

Institute for Public Policy Research



A POOR TAX

**REFORMING COUNCIL TAX
IN LONDON**

FINAL REPORT

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and Charlotte Snelling**

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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 It is economically inefficient particularly because of its banding system, reliance on considerably outdated property prices and the inconsistencies between it, and commercial property taxation.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.¹

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 efficient 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 (Wingham 2017). 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 update 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.

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

1. INTRODUCTION

The UK is not the only country in the world which faces political and policy challenges with property and local taxes. But the political barriers to the reform of council tax, following the failure of the poll tax (officially called the ‘community charge’) and its associated political consequences, appear to be more substantial here than the barriers experienced elsewhere.

Unsurprisingly then, with the exception of recent changes to the support system for those on low incomes, the council tax system has been left largely unreformed for the best part of 30 years. Even at its introduction, council tax was regressive with regard to its tax base of property values due to its banding system, and deliberately so – the council tax was a political compromise following the failure of the poll tax. But in the intervening period, council tax has become significantly more regressive and is widely seen to be unfair, inefficient and unpopular.

The case for reforming council tax is, in our view, overwhelming. The council tax system is now unacceptably regressive with regard to property value and is unfair. There are also significant spatial inequalities in the capital between different London boroughs. Council tax has also come to look more and more like the poll tax, the controversial system which it replaced. Many of those on the lowest incomes are no longer protected and will be hit ever harder by council tax increases.

Furthermore, increases in council tax are likely to become more necessary and frequent as a consequence of the wider context of local government finance. Unless the government changes course and commits more central government funding, local authorities will become ever more reliant on the revenue derived from an increasingly unfair means of taxation. Council tax is also inefficient, relying as it does on significantly outdated property prices from 1991.

Our work has also found that there is public appetite for reform. Many of those that we spoke to said that they found the system too complex in terms of its banding and out of date valuations. They also thought the support system was too difficult to navigate for those struggling to pay and in need of help. The vast majority also expressed the view that the poorest should be protected – and afforded better protection than under the current system. Many also believed the system to be unfair, didn’t understand why council tax levels differ between different local authority areas, and had particularly strong views on the unfairness of outdated property prices. We also found a lack of awareness and knowledge about the council tax system and what it pays for within local government.

There was less agreement on what reform should look like. Many Londoners thought the system was unfair, but there was suspicion of what fundamental reform might mean for them. People supported the elimination of discounts for empty and second homes, as well as the application of additional levies on these homes, but they also thought discounts for single people were broadly right. Furthermore, while many supported the updating of property prices and a more progressive system in the abstract, there was far less support if it meant that they might have to pay more themselves. There were mixed views on the potential options for reform, but that which carried the most support

was a proposal for a property tax that also accounted for people's incomes in some way.

Nevertheless, the lack of support for one particular option shouldn't lead to a counsel of despair. Experience abroad shows that other countries face similar problems to England, but in many cases manage to offer fairer and more efficient systems (though imperfect). They offer lessons for how to proceed with reform. These lessons include the need to phase in any changes over time, offering transitional relief for council tax payers to cushion the impact of reforms, and deferral mechanisms for those who are unable to pay charges upfront. There is also a need to ensure that reform is accompanied by an improvement in local public services. In the current circumstances this will require additional investment from central government, following significant cuts to local government budgets over the past decade.

Other countries' experience suggests that reform to property taxation is difficult, but not impossible. In this report we have set out our preferred option for the reform of the council tax system in London. However, there are many variations of reform which could lead to a more progressive, fair, efficient and sustainable system. Crucially, we argue for a devolved system for London. We believe that London's distinctive housing market, the overly centralised system in the UK and the higher levels of poverty and inequality in the capital all make a strong case for a customised solution for London. Moreover, the public are more likely to support a subnational approach. Also, most parts of the country would be unaffected.

Any option, however, will need to be accompanied by a strategy, the components of which are outlined in this report, to overcome barriers to reform. They will also need to be accompanied by considerable political will, which to date has been conspicuous by its absence.

2. THE CASE FOR CHANGE

IPPR's interim report, *A poor tax – Council tax in London: Time for reform*, set out the case for change of the council tax system in London. To guide our assessment of the council tax system and how it should be reformed, we set out the following four key criteria for a good system.

- **Fair:** Fairness within the context of property taxation can first be judged in relation to property wealth: the tax rate, as a proportion of a properties' value, should be at least equal if not higher, for more valuable properties than lower value ones (Leishman et al 2014). Second, various studies (Lyons 2007, CLTR 2015) have found that people's perceptions of fairness are also intrinsically linked to ability to pay. Within our context, the more progressive a property tax is with regard to its tax base, the fairer it is technically; however a 'pure' property tax would not be considered fair because it wouldn't be linked to ability to pay. We think that the ability to pay is important, and therefore we include income relief schemes in our overall assessment of a council tax system. Finally, inequalities between geographies is another part of fairness, which we consider as part of our criteria.
- **Effective, feasible and sustainable:** The system should be easy to collect, yield sufficient revenue (at least as much as at present) and be sustainable in the long term. Long-term sustainability needs to be considered in the context of the local government finance system. It requires that council tax contributes to an overall funding base that is at least sufficient for local government to meet its social and statutory obligations. Sustainability also includes political sustainability and the need for a council tax system to command and maintain public support. The system must also be sufficiently buoyant that regular review should be possible to allow for changes in the tax base.
- **Efficient:** The system should minimise economic distortions and support the smooth functioning of the housing market. Moreover, it should be as simple and transparent as possible. This means it must be set in a way that is comprehensible and easy for people to navigate.
- **Accountable:** Those responsible for raising revenues should be accountable to taxpayers for the amount of tax paid, but also for how those revenues are used. In practice, that means taxpayers should be aware of how their tax is set, who is responsible for setting it and the relationship between the tax paid and how it is spent.

Applying these four criteria, our interim report set out five central arguments for reform:

- council tax in London is unfair with regard to property value and place
- council tax is unfair with regard to income
- London's council tax system is inefficient
- council tax and local government finance are increasingly unsustainable
- there is appetite among Londoners for reform (see chapter 3).

2.1 COUNCIL TAX IN LONDON IS UNFAIR WITH REGARD TO PROPERTY VALUE AND PLACE

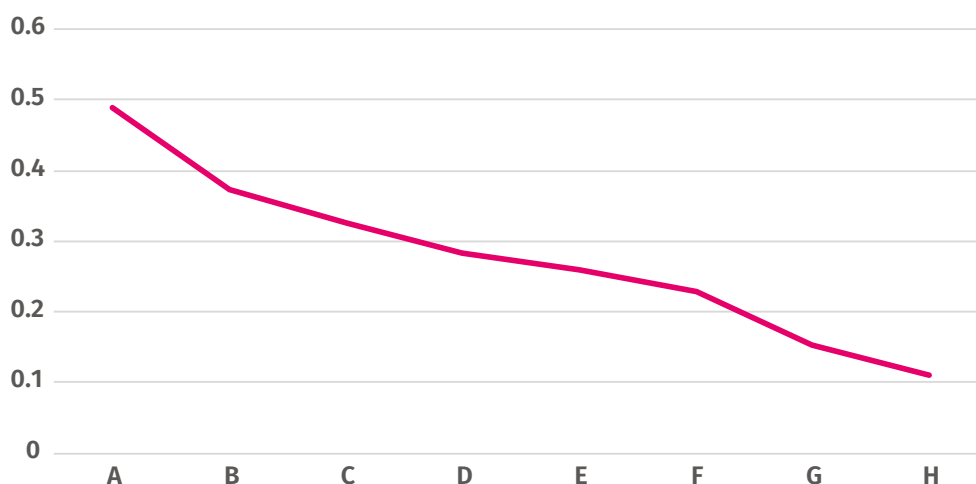
Unfairness in relation to property value

Those in the lowest-value homes in London are paying a higher proportion of council tax with regard to property value than those in higher-value homes (Murphy et al 2018, Wingham 2017). To the extent that the distribution of property values is a proxy for wealth, this is not fair, in the sense of being progressive (Gibb and Christie 2015).

The regressive nature of the present council tax system is embedded in its design (Murphy et al 2018, Corlett and Gardiner 2018). The highest-value property in Band H will attract a maximum of three times the tax on the lowest-value homes, even though (based on the current banding system) the high-value home is worth at least eight times the low-value one in 1991 property prices. As a proportion of property value, lower-value properties pay a larger proportion than higher-value properties (ibid).

FIGURE 2.1: LOWER-VALUE PROPERTIES PAY A LARGER PERCENTAGE OF THEIR VALUE IN COUNCIL TAX THAN HIGHER-VALUE PROPERTIES

Effective rate of council tax in London as a percentage of property value by band in 2017/18



Source: Wingham 2017, updated using IPPR analysis of the House Price Index, with data collected through the Land Registry

This disparity has increased over time as house prices have risen sharply, particularly in the capital. Our estimates show that an average London council tax bill on a Band A home of £40,000 (the top of its band) in 1991 prices would, in the early 1990s, have been 0.69 per cent of its value; for a Band H home, it would have been 0.26 per cent. Fast-forward to 2015/16 and the corresponding figure for the Band A home was 0.33 per cent, while the Band H property was paying as little as 0.12 per cent of the value of their home (Murphy et al 2018).

