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Report On The Funding And Structure Of Local Government

Part V - Some Possible Solutions

Michael Boon

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1. INTRODUCTION

In contrast to Part IV of my report - where I examined various options which have been proposed as "solutions" to the problem of Local Government finance and which I believe **won't** work - this part of my report examines some of the options which I believe **could** be made to work.

Any reform to any taxation system designed to address issues like affordability and "fairness" is bound to involve an element of redistribution of the burden. In any such redistribution there are always losers as well as winners. It is especially important that the **losers** see any changes as being broadly "fair" - even though they will almost certainly not like them! It is also important that the **impact** of any changes is phased in gradually. It is not just the poor who find it difficult to cope with large, sudden, unexpected demands on their resources. Many people on substantial incomes have already committed large slices of it on mortgages, school fees and the like. Only those with considerable liquid savings do not need to budget and plan so carefully.

In investigating possible alternative ways of funding Local Government, I have studiously avoided any attempt to make the overall impact of the tax and benefits system any more progressive or any more regressive than it currently is. Good arguments can be made for either position. However I believe that it would be dishonest to use any changes to the **system** to "smuggle in" other changes. The case for any such changes ought to be made completely separately. My sole aim has been to try to alleviate the real hardship and "unfairness" associated with the current system. I have therefore tried to minimise so far as possible the number of big winners and big losers. If this is achievable, then any proposals resulting from my investigations ought to be acceptable to the losers - as well as to the winners.

What I have attempted to do is to arrive at the type of situation illustrated in figure 1.

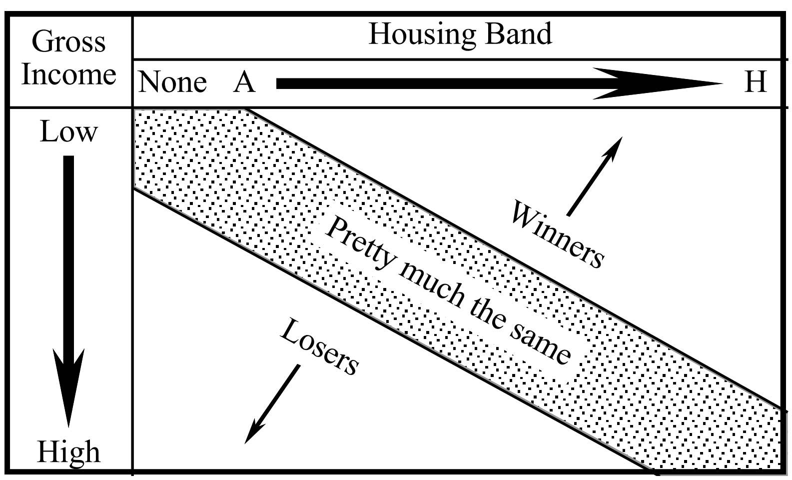

Fig. 1

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In such a situation, all those people who live in the type of housing which is “appropriate” to their incomes would see little change in their total tax bills. The main winners would be the people on lower incomes who currently pay relatively high amounts in Council Tax - often because there are not enough lowly Banded houses available for them to live in. The main losers would be those people who currently pay relatively little Council Tax but enjoy relatively high incomes.

The activities currently undertaken by Local Government require funding. This will be true whoever undertakes them. Insofar as it is possible, such funding should be achieved in a way that provides a close match to the somewhat idealised criteria for taxation developed in Part II of my report. In brief, this means that any new or increased taxes have to: be **affordable** for those who have to pay them; be **predictable** in terms of their impact both by those who pay them and by those who impose / collect them; be "fair" and **non-discriminatory**; be easily, efficiently, and cheaply collected and difficult to avoid; do minimum damage to the economy; bear a direct relationship to the expenditure that they are supposed to fund and who benefits from, or votes for, that expenditure.

I believe that this means that there are only a limited number of possibilities for improvement. In general terms these involve one, (or more), of:

- Changing the **balance of funding** so that any local tax takes a significantly **smaller share** of the overall tax burden than it does at present. I discuss this in Section 2 of this part of my report

- Introducing a reformed property tax which does not have so many disadvantages as the current Council Tax system. I discuss this option in Section 3 of this part of my report

- Reforming the **benefits system** so as to make the **impact** of any local tax more “affordable” and / or less “unfair”. I discuss some possible improvements to the Council Tax Benefit system in Section 4 of this part of my report.

- Introducing a local income tax. I discuss this option in Section 5 of this part of my report

- Re-introducing the Poll Tax - but **only** as a supplementary tax. I examine this option in Section 6 of this part of my report

- Changing the **relationship** between Central and Local Government so that **local** people have more control over the **local** taxes that they are asked to pay to fund **local** activities. This is dealt with in Section 7 of this part of my report.

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Finally, although I consider the case for repatriation of the business rates to be unproven, I include, as section 8, some ideas which might make some of the anticipated difficulties from doing so less severe.

2. CHANGING THE BALANCE OF FUNDING

2.1 Changes to national taxation

Any reduction in local taxation, including its complete abolition, will have to be paid for by changes elsewhere in the tax regime. This section is restricted to a consideration of some of the more plausible options for increasing taxation at the Central Government level.

Figure 2, which uses data from Table C8 of the budget report for 2005, shows the Treasury projections of the yields expected in the financial year 2005/6 from the major revenue generators. Unless there are good reasons for supposing that the revenues from any other existing tax could be substantially increased without causing undue disruption to the economy or rioting in the streets, these are the only **existing** taxes that it makes any sense to take into consideration when discussing how reductions in, (or abolition of), local taxation could be financed. The yields on all other existing taxes are simply too small to be able to make a significant contribution. Small increases in big, broadly based taxes are also much less likely to cause unexpected problems or unintended consequences, (such as hardship), than are large increases in narrowly based, small taxes. In a sense, this is exactly what has gone wrong recently in the case of the Council Tax.

Income Tax	£138.1Bn
National Insurance	£82.6Bn
VAT	£76.3Bn
Corporation Tax	£43.7Bn
Fuel Duties	£24.6Bn
Council Tax	£20.9Bn
Business Rates	£19.4Bn

Fig. 2

In the following subsections I briefly examine each of these major revenue generators in turn and assess their potential for increased yield. Where appropriate, I also make comments about the "fairness" of any possible changes.

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Income Tax

There are three main ways in which we could increase the take from income tax:

- We could increase tax **rates**
  - For example: increasing the starting rate from 10% to 11% would yield an extra £0.55Bn; increasing the basic rate from 22% to 23% would yield an extra £3.69Bn; whereas increasing the top rate from 40% to 41% would yield an extra £1.16Bn
- We could reduce tax **thresholds / allowances**.
  - For example: Reducing the personal allowance from £4895 to £4795 would yield an extra £0.61Bn; reducing the basic rate threshold from £2090 to £1990 would yield an extra £0.31Bn; whereas reducing the higher rate threshold from £32,400 to £32,300 would yield an extra £0.04 Bn.
- We could introduce **new bands and rates**
  - For example if we were to increase the top rate of tax from 40% to 50% on incomes over £100,000 p.a., (as proposed by the Liberal Democrats until recently), the extra yield would be £4.72Bn.

It is immediately apparent from these figures that the lion's share of any extra yield from income tax has to be taken from adjustments to the basic rate of tax. Adjustments to other rates and allowances really only make much sense when used to remove problems that might arise at the margin or to make the change politically more acceptable.

There will never be complete agreement on what the appropriate rates of Income Tax on different slices of income "should" be. Some people, (usually those on lower incomes), would like Income Tax to be more progressive than it currently is. Other people, (often those on higher incomes), would like it to be less progressive. I do not propose to try to adjudicate on this issue.

National Insurance

Although I doubt whether the National Insurance system is the best possible design of system for the function that it is supposed to perform, I do believe that the impact of the system on different sections of society is broadly "fair".

In any case, since the government has recently tapped National Insurance Contributions in order to provide extra funds, it would not now appear to be a prime candidate for further milking at this juncture.

