

## BACKGROUND TO SUPPORT CHAPTER 7

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**C.1** This annex provides details of the modelling undertaken as part of the Inquiry's work on council tax, council tax benefit (CTB) and local income tax (LIT). It includes the options discussed in Chapter 7 of the main report, as well as some others.

**C.2** Further outputs from this modelling are available as supplementary tables and charts, on the Inquiry's website: [www.lyonsinquiry.org.uk](http://www.lyonsinquiry.org.uk) (archived at [www.nationalarchives.gov.uk](http://www.nationalarchives.gov.uk))

### OPTIONS FOR REFORM OF COUNCIL TAX

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**C.3** This section summarises the options modelled by the Inquiry for reform of council tax as a property tax.

**C.4** Modelling of options for council tax reform as part of a revaluation of properties was published in full in the *Consultation Paper and Interim Report* in December 2005, and are only summarised here. A summary is provided of:

- revaluation modelling conducted in 2005; and
- work undertaken in 2006 to update the revaluation modelling using data on the 2006-07 local government finance settlement.

**C.5** Further modelling was conducted in 2006 after the extension of the Inquiry's remit, and is detailed below. This covers:

- changes to council tax band ratios;
- extra bands using 1991 valuations;
- reform of band H; and
- point value property tax.

## SUMMARY: 2005 REVALUATION MODELLING

**C.6** Under the Inquiry's original remit to prepare for a revaluation of properties for council tax, a range of options for reform through revaluation were explored. The options modelled were:

- **National update:** a straightforward revaluation that retains the existing band and ratio structure;
- **Regional update:** retaining the existing band and ratio structure, but with nine sets of regional bands based on regional house prices;
- **Extra bands:** adding new bands to the top and bottom of the existing structure. This creates a new lowest band by splitting the existing band A, splits band G, and creates two new bands at the top. This option also stretches the ratios between bands, such that the new highest band ratio is more than seven times the lowest.
- **Extra bands with Inner London region:** adopts the same band and ratio structure as the Extra Bands option, but has two sets of regional bands: one for Inner London and one for the rest of the country. This option was developed to address the large proportion of properties that would move up to a higher band in Inner London in a national revaluation or reform option (which was significantly higher than any other region examined).
- **Extra bands with limited upward movement:** designed to limit upward band movements to one band per revaluation cycle, whilst allowing unlimited band reductions. The option was developed in the context of considering more frequent revaluations, for example every five years.

**C.7** The results of that modelling showed that under any of the options modelled, between half and two thirds of all households would stay in the same band, with only minimal changes in their council tax bills (less than £1 per week up or down). Just over a third of all households would move bands under the national or regional update options, increasing to around half of all households under options which introduce new bands at the top and bottom of the range.

**C.8** Introducing extra bands allows around a quarter of all households to see bills reduced by between £1-3 per week, and a further 6 per cent see larger reductions of more than £3 per week after revaluation. Up to 12 per cent of households would experience an increase in bills of £1-3 per week, and a further 10 per cent see increases of over £3 per week.

**Table C1: Band movements by revaluation and reform option, England**

|  | Numbers of properties moving bands |             |           | millions (%) |                    |               |
|--|------------------------------------|-------------|-----------|--------------|--------------------|---------------|
|  | Down 2 or more bands               | Down 1 band | Same band | Up 1 band    | Up 2 or more bands | Changing band |
| National update                          | 0.3 (1)                            | 3.4 (16)    | 14.0 (64) | 4.0 (18)     | 0.3 (1)            | 7.9 (36)      |
| Regional update                          | 0.3 (1)                            | 3.4 (16)    | 14.1 (64) | 3.9 (18)     | 0.3 (1)            | 7.8 (36)      |
| Extra bands                              | 0.4 (2)                            | 6.1 (28)    | 10.8 (49) | 4.2 (19)     | 0.4 (2)            | 11.1 (51)     |
| Extra bands with Inner London region     | 0.4 (2)                            | 6.2 (28)    | 10.9 (50) | 4.1 (19)     | 0.3 (2)            | 11.0 (51)     |
| Extra bands with limited upward movement | 0.4 (2)                            | 6.1 (28)    | 10.8 (49) | 4.6 (21)     | 0.0 (0)            | 11.1 (51)     |

Source: Lyons Inquiry analysis

**Table C2: Estimated bill changes as a result of revaluation and reform options before discounts and exemptions, transition and council tax benefit <sup>1</sup>**

|  | Estimated bill changes    |                    |                    |                  | millions (%)    |
|--|---------------------------|--------------------|--------------------|------------------|-----------------|
|  | Down at least £3 per week | Down £1–3 per week | Within £1 per week | Up £1–3 per week | Up £3+ per week |
| National update                          | 1.3 (6)                   | 2.3 (11)           | 13.9 (64)          | 2.7 (12)         | 1.6 (7)         |
| Regional update                          | 1.4 (6)                   | 2.4 (11)           | 13.9 (64)          | 2.7 (12)         | 1.5 (7)         |
| Extra bands                              | 1.4 (6)                   | 5.2 (24)           | 10.6 (49)          | 2.5 (12)         | 2.2 (10)        |
| Extra bands with Inner London region     | 1.4 (6)                   | 5.2 (24)           | 10.9 (50)          | 2.3 (11)         | 2.1 (9)         |
| Extra bands with limited upward movement | 1.4 (6)                   | 5.2 (24)           | 10.6 (49)          | 2.6 (12)         | 2.1 (10)        |

Source: Lyons Inquiry

<sup>1</sup> Row totals may sum to 101% due to rounding

**C.9** The *Consultation Paper and Interim Report* included a commitment to finalise modelling on the basis of the 2006-07 local government funding settlement, in order to ensure that the analysis took account of significant recent changes. In that context, the Extra Bands option was re-run using latest settlement data.