Spatial inequality within the council tax system

As well as being regressive with regard to property value, there is also considerable spatial inequality within the London council tax system. Rates of council tax vary significantly across boroughs and bear very little relation to house prices. The Band D rate – upon which all other bands are calculated, and which is set by the local authority – is typically highest in outer London. For the financial year 2019/20,

households in Kingston upon Thames pay the highest council tax with a charge of £1,872 for Band D properties, followed closely by Richmond upon Thames at £1,804 and Harrow at £1,785. By comparison, residents in Westminster pay only £754, in Wandsworth they pay £770 and in Hammersmith and Fulham £1,083 (London Councils 2018).²

2.2 COUNCIL TAX IS UNFAIR WITH REGARD TO INCOME

In our interim report we found that the current council tax system and its associated income support system is more unfair with regard to income than we consider acceptable (Murphy et al 2018).

As council tax is based on the value of a property, its relationship with household income is always going to be significantly weaker than if the tax were based on income alone (CLTR 2015). Nevertheless, IPPR analysis has shown that there is a significant relationship between council tax band and gross annual income in London – the average Band A household in the capital has a gross annual income of £24,700, rising to £136,700 for Band H. The highest proportion of households on high incomes can be found in bands G and H; and in general, those in the higher income deciles are far more likely to be in the higher bands (Murphy et al 2018).

However, the relationship between council tax band and income distribution is complex. IPPR analysis has shown that, for earners in the highest income decile under the contemporary system (not accounting for any benefit or reliefs), the burden is less than 2 per cent, but for those in the lowest income decile it is around 10.8 per cent on average. This means the burden of council tax lessens as incomes become higher, suggesting an inverse relationship between income and council tax burden. Our research also found that the regressive nature of council tax has increased over time.

Since the introduction of council tax, council tax benefit has reduced the burden of council tax on those on the lowest incomes. However, there have always been problems with its design. First, the households that qualify need to have very low incomes. Second, the take-up of council tax benefit has always been relatively low – around 50 per cent of entitlement for the lowest income decile, and 57 per cent and 67 per cent respectively for deciles two and three (Adam and Browne 2012).

Furthermore, recent reforms to devolve council tax benefit (now renamed council tax support) to local authorities and to cut its funding has weakened its ability to alleviate the burden of bills on the poorest. Rather than offering full relief from council tax, a significant number of London boroughs (23) currently have a minimum payment requirement for working age council tax payers.³ Some councils have also reduced the upper savings limit, made changes to taper rates, and in some instances the second adult rebate (a 25 per cent reduction offered where one adult in a two-person household is on a low income) has been removed.

The number of people claiming a council tax reduction in London has dropped by nearly a quarter (23 per cent) from 824,000 claimants in March 2013 to 631,000 in December 2018 (Z2K 2018a and IPPR analysis of MHCLG 2019a). This might be attributed to reduced eligibility or an improved economy, but also suggests that the support system might be becoming increasingly inadequate at reaching those

² These figures include the precept charged by the Greater London Authority.

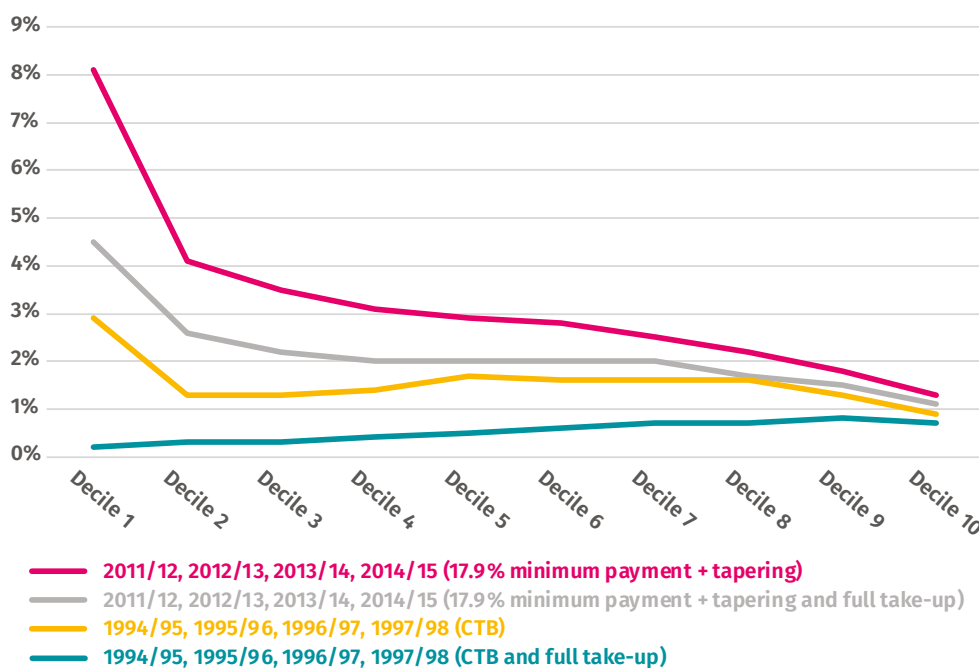
³ The total that currently have schemes with a minimum payment is currently estimated to be 23. Seven London Boroughs (Hammersmith & Fulham, Kensington & Chelsea, Kingston upon Thames, Merton, Tower Hamlets, Westminster and the City of London) have retained 100 per cent schemes similar to the scheme design that was devolved in 2013. In addition, Camden scrapped its minimum payment scheme in 2017 and Richmond did the same in 2019. Haringey council is expecting to have phased out minimum payments by April 2020 (Z2K 2018b).

in need. Furthermore, the number of people in council tax arrears and the total owed have both risen dramatically.

Across England, officially recognised annual total council tax arrears increased from £836 million in 2013/14 to £944 million in 2017/18. Moreover, the total arrears outstanding in 2017/18 were £3 billion, up from £2.5 billion in 2013/14 (Perraudin 2019, MHCLG 2019b). Research by the anti-poverty charity Zacchaeus 2000 Trust (Z2K) has also found that a number of councils are using bailiffs, and claimants are being charged court costs on top of their arrears (Z2K 2018a). At the most extreme, 305 people were given custodial prison sentences for non-payment of council tax between 2013/14 and 2017/18, with another 6,278 receiving suspended sentences (Perraudin 2019).

FIGURE 2.2: LOWER-INCOME HOUSEHOLDS SPEND A HIGHER PROPORTION OF THEIR INCOME ON COUNCIL TAX EVEN IF ALL THOSE ELIGIBLE TOOK UP COUNCIL TAX SUPPORT

Council tax as a percentage of household income, by equivalised income decile, 1994/95 to 1997/98 and 2011/12 to 2014/15



Source: IPPR analysis of the Family Resource Survey (FRS) 1994/95, 1995/96, 1996/97, 1997/98, 2011/12, 2012/13, 2013/14 and 2014/15⁴

IPPR analysis has shown that the burden of council tax for the poorest Londoners, accounting for council tax support, is more than six times greater (8.1 per cent) than on those in the highest decile (just over 1.3 per cent). The analysis also demonstrates how the council tax system has become more regressive over time. For London's poorest, the burden under the contemporary system was 10.8 per cent compared with 8.2 per cent in the early 1990s. If everyone who was entitled to council tax benefit took it up, the burden on those on the lowest incomes under the current system (4.5 per cent) is more than 22 times what it was in the early 1990s (0.2 per cent).

⁴ We have used data on entitlement to passported benefits from our Family Resource Survey (FRS) sample to help model full take-up of council tax benefit. However, some of those households which fall in the upper deciles were declared as receiving council tax benefit, but in reality would not have been entitled. This will have had a small impact on the figures in this modelling.

In addition, figures from the Institute for Fiscal Studies (Adam et al 2019) for across England show that 3.6 million working-age households in England are now entitled to £196 a year less (24 per cent) than they would have been under the previous system. In addition, the IFS analysis found that a quarter of the additional tax liability which arises from the reduction in council tax support is not collected – 10 times the normal rate of non-collection at 2.5 per cent – which raises questions about whether cutting council tax support is a false economy (Ayrton and Barker 2017).

2.3 LONDON'S COUNCIL TAX SYSTEM IS INEFFICIENT

Council tax is inefficient due to its design

Council tax is an unusual hybrid of a property-based tax, a consumption tax on housing and a charge for local services (Lyons Inquiry 2007, Lawton and Reed 2013). However, its design means that it is not an effective consumption tax, promoting the efficient use of housing. This is in part due to the flawed structure of council tax bands. These are very wide and allow a range of homes to sit within the same band. Furthermore, council tax is regressive with regard to property value, which encourages people to buy and remain in larger homes (Evans 2009), which similarly makes it less effective as a tax on property or consumption. Discounts for empty and second homes, as well as the 25 per cent discount for single persons, contribute towards the system undertaxing housing.

Council tax is inefficient due to the way it operates

Evidence has shown that recurring taxes on property can have some impact on the prices people pay for homes, in that they will be factored into the price (CLTR 2015). But the failure to revalue the property prices upon which the council tax system is based has contributed to its inefficiency as a property tax, exacerbating the issues created by its regressive structure. As Wingham (2017) points out, this has been worsened by the unequal distribution of house price growth over the last quarter of a century and more. Various reviews over the years, including the Barker Review (2004), have argued that changing property taxation in the UK is one way of tackling the volatility in house prices. Barker argues that a council tax more closely linked to property values could have an automatic stabilising effect (ibid).

