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CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

MEASURES ON RATES

Memorandum by the Secretary of State for the Environment

1. E Committee in June (ref E(81)22nd) invited me to prepare drafts of a consultative paper on interim rating measures and of a Green Paper on the Alternatives to Domestic Rates. I was also invited to prepare material on more direct control of rates in the longer term, in case it were decided either not to pursue the alternatives to rates, or to pursue them only on a lengthy timescale.
2. Drafts of the 2 papers are at Annex A and B. But since we discussed these issues in June events have moved on and I now think we should take further action on rates as soon as possible. A number of authorities have shown themselves to be totally irresponsible and we have to take account of the relative success of the Scottish efforts with some of their authorities and the Secretary of State for Transport's proposals in E(81)86 to limit revenue support to PTEs. I have, therefore, reconsidered the control of rates, in the context of it being an alternative to the interim rating measures.
3. At Annex C is a note outlining 3 possible systems for controlling rates. As with the interim measures, they would operate on a selected number of authorities which were blatantly challenging expenditure targets. Such action should also discourage other authorities from irresponsible budgetting, but the direct effect on the totality of overspending would be limited. On the other hand it would raise fundamental difficulties of both principle and practice; involve entering uncharted waters of legislation

and litigation; and ultimately risk defiance by authorities such as the GLC, leading to Clay Cross on a vast scale. In my opinion these objections are so serious, we ought not to go down this road certainly for the moment but should stay with the interim measures we agreed in June.

4. The Chief Secretary to the Treasury accepts that it would be impracticable to implement such a scheme next year by means of legislation next session but considers that it merits further serious consideration. He believes that controlling rates in any of the ways discussed in Annex C could help secure reductions in public expenditure until a replacement for domestic rates takes effect and that a similar scheme might usefully be combined with any new local tax. He accordingly proposes that direct controls of rates should be discussed in the Green Paper on Alternatives to Domestic Rates at Annex B.

5. Whether we go now for control or for the interim measures, we will have difficulty in getting the necessary legislation passed in time to have effect in 1982/83. My paper E(81)71 envisaged the measures coming into effect in 1983/84, but the pressures are now for more urgent action. This would require legislation to be tabled at the start of the new session and enacted by early February. There would be little or no opportunity for prior consultation with the local authority associations, and we would be likely to meet strong opposition in both Houses. Nevertheless, I think the situation is so serious that we must try to meet this timetable.

6. Colleagues may therefore consider if we have either the interim or control measures whether we need the Secretary of State for Transport's proposals.

7. If we decide to go ahead with the interim rating measures we need to decide whether the second supplementary rate should be subject to election or referendum. The appendix to Annex A is a note by officials summarising the pros and cons of both. I think the case for election is much the stronger and recommend we accept it (while recognising that it will not apply to ILEA or other non-elected preceptors). I also think that elections should take place before the second supplementary rate is levied (ie after 1 October) and that all members should be re-elected.

8. Colleagues will wish to consider the drafting of the Green Paper on the Alternatives to Domestic Rates (Annex B), in particular whether we need the annex on distributional effects of some of the alternatives. But the paper should be quickly published and unless major issues are involved, I hope the drafting can be settled by correspondence.

9. I invited colleagues, therefore, to agree:-

- a. that we should announce that we will legislate this session on the interim rating measures to come into operation in 1982/83 and start preparing legislation; the consultative document (Annex A) should be issued as quickly as possible;

- b. the interim rating proposals should require an election of the whole council before the second supplementary rate is made;
- c. that subject to any drafting amendments we should issue the Green Paper on Alternatives to Domestic Rates (Annex B) as soon as possible;
- d. we do not legislate now to control rate levels; but the Chief Secretary proposes that this possibility should be discussed in the Green Paper.

M H

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IMPROVING ACCOUNTABILITY FOR THE LEVYING OF RATES IN HIGH  
SPENDING AUTHORITIES

DRAFT CONSULTATION PAPER

I Introduction

1. Local authorities which spend at relatively high levels are obliged to levy high rate poundages in order to finance their high expenditure. This extra burden is serious for all classes of ratepayer, particularly at a time of recession. This document outlines possible measures to bring home to local authorities and their electorates the consequences of high spending policies, to strengthen accountability, and to give some protection to non-domestic ratepayers, who have no direct representation on their councils. Technical aspects of the proposals are discussed in more detail in two appendices.
2. The main features of the Government's proposals are as follows:-
  - (i) there would be a limit (expressed in terms of a rate in the £) on the initial main rate authorities could levy at the start of the year;
  - (ii) authorities would not be debarred from planning to spend more than could be financed by the initial main rate limited in this way, but they would have to raise the additional revenue by means of one or more supplementary rates to be levied at intervals during the course of the year;
  - (iii) any first such supplementary rate would also be subject to a limit and authorities requiring more revenue than could be raised under this limitation would have to levy a second supplementary rate;
  - (iv) the second supplementary rate would not be subject to any limit, but the council would be required [to put its proposal to the electorate by means of a referendum] or [to stand for re-election first].

- (v) all supplementary rates would be levied at a reduced poundage on non-domestic ratepayers who have no vote in that capacity, in order to afford them some protection from the consequences of the policies of high-spending local authorities.

#### Setting the limits on rate poundages

3. At the time of the annual rate support grant settlement, the Government would announce an overall limit on the initial main rate which could be levied on ratepayers for the coming year. The limit would be sufficient to enable local authorities to finance a certain level of expenditure above their grant-related expenditure assessments - the formula-based assessment of the cost to each authority of providing an average standard of services, which is calculated for the purpose of distributing rate support grant. The limit would be set each year and would take account of the prevailing economic situation and the Government's public expenditure plans.

4. The overall limit on the main rate would be sub-divided to produce a limit for each of the tiers of local government (for example, metropolitan counties, metropolitan districts, non-metropolitan counties, non-metropolitan districts, inner London boroughs and outer London boroughs) to reflect the different functional responsibilities of each tier. It would also be subject to adjustment in the case of certain authorities to ensure compatibility with the operation of the rate support grant system.

5. The limit on the first supplementary rate would be expressed as a percentage of the limit on the main rate and would also be specified at the time of the annual rate support grant settlement.

#### Supplementary Rates

6. The scheme would preserve the freedom of local authorities to determine their own levels of expenditure and rates. It would, however, require them to make a separate and explicit demand on their ratepayers where their expenditure policies require a rate levy in excess of an initial specified limit; and where those

policies require a rate higher than a further specified limit the scheme would give the electorate an opportunity to express their views on the continuation of those policies.

7. Authorities will, generally speaking, know what their revenue requirements for the financial year will be (and thus whether or not they will need to levy one or more supplementary rates or precepts under this scheme) at the start of the year. In order to ensure that the proposed procedure for levying supplementary rates, including the holding of [elections] [referenda], does not become confused with the levying of the main rate for the year or with the normal municipal election cycle, it is proposed that an authority whose spending plans for the year required one or more supplementary rates would be subject to a duty to levy the first supplementary rate as soon as practicable after 1 July. An authority whose expenditure plans required a second supplementary rate or precept would be subject to a duty to [stand for re-election] [hold a referendum] and then to make any rate or precept as soon as practicable after 1 October.

8. In order to set the [election] [referendum] procedure in motion, an authority requiring a second supplementary rate or precept would first have to pass a resolution of intent to make such a rate, specifying the amount in the £ proposed. This would be followed after a specified period by the [election] [referendum] and the authority would be subject to a duty to make any supplementary rate needed to meet the balance of its revenue requirements for the year as soon as practicable thereafter.

#### Protecting the non-domestic ratepayer

9. A supplementary rate would generally only be levied to finance a high level of spending. There is, however, concern that the interests of non-domestic ratepayers in authorities spending at high levels are not adequately safeguarded by existing legislation. It is therefore proposed that non-domestic ratepayers in such authorities should be given some protection from the full impact of the rate levels required to finance their expenditure policies. This would be achieved by requiring that supplementary rates be levied differentially on non-domestic and domestic ratepayers,

with a proportionately smaller burden falling on non-domestic ratepayers. There are several ways in which the rate burden on non-domestic ratepayers might be alleviated.

#### Perceptibility and Accountability

10. In order to ensure that as far as possible all sections of the electorate are fully aware of the consequences of their local authorities' spending policies, it is proposed that rating authorities levying a supplementary rate should be required to notify their own tenants separately and directly of the amount by which their rate bill will increase in consequence, and the extent to which this is due to the precepting or rating authority. Existing methods of rate collection from tenants should, however, continue.

#### Conclusion

11. This document has outlined the main features of the Government's proposals. Details of technical aspects of the scheme in respect of setting the limits on rate poundages, ensuring compatibility with the rate support grant system, the supplementary rate procedure and possible ways of reducing the proportion of supplementary rates levied on non-domestic ratepayers are discussed in Appendix 1; the detailed arrangements for special [elections] [referenda] associated with second supplementary rates are described in Appendix 2.

12. Comments on the proposals are invited. They should reach the Department of the Environment (in the case of Wales the Welsh Office) by [the end of October]. Subject to the outcome of these consultations it is envisaged that legislation might be introduced in the 1981/82 Session of Parliament to come into effect on 1 April 1982.

#### ELECTORAL ACCOUNTABILITY: Election or referendum?

##### Paper by Officials

1. This paper considers the disadvantages and advantages of an election or referendum for a second supplementary rate.

#### PRESENT POSITION

##### Elections

2. Ordinary local authority elections in England and Wales are held on the first Thursday in May. Non-metropolitan district councils may choose to elect en bloc or by thirds. Most metropolitan districts already elect by thirds and all will do so by 1986; some metropolitan districts and all county authorities, the Greater London Council and the London Boroughs elect en bloc (see table at Annex B). Casual vacancies which arise are filled by by-elections for which 25 working days' (approximately one calendar month's) notice has to be given.

##### Referendums

3. Local polls may be held in parishes and communities (Wales) on any question arising at a parish or community meeting (Local Government Act 1972, schedule 12); there is no provision for local referenda elsewhere.

#### IMPLICATIONS OF THE OPTIONS

##### Election

4. Advantages:

(1) The prospect of the upheaval and the risk for the majority group on the Council that it could lose political control altogether could provide a strong disincentive to action which makes an election necessary.

(2) The election should provide an unequivocal basis for the future direction of an authority's policies, producing either a new

council committed to a change of policy or a clear and specific mandate for the continuation of existing policies and higher rates.

5. Disadvantage: Local elections are not normally decided on a single issue and voting is on party lines, strongly influenced by national issues. But in a special election caused solely by a proposed supplementary rate, attention might well be focussed predominantly on rates and local spending.

6. Timing: The best time for the special election would be October because:-

- (1) March - mid-June - clash with normal election cycle;
- (2) mid-June - September are out because of holidays;
- (3) November - mid-February are out because of the unreliable electoral register and weather;
- (4) January - March are out because the election will be too close to the normal cycle.

7. In practice, however, a local authority may need to levy a second supplementary rate in the last quarter of the financial year or apply to the Secretary of State for borrowing approval in order to meet inescapable commitments. In these circumstances, the election might be held in March and be related to the main rate for the following year (ie an authority should declare its budget for the following year until it had been re-elected). If this were the case, the May election would probably have to be waived. This raises the question of whether the May election should in this case be waived where a special election has taken place in October. Otherwise there could be two elections within six months and councillors elected in a special election of an authority elected for thirds would have a very short term of office. On the other hand, it might be better to avoid rejigging the whole electoral cycle. Special elections might best be treated in the same way as elections for filling casual vacancies - ie members re-elected would serve out their original terms of office, while new members would serve out the terms of office of the councillors they replace.

8. Should the election be held before or after the levying of the second supplementary rate? The attraction of before would be the practical difficulties and uncertainty it would cause for the council, who might think twice before planning to spend at a level which would require a second supplementary rate. There are, however, problems. If a new council comes in it still might have to levy a rate because it could not reduce its inherited commitments quickly enough to keep the authority solvent. This would undermine the whole purpose of the election and, whatever happened, the money market might worry about the solvency of the council. So, from that point of view, it might be better to require a council to submit itself to election immediately after levying the supplementary rate - when, moreover, the request to pay rates would be fresh in peoples minds.

9. Authority to be re-elected: The authority responsible for voting the rate increase rather than the levying council should be the one submitting itself to re-election. However, in the case of parishes (communities in Wales), which are empowered to precept on district councils, it would seem sensible to follow existing practice in grant and expenditure matters whereby their expenditure is included in that of the districts concerned. This could, however, lead to a district council having to submit itself for re-election because of a parish's high spending.

10. Where the rate is increased as a result of a precept by a non-elected authority there could be no election. A particular problem arises in the case of ILEA which is both the largest local education authority and a major overspender but whose members are nominated by virtue of their being elected to other authorities. When the future of the ILEA was reviewed earlier this year, arguments for the establishment of a directly elected

single-service authority were fully considered along with a wide range of alternatives for the administration of education in inner London but the Government decided against any constitutional changes and a statement to that effect was made in Parliament as recently as last February. It would follow that, whatever the choice generally between election and referendum, in ILEA a referendum is the only feasible answer.

11. Members to be re-elected: All should have to stand for re-election, even if they opposed the rate increases or abstained. Otherwise big majority parties could subvert the process by ensuring only certain councillors with safe seats voted.

#### Referendum

12. Advantages:

(1) It would be confined to the particular issue of the proposed rate increase.

(2) It would not disrupt the electoral cycle, (although some of the timing problems outlined in paragraphs 6 and 7 above still apply).

(3) The difficulties about non-elected authorities (such as ILEA) do not arise and

(4) Councillors opposing the proposed increase would not lose their seats.

13. Disadvantages:

(1) To be effective, the result of the referendum would have to be mandatory rather than merely advisory. Otherwise, the council could ignore an unfavourable result and levy the supplementary rate anyway.

(2) What happens if the result goes against the supplementary rate but the authority finds itself unable - whether voluntary or not - to meet its financial obligations? This could lead to bankruptcy and confrontation with the Government which a handful of politically-motivated authorities may be prepared to put to the test. This could force the Government to appoint Commissioners to take over the authority, which could be followed by industrial action on the part of the council's employees and the breakdown of services in the areas concerned. Commissioners could almost certainly do no more than carry out a holding operation pending an election, which might beg the question of why the second supplementary rate should not have been made subject to an election in the first place.

14. Alternatively, a less dramatic but nevertheless difficult situation could arise whereby the majority party on the council, having lost the referendum, might abdicate but then frustrate all attempts by the remaining councillors to carry on the authority's business. (The ruling group on one council has already threatened this as a possible course of action over current plans to hold back rate support grant from authorities who fail to meet their expenditure reduction target.)

15. Question to be asked: At parish and community polls the question to be asked is identical to that put to the parish meetings prior to the poll. At the EEC referendum in 1975 and the devolution referenda in 1979 the questions were prescribed in legislation. It would be unwise to allow each local authority to set its own question without some form of approval by or appeal to the Secretary of State. The choices are:

- (i) approval by or appeal to the Secretary of State;
- (ii) the form of the ballot confined to a vote on a number of resolutions of the Council, with explanatory notes on the paper's face or in each polling booth;
- (iii) a simple question prescribed in legislation.

(iii) is recommended; (i) would involve too much work for central government and (ii) is too complex.

16. - Rules of conduct: Standard rules adapting existing electoral law could be prescribed. Should public funds be made available to ensure that electors receive appropriate information about the issues involved (which could be expensive) or should this cost be borne by the local authority?

#### OTHER MATTERS:

17. Consideration also needs to be given to the franchise for and cost of a special election or referendum.

18. Franchise: It is arguable that, as ratepayers will be directly affected by the issues in question at either a special election or a local referendum, the franchise should be specially restructured. This would seem to be more acceptable at a referendum on a specific financial matter than at an election to an authority with wide responsibilities. On the other hand concern about the level of rates is not confined to those formally responsible for paying for them, eg it affects those who pay rates indirectly with their rent or who contribute to them by way of their contribution to the household. A 'ratepayer only' franchise would, of course, exclude disproportionately women, young people

living in rented accommodation, the ethnic minorities, the institutional population (such as old people in local authority homes) and would, presumably, include aliens and other people, such as absentee landlords, who are not at present entitled to vote. It would be simpler, cheaper and quicker to use the existing electoral roll.

19. Cost: An ordinary local election in a district council area of 60,000 electors costs at least £10,000. The administrative costs of a local referendum would be about the same, although this could be doubled if special information were provided to electors. It seems essential that the administrative costs at least, if not the cost of providing information to the electorate as well, should fall on the local authority whose proposed rate has triggered the election/referendum.

#### CONCLUSIONS

20. If Ministers decide to go for elections they need to decide:

- (i) Their timing - do they agree officials recommendation that they should be limited to, say, mid-September - mid-November? If the supplementary rate is levied later the election should be the following March, related to the next main rate.

(ii) Before or after?

(iii) Should there be special arrangements for ILEA and parishes?

(iv) All or only some members to be re-elected?

21. If they decide on a referendum, they need to decide:

(1) Whether the question is to be prescribed by legislation.

(2) Is any support to be given for the provision of information for the electorate?

On either case they need to decide the franchise.

QUESTION/REFERENDUM

Advantages and disadvantages

Advantages

- less effective disincentive to high spending (possible loss of office)
- clearer result
- would be held after second supplementary
- no problem of council remaining with no mandate to finance commitments
- avoids risk of bankruptcy and confrontation
- no risk of ruling group dominating
- need to devise procedural rules
- need to fund literature

(ii) Disadvantages

- possible disruption of electoral cycle
- possible short terms for councillors
- decision could be on range of issues
- problem of parishes and non-elected authorities
- councillors against increase could lose seats
- no election possible in ILEA

REFERENDUM

Advantages

- disruption of electoral cycle
- short terms for councillors
- decision of specific issue
- no problem of parishes/non-elected authorities
- no risk of councillors against increase losing seats

(ii) Disadvantages

- less effective disincentive (no loss of office)
- advisory result could be ignored
- mandatory result could mean inability to finance commitments: risk of bankruptcy and confrontation
- pointless to hold after second supplementary
- ruling group could abdicate
- problem of setting question
- rules of conduct to be prescribed
- possible need to fund literature
- demands for other referenda

ANNEX B  
TIMETABLE OF LOCAL GOVERNMENT ELECTIONS IN ENGLAND

| Years                              | 1981<br>1985  | 1982<br>1986   | 1983<br>1987   | 1984<br>1988              |
|------------------------------------|---------------|--|--|---------------------------|
| Members and classes of Councils    |               |  |  |                           |
| County Councils                    | Whole Council | -  | -  | -                         |
| Greater London Council             | Whole Council | -  | -  | -                         |
| London Borough Councils            | -             | Whole Council  | -  | -                         |
| Metropolitan District Councils     | -             | 1982:<br>$\frac{1}{3}$ Council in 26<br>Whole Council in 10<br>1986:<br>$\frac{1}{3}$ Council all 36 | $\frac{1}{3}$ Council  | $\frac{1}{3}$ Council     |
| Non-metropolitan District Councils | -             | 1982:<br>$\frac{1}{3}$ Council in 103<br>1986:<br>$\frac{1}{3}$ Council in 124                       | 1983:<br>$\frac{1}{3}$ Council in 103<br>Whole Council in 193<br>1987:<br>$\frac{1}{3}$ Council in 124<br>Whole Council in 172 | $\frac{1}{3}$ Council 124 |
| 100 (about) Urban Councils         | -             | Whole Council (some)   | Whole Council (most)   | Whole Council (some)      |

## GREEN PAPER ON ALTERNATIVES TO DOMESTIC RATES

## PREFACE

1.1 For some time there has been dissatisfaction with the way in which local people contribute to the cost of local services through the present system of domestic rates. Some domestic ratepayers believe that they pay too large a share of that cost, pointing out that other local people who are not householders are not required to pay rates at all. Many of those professionally concerned with rating and valuation matters believe that the technical basis of the domestic system is no longer satisfactory in some respects.

1.2 The Secretary of State for the Environment said on 2 June 1981 "The Government have ... to consider ... the extent of the inequities in the way in which local revenue is raised through the rates. The Government therefore intend to issue a consultation document on the alternatives to domestic rates in the autumn".

1.3 This green paper therefore offers for public discussion the results of a preliminary review by the Government of possible alternatives to domestic rates. The paper describes a number of possible alternative systems and considers what the consequences of their adoption might be for local and central government, for the taxpayers who contribute towards the cost of local government services through various forms of exchequer support, and for those who pay domestic rates at present. It also considers implications that changes to the domestic rating system might have for non-domestic ratepayers (alternatives to non-domestic rates as a tax are not within the scope of the present review).

1.4 The Government's intention in publishing the green paper has been to set out the alternatives and draw attention to the considerations involved in each of them, rather than to set out a preferred strategy or to make firm proposals. Comments are invited from local government, professional bodies, commerce and industry and the public on the green paper and the issues that it raises. They should be sent by [ ] to: [ ]

DEPARTMENT OF THE ENVIRONMENT  
SCOTTISH OFFICE  
WELSH OFFICE

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## CHAPTER 1

### THE CONTEXT OF THE GREEN PAPER

#### DOMESTIC RATES

1.1 The present basis of domestic rating is that each local authority sets a rate poundage (expressed as a number of pence per pound per year) which is applied to the rateable value of each property in its area. In England and Wales that rateable value is assessed by the Valuation Officer (an Officer of the Inland Revenue who is independent of the local authority) and is based on annual rental value at the date of the last revaluation (1973 in England and Wales, 1978 in Scotland). In Scotland the assessment of rateable values is carried out by Assessors who, though employed by local authorities, are answerable only to the courts for the level of their valuations and thus operate independently. Principles of valuation in Scotland differ in some respects from those in England and Wales. Relative rate burdens in different parts of the country are shown in Table 1. The impact of rates is modified in three major ways.

1.2 Domestic rate relief reduces the poundage charged to all domestic ratepayers, compared with that for non-domestic premises. The reduction amounts to 18p in the pound in England (though larger reductions apply in parts of Inner London), 36p in Wales and 3p in Scotland. The relief is paid by the Exchequer to local authorities as the domestic element of Rate Support Grant, amounting to [£700m] in 1981/82, or 7% of total RSG. In money terms, the value of domestic relief increases with rateable value (in England, for example, it is worth £37 a year on a house of £200 rateable value, and £74 on a house of £400 RV). As a proportion of the rate bill, it favours those living in areas with relatively low rate poundages. The proportion varies in England from 8% of the rate bill in areas with the highest rates to 19%; in Wales from 18% to 28%; and in Scotland from 2% to 4%.

1.3 Rate rebates are a form of tax relief which reduces the burden that domestic rates impose on those on low to moderate incomes. The amount of rebate depends on the size of the rate bill, the income of the ratepayer and his or her spouse, and on the type of household. If income is equal to a needs allowance which the system prescribes for each type of household, the rebate amounts to 60% of the rate bill (net

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of domestic relief). The rebate is increased by 8p for each £1 by which income falls short of the needs allowance, and reduced by 6p in the £ of income if it exceeds the needs allowance.

1.4 The cost of rebates in England and Wales in 1981/82 is likely to be some £300m, 90% of which is met by central government and 10% from local authority rate funds. There were 2.68m recipients in 1979/80 amounting to 14% of all English and Welsh households and around 70% of those eligible. The cost of rebates in Scotland is estimated at £50m in 1981/82; there were 383,000 recipients in 1978/79.

1.5 Supplementary benefit takes account of the rates payable by a claimant as part of his housing costs. Housing requirements are added to the claimant's normal requirements and any additional needs, such as extra heating costs. The claimant's income (less some disregards) is subtracted from his requirements to arrive at his or her entitlement to SB. The benefit is not available to those in full-time work, or whose income exceeds their requirements, or those with more than £2,000 in capital.