Value Added Tax

Just about everybody spends money so that just about everybody also pays VAT. The virtues of increasing the take from VAT are very similar to those associated with the old Community Charge. Everybody who has the right to vote has to bear some of the consequences of their views on public expenditure. **Everybody** contributes **something**, (however little), to the common pot. There are two main ways of increasing the VAT take:

- We could increase the **rate** of VAT but still charge on the existing basis. Each "one per cent", (e.g. from 17.5% to 18.5%), increase in the rate would, on the latest figures available to me, lead to an increase in the revenue from VAT of between £3.68 Bn and £4.36 Bn. The lower figure assumes that consumers still spend the same amount in **pound** terms on items liable to VAT. The higher figure assumes that they still purchase the same amount in **volume** terms. Both calculations assume that intermediate rates of VAT rise in line with, (i.e. proportional to), the standard rate. The actual outcome is likely to come somewhere between these two values.

- We could **broaden the tax base** by increasing the range of goods and services on which VAT is payable and / or removing some of the lower rated, zero rated or exempt items and charging standard or the next higher rate for them. There are so many possible options here that any detailed calculations are probably meaningless. However it is comparatively easy to estimate the effect of charging VAT at the uniform rate of 17.5% on **all** consumer expenditure. Doing this would have raised between £35.5Bn and £41.8Bn extra in the financial year 2003/04. The lower figure is based on the assumption that the **gross value** of consumer spending stays unchanged, (i.e. that the volume of trade is reduced because of the effect of the VAT increase), whereas the latter figure assumes that the **volume** / pattern of consumer spending remains unchanged, (i.e. people save less). The actual turnout would be somewhere between these extremes.

The main disadvantages of increasing VAT are that it would add to headline inflation, (although this **ought** to be a once-off effect), and could lead to some of the extra revenue being diverted to the EU as part of Britain's budget contribution.

Corporation Tax

Although it would be perfectly possible to increase the tax take from businesses with very little ensuing fuss, (businesses don't have votes), I believe that the probable resultant economic damage should preclude this option from any further consideration.

Fuel Duties

Road fuel in Britain is more highly taxed than it is in most competitor countries. This already causes real commercial problems for hauliers near the Channel Tunnel and the ferry ports. Any increases in the price of diesel fuel would seem to me to be economically unwise. In fact, remembering the fairly recent fuel protests, **any** increase in the tax on **any** road fuel would appear to be asking for trouble.

Council Tax

Obviously we would not contemplate raising Council Tax in order to reduce it!

Business rates

Since business rates are already redistributed back to Local Authorities, “purloining” any portion of them, as called for by the Local Government Association, will do nothing to solve the funding problem associated with the reduction in other forms of local taxation. We could however potentially increase the **share** of the total burden borne by business rates. Indeed, I have already shown in Part IV, Section 4.1 of my report how the share of business rates in funding Local Authority expenditure has fallen over recent years. While I can see no logical argument for any particular share being the “right” one, I do consider that, so far as possible, business property should be taxed in exactly the same way as residential property. This would inevitably mean that any domestic property tax and business rates would march in step so that no further decrease, other than perhaps a one-off adjustment, in the business rates share of the total burden would take place. However, as I discuss in Part IV, Section 4 of my report, the case for any “repatriation” of the business rates is unproven.

Inheritance Tax

At first sight Inheritance Tax does not appear to be a particularly attractive candidate to replace any revenue lost from reductions in, (or abolition of), the Council Tax. The budget projections anticipate total revenues of only £3.4Bn from this source for the fiscal year 2005/06. However, this merely reflects the fact that Inheritance Tax is a largely **voluntary** tax - and is often so described. Avoidance is easy - and one suspects that it has been deliberately made so. However, at a conservative estimate, (based on figures for 2004), the total value of England’s, (not the UK’s), housing stock is some £3,186Bn. Even if only half of this is ever inherited and even then only every 60 years, (both conservative estimates), then the potential taxable base from Inheritance Tax purely on housing wealth alone is of the order of £26.5Bn per annum! A tax at a rate of 80% on this would yield more than the Council Tax!

For some reason Inheritance Tax now appears to be unpopular. One suspects that this is purely selfishness. It was OK, and even popular, when only a small number of other people’s estates were hit. Now that house prices have risen to the point where the many are faced with the prospect of paying the tax for the first time it suddenly becomes “unfair”. However, is it “fair” that some people can inherit thousands of acres, whole streets of attractive parts of London, and seats in the House of Lords or on boards of directors when others struggle to afford any sort of home or find a decent job? Inheritance tax at rates close to 100% on all but the tiniest estates would seem to be a “fair” tax. It would help to achieve equality of opportunity, would not involve rewarding the idle and spendthrift at the expense of the hard working and prudent and would, obviously, (since inheritance is always something of a windfall), be directly related to the ability to pay. Such a tax would also remove the anomalies and all the ill feeling associated with paying for care for the elderly. It would no longer matter whether the elderly paid for their care in homes or not. The state would get its dues in the end!

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Obviously, the rate of Inheritance Tax would have to be much the same on all sorts of wealth - otherwise people would simply tend to hold their wealth in the most tax efficient form. Equally, the rates would have to be much the same in all areas - otherwise the elderly might tend to congregate in areas with the lowest rates of Inheritance Tax.

Summing up

As a result of the considerations dealt with in this section, I have concluded that only Income Tax and VAT offer sufficient scope in the short term for funding a substantial reduction in, or the total abolition of, local taxation. How raising this extra tax would be divided between Income Tax and VAT, as well as between lower and higher rates of Income Tax, is largely a matter of taste.

2.2 Some sample calculations

According to figures from the Office of the Deputy Prime Minister, (as it then was), Council Tax in **England** is expected to yield revenue of £20.3 Bn in 2005/06. According to the most recent census, the population of **England** represents 83.9% of the total population of the **UK**. On this basis, to abolish the Council Tax in the whole of the UK, (including the Rates and / or *ad valorem* tax in Northern Ireland), we would need to raise around £24.2 Bn from other sources. However, the figures from the ODPM website are gross revenues. In 2002/03 Council Tax Benefit in Great Britain, (i.e. excluding Northern Ireland), amounted to £2.84 Bn. while gross receipts from Council Tax amounted to £19.4 Bn. Assuming that the same ratio of CTB to Council Tax applies in 2005/06 as applied in 2002/03, then the net amount of Council Tax collected should be of the order of £20.7Bn. The Treasury's estimate for the same figure, (obtained by a completely different method and using different data), is £20.9 Bn. The difference between these two figures is within the normal margin of error that has applied in the past to the Treasury's estimates of this particular budget item.

If we abolish Council Tax altogether, then the need for Council Tax Benefit will disappear - although those who currently receive CTB will need some other benefits to offset the increased VAT, and possibly Income Tax, used to finance the abolition of the Council Tax that they would incur. While calculations on alternative funding to enable the **total abolition** of the Council Tax could obviously be made on the net figure for the Council Tax yield, I believe that it would be sensible to include some over-funding to pay for the replacement of CTB for those who need it. However, if we are only to **reduce** Council Tax, we need to recognise that, although the amount of Council Tax benefit that needs to be paid will be reduced, some need for CTB will still remain. In my calculations, I have assumed that the amount needed for CTB is directly proportional to the amount collected in Council Tax.

On the basis of adding a bit to cover Northern Ireland Rates, or their probable replacement by an *ad valorem* property tax, (we need to do this because those in Northern Ireland pay Income Tax and VAT just like the rest of the UK), and for the reasons given above, I believe that we should deliberately aim for some over-funding. On this basis I believe that aiming for a total yield from additional taxes of the order of £25 Bn. would be appropriate.

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Income Tax

According to the Inland Revenue there are expected to be 22.6 million basic rate tax payers in the UK contributing £59.6 Bn to the exchequer in 2005/06, while the 3.6 million higher rate taxpayers are expected to provide a further £73.3 Bn. Only £20.9 Bn of this comes from having a higher rate tax of 40%. The remaining £52.4Bn comes from what is, in effect, basic rate tax on these same higher rate taxpayers.

In Section 2.1, I showed that the effect of putting a penny on the standard rate of income tax would be to increase revenues by £3.69 Bn. In round terms, £1.2Bn of this would come from higher rate taxpayers whereas £2.5Bn would come from basic rate taxpayers. Basic rate taxpayers would **on average** therefore contribute an extra £111 per head per annum whereas higher rate taxpayers would contribute an extra £333 p.a. per head.