**C.10** Table C3 below shows that the new settlement data did not significantly alter the outcome of the modelling. The same proportion of households (49%) would see only a minimal change in their council tax bill (before CTB) after revaluation and reform under both modelling runs. Similar proportions of all households would experience a £1 or more increase in their council tax bill as a result of the change, although the proportion experiencing an increase of £3 per week or more rises slightly in the 2006-07 run. This reflects the combined impact of 2006-07 tax increases, and any upward band movements due to revaluation.

**Table C3: Estimated changes in household weekly council tax bills as a result of the Extra Bands option, 2005-06 and 2006-07**

|         | millions (%)                 |     |                        |      |                       |      |                      |      |                   |      |
|---------|------------------------------|-----|------------------------|------|-----------------------|------|----------------------|------|-------------------|------|
|         | Down at least<br>£3 per week |     | Down £1-£3<br>per week |      | Within £1<br>per week |      | Up £1-£3<br>per week |      | Up £3<br>per week |      |
| 2005-06 | 1.4                          | (6) | 5.2                    | (24) | 10.6                  | (49) | 2.5                  | (12) | 2.2               | (10) |
| 2006-07 | 1.5                          | (7) | 5.1                    | (23) | 10.7                  | (49) | 2.3                  | (10) | 2.4               | (11) |

Source: Lyons Inquiry analysis

**C.11** The updated modelling shows a very similar proportion of income paid in council tax in each income decile, both before and after council tax benefit. This further confirms the conclusion expressed in the Interim Report: that revaluation does not have a significant effect on the progressiveness of council tax to income overall.

## CHANGING COUNCIL TAX BAND RATIOS

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### Summary of modelling work

**C.12** Local authorities are responsible for setting the level of band D bills in their area. Bills for properties in all other bands are set at a fixed proportion of the band D amount. These ‘band ratios’ are set by legislation and have not been changed since council tax was introduced in 1993.

**C.13** Modelling was carried out to identify the effect of changing the current ratios between council tax bands.<sup>2</sup> At the moment band H properties pay only three times as much as those in band A. Reform options were designed with a particular focus on increasing the differential between bills in the top and bottom bands, by widening the ratios applied either side of band D.

**C.14** Two options were modelled as alternatives to the current ratio of 3 to 1 between the amounts payable for band H and band A properties:

- a ratio of 5 to 1, which would be more closely linked to the average household income in the top and bottom bands; and
- a ratio of 10 to 1, which would be more closely linked to the mean property value in the top and bottom bands, at 2005 prices.

**C.15** The two scenarios are intended to be illustrative: in practice the Government could adjust the ratio applied to each band, and the overall ratio between bands A and H, according to its judgements about the appropriate scale of reform.<sup>3</sup>

### Main findings

**C.16** Two thirds of households (those in bands A to C) would pay less council tax than at present, before council tax benefit. One third would pay more than now (those in bands D to H). Average band D council tax would need to increase, by 5.4 per cent for a 5 to 1 ratio, and by 9.4 per cent for a 10 to 1 ratio. This is to compensate for the national tax base decreasing overall, without placing an excessive burden on bands E to H.

### Description of methodology

**C.17** The individual band ratios for the two options were set as in Table C.4, where the amount paid in each case is expressed as a proportion of the band D bill.

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<sup>2</sup> In particular, the aim was to identify the effect on 2006-07 Formula Grant distribution and consequent potential impact on council tax levels.

<sup>3</sup> As reported in the findings, both the modelled options resulted in a decreased tax base nationally, and hence increased band D bills, because the increase in bills paid by the higher band properties did not make up for the shortfall in yield from the much greater number of lower band properties. Whilst alternative options involving no reduction in the national tax base could have been modelled (for example, by significantly increasing the ratios for Bands E and F), such an approach would result in a reformed council tax structure in which ratios were determined rather arbitrarily.

**Table C4: Band ratios in options examined**

| Band | Current ratio (3 to 1) | 5 to 1 reform option | 10 to 1 reform option |
|------|------------------------|----------------------|-----------------------|
| A    | 6/9                    | 4/7                  | 2/5                   |
| B    | 7/9                    | 5/7                  | 3/5                   |
| C    | 8/9                    | 11/14                | 4/5                   |
| D    | 9/9                    | 7/7                  | 5/5                   |
| E    | 11/9                   | 17/14                | 6/5                   |
| F    | 13/9                   | 10/7                 | 8/5                   |
| G    | 15/9                   | 13/7                 | 11/5                  |
| H    | 18/9                   | 20/7                 | 20/5                  |

Source: Lyons Inquiry

**C.18** For each option, intermediate ratios for bands B to G were selected to achieve a relatively even distribution. A marked increase for band H compared with the other bands was, however, introduced in recognition that the average property value in that band is much higher than that in band G.

**C.19** Local authorities' total tax-raising capacity (or tax base) depends on the bandings of the properties in their area, and the amount of tax paid in each band. Changing the band ratios will change the total tax 'value' of properties in each area (high banded properties will yield more tax than now, and vice versa), which therefore changes the total size of the council tax base.

**C.20** For each option modelled, a revised tax base was calculated for each local authority, taking account of the new ratio for each band.<sup>4</sup> The revised tax bases for Formula Grant purposes were then used in the resource equalisation block of the four-block model to recalculate Formula Grant figures for each local authority for 2006-07. Average council tax bills were calculated for each authority using the process described in Annex B.

## Assumptions

- Modelling of the distribution of Formula Grant does not take account of floor damping, so that any effects can be properly attributed to the policy change.
- Formula Grant and council tax yield remain fixed nationally, but not at local authority level.
- Each local authority's level of spending for 2006-07 – as measured by its budget requirement – is assumed to be fixed, regardless of changes to Formula Grant.
- Each local authority's council tax yield is recalculated as the difference between its budget requirement and Formula Grant and other relevant items, as discussed in Annex B.