1.6 It is estimated that rate bills for SB households will amount to £ m in 1981/82. The number of SB households in was m, an estimated take-up rate of % among those eligible.

1.7 Figure 8.1 illustrates the distribution of the rate burden as a proportion of gross household income both before and after allowance has been made for rate rebates and Supplementary Benefit. It shows that unrebated rates take a higher proportion of the incomes of less well off households than of wealthier ones. When rebates and SB are taken into account, this effect is slightly reversed for those on low-to-middle incomes, but it persists for those on higher incomes.

#### CRITICISMS OF DOMESTIC RATES

1.8 Domestic rates have been widely criticised in recent years as a means of raising revenue from the local electorate. The most common criticism is that domestic rates are unfair as between different types of individuals and households, as between

people occupying property of a similar type in different local authority areas and as between householders and non-householders. These criticisms about the fairness of the present system are discussed in Chapter 2 (see para 2.9).

1.9 The fact that domestic rates take only limited account of the ability to pay is another frequent criticism. For households on lower incomes, rate rebates or rate payments in supplementary benefits mean that the system takes some account of their income. For households which do not receive these benefits, the higher the income, the smaller the proportion of it which tends to be paid in domestic rates.

1.10 Thirdly, the present system of domestic rates has been criticised on technical grounds by those professionally involved in its operation. In particular, the professional bodies concerned with rating and valuation told the Layfield Committee of Enquiry into Local Government Finance that there was insufficient market information available to allow a further rating revaluation to be carried out on the rental basis described in paragraph 1.1.

1.11 Most of this green paper is concerned with ways in which these criticisms could be met, by new forms of local taxation (or by a reformed rating system). The remainder of this first chapter sets the context for that examination by discussing the contribution that domestic rates make at present to local government finance and the nature of the central Government's interest in local authorities' financial affairs; and by examining some of the general economic effects that the replacement of domestic rates with alternative forms of revenue might produce.

#### THE CONTRIBUTION OF DOMESTIC RATES TO LOCAL GOVERNMENT REVENUES

1.12 At present about 15% of gross local authority expenditure is covered by rents and various other fees and charges for services. Of the balance, which is expected to total about £25,000 million in the financial year 1981/82, about 60%

will be provided from the exchequer by central government in the form of rate support grant, specific and supplementary grants, rate rebate payments and payments of rates through the supplementary benefit system; and of the remainder about 40% is expected to be contributed by domestic rates and about 60% will be contributed by industry, commerce and other non-domestic ratepayers through rates. In cash terms, the share of this revenue provided by domestic rates is equivalent to about £4,700 million at current values, not taking into account the relief available to those on lower incomes through rate rebate and supplementary benefits.

1.13 This paper does not consider new revenues to replace the proportion of rate fund revenue provided at present by non-domestic rates. Chapter 9, however, discusses the implications for non-domestic rates of the replacement of domestic rates by a new form of revenue and looks at the arrangements which could be made to ensure that at a minimum the relative burden of taxation on commerce and industry was not increased.

1.14 A number of the revenues which could provide alternatives to domestic rates would have implications both for the amount of exchequer grant made available at present to local authorities and for the way in which it is paid. At one extreme, it could be possible to make arrangements for financing local government services under which local authorities could be self-sufficient and which therefore required no exchequer grant to be paid at all. On the other hand, there could be a need for an increase in the total amount of exchequer grant paid to local government if new local taxes were set at a level which did not raise as high a revenue as that yielded at present by domestic rates. Corresponding adjustments to the total of central government taxation would be necessary. Exchequer grant is discussed in Chapter 7.

THE INVOLVEMENT OF CENTRAL GOVERNMENT IN LOCAL GOVERNMENT FINANCE

1.15 Neither local government nor local taxpayers are in a position to assess either the relative claim of local services as a whole to national resources or the overall economic impact of local expenditure. These are matters on which central government must take a strategic view in the course of its management of the national economy. The Government is concerned with the level and growth of output and employment, with prices and wage levels, with levels of investment and consumption and with the balance of payments, as well as with the provision of local services. The Government has to ensure that the level of public expenditure does not prejudice national objectives in any of these respects - and local government expenditure accounts for about a quarter of total public expenditure. In addition, the Government has overall responsibility for all public services, including those provided by local authorities. It also needs to be able to adjust levels of activity between particular industries and between regions. For all these reasons, it is essential that Government should be able to influence local revenue-raising and local expenditure.

1.16 At the same time, local government has traditionally enjoyed a degree of local discretion on the amount of local revenue it raises and the amount of expenditure it incurs. It is obviously desirable that authorities should be able to tailor local revenues and expenditure to the provision of a level of services on which they decide, provided that, on the one hand, the levels of revenue raised and expenditure incurred do not prejudice the Government's objectives for the national economy; and on the other, that local services are provided to acceptable standards.

1.17 Some of the new local taxes and other revenues which could provide alternatives to domestic rates would make it easier for the central government to influence the decisions of local authorities about revenue-raising and expenditure; others would make it more difficult. This is one of the factors which is dealt with in the chapters of this green paper which discuss the alternative new forms of revenue. The Government believes

that the retention of an appropriate central influence over the amount of public expenditure incurred by local authorities must be a feature of any system of alternative revenues which may be chosen to replace domestic rates.

ECONOMIC IMPLICATIONS

1.18 There would be a number of general economic effects if domestic rates were no longer to be levied. The exact nature of these effects would depend on the alternative source of revenue. Some of the most likely effects are discussed in broad terms in the remaining paragraphs of this chapter.

A. HOUSING

1.19 Rates are the only tax charged at present specifically on housing. Even if the present revenue of domestic rates were raised in alternative forms of taxation, therefore, their abolition ought to increase the attractiveness of housing in comparison with other goods and services. The effects of this relative increase in attractiveness and its consequences for house prices, rents and mortgage finance are uncertain.

B. LOW INCOMES

1.20 The burden of rates on those with low incomes is now mitigated by the special <sup>assistance</sup> referred to in paragraphs 1.3-1.6. At present about one in four (about 5 million) households benefit to some extent. The position of the less well-off has been particularly borne in mind, however, in the chapters describing the individual alternative sources of revenue.

C. REDISTRIBUTIVE EFFECTS

1.21 Although the replacement of domestic rates by a tax of equal yield would leave the aggregate burden of taxation in Great Britain as a whole unchanged, there would be likely to be significant redistributions of the tax burden between individuals and householders and to some extent between areas. Some of these effects are touched on in the chapters dealing with each alternative local tax. They are also dealt with in chapter 12 and Annex C.

EFFECTS ON DEMAND

1.22 Any new way of raising the revenues currently raised by domestic rates could be expected to produce some changes in the pattern of demand for goods and services. This effect would probably be most marked if the replacement for domestic rates involved a local sales tax under which retail sales of some goods and services were taxed, but others were not: for example, a local sales tax might be levied on the same tax base as national VAT, which excludes food, housing and a number of other items such as childrens clothes. The taxed goods and services would then become more expensive, leading to some increase in the demand for the relatively cheaper, untaxed goods and a reduction in purchase of the taxed goods and services. In time output, investment and employment might show some shift from the taxed field to the untaxed, and there might be some marginal shifts between domestic production and imports. However, the aggregate effect on national demand, output and employment could be expected to be minimal.

EFFECTS ON PRICES

1.23 The effect on the Retail Price Index (RPI) of replacing domestic rates with new forms of taxation would vary according to the kind of new tax adopted. Rates are an element in the RPI but income tax is not: the replacement of domestic rates with a local income tax would therefore lead to a direct fall in the

RPI (perhaps about 3%). Both rates and retail spending on goods and services are included in the RPI, so that the effects of replacing domestic rates with a local sales tax should balance out without affecting the RPI. Any rise in housing prices would, as it worked through, tend to be reflected in the RPI. Effects on the Taxes and Prices Index (TPI) would tend to be neutral, as one tax replaced another. The replacement of domestic rates by a poll tax would produce a direct fall in the RPI however.

CHAPTER 2

THE ALTERNATIVES TO DOMESTIC RATES

INTRODUCTION

2.1 Chapter 1 outlined the origins of the Government's present consideration of alternatives to domestic rates and set out the broad institutional, political and economic background against which the alternatives must be considered. This chapter sets out the alternatives for change; identifies those which the Government, after its initial review, considers to be worthy of further, serious consideration; and discusses how the possible alternatives ought to be assessed.

NEW LOCAL TAXES

2.2 It would be possible to raise some or all of the revenue which is raised at present by domestic rates through new forms of local taxation. The new taxes which have been most frequently suggested, and which the Government has examined in its preliminary review are:-

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

OTHER ALTERNATIVES

2.3 Some or all of the income now raised through domestic rates could be replaced by assigning to local authorities a share of a national tax or taxes. (This alternative would have implications

for the nature of the relationship between central and local government which are discussed in chapter 6.)

2.4 A further possibility would be to retain a system of domestic rates either instead of or as well as introducing new forms of local taxation, but to modify the present system to make it more generally acceptable.

ASSESSING THE ALTERNATIVES

2.5 The Government has identified seven questions against which it considers the alternatives to domestic rates must be assessed. Some of the factors concerned have already been touched on in chapter 1. None of the alternatives satisfies all of the criteria equally satisfactorily: there is no ideal solution. The questions are:-

- (i) Is it practicable?
- (ii) Is it fair?
- (iii) Would it make those who take decisions on local expenditure properly accountable to local people who pay?
- (iv) Could the costs of administration and collection incurred by the tax-gathering authorities and businesses be kept within acceptable limits?
- (v) Are the implications for the rest of the tax system acceptable?
- (vi) Would it encourage proper financial control by allowing local authorities to budget sensibly and accurately?
- (vii) Is it suitable for all tiers of local government?

REJECTED OPTIONS

2.6 In the light of the foregoing, the Government has concluded that five of the possible local taxes listed in paragraph 2.1 do

not merit serious consideration. They are:-

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

The reasons for rejecting these options are discussed in Annex A. The rest of this chapter discusses in general terms the seven questions set out in paragraph 2.5: the next five chapters discuss them in relation to each of the remaining options.

PRACTICABILITY

2.7 To be practicable as a new source of revenue, any alternative to domestic rates must:-

- (a) be capable of producing a sufficient yield, either on its own or in combination with other local taxes, to replace the £4,700 million yielded at present by domestic rates;
- (b) provide each local authority with a potential yield sufficient to meet an appreciable part of its expenditure;
- (c) enable each local taxpayer's liability to be determined with reasonable certainty in a way which commands general acceptance; and
- (d) not impose unacceptable costs of administration either for the taxing authorities or for the rest of the community.

2.8 It is not necessary for the base for any new local tax to be evenly distributed among local authority areas: some differences could be compensated for by an equalising grant similar to the present rate support grant. But the local tax base in each area must be large enough to enable the local authority to fix a tax rate sufficient to meet a reasonable proportion of its expenditure.

This will make it accountable to its electorate both for the rate of local taxation and the expenditure it helps to finance.

FAIRNESS

2.9 Judgements about the fairness of one tax or another inevitably tend to be somewhat subjective, depending on how people perceive the true effects. Criticisms of domestic rates as unfair tend to take one of three forms. First, they are said to be unfair because they are not paid by all who enjoy the benefit of local authority services, but are confined directly to householders. They are also said to be unfair because they take no account directly of capacity to pay, so that someone living on their own can face exactly the same rate bill as a large family living next door, and a retired person the same as his neighbour in work. This criticism is to some extent, but not wholly, met by the rate-relief scheme. Lastly, rates are said to be unfair because people occupying broadly similar kinds of property in different parts of the country may face significantly different rate bills. While none of these criticisms is clear-cut, judgements about alternative forms of local taxation will need to pay regard to considerations of coverage, individual capacity to pay, and perceived fairness between people in broadly similar circumstances enjoying broadly similar levels of service from their local authority. Moreover, it is clear that any alternative to domestic rates will need to command a wide degree of public support if it is to provide the basis for a viable and lasting system of local authority finance.

ACCOUNTABILITY

2.10 It is a basic requirement of democratic government that public authorities should be accountable to their electorates for what they spend and for the revenue they raise. Taxpayers have a right to expect that local services are provided efficiently - that services are not only up to the standard that is required by the community, but also that they are provided at minimum cost. Local authorities have a monopoly in many of the services that they provide and are therefore not subject to the automatic pressures for

efficiency that come with competition. The Government believes that the best way of encouraging efficiency and safeguarding against extravagance by local authorities is to ensure that the way in which local taxation is raised allows local electors to be clearly aware of authorities' decisions about expenditure and revenue; and of the effects of those decisions on the level of local taxes that they pay.

2.11 Ideally, local taxation should have a number of features if accountability is to be fostered:-

- (i) local taxes should be clearly perceptible to local electors and taxpayers, who should be aware of how much tax they are paying, which authority they are paying it to and what services it is to be spent on;
- (ii) as far as possible, local taxes should be paid directly by local electors and as many as possible of those who benefit from the services provided by the local authorities should contribute;
- (iii) local taxpayers should be able to tell readily when the rate of local tax has been changed and by how much: and should be able to relate this to the local authority's expenditure.

COST OF ADMINISTRATION

2.12 The likely cost of administering each of the possible alternative local taxes must be considered in relation to the administrative savings if domestic rating were abolished. The Government estimates that the cost to the public sector of operating the domestic rating system is currently approximately £120 million per year.

FISCAL DIMENSIONS

2.13 Domestic rates are an important component of the United Kingdom tax system. This year local authorities are expected to raise from domestic rates as much as the central Government received in corporation tax or from the excise duties on hydro-carbon oils, or from the taxes on North Sea oil operations. The yield is also equivalent to more than one sixth of the revenue from VAT and one sixth of that from income tax. The replacement of domestic rates by some other local tax or taxes would be bound to have important consequences for the balance of the tax system and for the distribution of the tax burden between different individuals and households. The Government would need to pay particular attention to the likely repercussions on overall tax levels and tax rates from substituting for domestic rates new local taxes, such as a local income tax or a local sales tax, which applied to areas already subject to national taxes. The Government would need to consider the implications of any such narrowing of the tax base for its overall fiscal strategy, and for its future freedom in setting the level of corresponding national taxes.

FINANCIAL CONTROL

2.14 Certain characteristics of any tax affect the degree of financial control which it permits local authorities to exert. In order to be able to budget sensibly and tightly, local authorities need to be able to predict their income and their cash flow reasonably precisely. There is therefore considerable advantage for them in having a source of income whose yield for a given tax level is fairly predictable. Unpredictable yields would lead to greater uncertainty and would be likely to cause authorities frequently to maintain higher average levels of balances as a precaution against any shortfall. It should be possible to devise arrangements under which the burden of this uncertainty about yields could be shared by local authorities as a whole, so that surpluses in some areas could be offset against shortfall in others. This would require authorities to give up the possibility of windfalls in return for a greater

measure of predictability of income. Alternatively, it would be possible for the Government to shoulder some or all of the burden itself by guaranteeing authorities a given income for a given tax rate. This could involve the making good of all or part of any national shortfall compared with predicted revenue. Although it might be possible for costs to the exchequer to be offset over a number of years by clawing back the surplus in years when tax revenue exceeded forecasts, any arrangement which involved the underwriting by the Government of shortfalls in tax revenue would be an open-ended commitment which simply transferred some or all of the problem from local to central government. No government would be likely to enter into such an arrangement unless it was clear that satisfactory alternative arrangements could not be made.

2.15 It is also necessary to consider the buoyancy and lumpiness of the yield of a local tax. If the local tax revenue can be expected to keep pace with the growth of prices or earnings more or less automatically, local authorities are more likely to be able to support the volume of goods and services financed by the tax at the same level without varying the nominal rate of tax. For a tax that is not buoyant the nominal rate has to be increased (in a time of inflation) even if the level of services provided stays the same. This has the advantage of increasing the perceptibility of local authorities' decisions to local taxpayers.

2.16 If the yield of a local tax is lumpy - that is, if the minimum practicable change in the tax rate produces a large variation in tax revenue - then local authorities will have to budget for expenditure rather differently than with a smoothly variable tax. They may find it necessary to run appreciably higher average balances, or a tendency may develop for local authorities to gear their spending to the yield of the tax rates that are practicable. This could restrain expenditure growth in some areas and make expenditure increases easier in others.

2.17 If a local tax were both buoyant and lumpy, many local authorities could leave their tax rates unchanged for many years at a stretch. A decision to change the tax rate, even by the smallest available step, could therefore assume significant importance in local politics. Conversely, small variations in

expenditure levels might not be immediately appreciated by local taxpayers.

2.18 The degree of predictability, buoyancy and, particularly, lumpiness of a local tax may also have a considerable impact on the shape of exchequer grant to local government. This question is considered further in chapter 7.

#### SUITABILITY TO ALL TIERS OF LOCAL GOVERNMENT

2.19 Table 2 shows the way in which local government functions are divided between two main tiers of local authorities. Authorities in both tiers draw on domestic rates to finance the services that they provide, though the level of expenditure of authorities in each tier varies between different parts of the country. The expenditure levels of shire counties in England and Wales, for example, are higher than those of metropolitan counties: this reflects differences in their statutory functions. Some new taxes could, like rates, be levied at different rates by both tiers to provide an independent source of income. Other taxes could only be levied at the level of the upper tier - counties in England and Wales, regions and, perhaps, islands area in Scotland. Such taxes might, however, form part of an acceptable system of taxation for local government as a whole if combined with a second new tax for the lower tier. <sup>Some</sup> possible combinations of local taxes are discussed in chapter 11.

2.20 Parish and community councils in England and Wales, as well as the two main tiers in Great Britain as a whole, would also need a new source of income. If they were to retain their freedom to determine their own levels of expenditure and set their own income they too would need access to a new form of taxation.

### CHAPTER 3

#### LOCAL SALES TAX

3.1 The possibility of a local sales tax has been canvassed from time to time in recent years. It was considered, in particular, by the Committee of Enquiry into Local Government Finance chaired by Sir Frank Layfield QC which reported in 1976. Although the Layfield Committee identified a number of strong arguments against local sales tax as a means of raising revenue for local authorities, the Government considers that it would be inappropriate to exclude such a tax from the present review.

#### TYPE OF SALES TAX

3.2 The Government has looked at the possibility either of a single-stage sales tax or a multi-stage tax akin to VAT. Theoretically, a local sales tax could take the form of a full-scale value added tax levied locally on all the transactions currently subject to national VAT. The Government believes, however, that this possibility is not worth pursuing. A value added tax is charged not only on supplies of goods and services to the final consumer, but at each preceding stage of the process of manufacture and distribution. There is provision (the input tax deduction system) to allow businesses to reclaim tax on purchases of goods and services for business

purposes. If local authorities were free to set their own local rate of tax, an item might incur tax in a number of different areas at a number of different rates during the process of manufacture, distribution and sale. This would impose a considerable burden on traders in producing an appropriate analysis of their input tax deductions in their tax return, and it would entail a major responsibility for central Government in allocating input tax deductions to local authority accounts. The Government considers that in practice such a system would prove unworkably complicated.

3.3 In any case, any new form of sales tax would have to be compatible with the European Community rules relating to indirect taxes. Existing Community rules require that VAT should be charged uniformly throughout each Member State, and they prohibit the introduction of turnover taxes in addition to VAT. This of itself probably means that it would be prohibitive to introduce any local sales tax in the UK in the form of a single-stage tax which it would be more difficult to characterize as a turnover tax. Nevertheless, there would still be a number of common features between local sales tax and VAT.

3.4 The Government has therefore concluded that any local sales tax should be of the single-stage variety. In examining the options the Government have considered two basic models:

Model I:

A single stage tax administered and collected in conjunction with <sup>the</sup> Value Added Tax system by H M Customs and Excise on behalf of local authorities; the single-stage tax would be applied to all goods and services currently subject to VAT but local authorities would be given freedom to set the rate of tax, possibly within limits to be set by Parliament.

Model II:

A single stage tax with an entirely separate system of collection administered by local authorities themselves; as with model I, local authorities could have the freedom to set their own rate of tax. It would be for consideration whether they should also be given the power to decide which goods and services should be taxable.

DEFINITION OF A SALES TAX

3.5 A major problem with a sales tax would be that of defining the transactions to which it applied. Since it would be a replacement for domestic but not for non-domestic rates, it should in theory be limited in its application to goods and services purchased by households. In this sense a sales tax is often thought of as a tax on retail sales. However, such an approach would run into two immediate difficulties. First, the concept of a retail sale is essentially related to goods; special rules would still be required for

services. Secondly, there would be no readily identifiable group of "retailers" or those making retail sales. For example, of the 1,350,000 businesses registered for VAT, about one-quarter make the bulk of their supplies to other businesses, about one-quarter to domestic households and about one-half make supplies to both businesses and domestic households. Considerations of equity would suggest that all those supplies of taxable goods and services to domestic households which already bear VAT should also be subject to sales tax. At the same time it would be difficult to totally exclude all business purchases, especially at the retail level. Further examination would be required of the best way of overcoming the difficulties of definition while minimising the anomalies.

RATE OF TAX AND TAX BASE

3.6 Assuming for the purposes of illustration that a local sales tax were to be levied on the same range of goods and services to which VAT currently applied, and that a way could be found to exclude most business purchases, an average rate of 7% would be required to raise the £4,700m at present raised by domestic rates.

3.7 The question of the interaction of a local sales tax and the VAT rate would need careful examination. At present, European Community rules require that VAT should be levied on a base including all other taxes, duties, levies and charges. Hence, VAT would have to be charged on a tax base which

already included local sales tax. This would mean that, for example, a 7% rate of local sales tax and a 15% rate of VAT would produce a composite rate of 23.05% on basic price. To achieve a composite rate set in whole percentage points would require rates of local sales tax to be set to several decimal places. Either alternative could pose difficulties for retailers, who have found VAT easiest to operate when set at "convenient" round rates of tax, and would be difficult for the general public to understand. It is possible that, if a local sales tax were introduced, the Government would have to consider seeking a derogation from Community rules to enable sales tax and VAT to be charged in parallel on a common base, which taking our illustration of a 7% rate of local sales tax and 15% VAT would entail a readily understood composite tax rate of 22%. Even this, however, would not be free from difficulties for the retailer who worked from tax-inclusive prices.

CROSS BORDER SHOPPING

3.8 A quite different problem which was identified by the Layfield Report as a significant consideration in the case of sales tax would be cross-border shopping. There has been a growing tendency with the increase in private transport and the development of supermarkets and hypermarkets for large towns and cities to become the shopping centres for surrounding regions. Generally speaking, a large proportion of domestic purchases are no longer made in the village or suburban shop, but in stores the urban centres. The revenue from a sales tax might therefore tend to accrue to different local authorities

under a  
Model I  
sales tax/

in a distorted fashion, unduly favouring those accommodating popular shopping centres near their borders at the expense of neighbouring authorities where consumption actually took place. Any such trend would, of course, be expected to divert trade, particularly in the more expensive consumer durables, to areas where the rate was low. In the particular case of a Model II system under which local authorities were allowed to vary the coverage of the tax, there would be a further problem. The incentive to cross-border shopping would be greatly increased if the difference was not just a matter of a percentage point or two on the rate of tax but the difference between the item being taxable or tax-free.

3.9 Two further aspects of cross-border shopping would pose particular problems. The first would be the question of where services should be treated as being supplied, and the rate of tax to be charged when the trader lived in one local authority area and the customer in another. To charge tax at the rate of the trader's local authority could risk significant distortion of competition to charge it at that of the customer's local authority would involve the trader in additional, possibly substantial, compliance costs. The other problem would be the position of mail-order traders. Unless special arrangements were made for charging the tax according to where customers lived, which again might greatly increase traders' costs, there would be a considerable incentive for mail-order companies to establish themselves in low tax areas, and these areas would gain significant windfall revenues.