Figure 3 shows how much extra revenue would be raised by the various possible combinations of putting 2 p, 3p or 4 p on basic and / or higher rates of income tax.

Basic Rate IT	Higher Rate IT	Extra Revenue	Funding Gap
24%	42%	£9.69Bn	£15.31Bn
25%	42%	£13.38Bn	£11.62Bn
26%	42%	£17.07Bn	£7.93Bn
24%	43%	£10.85Bn	£14.15Bn
25%	43%	£14.54Bn	£10.46Bn
26%	43%	£18.23Bn	£6.77Bn
24%	44%	£12.01Bn	£12.99Bn
25%	44%	£15.70Bn	£9.30Bn
26%	44%	£19.38Bn	£5.62Bn

Fig.3

The funding gap shown in figure 3 is the amount of extra revenue that would still have to be raised from other tax increases in order to reach our target of £25 Bn

It is a simple matter to work out how much more, (or how much less), any individual on a given income would pay in income tax resulting from any changes to rates or allowances. However, for most people, total **household** disposable income is much more important than **individual** disposable income in determining their well-being. Unless we have a flat rate income tax regime, or unless we revert to taxing joint incomes of husband and wife, (or more accurately start taxing total household incomes), then the effect of any income tax changes on household incomes will be very dependent on how the total income is split between the various individuals comprising the household.

Under any progressive, separate taxation regime, one earner households will always be penalised when compared with similar households on similar gross incomes whose incomes arise from more than one earner. For two earner families the amount of extra tax rises as the percentage of the total household income that the main bread-winner brings in rises.

The effect of splitting incomes is most marked among lower income households. This is unfortunate since most single earner households which are not just single adult occupancy ones, usually consist of families with young children. Children tend to be expensive. Since people also tend to earn less when they are younger and less experienced, and since people with young children tend to be young themselves, one wonders whether this apparently undesirable effect is simply the unintended result of governments pursuing otherwise desirable but mutually contradictory objectives.

The only way to mitigate this effect is to make income tax somewhat **less progressive** as one raises the total amount of income tax that one tries to collect. With a totally flat tax and no allowances, the effect would disappear altogether.

Bearing in mind that our sole purpose in considering rises in income tax is so as to be able to fund substantial reductions in the Council Tax, or even its complete abolition, it makes sense to examine how a household's disposable income would change in money terms from combining the reduction in Council Tax with the increases in income tax. There are obviously many possible combinations. Much will depend upon the band of the property one lives in and how the earnings within the household are split as well as on the level of gross household income itself.

However, we can only get a realistic picture of how the Council Tax burden would be redistributed by considering the impact on typical households of the other taxes, (mainly VAT), that would need to be raised in order to close the funding gap.

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Value Added Tax

One of the great advantages of using changes in VAT to finance any reductions in the Council Tax, including its complete abolition, is that it is the **broadest based** of all our existing taxes. This means that the size of anyone's losses arising from an increase in VAT are likely to be smaller than they would be with other taxes. As I indicated at the beginning of this section, there are some difficulties in predicting the exact yield from any increases in the rate of VAT or indeed any broadening of the tax base. This difficulty arises because nobody can be absolutely sure how the spending behaviour of the consumer will be altered by the price changes resulting from a change in VAT. The two extreme assumptions are that people will continue to spend the same amount on each type of goods as they did before, (i.e. they purchase less of them as the prices rise so as to keep their spending constant in money terms), and that they ignore the price changes and buy exactly the same volume of each type of goods as they did before. These are known as the constant spending and constant volume scenarios respectively.

Based on figures for 2003/04 only the equivalent of some 66% of total consumer expenditure is, on average, currently subject to VAT. This percentage is not much altered whether one adopts the constant spending or constant volume scenario. The figure remains at sixty six point something percent.

(***Technical note:*** *in my calculations of the fraction of consumer expenditure that is VAT free I have treated items like domestic energy which carry a preferential rate of VAT as though they were two items - one subject to VAT at the full rate and the other VAT free. This has no significant effect on any of the calculations*)

This result is important since it means that, in some respects, we do not need to worry over much about the difference between the constant volume and constant spending scenarios when we come to consider the effects of any VAT changes.

The most obvious effect of VAT changes on individuals and households is by way of the increased prices that people would have to pay on those items that are subject to VAT. For example, an increase in VAT from 17.5% to 18.5% would increase the price of something currently costing £100 by 85 pence, but the retail price index would only rise by 0.56%. The change in the retail price index is smaller than the rise in price of items liable to VAT since approximately 34% of consumer expenditure is not liable to VAT.

There is no doubt that VAT is intended to be a progressive tax. Given that most essential items of expenditure, like food and housing, do not bear any VAT, it probably is. However some statistics on households produced by the Office for National Statistics suggest that it might not be.

This is probably a statistical freak caused by the way in which households are aggregated and segmented. For example, households are segmented according to their gross incomes. It is obvious that a household of two people who are both earning will normally have a higher income than a household of one person. Yet it is quite possible that the single person household will spend a greater proportion of their income on non essential items, and therefore pay more VAT, than a household in which a slightly larger gross household income has to support more people. I have therefore decided that I will use a constant amount of VAT for every £100 of everybody's expenditure when examining the effect of any VAT changes on individuals or households. Despite the fact that the ONS figures would suggest that households at **both** ends of the income distribution actually save a greater proportion of their incomes than do households in the middle, I have also decided to use a uniform savings ratio across all income brackets. (The ONS figures for saving are potentially distorted by much the same sort of effects as the figures for gross income. If you are single and have plenty of money for essentials, you are likely to spend more on items liable to VAT as well as saving more of your income than people who are really hard up - e.g. one slightly larger income supporting two people).

With these (rather sweeping) assumptions, it is relatively easy to calculate the effects of any changes in VAT on people and households in various income brackets.

Combined effects of VAT and income tax on real household incomes

If we were actually trying to increase the total amount of revenue to the Exchequer by raising taxes, we would undoubtedly have to consider the effect that increasing income tax would have on the aggregate disposable income or purchasing power, and hence on spending, of the population as a whole. However my aim is to achieve a situation that is more or less revenue neutral once Council Tax has been reduced or abolished. This means that the purchasing power lost by increases to Income Tax and VAT ought to be completely offset, on aggregate, by the gains in purchasing power from the abolition or reduction of the Council Tax. It also means that, in the long term once things have settled down and perceptions have adjusted to reality, that the **constant volume** assumption on spending is likely to be nearer the truth from a **revenue** raising perspective but that a **constant real spending** assumption is likely to be more relevant when considering the behaviour of **individuals and households**.

The **immediate** effects of any proposed changes are harder to predict than the **long term** effects. Nobody really knows whether the psychological effect of having more money in one's pocket will lead to increased spending or whether the higher prices will cause people to cut back. As I have indicated, in the longer term these effects ought to more or less counterbalance each other when considering **aggregate** spending.

When we come to consider how to raise the extra £25Bn or so that I have indicated that we would need to raise in order to abolish the Council Tax, we find that our **plausible** options are very limited. For example, to raise the whole amount by way of VAT, the rate of VAT would have to increase to 23.24%. To raise the whole amount by way of increases to the basic rate of Income Tax, this rate would have to rise to 28.78%, whereas to raise it all by increasing the higher rate of tax would take higher rate tax to 61.58%. This suggests that the plausible limits within which VAT could be varied are something like between 20% and 22% and the plausible limits for basic rate income tax lie between 24% and 26%.

Figure 4 shows most of the plausible whole number combinations of changes to basic rate tax and VAT which will enable us, with appropriate changes to higher rate tax, to achieve this figure of approximately £25Bn total extra yield. In this table I have chosen to use the higher rate income tax as the "balancing item" since this is the smallest yielding of the three tax elements involved.