<sup>4</sup> A few adjustments were made to put tax base figures on to the same basis as those used for calculating Band D council taxes for 2006-07. The biggest adjustment was to take account of each billing authority's assumed collection rate instead of the 100% assumed initially when calculating the initial tax base figure.

## Detailed findings

**Impact on tax bases** **C.21** Wider band ratios would create a greater disparity in tax bases between local authorities than at present, and consequently a greater proportion of Formula Grant would be needed for resource equalisation. Currently £5.1 billion is removed from grant for resource equalisation in the form of the Relative Resource Amount, but this would increase to £6.1 billion under the 5 to 1 ratio option and £8.6 billion under the 10 to 1 option.<sup>5</sup>

**Table C5: Tax base totals under changed band ratios**

| Ratio H to A           | Tax base<br>(Band D equivalent<br>properties) -million | Reduction<br>in tax base<br>(%) | Implied increase in<br>Band D bills (%) |
|------------------------|--|---------------------------------|---|
| Current ratio (3 to 1) | 17.7   | -                               | -                                       |
| 5 to 1                 | 16.8   | 5.1                             | 5.4                                     |
| 10 to 1                | 16.2   | 8.6                             | 9.4                                     |

Source: Lyons Inquiry

**C.22** The modelling was constrained so that the combined total of Formula Grant and council tax yield remained constant nationally. Under both new ratio options, the national tax base (the number of band D equivalent properties) would fall. This is because the increased tax base from the higher band properties would not, at the ratios applied here, fully compensate for the reduced tax yield from the much greater number of band A, B and C properties.

**C.23** It would be possible to compensate for this loss of tax base by adjusting the ratios applied to bands E to H. However, given the relatively small numbers of properties in those bands, it was judged that this might concentrate the burden too heavily on those households. Also increasing band D bills would spread the burden more widely (across a third of all properties altogether), and avoid the need for very large bills in the top bands.

**Impact on household tax bills** **C.24** Table C6 shows average annual bills by band, before CTB. Two thirds of households (all those in Bands A to C) would pay less council tax under this model. A third (bands D to H) would pay more.

<sup>5</sup> Formula Grant used for resource equalisation' is defined as the total Relative Resource Amount in the four-block model.

**Table C6: Average annual bills with new band ratios**

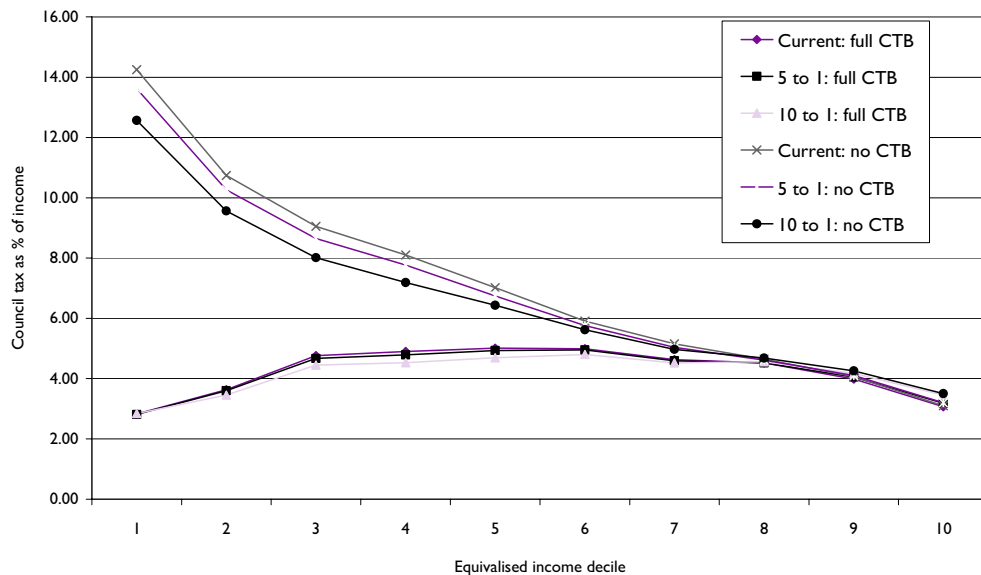
|   | Current<br>£ | 5 to 1<br>£ | 10 to 1<br>£ | Change      |      |              |       |
|---|--------------|-------------|--------------|-------------|------|--------------|-------|
|   |              |             |              | 5 to 1<br>£ | %    | 10 to 1<br>£ | %     |
| A | 846          | 764         | 555          | -82         | -9.7 | -291         | -34.4 |
| B | 987          | 955         | 833          | -32         | -3.2 | -154         | -15.6 |
| C | 1,128        | 1,050       | 1,111        | -78         | -6.9 | -17          | -1.5  |
| D | 1,269        | 1,367       | 1,388        | 98          | 7.7  | 119          | 9.4   |
| E | 1,551        | 1,623       | 1,666        | 72          | 4.6  | 115          | 7.4   |
| F | 1,833        | 1,910       | 2,221        | 77          | 4.2  | 388          | 21.2  |
| G | 2,115        | 2,483       | 3,054        | 368         | 17.4 | 939          | 44.4  |
| H | 2,538        | 3,820       | 5,553        | 1,282       | 50.5 | 3,015        | 118.8 |

Source: Lyons Inquiry analysis

**C.25** Under the 5 to 1 option, overall ‘turbulence’ (the amount of change in households’ bills at reform) would be relatively limited. Most households would experience a change in bills of less than £1 per week, before council tax benefit. The 10 to 1 option unsurprisingly creates greater turbulence, with 3.5 million households seeing bills reduced by more than £3 per week before CTB, while 1.7 million would pay at least £3 per week more before CTB.

**C.26** Bills in the lowest income decile would remain unchanged under both new ratio options – many of these households would be receiving CTB or be exempt from council tax. Council tax would become slightly more progressive to income overall.