COSTS

3.10 It is not possible to give any detailed estimate of the additional administrative costs incurred by the taxing authority or the operating costs for business of compliance with a sales tax without a much more detailed study of the form such a tax might take. The costs of a taxation system depend very much on its complexity and hence with a local sales tax would depend on the extent to which it could be tailored to fit in with the existing VAT system and whether such difficult areas as imports and exports and the exclusion of business purchases from the incidence of the tax could be dealt with satisfactorily without unduly complicating the tax structure. If in the light of this green paper it were decided to proceed with further consideration of a sales tax option, some quantification of cost would clearly be necessary before any final decision could be taken. However, preliminary study suggests the following conclusions:

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(a) Administrative costs. Under a Model I tax administered in conjunction with the VAT system, costs could be significant, but would be likely to be substantially less than the estimated £120m cost of domestic rates. Under a Model II tax each local authority would have to set up a separate tax gathering force. This would greatly increase costs of administration and could approach more closely, or could even exceed, the present cost of collecting domestic rates.

(b) Compliance costs. Quantification is again impossible. However, experience with VAT suggests that even under a Model I system, there would be some substantial additional costs which would tend to bear disproportionately heavily on small businesses who would make up the bulk of those traders operating a sales tax system. A Model II sales tax which differed from the VAT system would greatly increase compliance costs because retailers would have to apply two different sets of rules to their sales and possibly have to keep a separate set of records in addition to their VAT accounts.

TIMETABLE

3.11 The Government does not consider that a local sales tax on either model could become operative before 1987/8 at the earliest. In the case of model I this is because Customs

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and Excise are engaged in replacing their VAT computers, which are coming to the end of their operational life. This involves major re-programming prior to the changeover of computer systems and the introduction of a sales tax could not be contemplated until the new computers were fully operational. A Model II tax would require local authorities to set up their own tax administrations, which would almost certainly need to be computer-based. This would require a great deal of detailed planning and it would be unlikely that these could be completed much earlier than five years from a decision to proceed.

FAIRNESS

3.12 At present, VAT is charged on about 50% of consumer expenditure and it does not apply to necessities like food, heating fuel, housing, and public transport.

In general a local sales tax that was levied on the same items as VAT should be slightly more progressive than rates for most households. In other words, it would take a higher proportion of the income of richer households than of poorer ones because richer households, generally speaking, would tend to spend a higher proportion of their incomes on taxable items. However, although the overall effect of a switch to a sales tax should be to increase progressivity slightly, those on low incomes could be expected to lose from a change to a local sales tax unless some new form of support were to be introduced to replace rate rebates and payments of rates in supplementary benefits.

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The introduction of local sales tax might go some way to meet the criticism, often made against rates, that a tax should be distributed to fall broadly equally on individuals or households of similar means. It would also widen the incidence of tax to include all domestic consumers compared with the 20 million heads of households who pay domestic rates at present.

3.13 The fairness of a Model II tax in which local authorities were allowed to vary coverage would depend on the resulting shape of the tax. It is unlikely that the progressivity of VAT could be significantly improved by adding to the present reliefs, while reducing the extent of reliefs (in order, for example, to lower the rate at which tax needed to be charged) could make the tax regressive. A sales tax charged on all goods and services would be highly regressive.

#### ACCOUNTABILITY AND PERCEPTIBILITY

3.14 As noted in paragraph 3.9 above, the sales tax that an authority received would not necessarily be paid only by those living in its area, with the result that local accountability would not be complete.

The perceptibility of a local sales tax would clearly depend on the extent to which its effect could be separately identified by the customer when a purchase was made. A high degree of perceptibility could probably only be achieved if traders could be required to show the tax as a separate item on bills and receipts. Such a requirement would, however, add significantly to traders' costs and would probably be

inconsistent with the operation of the special accounting schemes for retailers which already apply to VAT and would need to be extended to local sales tax.

3.15 An alternative might be to place local authorities under a duty to write annually to each household with an explanation of their rate of tax and other financial information on similar lines to the publication of performance information to be published in connection with rate demands by virtue of section 2 of the Local Government, Planning and Land Act 1980.

#### FINANCIAL CONTROL

3.16 There could be real problems in predicting the yield of a local sales tax each year. Experience with VAT suggests that the national outturn of a local sales tax would vary from its estimate for each year. In most years the variation in the VAT outturn has been of the order of 2% or a little more, but at the exceptional extreme it has approached 10%. For sales tax this margin of error would itself vary between individual authorities. Furthermore, there would be a particular difficulty in prediction if substantially different tax rates or structures in neighbouring authorities led to a significant increase in cross-boundary shopping.

3.17 The substitution of a tax with an unpredictable yield for domestic rating, the yield of which is highly predictable, would raise problems of financial management. This is inevitable although (as with local income tax) the unpredictability could be made to fall either on local or central government.

3.18 The yield of a local sales tax would be more buoyant than that of domestic rates, so local authorities would probably not have to change their tax rates frequently unless it were necessary to do so because expenditure had gone up or down in real terms. Adjustments to the tax rate could be necessary, however, even without real changes in the level of local authority's expenditure if local authority costs, which mainly comprise wages, salaries and loan charges, increased more quickly or slowly over a period of time than the retail turnover on which the tax was levied. Where an authority's need to spend on local services was declining, there could be a danger that caution and a desire to budget for a sufficiency of income over a number of years might tend to make it slower to revise its rate of local sales tax downwards than it would have been with an alternative form of tax whose yield was more accurately predictable.

3.19 Changes in the tax rate by local authorities would have to be limited by consideration for the impact on traders many of whom already experience difficulty in operating VAT correctly. The Government thinks that this would mean that steps of the order of 1% would be the minimum acceptable, but the actual position would depend on the way the local sales tax

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rate was combined with the VAT rate (paragraph 3.7 above). Steps of whole percentage points, however, would cause a problem for local authorities because of the extreme lumpiness of the yield. A 1% change in the average tax rate would change the yield by about 10% - 15%. Because of this problem, the Government believes that a sales tax would be inappropriate as a complete replacement for domestic rates, and that it would need to be supplemented by some other more flexible source of income (see Chap. 11). Even a hybrid solution would not eliminate all the local authorities' budgeting problems.

3.20 A local sales tax would in any case imply restrictions on the local authorities' freedom to make frequent changes of rate, because any rate change would cause problems for businesses. For example, stock repricing would be an onerous task in shops with a large range of low unit-price goods. Where advance bookings and orders were concerned, identifying the rate of tax to be charged could become difficult. Moreover, if local sales tax accounting were to be integrated with VAT accounting, those businesses which use the VAT retail schemes could have to carry out certain accounting adjustments or possibly an extensive stock-taking. Larger traders with computer-based accounts, such as the major retailing chains, would have to carry out reprogramming, as would other concerns who produce all their accounts from a single central source - (telephone bills, for example).

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3.21 For the reasons set out in paragraphs 3.16 - 3.20 the Government believes that among the leading options a local sales tax would cause local authorities the greatest difficulties for stable financial planning.

FISCAL DIMENSIONS

3.22 A local sales tax designed to replace entirely the present yield from domestic rates and running in parallel with national VAT would produce a combined sales tax/VAT rate of about 22% (paragraph 3.6 above). This would obviously have implications for prices and for the demand for taxed goods. It would be bound to constrain the freedom of central Government in relation to changes in the rates or rate structure of VAT. Future Chancellors would also have to bear in mind that the impact on patterns of consumer expenditure of any change in the VAT rate could have a significant effect on local authority revenue. So, too, could any changes in national VAT coverage (eg changes in zero-rating or exemptions) if the local tax were to be levied on an identical base.

3.23 Conversely, decisions by local authorities about their tax rates would have an impact on Government revenue, especially if the tax rates were set at a higher level than expected. In any case, if local authorities set their tax rates before the Budget each year, the Government would have to take these decisions into account in framing the Budget judgment.

3.24 These problems could be mitigated to some extent if there were some formal constraint on the freedom of local authorities to levy sales tax at whatever level they chose. On the other hand, such a constraint would, of course, have implications for the independence of local government and its accountability to local electors.

SUITABILITY FOR ALL TIERS OF LOCAL GOVERNMENT

3.25 The Government's view is that a local sales tax with independently variable rates could not reasonably be operated at any level below that of the 66 authorities in the upper tier of local government - counties in England and Wales, regions and the islands authorities in Scotland. The Government considers that to vary the tax rates at the level of the 450 or so local authorities in the lower tier would be disproportionately costly to operate both for the tax collecting agency, whether the central government or the local authorities, and for traders (especially multiple traders). The Government further considers that the divergence of tax rates at district level could tend to stimulate an undesirable amount of cross-boundary shopping.

CONCLUSIONS

3.26 The Government considers that a local sales tax might conceivably be capable of providing a source of local revenue to replace in the upper tier of local Government a substantial part of the local authority income at present raised by domestic rates. Devising a workable system, however, would involve finding solutions to a diverse range of important

problems. For both local and central government, a local sales tax would bring financial control problems which would have to be surmounted. Because of the unpredictability of the yield, local authority budgeting would become more difficult; while the "lumpiness" of the yield would mean that even relatively small changes in the rate would produce considerable variations in income. The high combined effective tax rate of national value added tax and the local sales tax could have implications for the government's overall fiscal policy and its freedom for manoeuvre, while the interaction of the two taxes would almost certainly impose some restrictions on local authorities. For these reasons the Government does not believe that a sales tax could be the sole replacement for the domestic rates, but would have to be combined with some other form of local revenue.

3.27 Even as a partial replacement, a local sales tax would present a number of problems. It would be necessary to present a scheme based on a definition of a taxable supply which that as far as possible all goods and services consumed by households bore the tax, while those consumed by businesses (which would still be paying non-domestic rates) were excluded. The Government would still need to take a view on the extent to which local authorities could be given an unfettered ability to vary local rates of tax. It would also be necessary to minimise the extra costs of compliance for businesses, especially for the smaller retailers who would form a large proportion of those accounting for the tax. Questions of accountability and perceptibility would also require consideration. Any new incentive to cross-border shopping would not

further reduce the predictability of the yield, but could mean that more people would be paying tax outside their own local authority area. In any case it might be difficult to make the local population properly aware of the incidence of a local sales tax without either imposing onerous burdens on traders or additional administrative requirements on the authorities themselves. The perceptibility and accountability of a local sales tax would not necessarily therefore be very high, although it would have the advantage that its incidence would on the whole be seen to be more equitably distributed than the present rating system.

3.28 Any system of local sales tax would have to be compatible with the United Kingdom's continuing obligations to the European Community.

3.29 Of the two possible models of a local sales tax the Government has considered, Model I seems preferable on the grounds of lower administrative cost and lesser burden on traders. On the other hand, Model II would offer the advantages of being more obviously locally based and administered. In either case, however, it is important that the costs and difficulties of devising a satisfactory system should not be underestimated.

attempt the difficult task of/

## CHAPTER 4

## LOCAL INCOME TAX

4.1 Local income tax is an option which has been studied closely in recent years. The Layfield Committee on Local Government Finance gave qualified approval to one form of local income tax as a supplement to domestic rates. The Committee recognised, however, that it would not be without its problems and that the cost of operating it would be substantial. The Government has therefore looked again at the issues raised by a local income tax.

## THE RELATIONSHIP BETWEEN LOCAL INCOME TAX AND THE NATIONAL TAX SYSTEM

4.2 After detailed discussions with the Inland Revenue the Layfield Committee recommended that if a local income tax was to be introduced, it should be fully integrated with the national tax system. The Government agrees that this would be the most straightforward way of operating a local income tax. This course would however impose a number of constraints on the form of local income tax which it would be possible to introduce. In particular, as explained in paragraph 4.7 below, the tax would be suitable only for the major spending authorities and in addition the local income tax would need to be charged on the same tax base as the national tax. In other words, local income tax would be levied on income from earnings and pensions, investment income and the profits of unincorporated businesses, but not on company profits. In what follows it is also assumed that the tax would be charged on the basis of residence; that is, liability to local income tax would be decided by where a person lived, not, for example, where he worked. The Layfield Committee said that they preferred

a tax based on place of residence since the services which local authorities provide are the main related to where people live. It would, however, be necessary to decide how to treat people with homes in more than one local authority area.

4.3 For the present income tax a taxpayer's area of residence is of no particular significance, and to a large extent the system is not organised on the basis of areas of residence; under PAYE all employees of a single employer are handled together. The rate of local tax would however have to be capable of some variation between one local authority and another. In an integrated system, this would have to be done in a way which could fit in with the national system without undue difficulty if major changes in the national system itself are to be avoided.

#### A LOCAL INCOME TAX INTEGRATED WITH THE EXISTING TAX SYSTEM

4.4 An integrated local income tax would be collected by the same machinery used to collect national income tax. In particular, the system would collect the tax from all wage and salary earners and from occupational pensioners. PAYE currently brings in about 85% of the yield of national income tax. This system is not designed to take account of the taxpayer's place of residence; nor do employers normally organise their payrolls according to employees' areas of residence. Also, the economical working of the system depends on the tax deducted in the course of the year accurately representing the taxpayer's liability in as many cases as possible so that no subsequent adjustment is required; at present this is achieved in about

5 cases out of 6. To do this, there is a system of code numbers which reflect the taxpayer's allowances and reliefs and which can also accommodate certain other adjustments. These code numbers are notified to employers who can then calculate the tax to be deducted using the tax tables.

4.5 For a local income tax operated centrally by Inland Revenue as part of the PAYE system, this system of coding and tax tables would have to be elaborated further (probably by adding a local tax rate indicator to each employee's code) to enable employers to withhold local tax at the appropriate rate for each employee as well as national tax. This would complicate the operation of PAYE for employers as well as for the Revenue: code numbers would be more complex, the tax tables would be more elaborate and different tables might have to be used for different employees. Employers might also have to keep a separate record in some form of the local tax deductions.

4.6 If the additional complications to the operation of PAYE were not to become unmanageable, some limit would have to be placed on the number of tax rates from which local authorities could choose. This would mean that the rates of local tax would have to be set in fairly broad steps, resulting in lumpiness in the yield. As matters stand at present, it would be impracticable to have steps of less than  $\frac{1}{4}\%$ . If employers' methods of calculating tax deductions become more sophisticated, or if the total spread of rates for the local tax were fairly narrow, somewhat finer graduation - say by  $\frac{1}{8}\%$  - might not prove too burdensome. Even with this

limitation, a local income tax would be intolerably burdensome to PAYE employers and costly for the Inland Revenue if it allowed 450 lower tier authorities to set independent tax rates; indeed Layfield recognised that this would be administratively unworkable. A tax on these lines would, therefore, probably have to be restricted to the County Councils (in Scotland the Regions and Islands Authorities) plus perhaps the Metropolitan Districts and London Boroughs. That would mean up to 123 local tax areas.

4.7 Tax codes indicating the appropriate rate for each taxpayer would have to be notified to employers before the start of the tax year, and it would therefore be necessary to determine, probably not far short of 12 months before the year began, the area to which the taxpayer belonged for local income tax purposes for that year. Local authorities would have to advance their budget cycle and determine their tax rate towards the end of the calendar year so that the necessary information could be passed to employers by the start of the tax year. This would involve major difficulties for local authorities in their budgeting and for central government in determining the total level of Exchequer grant.

4.8 It would be extremely difficult to apply independent variable rates of local income tax to investment income. Some types of interest-bearing income tax deducted at source. Tax on interest paid by Building Societies is not deducted at source but is paid by the Society at a composite rate under special arrangements. Company dividends carry a tax credit which covers the shareholder's liability to basic rate income tax. It would hardly be feasible to expect the various

paying institutions under these arrangements to deduct tax from all investment income at variable rates according to the recipient's area of residence. Other arrangements would therefore be needed. One possibility might be a uniform tax surcharge levied, at a single standard rate, by central Government on investment income and distributed to local government; and arrangements for deduction of tax at source might have to be extended to types of income to which they do not apply at present.

4.9 Some types of income are directly assessed - in particular the profits of the self-employed and partnerships. Local income tax on these types of income would have to be collected as part of the national income tax assessment.

4.10 A detailed costing for a scheme of this kind was worked out for the Layfield Committee; the estimated cost was about £110 million at 1981/82 prices (for 12,000 to 13,000 extra staff). Additional costs falling upon employers could be of a broadly similar order. This assumed that the scheme would be introduced before the computerisation <sup>of PAYE</sup> and operated manually; Computerisation would enable the cost to the Inland Revenue to be reduced - possibly substantially - though at this stage it is not possible to say by how much. The additional cost to employers would be broadly unchanged, though employers with computerised payrolls would in general find it easier to cope.

#### TIMING

4.11 The timing of the introduction of a local income tax integrated with the national tax system would be affected by the Inland Revenue's project for computerising the national PAYE system, which is already under way. It would not be sensible to suspend that project now to allow

for the possibility of local income tax being introduced on a manual basis in the next few years. That would be likely to delay the benefits of computerisation for many years, in view of the organisational changes needed for a local tax; and it would, in any case be more expensive to run a local income tax manually than if a computerisation project were first completed. The Government hopes that computerisation will be completed by about the end of 1987 or early in 1988, but with a project of this size and complexity it is impossible to be certain at this stage. The major organisational changes that would be required for a local income tax linked to the national tax system would take some time to make after the completion of PAYE computerisation.

#### ALTERNATIVE FORMS OF LOCAL INCOME TAX

4.12 As mentioned earlier a local income tax integrated with the national tax system would be suitable only for the major spending authorities and could operate with only a limited range of local income tax rates. A wider variation in tax rates would require either prior changes to the national tax system or collection of local income tax separately from national income tax.

#### A LOCAL INCOME TAX ADMINISTERED CENTRALLY ON THE BASIS OF YEAR-END ASSESSMENT

4.13 One possibility is that local income tax might be administered centrally on the basis of year-end assessment. This would be possible only if the national PAYE system were replaced by a radically different system, similar to those of some other countries, in which the deductions made during the year from each employee's pay were made on a non-cumulative basis and so were only a rough approximation of his correct national tax for the year, plus a

national average rate of LIT. There would then have to be an exact calculation for each taxpayer after the end of each year. This would take into account his actual income and the correct rates of national and local income tax: he would then receive either a repayment or a further tax demand.

4.14 Among the advantages of this system would be the capacity that it would give to local authorities to apply local tax rates down to the level of about 450 lower tier authorities - though this would add to the cost of administration. The cost to employers would be less than for a local income tax integrated with the present national tax system; the codes and tables would be simpler because tax deductions would be more provisional and would not attempt to be exact. Variation of tax rates under this scheme by steps of less than  $\frac{1}{2}\%$  would not add to the burden on employers since the single average rate of local tax would be built into the tax. It should therefore be possible to vary local rates down to one or even two decimal points: a tax-rate of 0.01p would raise about £9m in Great Britain. This flexibility would eliminate the lumpiness of a local income tax integrated into the present system and make financial planning by local authorities less difficult. Local authorities could determine their budgets, as now, in February to March. It would be possible to tax investment income at the appropriate local rate instead of at a national standard rate; this would be done as part of the end-of-year assessment which would have to be made anyway.

4.15 The implications of moving to a system of year-end assessment go beyond questions of local government finance, and raise major issues of

tax policy and administration. These issues would need to be examined in detail on their own merits before any decision could be reached. Moreover, the restructuring of the tax system, which would be a major task and would have to be spread over a number of years, could not begin until PAYE computerisation was complete. A local income tax in this form could not be introduced until after the restructuring was complete. It follows that the earliest date on which this option could be brought in would be some time in the 1990's.

4.16 The additional cost of creating a local income tax based on year-end assessment, if the Government had decided on other grounds to move to a compatible system for collecting national income tax, cannot be assessed accurately at this stage. It is likely, however, that the additional cost of this scheme of local income tax would, in those circumstances, be less than the cost of a scheme in which a local income tax was integrated with the existing PAYE system.

#### SEPARATE COLLECTION OF LOCAL INCOME TAX

4.17 A wider variation in local tax rates would also be possible if local income tax was collected separately from national income tax. In principle this could be done either by local authorities on the basis of information supplied by the Inland Revenue or with a completely separate local authority system.

#### A CENTRAL DETERMINATION OF TAXABLE INCOME COUPLED WITH LOCAL ASSESSMENT AND COLLECTION

4.18 Under this hybrid tax system, the taxable income of each taxpayer would be determined centrally by the Inland Revenue. This

information would be passed to local authorities, who would apply the appropriate local rate of tax and themselves collect the tax from the taxpayer. A scheme on these lines could not be introduced until some time after the completion of PAYE computerisation in 1987 or early 1988.

4.19 Like the previous scheme in 4.13, this system would allow local income tax to be levied on the basis of a year-end assessment. For that reason, and because PAYE employers would have no part to play in determining tax liability or collecting revenue, a tax on these lines would be capable of being levied at rates which could vary at the level of the lower tier and which could be adjusted by steps of less than  $\frac{1}{4}\%$ . It would therefore have the same flexibility and benefits for financial control as the previous scheme. There would however be difficulties with it. First, the tax base on which local authorities operated would be out of date, sometimes seriously. A taxpayer's taxable income during year 1 would be determined in arrears by the Inland Revenue and passed to the local authority at some time during year 2. An assessment of the taxpayer's liability for year 1 could not be made until that point - by which time he or she might have moved out of the local authority's area. Moreover the transmission of information about 28 million taxpayers to <sup>more than</sup> 450 local authorities by the several hundred local tax offices of the Inland Revenue would be a new and highly complex task. This transfer of information from central to local government also raises potentially difficult issues of confidentiality. Information held by Inland Revenue about individual incomes is not at present disclosed outside the Department even to other branches of central government except in certain strictly

limited circumstances which are specifically authorised by statute.

4.20 As with the other schemes, the cost of a local income tax in this form is difficult to establish reliably. The Government tentative estimates, however, that its cost might be double that of a scheme integrated with the present national tax system; that is about £220 million. This higher cost is due partly to the complex arrangements required for transfer of data, and partly to the heavy collection cost, since there would be neither any possibility of deducting tax from pay at source, nor - as with rates - any link with the occupation of property.

#### B. LOCAL INCOME TAX ADMINISTERED BY LOCAL AUTHORITIES INDEPENDENTLY OF THE NATIONAL SYSTEM

4.21 An alternative would be for each revenue-raising authority to run its own income tax department quite separately from the national system. This would require each authority to be responsible for issuing tax returns to its residents and for assessing and collecting the tax for which each of them was liable. Whether a completely separate tax base was used or the national rules were adopted, this would be an extremely expensive operation with each authority separately responsible for the application of a complex legal code. All taxpayers would have to make returns to two authorities, national and

local. It would be very burdensome to ask employers to operate two separate PAYE schemes and the tax would therefore probably have to be paid after the end of the income year in one lump or by instalments (like rates at present).

4.22 The main advantage would be that the tax could be planned and introduced without waiting for the computerisation of PAYE to be completed. Even so, it is doubtful whether a tax on these lines could be introduced in less than five years. Moreover, a system of this kind would be cumbersome to operate, confusing to taxpayers and expensive in staff. If the local authorities between them needed no more staff than the Revenue have at present administering income tax, the numbers required would be around 55,000 costing roughly £500 million a year.

#### PERCEPTIBILITY AND ACCOUNTABILITY

4.23 It is unlikely that many local government electors would find a local income tax integrated into the present national tax system very perceptible. Even though some taxpayers might give closer attention to their tax deduction than others, national and local tax rates would probably have to be combined in composite tax tables if the employer's job in operating PAYE was to remain manageable: the local and national components of the tax deducted from the taxpayer's pay would therefore probably not be readily distinguishable, except, perhaps in his annual statement of pay and tax. Because the Inland Revenue would continue to be responsible for enforcement and collection of taxes, whether local or national, central government would tend to be seen by many people as being responsible for the rates of local tax being levied. As in the case of a sales tax, however, local authorities could be required to send out annual statements to each

for each group of authorities, if a grouping arrangement were found preferable,

taxpayer explaining and justifying the rate of tax they had determined upon. A local income tax based on a recast national tax system involving end of year assessment might be little more perceptible than one integrated into the present tax system but under a scheme where the tax was collected directly by the local authority it would be highly perceptible.