Inconsistencies between residential and commercial property taxation

There are significant inconsistencies between commercial property tax in the form of business rates and residential property tax in the form of council tax, and many would argue they promote inefficiency in land use. For instance, GLA Economics (Wingham 2017) found that the effective tax rate of business rates in 2015/16 was 49.3 per cent in London compared with just 7 per cent for the average Band D property. Taking into account the various reliefs and discounts available under each of the taxes, the same research found that the effective tax rate for commercial property in the capital was 34 per cent in 2015/16 and 3.9 per cent for residential property.

2.4 COUNCIL TAX AND LOCAL GOVERNMENT FINANCE – INCREASINGLY UNSUSTAINABLE

Council tax is a key part of the local government finance system in England and the capital. While revenue from council tax has for a long time contributed significantly towards the funding of public services delivered by local authorities, in recent years, it has become more important. In 2015/16, council tax accounted for 40 per cent of the core spending power of local authorities in the capital (IPPR analysis of London Councils 2017 and MHCLG 2017a) but by 2019/20 this had risen

to 51 per cent (IPPR analysis of MHCLG 2019c and London Councils 2019). Although there are significant variations between London boroughs. In Richmond upon Thames and Kingston upon Thames it is 82 and 78 per cent respectively, but in Hackney, Newham and Westminster council tax revenue made up only 32, 31 and 27 per cent respectively of core spending power in the same period (ibid). The government is now allowing councils to increase council tax, in part to make good reductions in central funding.

Meanwhile, upward pressures on spending are rising. As reductions to central government grants continue and demand for critical services such as adult social care grows, pressure on local authorities to raise more revenue through council tax will only increase. Figures from the Local Government Association (2019) suggest that between 2010 and 2020, councils will have lost nearly 60p in every £1 of central government funding. The funding gap in 2019/20 for councils is estimated at £3.1 billion and is set to rise to £8 billion by 2024/25 (ibid).

Given the wider context, there are two central problems with ignoring reform of the council tax system. First, local government finance cannot be properly sustainable unless the funding sources upon which it relies are also sustainable. Second, in the absence of reform, year-on-year tax rises will put an ever-increasing burden on those on the lowest incomes.

3.

LONDONERS' VIEWS ON THE COUNCIL TAX SYSTEM

In our interim report, we set out the views of Londoners on the council tax system, and their desire to see change. Here we summarise those views before outlining the findings of our research following the testing of ideas for reform with Londoners.

The people we spoke to as part of our research were diverse and represented people of different socioeconomic status, gender, ethnicity and tenure including homeowners, private renters and social renters.⁵

Our research found that there was consensus on a number of issues. Broadly, these included:

- **That the system is too complex:** the Londoners we spoke to believe that the system is complex to understand in terms of its banding and out of date valuations, but that it is simple to pay. For those whose circumstances change – particularly, for instance, those who find themselves suddenly out of work or with a sudden loss of income – they believed that the system of support was too difficult to navigate. Seeking help from your local council was seen as more difficult than it should be.
- **That those who cannot afford to pay are not sufficiently protected:** there was consensus that those on low incomes or who were vulnerable were not receiving enough support. It was also felt that councils were too swift to take aggressive action by issuing demands, fines and involving bailiffs.
- **That the current system is unfair:** many believed the disparities in payments made across different London boroughs were unfair. One of the other strongest issues of injustice raised was the reliance on property prices from 1991.
- **That the current system lacks transparency and awareness:** there was a lack of awareness and knowledge about the council tax system and what it pays for within local government.

3.1 WHAT REFORM DO LONDONERS WANT?

We found that there was little support among those Londoners we spoke to for the current council tax system, as outlined above. On what kind of reform or changes they would like to see to the system, there were also some areas of consensus.

A simplified system

The majority of Londoners that we spoke to favoured a simplification of the system. They found the banding system confusing and the reliance on property prices from nearly 30 years ago doubly so. There was also a clear desire for the system to be less complex and straightforward for those struggling to pay council

⁵ We spoke to people who were in work, retired and who were or had been unemployed. Our focus groups also comprised people from single households, and multi-person households with and without children.

tax, who were vulnerable or who needed help from their council in some way in relation to their council tax.

Protecting the most vulnerable

There was also broad consensus that those on low incomes and the vulnerable were deserving of much greater support. In practical terms, the kind of additional support Londoners called for included:

- greater support in terms of advice and navigation of the system for the most vulnerable and those struggling to pay
- that councils should resist aggressive tactics in seeking payment of council tax, particularly with the use of bailiffs
- that there should be a stronger safety net for those who struggle to pay their council tax, including through a stronger and better funded benefit or support system.

“The system should protect people who cannot pay, I’m not sure it does that at the moment.”

Tackling particular issues of unfairness

There were two particular issues regarding the structure of the council tax system which stood out to the Londoners we spoke to.

- **The reliance on property prices from 1991:** Most of the participants found the reliance on such out-of-date figures ‘bizarre’, as one participant put it, and supported a move towards a system that relied upon up-to-date values.
- **The discrepancies between payments in different boroughs:** There was a feeling of injustice that residents could be on different sides of the same street but pay vastly different amounts.

A transparent system and additional consultation

The vast majority of the Londoners we spoke to wanted more information about council tax, or a reformed system, and the services that the revenue paid for. Some called for greater information on their bills, in the form of a pie chart for example.

“There should be a council tax book – broken down with payments, street cleaning, police...”

“There should be a pie chart on every council tax bill and the council website showing percentages showing what pays for what.”

The calls for greater transparency, however, were at odds with the fact that many councils already provide much of this information either in leaflets that accompany the bills or through weblinks. It does suggest, however, that the ways of communicating what council tax revenues are spent on could be vastly improved.

In addition to the calls for transparency, many of the people we spoke to also sought greater involvement in how spending decisions were made.

“Who is deciding the ‘priorities’ of their local communities? Local people need to be involved more, there needs to be more meetings and more involvement.”

Prepared to pay more for better local public services

The majority of the people we spoke to were in favour of reforming the council tax system, even if it meant some people paying more. However, when we asked people whether they would be willing to pay more themselves if a more progressive system was introduced many people said no.

This was not the case when we asked people whether they would be willing to pay more if it meant an improvement in their local public services. In this instance, the majority of people said they would be prepared to support a reformed system that meant a higher burden on them if local services improved as a result.

“If I could see an actual improvement in the local services like bin collection or potholes, I could see myself paying more for that, yes.”

Views on particular types of reforms

As part of our research, we tested a number of ideas for reforms of the council tax system in London to gauge the views of Londoners and potential issues with, or support for, particular proposals. These included:

- reforming council tax discounts
- introduction of local income tax
- a property tax based on a proportion of up-to-date property values
- a service charge similar to the poll tax
- a land value tax.

While there was consensus on some aspects of reform, there were decidedly mixed views on different options for reform and what shape any future changes should take.

Reforming council tax discounts

There was a strong consensus for abolishing any remaining exemptions on empty and second homes. There was also broad agreement that, given the state of the housing crisis in London, there should be additional charges for empty and second homes.

“There’s a housing crisis; it doesn’t make sense to give people a discount if their home is empty or if they have another home.”

As outlined in our interim report, however, there was greater support for retaining help for those in receipt of the single persons discount because they believed they would either be on lower incomes or consume fewer services than larger households.

Introduction of a local income tax

The majority of those we spoke to did not support a local tax that was based on income alone. For some, it was an aversion to the idea that there would be an additional means of taxing income on top of the national income tax and national insurance. For others, it was the idea that a new income tax might be avoided by some, for instance the self-employed, in a way in which property tax cannot be avoided.

“It would have too many opportunities to avoid paying by decreasing income on assessments.”

“I think it would be difficult in practice. What about the loopholes?”

However, there was a minority that saw benefit in a local income tax deeming it a means to ensure that richer people (by income rather than wealth) pay more.

“This is fairer than the current system as [the] rich pay more.”

A property tax based on a proportion of up-to-date property values

Most of the Londoners we spoke to favour a property-based tax but with the strong caveat that it must take into account income. While most agreed that the current system was in need of reform, they did like the fact that it did take into account personal circumstances, albeit imperfectly and inconsistently. Most people also agreed that a property-based tax should reflect the different circumstances of people in different tenures.

“Yes, but depending on personal circumstances [income] and regular value reassessment.”

“If renting, the landlord should take [pay] the majority of the council tax. Circumstances vary from case to case. Social housing for example, they [renters] don’t own the house. Different rules should apply.”

There was a minority, however, who believed that a property tax was simply unfair because it wasn’t ‘the fault’ of those living in a property if its value rose and they might not have the income to pay the tax.

“Not fair as you may have lived in a property for years and the value has increased but you may be on a low income.”

Nevertheless, most people concluded that a system which was based on property value but took income into account was the best way forward. They wanted to see a more progressive system that considers today’s property values. However, there was also a nervousness about a complete overhaul of the system.

“Could there be a fairer equation that takes income and property value into account? The system should be more progressive but require the least amount of change.”