Basic Rate IT	Higher Rate IT	VAT Rate	Extra Yield
23.00%	41.46%	22.00%	£25.00Bn
24.00%	45.81%	20.00%	£25.01Bn
25.00%	42.62%	20.00%	£25.00Bn
26.00%	39.44%	21.00%	£25.00Bn
24.00%	42.04%	21.00%	£25.00Bn
25.00%	38.86%	21.00%	£25.00Bn
26.00%	35.68%	21.00%	£25.01Bn
24.00%	38.28%	22.00%	£25.00Bn
25.00%	46.39%	19.00%	£25.01Bn

Fig. 4

For the reasons that have already been discussed in connection with the potentially "unfair" effect on families with only one earner, I believe that we should only examine those combinations in figure 4 where the increase in higher rate tax is less than that in basic rate tax. If we don't do this, then we would, in effect, be making the overall taxation system more progressive than it currently is - in contravention of the principles illustrated in figure 1. In fact, to avoid the overall system becoming more progressive, we would probably need to **reduce** higher rate tax if we were to use a combination of Income Tax and VAT to reduce or abolish Council Tax.

Since I suspect that actual decreases to higher rate tax would be politically unacceptable, (although perhaps very desirable economically and in other respects), we are left with very few options. In round terms, the central options would appear to be either an increase of basic rate tax from 22% to 24%, an increase in higher rate tax from 40% to 42% and an increase in VAT from 17.5% to 21%, (which would raise an extra £24.95Bn), or an increase in basic rate income tax to 25%, an increase in higher rate tax to 43% and an increase in VAT to 20%, (which would yield an extra £25.44Bn). There is no reason of course why we should submit to the tyranny of whole numbers. An intermediate solution which would raise an extra £25.3Bn would be basic rate tax at 25%, higher rate tax at 41% and VAT at 20.5%. This is indeed the central position that I have chosen for further analysis.

Figure 5 shows how the **abolition** of the Council Tax, the change in VAT rate to 20.5%, the change in the basic rate of income tax to 25% and the change in the higher rate of income tax to 41% might be expected to **change** the percentage of gross income taken by the sum of all these taxes for some sample households. (A negative number means that a household gains whereas a positive number means that it loses out.) These households are assumed to be "standard" two earner households where the main breadwinner brings in two thirds of the total household income.

Gross Household Income	Council Tax Band							
	A	B	C	D	E	F	G	H
5000	-13.4%	-15.8%	-18.3%	-20.7%	-25.6%	-30.6%	-35.5%	-42.8%
10000	-6.0%	-7.3%	-8.5%	-9.7%	-12.2%	-14.6%	-17.1%	-20.8%
15000	-3.1%	-3.9%	-4.7%	-5.5%	-7.2%	-8.8%	-10.4%	-12.9%
20000	-1.6%	-2.2%	-2.8%	-3.4%	-4.7%	-5.9%	-7.1%	-9.0%
25000	-0.5%	-1.0%	-1.5%	-2.0%	-3.0%	-4.0%	-5.0%	-6.4%
30000	0.2%	-0.2%	-0.6%	-1.1%	-1.9%	-2.7%	-3.5%	-4.7%
35000	0.7%	0.3%	0.0%	-0.4%	-1.1%	-1.8%	-2.5%	-3.5%
40000	1.1%	0.8%	0.5%	0.1%	-0.5%	-1.1%	-1.7%	-2.6%
45000	1.4%	1.1%	0.8%	0.5%	0.0%	-0.5%	-1.1%	-1.9%
50000	1.6%	1.4%	1.1%	0.9%	0.4%	-0.1%	-0.6%	-1.3%
100000	2.1%	2.0%	1.8%	1.7%	1.5%	1.2%	1.0%	0.6%

Fig. 5

In deriving these results, I have also assumed that all households save 8.6% of their disposable income and spend around 66% of what is left on purchases liable to VAT, (roughly the national **average**), using the constant real spending assumption.

If we compare figure 5, with figure 1, we can see that the main winners are to be found in the top right hand part of the diagram whereas the main losers are to be found in the bottom left in both instances. In other words, the main effect of a regime of this type is to achieve precisely what we were aiming to achieve: lower income households living in the more highly banded properties are significantly better off. These tend to be just the sort of households who are suffering most from the "unfairness" of the current system of Council Tax. The main losers are those households in the upper income brackets living in more lowly banded property or those who currently pay no Council Tax at all. However, nobody loses in a really big way. The burden is spread around.

There are, of course, many other types of household besides my "standard" one, (some more possibilities are examined in the Appendix to my report). Figure 5 can only give a flavour of what would happen in practice. The overall picture would also be complicated by the impact of any changes to benefits. These would undoubtedly occur. However, since it appears to me that the overall impact of the benefits system tends to be somewhat haphazard in any case, there seems to be little point in attempting to allow for these effects here.

3. REFORMING DOMESTIC PROPERTY TAXES

In Part III of my report I presented analyses which showed that the present Council Tax system was "unfair" in two different senses:

- People on very similar incomes pay very different amounts in Council Tax
    - The percentage of people paying over 10% more in Council Tax than the average for their income bracket is substantial and is concentrated within certain Regions and certain types of Local Authority - see, for example figure 7 in Part III section 3.1
    - Certain Regions and certain types of Local Authority receive "too little" by way of Central Government grants, whilst others receive "too much" - see, for example figure 8 in Part III section 3.1

- Many people on lower incomes are paying substantially more in Council Tax than some other people on significantly higher incomes

There are two main reasons for this state of affairs - neither of which is directly due to Council Tax being based on property values, (in 1991 as it happens):

- The Council Tax Bands are used for two mutually incompatible purposes:

  — They are used to determine how much Central Government thinks that Local Authorities should raise from Council Tax - and hence to determine the size of Central Government grants. In other words they are used to determine how the tax burden is shared out **between** different Local Authorities

  — They are also used to determine how the burden of taxation is shared out between people **within** each Local Authority

  In effect, a **national** taxation system is being applied to what is really a **local** situation. This is why none of the ideas that involve making the Council Tax more progressive will actually work. Significant alterations to the Banding structure or the Band Multipliers will **only** work if they are **not** used to drive Resource Equalisation. Any extra subsidies to the less well off Local Authorities need to be arrived at on a completely different basis - such as the average income of the residents of that Authority. We need an extra "degree of freedom".

- The **shape** of the Council Tax Band profile does not remotely resemble the **shape** of the income profile. This is illustrated in figure 6 where I show the national household income distribution, (taken from the DWP report on *"Households Below Average Income"* for 2004/05, http://www.dwp.gov.uk/asd/hbai.asp), superimposed upon the current profile of the national distribution of property bands spaced according to the average Council Tax in each Band. In this diagram, the horizontal axis is money and the vertical axis is relative population / frequency.

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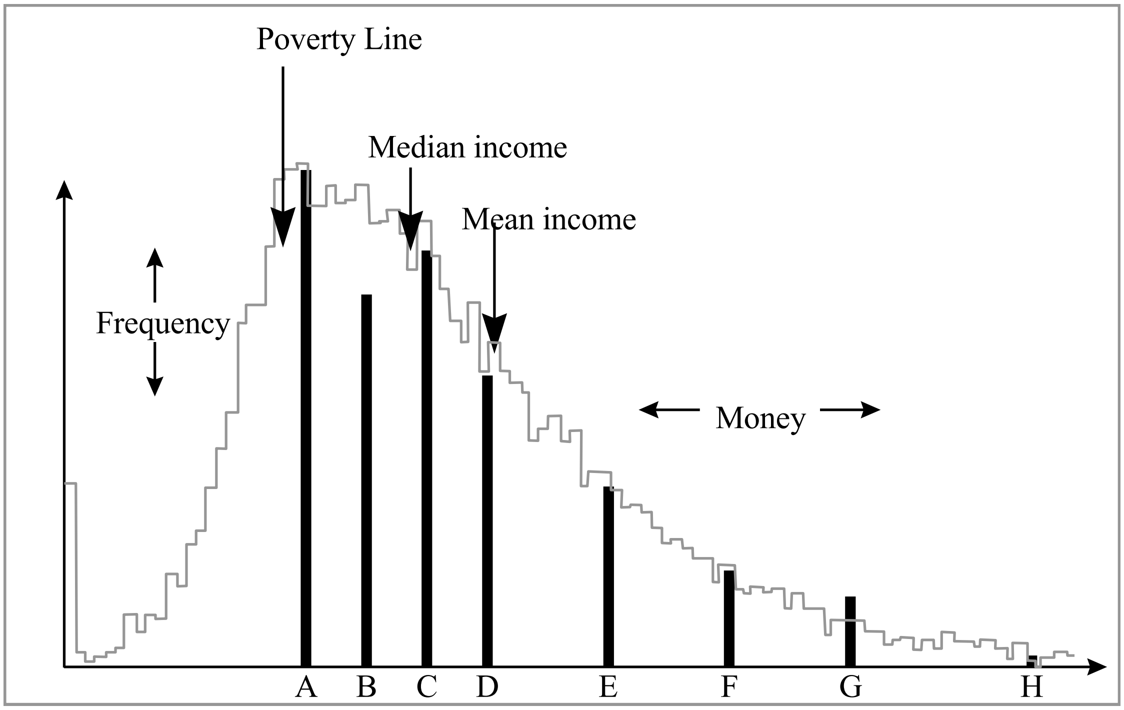