#### FINANCIAL CONTROL

4.24 Any local income tax would be subject to problems of predictability of yield broadly similar to those already discussed in relation to local sales tax (see paragraphs 3.16 - 3.17). The yield of local income tax might vary by as much as 5% from the level predicted by the local authority in its budgeting. It would be necessary to decide how this uncertainty, which is implicit in the replacement of a highly predictable tax such as domestic rates with a less predictable one such as local income tax, should be coped with (see paragraph 2.14).

4.25 The yield of local income tax would be buoyant and it would probably be unnecessary

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local authorities to change their tax rates at all frequently except when there was a change in their real levels of expenditure. This might tend to reduce accountability.

4.26 The lumpiness of yield of local income tax has been mentioned in paragraphs 4.7 and 4.14. Although a local income tax integrated with the present national tax system would pose severe problems of lumpiness the difficulties would be less than those associated with a local sales tax (see paragraph 3.19), and the Government considers that, as with sales tax, there could be scope for mitigating those problems by combining a local income tax on these lines with some less lumpy source of income for local authorities. This possibility is dealt with further in Chapter 11.

#### FAIRNESS

Local income tax  
4.27 / would be a direct tax on the whole of the local electorate, except those whose incomes were below the tax threshold, and liability would - unlike rates - be directly related to income. It could be argued, however, that the scope for avoiding or evading liability would be greater than with rates. The need to tax investment income at a standard rate set nationally could be seen as giving favourable treatment to investors living in areas with higher rates of local tax and discriminating against those living in an area with low tax rates. The position of unincorporated business would also need to be considered. If such firms remained liable to non-domestic rates, and the proprietors were also charged local income tax on their profits, it could be argued that they were at a disadvantage compared with companies (which would not be liable to local income tax.)

4.28 How fair any model of local income tax was considered to be would depend to a considerable extent on the rates at which it was levied.

There are a number of ways in which the tax might operate:-

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i. The tax could be levied according to a progressive scale which took a higher proportion of marginal income the higher the taxpayer's total taxable income. This raises difficult questions about how far central government should be prepared to delegate to local government decisions which would have an effect on the progressivity of taxation in the country as a whole. At a practical level, such a system would also be very complicated to operate and would not be feasible at all without imposing an intolerable burden on employers.

ii. The taxpayer's liability for local income tax could be determined as a percentage of his liability for national income tax. This might be simpler to operate than the alternatives if the local tax was collected along with the national income tax. Like alternative i, however, it would affect the steps of progression of the tax system particularly at higher levels of income.

iii. The local tax could be levied at a flat rate applied to the same tax base as national income tax. This system would result in total tax rates for all income levels within any individual authority being a constant number of percentage points higher than the national rate.

#### COMPATIBILITY WITH GOVERNMENT'S FISCAL STRATEGY

4.29 Introduction of a local income tax would

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increase the total burden of direct taxation. This would run counter to the Government's policy of switching more of the burden of total taxation away from personal incomes and onto personal expenditure. If a local income tax was not to increase the total burden of income taxation, it would be necessary to reduce the national rate of income tax and to increase other taxes correspondingly.

4.30 As with a sales tax, sharing income tax between central and local government would lead to problems. Where LIT was based on the income determined for national tax purposes the Chancellor's Budget decisions on personal allowances would have direct repercussions on local authorities' tax yield. Local authorities, over time, might increase their rates of tax to raise far more than the £4,700 million currently yielded by domestic rating, and this would raise the marginal rates of tax for all income taxpayers. If considerations like these made it necessary for central government to impose constraints on authorities' powers to set tax rates, there would be implications for relations between central and local government. Whether such constraints would be necessary would depend largely on whether a local income tax would be likely in practice to be perceptible - that is, how far it would encourage local accountability and discourage high expenditure and consequent high tax rates. On this score a local income tax collected by local authorities is likely to do better than one collected by the Inland Revenue (see paragraph 4.23).

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## SUITABILITY FOR ALL TIERS OF LOCAL GOVERNMENT

4.31 As explained in paragraph 4.6 a local tax system integrated with the present national tax system would probably have to be restricted to Shire counties in England and Wales and to regional and islands authorities in Scotland, perhaps, metropolitan districts and London boroughs. Local income tax systems operating on the basis of year-end assessment could be operated down to district level (though not down to parishes).

## CONCLUSION

4.32

Compared with domestic rates, a local income tax would be seen to spread the tax burden more widely and for many people contributions would be related more closely to ability to pay. The most straightforward means of introducing a local income tax would be to integrate the tax with the national tax system and the Government considers that such a scheme would be feasible. It could not, however, be introduced until after the computerisation of PAYE has been completed and a number of important practical difficulties would also have to be solved. As with the sales tax there would be problems of budgeting and financial control caused by the unpredictability and lumpiness of the tax yield. In addition the system would be suitable only for the major spending authorities and might therefore need to be combined with some additional form of local revenue. The local tax would, moreover, not be very perceptible to taxpayers.

4.33 To overcome some of these drawbacks it would be necessary to move to a scheme based on end of year assessment for national income tax or alternatively to a system under which the local tax was collected by local authorities themselves. The first of these alternatives would, however,

involve major changes to the national tax system, which would have first to be decided upon and justified on their own merits, while the second would involve much higher administrative costs. Both the Royal Commission on the Constitution and the Layfield Committee of Enquiry into Local Government Finance considered that a local income tax system under which the tax was collected by local authorities was not worth further examination and it must be doubtful whether the high cost of a completely independent system could be justified by the higher degree of perceptibility and accountability that it would bring. But a system under which the Revenue gave details of income to local authorities, if it could be made to work, could make local income tax available to both tiers of local government with comparatively few problems of financial control. Though its practicability has yet to be established, it should therefore not be ruled out of consideration at this stage.

CHAPTER 5

POLL TAX

5.1 Another possibility would be to levy a fixed annual charge on each adult resident in a local authority area as a contribution to the cost of providing local services. A capitation charge, or poll tax, of this kind has not been operated in Britain for some centuries but is employed in some other countries. It has not been given much consideration in previous examinations of reforms of local authority finance. The Government would not rule it out at this stage but if it were thought a poll tax could contribute towards a better system of local authority finance more consideration would have to be given to the way in which such a tax could be operated.

PRACTICABILITY

5.2 A poll tax could, in principle, be levied according to a number of different criteria. For example, it could be levied on every adult, every elector or every earner. In general, the higher the proportion of the adult population liable for the tax, the more evenly it would be spread among the recipients of local government services. The more universal the coverage of the tax, also, the smaller the administrative costs incurred in providing the exceptions and differing methods of assessment.

5.3 There are about 40 million adults in Great Britain. In order to raise £4,700 million annually it would therefore be necessary to levy a poll tax of about £120 per head on average if all adults were liable. If there were any significant exemptions the tax might have to be significantly higher. If a poll tax were used to supplement another tax such as sales tax or income tax, however, rates would obviously be lower.

5.4 These figures would not be very different if electors, rather than all adults, were taxed; but if only earners were to pay, then the yield would be nearly halved (or the average tax rate nearly doubled).

5.5 A fundamental question is how the tax roll could be compiled. One possibility would be to limit the incidence of a poll tax to those registered as electors in a particular area. This would exclude minors and citizens of countries outside the Commonwealth and the Republic of Ireland, who cannot vote in our elections. But even if they were exempt from a local poll tax they would still be liable to national taxes. Furthermore, although the electoral registration officer has a statutory duty to compile a register of the electors in his area and power to require householders to furnish him with information, the process depends to a large extent on the elector's co-operation. There are bound to be limits to the comprehensiveness and accuracy of the register, and if it were to be used for the assessment of taxation, individuals might well decide to forgo their vote in order to evade their liability to a local tax. There is evidence of under-registration among certain groups in our society, in particular young people and the ethnic minorities, and a tax based on the electoral register might make that under-registration even harder to remedy.

5.6 The compilation of a separate poll tax roll might well be necessary to overcome these problems. This could be done in a similar way to the census by delivering a return to each household: a statutory responsibility could be placed on each head of household to complete it fully and accurately. For enforcement purposes, it would be possible for local authorities to run cross-checks (though clearly not exhaustive ones) with lists maintained for other purposes by Government and nationalised industries: for example, against the electoral roll and, possibly, against national insurance records. In practice, however, it might prove difficult and expensive to compile a roll which could form a satisfactory basis for assessment of a poll tax. The cost of compiling the electoral register in Great Britain is currently about £21m per annum, but even with a minimum of cross-checking the cost of an adequate poll tax register would probably be considerably more. There would also be problems in deciding what degree of residence in an area made a person liable to poll tax. A person is entitled to be registered as an elector if he is

resident on a qualifying date. Even if it were decided to apply a similar system to poll tax assessment, it might be difficult to trace those who moved away from an area after the qualifying date and enforce the tax against them. Three to four per cent of the population move across county boundaries each year and twice as many across district boundaries. If it were decided that a longer period of residence were necessary, the registration process would be bound to be more complex - and still more expensive.

5.7 It would, therefore, obviously be much harder for local authorities to ensure that poll tax was paid by individuals who might be non-householders and highly mobile than it is at present to ensure that rates are paid by householders who are charged on the basis of their occupation of fixed property. The Government estimates that the cost of chasing up arrears could make administration at least as expensive as that of domestic rating. With a new tax, a new statutory code of enforcement and penalties would also be needed.

FAIRNESS

5.8 As a flat rate payment a poll tax would represent a higher proportion of a lower income than a high one, but whether particular households would be better or worse off than paying domestic rates would also depend on the number of adults they contained. A flat-rate payment of £120 per person would be a substantial burden for poorer people, however. It is interesting to compare that figure with other lump sums: the average quarterly electricity bill is £ , a colour television licence is £34 and the vehicle excise duty on a car is £70, for example. Moreover, the payments mentioned above would be paid, in the majority of cases, only once a household a year whereas poll tax, whatever the precise basis on which it was levied, would normally have to be paid by each adult member of a household. Television licences and vehicle excise duty can be paid for by stamps which can be bought at post offices, and rates can be paid by monthly instalments. There would be a very strong case for providing similar schemes

to help people to budget for poll tax, but this would inevitably add to the cost of running the system. As well as easy-payment arrangements of this sort, it would be possible to introduce a rebate scheme similar to the rate rebate system. This also would increase the cost of administration - some millions of families might have to be means-tested. The rebate scheme could be financed either by putting up the nominal rate of poll tax or, like the present rate rebate scheme, mainly out of general taxation.

5.9 The position of individuals who were not earners would have to be considered. A decision would have to be taken on whether housewives and students should be exempted or whether they should pay. One possibility would be to make the head of each household responsible for the tax for which the members of his household were liable. There could be anomalies and unfairness in such an arrangement, however, particularly since the people for whose tax the head of household would be responsible would not necessarily even be members of his or her family.

COST OF ADMINISTRATION

5.10 It is not possible to estimate with any degree of certainty the cost of administering poll tax. As explained in paragraph 5.7, however, enforcement problems would probably make the tax at least as expensive as domestic rates to collect. The cost of maintaining the register would be additional to this, as would the cost of administering a rebate system.

PERCEPTIBILITY AND ACCOUNTABILITY

5.11 A poll tax would be highly perceptible - possibly even more so than domestic rates. This should tend to strengthen the accountability of authorities to their electorates.

FINANCIAL CONTROL

5.12 Like rates, poll tax would produce a predictable yield. Also like rates, it would lack buoyancy and annual re-setting of the tax rate would be necessary. This would make the tax even more

perceptible. The tax rate could be altered in comparatively small steps, however, so the yield would not be lumpy. A poll tax could provide a stable and predictable source of income and would be readily adaptable for use in conjunction with an equalising Exchequer grant.

FISCAL DIMENSIONS

5.13 As an entirely new tax, a poll tax would have rather different implications for the shape and structure of the total tax system than alternative local taxes, like a sales tax or a local income tax, which would overlap much more directly with existing national taxes.

SUITABILITY FOR ALL TIERS OF LOCAL GOVERNMENT

5.14 Poll tax could be made to provide revenue for both main tiers of local government. It is the only option discussed in this green paper which would clearly be capable of operating at paris level.

CONCLUSION

5.15 A poll tax would have a very broad base and would be suitable for all tiers of local government. It might be possible to take advantage of these desirable features while minimising enforcement difficulties and the effect of the tax on those on lower incomes if a poll tax used only to supplement a major revenue-raising tax such as a local sales or income tax. A flat rate poll tax at an average rate of, say, £25-£30 a head a year, for example, could raise £1,000-£1,200 million. The cost of enforcement could not be expected to be proportionately reduced, however, although a scheme of poll tax at low rates would be somewhat cheaper to enforce than a scheme operating at higher rates because of the diminished incentive for evasion. Possible combinations of poll tax with other sources of revenue are discussed in Chapter 11.

## CHAPTER 6

## AN ALTERNATIVE APPROACH: ASSIGNED REVENUES

6.1 One radically different alternative would be to replace the yield of domestic rates, not with a new local tax, but with an assigned share of the revenue from a national tax or taxes. This solution could be very much less complicated, and therefore cheaper to run, than any of the possible new local taxes. It would also give central government a much stronger and more direct influence over local government revenue. The division of financial and operational responsibility for local government services might tempt some local authorities to irresponsibility and the incentives to efficient management would be greatly reduced. The structure of the relationship between central and local government would be fundamentally altered: eventually local authorities might cease to enjoy any effective autonomy.

## THE ROLE OF THE CENTRAL GOVERNMENT

6.2 Central government would, in practice, be able from year to year to vary the amount of revenue to be assigned to local government. The central government's responsibility for the oversight of public expenditure and for the management of the economy generally would make the pressure to take decisions of this sort practically impossible to resist. To replace domestic rates with assigned revenues would therefore be to replace a revenue whose annual yield is determined locally with a revenue whose annual yield would, in practice, be decided centrally. It would not be possible to make arrangements which would prevent such intervention. A government could not bind Parliament or its own successors: even legislation which provided for assigned revenues to be determined each year on a fixed basis free from central government control would be subject to annual review by Parliament.

6.3 Even if the central government did not nominally vary the total of assigned revenues from year to year, it would still be able to influence total revenues more directly than at present because exchequer grant could smoothe out any variations. In effect, there would be little practical difference between finance by assigned revenue supplemented by grant and 100% exchequer grant.

6.4 In either case, the only way in which local authorities could influence the size of the revenue that they received in lieu of domestic rates would be by bidding for the maximum exchequer resources to be made available each year, either through assigned revenues themselves or as grant.

#### CENTRAL/LOCAL GOVERNMENT RELATIONSHIPS

6.5 A system of this sort would have implications for the existing constitutional relationship between central and local government. Even if local authorities had another source of revenue whose yield they were free to determine locally, assigned revenues would reduce considerably their present freedom to take decisions about overall revenue and expenditure and about what level of local services should be provided. If local authorities were dependent on assigned revenues and non-domestic rates but no longer free to determine their non-domestic rate poundages (see paragraphs 9.5-9.6), their income would be determined entirely by the central government. This could, at the extreme, call into question the justification for elected local authorities as they are constituted at present. The effect of assigned revenues on accountability of authorities to their electors is further discussed in paragraph 6.10 below. The implications of assigned revenues for the relationships between central and local government, and between local authorities and local electors, would therefore have to be weighed very carefully before any decision to adopt them was made.

#### DISTRIBUTION

6.6 It may be that the yield of the assigned local tax could be distributed in proportion to the yield of assigned national revenues in individual local authorities' areas, though this would depend on the availability of adequate information on the geographical distribution of tax yields. Depending on the source of national revenue chosen, this could produce uneven distribution between local authorities and assignment itself would be a complicated operation. If the scheme operated in conjunction with an equalised grant, however, the most practical and convenient method of distribution would, for the reasons outlined in paragraph 6.3, be to merge the arrangements for distributing assigned revenues with those for distributing grant and to distribute the combined amount according to some sort of needs assessment.

#### PRACTICABILITY

6.7 The administrative arrangements needed to operate a system of assigned revenues could be much simpler to make than those for any of the local tax options. Little more than the present arrangements for distributing exchequer grant should be needed.

#### FAIRNESS

6.8 The fairness of the system would depend on the distribution of the national tax or taxes which yielded the revenues to be assigned. The local effects would be no more nor less fair than those of the national tax or taxes concerned.

#### COST OF ADMINISTRATION

6.9 Costs would be negligible compared to those of other options.

#### PERCEPTIBILITY AND ACCOUNTABILITY

6.10 The substitution of assigned revenues for domestic rate income would break the present link of accountability between authorities and their electors. The system would not be at all perceptible locally because there would be no separate collection of local revenues from those who now pay domestic rates. Local authorities would no longer have the discipline of accounting to electors for a rate poundage that they set in order to determine the amount of revenue that they raised from domestic sources. Their freedom to decide on the standard of local services to be provided, and thus their responsibility to local people for the level of those services, would also be affected. Such changes would be likely to lead to pressure for central government to seek more control over the level of services provided by individual local authorities and the degree of value for money they represented. The National Health Service is an example of a service which is already run in this way. The constitutional significance of these effects has already been touched on in paragraph 6.5.

## FINANCIAL CONTROL

6.11 Assigned revenues would allow local authorities to budget for the coming year on the basis of a definite figure which should be known in good time beforehand. On the other hand, the ability of central government to influence the amount of assigned revenues payable from year to year would in practice make revenue unpredictable for more than one year ahead.

6.12 There would also be problems for authorities if their income from assigned revenues and other exchequer sources fell short of the levels which had been budgeted for. Because replacing domestic rates with assigned revenues would reduce the freedom of authorities to increase their revenue such shortfalls would be more difficult to make up. If authorities' freedom to decide the level of revenue to be raised through non-domestic rates were also to be constrained in some way as discussed in paragraph 6.5, authorities could conceivably find themselves without any means of making up such shortfalls.

## FISCAL DIMENSIONS

6.13 Whilst this option would not involve the levying of separate local taxation, it would require a corresponding increase in other taxes to make good from central revenues the yield now provided by domestic rates.

## SUITABILITY FOR ALL TIERS OF LOCAL GOVERNMENT

6.14 Provided that central assessment of local spending needs could be satisfactorily taken down to district level, a system of assigned revenues could provide a source of revenue for either or both main tiers of local government. It would leave parishes in England and Wales without an independent source of revenue, however, and some other means of financing them would have to be found. One possibility would be for parishes in England and community councils in Wales to be financed by grant from one or both main tiers of local government.

## CONCLUSION

6.15 A system of assigned revenues would be administratively simpler and cheaper to run than a new local tax. These advantages give assigned revenues a claim to serious consideration. But the system would be less flexible for local authorities than the present system of domestic rates. It would also very significantly reduce the extent to which local authorities were accountable to local people for the revenue they raised, and would change the relationship between central and local government in a way which would raise constitutional issues which went wider than questions of finance alone.

CHAPTER 7

EXCHEQUER GRANTS TO LOCAL AUTHORITIES

7.1 As noted in Chapter 1 (paragraph 1.12) Exchequer grants from central Government currently provide local authorities in England and Wales with more than half their income (£            bn, out of £            bn in 1981/82.

Specific Grants

7.2 Some of the total of Exchequer grants is paid in the form of specific grants to support expenditure by local authorities on particular services. Such grants typically involve a fairly close degree of central government involvement and oversight of the particular programmes on which the money is spent. The police grant administered by the Home Office and the urban programme grant administered by the Department of the Environment are two examples of such grants. For the purposes of this Green Paper it is assumed that the reasons for existing specific grants would not in general be affected by a change to a new tax base for local government, and that they can therefore be assumed to continue essentially unchanged. It might however be appropriate to consider a more extensive use of hypothecated grants, particularly if a low-yielding tax such as poll tax were adopted in place of rates. One possibility which might merit further consideration would be the re-introduction of a general grant in support of education. Clearly there are a number of forms which this could take. The main possibilities are examined in Annex B.

Rate Support Grant

7.3 The major part of Exchequer support to local government is however given in the form of an unhypothecated rate support grant for the support of local authority expenditure in general. Rate Support grant accounts for £            bn out of the total of £            bn of all Exchequer grants in 1981/82. Rate Support grant in its present form is intricately interwoven with the rating system, and a major change in the local tax base would therefore make it necessary to review this grant system.

Purposes of a General Grant System

7.4 The present rate support grant system serves three main purposes:

- (i) Transferring a major part of the cost of providing local authority services from rates onto the wider and more equitable range of national taxes which are drawn on to finance the rate support grant (along with all other central government expenditure);
- (ii) Equalising the cost to ratepayers of receiving a similar standard of local authority service in different areas;
- (iii) Enabling central government to influence the general level of local authority expenditure while maintaining the freedom of individual authorities to make their own budget decisions, and to decide priorities between services.

In considering the need for a new grant system to support a new local tax base it would be necessary to consider how each of these three objectives of the present grant system might feature in the new situation. In addition it would be necessary to consider how a grant system might assist in partially overcoming some of the problems identified in relation to some of the possible alternative taxes, notably

- (iv) lumpiness;
- (v) unpredictability of yield; and
- (vi) how a grant system would work in a system with more than one local tax.

## SCOTLAND

7.5 Although the details of the present system in Scotland differ significantly from that in England and Wales, the aim is the same and is achieved by pursuing a similar principle of equalising local needs and resources up to accepted standards. Introduction of a new local taxation system in Scotland would entail grant considerations broadly similar to those applicable to England and Wales.

Transferring the Cost of Local Services to Central Government

7.6 Whether it would be necessary to continue to transfer a major part of the cost of local services from local to central government would depend on the capacity of the new local tax or taxes to generate income in an acceptable and equitable way. A poll tax might not be sufficiently equitable to provide more than a small part of the income needed by local government. It would be necessary to consider whether it would be advisable to raise Exchequer grant significantly, since a high level of grant tends to <sup>cushion</sup> local authorities from taking resources into account when taking expenditure decisions. But in principle it may be that either a local income tax or a local sales tax would be capable of producing sufficient local revenue to make it unnecessary to have a large Exchequer grant.

7.7 In reaching a decision on this it would however be necessary to consider how far central Government was continuing to draw on the same tax base. For example, to make room for a local income tax levied at an average of say 10p and producing £        bn for local government, it would no doubt be necessary to reduce the level of national income tax, which would raise much larger questions about the Government's overall fiscal strategy.

Equalisation

7.8 Different local authorities face different problems, and their areas and populations have different characteristics and different needs. The cost per head of population of providing a similar level of service therefore varies between local authority areas. The resources of different local authority areas measured in terms of rateable value per head of population also vary substantially. Successive Governments since the war have considered it right to compensate authorities for these differences by means of Exchequer grant.

7.9 The form of the grant, and the extent of the compensation for such differences has been changed several times. The present block grant, introduced in 1981, is intended to provide virtually full equalisation between authorities in respect both of differing needs and of differing resources. As did the system it replaced,

it aims to do this by distributing grant in such a way that local authorities are able to provide similar standards of service by levying a similar rate in the pound.

7.10 The introduction of a new tax base cannot alter the fact that the cost per head of providing similar standards of service vary between authorities. Moreover, it is virtually certain that whatever new tax or taxes are chosen there will still be significant differences between the resources per head of authorities as measured in terms of the tax base for the new tax (eg the average income per head of the residents of each local authority area if a Local Income Tax were adopted). There is therefore likely to be a continuing case for equalising needs and resources under any new local tax system.

7.11 The present block grant system provides a mechanism for achieving this kind of equalisation in conjunction with rates. The essential feature of this system is the rate poundage schedule which lays down a tariff of the "grant-related rate poundages" that an authority is assumed to levy in order to provide any particular level of services. The amount of block grant to be paid is then determined as being the difference between the total expenditure of an authority, and the amount assumed to be raised locally by the levy of the notional "grant-related poundage" for that level of expenditure.