A service charge similar to the poll tax

Some people supported a service charge that looked very much like the poll tax. They argued that it was only fair that everyone should make a contribution to local services regardless of income.

“Some people only use basic services but are expected to pay for all services. What about those without children?”

However, overall, most people did not support such an approach, favouring the property tax measure that took account of income. For many, the memory of the

poll tax and its failings continued to live on, but there was also a sense that such a charge would be unfair in comparison with the other options on offer.

“No it was already tried and failed with the poll tax.”

“No, services are available, people choose not to use them.”

A land value tax

There was little support for a land value tax but much of this derived from a lack of familiarity with such a system and understanding about how it might work. The two central concerns were that such a system would be very complicated for people to understand and that this would present a radical overhaul compared to the current system which many people were reluctant to contemplate.

“No, land and property together is much clearer.”

3.2 CONCLUSION

There was little doubt from our conversations with Londoners that they supported reform of the council tax system. Many wanted to see a simplified system, that was more transparent, reduced unfairness – in particular the use of out-of-date property values – and one that provided greater protection for the most vulnerable. In addition, the majority of people said they would be prepared to contribute more if it meant an improvement in local public services.

While there were mixed views on what reforms to make to the system and the different options for change, the vast majority of people felt that they could support a more progressive property tax system based on up-to-date property prices provided that it took account of income and people’s ability to pay.

4. LESSONS FROM ABROAD

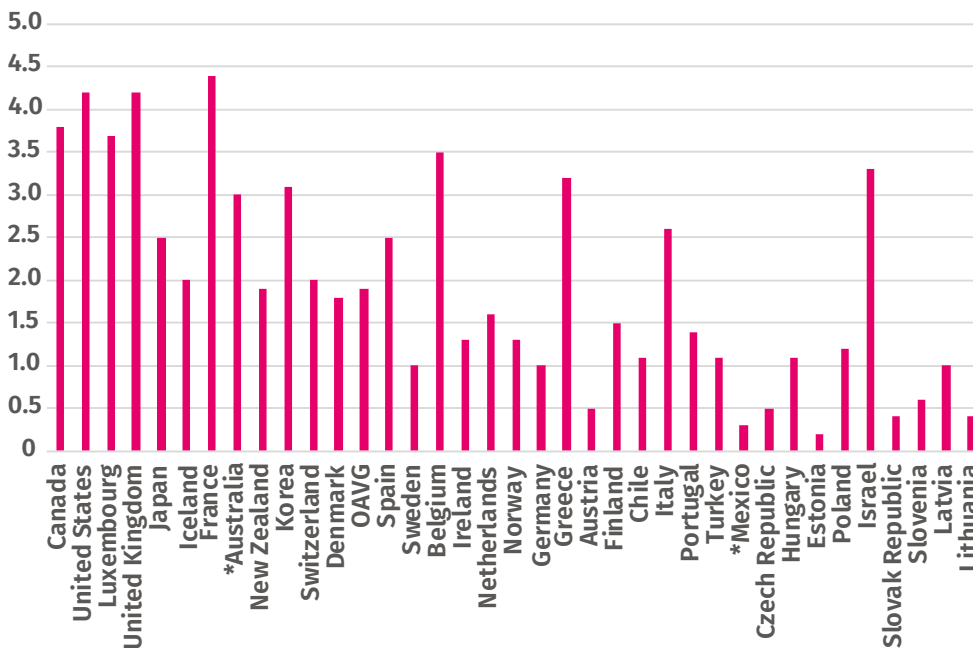
As part of our research, we commissioned a literature review (Whitehead and Travers 2018) on the international experience of property taxation. We used it to inform our understanding of how property taxation in London and England compares internationally and to learn from the experience of reform elsewhere.

4.1 THE UK AND INTERNATIONAL COUNTERPARTS COMPARED

Given its hybrid nature, there is a need to compare council tax as a property tax to examples abroad but also to other forms of local taxation.

FIGURE 4.1: THE SIGNIFICANCE OF THE RECURRENT IMMOVABLE PROPERTY TAX VARIES ACROSS COUNTRIES

Share of recurrent immovable property tax revenue in GDP, 2017



Data obtained from new-display.compareyourcountry.org in 2019-04-18 08:14:02 GMT

*2016 data used (2017 data unavailable)

Source: Office for National Statistics, Global Revenue Statistics Database (OECD 2019)

As a property tax

The review found that, although there are some similarities, property taxation in the UK is atypical in important ways.

- As is the case in the UK, most land or property is taxed in the same way in the majority of countries⁶ based on values – either capital or rental – and collected annually.
- The UK is ranked by the OECD as having, after France, the greatest reliance on property taxation of all OECD country respondents as a proportion of GDP. For 2017, property taxes accounted for around 4.2 per cent of GDP, more than twice the OECD average.
- The UK has the largest proportion of property tax revenue collected by central government for its own use (council tax not being one of them). In most other OECD countries property taxes are basically a local or regional tax.
- In the UK a relatively high proportion of taxation, close to half, is levied on residential property. This is driven largely by the increasing levels of revenue accrued from stamp duty on property transactions, a consequence of higher rates at the upper end and rapidly increasing house prices (Scanlon et al 2017).

As a local tax

The review of international experience found that local taxation is common among developed countries and that most were forms of property taxation. In contrast, local income taxes and sales taxes are rare. The review raised a number of common issues and features.

- **Who pays the tax:** most commonly it is the owner of the property (in contrast to council tax with some exceptions), requiring a means of identifying property owners.
- **Coverage:** both residential and business property are usually taxed in the same way, although often with different rates. Main residences are sometimes exempt, but second properties are almost always taxed. Undeveloped land is generally exempt, as is agricultural land. In most cases, taxes cover both land and buildings. The review cites three examples of ‘pure’ land taxes: in Denmark, Estonia and New South Wales in Australia.
- **Information required for valuation purposes:** capital values or rental values, accompanied by a determined tax rate, are the usual means of calculating the charge.
- **Determining and updating values:** valuation and revaluation rules are normally set by central governments. The typical approach is to compare sales prices, although a more sophisticated approach is now being deployed by some countries through the use of statistical analysis to generate hedonic (characteristic) prices. There are some that use cost estimates and others that use a hybrid of sales values for land and cost for properties. Revaluation is not uniquely a problem for the UK. Denmark and Korea update capital values annually (but do struggle with the regularity of complaint), while others have a defined period (which is often put off). Multiple countries use indexation but the complexity of behaviour across spatial markets still often requires revaluation.
- **Exemptions and reliefs:** these are common across all countries. They include – for residential properties – exemptions for owner-occupied units, new build and vacancies (and also type of use). There are also often exemptions for groups of certain owners, such as charities or vulnerable persons.
- **Tax rates:** unlike council tax in England, where there has long been capping, tax rates are commonly set by local government which gives far greater fiscal freedom but also means there are can be big variations between different areas.

6 At least those included in the OECD comparative study highlighted in the literature review.

4.2 COMMON CONCERNS

A number of issues are common to property taxation in many countries.

- **The means of assessing and updating values:** no matter the means of valuation and revaluation, the politics of setting and updating values remains problematic. It is also noted that the longer the system deviates from real market values, the more difficult it is to correct.
- **Progressivity in relation to property value:** in the majority of countries, the tax base is related to property or rental values, although some may not be exact or are out of date. However, England's system is likely to be the most distant from having a strong relationship with value. The review also highlights the issue of the progressivity of the tax rate – in most countries it is simply a percentage of value or rent. However, in some countries a higher rate for higher-valued properties is used. For example – in Ireland, a charge of 0.18 per cent is levied for a property valued up to a million euros, but this rises to 0.25 per cent for any element above a million.
- **Progressivity in relation to income:** incomes are almost never directly taken into account. However, issues around payment by low income households and those who are asset rich and cash poor in relation to taxes based on property value are nearly universal. These issues are particularly acute when revaluations take place after a long period of time; when house prices are rising rapidly; or during periods of falling incomes or rising unemployment. The review highlights three means of addressing these issues.
 - **Reliefs for particular categories of household.** For example, vulnerable households such as the elderly or disabled.
 - **Deferral systems.** These might include deferring the tax until the property is sold or the owner dies. This approach sometimes involves interest charges.
 - **Income-related benefits subsidies.** Most OECD countries provide income-related housing benefits linked to housing costs, which may or may not include property taxation; although some are highly restricted to only the most vulnerable or those on very low incomes (Austria) or to private tenants (Australia). Other forms of welfare benefit may also be relevant.
- **Tax collection and payment:** in many countries, property taxes are collected by the national tax authority, despite being levied and spent locally. Ireland has recently introduced the facility to pay from wages, pensions and benefits.

4.3 WHAT ARE THE STRATEGIES FOR REFORM?

As the common issues set out above highlight, the UK is not the only country preoccupied with issues that arise from its property taxes and local taxes. Table 4.1 sets out the issues identified and some of the potential avenues to overcome them.

Many of the strategies set out in table 4.1 are quite high-level but they provide some guidance on promising approaches in delivering successful property tax reforms. Some of the least promising approaches in terms of dealing with issues include capping the tax and setting assessment limits. The more promising approaches, as we highlight in our final chapter on recommendations, include offering tax deferrals and undertaking regular reassessments (or indexation) of property values.