**Chart C1: Council tax as a percentage of net household income by income decile, extra bands without revaluation option**



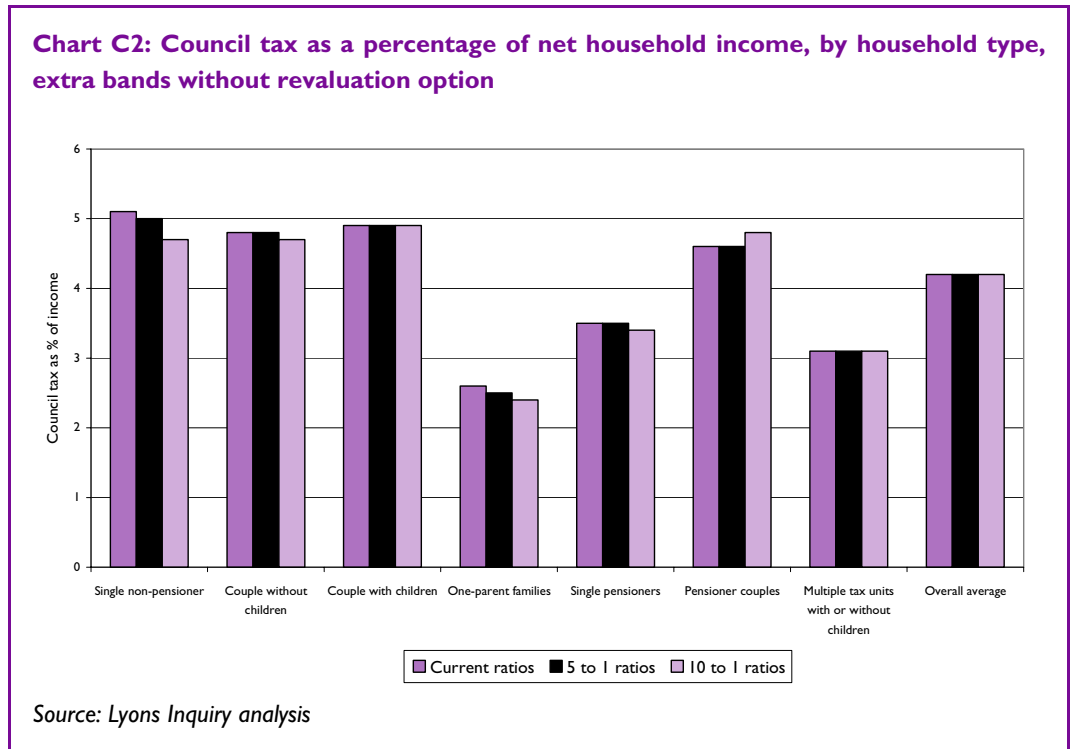
Source: Lyons Inquiry analysis

**C.27** After allowing for CTB, there would be little difference between the percentage of net household income payable as council tax for the current bands and those for a 5 to 1 ratio, but the percentage would be more noticeably reduced for most lower and middle deciles under a 10 to 1 ratio.



**C.28** Pensioner couples would see the greatest increase in bills if new ratios were introduced. Those households typically living in more expensive homes (for example, those couples with children) would also see increased bills. Single parent families and single non-pensioners would, on average, face reduced bills.

**C.29** Chart C2 shows the percentage of net household income paid as council tax by household type. Couple pensioners would be the only group to see the percentage of its net household income to be paid as council tax increase under the new ratios, despite higher average bills overall. This arises from the type of average used in the analysis, as discussed in Annex B.

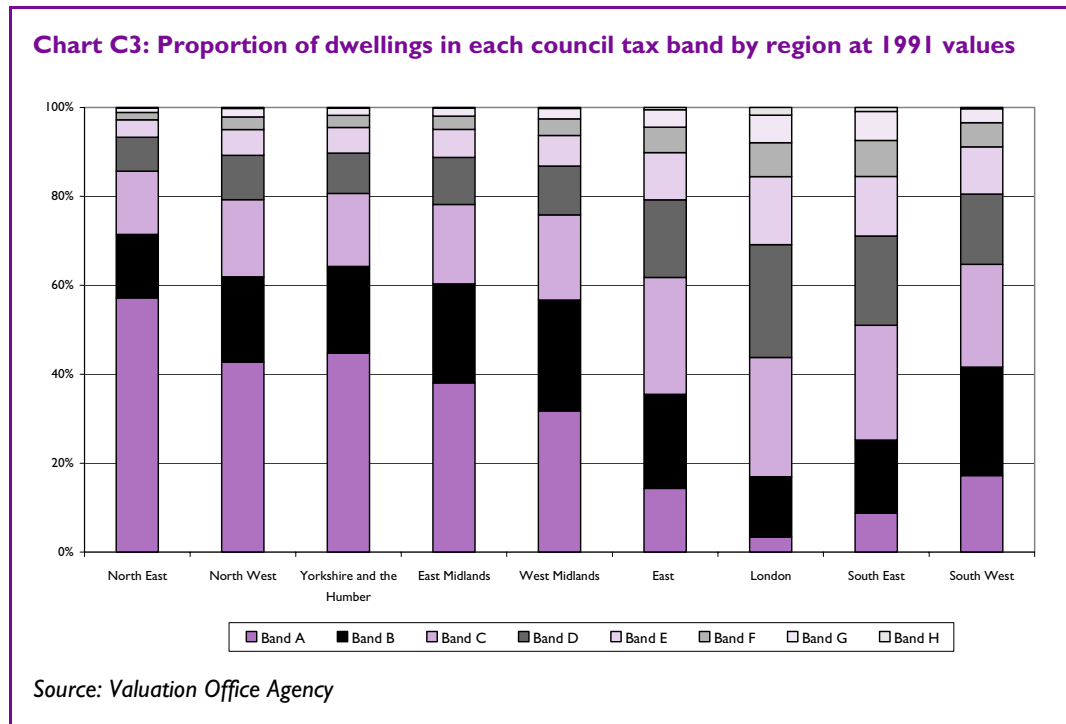


**CTB costs C.30** Because most of the low-income households qualifying for CTB are concentrated in lower value properties, any reform that reduced the liability of those properties would also reduce the amount to be paid through CTB. Even allowing for the increased cost of CTB claims in the higher bands, this would reduce total CTB eligibility by approximately £240 million at a ratio of 5 to 1, and approximately £570 million at a ratio of 10 to 1.<sup>6</sup>