7.12 Exchequer grant is a convenient means of achieving equalisation. It is not however essential. In theory it would be equally easy to achieve equalisation by means of a rate pool or equalisation scheme without any central grant. Under such a scheme high resources or low need authorities would have to contribute some of their local revenue to a central pool for redistribution to low resources or high need areas. The calculations involved would be essentially similar, though there might possibly be more difficulty in practice in persuading the authorities contributing to the pool of the equity of the arrangements.

7.13 With a different local tax base equalisation could in principle be achieved in a similar way, either by means of an Exchequer block grant distributed on equalising principles, or by means of a revenue pooling or sharing arrangement.

#### Grant as a Means of Influencing Local Authority Expenditure

7.14 In order to be able to manage the national economy and the levels of public expenditure central Government needs means of influencing the overall level of local authority current expenditure. At the same time however successive Government have wanted local authorities to have a wide measure of independence and local autonomy over their budgets and priorities, and to be accountable to their own electorates for their decisions on these matters rather than to central government.

7.15 An unhypothecated grant has for a number of years provided the means of reconciling these objectives. The level at which the grant is set, and the way in which it is distributed, can exert a considerable influence on the general level of local authority expenditure. This has been enhanced by the new block grant system which enables central government to exert greater pressure on high levels of spending by making each increment of "high" expenditure more expensive for local authorities in terms of the rate poundage they must levy to pay for it. This is not suggest that block grant is a control system. Individual authorities remain free to determine their own level of expenditure, provided they are prepared to levy the necessary rates; and they have complete freedom to determine their own priorities as between their different services.

7.16 Under a new structure of local taxes, it should in principle be possible for central government to use a block grant system to exercise a similar degree of general influence over the level of local authority spending while leaving individual authorities with full freedom over their own expenditure decisions and priorities. Alternatively, if it were decided to reduce or eliminate Exchequer grant, and to use a revenue-polling arrangement for equalisation,

the revenue pooling system could be set up in such a way as to exert a similar degree of pressure on high-spending; this could be achieved by making high-spending authorities contribute more to the pool for each additional increment of expenditure than lower-spending authorities.

### Lumpiness

7.17 The lumpiness of some of the alternative sources of local revenue has been identified as a problem in previous Chapters (paragraphs 2.15-2.18, 3.19, 4.7 and 4.14). In the case of a sales tax for example the average rate might initially be 5% on all sales, and for practical reasons the tax might be variable in steps no smaller than 1%, so that the authority's revenue from the tax would change by 20% at a time. It would be possible to use a block grant system to overcome this problem but only at the price of distorting the equalisation objective to some extent. This would be achieved in the block grant calculations by assuming a notional sales tax of say 5% for all levels of expenditure from an initial level up to an expenditure level 20% higher, when the notional tax rate would go up to 6%. Throughout each step of this 20% expenditure increase, block grant would increase progressively to take up the full extra cost, but would actually reduce again when expenditure actually reached the level at which the notional tax rate moved up to 6%. In this way the authority would be assured of a smoothly increasing revenue as its expenditure increased. But the equalisation objective would be seriously distorted, and the influence of grant on expenditure levels would be perverse in that all increases in expenditure in the 20% range discussed would be paid for 100% by the grant.

7.18 An alternative approach would be to make the block grant calculations using the assumption for this calculation alone that the new tax could vary in much smaller steps. This would then preserve the influence of grant on expenditure. For these reasons it would probably be preferable. It would however leave the authority itself to deal with the consequences of a lumpy revenue source. They might do this by running much larger balances as a matter of course.

7.19 Alternatively, it would be possible to overcome this difficulty if each authority had a package of local revenue sources that included at least one that could be varied by small amounts - say increments of 3% of the authority's expenditure or £1 per head of population. In a system like this, lumpy taxes might perhaps provide the bulk of the income, but more finely-adjustable taxes would provide scope for adjustments at the margin. (Poll tax might fill the role of the less lumpy tax.)

### Predictability

7.20 Paragraph 22 discussed how a tax whose yield could not be predicted accurately each year could cause local authorities to maintain higher levels of balances as ways of guarding against the possibility that revenue might, in some years, be lower than expected. As Chapter 2 explained, it would be possible to avoid these effects by using exchequer grant to make good any shortfall of yield from the predicted levels. This would be a new function, which the present grant system does not fulfil. In practice, local authorities might receive grant payments, or contributions from pooling arrangements which not only performed an equalising function, but also compensated for differences between authorities' taxation and prior estimates of them. There would be difficulties in such an arrangement, however: these have been discussed in paragraph 2.14.

### More than One Local Tax

7.21 At present, local authorities have only one kind of local tax: rates. Because abolition of domestic rates would make local authorities dependent on more than one tax - non-domestic rates plus one or more new local taxes, for example - the mechanics of any exchequer grant system would have to cater for the complications that this would cause. In practice, this would mean that notional "exchange rates" would have to be established between the different taxes for the purposes of calculating grant. In other words, it might be necessary for example, to calculate a level of non-domestic rate poundage which was notionally equivalent to a rate of 1% on the new tax: it would then be possible for any combination of levels of different taxes to be expressed as an equivalent level of a single tax against which the grant schedules could be constructed.

CHAPTER 8

A REFORMED DOMESTIC RATING SYSTEM

8.1 One of the possibilities for reform identified in Chapter 2 of this paper was the retention of a fairer system of domestic rating either instead of or as well as introducing new forms of local taxation.

8.2 The rating system has operated in Great Britain since the sixteenth century. The £4,700 million which it is estimated will be raised by domestic rates during 1981/82 is equivalent to about 15% of expenditure incurred by local authorities. Historically, rates have provided an acceptable way of raising revenue for local services, as their survival to the present day indicates. It is sensible, therefore, to discuss rates against the seven criteria used for assessing alternative forms of local taxation so that a reformed domestic rating system may be considered alongside possible new forms of local revenue.

PRACTICABILITY AND COST OF ADMINISTRATION

8.3 The present system of domestic rates is well-established, quite clearly workable and reasonably well-understood by the public. Although there are wide variations between areas in rateable value the tax base is sufficiently large to support revenue requirements. The cost of administering domestic rates (including rate rebate administration and valuation costs) is estimated at £120m in 1981/82 (2½% of yield). There is little scope for avoidance or evasion because rates are a tax levied on fixed property. There is a great deal of administrative experience with the present system and a highly-developed body of statute law.

FAIRNESS

8.4 As discussed in Chapter 1, a major criticism of domestic rates is that they bear little relationship to ability to pay for those on middle to high incomes, although rebates and supplementary benefit relate rates to income for the worse off. The illustrative examples in [ ] show that there is a wide variation in the amounts that households with similar incomes pay in rates.

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8.5 A related point is that non-householders are not required to make any direct contribution to domestic rates. A household which consists of a single person therefore pays the same amount as a household with several earners. Figure 8.2 shows, as one would expect, that the higher the number of earners in a household, the smaller the proportion of household income taken by rates. This effect is not eliminated by rate rebates, though it is lessened by them, and many would argue that it was inequitable. On the other hand it has been pointed out that earning non-householders, though they may pay no rates directly

do contribute to the general taxation which finances the grants which form local government's main source of income.

8.6 A further point is that the base on which rates are levied is unevenly distributed across the country, and this distorts the application of the principle of equalisation in distributing rate support grant. In ensuring

that a similar rate poundage is needed to provide the local contribution to a similar level of services across the country the tax burden varies from area to area. For example, Welsh rateable values (and hence rates paid by Welsh ratepayers) are generally a lower proportion of net disposable income than rateable value in the south east and especially London.

The effect is that the distribution of rate support grant forces a variable local tax burden compared to an objectively fair system and the wide variation in rate poundages, by as much as a factor of 2.7 illustrates this.

PERCEPTIBILITY AND ACCOUNTABILITY

8.7 For owner-occupiers, the amount charged in domestic rates is clearly spelt out in a bill sent at the beginning of the financial year. Most council tenants and many private tenants, however, pay rates as an inclusive charge with their rent. This means, inevitably, that domestic rates are less perceptible at present to council tenants and to some private tenants than to owner occupiers. It might be possible to remedy this by ensuring that all householders were told the amount of rates payable on their homes, as owner-occupiers are at present by means of their rate demand note. The poundages levied by each tier of local government are set out in the rate demand note, which must be accompanied by further explanatory material. Perceptibility and accountability are both somewhat reduced in the case of rebate recipients, who may pay a small proportion only of rates due; and those of Supplementary Benefit, who in most cases pay no rates at all. As the system is constituted at present, domestic rates do not, of course, provide any direct link of accountability or perceptibility between local authorities and earning non-householders, who pay no rates.

FINANCIAL CONTROL

8.8 The yield of rates is predictable and the tax base is relatively constant, since rateable values generally vary little

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from year to year between revaluations. Poundages can be varied in steps of 0.01p, so the tax is not lumpy. From the point of view of financial control, therefore, domestic rates compare well with alternative forms of taxation.

#### FISCAL DIMENSIONS

8.9 Although rates are entirely a local tax, they have an effect on the degree of freedom that the central government has in its fiscal policies. They affect the aggregate amount of taxation levied in Great Britain, as a whole, as well as having important consequences for the level of total public expenditure. They are also the only tax in this country applied specifically to domestic property. These effects are reflected in the overall balance of the present taxation system.

#### SUITABILITY FOR ALL TIERS

8.10 Rates can be levied by county, district and parish, or community councils in England and Wales; in Scotland by regional, district and islands councils.

#### REFORMS OF THE RATING SYSTEM

8.11 A number of possible reforms of domestic rates which would be capable of being implemented in the short - or medium-term are listed below. Most of these reforms are ways of achieving greater fairness in the distribution of the rate burden. Others are ways of reducing the overall impact on households and of removing technical difficulties associated with the present system.

##### Earning non-householders

8.12 A levy on all earners, rather than limiting liability to householders, has often been proposed as a means of improving fairness and widening the rate base. A scheme could be devised to add a fixed amount to the rate bill for each non-householder who had some income during a given period. Since the levy would be relatively small it would almost certainly be inefficient to relate the amount to income, though consideration could be given

to excluding part-time or occasional work. There could nevertheless be scope for evasion, which could be difficult to counter. A more easily workable version of the proposal might involve a discount for households containing only one earner.

8.13 On average, this scheme would result in a relative reduction in rates for those on lower incomes, but at the expense of creating some anomalies. A family with a single earner, for example, would pay less in rates than another where both husband and wife worked, but where their combined income was the same as the single earners.

##### Offsetting rates against income tax

8.14 Another means of improving the position of ratepayers in relation to non-householders would be tax relief for those who pay rates. The relief could take the form of an additional personal allowance, either at a fixed level or varying according to actual rate payments.

The cost of tax relief in respect of rates would, of course, have to be made good by an increase in the general level of taxation.

##### Restructuring domestic rate relief

8.15 It might be possible to make the rating system fairer by changing the form of domestic relief from a flat poundage to a different basis. Some alternatives are examined below.

8.16 A discount on rateable values at a rate of £25 would cost about the same as the existing domestic relief in England. It would be of most benefit to people living in low rated houses and in areas with high poundages.

8.17 A percentage reduction in domestic rate bills of 14% could

replace the poundage discount in England. It would favour areas charging above-average poundages.

8.18 The relief could instead be related to rate bills on standard houses. A standard house would be a national comparison of several well-defined house types for which valuations had been made throughout the country. This would be a way of paying a similar amount of relief in respect of properties of similar quality wherever they might happen to be in the country: it would even out differences in the rateable values of similar properties caused by differences in the relative desirability of their locations. The relief could take the form of a percentage reduction in rate bills, so that the average relief of 14% in England would apply in areas where the standard value was the same as the national average, a 28% reduction applying where the standard RV was twice the national average, etc. A further possible refinement would be to take account of regional income variations in calculating the extent of relief.

Capital Valuation

8.19 The Layfield Committee recommended that the next revaluation of domestic property should be carried out on the basis of capital values, ie sale prices on the free market, rather than on the present basis of the rent which the property would command on the free market. Capital valuation would have the advantage of plentiful comparators compared with the scarce evidence available of market rentals owing to the decline of the private rented sector and the wide influence of rent control in what remains of it.

It is therefore difficult for a householder to form a view on the fairness of a rating assessment, because changes in the renting market have made the assumptions on which rateable values are assessed more and more notional, whereas there is plentiful evidence on sale prices which would enable him to reach a better informed opinion on the reasonableness of a capital valuation of his home.

8.20 Any revaluation for rating purposes of the domestic sector which comprises some 20M hereditaments, would take some time to complete, whether on a rental or capital basis. Some simplification

might have to be introduced into the valuation process. These might include a system of banding, so that properties lying within a certain range of values were allocated the same valuation for rating purposes. There would inevitably be some rough justice involved in such a scheme, but it could be argued that this would be a reasonable price to pay in order to achieve valuations based on up-to-date and easily understandable information.

8.21 A further possibility would be the introduction of a "beacon" system. This would involve the valuation in each district of a very limited number of properties chosen to be representative of broader types of domestic property. These properties would be the "beacons": each property in the rating district would be linked to the most appropriate "beacon" and would be assigned that beacon's rateable value. Such a system could save time and money, though it would be even more rough and ready than a system of banding and would require thorough investigation and analysis before it could be considered feasible.

8.22 The introduction of capital valuations for the domestic sector would cause some redistribution of the rate burden between households. It appears likely that the main effect would be a slight increase in the relative values of both large and small houses compared with the middle range of properties.

CONCLUSION

8.23 The Government's starting point in publishing this green paper has been that domestic rates should be abolished if a more satisfactory alternative form of local revenue can be found. The long history of rating, and the consequent high degree of experience that has been gained in its operation, nevertheless constitute potential advantages which should not be discounted out of hand. The Government is therefore prepared to consider submissions on the retention of a system of domestic rating on the same basis as submissions on the alternative forms of local taxation and finance identified in this green paper.

## CHAPTER 9

## NON-DOMESTIC RATES

9.1 There are some two million non-domestic ratepayers in Great Britain. Rates are paid, not only by private industry and commerce, but also by nationalised industries and undertakings, entertainment and recreational concerns, educational, medical and cultural institutions and many others (including the Crown). Non-domestic rates will provide an estimated 24% of local government rate fund revenue in 1981/82, compared with the 16% contributed by domestic ratepayers and the 60% which will come from exchequer sources in one form or another. In cash terms, their estimated yield is £6,000 million for the current financial year. They thus make a large and important contribution to the cost of local services.

9.2 There are various ways in which the abolition of domestic rates and their replacement by some alternative form of revenue could have repercussions for non-domestic rates. All of the alternatives to domestic rates discussed in this green paper involve changes in the overall national pattern of taxation which, unless preventive measures were taken, could result in a shift in the balance of taxation between those who currently pay domestic rates and others, including industrial and commercial firms, who pay non-domestic rates. In particular, if domestic rates were replaced by assigned revenues, or by some other form of local taxation which authorities were not free to use to increase revenue at their own discretion, there would be a temptation to finance higher levels of expenditure by increasing non-domestic rate poundages.

9.3 The scope of this green paper does not extend to alternatives to non-domestic rates. That is a question which goes beyond the issues raised by the possible alternatives to the domestic system. It may nevertheless be necessary to consider separately whether, in the long run, the national taxation system should continue to include a local tax on non-domestic property; and in what form

and from whom, alternative revenues might be raised. For the Government will pay close attention to the implications for non-domestic ratepayers of all the alternatives proposed to replace domestic rates. In particular, the Government is concerned that any new arrangements should not increase the relative burden of taxation on commerce and industry.

9.4 It is conceivable that this objective could require some constraint to be imposed on the present freedom of local authorities to decide their own non-domestic rate poundages. This is the more likely because, since the abolition of the so-called business vote in 1969, there has been no direct link of accountability between local authorities and their industrial and commercial ratepayers similar to that which exists between authorities and domestic ratepayers, who are able to vote in local elections.

#### CONTROL OF NON-DOMESTIC POUNDAGES

9.5 One possible means of controlling the demands of local government on commerce and industry through non-domestic rates would be for the central government to bring forward legislation which would give it the power to determine each year, by order, a single national non-domestic rate poundage which would apply equally to each local authority in the country.

9.6 This approach would allow the Government to safeguard the interests of non-domestic ratepayers. It would ensure that local authorities would not be able to finance excessively high levels of expenditure by increasing non-domestic rate bills. When prescribing the rate poundage each year, central government would presumably take account, as it does in determining the total of exchequer grant, of its own expectations about inflation, the expenditure plans of local government and the revenue which it estimated would be available to local authorities as a whole from other sources. A national standard poundage, in eliminating the possibility of excessive demands on commerce and industry and the rest of the non-domestic sector, would clearly affect the financial flexibility that the rating system as a whole gives to local authorities at present. In effect, it would turn non-domestic

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rates into a nationally-determined tax whose collection and use was delegated to local authorities: an assigned revenue, in fact. This would mean that local authorities would be wholly reliant for the rest of their income on whatever new form of revenue they were given in place of <sup>domestic</sup> rates, coupled with any continuing system of exchequer grant. Another effect would be that local authorities would not be able to use small variations in their non-domestic rate poundages to compensate for the lumpiness of another local tax such as sales tax. Central control of non-domestic rate poundages would therefore mean that any reformed <sup>domestic</sup> system relying largely on a lumpy tax would have to include a less <sup>lumpy</sup> tax of some sort to allow the necessary compensation to be made.

#### NATIONAL ADMINISTRATION OF NON-DOMESTIC RATES

9.7 As an alternative to providing for non-domestic rates at a centrally-prescribed poundage to be collected locally by each authority, it would be possible for the national revenue from the tax to be collected by the central government and redistributed to local authorities either through the grant system or as an assigned revenue. The extent to which the effects of such an arrangement differed from those of a system under which a centrally-set poundage was levied locally would depend on the way in which any exchequer grant arrangements operated and how far they resulted in a redistribution of resources between authorities.

#### LINKAGE OF NON-DOMESTIC RATES WITH LOCAL TAX RATES

9.8 It might also be possible to preserve a fair balance between the interests of non-domestic ratepayers and those of domestic ratepayers, who would pay any new local tax or taxes by linking non-domestic rate poundages in some way with the new local tax rates.

9.9 This would be more complicated and administratively difficult than either of the possibilities discussed in paragraphs 9.5 - 9.7. If different taxes were chosen to provide revenue in place of domestic rates for the different tiers of local government, for

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example, and a linkage was thought desirable, then poundages would have to be linked to the type and rate of tax levied by each tier. Assume, for example, that counties were given a local sales tax and the districts a poll tax, and that both tiers continued to levy non-domestic rates. In this situation, the rate poundages that the counties levied would have to be linked to their rates of sales tax and the poundages that the districts levied would have to be separately linked to their poll tax rates. Complicated linkages of this sort would be feasible, but would require a difficult judgement by central government on the appropriate balance to be established between non-domestic poundages and the levels of the different taxes at the different tiers.

9.10 Such linkages would obviously also bring considerable technical difficulties. The new local tax - local sales or income tax, for example - might be buoyant, while non-domestic rates are not. This would make periodic adjustments to the linkage necessary, perhaps by means of indexing.

9.11 Also, if the new local tax were lumpy - sales tax, for instance - then a direct linkage would make non-domestic rates similarly lumpy. This might be overcome by allowing the ratio of the two sources of revenue to vary within a stipulated range, rather than being fixed absolutely, but that in turn could reduce the protection that the linkage gave to non-domestic ratepayers: because the levels of the lumpy tax could not often be changed, it would be tempting for local authorities to use non-domestic rates as far as possible to make any marginal adjustments to their income which might be necessary from year to year.

#### REINTRODUCTION OF THE BUSINESS VOTE

9.12 It has been suggested that the interests of non-domestic ratepayers could be protected to some extent even without the introduction of controls on non-domestic rate poundages if something like the so-called business vote, which was abolished in 1969, were reintroduced. This arrangement was not really a business vote as such: it was a non-residential vote exercised by the owner of property in an area where he was not a resident. Incorporated

companies did not have votes. It is argued, however, that enfranchising businesses might make local authorities accountable to the industrial and commercial community in their areas in the same way as they are accountable at present to domestic ratepayers, who are able to vote in local elections. The difficulties of providing for a business vote in a way which could produce a real degree of accountability, however, would be daunting. This would be particularly true if it were desired to find ways of enfranchising large industrial and commercial concerns and retail chains which may have interests very widely spread over the areas of many local authorities. Of the two million business ratepayers in England and Wales, only 150,000 were entitled to vote before 1969. The view of the present Government has therefore been that the interests of business ratepayers can be more effectively represented to local authorities through the influence that central government itself brings to bear on local government's revenues and expenditure levels and through direct representations to local authorities by individual firms and representative bodies than through a business vote.

#### OTHER FORMS OF RELIEF FOR NON-DOMESTIC RATEPAYERS

9.13 Over the last two years the Government has received a number of pressing representations from industry and commerce arguing for a reduction of the burden imposed on them by non-domestic rates, which in some cases may be substantial. It has been suggested that industrial property should be derated, as it has been at certain times in the past, and as agriculture is at present. Alternatively, it has been suggested that a measure of rate relief should be provided for non-domestic ratepayers by means of a similar arrangement to that under which relief is provided at present in the domestic sector. It has been suggested that this relief should apply either generally or, more specifically, to premises, plant and machinery which have been temporarily "mothballed" owing to reduced production.

9.14 To date, the Government has not decided to introduce any of these measures. De-rating of industry would mean a considerable change in the contribution that firms make through local taxation towards the cost of the local services from which they benefit, often substantially. All of the measures mentioned above would lead to decreases in local revenues which, to the extent that they were not made good from national taxation, would fall on the local domestic sector. The Government will nevertheless keep under review the contribution that industry and commerce make through rates to the cost of local services, and does not rule out the possibility of measures to reduce that contribution if it should become essential to do so.

#### A NON-DOMESTIC REVALUATION

there is no prospect that

forms of taxation in the

9.15 Since/the non-domestic rating system will be replaced by other immediate future, it is necessary to consider a revaluation of the rate base. The last revaluation took place in 1973 in England and Wales and in 1978 in Scotland: since then there have been some quite large changes in the relative values of some categories of non-domestic property. The effect of these changes is that some categories of non-domestic ratepayer are paying larger rate bills than would be the case if the values of all non-domestic property were brought up to date. Effectively those ratepayers subsidise other categories of non-domestic ratepayer whose burden would, at present-day values, be higher. Present indications suggest that a revaluation of non-domestic property might possibly produce the following broad effects:-

- (i) Substantially reduced comparative rate burdens for:
  - larger, older, labour-intensive factories in the Midlands and the North;
  - older steelworks.
- (ii) Slightly reduced comparative rate burdens for:
  - newer steelworks;
  - local shops;
  - older offices in some cities outside London.

- (iii) Slightly increased comparative rate burdens for:
  - new offices in more prosperous centres;
  - small factories on modern industrial estates.
- (iv) Substantially increased comparative rate burdens for:
  - shops in primary locations; and
  - modern oil refineries.

These indications must, however, be treated with caution, as it would not be possible to forecast the effects of a revaluation with precision until one was well under way.

9.16 The argument for a non-domestic revaluation is simply that it would make the tax base fairer by eliminating the degree of cross-subsidisation that has crept in because of relative changes in the values of some categories of property since the last revaluation in 1973. On the other hand, a revaluation would involve a substantial cost: the Inland Revenue's Valuation Office alone would require additional staff in order to carry it out as staff numbers have reduced substantially since 1979. There would, of course, also be consequential administrative costs for rating authorities. The Government is considering whether these additional costs would be justified in order to rectify the present degree of distortion in the tax base. In order to carry out a revaluation which would take effect from 1 April 1985, it would be necessary for the Government to reach a decision very shortly.