TABLE 4.1: STRATEGIES FOR PROPERTY TAX REFORM

Issues and problems	Promising approaches	Less promising approaches
Salience: property tax is more noticeable than other taxes	Couple tax reform with improvements in local services Withhold tax at source or provide other payment options Phase in changes	Set assessment limits Cap the property tax
Liquidity constraints: imperfect association between taxpayers' incomes and property taxes, especially for seniors	Offer tax deferrals for seniors Provide more payment options Phase in changes	Set assessment limits Cap the property tax
Perceived regressivity: taxes higher as a per cent of income for low-income taxpayers	Offer property tax credits Offer tax deferrals Bundle with other tax reforms Package with expenditure changes Provide low-income housing exemptions	Implement banding Implement classified property tax rates Set progressive tax rates Set assessment limits Cap the property tax
Volatility: potentially large swings in taxes for some taxpayers	Conduct annual reassessments Index the tax base Provide taxpayer education Communicate in an understandable form Phase in changes	Set assessment limits Cap the property tax
Presumptive tax: tax base is inherently arbitrary	Provide taxpayer education Conduct public consultations Make appeal process accessible Phase in changes	Allow self-assessment Implement classified property tax rates Set assessment limits Cap the property tax
Inelasticity (a problem for local governments, not for taxpayers): taxes do not increase with growth	Conduct annual reassessments Index the tax base Phase in changes	

Source: Slack and Bird (2015)

5. REFORMING COUNCIL TAX IN LONDON

5.1 OVERVIEW

Throughout this report we have set out the case for reforming the council tax system. We are not alone. Over the past decade or so, there have been numerous reports from government commissions, charities and thinktanks highlighting the inequities of the council tax system and the need for reform (Lyons 2007, Mirrlees et al 2011, Corlett and Gardiner 2018, Wingham 2017).

We have set out four key criteria against which we have measured the current system and against which we would test any proposals for reform. These are that the system should be:

- fair
- effective, feasible and sustainable
- efficient
- accountable.

Against these criteria, our research suggests that the system has gone backwards since it was first implemented, a process which has been accelerated by recent policy change.

Political barriers to reform

As we highlighted in our interim report, there are significant political barriers to the reform of council tax (Murphy et al 2018).

- **Previous experience with reform of property taxation.** The 1989/90 recent experience of reforming local property taxation has led many politicians to place council tax in the ‘too difficult to touch’ box. Whatever the rationale for reform, there is a significant gap between the economics and politics of property taxation, a position which is not uncommon in other OECD countries (Slack and Bird 2014).
- **Council tax is unpopular, and the tax base is contested.** Some people simply disagree with the basis of the tax which makes it harder to alter the status quo. For instance, the Lyons inquiry into local government (2007) found resistance to the idea that tax bills should reflect property values or that taxes should increase with property values.
- **Salience.** Council tax and property taxes more generally are highly visible. Households are presented with a bill, rather than it being taken at source.
- **Winners and losers.** Reforming council tax will create winners and losers. Even if reforms create far more winners than losers, it is those who will lose out who are likely to be more vocal and actively campaign against any change.
- **Links to services and transparency.** There is little awareness as to what council tax is spent on. There is also a presumption that council tax funds the majority of services being provided by their local authority.

- **Speed of reform.** The speed at which any government could undertake reform has proved limiting. Implementation of significant reforms to council tax or any other property tax will often take longer than one electoral cycle.

The difficulties in undertaking reform of property taxation should not be underestimated. To be politically achievable and command public support it must be done with caution and with a mind to the public's notions of fairness.

5.2 OUR PROPOSALS FOR REFORM

In light of the difficulties of reforming council tax, we recommend a staged approach to transitioning to a new system of taxation in the capital, and to learn from experiences elsewhere. There is a strong argument for addressing some of the most fundamental injustices within the council tax system now, before moving on to wider and more substantial reform of the system.

Stage 1: Devolving 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, as we argued in our interim report, there is a clear case for a customised and piloted solution in the capital. This case rests on a number of key arguments.

- **London's distinctive housing market (LHC 2016) and high levels of inequality makes devolution and reform more palatable and necessary.** House prices have, until recently, risen in the capital at a faster pace than elsewhere, particularly in inner London. Meanwhile London has higher levels of poverty and inequality than the rest of England, making some of the impacts more acute. The revaluation of property prices would be an essential component of any meaningful reform of council tax and such an exercise would have its greatest impact on London. For this reason, previous reviews and studies (Lyons 2007, Leishman et al 2014) recommended that separate bands be introduced for inner London to reflect its special circumstances and to reduce the instability any purely national reforms might have on London. Introducing a national system, with no regard to the exceptional London housing market, would increase, not reduce, the burden on London's poorest.
- **The UK is highly centralised by international standards.** Council tax and a proportion of business rates are the only taxes that can be seen as local. Yet, by and large, council tax is set nationally, with central government setting the bands and applying arbitrary caps on increases, above which referendums are required. As the London Finance Commission (LFC) found, the centralised system found in the UK is out of step with best practice in most OECD countries, and is a weakness within British democracy (LFC 2013).
- **The public are more likely to support a subnational approach.** Our focus groups showed Londoners are more supportive of reform led by politicians who are closer to the issues at hand. Polling by the London Finance Commission also supported this view (LFC 2017). In light of the difficulties in reforming property taxes, enacting reform to the council tax system will be easier at the devolved level. Considerations of the winners or losers from any changes, and the impact on services, will be more directly relevant to local communities at a London level, allowing them to design a system that is more tailored to their needs.

The government has been undertaking its local government finance review – *the Fair Funding review* – since 2017 (MHCLG 2017b). Failing to evaluate one of the

main sources of local government income, which many people agree is in severe need of reform, will significantly undermine its conclusions. However, there is another opportunity to look again as part of the comprehensive spending review (CSR), which the government has said will begin before the summer recess (HMT 2019). As part of the CSR, the government should commit to initiating the process of devolving the council tax system to London (the mayor and London councils, as suggested by the London Finance Commission 2013), allowing the capital to determine its future and to provide greater freedom for revenue raising at a local level. There would be an expectation that the capital would be no better or worse off immediately following devolution, that is, central government funding to London would be amended accordingly.

Recommendation: The government should commit, as part of the CSR, to initiating the process to devolve the council tax system to London.

Stage 2: Interim reform of council tax in London

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 that some immediate steps be taken to address some of the biggest injustices in the system.

Support those on low incomes

The decision to devolve and cut the budget for the council tax benefit system has been a disaster for those on the lowest incomes across much of the capital. The simplest and quickest way to address these issues would be to introduce a capital-wide council tax benefit system to support those on the lowest incomes. This system should ensure that no minimum payment is required of those on the lowest incomes, reversing the changes made by local authorities under significant financial pressures. It could also restore the previous protections available to those claiming council tax benefit, including restoring eligibility, tapers and reliefs to their previous levels.

The alternative to reintroducing the system exactly as it was would be to introduce a replacement that also helps tackle the low take-up of the previous systems. An alternative might be a discount scheme based on universal credit entitlement modelled for some councils by the organisation Policy in Practice.⁷ Under this system, universal credit claimants would receive the standard discount, which could be 100 per cent, and then entitlement would be reduced for those with higher incomes. Such a system would have a number of advantages including aligning council tax support with universal credit, preserving work incentives, and it would be more straightforward to administer. It would rely entirely on information from DWP shared with local authorities.

Even if central government doesn't devolve the full council tax system to London government, we believe that the mayor and all London councils should explore the establishment of a capital-wide scheme.

Recommendation: A capital-wide council tax benefit system should be introduced to support London's poorest and most vulnerable.

Removing reliefs for empty and second homes and applying a premium

As our interim report highlighted, there are a number of reliefs and exemptions in the council tax system including for second and empty homes. Our focus groups with Londoners highlighted that there is little support for these exemptions, although there was considerable support for a single persons' discount.

7 This was proposed in discussions between Policy in Practice (<http://policyinpractice.co.uk>) and IPPR.

When council tax benefit was devolved, local authorities were also given the freedom to remove exemptions for empty and second homes and to apply a premium on empty homes. The current premium which can be applied is 100 per cent for homes that have been empty for more than two years.⁸ There are currently 49,343 empty homes and 45,980 second homes identified in the capital (MHCLG 2019b). In 2018/19, the empty homes premium was being levied on 7,524 homes and raising circa £5 million (IPPR updating analysis from Wingham 2017 using MHCLG 2019b). There are also just over 1,362 homes which receive some form of discount (MHCLG 2019b).

To help raise funds to support a capital-wide council tax support scheme we propose three measures. First, we propose that any remaining exemptions be removed from empty and second homes with a one-month grace period, and except in limited circumstances (see below). Second, we propose that the premium level for homes that are empty for longer than two years be increased to 300 per cent (three times the council tax rate) and that a premium of 200 per cent (twice the council tax rate) be applied to all other empty homes. Third, we recommend that a premium of 200 per cent (twice the council tax rate) also be applied to second homes. There are some circumstances where an exemption would still be appropriate or a premium would be inappropriate. These would include (but not be limited to) homes where the owner is seriously ill or has gone into a care home, properties subject to probate and homes owned by members of the armed forces who are serving abroad. Such exemptions would have to be consulted on to ensure appropriate extenuating circumstances were covered.

