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CABINET

STEERING COMMITTEE ON LOCAL GOVERNMENT FINANCE STUDIES

DRAFT GREEN PAPER ON LOCAL GOVERNMENT FINANCE

Note by the Secretaries

Attached is a draft of Annex F of the Green Paper, on the Relationship between Local Taxes and Income. It was not yet been approved by Environment Ministers. Any comments should be sent to Ms J Rutter, Department of the Environment, by 24 December.

Signed J E ROBERTS
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Cabinet Office

19 December 1985

ANNEX F: The Relationship between Local Taxes and Income

F.1 This Annex describes the relationship between local taxes and incomes under the present and proposed systems of local taxation. It supplements the discussion in Annex J. The Annex includes seven tables and histograms - Figure F1 to Figure F7 - which are grouped together at the end.

F.2 A *prima facie* argument against a flat-rate per adult local tax such as the proposed community charge is that it would be regressive, comprising a higher proportion of income for low income households than for high income households. The results in this Annex show that this is also a feature of the present local tax system and that, by comparison with domestic rates, the community charge would bear less heavily on households with the lowest incomes.

F.3 The results are based on actual expenditure and grant entitlements (before holdback) for 1984/85, and in the case of the community charge, assume operation of a "safety net" to remove inter-area effects arising from the proposed reforms to grant and non domestic rates. Average local tax bills, rateable values and net incomes are all calculated at a household level for Great Britain. The work is based on 4 years' data from the Family Expenditure Survey (FES), giving a sample of 28778 households whose incomes, benefits and expenditure have been scaled to 1984/5 price levels. Net household incomes and net local tax bills have been calculated throughout assuming prior implementation of the proposals contained in the White Paper "Reform of the Social Security" (Cmnd 9691), including the new system of housing benefit with everyone paying at least 20% towards local taxes.

The present rating system

F.4 The Allen Committee, set up in the early 1960s to investigate the impact of rates on households, concluded that rates were a regressive tax.

"The regressive nature of rates is most clearly bought out by the fall in rates as a percentage of income, from about 8% for the lowest incomes ... to less than 2% of high incomes..." (Cmnd 2582).

Following the Committee's report, rate rebates and allowances were introduced for those on low incomes. A more recent analysis of impact of rates is contained in the Layfield Committee report (Cmnd 6453).

F.5 Figure F1 and Figure ■ in Chapter 3 show average gross and net rate payments both in absolute terms and as percentages of net income in each band of net income.* Gross rate bills increase in absolute terms as net incomes rise, but as a percentage of net incomes they fall rapidly at first and then more slowly as net incomes rise. Gross rate bills for those with the lowest incomes (less than £50 per week) represent more than 10% of net income, whereas for those with the highest incomes (greater than £500 per week) they amount to less than 2% of net income. These results clearly confirm the findings of the Allen and Layfield reports.

* "Net income" is income from employment, unearned income, and state benefit (except for any housing benefit attributable to local taxes) net of income tax and national insurance contributions.

F6. The effect of the rebate system is to make rates mildly progressive for households with net incomes up to £100 per week. Under the new housing benefit proposals rates would be reduced from 10% to just over 3% of net income for households with incomes of less than £50 per week.

F.7 The main reason for the regressive impact of unrebated rates is the relationship between rateable values and incomes. For rates to be a progressive tax, rateable values would need to rise at least proportionately with incomes. But Figure F2 shows that the ratio of rateable values to net income actually falls as incomes rise. The ratio is 5 times higher for households in the lowest income band than for those in the highest income band. Since rate poundages are largely unrelated to household income, it is the declining ratio of rateable values to net incomes which explains the falling proportion of income accounted for by rates.

F.8 The average rateable values for each income band conceal wide variations in rateable values within each income band which further undermine the usefulness of rateable values as a measure of the ability to pay. Figure 3 shows the distribution of rateable values within five broad net income bands. Almost 7% of households with net incomes below £50 per week have rateable values greater than £250 (ie over 80% above the average for this income group). Over 10% of households with incomes over £300 per week have rateable values of less than £150 (ie less than 50% of the average for this group).

F.9 The wide variation in rateable values within income groups is due to two main factors:

- regional variations in the relationship of average house prices to income;
- the fact that the value of housing currently occupied is related to past levels of household income for most households.