Fig. 6

It is immediately apparent from this diagram that, whereas there is a reasonably good fit at the upper income / more expensive property end of the distributions, the fit at levels below the median income and especially the fit near and below the poverty line, (defined as 60% of median income), leaves something to be desired. It is also noticeable that the mean, (average), income falls almost exactly in the same position as a Band D property, which is often, (but totally erroneously), described as the average property Band.

Despite the fact that average incomes do indeed differ from place to place, (and quite substantially), the **shape** of the income distribution is much the same everywhere. This suggests that the **same** banding profile with the **same** multipliers in each Local Authority might produce a "fairer" result - with differences between average incomes in different areas being reflected in the amount of Central Government grant given to each Local Authority. Indeed, with the banding and multiplier structure shown in figure 7, which does indeed use the same banding and multiplier everywhere, a much better fit between incomes and Council Tax bills is obtained.

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	A-	A	B	C	D	E	F	G	H	H+
Nos / 10	2.4	1.8	1.4	0.8	1	0.8	0.6	0.4	0.2	0.6
Multiplier	0.7097	0.7889	0.8565	0.9152	1	1.0858	1.2062	1.3367	1.4444	1.518

Fig. 7

As can be seen, this model involves the use of ten bands with different multipliers, and very different populations of housing within each band, than that which currently applies.

Although this structure **looks** more regressive, than the current structure, (since the "new" ratio between the top and bottom bands is lower than it is currently), this is by no means the case. Indeed, with the "correct" Central Government Grants, (within the same overall total), the degree of progression is almost identical in the two systems. This is shown in figure 8.

	New	Old		New	Old
First decile	18.4%	18.3%	Sixth decile	5.4%	5.4%
Second decile	11.6%	12.0%	Seventh decile	4.8%	4.7%
Third decile	9.3%	9.4%	Eighth decile	4.2%	4.1%
Fourth decile	7.4%	7.5%	Ninth decile	3.5%	3.5%
Fifth decile	6.2%	6.3%	Tenth decile	2.4%	2.7%

Fig. 8

When we look at the percentage of **gross** incomes taken by full Council Tax, (i.e. before any discounts or Council Tax Benefit), we see that this system produces almost identical results to the current one.

It is instructive to see why the new banding structure, multipliers and Central Government grant system suggested in figure 7 is actually no more regressive than the current system. This is simply because, under the current system, many people on low incomes are paying "too much" in Council Tax, thereby raising the average Council Tax bill for their particular income decile, whilst many people on higher incomes are paying "too little" Council Tax thereby lowering the average for their income decile!

I should like to stress that this banding structure is **not** a recommendation in itself. It merely shows what is possible. In fact I have chosen the Central Government grants to each Authority and the Band distribution and Band Multipliers quite deliberately in order to ensure that the degree of progressiveness was not changed from what it is currently. This is not because I believe that the current degree of progressiveness is necessarily "right". It is because I believe that the decision on how progressive or how regressive any tax should be is a **political** one - and any changes should not be "smuggled in" by "reforms to the system". The political debate needs to be **open**.

The real advantage of the more uniform banding distribution is that it removes the two main types of "unfairness" associated with the current one. In part III Section 3.1 figure 8 of my report we saw how some Regions, (such as the South East), and some sorts of Local Authorities, (such as the Shire Districts), end up with less government grant than they "ought" to do on the basis of their residents' incomes. Figure 9 shows how the total amount, (in millions of pounds), of "misallocated" money changes as one moves from the current system to the new one.

	Current situation - all incomes				New situation - all incomes			
	Shires	Units	Mets	Region	Shires	Units	Mets	Region
North East	0.3	-20.9	-49.0	-69.6	1.4	1.3	2.5	5.2
North West	32.2	-22.8	-166.6	-157.2	0.5	1.2	5.9	7.7
Yorks & Humber	29.0	-27.8	-208.6	-207.4	-0.7	1.5	5.0	5.8
East Midlands	-12.5	-38.3		-50.8	1.5	1.9		3.5
West Midlands	40.0	-10.5	-110.1	-80.6	-0.3	1.3	4.7	5.7
Eastern	143.2	-32.0		111.2	-8.7	0.8		-7.9
South East	317.2	-15.0		302.2	-21.0	-2.7		-23.7
South West	144.5	7.8		152.3	2.1	1.6		3.8
England	693.8	-159.5	-534.3	0.0	-25.0	6.9	18.2	0.0

Fig. 9

Given this improvement, it is no surprise to discover that the percentages of people in each region paying too much or too little Council Tax, (when compared with others on similar incomes), is very much reduced. This is illustrated in figures 10 to 13, which show how those below £50,000 p.a. (figures 10 and 11) and those above £50,000 p.a. (figures 12 and 13) are affected.

	Current situation				New situation			
	Shires	Units	Mets	Region	Shires	Units	Mets	Region
North East	13.2%	0.0%	0.0%	4.2%	1.7%	0.0%	0.4%	0.7%
North West	19.7%	0.0%	0.6%	7.0%	0.4%	1.6%	0.2%	0.4%
Yorks & Humber	55.2%	0.6%	0.0%	6.4%	0.0%	1.0%	0.1%	0.3%
East Midlands	12.6%	3.8%		10.9%	0.4%	0.7%		0.4%
West Midlands	23.6%	24.9%	0.2%	15.5%	0.3%	0.9%	1.1%	0.8%
Eastern	44.1%	0.0%		38.7%	1.6%	0.0%		1.4%
South East	63.8%	19.3%		52.1%	2.6%	1.8%		2.4%
South West	47.5%	12.4%		34.5%	0.2%	0.0%		0.1%
England	39.4%	12.2%	0.3%	23.3%	1.2%	0.8%	0.4%	0.9%

Fig. 10 Percentage of people on incomes £0-£50k paying > 10% too much Council Tax

	Current situation				New situation			
	Shires	Units	Mets	Region	Shires	Units	Mets	Region
North East	18.5%	41.1%	55.8%	40.2%	0.0%	0.0%	0.0%	0.0%
North West	5.5%	48.8%	50.8%	35.3%	1.1%	0.0%	0.0%	0.4%
Yorks & Humber	0.0%	30.4%	79.6%	59.8%	0.0%	0.0%	0.0%	0.0%
East Midlands	16.2%	70.9%		27.1%	0.1%	0.0%		0.1%
West Midlands	2.8%	14.4%	61.6%	28.0%	0.4%	0.3%	0.0%	0.2%
Eastern	3.4%	57.4%		10.0%	2.0%	0.0%		1.7%
South East	0.4%	20.3%		5.6%	3.4%	2.1%		3.0%
South West	0.2%	7.9%		3.0%	0.1%	0.0%		0.1%
England	4.8%	27.5%	62.6%	24.6%	1.4%	0.5%	0.0%	0.8%

Fig. 11 Percentage of people on incomes £0-£50k paying > 10% too little Council Tax