**Regional impact C.31** Because a wider range of band ratios than at present would mean that bills were more closely related to property values, council tax would also more clearly reflect the regional differences in average house prices at the time when houses were allocated to bands at 1991 prices. This would result in a shift in the tax burden away from the three northern regions and the West Midlands, towards London and the South East. Under the current system of grant equalisation, Formula Grant would therefore be reduced in London and the South East, where tax-raising capacity would have grown. Total Formula Grant would increase in the North East, North West and Yorkshire & the Humber, where tax bases would become smaller as lower-banded properties became

<sup>6</sup> The statistical model used by the Inquiry is not adapted to forecast actual take-up levels after policy change. Broadly speaking however, if take-up of CTB entitlements remained at around 65-71 per cent (on an expenditure basis), cashable savings in council tax benefit after reform might be around the same percentage of the gross figure given above.

liable for less tax. Chart C.3 indicates the varying distribution of bands across regions on current valuations.



**C.32** Wider band ratios would, by altering local authorities' tax bases, also alter the distribution of grant assuming resource equalization continued as now. Those authorities with more high-banded properties than average would receive less grant (almost 40 per cent of all authorities), whereas those with more lower band properties would receive more grant.

**C.33** However, under the 5 to 1 ratio option, the changes in grant allocations would be modest for most authorities. Under that option, 27 authorities would face a reduction of more than 10 per cent; generally those which receive only a low level of grant at present. Under the 10 to 1 option, many more authorities would see a significant reduction in Formula Grant, with 49 authorities facing a reduction of more than 20 per cent, including 30 in the South East, eight in East of England and seven in London.

**C.34** The impact on tax bases would vary somewhat by authority class. For example, there are large increases in council tax yield in London, and large reductions in other metropolitan areas.

## EXTRA BANDS WITHOUT REVALUATION

### Summary of modelling work

**C.35** As part of the original modelling, the Inquiry considered the option of adding new bands at the top and bottom of the existing council tax band structure alongside the revaluation of all domestic properties. This was felt to have a number of advantages, but the postponement of revaluation would make it difficult to implement that option in the immediate term. An alternative was therefore to assess the feasibility and attractiveness of adding new bands using the existing, 1991-based property valuations.

### Main findings

**C.36** About 2.5 million properties would move down to the new lowest band – 11.4 per cent of all households. For those properties, the average bill would be reduced from £846 to £711 per year. Approximately 150,000 households would move up a band (0.7 per cent of all households). This comprises 29,000 band H properties (those moving to bands H2, H3 or H4) and around 122,000 current band G properties (those moving to band G2). Around 800 properties would move into the new highest band, becoming liable for bills of around £6,400 per year.

### Description of the methodology

**C.37** Modelling work examined the effect of increasing the number of council tax bands based on their 1991 valuations (i.e. without carrying out council tax revaluation). More specifically, the existing bands A, G and H were split as shown in bold in Table C.7. This would effectively widen the current floor and ceiling on council tax liability, but maintain the current practice of assigning properties, including newly-built homes, according to their assumed value at the time of the last valuation exercise in 1993, based on values in 1991.

**C.38** The band intervals were based on breakdowns of numbers of properties in bands in the current 1993 list (based on 1991 values) produced by the Valuation Office Agency (VOA). Details of these are given below, together with the rationale for the ratios used.

**Table C7: Existing council tax bands and extra bands without revaluation**

| Existing bands |                               |                      | Extra bands |                          |                 |
|----------------|-------------------------------|----------------------|-------------|--------------------------|-----------------|
| Bands          | Existing range of 1991 values | Existing band ratios | Bands       | New range of 1991 values | New band ratios |
| A              | Under £40,000                 | 6/9                  | A1          | Under £30,000            | 5/9             |
|                |                               |                      | A2          | £30,001 to £40,000       | 6/9             |
| B              | £40,001 to £52,000            | 7/9                  | B           | £40,001 to £52,000       | 7/9             |
| C              | £52,001 to £68,000            | 8/9                  | C           | £52,001 to £68,000       | 8/9             |
| D              | £68,001 to £88,000            | 9/9                  | D           | £68,001 to £88,000       | 9/9             |
| E              | £88,001 to £120,000           | 11/9                 | E           | £88,001 to £120,000      | 11/9            |
| F              | £120,001 to £160,000          | 13/9                 | F           | £120,001 to £160,000     | 13/9            |
| G              | £160,001 to £320,000          | 15/9                 | G1          | £161,001 to £240,000     | 15/9            |
|                |                               |                      | G2          | £240,001 to £320,000     | 17/9            |
| H              | Over £320,000                 | 18/9                 | H1          | £321,001 to £450,000     | 21/9            |
|                |                               |                      | H2          | £451,001 to £700,000     | 27/9            |
|                |                               |                      | H3          | £701,001 to £1,000,000   | 36/9            |
|                |                               |                      | H4          | Over £1,000,000          | 45/9            |

Source: Lyons Inquiry analysis

**C.39** Under this model, properties in bands B to F (71 per cent of all households) would be unaffected, because their current bandings are assumed to be correct to 1991 values and there are assumed to be no change in their band ratios. The only properties to move bands would be those moving down from the current band A to band A1, and those moving around in the restructured bands G and H. Those properties which, if revalued to current prices, would move from bands B to F, down to Band A or up into the top bands, do not move in this model.