Regional average net household incomes only range from 90% of the Great Britain average in Yorkshire and Humberside to 110% in Greater London, whereas average rateable values range from 70% to 130% of the Great Britain average. Single pensioners on average have net incomes which are only 40% of the Great Britain average but the average rateable values of the properties they occupy are over 80% of the Great Britain average.

F.10 Thus rates are not well related to ability to pay because rateable values on average do not rise proportionately with income, and households with similar incomes can occupy properties with very different rateable values.

How the community charge compares with domestic rates

F.11 The proposed community charge will be collected from each adult in any local authority area at a flat rate. Because the gross charge would not vary with income, its incidence before rebates might be expected to be regressive. Figure 4 sets out the relationship between a 100% community charge and net household income. As with rates, the charge rises in

absolute terms as incomes rise - though in this case this is largely the result of the increased number of adults per household on average as household incomes rise. The gross community charge falls from 7.4% of net income in the lowest band to only 1.6% in the highest income band. As with rates the rebate system makes the incidence of the charge progressive for households with net incomes of up to £150 per week.

F.12 Figure ■ in Chapter 3 compares the relationship between gross rates and community charge across the income range. The community charge results in a much lower gross local tax bill for households in the two lowest net income bands. For those households with net incomes of less than £50 per week the community charge, before rebates, would represent 7.4% of net income compared to 10.1% for rates. After rebates the figures are 2.4% and 3.1% for the community charge and rates respectively. In the middle ranges of net household incomes, containing the majority of households, the gross community charge is a slightly higher proportion of net income than gross rates. Only at the highest levels of income (£500 per week and above) is the charge a lower proportion of net income.

F.13 The lowest income households, therefore stand to gain, on average, from the introduction of the community charge. This is because of household size. 94% of households with net incomes below £50 per week and 65% of the next income band, are single adult households. Thus very low income households gain because of the redistribution of the local tax burden from small to large households.

F.14 However the comparison between rates and a community charge by bands of actual household net income takes no account of differences in household size and composition. Another approach is to split all households into bands of equivalent net income and then to measure rates and the community charge as percentages of actual net income within each band. Equivalent income is a way of measuring relative standard of living or ability to pay by adjusting actual income for differences in household composition. So for example, a single adult with the same net income as a couple would have an equivalent net income nearly double that of the couple. The adjustment factor used is the ratio of the supplementary benefit level of a couple with no children to the calculated supplementary benefit level for each household type considered.

F.15 Figure F5 shows the relationship between gross and net local taxes and actual net income, by bands of equivalent net income. Figure F6 shows the relationship between unrebrated rates and the unrebrated community charge as a percentage of net income, while Figure F7 shows the same relationship with rebates. On this equivalent basis, the community charge is still a slightly lower percentage of income, both before and after rebates for the lowest income groups; it is slightly higher for middle bands of equivalent income and considerably lower for the highest bands.

Conclusions

F.16 The following main conclusions can be drawn from this analysis.

(i) There is a poor relationship between domestic rateable values and income. Domestic rates do not reflect ability to pay.

(ii) Both domestic rates and the community charge, without rebates, would constitute a much larger proportion of income for low income households. The impact on low income households would be reduced in both cases through

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the operation of housing benefit. For low income households the incidence of local tax depends less on the characteristics of the local tax system than on the system of rebates.

(iii) As compared with domestic rates, the community charge would reduce the burden of local taxation on single adult households, who constitute a large proportion of those households with the lowest incomes.

(iv) The switch from rates to a community charge would produce relatively small average changes in the pattern of local tax incidence across households. After rebates, the average proportion of net income paid in local taxes under the community charge would decline from 1.9% for the lowest income households -on an equivalent income basis - to 1.0% for those households with the highest incomes. With rates, the equivalent figures are 2.0% and 1.8%.

(v) The greatest burden of local taxation relative to income in both cases would be borne by households whose income is a little above the level where they would qualify for housing benefit. Under the community charge, the average tax burden on these households would slightly increase -from 3.6% to 3.8% of net income.