[9.16A SCOTTISH PROPOSALS - presently the subject to Ministerial correspondence.]

9.17 It would almost certainly be impossible to replace domestic rates by a new system of local taxation before 1 April 1985. However, the revaluation of non-domestic property would not affect the relative rate burdens borne by the domestic and non-domestic sectors. The powers under which the Secretary of State may require a partial revaluation (that is, in this instance, a revaluation of non-domestic, but not of domestic, property) to be carried out

oblige him to make an order prescribing a "multiplier" whose effect would be to preserve the ratio which obtained before the revaluation between the aggregate of the values of those categories of property which had been revalued and those which had not. In other words, a revaluation of non-domestic property which took place while the present domestic rating system remained in existence would not shift any of the present proportional burden of rates from domestic onto non-domestic ratepayers or vice-versa.

CHAPTER 10

FEES AND CHARGES

THE CONTRIBUTION OF RENTS, FEES AND OTHER CHARGES

10.1 A number of local authority services are expected to be financed primarily from charges. These are the Trading Services which account for about 23% of gross spending. They include public passenger transport, local authority ports and aerodromes, civic halls and theatres, and a number of other services. Sales, fees and charges within the trading services yielded £(400)m in 1979/80, covering (65)% of costs.

10.2 The largest single source of revenue from charges is local authority housing rents. In 1979/80 rents totalled £(1,400)m, and covered (38)% of local authorities' current expenditure on housing. Central Government subsidies and grants contributed 43%. The proportion of authorities' costs met by rents is, however, rising following changes in the subsidy system which have the effect of concentrating Government assistance where it is most needed.

10.3 The bulk of local authority services is financed primarily by central and local taxes. These are referred to as the Rate Fund Services. In 1979/80 they cost £(21,000)m, approximately 83% of gross local authority spending. Sales, fees and charges yielded £1,700 m and covered 8 % of costs. The main sources of revenue were fees for adult and further education, school meals and milk, and charges for personal social services.

10.4 The contribution made to the total cost of local services by all fees, rents, sales and other charges is similar at present to that made by domestic rates, amounting to 14% of gross spending in 1979/80.

THE ARGUMENTS FOR AN EXTENSION OF CHARGING

10.5 It has been suggested that charging for a wider range of local authority services, or increasing the levels of existing charges, could provide some or all of the revenue currently raised

by domestic rates. The main argument for financing a higher proportion of local authority spending from charges is that it would make users pay a greater contribution to the cost of the services they consume than they do at present. There is also an argument that an increased level of charging would help to achieve a more efficient use of resources by relating the provision of services to the prices that users were willing to pay for them.

10. Many local authorities services have features which make it either impracticable or inefficient to try to charge consumers - the economic cost of the services that they consume. This applies to a considerable extent in the case of services such as the cleaning and lighting of streets, highways, the provision of public open space and the police and fire services, which are all provided by the community for the public good. Although it is possible to charge users for some of the functions that the police perform, for example, it is hard to imagine how charges could be made for the whole range of their activities, including the prevention and prosecution of crime. Any system which sought to achieve this would be so cumbersome, and the logic of its operation would be so far from evident, that it would be unrealistic and uneconomic to try to devise one.

10. Other local services, though the mechanics of systems of charges for them would be less problematical, are intended to be redistributive: that is, they are financed in a way which deliberately prevents the worse off from having to bear their full cost. Charging consumers the full economic costs of these services would often defeat the redistributive intention of the services themselves. The public financing of education, for example, is very largely redistributive in its intentions, though charges are made for some parts of the service (school meals, for example). Full economic charges for education, combined with a statutory responsibility on parents to send their children to school up to the age of 16, could clearly impose an intolerable strain on the finances of less well-off families. Similarly, although charges are levied in respect of some of the personal social services - home helps, for example - the purpose of the social services as a whole would be defeated if their full economic cost was recovered from beneficiaries by means of charges.

10.8 Education, law and order, highways, and the social services together account for 83% of current rate fund expenditure and offer little scope for additional charging. This suggests that it would not be possible to replace a significant proportion of the revenue currently raised through domestic rates with an extended system of fees and charges.

10.9 Nevertheless there are, particularly within local environmental services, a number of individual services where charges may have a very considerable role to play. The Government have recently received a report from consultants about charging in this area which shows, if the sample of authorities considered is representative, that there is room for very substantial improvement in practice. Not only do some authorities not seem to have a policy in relation to charging at all, but many of those that have ignore major questions which should be taken into account, such as the true financial cost of uneconomic charging, the wishes and needs of the clientele of the service and the effect on the service as a whole of indiscriminate subsidisation. The Government will be discussing this report with the local authority associations shortly.

CHAPTER 11

COMBINATION OF NEW LOCAL TAXES

11.1 Though they have been discussed individually in this green paper, the five main possible sources of local revenue identified - local sales tax, local income tax, poll tax, assigned revenues and a reformed domestic rating system - can be treated as components which could be fitted together, along with non-domestic rates, in a large number of combinations to produce a range of local taxation systems which would have very different emphases and characteristics. The variables which would have to be taken into account in building up a system which depended on more than one local tax are:

- different tiers of local government;
- different local taxes;
- different models of each local tax;
- different quantities of exchequer grant; and
- the continued existence of a (modified or unmodified) system of domestic rates.

11.2 The number of possible permutations is very large, and it would not be practical for this green paper to try to identify and discuss them all.

HOW THE TAXES MIGHT BE COMBINED

11.3 Each of the major candidates for a new local tax has characteristics which affect the way in which it could fit into an overall structure of local revenues. The merits of some of the possible combinations are set out in the table and discussed against the criteria on which the individual taxes were assessed in earlier chapters in the remainder of this chapter.

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TABLE Examples of Schemes for Replacing Domestic Rates

(A) SALES TAX

(1) Sales tax for counties and Scottish regions      Poll tax for districts, boroughs and parishes

(2) Sales tax and poll tax for counties and Scottish regions      Assigned revenue from sales tax and poll tax for districts and boroughs. Poll tax for parishes

(B) INCOME TAX

(3) Income tax for counties, Scottish regions, boroughs and all districts

(4) Income tax for major spenders (shire counties, met districts, London boroughs, Scottish regions)      Poll tax for minor spenders (districts and met counties) and parishes

(5) Income tax and poll tax for major spenders      Poll tax for minor spender and parishes

(C) POLL TAX

(6) Poll tax for counties, Scottish regions, boroughs, all districts and parishes      Need to have a rebate

(7) Poll tax at low rates for all tiers, augmented by higher levels of Rate Support Grant or by assigned revenues

Note: For each of these schemes non-domestic rates (either at fixed poundages, or at poundages linked with the rates of other taxes, or unconstrained) would continue to be available to both county and district tiers.

Domestic rates could be retained as an alternative to poll tax. The Layfield Committee's preferred solution was one based on income tax plus rating or major spenders and rating alone for other spenders. Taxes proposed for either tier elsewhere could generally be suitable for Scottish islands authorities.

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SALES TAX SCHEMES

11.4 A sales tax could be levied only by English and Welsh counties and Scottish regions and islands, and it would be a lump y tax. Counties would therefore need a further tax in order to make marginal changes in income, and districts and London boroughs would have to be allocated a separate tax.

11.5 These conditions would create difficulties for any schemes involving a sales tax. Since the metropolitan counties are responsible for much lower levels of expenditure than shire counties, they could manage with a relatively low rate of sales tax. The yield of sales tax in shire counties close to metropolitan areas would therefore tend to be low and difficult to predict, since goods subject to the tax could be bought at lower prices in neighbouring areas. Furthermore, a combination of revenues which required counties to rely on sales tax could tend to be confusing for local people, since these differences in tax rates would reflect not only decisions taken by authorities about the level of services to be provided, but also differences in the services for which shire and metropolitan authorities are statutorily responsible.

11.6 To avoid this problem it may be possible to arrange for both major tiers of local government to receive a share of sales tax although it would be collected only by the counties. If so, there would need to be a formula determining how much of the sales tax revenue should be allocated to districts or boroughs within each county and how it should be shared out between them. The allocation might be related to each district's desired spending level, or to a standard assessment of need to spend (such as the grant related expenditure assessment used for block grant) or to the estimated yield of sales tax in the district. However, there would be objections to any of these methods of distributing the tax, and practical problems as to how any shortfall in expected yield would be shared between the tiers.

11.7 In terms of practicability, therefore, there are doubts as to whether a sales tax would work if shared between both tiers. If it were to be a source of revenue for counties only, the tax would score badly against the criteria of accountability and fairness since the rates of tax would be quite different in metropolitan and shire areas. Either version of a sales tax scheme would require a further tax to be available to both tiers - perhaps either a poll tax or, possibly, domestic rates at a reduced level. Financial control would be more difficult in relation to sales tax than income or poll taxes owing to its lumpiness and unpredictability of yield. For the reasons given in paragraph 3.8, it is not possible to quantify the cost of schemes including a sales tax precisely at this stage. If it were decided to pursue these schemes further some quantification would clearly be necessary before any final decision could be taken however. Nevertheless, it is clear from preliminary examination that sales tax schemes, because they would probably have to include a poll tax or some other non-lumpy revenue, would cost more than domestic rating does at present. The cost would vary with the method of running the sales tax: a poll tax and a sales tax run independently of the VAT system would be particularly expensive.

#### INCOME TAX SCHEMES

11.8 A local income tax integrated with the existing national income tax system would be suitable for the major spending authorities - shire counties, metropolitan districts, London Boroughs and Scottish regions and islands. Since the services provided by these authorities are of the same order of magnitude, differences in income tax would largely reflect the level of services provided. As this type of income tax would be somewhat lumpy, it would have to be supplemented by a further source of revenue for the major spenders; either a poll tax or domestic rates as well as non-domestic rates. The remaining authorities - shire districts, metropolitan counties and Scottish districts - would need to have access to poll tax or domestic rates, as well as non-domestic rates.

11.9 A combined scheme involving local income tax integrated with the present national system plus poll tax or rates would have the potential to replace the present yield of domestic rates. Administrative cost would be high, however, since two new local taxes would be involved - about £110m, together with a similar amount in additional costs to employers arising from handling PAYE at different rates for employees living in different tax areas. Perceptibility, financial control and fairness have been discussed in Chapter 4.

11.10 The other versions of local income tax could be made available to both main tiers of local government, and so have the advantage that they could stand on their own as a replacement for domestic rates. Since they are not lumpy, they could work in combination with non-domestic rates set at either a fixed or variable poundage. There would remain the problem of how parishes would raise their revenue if neither domestic rates nor poll tax were available.

11.11 It would be feasible for any of the alternative versions of local income tax to be combined with poll tax or domestic rates if it were decided that they should not be used as a complete alternative to domestic rating. It would be possible for a scheme similar to that discussed in paragraphs 11.14-11.15 to be implemented, or different revenue sources could be assigned to different tiers, so that the major spenders would levy income tax and the minor spenders, plus parish councils, have access either to poll tax or possibly to a reformed system of domestic rates.

11.12 The degree of perceptibility of local income tax would depend on whether its collection was integrated in the national tax system or whether separate assessment was carried out by

local authorities. In the latter case, if the tax were collected only by one tier of authorities, it would be difficult for the taxpayer to identify separately to himself the respective demands of county and district authorities. Since some local electors would not be income tax payers, a second local income tax in addition to local income tax would tend to ensure greater accountability to the electorate as a whole.

11.13 From the point of view of financial control, the reform of a predictable form of revenue such as poll tax or a reformed system of domestic rates would be preferable to reliance on income tax alone. Such a combination would also have a small impact on central government's freedom to set appropriate national rates of tax, since the local income tax rate - and hence the overall national level of taxation of incomes - would be correspondingly lower.

POLL TAX SCHEMES

11.14 The use of poll tax as an adjunct to a local sales or income tax has been discussed earlier in this chapter. But poll tax could also provide a major source of revenue in its own right. It could either be introduced as a complete replacement for domestic rates, perhaps in conjunction with a rebate system; or it could be levied at a relatively low level, the gap being made up by additional Exchequer grant or assigned revenues. In either case, all tiers of local government could be given access to poll tax.

11.15 The characteristics of a poll tax were discussed in Chapter 5. In the context of this Annex, it should be added that domestic rates were to be replaced by a low-level poll tax in combination with an increased level of exchequer grant there

be an obvious loss of accountability. A scheme of this sort would run the danger of increasing the overall contribution of industry and commerce to the cost of local services through the national tax system if the grant or assigned revenues were financed from general Exchequer revenues. (Non-domestic rates would, as explained in chapter 9 continue for the immediate future). These criticisms would not apply if the poll tax were operated in conjunction with a reformed domestic rating system rather than with grant or assigned revenues.

CONCLUSION

11.16 It is clear that either a local income tax (unless integrated with the present national tax system) or poll tax could be used on their own as replacements for domestic rates. Sales tax, however, could almost certainly not function without the aid of a secondary source of revenue and it might also be considered desirable to combine a local income tax with either poll tax or domestic rates retained at a lower level of yield.

## CHAPTER 12

### SOME FISCAL AND DISTRIBUTIONAL EFFECTS

12.1 Earlier chapters have examined the background to the green paper and the present examination of the alternatives to domestic rates. They have also:-

- discussed various general consequences for central and local government and individual and corporate taxpayers of replacing the present system with alternative revenues;
- looked at the more promising alternatives individually and in some detail; and
- examined how far the individual alternatives could stand on their own and how far they would have to be combined with other forms of revenue or local taxation to produce the income currently yielded by domestic rating.

This final chapter compares the tax rates which would probably have to be levied if any of the new local taxes discussed in chapters 3 - 5 replaced the whole of the present yield of domestic rates on its own; and draws together some of their fiscal and distributional implications.

12.2 In some respects, any comparison between the likely rates of new taxes is inevitably a very notional one. Chapter 11 showed how it would be possible for the various alternative forms of new local revenue to be grouped together in a wide range of combinations: the distributional effects of any of the alternative forms of revenue could obviously be affected if it were included as part of a "package" of two or more new revenues. Chapter 11 explained why it was not practical for the green paper to identify all the possible combinations and consider their effects and characteristics in detail. It also explained that it seems very unlikely that either a local sales tax or a local income tax integrated with the present system of PAYE could be used to replace the yield of

domestic rates on their own without a contribution from some other form of local revenue. This chapter should however cast some further light on the nature of the alternatives, the ways in which they would affect the balance of the national tax system as a whole and the contribution required from different types of household in different areas with different sized incomes.

#### LOCAL TAX RATES AND THE NATIONAL TAXATION SYSTEM

12.3 A local sales tax which was levied on the retail transactions which are currently liable to national VAT would have to be set at an average rate of 7% to raise the same revenue as domestic rates: a local sales tax on all goods and services, including those zero-rated or exempt from VAT, would have to average 3 - 4%. A local income tax would have to average five pence in the pound to raise the same amount nationally, and a poll tax would have to average £120 a head to produce the same revenue.

12.4 Domestic rates can be regarded as a tax on expenditure, at least in their effects. In the absence of any compensating changes in the level of national income tax, the replacement of domestic rates by a local income tax would therefore alter the balance in the present taxation system between taxes on income and on expenditure by increasing overall marginal rates of taxation of personal incomes. It might be necessary in those circumstances to consider making offsetting adjustments in national tax rates in order to restore the overall balance of the taxation system with, of course, consequential adjustments elsewhere to make up for any loss of revenue from national income tax.

12.5 The replacement of domestic rates with a local sales tax would similarly increase the total level of taxation on the range of goods and goods and services involved. This would not alter the overall level of taxation on expenditure, but it would alter the relative rates of taxation which would apply to housing on the one hand and other goods and services on the other.

12.6 Because it would be an entirely new form of taxation in modern times in this country, a poll tax might be thought to have

less direct implications for other taxes than either a local sales tax or a local income tax. Nevertheless it would be important, in judging the case for a poll tax, to consider its impact on the shape of the tax system as a whole.

#### DISTRIBUTIONAL EFFECTS

12.7 It is not possible at this stage to estimate how many households would gain or lose, or by how much, by the adoption of any of the alternative new local revenues discussed in this green paper. It is possible, however, to give some indication of the likely effects of notional, representative households of differing composition and income by comparing estimated savings from the abolition of domestic rates against estimates of what such households could be expected to have to pay under the alternative forms of new taxation. The results of some such comparisons, and the assumptions on which they are based, are set out in Annex [ ] .

12.8 It should be noted at the outset that no allowance is made in the comparisons in Annex [ ] for support to low income households to replace rate rebates and rate payments in supplementary benefits would not be replaced. This is purely a working assumption made for the technical purposes of the calculations: it does not imply a view on the part of the Government that no analogous forms of relief would be made available. The provision of any relief of this sort would modify the distributional effects of the taxes as set out in the Annex. Estimates are made in the Annex of the gains and losses for representative households in Scotland, Wales, London and the South-East and the rest of England, taking no account of variations between the different local authority areas within those broad geographical regions.

12.9 For most of the household types in the illustrations, a local income tax would be the most effective means of reducing the burden that domestic rates impose at present on those with low incomes, though it would correspondingly increase the burden on those with higher incomes. Those on very low incomes might gain slightly. It is also notable in the illustrations that with either a local income tax or a local sales tax the burden of taxation, as one

might expect, is shifted towards households with two or more earners. The illustrations show that on the assumptions used, gains or losses would not be greater on average for representative household types than four or five per cent of disposable household income.

12.10 At the lower end of the income range, in general pensioner households not on supplementary benefits would tend to gain from the replacement of domestic rates by either a local income tax or a local sales tax [ ], except, in the case of a local sales tax, for those pensioners on supplementary benefits.<sup>7</sup> Very low income households with children would tend to experience little change with the introduction of a local income tax, but would be considerably worse off with a local sales tax unless some relief for those on low incomes were provided. Households of all types on supplementary benefits would be worse off under a sales tax.

12.11 The relative effects of a local sales tax on those on high and low incomes are more uncertain than those of a local income tax because the composition of household expenditure tends to vary with income. With a VAT-based tax those with higher incomes would bear a higher tax burden, but this would not be the case with a more widely-based tax. Of course, on the working assumption that there would be no new relief to replace rate rebates and supplementary benefit rate allowances, very low income households, including many pensioners, would be worse off.

12.12 With a poll tax, gains and losses would depend mainly on the number of adults in the household. Because a poll tax is assumed for the calculations in the Annex to fall on adults who are not necessarily earners, there are a number of cases shown here where it would impose a higher relative tax burden than domestic rates on households with power incomes and a lower relative burden on those with higher incomes.

12.13 It is assumed for the illustrations that the amount of tax revenue to be raised in each country within Great Britain would equal the total that would be raised by domestic rates, but there

would be shifts in the tax burden between areas within each country. This is because the distribution between areas of the tax base for rates differs from those of the alternative income, population and expenditure tax bases. The shift in the tax burden from London and the South-East to the rest of England in the illustrations is an example.

on the whole range of the personal family finances of those who would contribute, the green paper sought to give a broad indication of what those effects would be. Equally, it has sought to bring out the nature of the implications that each alternative would have for the interests of central and local government and of the national taxpayer. Each option has advantages and drawbacks.

The Government will consider very closely all representations. This is to produce proposals for a system which would remedy as far as possible the shortcomings of the existing system of domestic rates and which would command the widest possible acceptance in the country as a whole.

CHAPTER 13  
CONCLUSION

13.1 In publishing this green paper, it has been the Government's intention to identify the range of realistic alternatives to domestic rates and to put them in a common context for public discussion. Although it is not possible to quantify the effects that each alternative would have on the whole range of the personal and family finances of those who would contribute, the green paper has sought to give a broad indication of what those effects would be likely to be. Equally, it has sought to bring out the nature of the implications that each alternative would have for the interests of central and local government and of the national taxpayer. Each alternative has advantages and drawbacks.

13.2 The Government will consider very closely all representations. Its aim is to produce proposals for a system which would remedy as fully as possible the shortcomings of the existing system of domestic rating and which would command the widest possible acceptance in the country as a whole.

ON PETROL, ALCOHOL AND TOBACCO

FEASIBILITY

2. In order to simplify administration and because the very high proportion of tax in price provides an obvious incentive to evasion, the excise duties currently levied on petrol, alcohol and tobacco are collected at an early point in the distribution chain - either when they enter the country or when they leave specially approved and controlled premises for distribution to the UK market. But to be used as local revenues, duties on these goods would have to be charged at the final point of sale. If a duty were charged at the wholesaling stage or earlier, the distribution of the tax base between local authority areas would be seriously distorted. Levying duty through individual petrol stations, off-licenses or other tobacconists would require very high rates of tax to be collected at single points of retail sale. This would lead to formidable problems of accounting and control for the taxing authority and would greatly increase accounting costs for traders, who would have to keep a second set of tax records in addition to those kept at present for VAT. The Government believes that these

APPENDIX A : THE REJECTED TAX OPTIONS

INTRODUCTION

1. Paragraph 2.6 listed a number of forms of local taxation which the Government considers can be eliminated at this stage as possible alterations to domestic rates. They are:

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

This appendix explains the Government's reasons for rejecting each of these possibilities. In most cases, the reasons are related to practicability and cost. Table [ ] brings the main points together in summary form.

LOCAL DUTIES ON PETROL, ALCOHOL AND TOBACCO

PRACTICABILITY

2. In order to simplify administration and because the very high proportion of tax in price provides an obvious incentive to evasion, the excise duties currently levied on petrol, alcohol and tobacco are collected at an early point in the distribution chain - either when they enter the country or when they leave specially approved and controlled premises for distribution to the UK market. But to be used as local revenues, duties on these goods would have to be charged at the final point of sale. If a duty were charged at the wholesaling stage or earlier, the distribution of the tax base between local authority areas would be seriously distorted. Levying duty through individual petrol stations, off-licences or corner tobacconists would require very high rates to tax to be collected at single points of retail sale. This would lead to formidable problems of accounting and control for the taxing authority and would greatly increase accounting costs for traders, who would have to keep a second set of tax records in addition to those kept at present for VAT. The Government believes that these

problems are so great as virtually to rule out local duties on grounds of impracticability.

3. Locally variable rates of duty could result in prices being higher in some local authority areas than in others. Where this happened, consumers would tend as far as possible to stock up on alcohol, tobacco and petrol from low tax areas, and firms would tend to buy petrol in bulk in low tax areas. This movement of trade towards low-tax areas would handicap traders in high tax areas, and particularly those whose businesses were close to local authority boundaries. It would also tend to weaken the accountability of local authorities to their electorates for their decisions about spending.

4. Local duties would fall on a narrow range of goods and would tax individuals in the population very unevenly - only about 50% of households have a car, for example. They would have to be levied at very high rates to recoup a significant part of the revenue forgone by the abolition of domestic rates. Their yield would be unpredictable, since demand for drink, tobacco and petrol varies more within any given area than other possible tax bases such as, for example, income or total retail sales. This unpredictability would be substantially increased by the effect of cross-border trading between high and low-duty areas.

5. Duties on alcohol, tobacco and petrol are important sources of central government revenue and can be used between budgets, via the regulators, to vary Government income. Their usefulness to the Government would be diminished to the extent that local authorities shared any of their yield or reduced overall demand by imposing supplementary local rates of duty.

6. The Government believes that the problems of accounting, collection, enforcement and financial control rule out local duties on grounds of impracticability for both local authorities and traders.

LOCAL VEHICLE EXCISE DUTY

7. The collection of a local vehicle excise duty would be

expensive and administratively burdensome. Even if the local duty was collected by the Department of Transport's Driver and Vehicle Licensing Centre at Swansea on behalf of the local authorities, its introduction would inevitably give rise to administrative complications and higher costs than the present system. The Centre's computers are being replaced between 1983 and 1985 and a local duty could not be introduced until after that.