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	Current situation				New situation			
	Shires	Units	Mets	Region	Shires	Units	Mets	Region
North East	45.6%	34.4%	37.4%	39.3%	0.0%	0.0%	0.0%	0.0%
North West	25.3%	24.4%	20.6%	22.7%	0.0%	0.0%	0.0%	0.0%
Yorks & Humber	36.5%	27.7%	11.1%	18.4%	0.0%	0.0%	0.0%	0.0%
East Midlands	22.6%	37.9%		24.6%	0.0%	0.0%		0.0%
West Midlands	24.8%	28.6%	19.1%	24.9%	0.0%	0.0%	0.0%	0.0%
Eastern	17.6%	14.7%		17.4%	0.0%	0.0%		0.0%
South East	21.5%	8.9%		18.8%	0.0%	0.0%		0.0%
South West	41.6%	23.5%		35.1%	0.0%	0.0%		0.0%
England	24.4%	22.1%	18.7%	22.9%	0.0%	0.0%	0.0%	0.0%

Fig. 12 Percentage of people on incomes > £50k paying > 10% too much Council Tax

	Current situation				New situation			
	Shires	Units	Mets	Region	Shires	Units	Mets	Region
North East	5.0%	52.5%	48.9%	35.4%	0.0%	0.0%	0.0%	0.0%
North West	5.4%	48.2%	50.2%	32.4%	0.0%	0.0%	0.0%	0.0%
Yorks & Humber	2.8%	26.9%	55.0%	41.0%	0.0%	0.0%	0.0%	0.0%
East Midlands	26.6%	36.6%		27.9%	0.0%	0.0%		0.0%
West Midlands	9.5%	9.6%	46.3%	18.9%	1.3%	1.1%	0.0%	0.9%
Eastern	19.4%	71.3%		23.7%	4.0%	0.0%		3.7%
South East	9.7%	44.4%		17.2%	8.6%	5.1%		7.9%
South West	4.2%	21.2%		10.3%	0.0%	0.0%		0.0%
England	12.7%	31.1%	50.8%	23.5%	3.9%	1.7%	0.0%	2.7%

Fig. 13 Percentage of people on incomes > £50k paying > 10% too little Council Tax

The very marked improvements shown in figures 10 to 13 are no mere accident. The improvement is evident in all income ranges - even the lowest (below £10k).

I should emphasise that the results quoted above are based on a particular **model**, (although a well proven one), of income distributions. It might be argued that it is just possible that the results are a consequence of the model rather than being a true representation of what actually happens on the ground. However, it is possible to get a similar **pattern** of "unfairness" by using actual data and dispensing with the model altogether - as I show in the Appendix to my report.

In particular it is worth noting that the correlation coefficient between **average** incomes in each Local Authority, (which we know independently of the model), and Council Tax per dwelling improves from only 0.8309, (i.e. leaving 31% of the variance in Council Tax unrelated to income) to 0.9832, (leaving just 3.7% of the variance unrelated to income).

It is important to realise that the results shown in figures 10 to 13 represent the **minimum** numbers of people adversely affected. This is because the analysis is based on the assumption that everyone lives in the most appropriate housing for their incomes that actually exists in the Local Authorities where they happen to live. No alterations to the system of Banding, (other than making it more **regressive**), can deal with those people who live in "inappropriate" housing. Making the system more regressive will however hurt those poorer people who **do** live in appropriate housing.

Although there remain "victims" in the new system, there are many fewer of them than there are under the current arrangements. However, I should emphasise that the "victims" in each case might be very different people.

4. REFORMING COUNCIL TAX BENEFIT

Many of the published submissions to the Lyons Inquiry from Local Government and related organisations have recommended various "tweaks" to the existing system of Council Tax Benefit so as to improve its take-up, treating this as **the** "answer" to the problem of Council Tax.

I doubt whether any improvement to Council Tax Benefit will ever deal with **all** of the hardships and inequities associated with the Council Tax. Indeed, it would probably be better if Council Tax Benefit could be abolished altogether, (as a result of a better local taxation system!). There has to be something wrong with the very **structure** of any tax if people can only afford to pay it when they are given benefits which are specifically targeted so as to enable them to do so. Nevertheless I think that it is appropriate to comment on possible reforms to the Council Tax Benefit system which might, I believe, result in a "fairer" system and one where take-up rates would be improved.

- In view of the problems currently being experienced with the Tax Credit system, I am somewhat reluctant to suggest that the Council Tax Benefit system should be integrated with the Income Tax system. Nevertheless I do believe that, if it could be done in a relatively simple way, then such a move would help to remove the stigma that many potential claimants feel is associated with receiving CTB - and which, I believe, is at least part of the cause of its low take-up rate, (if indeed take-up rate **is** low).

- Another reform that I believe might help to minimise any stigma associated with claiming CTB would be to "delocalise" benefit assessment. Some people, especially older people who have seen (financially) better days are often intensely proud and private. They tend to see any means testing as demeaning and intrusive. A common concern is that their neighbours might learn too much about their financial, (and other), circumstances. If assessments were to be made by people hundreds of miles away from the potential beneficiary, concerns about privacy would be much less prominent.

- It is clear from many of the communications that Isitfair has received that there is widespread agreement that the savings threshold for claiming CTB is too low. Indeed, I am not persuaded that there should be any savings threshold at all. Savings are normally placed on deposit and these deposits generate income. It would seem to be much more sensible to have any means testing based on income alone. It also seems somewhat unfair to penalise those who prefer liquidity while allowing those who decide to invest their savings in the purchase of an annuity to claim benefit, (as CTB currently does). In the current climate, the assumed interest earned on savings is also ridiculous.

- I am also concerned that Council Tax Benefit currently takes into account people's **actual** Council Tax bills. This runs counter to any sense of democratic accountability for those on 100% benefit. There is a clear incentive for such people to vote for ever more, and more expensive, services since they themselves do not have to foot the bill. (Whether they **actually** do so is uncertain - and to some extent beside the point.) I can envisage two ways of addressing this concern:

    — We could ensure that **nobody** received 100% CTB. If we had (say) an upper limit of 90%, this would not only act as some sort of countervailing pressure to keep Council Tax down, it would also satisfy the widespread view, (as evidenced in the submissions that Isitfair has received), that everybody should contribute **something**, however, little, to the financing of the local services from which they benefit.

    — We could make the **amount** of CTB dependent upon the **average** council tax charged by all authorities for the particular band concerned. People who had extravagant councils that charge above average council tax would then have to pay the difference out of their own pockets, whereas those who resided in areas ruled by frugal councils could benefit from the difference.

- Another way of dealing with the problem of people who face (what most other people would regard as) exorbitant Council Tax bills is simply to legislate that **nobody** should **ever** pay more than a given percentage, (to be determined), of their income in Council Tax. Under such a scheme, anybody who could show that this proportion would be exceeded given their particular Council Tax bill, would be entitled to an automatic discount equal to the excess. Alternatively, they could claim benefit to this amount. I believe, however, that discounts are more likely to be acceptable than benefits, both to those entitled to receive them as well as to those not entitled to do so.

5. LOCAL INCOME TAX

In Section 6, Part IV of my report I concluded that a local income tax in which Local Authorities were enabled to set the **rates** of tax was probably unworkable - mainly for reasons of displacement and administrative expense. In this section I suggest some ways in which these major objections could, perhaps be overcome.

I believe that the way to solve these problems is not to have any local setting of income tax **rates** at all. Instead, the Local Authority could be given the right to determine the size of the **personal allowance** that each of its residents receives. This should not cause much in the way of significant problems to computerised payroll systems because all such systems currently have to cope with a wide range of **tax codings** - which are essentially a way of determining what the effective personal allowance of each individual taxpayer should be.

Such a system would work as follows:

- First the basic rate of tax collected **nationally** would be raised to whatever level was required to fund the degree to which Council Tax was to be replaced by LIT. If we take the full abolition of Council Tax and the £25 Bn or so of extra funding this would require to be raised through Income Tax, this would make the basic rate of Income Tax 28.8p, (figures are for 2005/06 and it is assumed that the **gaps** between any personal allowance, basic / reduced rate thresholds and basic / higher rate thresholds remain the same).

- Second, the **national** personal allowance would be raised so that the **national** yield from Income Tax would remain the same. In the case of the extra 6.8p in the pound needed to raise the extra £25 Bn to abolish Council Tax altogether, personal allowances would have to be raised from £4,895 to £8,275, (again figures are for 2005/06). This would provide the “headroom” for Local Authorities to set lower rates of personal allowance so as to raise revenue for local purposes.