Relationship of Gross and Net Rates to Net Household Income
(post-Social Security Reforms)

Ranges of net household income (£pw)	50	50-75	75-100	100-150	150-200	200-250	250-300	300-350	350-400	400-500	500+	ALL
<u>Rate Bills</u>												
Gross Rates £pw	4.15	4.64	4.93	5.26	5.75	6.35	6.98	7.70	8.42	9.57	12.00	5.68
Net rates £pw	1.28	2.14	3.26	4.81	5.60	6.26	6.90	7.64	8.38	9.49	11.93	4.80
<u>Average Rates as a % of net income in each range</u>												
Gross Rates	10.1	7.4	5.7	4.2	3.3	2.9	2.6	2.4	2.3	2.2	1.9	3.6
Net Rates	3.1	3.4	3.9	3.8	3.2	3.1	2.5	2.4	2.3	2.2	1.9	3.0

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Relationship between Rateable Value and Income

Ranges of net household income (£pw)	50	50-75	75-100	100-150	150-200	200-250	250-300	300-350	350-400	400-500	500+	ALL
<u>Average Rateable Value</u>												
- annual	139.58	155.31	165.80	178.11	196.48	216.08	238.41	264.09	289.63	327.41	409.95	192.8
- weekly	2.68	2.99	3.19	3.43	3.78	4.16	4.58	5.08	5.57	6.30	7.88	3.7
<u>Average Rates/Average Net Income</u> (in weekly terms)	6.50	4.75	3.19	2.74	2.17	1.87	1.68	1.58	1.50	1.44	1.23	2.3

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Distribution of Rateable Values by Income Group

<u>Ranges of Net Household Income (£pw)</u>	£50	£50	£100	£200	£300+	ALL
<u>Ranges of Rateable Values (£s)</u>	<u>% of households in each income group</u>					
0 - 50	6.2	2.6	1.4	0.4	0.1	1.8
50 - 100	26.2	16.6	11.0	6.2	2.8	11.9
100 - 150	28.1	29.1	20.2	13.6	7.4	20.6
150 - 200	23.1	27.1	28.2	22.6	14.6	25.4
200 - 250	9.8	15.5	21.4	24.0	17.4	19.3
250 - 300	4.4	6.1	10.7	16.4	16.6	10.7
300 - 400	1.6	2.4	5.8	12.9	23.3	7.5
400+	<u>0.6</u>	<u>0.6</u>	<u>1.3</u>	<u>3.9</u>	<u>17.8</u>	<u>2.9</u>
	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>
<u>% of all households in each income band</u>	7.6	24.5	40.0	20.0	7.9	100.0

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Relationship of Gross and Net 100% Community Charge to Net Household Income
(post-social security reforms)

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Ranges of Net Income	50	50-	75-	100-	150-	200-	250-	300-	350-	400-	500+	ALL
£pw		75	100	150	200	250	300	350	400	500		
<u>100% Community Charge</u>												
Gross £pw	3.07	3.95	4.93	5.46	6.08	6.79	7.55	8.31	9.02	9.68	10.04	5.74
Net £pw	1.01	1.75	3.05	4.82	5.69	6.45	7.18	7.94	8.58	9.19	9.51	
<u>As a % of net income</u>												
Gross Com. Charge	7.4	6.3	5.7	4.4	3.5	3.0	2.8	2.6	2.4	2.2	1.6	3.6
Net Com. Charge	2.4	2.8	3.5	3.9	3.3	2.9	2.6	2.5	2.3	2.1	1.5	3.0

Relationship of Rates and 100% Community Charge (both Gross and Net)
to net household income in each band of equivalent net income