In total, we would expect these changes to raise over £200 million, which could support a capital-wide council tax support scheme for those on the lowest incomes (IPPR updated analysis from Wingham 2017 using MHCLG 2019b).

Recommendation: Abolish council tax exemptions (except in limited circumstances) for empty and second homes and introduce a council tax premium for a) all empty homes at a level of 200 per cent, b) empty homes for longer than two years at a level of 300 per cent, and c) second homes at a level of 200 per cent. IPPR estimates this could raise over £200 million a year.

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 important 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.

There are a number of options for the reform or replacement of the council tax system which would ensure that the system is simpler and fairer, and which would make the housing market more efficient. These measures include minor changes such as adding additional bands to the current system or more substantial reform including revaluation, changing the ratios between the bands to ensure they are more progressive and adding additional bands at the top. However, the current system is not particularly popular and increasingly resembles the poll tax it replaced. Moreover, as others have pointed out (Corlett and Gardiner 2018),

⁸ Prior to April 2019, it was 150 per cent. The Rating (Property in Common Occupation) and Council Tax (Empty Dwellings) Act 2018 which received Royal Assent last November introduced higher premiums for long term empty homes which are being phased in over the next three years. These are a 100 per cent premium (for properties empty for 2-5 years) in place from April 2019; a 200 per cent premium (for properties empty for 5-10 years) commencing in April 2020; and a 300 per cent premium (for properties empty for 10+ years) commencing in April 2021.

there is a strong consensus among those who have proposed reform about what a replacement for the council tax system should look like. Put simply, an annual property tax, which is proportional to the present-day value of homes, would best meet the criteria we have set out for reform.

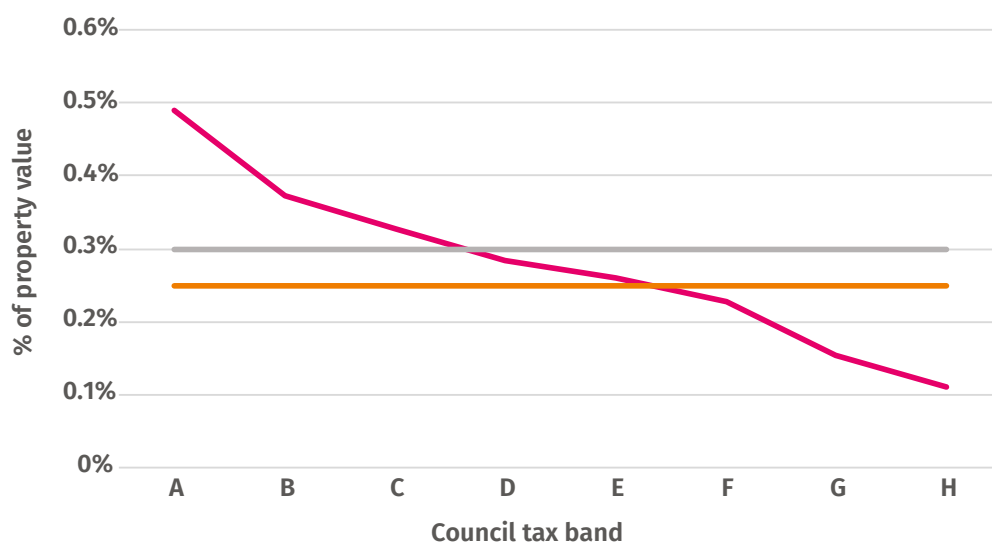
Revaluation and an annual property tax to replace council tax

Under our recommended option, council tax bands would be abolished and replaced with a property tax which is proportional to the present-day value of homes. This system would be an effective ‘flat-tax.’ It would not be regressive and, provided there were regular revaluations, would capture increases in house prices, that the current system does not. Our analysis suggests that a rate of 0.25 per cent would be fiscally neutral across the capital, while a rate of 0.3 per cent would raise approximately £631 million in additional revenue.

As figure 5.1 demonstrates, any system which deploys a flat-tax rate would be significantly less regressive than the current system in relation to property values.

FIGURE 5.1 THE CURRENT SYSTEM IS HIGHLY REGRESSIVE COMPARED TO ANY ‘FLAT-TAX’ SYSTEM

Effective rate of current council tax band system compared to an annual property charge as a percentage of property value (0.25 per cent and 0.3 per cent)



Source: Wingham 2017, updated using IPPR analysis of the House Price Index, with data collected through the Land Registry

In terms of distributional impacts, a fiscally neutral flat-tax rate⁹ 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 (Wingham 2017). Properties in the top bands (around 21 per cent) would pay more under this option. Because a higher proportion of properties in higher bands are located in inner London, there would be a shift of the council tax burden onto inner London (ibid and IPPR analysis). A redistribution mechanism will therefore be necessary between London boroughs to ensure that some boroughs don’t lose out at the expense of others.

IPPR analysis suggests that the introduction of a flat-tax would slightly reduce the regressivity of the council tax system with regard to income. However, our

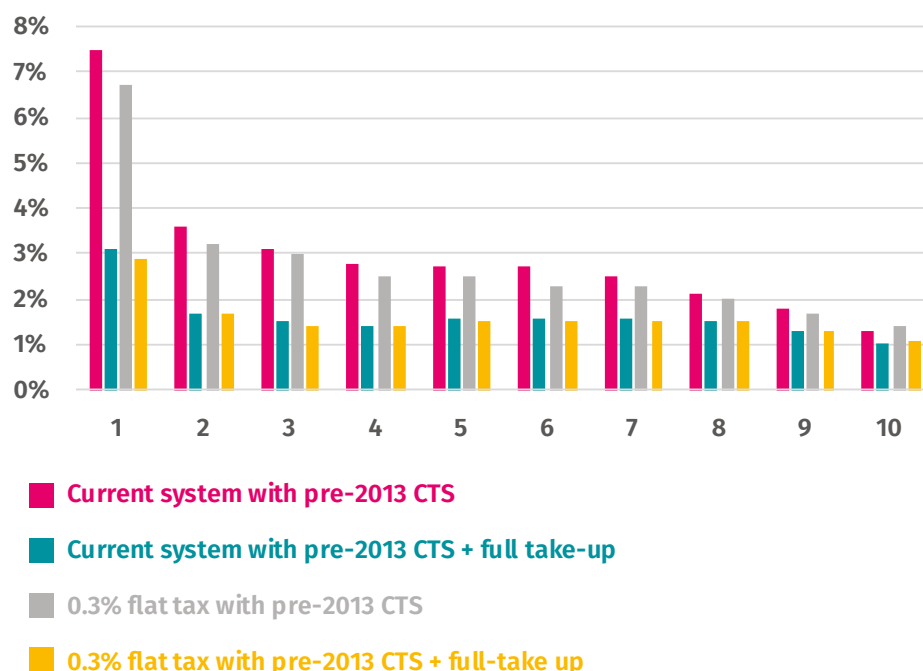
⁹ It should be noted that Wingham’s analysis suggests a flat-tax rate of around 0.2 per cent would be fiscally neutral.

analysis also shows that the most important factor in reducing the burden on those on the lowest incomes is the council tax support system. The system is particularly effective if everyone who is entitled takes up the support.

Figure 5.2 shows the burden on incomes (by income decile) of a flat-tax rate (using today's values) compared to the current banding system in a scenario of council tax support (using the pre-2013 system) under normal take-up and full take-up. The figure shows that while a flat-tax is marginally more progressive than the current banding system, it is in fact the full take-up of council tax benefit which makes the difference.

FIGURE 5.2: A FLAT-TAX RATE LOWERS THE BURDEN ON THE LOWEST-INCOME HOUSEHOLDS, BUT FULL TAKE-UP OF COUNCIL TAX BENEFIT HAS THE BIGGEST IMPACT

Council tax as a percentage of equivalised household income under the current banding system and a flat-tax rate of 0.3 per cent, using the pre-2013 council tax support system under normal take-up and full take-up scenarios. By equivalised income decile before housing costs



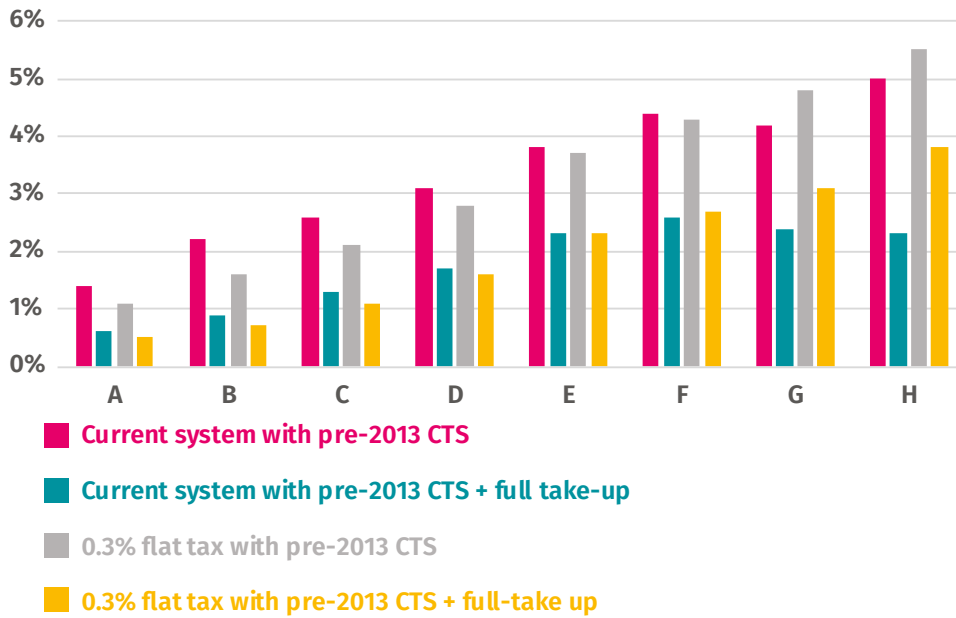
Source: IPPR analysis of FRS 2011/12, 2012/13, 2013/14 and 2014/15, the House Price Index, and data collected through the Land Registry

As with the figure above, figure 5.3 shows that it is the council tax benefit system which makes the difference in terms of reducing the burden by income across the different council tax bands. A flat tax rate does however lower the burden on households living in the lower council tax bands.