**C.40** The intervals for the extra bands within bands A, G and H were chosen so as to be broadly consistent with those used for the extra bands revaluation option, as described in Annex A to the December 2005 Interim Report (although this modelling involved splitting Band H into four, rather than three, sub-bands, to include a top band for properties worth more than £1 million in 1991). The underlying aim was for the margins of the higher bands to be set so that there was a consistently reducing number of properties through the top bands, but with approximately equal numbers of properties in Bands A1 and A2.<sup>7</sup> See Table C8 for more details.

**C.41** The band ratios were also chosen to be broadly consistent with those used for the extra bands revaluation option. This led to a wider overall range of ratios than at present, with the ratio between the bottom end of the highest band (H4) and the top end of the lowest band (A1) being nine, compared with three under the current bandings.

**C.42** For each local authority, a revised tax base was derived, taking account of the number of properties in each band and each band's ratio. To ensure that the modelling quantified only the effects of introducing extra bands – rather than also reflecting differences between CLG and VOA figures for tax bases – the VOA national totals for

<sup>7</sup> The aim of achieving tapering numbers of properties in the top and bottom bands was regarded as desirable in the interests of arriving at a coherent distribution of properties across bands.

bands A1 plus A2 were scaled down slightly so that they totalled the national total of band A dwellings as reported by authorities on CTB1 returns as at October 2005. Similar scaling was carried out for the sub-bands within bands G and H. These figures were then projected to give figures for the tax base for 2006-07, and then scaled in line with 2006-07 budget information to give a corresponding figure for the tax-setting tax base for each local authority.<sup>8</sup> The revised tax bases were then used to recalculate Formula Grant figures for each local authority for 2006-07.

**C.43** Average council tax bills were calculated for each local authority as described in Annex B.

## Data sources

**C.44** Because data on individual property values in 1991 were not directly available, they were derived by VOA at a billing authority level as follows:

- a) Values of properties as at 1 April 2005 were taken from the VOA's Automated Valuation Model (AVM), having been based on verified and validated sales data, using preparatory work which was undertaken as part of the now-postponed revaluation. These valuation estimates were all direct outputs from the AVM, without having been reviewed or adjusted.<sup>9</sup>
- b) The distributions of banded properties from the current council tax list – i.e. banded values as at 1991 – were compared with the AVM value estimate profiles as at 2005, by VOA. The resulting information helped to identify where the numbers of properties that were in the tails of the distribution (i.e. the numbers of properties at the extreme low and high levels of value) had changed significantly between 1991 and 2005.
- c) A 'market movement ratio' was derived for each billing authority by dividing the median value at 1 April 2005 (provided by data in (a) above) by the median value at 1 April 1991 (derived from the current council tax band distribution) to provide a proxy for average price change.
- d) For properties in existing bands A, G or H, each billing authority's market movement ratio was used to scale down property values as at 1 April 2005 to give an estimate of the number of properties in each new band as at 1 April 1991. For some billing authorities, this approach resulted in extreme values, which were then manually adjusted on a case-by-case basis to bring them more in line with figures for other authorities.

## Assumptions

- The market movement ratio calculated for each billing authority area accurately reflects changes in value between 1991 and 2005 for each property in the billing authority's area, regardless of its band.
- Total Formula Grant and council tax yield remain fixed nationally, but not at local authority level.

<sup>8</sup> As reported on Budget Requirement returns to CLG for 2006-07.

<sup>9</sup> Only properties with insufficient attribute data - and figures for the Isles of Scilly, which were thought to be skewed relative to those for elsewhere - were excluded from the modelling. As a result, the total number of properties included across England (22.051 million) was only slightly below the number reported by VOA as being on valuation lists as at 26 March 2006 (22.086 million).

- The redistribution of Formula Grant does not take account of floor damping, so that any effects can be properly attributed to the policy change.
- Each local authority's level of spending for 2006-07 – as measured by its budget requirement - is assumed to be fixed, regardless of changes to Formula Grant and changes resulting from the creation of the extra bands.
- Each authority's council tax yield is recalculated as the difference between its budget requirement and Formula Grant.<sup>10</sup>

## Detailed findings

### Impact on household tax bills

**C.45** Table C8 shows how the numbers of properties in Bands A, G and H would be split across the new bands. It also shows the average bills for 2006-07 for each band.

**Table C8: Bills by council tax band – existing bands and extra bands without revaluation**

| Existing bands | Existing bands  |  | New bands    |                                 |  |
|----------------|---|--|--------------|---------------------------------|--|
|                | Number of properties (thousand) according to CTBI returns | Average area council tax for 2006-07 (£) | New bands    | Number of properties (thousand) | Average area council tax for 2006-07 (£) |
| A              | 5,575   | 846                                      | A1           | 2,506                           | 711                                      |
|                |   |  | A2           | 3,069                           | 853                                      |
| B              | 4,237   | 987                                      | B            | 4,237                           | 995                                      |
| C              | 4,745   | 1,128                                    | C            | 4,745                           | 1,138                                    |
| D              | 3,333   | 1,269                                    | D            | 3,333                           | 1,280                                    |
| E              | 2,081   | 1,551                                    | E            | 2,081                           | 1,564                                    |
| F              | 1,100   | 1,833                                    | F            | 1,100                           | 1,848                                    |
| G              | 785   | 2,115                                    | G1           | 663                             | 2,133                                    |
|                |   |  | G2           | 122                             | 2,147                                    |
| H              | 123   | 2,538                                    | H1           | 94                              | 2,986                                    |
|                |   |  | H2           | 24                              | 3,839                                    |
|                |   |  | H3           | 4                               | 5,119                                    |
|                |   |  | H4           | 0.8                             | 6,399                                    |
| <b>Total</b>   | <b>21,979</b>   | <b>1,268</b>                             | <b>Total</b> | <b>21,979</b>                   | <b>1,268</b>                             |

Source: CTBI and BR returns to CLG; Valuation Office Agency, Lyons Inquiry

**C.46** The resulting national total tax base for Formula Grant purposes was 0.8 per cent lower than that used in the 2006-07 Settlement. This was due mainly to a large reduction for band A, resulting primarily from band A1 being given a lower band ratio, of 5/9. This more than cancelled out the results of applying significantly higher band ratios than at present to the relatively few properties within band H.