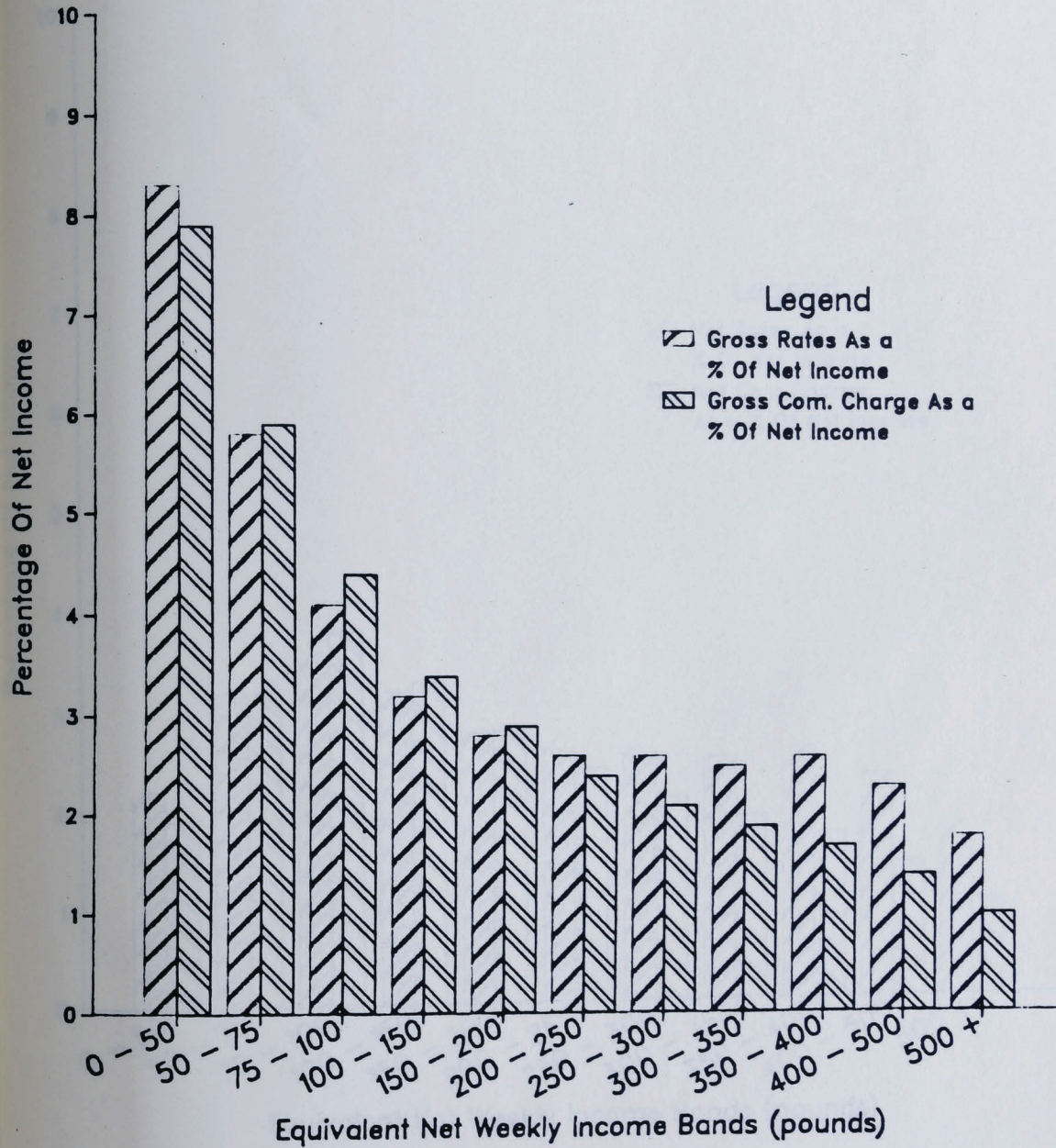
<u>Ranges of Equivalent</u>	50	50-	75-	100-	150-	200-	250-	300-	350-	400-	500+	ALL
<u>Net Income (£pw)</u>		75	100	150	200	250	-300	350	400	500		
<u>Average Local Tax</u>												
<u>Bills (£pw)</u>												
Gross Rates	4.51	4.81	5.30	5.89	6.39	6.76	7.59	8.35	9.50	10.22	12.49	5.68
100% Com. Charge	4.31	4.93	5.68	6.33	6.45	6.22	6.11	6.18	6.15	6.06	6.64	5.74
Net Rates	1.11	2.71	4.69	5.81	6.37	6.74	7.59	8.32	8.50	10.16	12.48	4.80
100% Com. Charge	1.02	2.77	4.94	6.08	6.33	6.16	6.06	6.12	6.08	6.00	8.64	4.76
<u>As a % of net income</u>												
<u>in each equivalent</u>												
<u>income band</u>												
Gross Rates	8.3	5.8	4.1	3.2	2.8	2.6	2.6	2.5	2.6	2.3	1.8	3.6
100% Com. Charge	7.9	5.9	4.4	3.4	2.9	2.4	2.1	1.9	1.7	1.4	1.0	3.6
Net Rates	2.0	3.2	3.6	3.2	2.8	2.6	2.6	2.5	2.6	2.3	1.8	3.0
100% Com. Charge	1.9	3.3	3.8	3.3	2.8	2.4	2.1	1.9	1.7	1.4	1.0	3.0

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Relationship Of Gross Rates and 100% Community Charge To Net Household Income — For Each Equivalent Income Band —



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Relationship Of Net Rates and 100%
Community Charge To Net Income
For Each Equivalent Income Band
(Post-Social Security Reforms)