8. Accounting and control would present major practical problems. Variable local duties would encourage firms to register company vehicles in low-duty areas, and private motorists would do the same if they could. At present, there is no direct link between the registration of a vehicle and the owner's place of residence. The registration system would have to be changed to introduce such a link in order to prevent the evasion of duties in more highly-taxed areas. (Increased evasion would decrease the reliability of the vehicle register, on which the police rely heavily). The problems of compiling a register based on residence and keeping it up to date would be comparable to those of compiling a poll tax register (see Chapter 5). There would be a shift in the burden of local taxation from the domestic sector to industry and commerce if a local duty applied to goods vehicles and to the two million cars owned by businesses.

9. About a half of all households own cars, so that local vehicle excise duty would tax the local population fairly unevenly. It is hard to see how a duty could be related to the ability of the car-owner to pay: the duty would therefore bear much more heavily on poorer households than on the better-off (except to the extent that wealthier households might own, and pay duty on, more than one car). Some business car-users might, in practice, have the duty paid for them by their employers. This would be seen as unfair by private motorists who paid their duty from their own resources. By tending to cushion some business motorists against the effects of decisions by local authorities about spending, it would also reduce the perceptibility of the tax and the accountability of the local authority to its electorate.

10. The Government considers that vehicle excise duties (whose

present yield is £1,600m, substantially less than half of the yield of domestic rates) could at best do no more than provide a partial replacement for the domestic rating system. Because of this limitation, taken together with the narrow base of the tax and the problems of accounting, accountability, control and enforcement, which it would present, the Government considers that local vehicle excise duty can be disregarded as a possible alternative local tax.

#### CHARGES FOR LICENCES FOR THE SALE OF ALCOHOL OR PETROL

11. It would be possible to impose a tax on any type of premises which had to be licensed for any purpose. There would be a substantial and prohibitive cost in setting up any entirely new licensing system, however. The most widespread existing systems of licensing apply to premises used for the storage of petrol and the sale of alcohol.

#### PETROL

12. In the case of petrol, the main reason for licensing is to ensure its safe keeping: all premises where petrol is stored are licensed, not only those where it is sold. It would therefore be difficult for a licence fee based on the present licensing system to be levied only on premises selling to domestic customers. It is also doubtful whether a system designed for public safety should be used as a base for revenue collection because of the incentive this would give for illegal and potentially unsafe storage. Moreover, such a licensing system would have only a small yield: a flat rate charge of £1,000 for a licence for a year would raise some £130m. For these reasons the Government considers that petrol licensing can be ruled out as an alternative to domestic rates.

#### ALCOHOL

13. About 150,000 premises are licensed for the sale of alcohol: clubs, hotels and restaurants as well as pubs and off-licences. It should be possible to devise practical and enforceable methods of charging but, like petrol licensing, this tax could produce

only a small yield. To yield £150m a year at a flat rate, each retail outlet would have to pay £1,000 a year for its licence. This would be a substantial burden for traders and could raise alcohol prices to the consumer by perhaps [ 4 % ] if it was passed on entirely. Substantially higher tax rates than this would penalise small retailers and could produce other economic distortions and encourage the setting-up of illegal outlets.

14. Although the Government might expect the full cost of the tax to be passed on to consumers, traders would see a licence as a new tax on their businesses in addition to the business rates that they would continue to pay; and would consider that the narrow base of the tax singled them out for unfair treatment. If levied at a flat rate, the tax would affect large traders less than small ones and could affect the competitiveness of the latter. The cost of collection would be high in relation to yield. Although charges might be substantially passed on in consumer prices, marginal charges in licence charges (reflecting local authority budget changes) would seldom be apparent to the consumer. For this reason, licence fees would be largely imperceptible to most of the local electorate and local authority accountability would be affected accordingly.

15. The Government considers that licence charges for premises selling alcohol can be dismissed as an alternative to domestic rates because of their very limited yield, the additional tax burden they would impose on traders, their adverse effect on the competitiveness for small business and their low perceptibility to the consumer.

#### PAYROLL TAX

16. A local payroll tax of [ 4 per cent ] levied on the same basis as the National Insurance Surcharge could raise sufficient revenue to replace local rates, but that would mean replacing a tax on individuals with a new tax on businesses, which would continue to pay non-domestic rates. The Government is concerned that any new local system of taxation should not increase the proportion of the burden borne by industry and commerce. On these grounds alone, the Government considers that payroll tax must be ruled out as

an alternative to domestic rates.

### DEVELOPMENT LAND TAX

17. Development land tax (DLT) with locally variable rates would be a very small and uncertain source of income. The present yield is only some £30m, and that is likely to fall when recent increases in exemption limits work through into receipts. The complexities of the tax would make central administration desirable. The cost would be high in relation to yield.

18. There would be a very narrow class of taxpayers, who would see as discriminatory any significant liability additional to their payment of national development land tax; a local DLT would rank low on grounds of perceptibility and accountability because there would be no material link with the electorate; and the yield for any authority would depend on the level of activity in the local land market, and therefore be extremely unpredictable.

19. The Government considers that these limitations make local development land tax incapable of providing a satisfactory alternative source for a significant part of the revenue raised at present by domestic rates.

### APPENDIX B: FINANCING THE EDUCATION SERVICE

1. Chapter 7 touches upon the possibility of reorganising the distribution of Exchequer grant in support of local authority services. One kind of change would be to pay a high specific grant in support of one service or services, leaving the remainder of the Exchequer grant as an equalising grant to be distributed among local authorities without hypothecation to services. This would require local authorities (and their taxpayers) to meet a much higher proportion of the cost of the remainder of the services than they do at present. Local taxpayers might then be more concerned that their elected representatives sought and obtained proper value for their money, with beneficial results for local authority efficiency.

2. The natural candidate for separate Exchequer grant is the education service - indeed such an arrangement existed until 1958. The education service accounts for about half of all expenditure by local authorities, and it is more than four times the size of any other single local authority service.

3. To put the scope for change in perspective, at present the cost of the education service is borne about equally by local ratepayers and by the block grant. If the Exchequer were to bear the whole cost of the service, the rate of Exchequer grant on the remainder of local authority services might fall to  $\left[ \frac{30}{100} \right]$  per cent or alternatively if sufficient national tax revenue could be spared, local tax bills might be halved. Variations part way along the road would also be possible: for example, a 75 per cent specific grant for education could lower Exchequer support for the remainder of local authority services to  $\left[ \frac{75}{100} \right]$  per cent or allow a 30 per cent cut in rate bills, again assuming that additional tax revenue could be made up elsewhere.

4. There are various possibilities for alternative ways of financing the education service. Only the major alternatives are outlined here.

5. Financial responsibility for the education service could be removed altogether from local authorities. This would involve a radical change from the present position. Central government would become responsible for supplying the funds to support any given level of education expenditure; and would in practice have to determine the budget and monitor the performance of each authority with educational responsibilities. Local accountability, whether by the continuation of the present local authorities' education committees, or otherwise, would have to be reconsidered.

6. Other options would leave some financial responsibility with local authorities while supplying a substantial tranche of central government funds to meet the cost of the education service. One possibility which has been raised from time to time is that central government should become responsible for meeting the cost of teachers' salaries, which currently account for more than half of local authority expenditure on education. It might then be necessary to return the practice of fixing teaching complements centrally, since otherwise the grant would be open-ended. At the same time major areas of responsibility for the education service would remain with the local authority, which would consequently have greatly reduced discretion. In practice the division of responsibilities probably prove unsatisfactory.

7. A further option would be to pay an education "block grant" in support of education expenditure by local authorities. Payment of specific elements of the grant could, if desired, be made conditional on their being devoted to specific items of education expenditure. The cash limit on the grant could be set at a level which was high enough to remove most of the financial burden of the service from local authorities while still retaining a sufficient local financial stake to allow the partnership between central and local government to continue. An assessment could be made of each authority's need to spend, comparable to the grant-related expenditure (GRE) assessment under the present English system. The grant would be paid as a percentage of actual expenditure up to this level, and tapered on expenditure above it.

8. An education block grant regime of the kind outlined in paragraph 7 would have attractions as a means of adjusting the local taxpayer's stake in education services, and of encouraging a greater degree of consistency in standards of educational provision across the country. There would, however, be considerable advantages involving an hypothecated grant for education would reduce the freedom of local authorities have at present to determine their own spending priorities. The grant for government services: it would also require an increase in central government expenditure probably without any offsetting reduction in local authority staff.

### APPENDIX C: THE DISTRIBUTIONAL EFFECTS ON HOUSEHOLDS OF ALTERNATIVES TO DOMESTIC RATES

This annex sets out in greater detail the assumptions and methodology used in calculating distributional effects of alternative taxes summarised in Chapter 12, together with a fuller account of the distributional effects by tax, by region and by household type.

2. The effects on a particular household of a change to an alternative local tax will depend particularly on the composition of the household, its income level, the number of earners, the number of adults and whether it resides in a high or low rate poundage area.

#### Assumptions

3. To provide these illustrative effects of the change to the alternative taxes (a local income tax, a local sales tax or a poll tax) some broad assumptions have been made about the form of these taxes. It has been assumed that the LST will be a tax on all retail sales liable to VAT (thus restricting its coverage to around a half of total consumer expenditure). LIT is assumed to be a flat-rate addition to all rates of tax levied on the whole of a household's taxable income (which is calculated as for national income tax). Poll tax is assumed to be paid at the specified rate by all persons aged 18 and over, without any exemptions.

4. The local tax rates are set for England, Scotland and Wales at levels which would yield approximately the same revenue (in 1981/2) as domestic rates in each country. They are based on (somewhat rough) estimates of the alternative tax yields in each country.\* Thus house-

\* The LST rate makes some allowance for the possibility that households may switch expenditure away from taxed goods and services, thus eroding the tax base.

holds in each country would as a whole be paying about the same in the alternative local taxes as they pay in domestic rates. There is no redistribution between households as a whole in England and households in Scotland or Wales, though some household types may fare better or worse in one country than another if rates are replaced by an alternative local tax.

5. There may however be significant redistributions between local authority areas within a country due to the exchequer support grant arrangements. A change in the tax base would redistribute central government grant and change the tax burden on households in some areas. Local variation in rate poundages will also be reflected in the rates at which alternative taxes are levied. It has not been possible to analyse this element of distribution between local authority areas, though a broad distinction is made in the figuring between London and the South East and the Rest of England.\*\* Thus households in Scotland, Wales and the two 'regions' of England are treated as 'typical' of the country or region as a whole, though in practice households in some parts of a country may fare less well than similar households in other parts of a country.

6. The calculated rates of income tax, sales tax and poll tax have been expressed, respectively, to the nearest 1p, 1% and 11 pph head per annum. These tax-rates may thus be seen as illustrative of the sort of local tax-rates that might be faced, on average, in an area. For 1981-82, the rates at which the new taxes would have to be levied to approach revenue neutrality are:-

\*\* The tax rates are set in proportion to rate poundages in these two broad regions of England.

|          | Wales  | Scotland | London and SE | Rest of England |
|----------|--------|----------|---------------|-----------------|
| LIT      | 4½p    | 5½p      | 5p            | 5p              |
| IST      | 5½%    | 7%       | 7%            | 7%              |
| Poll Tax | £77 pa | £117 pa  | £118 pa       | £121 pa         |

The lower than average tax rates that would need to be imposed in Wales reflect the lower level of rate payments in Wales relative to the rest of Great Britain.

7. Apart from the replacement of domestic rates, it is assumed that there is no further change to the taxation system, nor to the overall level of exchequer support grant. The alternative local tax arrangements considered here do not include any mechanism to provide assistance to low-income households.

#### Method

8. As outlined in paragraph 2 of this annex, the distributional effects will vary with a number of household characteristics. The approach adopted is to set up a number of household types which differ in composition, income etc and for each of these households, to estimate its gain from the abolition of rates, its loss from the imposition of each of the alternative taxes, and its overall gain/loss from these two changes, expressed as a percentage of the household's net income.

9. The household types are described in Table 1. Three income levels were used for each household type in the main analysis: <sup>2/3</sup> average and 1½ times regional average earnings. This range of incomes covers the big majority of households.\*

10. The household types used are representative abstractions with stylised, though typical, patterns of expenditure at the assumed income level. At any given income level, there will be households

\* [It should be noted that pensioner householders on these income levels are relatively well-off for households of this type.]

who will gain more or less than the representative household, or because their rates payments are larger or smaller than those used, or because their expenditure pattern is different. It is not possible to infer from the gains or losses of the representative household the number of households that would gain or lose from the switch to a particular local tax.

11. The calculation of the overall gain/loss of a household shows only the 'impact' effect of the change to an alternative tax. A household may well adjust its behaviour in response to the new tax, eg buy fewer goods that bear LST, but this is not allowed for.

12. Table 1 gives the initial incomes (at estimated 1981/2 levels) and the tax allowances of the various representative household types.

From these, the household's taxable income can be calculated, and hence using the rates of LIT from paragraph 10 its liability for LIT. This approach may overestimate taxable income and LIT payments since other tax allowances eg mortgage interest relief, and work expenses are not included. The household's net income is the denominator for the comparisons is calculated by deducting both income tax and contracted-in National Insurance contributions from the gross household income and adding any child benefit.

13. Payments of poll tax are determined by the number of adults in the representative household (from Table 1) multiplied by the appropriate tax per head from paragraph 8.

14. The Family Expenditure Survey (FES) provides information on a large number of households over the range  $2/3$  to  $1\frac{1}{2}$  times average earnings, and data from this source were used to estimate rate and VAT payments (at 81/82 levels) for each household type, and each region, at different income levels. Rate payments vary widely for a given income level, so that the use of 'average' rate payments will mean that the range of gains/losses shown here for the representative household will understate the true variation in all comparisons.

VAT payments also vary somewhat for a given income level, and as LST payments are derived from the estimated VAT payments this understates the range of gains/losses under LST.

15. This approach is not satisfactory for households with incomes above about  $1\frac{1}{2}$  times average earnings because of data limitations, and they have not been considered. Such households are a small proportion of the total number of households.

#### Low Income Households

16. For households on SB, and with low incomes, a modified version of the main approach was

used. Two groups of low-income households were considered: those on SB, and those not on SB, but with gross income (including benefit income) up to and <sup>including</sup> half the national male average earnings. For each of these groups a limited number of household types were chosen:-

- 1 adult, retired
- 2 adults, retired
- 1 adult, not retired
- 2 adults, not retired
- 2 adults, with children
- 1 adult with children

17. Data on household incomes from the 1978 and 1979 FES was updated in line with national trends to give a sample of households of each household type for each region for both SB, and low-income households. Within each household type and region, average payments of rebated rates, LST, LIT and poll tax (at 81/82 levels) were calculated, and the overall gain/loss expressed as a percentage of new household income.

18. The gain to these households from the abolition of rates was limited to the net rebated rate payments; for SB households this was assumed to be zero, as housing costs are met by SB payments. <sup>18</sup> SB households were assumed to pay no income tax so they would be unaffected by the replacement of rates by LIT. In other cases, it should be remembered that the new local taxes do not include any scheme of assistance to low income households.

19. Given the small sample sizes on which the overall gains/losses are based, the results on low income households in Table 3 should be treated with considerable caution and be seen as indicating direction rather than precise magnitude.

### Results

20. Results for a selection of representative household types with incomes of  $\frac{2}{3}$ , 1 and  $1\frac{1}{2}$  times average earnings are shown in Table 2. This gives their overall gain/loss from the replacement of rates by each alternative tax expressed as a percentage of household net income. It should be remembered that the overall gain/loss is based on an 'average' rate payment for the household type and income level. Particular households may gain or lose more or less than is shown in the tables for that household type.

21. Figures 1 to 4 give a diagrammatic presentation of the material for a slightly different selection of households, for each region. Here the vertical lines link, for each representative household, the overall gain/loss at  $\frac{2}{3}$  average earnings, (denoted by a dash) with the gains/losses at average earnings (a white spot) and  $1\frac{1}{2}$  times average earnings (an arrowhead). Where the arrowhead points down the page, the change to the alternative tax is 'progressive'; the length of the line gives an indication of how progressive the change is, (the longer the line the greater the progressivity).

### Local Sales Tax

22. Payments of VAT tend to increase rather more than proportionately to household income while rate payments increase less. Replacing domestic rates by a local sales tax on goods and services subject

to VAT thus makes local taxation more progressive.

Households on  $1\frac{1}{2}$  times average earnings gain less (or lose more) than households on  $\frac{2}{3}$  average earnings. [See table 2]. The number of children in the household make little difference to the proportionate gain or loss. (Compare, for example, representative household type 4 with 6 and 8, or 5 with 7 and 9).

23. Most representative households at the bottom end of the income range however lose substantially. Rate payments are low because of rebates or supplementary benefit receipts, so that they gain little from the abolition of rates, while paying more on taxed goods.

### Local Income Tax

24. Since income tax is even more progressive than VAT, replacing rates by a local income tax will tend to give a wider range of gains/losses between lower and higher income households than the local sales tax. Given the way the allowances have been calculated, the number of children again makes little difference to the pattern of gains and losses.

25. At the bottom end of the income scale, households not on supplementary benefit may gain (though both their rate payments and income tax payments are likely to be small). The illustrative households on supplementary benefit are not affected since they are assumed to pay neither rates nor income tax.

26. It will be noted that the range of gains and losses shown in Table 2 and Figures 1-4 are centred below the zero level. This is a consequence of the method of comparison and reflects some of its limitations.\* The results do not of course mean that households

\* The representative households chosen do not cover the whole of the income distribution and the tables do not show how many households there are of each type. In the case of the local income tax calculation because some allowances against tax (eg on mortgage interest, work expenses) are not taken into account, the taxable income, and hence liability to LIT, calculated here is higher in relation to rate payments, than a more accurately 'representative' calculation would show. Such a calculation would require more detailed estimates of tax allowances, by region, by household type and income level.

as a whole would be worse off if rates were replaced by local income tax rather than by a sales or poll tax. The tax rates used in the calculations are chosen to yield approximately the same revenue as the local rates, so that, in total, households are paying the same amount of tax under all regimes.

#### A Poll Tax

For the purpose of this analysis, it is assumed that

27. /a poll tax would be levied on all adults in the household irrespective of income. For any given household type therefore the poorer households would pay a higher proportion of their income in tax than the richer. Moreover, since domestic rates increase with income - though less than proportionately - replacing rates by a poll tax will mean that the richer households gain more or lose less (in £/wk) than the poorer households of the same type. But that in some circumstances, the gain to a poorer household may be larger in relation to its income than the gain to a richer household of the same type, even though the gain in £/wk is less. (See for instance the percentage gains and losses for 'representative' single adult/earner households in Table 2). Thus the switch from rates to poll tax may be 'progressive' for some household types though regressive for most.\*

28. Figures 1-4 suggests that (within the limitations of the method of comparison used here) the range of gains and losses for each of the various representative household types is smaller, when rates are replaced by a poll tax rather than a local sales or income tax. A poll tax thus alters the progressive/regressive balance of taxation less than a local income or sales tax.

\* Whether richer households as a whole would pay a lower proportion of their income in poll taxes than poorer households (the 'overall' regressivity of the tax at household level) depends on the relation between household income and the income of adults. The results here do not show the 'overall regressivity' since the income levels used are imposed for purposes of illustration only.

29. Not surprisingly, the 'representative' households with many adults tend to lose and single adult households to gain. The notable exception here is households at the bottom end of the income range who save little on rates (because these are rebated or covered by supplementary benefit) but become liable for poll tax at the full rate, and whose losses may be as much as 10 per cent of their net income, (in the absence of any relief for low-income households).

#### Redistribution between areas

30. As mentioned in paragraph 5, the illustration of the effects of redistribution within a country is limited here to two regions within England. This redistribution arises because the new tax bases are each in a different ratio to rateable value, and secondly, because tax-rates will in principle differ between areas. Only the first of these effects is shown here for LIT and LST, since the differences in tax-rates is lost in the rounding. For poll tax, it has been possible to distinguish different rates for London and the South East and the Rest of England, so that both effects are shown in the calculations.

31. The comparison of London and the South East with the Rest of England shows that for LST and LIT, households in London and the South East have on average greater overall gains (or smaller losses) than households in the Rest of England, [though at 1½ times average earnings differences are small]. For poll tax households in London and the South East again show higher gains and, in addition, the poll tax tends to be less regressive than for equivalent households in the Rest of England.

| HOUSEHOLD TYPE | COMPOSITION                                    | DEFINITION OF AVERAGE EARNINGS  | OTHER INCOME | PERSONAL ALLOWANCES  |
|----------------|--|---|--------------|--|
| 7              | Two adults, *<br>two earners<br>1-2 children   | As for 5  | CB x 2       | As for 5   |
| 8              | Two adults, *<br>single earner<br>3 + children | As for 3  | CB x 4       | As for 4   |
| 9              | Two adults, *<br>two earners<br>3 + children   | As for 5  | CB x 4       | As for 5   |
| 12             | Three or more adults<br>three or more earners  | 2 x regional average male earnings <u>plus</u> regional average full-time female earnings | Nil          | Married couple's allowance <u>plus</u> 2 x single person's allowance [£2145 + (2 x £1375) = £4895] |

\* The tax allowances for two-adult households are based on the assumptions that they consist of a married couple, and that if there is only one earner, it is the husband.

| HOUSEHOLD TYPE | COMPOSITION                                    | DEFINITION OF AVERAGE EARNINGS  | OTHER INCOME                                     | PERSONAL ALLOWANCES OFFSET-TABLE AGAINST INCOME TAX AVAILABLE TO HOUSEHOLD   |
|----------------|--|---|--|--|
| 1              | Single adult retired (pensioner)               | Regional average male earnings.<br><br>NB: This is well above the average income for single pensioner households as a whole   | NIL  | Single age allowance of £1820 reducing by £2 for every extra £3 of income above £5900 pa to single allowance £1375             |
| 2              | Two adults retired (pensioner)                 | Regional average male earnings plus dependent adult's (wife's) retirement pension.<br>NB: This is well above the average income for two-pensioner households as a whole | NIL  | Married couple's age allowance of £2895, reducing by £2 for every extra £3 of income above £5900 pa to married allowance £2145 |
| 3              | Single adult earner                            | Regional average male earnings  | NIL  | Single person's allowance  |
| 4              | Two adults, *<br>single earner                 | As for 3  | NIL  | Married couple's allowance   |
| 5              | Two adults two earners                         | Regional average male earnings <u>plus</u> regional average fulltime female earnings  | NIL  | Married couple's allowance <u>plus</u> single person's allowance   |
| 6              | Two adults, *<br>single earner<br>1-2 children | As for 3  | Child benefit (CB) (non-taxable)<br>£5.25 pw x 2 | As for 4   |