- Third, all income tax would be collected **centrally** as at present. Local Authorities would receive a per capita amount back. The share that each Local Authority would receive back of the **additional** amount that is **actually** collected would be in proportion to the amount that **would have been** collected per capita **nationally** if their particular personal allowance had been applied **uniformly** across the nation.

  — For example, if the **national** average personal allowance were to be £5,000 with a basic tax rate of 28.8%, then the total national yield from the "local" portion of the income tax would be £24.26Bn. However, if the Local Authority were to set its own personal allowance at £4,500, then the national average collection for such a rate would be £28.14Bn. The Local Authority setting this rate would therefore receive a per capita allowance of 15.9% more than the national average, (figures are approximate).

This "unconventional" system offers several advantages over the more "conventional" rates based system described in Part IV of my report.

- First, unlike the case with the more conventional type of LIT, the administrative cost of operating this less conventional form of LIT is unlikely to be significantly more than that involved in operating the current national Income Tax system. It is certainly likely to be lower than the (over-optimistic) estimates of administrative costs of LIT contained within the Balance of Funding Review and less than the administrative costs of operating the current Council Tax system.

- Second, there is no incentive for any Local Authority to set artificially high personal allowances, (equivalent to low rates of tax). The amount a Local Authority receives is independent of the actual incomes of its residents. The Isle of Man / Channel Islands strategy simply does not work.

- Third, and because of the above, there is an implicit resource equalisation which can not be manipulated by Central Government, (unlike the present Council Tax system which **could** be - but may **not actually** be). Local Authorities are not penalised for having many residents on lower than average incomes.

- Fourth, there will be little incentive for tax displacement activities. Since no Local Authority gains from being over generous or over mean, (high spending Local Authorities **always** have to charge their residents higher taxes - and they will vote them out if the improved services are not good value for money), personal allowances are not likely to be sufficiently different to encourage people to "lie" about where they live or to move elsewhere. The differences in their overall tax bills depending upon which Local Authority they pay their taxes to are likely to be too small to be worth the trouble

  — No Local Authority can curry favour with one section of its electorate at the expense of another.

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6. POLL TAXES

Given all the unrest generated last time around, it might seem somewhat foolish to even contemplate reintroducing the Community Charge. However it is worth remembering that when the such a tax was first mooted it received a considerable amount of popular support. The Conservatives included their poll tax proposals in their 1987 manifesto and gained a majority of over 100 seats! It was only when the **size** of the bills emerged that people violently opposed it. A poll tax involving much smaller bills might still be an acceptable possibility. The problems associated with the past implementation of the Community Charge were:

- For various reasons, many local politicians took the opportunity to raise the total amount of local taxation while blaming the change in the taxation **system** for the increase. As a result, the total burden of the poll tax was very much higher than that envisaged by the then government's Civil Service advisors. Also some local politicians used the change in taxation system for flagrantly political purposes. They raised taxes in order to make the tax, and the government that introduced it, unpopular.

- The Poll Tax proved to be unexpectedly difficult and expensive to collect - partly, one suspects, because there were attempts to mitigate its severity and partly because some Local Authorities, vehemently opposed to the principle of the tax, made little effort to collect it. There were however some advantages. People who did not want to vote did not have to pay the Poll Tax whereas those who did want to vote did have to pay it.

- The Poll Tax was unpopular and seen by many people as "unfair". This was mainly because more people had to pay it than had previously paid the Rates that it replaced. Freeloaders, who before contributed nothing, whilst benefiting from local services, were especially outraged. Many of the "can't pay won't pay" brigade were, in truth, simply won't payers.

- The high levels of local tax that coincided with the introduction of the Poll Tax, (whether due to deliberate politically motivated sabotage, genuinely increased costs of local services or increased obligations imposed on Local Authorities), meant that there really were some people for whom ability to pay became a real issue.

The real problem with the old poll tax was simply that the bills were too high. The tax was required to take too large a share of the total burden. In this context it is interesting to note that, in order to buy time for the implementation of any replacement tax, the contribution of Central Government to Local Government expenditure was increased, (by raising VAT to 17.5%), which was also intended to smooth the passage for the introduction of the Council Tax. A Poll tax cannot possibly be the main source of taxation in any modern economy where expensive services, free at the point of delivery, are so numerous.

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A poll tax is only sensible if at least one of the following is true:

- The distribution of income and / or wealth is much narrower than it presently is in Britain or, indeed, in most advanced economies.
- The tax is supplemented by other taxes and only covers a small amount of total expenditure. Ideally this should be the expenditure that is more or less discretionary.

The extra yield **in England** for every £100 of a poll tax charged on all people aged 18 or over would be £3.81Bn. If, (for some reason), those over 65 were exempted, the yield would drop to £3.07Bn.

Obviously if we were to reintroduce a poll tax as a **supplementary** tax, this would enable Council Tax bills to be reduced. Figure 14 shows how much poll tax would have to be collected, (in the financial year 2004/05), on **average** in **England** in order to reduce **English** Council Tax by 25%, 50%, 75% and 100%. These correspond to reductions in the "average" band D council tax of £1167 to £876, £584, £292 and nothing respectively. (figures are for 2005/05).

Band D Council Tax (2004/05)	1167	876	584	292	0
Poll Tax on all adults >17	0	133	266	399	533
Poll Tax on all adults <65	0	165	330	496	661

Fig. 14

I show two possibilities. In the first option **all** adults pay the poll tax. In the second option all adults over 65 are exempt from making any contribution. There are, of course, numerous intermediate positions between these two extremes.

I am, of course, only considering the possibility of re-introducing a poll tax as a **supplementary** tax to the Council Tax, thereby enabling the latter to be reduced. Figure 15 shows how the total bill for local taxation might differ from the present system for different types of household. I have assumed a 50/50 split between poll tax and Council Tax. and that **all** adults pay the poll tax in **full**. In deriving this table I have allowed for the 25% reduction in Council Tax enjoyed by single occupants.

	Band A	Band B	Band C	Band D	Band E	Band H
1 adult	-25	-74	-122	-171	-268	-608
2 adults	144	79	14	-51	-180	-634
3 adults	410	345	280	216	86	-367

Fig. 15

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As would be expected with **any** system that involves some funding from a poll tax, the biggest gainers would be those households with small numbers of adults living in expensive housing and the biggest losers would be those households with large numbers of adults living in cheaper housing. Such an arrangement would undoubtedly help those, mainly pensioners, who are housing asset rich but income poor. (In fact Isitfair has received many submissions asking for such a return to the days of the Community Charge). However it would also give substantial gains to others whose circumstances provide little reason for giving any help. This is almost inevitable with any reformed system of local finance where the total amount that has to be raised is as large as it currently is. Nevertheless, it does seem to me to be more important to help the needy than it is to worry about whether or not some of the better off are not contributing quite as much by way of taxation as perhaps they "ought" to.

I note that in their manifesto for the general election of 2005, the Conservatives proposed a rebate of 50% or £500 on Council Tax bills for those over 65. If, purely by way of example, pensioners were to be exempted from paying the Poll Tax and Poll Tax accounted for 50% of locally raised finance, most pensioners would find themselves in much the same financial position as under the Conservative proposals. However the actual result would depend upon whether the pensioners were (now) single or married couples as well as the Banding of the house that they live in.

Since I am not proposing to do anything much about income (re)distribution, it is clear that a poll tax could only be used as a **supplementary** tax. However, there are a number of "tweaks" that we could consider:

- We could make it a **voluntary** tax. Only those who paid this tax would be entitled to vote at <u>local</u> elections. Anybody who paid the tax would also receive a sort of identity card which would entitle them to use some local authority provided services, such as car parking, sports and leisure centres, theatres, libraries or whatever at preferential rates.

- We could charge a **negative** rate of poll tax for children. It is usually people with the largest families to support who find paying any taxes more of a burden

- If the tax were to be made **compulsory**, (as is normal with taxes), we could allow **one** member of any household to offset this tax against their Council Tax, or whatever local tax were to replace it. This offset would replace the current discount for dwellings with single occupants, (one wonders how many of these are really occupied by more than one person), and would ensure that those households with several adults would pay more. The justification for this is that the **total** household income of these households tends to be higher than those households with only two adults and that local services are used by **people**. The more people there are in a household, the greater is the likely usage, (and hence the greater is the likely cost), of those services by people in that household. It seems to be "fair" that those who can afford to make a real contribution to the cost of these services actually do so.