Figure 5.4 shows that a flat-tax rate lowers the burden on private renters and social renters and marginally increases the burden on those who buy with a mortgage. A flat-rate increases the burden on owner-occupiers. In both cases however, the council tax benefit system where full take-up of all those that are eligible is achieved has a much more significant impact on the burden of council tax across all tenures.

FIGURE 5.3: A FLAT-TAX RATE INCREASES THE BURDEN ON HOMES IN THE HIGHER COUNCIL TAX BANDS AND LOWERS IT ON HOMES IN THE LOWER BANDS

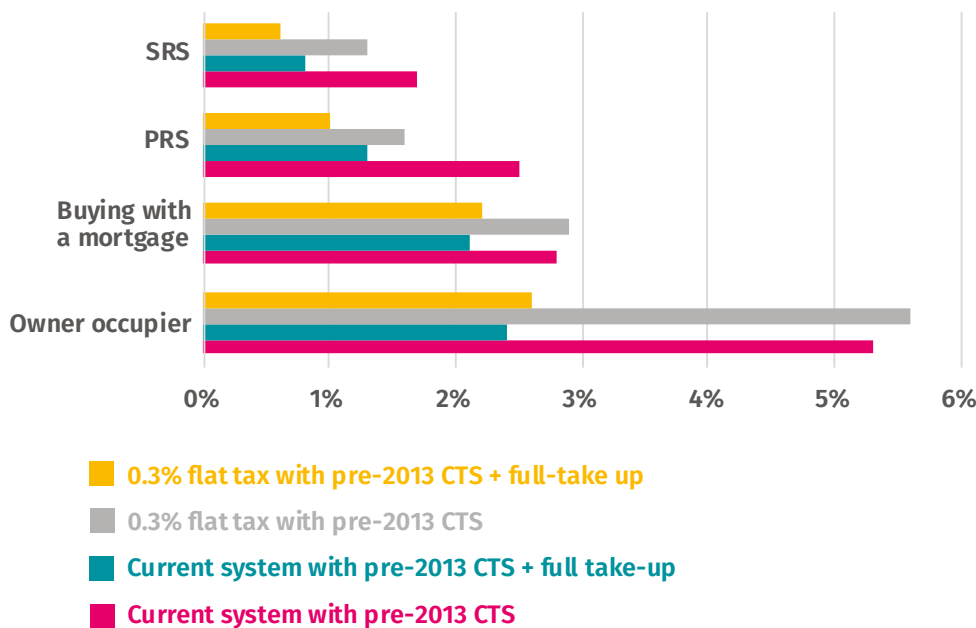
Council tax as a percentage of equivalised household income before housing costs by council tax band under the current banding system and a flat-tax rate of 0.3 per cent, using the pre-2013 council tax support system under normal take-up and full take-up scenarios



Source: IPPR analysis of FRS 2011/12, 2012/13, 2013/14 and 2014/15, the House Price Index, and data collected through the Land Registry

FIGURE 5.4: A FLAT-TAX RATE INCREASES THE BURDEN ON OWNER OCCUPIERS

Council tax as a percentage of equivalised household income before housing costs, by tenure under the current banding system and a flat-tax rate of 0.3 per cent, using the pre-2013 council tax support system under normal take-up and full take-up scenarios



Source: IPPR analysis of FRS 2011/12, 2012/13, 2013/14 and 2014/15, the House Price Index, and data collected through the Land Registry

Who should pay a flat-tax rate?

Our analysis of distributional impacts is based on a system where the flat-tax rate is paid by occupants rather than owners of properties, as is the case under the current council tax system. However, to bring the UK in line with many of its international counterparts, we recommend that the property tax be levied on owners rather than occupiers.

As Corlett and Gardiner (2018) outline, there are considerable administrative savings to be made through this approach. After all, owner occupiers tend to move less frequently which means costs would be lower and the tax would have to be applied to fewer new people each year. It would also likely see lower volumes of arrears and court action which come about through non-payment of council tax under the current system (ibid). There would clearly still be implications for tenants under the new system. An increase in tax on owners may be partially offset by higher rents passed on by landlords. The importance of the benefit system as part of any reform will therefore be crucial, as will mechanisms for deferral (see below). Under a system where the tax only applies to owners, consideration should be given as to how best to provide support.

In addition, it should also be noted that applying the tax to owners alone would reduce the salience of property tax, which is frequently cited as a major cause of council tax's unpopularity (Slack and Bird 2014).

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. A rate of 0.25 per cent would be fiscally neutral for London.

5.3 DELIVERING A REFORMED SYSTEM IN PRACTICE

Replacing the current council tax system will require a number of measures and strategies to ensure a successful transition. Here we set out those measures to help ensure such a transition, learning from experience abroad.

Transitional relief for council tax payers

The implementation of a flat-tax rate will inevitably see winners and losers and for some the changes could be significant. As the international experience suggests, there is a strong case for phasing in changes in order to cushion the impact of any reforms. There is also precedent for such a system in England in the case of business rates where a transitional relief system exists (MHCLG 2019d, Wingham 2017). Under this system, changes are phased in gradually with a limit applied to increases or decreases in rates each year. This approach could be replicated under a reformed council tax system for affected households, but such a system would have to be paid for. Wingham (2017) sets out three options for paying for such scheme; using additional revenue raised through a new system; utilising the potential 'gains' from those who benefit from the reforms in the early years to pay for the support for those who lose out; or by applying a time-limited additional levy to pay for the relief in the short term.

Support for those on low incomes

Even with a transitional relief system, low-income households will still face issues of payment. For many owner occupiers, given they are asset rich, an deferral system will be the most appropriate. However, there will still need to be a form of system that recognises and supports low-to-middle income renters (social and private) and some owner occupiers. Even where a tax is applied to owner-occupiers, we would expect some of the tax to be passed on. Therefore, under the new system, there is still a case for retaining 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 in this situation. This would help support those living in inner London in particular who otherwise might face an undue burden from the reforms.

Mechanisms for deferral

There is a strong case for introducing a scheme which allows the deferral of payment until a property is sold or the owner dies. As outlined earlier, Ireland has introduced a system for those in financial distress where interest is charged, and payment is made when the property is sold or if financial circumstances improve (Whitehead and Travers 2018). There are of course important sensitivities around taxes that arise following a person's death which will need to be considered as part of any mechanism for deferral. This will include how such payments might be administered alongside inheritance tax for example and who might administer the payments, including whether there is a role for HMRC.

Payment at source

The international experience (ibid), as well as the evidence from our focus groups with Londoners, suggests that the salience of property taxation (and therefore the opposition to increases in rates) is partly a consequence of the way in which it is paid. We therefore recommend that any system should include the capability for payment to be taken at source. Such a system already exists in Ireland.

Regular revaluations

One of the key problems of the current council tax system is the failure to update property values. As the international evidence attests, this is not a problem unique to England and it causes difficulties in almost all countries. Nevertheless, it is essential to incorporate into any system the ability to revalue properties on a regular basis. In this instance, we recommend two potential ways of approaching regular revaluation. The first option would be to carry out revaluations on an annual basis. Revaluation is a more straightforward and less expensive process than it used to be due to the availability of sophisticated computer models and large datasets (Whitehead and Travers 2018). However, if the time or resources proved to be too burdensome then we would recommend revaluation every three years, using an indexing system to uprate in between. We would note, however, that even with an indexing system in place, the longer changes in property prices are not reflected in the tax system, the harder it is to update the values.

Invest and reform

As the system of local government finance comes under increasing strain, the case for council tax reform becomes stronger. However, as we learned from our focus groups with Londoners and from the international experience indicates, undertaking substantial reform of the council tax system while local public services continue to be cut back is a recipe for failure. While the case for reform grows, our research suggests that it would be wise to couple reforms with rising investment and improvements in local public services.

Transitional relief and long-term redistribution measures for local authorities

As with individual taxpayers, reforms to the council tax system will see winners and losers among local authorities. In some cases these differences will be substantial. A system to allow redistribution to occur between local authority areas within London will therefore be necessary. These measures could be phased out over time, but equally will need to last as long as necessary to ensure that individual areas are not disproportionately disadvantaged.

