

## A POOR TAX

### REFORMING COUNCIL TAX IN LONDON - FINAL REPORT

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## 60-SECOND SUMMARY

**The current council tax system in London is unfair. The tax could be a sustainable means of funding local government services while also functioning as a progressive tax on property wealth. However, at present it is highly regressive in relation to property value as well as representing an unduly large burden in terms of income for poorer Londoners. It is economically inefficient particularly because of its banding system, reliance on considerably outdated property prices and the inconsistencies between it, and commercial property taxation. Furthermore, it is increasingly unsustainable as a source of local government finance, a trend which is only set to continue.**

In this paper, we set out the case for change of the council tax system in London. We outline some of the views of those who live in the capital and pay council tax in the system as it is, and how they would like to see it change. We also set out some key lessons from abroad on how our system compares.

We propose major reform of the system in three stages. First, the devolution of council tax to the capital. Second, we argue for some immediate reforms to the system to protect the poorest Londoners, who are being hit by a tax that increasingly resembles the poll tax. Third, in the longer term, we argue for the replacement of the existing banding system with a proportional property tax, with one rate, to be applied across London, which should be calculated on up-to-date property values. Finally, we set out some key strategies to help overcome some of the difficult issues and barriers to reform.

Such a system would be fairer, more efficient, and in addition could be used to raise revenues in a way that is fairer and more politically acceptable than the current system.

### KEY FINDINGS

The council tax system is increasingly regressive with regard to property value and is therefore unfair. We also highlight the spatial inequalities that exist in the capital with substantial differences in what is charged in different areas of London.

The council tax system takes too little account of ability to pay and is therefore unfair. Accounting for council tax support, the burden of council tax on London's poorest households is more than six times greater (8.1 per cent) than on those in the highest decile (just over 1.3 per cent).

The council tax system is inefficient. We expose the inefficiencies of the council tax system including its reliance on outdated property prices, discounts and exemptions and the inconsistencies between residential and commercial taxation.

Council tax is increasingly unsustainable. Council tax is becoming ever more important as a source of local government revenue, but its sustainability is undermined by its lack of fairness and its inefficiencies.

There is public appetite among Londoners for reform. The public recognise many of the flaws in the council tax system and want to see change.

There are some key lessons to learn from property and local taxation systems abroad, including strategies for reform. The UK is exceptional in that, among OECD countries, it has the second highest proportion of GDP taken in property taxes and the largest proportion of property tax revenue collected by central government for its own use. The UK also has a relatively high proportion of taxation, close to half, levied on residential property. The updating of property values for the purposes of taxation presents issues internationally, but the English system is extreme in relying on property values that are nearly 30 years out of date.

The political barriers to reform in England are high. These barriers include: previous experience with reform of property taxation; the visibility of council tax and the means of payment; the fact that the 'losers' from any reform are likely to be far more vocal than the 'winners'; there is low awareness of what services council tax pays for at a local level and bills have been rising while overall spending has been falling; and the likely need for reform to move slowly, that is over more than one parliamentary term, which is limiting. Also, the long period since the creation of the system and its valuation base being set means there would be elements of retrospection if there were a sudden attempt to modernise it.

## KEY RECOMMENDATIONS

To address the challenges identified in this and our interim report, we propose a phased approach to reforming the council tax system in London, with three key stages.

### **Stage 1: Devolve council tax to London**

The case for reforming council tax is overwhelming and there is a compelling argument for overhauling the system across England, not just in London. However, there is a clear case for a customised and piloted solution in the capital due to London's unique housing market, the overly centralised system in the UK and because the public are more likely to support a subnational approach. Meanwhile London also has higher levels of poverty and inequality than the rest of England, making some of the impacts more acute. Any impacts of reform would be contained within London.

**Recommendation:** The government should commit, as part of the comprehensive spending review, to devolve the council tax system to London.

### **Stage 2: Protect those on low incomes**

Once the council tax system has been devolved to the London level, there is a case for fundamental reform of the system. However, such reforms will take time to review, consult and achieve consensus on. In the meantime, we propose some immediate steps to address some of the system's biggest injustices. It could also be possible for these reforms to take place without the devolution of the whole system to the capital.

**Recommendation:** A capital-wide council tax benefit system should be introduced to support London's poorest and most vulnerable. This could be funded partially by the revenue raised through additional council premiums on empty and second homes (below) and additional grant from central government.

**Recommendation:** Council tax exemptions for empty and second homes should be abolished and a council tax premium should be introduced for a) all empty homes at a level of 200 per cent (twice the council tax rate), b) empty homes for longer than two years at a level of 300 per cent (three times the council tax rate), and c) second homes at a level of 200 per cent (twice the council tax rate). IPPR estimate this could raise over £200 million a year, which could be used to support the council tax benefit system.<sup>1</sup>

### Stage 3: Fundamental reform of council tax in London

Devolving the council tax system to the capital, alongside other property taxes, and introducing a London-wide council tax benefit system, with higher rates for empty and second homes, would be welcome steps in improving the council tax system in the short term. But these measures are no replacement for more fundamental reform to ensure the council tax system is fairer, more effective and sustainable.

**Recommendation:** Council tax should be abolished and replaced with a property tax which is proportional to the present-day value of homes. The tax should be levied on owners, not occupiers. IPPR analysis suggests that a rate of 0.25 per cent would be fiscally neutral for London. In terms of distributional impacts, a fiscally neutral flat-tax rate would see around 79 per cent of households benefit from the reform, the majority of which would be in the current bands A to C. Properties in the top bands (around 21 per cent) would pay more under this option.

## DELIVERING A REFORMED SYSTEM IN PRACTICE

Implementing reform of the council tax system will not be easy but there are several strategies that can help overcome opposition and potential issues that might arise.

- **Transitional relief for council tax payers:** changes should be phased in gradually with a limit applied to increases or decreases in rates each year.
- **Support for those on low incomes:** there will remain a need for a reformed council tax support scheme or for developing a form of property tax credit, low-income housing exemptions, upper limit to the property tax or other intervention to support those on lower incomes.
- **Mechanisms for deferral:** a scheme to allow the deferral of payment until a property is sold, the owner passes away, or financial circumstances improve should be introduced.
- **Payment at source:** any system should include the capability for payment to be taken at source, as with income tax and national insurance.
- **Regular assessments of property value:** revaluation should be carried out either annually or every three years using an indexing system to uprate in between.
- **Invest and reform:** reforms to council tax should be coupled with rising investment and improvements in local public services so as to help build public support.
- **Redistribution measures for local authorities:** a system to allow redistribution of the property tax revenues to occur between local authority areas within London will be essential.
- **Communicating any reforms:** any reforms need to be communicated in an easily understandable form.

<sup>1</sup> As we set out in the report, some minor exemptions should apply depending on circumstances.

## The progressive policy think tank

Citation: Murphy L and Snelling C (2019) *A poor tax: Reforming council tax in London - final report*, IPPR. <http://www.ippr.org/research/publications/reforming-council-tax-in-london>

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