TABLE 2 CONTINUED

|                         | 7  |         |         | 8   |         |         | 9   |         |         | 12   |         |         |
|-------------------------|--|---------|---------|---|---------|---------|---|---------|---------|--|---------|---------|
|                         | Two adults, both working<br>1-2 children |         |         | Two adults, one earner,<br>3 or more children |         |         | Two adults, both earning,<br>3 or more children |         |         | Three or more adults,<br>three or more earners |         |         |
|                         | £  | AVERAGE | 1½ AVER | £   | AVERAGE | 1½ AVER | £   | AVERAGE | 1½ AVER | £  | AVERAGE | 1½ AVER |
| <u>LOCAL SALES TAX</u>  |  |         |         |   |         |         |   |         |         |  |         |         |
| LONDON & S. EAST        | 1.1                                      | -0.1    | -1.0    | 3.3   | 1.8     | 0.4     | 1.2   | 0.2     | -0.5    | -0.5   | -1.6    | -2.2    |
| REST OF ENGLAND         | 0.3                                      | -0.8    | -1.7    | 1.9   | 1.0     | 0.2     | 0.4   | -0.5    | -1.3    | -1.1   | -2.1    | -2.7    |
| SCOTLAND                | 0.7                                      | -0.7    | -1.7    | 2.2   | 0.9     | -0.3    | 0.4   | -0.8    | -1.7    | -0.6   | -2.1    | -3.0    |
| WALES                   | -0.1                                     | -0.7    | -1.1    | 1.3   | 0.3     | -0.6    | -0.3  | -0.8    | -1.2    | -1.1   | -1.8    | -2.2    |
| <u>LOCAL INCOME-TAX</u> |  |         |         |   |         |         |   |         |         |  |         |         |
| LONDON & S EAST         | 0.2                                      | -1.7    | -3.2    | 2.2   | -0.1    | -1.9    | 0.4   | -1.5    | -3.0    | -1.7   | -3.3    | -4.5    |
| REST OF ENGLAND         | 0.0                                      | -2.0    | -3.5    | 1.4   | -0.6    | -2.2    | 0.1   | -1.8    | -3.4    | -1.9   | -3.4    | -4.7    |
| SCOTLAND                | -0.2                                     | -2.4    | -4.2    | 1.6   | -0.8    | -2.7    | -0.2  | -2.3    | -4.0    | -1.9   | -3.9    | -5.5    |
| WALES                   | -0.9                                     | -2.2    | -3.2    | 0.5   | -1.2    | -2.6    | -0.8  | -2.0    | -3.0    | -0.8   | -3.4    | -4.4    |
| <u>POLL-TAX</u>         |  |         |         |   |         |         |   |         |         |  |         |         |
| LONDON & S EAST         | 0.9                                      | 0.9     | 0.9     | 1.0   | 1.0     | 1.0     | 0.9   | 1.0     | 1.0     | -0.4   | -0.1    | 0.1     |
| REST OF ENGLAND         | -0.3                                     | 0.0     | 0.2     | -0.8  | -0.3    | 0.2     | -0.2  | 0.0     | 0.2     | -1.5   | -0.8    | -0.4    |
| SCOTLAND                | 0.1                                      | 0.2     | 0.3     | 0.2   | 0.3     | 0.4     | 0.1   | 0.2     | 0.3     | -0.8   | -0.6    | -0.5    |
| WALES                   | -0.2                                     | 0.3     | 0.6     | -0.1  | 0.1     | 0.2     | -0.1  | 0.3     | 0.7     | -0.8   | -0.4    | -0.1    |

REGISTRATION FEES

WAGES AND SALARIES AND PAY BY THE WEEK

|                         | 3                   |         |         | 4                      |         |         | 5                        |         |         | 6                                       |         |         |
|-------------------------|---------------------|---------|---------|------------------------|---------|---------|--------------------------|---------|---------|---|---------|---------|
|                         | Single adult earner |         |         | Two adults, one earner |         |         | Two adults, both earning |         |         | Two adults, one earner,<br>1-2 children |         |         |
|                         | £                   | AVERAGE | 1½ AVER | £                      | AVERAGE | 1½ AVER | £                        | AVERAGE | 1½ AVER | £                                       | AVERAGE | 1½ AVER |
| <u>LOCAL SALES TAX</u>  |                     |         |         |                        |         |         |                          |         |         |   |         |         |
| LONDON & S. East        | 2.5                 | 0.2     | -0.9    | 3.8                    | 2.1     | 0.7     | 0.7                      | -0.8    | -1.8    | 3.6                                     | 1.8     | 0.4     |
| REST OF ENGLAND         | 2.0                 | -0.4    | -1.5    | 2.4                    | 0.9     | -0.3    | -0.1                     | -1.1    | -1.9    | 2.6                                     | 1.0     | -0.4    |
| SCOTLAND                | 0.9                 | -0.6    | -1.6    | 2.3                    | 1.4     | 1.7     | -0.2                     | -1.2    | -1.9    | 1.6                                     | 1.0     | 0.2     |
| WALES                   | 1.4                 | 0.3     | -0.2    | 1.5                    | 0.0     | -1.1    | -0.7                     | -1.2    | -1.6    | 1.8                                     | 0.6     | -0.5    |
| <u>LOCAL INCOME TAX</u> |                     |         |         |                        |         |         |                          |         |         |   |         |         |
| LONDON & S EAST         | 0.2                 | -2.0    | -3.8    | 2.5                    | -0.3    | -2.3    | 0.1                      | -2.3    | -3.8    | 2.2                                     | -0.2    | -2.1    |
| REST OF ENGLAND         | -0.1                | -2.1    | -3.9    | 1.5                    | -1.0    | -2.8    | -0.2                     | -2.3    | -3.9    | 1.8                                     | -0.6    | -2.5    |
| SCOTLAND                | -1.3                | -3.0    | -4.8    | 0.8                    | -1.5    | -3.2    | -0.9                     | -2.8    | -4.3    | 1.3                                     | -0.1    | -2.8    |
| WALES                   | -0.9                | -2.5    | -4.0    | -0.1                   | -2.0    | -3.4    | -1.2                     | -2.8    | -4.0    | 0.5                                     | -1.4    | -2.9    |
| <u>POLL-TAX</u>         |                     |         |         |                        |         |         |                          |         |         |   |         |         |
| LONDON & S EAST         | 2.5                 | 1.8     | 1.4     | 0.9                    | 1.0     | 1.0     | 0.6                      | 0.5     | 0.5     | 0.8                                     | 0.9     | 1.0     |
| REST OF ENGLAND         | 1.5                 | 1.2     | 1.0     | -1.4                   | -0.7    | -0.2    | -0.5                     | -0.2    | 0.0     | -0.7                                    | -0.3    | -0.0    |
| SCOTLAND                | 1.1                 | 1.0     | 1.0     | -1.1                   | -0.3    | 0.3     | -0.5                     | -0.0    | 0.3     | -0.4                                    | 0.1     | 0.5     |
| WALES                   | 1.5                 | 1.1     | 0.9     | -0.8                   | -0.4    | -0.1    | -0.5                     | -0.2    | 0.0     | -0.2                                    | 0.0     | 0.2     |

# FIG. 1 LONDON & S. EAST

E.R.

LOCAL

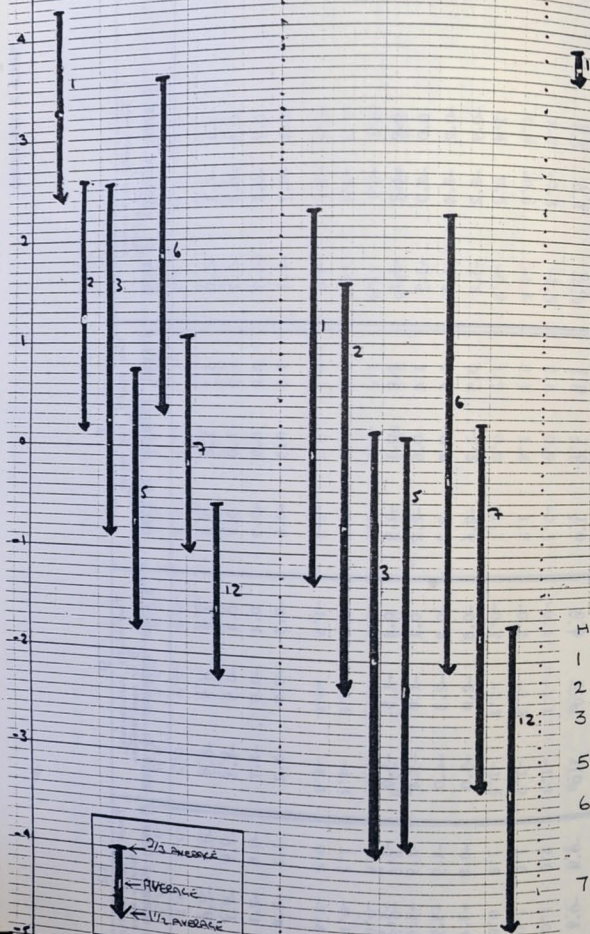
SALES-TAX

Gain/Loss as %  
of net household income

LOCAL

INCOME-TAX

POLL-TAX



HOUSEHOLD TYPES

- 1 SINGLE PENSIONER
- 2 TWO PENSIONERS
- 3 SINGLE ADULT (EARNER)
- 5 TWO ADULTS BOTH EARNERS
- 6 TWO ADULTS (EARNER) WITH ONE OR TWO CHILDREN
- 7 AS 5 WITH ONE OR TWO CHILDREN
- 12 THREE OR MORE EARNERS

# FIG. 2 REST OF ENGLAND

LOCAL

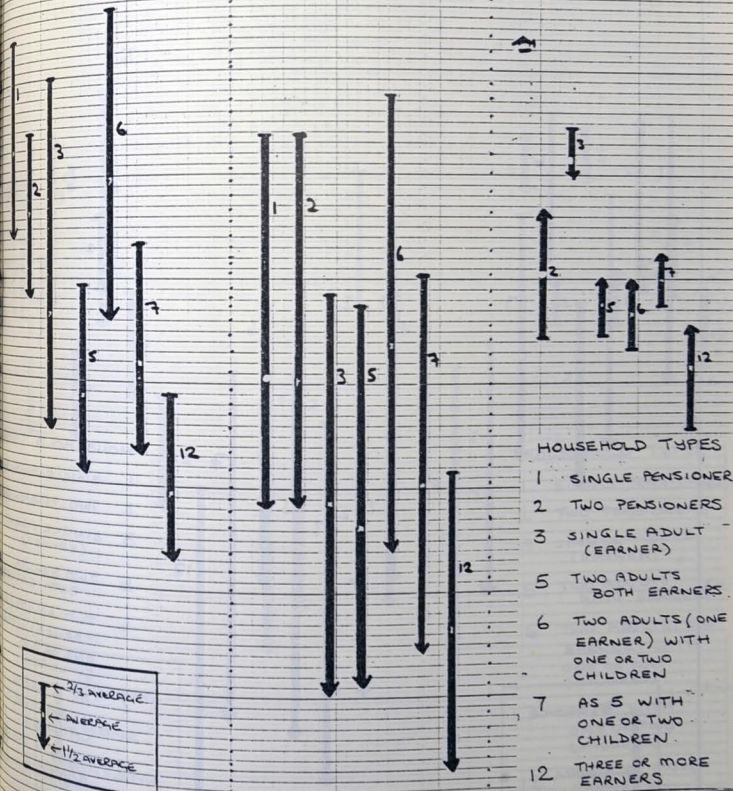
SALES-TAX

Gain/Loss as %  
of net household income

LOCAL

INCOME-TAX

POLL-TAX

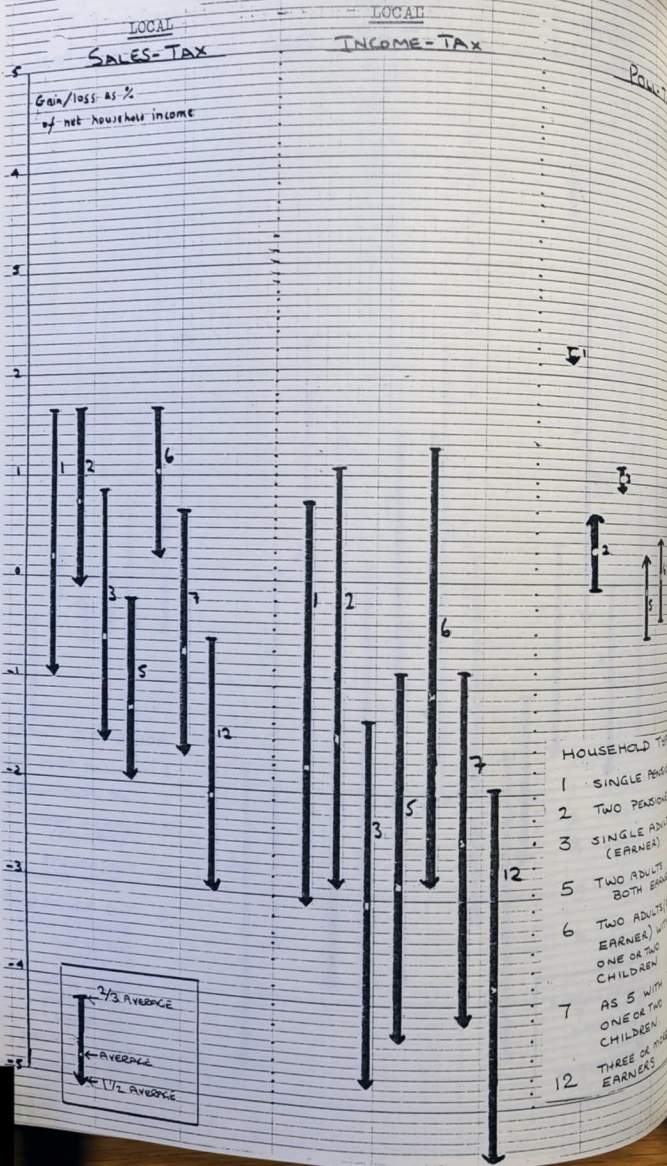


HOUSEHOLD TYPES

- 1 SINGLE PENSIONER
- 2 TWO PENSIONERS
- 3 SINGLE ADULT (EARNER)
- 5 TWO ADULTS BOTH EARNERS
- 6 TWO ADULTS (ONE EARNER) WITH ONE OR TWO CHILDREN
- 7 AS 5 WITH ONE OR TWO CHILDREN
- 12 THREE OR MORE EARNERS

# FIG. 3 SCOTLAND

E.R.



# FIG. 4 WALES

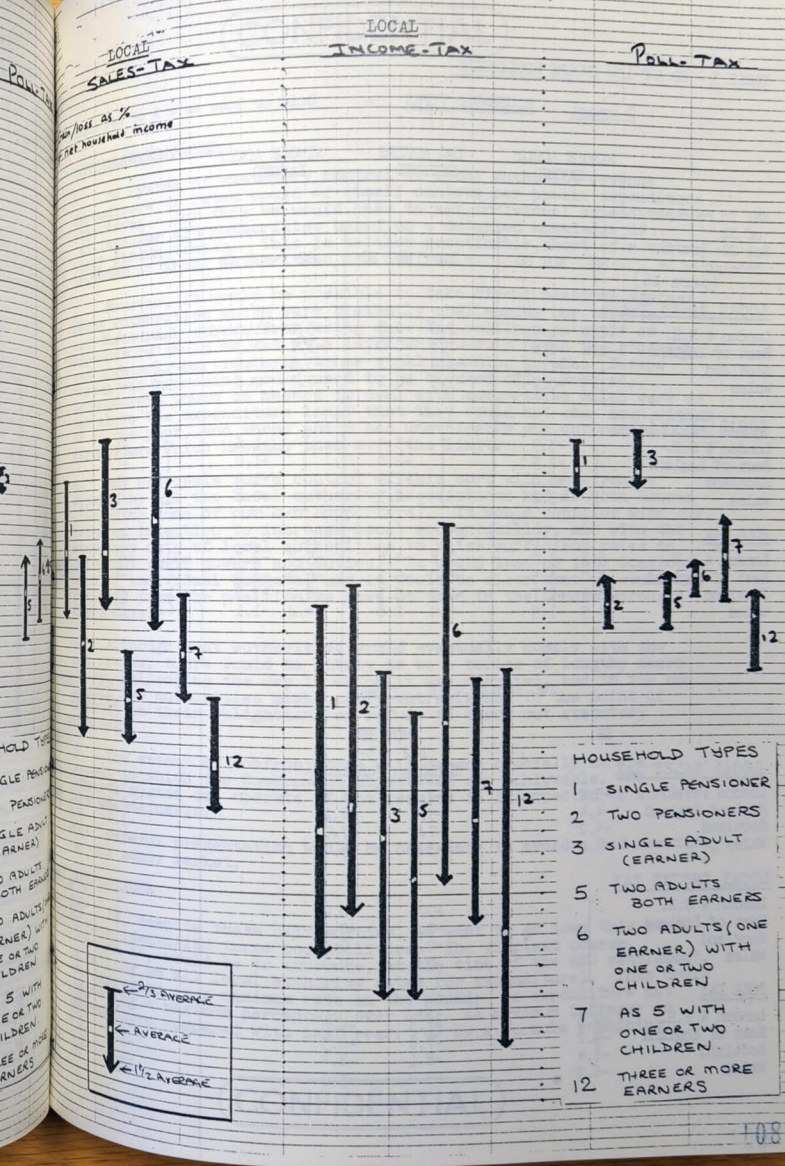


TABLE 3 - SB AND LOW INCOME HOUSEHOLDS

HOUSEHOLD TYPES

Gain or loss as a % of net income

SINGLE ADULT  
RETIRED

TWO ADULTS  
RETIRED

SINGLE ADULT  
EARNER

TWO ADULTS

SB: in receipt  
of SB  
Not SB: not in  
receipt of SB  
(para 16)

SB NOT SB

SB NOT SB

SB NOT SB

SB NOT SB

LOCAL SALES TAX

|                 |      |      |      |      |      |      |      |      |
|-----------------|------|------|------|------|------|------|------|------|
| London & S.E.   | -1.9 | +1.9 | -2.0 | +0.6 | -3.0 | -1.0 | -6.0 | -4.8 |
| Rest of England | -1.6 | +0.8 | -1.8 | +0.0 | -3.1 | -1.3 | -6.0 | -3.9 |
| Scotland        | -1.6 | +1.2 | -1.9 | -0.1 | -3.8 | -0.6 | -5.8 | -3.9 |
| Wales           | -1.3 | +0.2 | -1.5 | +0.1 | -2.3 | -0.6 | -3.9 | -3.1 |

LOCAL INCOME TAX

|                 |      |  |      |  |      |  |      |  |
|-----------------|------|--|------|--|------|--|------|--|
| London & S.E.   | +3.9 |  | +3.4 |  | +1.6 |  | +1.9 |  |
| Rest of England | +2.9 |  | +2.8 |  | +1.0 |  | +1.1 |  |
| Scotland        | +3.0 |  | +2.9 |  | +1.4 |  | +1.1 |  |
| Wales           | +2.2 |  | +2.3 |  | +0.8 |  | +1.0 |  |

POLL TAX

|                 |      |      |      |      |      |      |       |      |
|-----------------|------|------|------|------|------|------|-------|------|
| London & S.E.   | -6.8 | -3.0 | -7.8 | -4.6 | -5.8 | -2.7 | -10.5 | -8.2 |
| Rest of England | -7.0 | -3.5 | -8.0 | -5.3 | -6.9 | -3.8 | -12.1 | -8.7 |
| Scotland        | -6.9 | -2.7 | -7.5 | -5.1 | -8.2 | -3.2 | -11.2 | -9.1 |
| Wales           | -4.5 | -1.9 | -5.0 | -2.8 | -4.2 | -1.1 | -6.3  | -5.3 |

TWO ADULTS, WITH CHILDREN

SB

NOT SB

1-2 children 3+ children

LOCAL SALES TAX

|                 |      |      |      |
|-----------------|------|------|------|
| London & S.E.   | -5.2 | -4.4 | -6.6 |
| Rest of England | -4.4 | -5.8 | -6.2 |
| Scotland        | -4.2 | -7.1 | -7.0 |
| Wales           | -4.2 | -3.5 | -5.2 |

LOCAL INCOME TAX

|                 |      |  |      |  |
|-----------------|------|--|------|--|
| London & S.E.   | +0.8 |  | 0.0  |  |
| Rest of England | +0.4 |  | +0.2 |  |
| Scotland        | +0.0 |  | 0.0  |  |
| Wales           | +0.8 |  | 0.0  |  |

POLL TAX

|                 |      |      |      |
|-----------------|------|------|------|
| London & S.E.   | -9.5 | -7.3 | -9.0 |
| Rest of England | -9.2 | -7.8 | -8.3 |
| Scotland        | -8.4 | -8.1 | -8.4 |
| Wales           | -6.9 | -5.2 | -5.9 |

SINGLE PARENT  
HOUSEHOLD

SB NOT SB

|      |      |
|------|------|
| -3.5 | -5.1 |
| -2.9 | -4.1 |
| -3.4 | -5.5 |
| -2.7 | -3.5 |

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Annex C

CONTROL OVER RATES

1. No system of statutory control of local authority revenue expenditure or rates could of itself achieve our public expenditure objectives - for this we would need to set individual expenditure ceilings for 413 authorities based on a detailed knowledge of their circumstances. This is neither practicable, short of a virtual takeover of local authorities, nor desirable.

2. However, it would be possible to take direct measures against those authorities which were blatantly challenging our targets, and discourage others from doing so. The ceilings on rates or expenditure could be set at a level which would catch the grossest overspenders, particularly those still planning growth. Escape routes via borrowing would need to be blocked off. Even so, arrangements would be needed to deal with authorities which were so far above the expenditure limit that they could not come down within it in one year, and those which had unavoidable and unforeseen expenditure which brought them over the limit.

3. Any proposals for a control of this sort will be strongly opposed by all the local authority associations and in both Houses (including some of our own supporters). It would conflict with our declared intention to increase local accountability, and with the statutory duty of local authorities to raise sufficient rates to carry out their powers and duties. It could lead us into consideration of individual budgets, and it would be clear that we would be resiling from the position we have adopted in the London Boroughs Court Case.

4. Although most authorities would eventually comply with the new system, there would be likely to be a series of lengthy court cases challenging the way in which it was operated, and in the end one or two authorities might carry intransigence to the point of default on their obligations or refuse to carry out statutory duties.

5. The extent of confrontation will depend crucially on the extent to which the Government objectives are achievable. No control system can operate if the results it is expected to achieve are unattainable.

6. Careful presentation would be necessary to avoid a bad reaction by the money market.

THE OPTIONS

7. If, despite these difficulties, we want to go down this road, I have identified three possibilities. The simplest course, 'Option A', would be to announce, at the time of the RSG settlement, a ceiling on all local authority rates (or expenditure). This could be expressed as a maximum rate in the pound; as expenditure not exceeding a maximum percentage over GRE; as maximum increase in expenditure compared with last year; or by a formula combining

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growth and absolute level of expenditure. (But it would not be sensible to operate on rate poundage increase alone, at least until the distributional effects of the new block grant system had settled down.)

8. Since such a ceiling would be set before we had any knowledge of individual expenditure plans, it would be bound to be somewhat arbitrary in effect and there would be many claims for exemption, which would require detailed scrutiny of budgets. This procedure would unite local authorities in opposition at an early stage.

9. Option 'B' would seek to defuse the opposition by allowing authorities the maximum time to reconsider their positions. A limited number, selected on the basis of past performance, would be required to submit draft budgets in advance, on the basis of which we would set rate or expenditure ceilings (as for Option 'A'). If they did not revise their budgets accordingly, I would impose a 6 month interim rate, and invite them to commission an independent inquiry into their budget. I would then hope to agree a budget for the full year with the Council on the basis of this inquiry, but if it still proved impossible to reach agreement I would have power to determine the rate for the rest of the year.

10. Option 'C' is a variant of 'B'. There would be a pre-selection of authorities, and ceilings chosen in the knowledge of their budget proposals. But in March I would impose a rate for the full year, instead of a 6-month interim rate. The onus would then be on an authority to demonstrate, by an independent inquiry, its case for a higher level which, if I agreed, would necessitate a supplementary rate.

11. The public expenditure gains of any of these options would be uncertain and would depend on the levels at which ceilings were set. Lower ceilings would increase the potential gains but also the number of authorities with whom we would be in direct confrontation. The choice of option would probably not make a significant difference to the authorities directly affected, but other authorities would be more likely to continue cooperating if the Government adopted the least confrontational approach.

12. Option B, which would limit the number of authorities directly involved, would provide them with the most opportunity to adjust their budgets and would enable us to demonstrate that we were being reasonable and taking into account local circumstances on the basis of the independent inquiry, seems the best course.

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