Communicating any reforms

Our conversations with Londoners made clear that the complexities of the current council tax system are off-putting. Moreover, it was also clear that for

any reforms to be successful, particularly around such a potentially controversial topic as property tax, they need to be communicated in an easily understandable form. Any communications should also be clear how a reformed tax system will be allied to improved local public services.

What about the rest of England?

The council tax system is in need of reform in the rest of England as it is London. On the basis that we have set out a London system for council tax in this report, there could also be a case for council tax to be devolved elsewhere. However, extensive consideration of the system outside London was beyond the scope of this report.

We also believe that the need to provide greater support those on the lowest incomes is both urgent and essential. Therefore, in the absence of devolution or London-only reform, we believe that there is a strong case for reform of the council tax benefit system across England. This could be in the form of returning to the pre-2013 system or on the basis of mirroring the universal credit system as set out earlier in this report.

There is also an argument that it is unfair to allow London to collect a property tax on London property (particularly inner London property) from a national perspective. There is a strong case that London's property market is at the centre of a national economy, and that people outside of London should also benefit from the taxation of that property wealth. A recent IPPR report (Roberts and Lawrence 2017) found that the total value of housing stock in London is now greater than the housing stock of all of Wales, Scotland, Northern Ireland and the north of England combined.

Our proposal in this paper proposes that council tax be replaced by a devolved property tax in London, but this does not negate the idea of a nationwide levy to be applied on top of this. This could work in tandem with other devolved schemes in other regions of England. However, the political difficulties associated with this would be difficult to say the least and assessment of such a proposal is beyond the scope of this paper.

6. CONCLUSION

The council tax system in the capital is increasingly unfair and unsustainable. At any point over its lifetime, it would be difficult to claim that the council tax system met our criteria particularly well – fair; effective, feasible and sustainable; efficient; and accountable. But it is now falling further and further short.

In the short term, devolving responsibility for council tax to London, and putting in place a system which protects those on the lowest incomes who are increasingly being hit as a result of the government's reforms, must be the priority.

But in the long term, there is a strong case for more fundamental reform. We recommend replacing the current system with a tax that is a percentage charge of today's property values, with regular revaluations, a deferral scheme. We also recommend making the necessary changes one that international experience shows can, crucially, ensure reform commands political and public support.

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ANNEX A: REFORM OPTIONS TESTING

For each reform, we tested the impacts on two key indicators: (1) household burden (council tax as a proportion of gross annual income), and (2) council revenue.

HOUSEHOLD BURDEN

Using our imputed house price data for 2015 as used in our interim report, *A poor tax – Council tax in London: Time for reform*, for each reform option we have assigned a household a new expected council tax rate. Once applied, we have repeated the original burden analysis following the same methodology as presented in our interim report.

The FRS sample we use in this research is London-only and comprises households buying with a mortgage, outright owners, or households renting (both social and private rent) over the period 2011/12 to 2014/15 (n=6,541).¹

Council tax rates have been applied using a London-wide average, for the period 2011/12 to 2014/15, to correspond with the survey waves. The average council tax bill for Band D across London's boroughs during this period, including the GLA precept, was £1,309. Where we have applied progressive rates, we have used this Band D as a constant and proportions modelled by the GLA (Wingham 2017); similarly, where we have included additional higher bands.

For each reform option, additional information has been used to apply further discounts and adjustments in calculating each household's liability. Households identified in the FRS as having a formal exemption as an all-student (full-time) household are deemed not liable for council tax in this analysis. We have also applied a 25 per cent discount to all single-person households who report receiving this adjustment. These are features built into the council tax system itself, rather than the benefits system. They are consistent nationally and have been present since the introduction of council tax.

As a proxy for the current mix of discounts, minimum payments and exemptions applied to council tax following the reform and devolution of council tax benefit in 2013, for any household entitled to council tax benefit and claiming it – approximately two-thirds of eligible households nationally (Adam and Browne 2012) – we have applied a total exemption for disabled households. To all others, a 17.9 per cent minimum payment.¹⁰

Where we have applied new bands, band limits have been calculated as per the method applied for our council revenue analysis detailed below – and based on Land Registry price paid data.

COUNCIL REVENUE

To estimate the financial impact for councils, we have used data reported by London Councils' council tax monitor for 2015–16 – providing councils' Band D rates and total revenue raised – and housing stock data from DCLG for the

¹⁰ See Annex A in our interim report (Murphy et al 2018).

corresponding year which identifies the number of properties in each band in each borough. Adopting the methodology developed by Wingham (2017), we have calculated a ‘propensity to pay’ ratio for each band. This is designed to control for variation in discounts, exemptions and minimum payments, both across London’s boroughs and between households.

This is calculated for each borough and band by estimating the total revenue raised by a band and dividing this by the council tax rate for that band. This provides an estimate of the number of properties paying 100 per cent council tax. By then dividing this by the total number of dwellings for the band, we generate a likelihood of paying full council tax which can be attached to all properties falling within that band.

We estimate ‘total revenue raised by band’ first by calculating the difference between the total potential revenue (that is, the sum of all council tax receipts if all properties paid a full council tax liability with no discounts or exemptions) and the actual revenue raised, as reported. This difference in revenue is then divided across council tax bands based on the proportion of a borough’s dwellings in each band and subtracted from the total potential revenue for that band.

Land Registry price paid data for 2015 provides information on the distribution of house prices across London, with a sample size of 129,566. Deflating these prices to 1991 levels (see annex A in our interim report Murphy et al 2018), we have assigned each a council tax band. Each property is then designated a propensity to pay ratio based on their band and borough, and a council tax rate. The data is then weighted to be scaled upwards to reflect the total number of dwellings by band and by borough.

Using this method, we estimate a total revenue across London of £3,532 billion. This is £2–3 million higher than the actual reported figure of £3,529 billion. This suggests a fairly good estimation method.

For each reform option, the band limits and/or council tax rates are adjusted accordingly, and the total for each borough – and for London as a whole – calculated as the sum of each dwelling’s council tax liability (the product of band rate and propensity to pay – or in the case of a flat rate tax, the product of tax-proportion, house price, and propensity to pay).

To reset council tax bands, we have used a combination of existing proportions, uprating indices, and percentiles, attached to the 2015 price paid data. Details of each reform methodology can be found in table A1.

TABLE A1: REFORM OPTIONS MODELLING USING 2015 LAND REGISTRY PRICE PAID DATA

Reform option	What is it?	How is it conducted?
Reform 1	2 new bands at top of scale in 1991 prices	(1) Uprate current bands to 2015 prices using uprating factor of 4.24 (as used in FRS modelling) (2) Select all properties from Greater London's 2015 price paid data from the Land Registry which would fall in Band H (> approx. 1.36m) (3) Record price of 33rd and 67th percentiles (4) Deflate prices back to 1991 using factor of 4.24 above
Reform 2	5 new bands at top of scale in 1991 prices	See Reform 1 using the 17th, 33rd, 50th, 67th, 84th percentiles
Reform 3	Revaluation to 2015 prices – same number in each band	(1) Select all properties from Greater London's 2015 price paid data from the Land Registry, all prices (2) Use proportion of properties in 2015 current bands to identify percentiles for each in 2015 prices
Reform 4	Revaluation to 2015 prices – same number in each band, with 2 new top bands	See Reform 3 – then... (3) Divide band H into 3 equal groups, record price of 33rd and 67th percentiles
Reform 5	Revaluation to 2015 prices – same number in each band, with 5 new top bands	See Reform 3 – then... (3) Divide band H into 6 equal groups, record price of 17th, 33rd, 50th, 67th, 84th percentiles
Reform 6	Revaluation to 2015 prices – uprating band ranges to 2015	(1) Uprate current bands to 2015 prices using uprating factor of 5.24 (as used in FRS modelling) (2) Calculate proportion of properties falling in each band within Greater London's 2015 price paid data from the Land Registry (3) Use proportions to assign number of properties within London's 2015 total stock count
Reform 7	Revaluation to 2015 prices – uprating band ranges to 2015, with 2 new top bands	See reform 6 – then... (3) Divide band H into 3 equal groups, record price of 33rd and 67th percentiles
Reform 8	Revaluation to 2015 prices – uprating band ranges to 2015, with 5 new top bands	See Reform 6 – then... (3) Divide band H into 6 equal groups, record price of 17th, 33rd, 50th, 67th, 84th percentiles
Reform 9	Revaluation to 2015 prices – same number in each band, progressive rates	See Reform 3 – then... (3) Based on average band D, apply GLA Economics' progressive bands for the rates
Reform 10	Revaluation to 2015 prices – same number in each band, with 2 new top bands, progressive rates	See Reform 4 – then... (3) Based on average band D, apply GLA Economics' progressive bands for the rates
Reform 11	Revaluation to 2015 prices – same number in each band, with 5 new top bands, progressive rates	See Reform 5 – then... (3) Based on average band D, apply GLA Economics' progressive bands for the rates
Reform 12	Revaluation to 2015 prices – flat rate tax of 0.25%	See Reform 3 – then... (3) Calculate average price paid per band using Greater London's 2015 price paid data from the Land Registry (4) Calculate 0.25% of average price per band (5) Multiply average tax amount by number of properties in each band (actual)



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