**C.47** Under the option modelled there would therefore need to be a small increase of 0.8 per cent in the national average band D council tax, to compensate for the 0.8 per cent reduction in the total council tax base.

**C.48** Table C.9 shows that council tax as a percentage of net household income under extra bands, before taking account of CTB, would be more progressive in the lower

<sup>10</sup> Also taking account of other relevant items, as discussed in Annex B.

bands The changes in levels of burden within bands A, G and H may be partly explained by the random allocation of households to new bands, discussed below, and partly to the smaller sample size for higher bands giving larger sample errors.<sup>11</sup>

**Table C9: council tax as a percentage of net household income under extra bands without revaluation**

| Bands    | Council tax as % of net household income |             | Council tax as % of net household income if no CTB (%) |             |
|----------|--|-------------|--|-------------|
|          | Full take up of CTB                      |             | No take up of CTB                                      |             |
|          | Current bands                            | Extra bands | Current bands  | Extra bands |
| <b>A</b> | <b>2.9</b>                               | ..          | <b>7.5</b>   | ..          |
| A1       | ..                                       | 2.5         | ..   | 6.6         |
| A2       | ..                                       | 2.9         | ..   | 7.2         |
| <b>G</b> | <b>6.4</b>                               | ..          | <b>7.6</b>   | ..          |
| G1       | ..                                       | 6.6         | ..   | 7.9         |
| G2       | ..                                       | 6.6         | ..   | 7.4         |
| <b>H</b> | <b>6.5</b>                               | ..          | <b>8.8</b>   | ..          |
| H1       | ..                                       | 7.4         | ..   | 10.1        |
| H2       | ..                                       | 6.2         | ..   | 10.3        |
| H3       | ..                                       | 8.4         | ..   | 8.4         |

**C.49** A note of caution should be attached to the distributional analyses described below because, in reality, the allocation of properties to the new bands would differ from that shown. This is because, in order to split bands A, G and H, households were allocated to one of the new bands in proportion to the national total of properties in that band according to VOA data.<sup>12</sup> This means that, particularly for bands A, G and H and their replacement bands, the relationship between household income and property value in reality is likely to be stronger than that between household income and the randomised band allocation used in the model.<sup>13</sup>

**C.50** The lower income deciles would see the largest changes in average weekly council tax bill, with the changes taking the form of reductions. This is due largely to the structure of the changes in bands, with many benefiting from the creation of band A1. Council tax would become slightly more progressive to income, although the overall burden of council tax (before CTB) would remain regressive. Average net bills would be lower as a result of introducing extra bands.

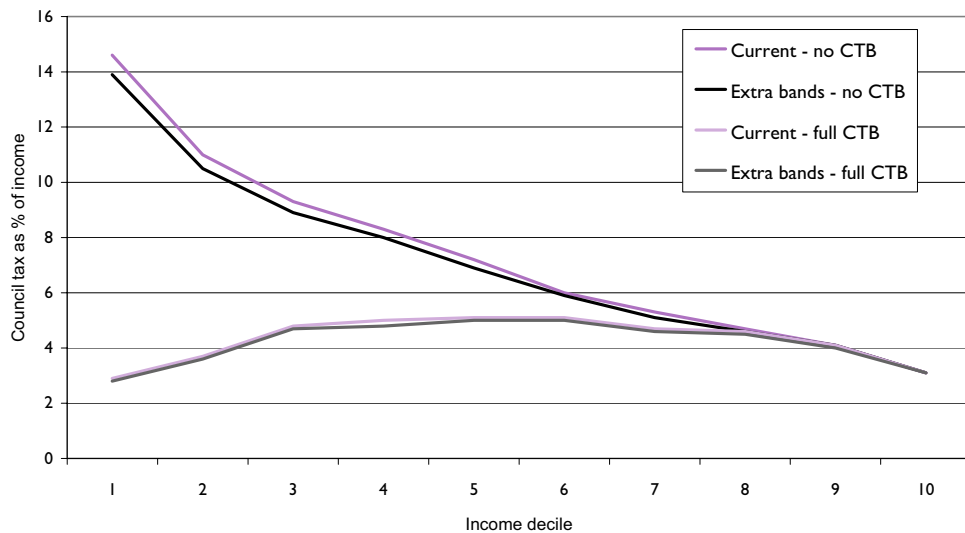
<sup>11</sup> IGOTM's use of democratic averages may compound the low burdens in the higher bands because outliers that have lower burdens would skew the average downwards more than would be the case with plutocratic averages. See Annex B.

<sup>12</sup> This was done by assigning a random number to each household that was in either Band A, G or H according to the FRS-based data, with the allocation to sub-bands within a billing authority area being constrained so that the spread across the bands equated to the VOA figures for that billing authority area. For example, for billing authority A, if VOA data showed that 60% of band A properties would be in A1, IGOTM ensured that 60% of band A households in that billing authority area were allocated to Band A1.

<sup>13</sup> A table showing the distribution of households across bands used in the IGOTM was broadly similar to the distribution of underlying VOA property data for 2005. The FRS dataset allocated very small numbers of households to Band H4, however, and so results for Band H4 are not displayed in the table. The same approach was taken in the modelling of extra bands after revaluation reported in the Interim Report.

