this stage, to give estimates. (See Appendix I.)

4. The June 1980 report noted potential difficulties with the European Community if a local sales tax were to be introduced. The main risk is that the Commission might view the introduction of a sales tax as a retrograde step and feel it necessary to take infraction proceedings in the European Court in order to preserve its structure of future indirect tax harmonisation in the Community. The possible legal grounds which the Commission might adduce for such a challenge, and the strength of our defences, are currently under examination. While the existence of the Community dimension must clearly be indicated, it may be desirable not to go into much detail in the Green Paper.

5. It is proposed to provide in the Green Paper only general comments on economic and fiscal aspects such as housing, the poverty trap, the effects on the RPI and TPI, and any detailed analysis of these aspects would be left until after publication.

6. The framework for a Green Paper provides for a section on non-domestic rates in which there would be discussion of options for protecting the non-domestic ratepayer from excessive rate poundages after abolition of domestic rates. Among the options could be that of making non-domestic rates a national tax, in which case there would be both increases and reductions in rate bills as the national standard poundage came into effect. Some preliminary work will be attempted by September on the extent of gains and losses that would be associated with this option.

7. Preliminary estimates will be made of the public sector manpower costs of the different tax options. These must be very rough and ready at this stage.

8. Officials' report of June 1980 identified LIT, LST and a poll tax as practicable options (though with distinctive merits and demerits). The Green Paper will repeat this. It is important to remember however that these have been judged to be practicable on only a preliminary study. Particular practical problems could be seen as much more difficult to surmount on closer study at a later planning stage. Timing constraints may prove critical, for example (see Appendix II). It is essential therefore not to narrow the options further in the Green Paper.

9. Finally, there is a question of what the Green Paper should say about possibilities for changes to the finance of the education service. Officials suggest that the pros and cons be reviewed of transferring the cost of all or part of the education service to central government, leaving it as an open question for consultation. The subject is allocated an annex in the framework for a Green Paper. It has not previously been examined in the review of rating, and officials would report to Ministers on it in September.

#### Further Development Work

10. Analytic work begun for the Green Paper will continue beyond publication so that further advice can be given at a later date when Ministers wish to take further decisions on the development of policy.

11. For example, it is planned to extend the analysis of changes in tax distribution. Several possibilities are being kept in mind for study in the period September to January and, although decisions on these need not be taken yet, the possibilities include:-

- (i) distributional changes with combinations of two new taxes;

- (ii) distributional changes if the local tax yield is greatly increased and exchequer support grant reduced;
- (iii) exploring possible rebate introductions (as with poll tax) or tax allowance changes.

12. Other economic aspects may also require further consideration after publication of the Green Paper and before a further round of Ministerial discussions in, say, the new year.

For example, there are these issues to consider:-

- (a) the extent to which LIT or LST might infringe upon the potential yield of the national taxes; consequent problems for fiscal policy;
- (b) how far there would be a continuing need for an exchequer support grant; equalisation of resources of different tax areas;
- (c) problems of influencing local decisions on spending and taxation (given greater buoyancy and unpredictability of yield and the greater "lumpiness" with which LIT or LST yield would respond to the minimum possible variations in the local rate of tax); further measures to improve accountability; the extent to which LIT and especially LST would be perceptible to their local electorates;
- (d) as an alternative approach, the problems of defining and enforcing absolute limits upon local expenditure or revenue-raising;
- (e) repercussions on the housing market, eg whether there are repercussions for (i) assistance to owner occupiers and particularly new entrants to the housing market and (ii) the structure of housing subsidy to the publicly rented sector;
- (f) further review of the likely direct and indirect effects of the different options on inflation, as measured by the RPI and TPI.

13. Decisions could be taken around September on the further studies that would be required. The list in paragraph 12 above makes clear the number and importance of topics that are as yet quite inadequately researched and the scale of work that is likely to be found necessary.

## IMPLICATIONS FOR EMPLOYERS' COSTS

If LIT is deducted from pay, and not collected direct from the taxpayer, one of the consequences of introducing it will be an increased burden on employers in operating the PAYE system. This will be a factor of some political sensitivity: employers are always very conscious of the fact that they act as unpaid tax-collectors on a large scale in operating PAYE. It is impossible to quantify the likely additional cost to employers with any accuracy, since no reliable data about employers' PAYE costs are available. It has, however, been estimated that employers' costs are at present broadly equal to those of the IR, who currently have some 35,000 staff on PAYE work; and it seems a reasonable working assumption to take the probable additional cost to employers of operating LIT costs as comparable to, but not greater than, those of the IR. But much would depend on the form of local income tax chosen.

The position is rather different with a retail sales tax. The tax would not be a VAT supplement in the way that an LIT would probably be a supplement to national income tax; it would have to be a separate new tax distinct from VAT and different in concept. The degree of complexity of such a tax, and hence compliance costs for businesses, would depend on the extent to which we could align the sales tax structure with the VAT system. Preliminary work and experience with VAT has shown, however, that a local sales tax would undoubtedly involve traders in some heavy additional costs, and would bear disproportionately hardly on smaller businesses.

## TIMING CONSTRAINTS

1. There are important timing constraints which affect the introduction of a local income tax or local sales tax and which rule out introduction before the late 1980's or 1990's onwards, depending on the option.
2. The Inland Revenue's programme for computerising PAYE is under way, but the cautious step-by-step approach which Ministers endorsed means that there is no firm date for completion. The provisional planning date is end 1987 or early 1988, but it could be later if problems arise. The major organisational changes that would be required by an LIT linked to the national tax system could not be made until some time after completion of PAYE computerisation. How much later would depend on the form of LIT chosen, but it could not be less than 2 years - after the new system had been given the chance to settle down.
3. Similarly for a centrally administered local sales tax it would be essential to use computers which could handle both VAT and LST. The present VAT computers are due to be replaced by new computers in April 1984. Preparations are well advanced and a sales tax could not be grafted on at this stage. Extra computer capacity would be needed before an LST could be implemented. Together with the necessary modifications to the post-1984 system, this makes it unlikely that implementation of a model I sales tax could take place for at least 5 years.
4. An LIT or LST wholly independent of national income tax or VAT would not be constrained in timing by these computerisation programmes - but even so it is doubtful whether either local tax could be planned, legislated for and set up by local authorities in less than 5 years.