It is a sad reflection on our society that people don't vote to pay taxes. They vote for other people to pay taxes. As a result, most taxes are seen as iniquitous and unfair by those who actually pay them or on whom the main burden falls. If everybody entitled to vote made some contribution to the services to which they were entitled, then, other things being equal, this would tend to keep taxes low. There would be no "representation without taxation". This is the one great advantage of a **compulsory** poll tax. E**verybody** contributes **something**, (however little), to the local services that they are entitled to use and therefore has an interest in the local authority providing good value for money.

In order to avoid any gerrymandering, or attempts to play one section of the population off against another, it would seem to be a good idea to rigidly index any compulsory poll tax to whatever was the main local tax, (currently the Council Tax). It would probably be sensible to retain this rigid indexing for any voluntary poll tax as well. The problem with a **compulsory** poll tax is that, with some people on very low incomes, anything more than a very low rate for the poll tax becomes, quite literally, unaffordable.

It is perhaps interesting to note that poll taxes pass all the attributes of "fairness" suggested in Part II of my report: people in broadly similar financial circumstances pay broadly the same amounting tax; people on lower incomes do not end up paying more tax than people on higher incomes (everybody pays the same); there is equality of contribution, (in volume terms); and there is probably equality of benefit. What a poll tax does **not** achieve is automatic "affordability"!

7. LOCAL AND CENTRAL GOVERNMENT

In many ways this section is little more than a recapitulation of other bits of my report - in particular Section 2 of Part II and Section 2 of Part III. However, for the sake of completeness, I consider that some of these points are worth re-iterating.

In my view it is absolutely essential that, in any reform of the relationship between Local and Central Government, there should be complete clarity concerning precisely **who** is responsible for **what**. Without such clarity, no electorate really knows whom to blame or whom to praise when things are or are not to their liking. Democracy in such a situation is not really democracy at all. I also believe that no individual, group or organisation should have power without responsibility - which means that nobody should have responsibility without power. Power and responsibility need to be matched.

Without funds, no government, local or national, can have much in the way of power. Unless "national" funds "belong to" National Government and "local" funds "belong to" Local Government then any powers that either may have will be, to some extent, illusory. Local democracy without true local taxation is probably impossible. If so-called "local" funds are provided by Central Government, then it seems to me to be highly unlikely that Central Government will be able to refrain from dictating, or at least influencing, how they are spent. Indeed, in the name of accountability to the **national** electorate, (who provided the funds), I believe that they should probably be **obliged** to interfere.

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The amount that any Government, Local or National, can raise, or feels that it can raise, by way of taxation is limited by the likely impact of that taxation on the poorest members of the community. If there is very little differentiation within the local tax base, (as there is for example in the case of Council Tax within the North East Region - where some 58% of all properties fall into Band A), then the amount that can be raised locally by way of tax is much less than where the differentiation is greater. However, even with more differentiation, unless there is a very close correlation between local taxation, (i.e. whatever forms the local tax base), and ability to pay, (virtually a synonym for income), then the total amount that any Local Authority can raise without causing significant "unfairness "or "hardship" is going to be subject to some quite low limits. The more local democracy that we want, the more taxation we will have to raise locally, and with the higher bills, the more essential is it that such taxation is "fair" and "affordable".

Unless we can devise a form of local taxation that is both "fair" and "affordable", then the requirement to match power with responsibility implies that the powers of Local Government will have to be limited to a fairly small fraction of what they are nominally, (but probably not in reality), today.

Nobody knows for certain how much of current Local Authority spending is discretionary and how much is mandated by Central Government. Generally, if asked, Local Authorities will quote a higher percentage than Central Government. However, if Central Government were to ask itself the question: *"what do we **require** Local Authorities to provide?"*, then **everything** which formed part of the answer should really qualify as a Central Government Responsibility. Only those activities that remained, (which, for example, are unlikely to include rubbish collection!), would become the responsibility of Local Government.

Until this question is properly posed - and honestly answered - then the best that we can do is to accept as being correct something like the widely quoted figure of 20% for the **average** discretionary proportion of total Local Government spending. As I argued in Section 4, Part III of my report, this equated in 2005/06 to around a fairly uniform £281 per head. This would be the amount that "ought" to be raised locally and would represent an average reduction in local taxation of around 36.6%

There is little doubt in my mind that an average reduction of local taxation of something like this amount would do much to alleviate the problems of "affordability" currently being experienced. I also suspect that people would be exercised a lot less by considerations of "fairness" were the level of taxes to be reduced to such an extent. I realise that this is definitely not what most Local Governments want. Like all governments and bureaucrats virtually everywhere, they want more power. To achieve this aim they will really need **both** to sort out the local taxation question **and** persuade Central Government to give up some of **its** power!

It is just possible that a truly self sacrificing Central Government might give Local Authorities some grants to spend exactly how they wish. However, even in this unlikely event, unless we have a fairly good correlation between the level of any residual local taxation and the quality and quantity of Local Authority services provided, the local electorate is likely to feel disenfranchised and "turned off". I would argue that this means that we can not have any **differential** Central Government funding for services that are supposed to be a Local Authority's responsibility.

Even if all Local Governments were to be given exactly the same per capita grant as each other, (as happens with NNDR), it is important to recognise that such grants and the funds raised from any local taxation must not be diverted to what are Central Government responsibilities. Unless Local Governments are **forbidden by law** to spend the money on things that Central Government is supposed to be responsible for there will always be scope for Central Government to under or over-fund other "local" activities which are really the responsibility of Central Government - thereby blackmailing Local Authorities to make up the difference.

It is important to recognise that the avoidance of any differential Central Government grants means that there can be **no** form of Resource Equalisation between Local Authorities **whatever**. Equally an important corollary is that **Central** Government funds should **never** be used to provide benefits designed to enable people to pay purely **local** taxes. If this corollary is not observed, then Local Authorities with above average numbers of benefit recipients could, in effect, raise more in tax than other Authorities and yet cause central Government to pick up the tab. If Local Authorities are only responsible for "non essential" services, (as they would be if they did not have to provide what Central Government decided that they should provide), neither of these restrictions should matter. Both restrictions provide a further cogent argument in favour of a much more limited scope of Local Authority responsibility, (and spend), than that applying nominally at the moment.

I really do not see how the present state of muddle is sustainable. I believe that the way forward is to have two completely independent forms of "Local Government". One of these would have executive powers and responsibilities and raise **all** the tax locally that it decides to spend. The other would be a purely advisory body whose role would be to advise Central Government on local spending priorities for those services that are the responsibility of Central Government.

I am deliberately leaving the question of what exactly are the services that should be Local Government's responsibility. To a large extent this is a political matter. However, it is difficult to see how we can ever get true local democracy unless people are either prepared to accept the "post code lottery" or else accept that the scope for Local Government is relatively small compared with that of Central Government.

8. BUSINESS RATE REPATRIATION

Although I do not regard the case for repatriation of the business rates as a particularly strong one, given the momentum from Local Government for such a move I think it worthwhile to make a few suggestions as to how some of the worst problems could be mitigated.

- We could deal with the very real fear on the part of business that they would be used by some Local Authorities as a "soft touch" for taxation which would then be used to keep down the amount of tax paid by those with votes by indexing business tax bills to voters' tax bills.

- One possible solution to the problem of ensuring that the main beneficiaries from business rates are those who have effectively paid them (albeit indirectly as customers, owners or employees), would be to restrict **local** business rates to <u>retail premises</u>. These would include any establishments which deal directly and face to face with the general public such as pubs, restaurants, garages, branch banks, insurance brokers and estate agencies as well as shops. Most of these will have local customers and (mainly) local employees - even if they form part of a large chain. Other enterprises such as offices, factories and so on could continue to have their business rates redistributed as at present.

However, not only do I consider the case for business rate repatriation unproven, I would also suggest that, on the basis of what is really **discretionary** spend on the part of Local Authorities, they don't need to raise any **more** money to fund it. For most Local Authorities, their discretionary spend is already over-funded by the Council Tax.