**C.51** Chart C4 shows that the average proportion of income spent on council tax in each decile with full or zero take up of CTB would not change very much after the introduction of extra bands, and that the introduction of extra bands would make the tax only slightly more progressive. It can be assumed, however, that the extent of progressiveness is slightly understated in the modelling for the reasons given above.

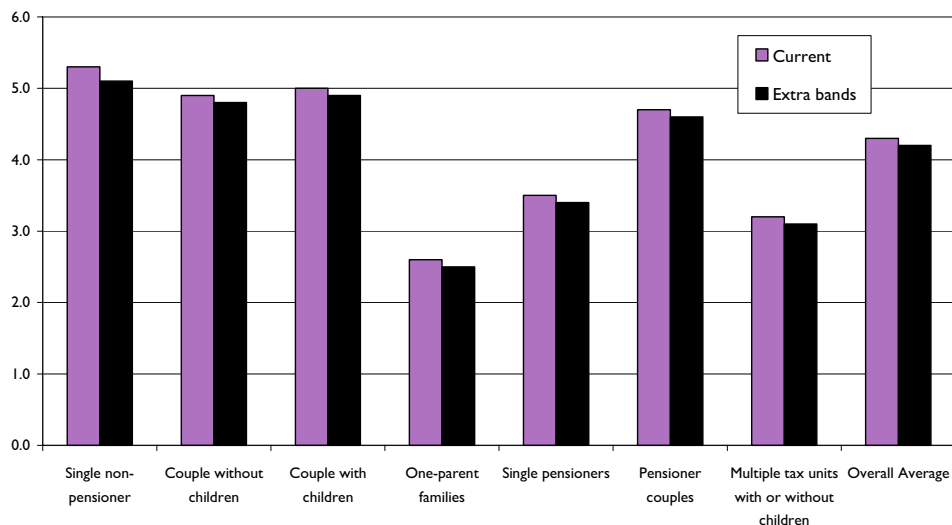
**Chart C4: council tax as a percentage of net household income, under extra bands revaluation option compared with no reform**



Source: Lyons Inquiry analysis

**C.52** Chart C5 shows that all household types would face a decrease in council tax as a percentage of net household income. This is because this gain results in more gainers than losers overall.

**Chart C5: Council tax as a percentage of net household income, extra bands without revaluation option**



Source: Lyons Inquiry analysis



## CTB costs

**C.53** Because most of the low-income households qualifying for CTB are concentrated in lower-value properties, any reform that reduced the liability of those properties would also reduce the costs of paying CTB to those households. Many of the properties moving down to the new bottom band would be entitled to full or partial council tax benefit, so reductions in their council tax liability would produce savings in the benefit bill. The option modelled above would be likely to reduce total CTB costs by around £110 million per year, assuming full take-up of entitlements.

## Regional impact

**C.54** The regional impact of adding new bands at top and bottom is mostly determined by the location of the large number of Band A properties. Since most of them are in the north, a new bottom band would reduce tax bases in many northern authorities, with Formula Grant then shifting towards the northern regions from London, the South East, East and South West.

**C.55** To some extent, the regional pattern of tax base change is a mirror image of the shift in Formula Grant shown above, with large increases in tax base for London and the South East. Although there would, as stated above, be a small increase in band D council tax nationally, the pattern would vary regionally, depending largely upon the band mix in each region. For example, the decrease in the council tax yield needed for the North East – as a result of its increase in Formula Grant - is more than cancelled out by a large decrease (of about 5 per cent) in its tax base when the council tax yield is divided by tax base to give a band D figure. This results in a 3.5 per cent increase in average band D council tax. The large reduction in tax base in the North East is due mainly to large numbers of band A properties moving down to the A1 band. This shows that the impact on band D as a result of introducing extra bands could be rather unpredictable if not done in a constrained way, with widely varying changes at a regional level reflecting the widely varying impact of creating extra bands.

## REMOVING OR RAISING THE CEILING ON BAND H PROPERTIES

### Summary of modelling

**C.56** The existing ceiling on band H bills is a feature of the system set in place in 1993, and could be altered through reform of the council tax band structure. Under the current system, the top band contains all properties worth at least £320,000 in 1991 (equivalent to approximately £900,000 in 2005 prices), right up to the most expensive property in the country at that time. Because of the way band ratios are set at present, the most valuable properties can only pay twice the tax paid by a band D home, and only three times as much as the least valuable home in band A, despite being at least eight times more valuable than band A homes at 1991 valuations.

**C.57** The options modelled consider the impact of raising the effective ceiling on bills by:

- adding new top bands, (in recognition of the fact that the existing top band is extremely wide capturing properties worth £320,000 in 1991, up to the most valuable); and

- removing the ceiling altogether by operating individual valuations for the most expensive properties, with bills charged at a fixed proportion of property values.

### **Main findings**

**C.58** Creating new bands at the top could deliver additional council tax revenue, depending on the band margins and the ratios applied. In the option modelled, extra revenues totalled around £75 million. However, band H properties are heavily concentrated in a small number of authority areas.

### **Creating extra bands in place of band H**

**C.59** Work was done to model the effect of replacing existing band H with four new bands. The results are summarised in Table C10. Creating the new bands with the margins and ratios shown in the table would raise about £75 million in additional council tax revenue.

**Table C10: Impact of splitting band H into four bands**

|                       | Ratio to Band D | Range (1991 prices)   | Number of equivalent properties for the band (after discounts & exemptions) <sup>(a)</sup> | Average area CT for the band<br>£ | Total yield<br>£m |
|-----------------------|-----------------|-----------------------|--|-----------------------------------|-------------------|
| <b>Existing band:</b> |                 |                       |  |                                   |                   |
| Band H                | 2               | £320,000+             | 104,404  | 2,538                             | 265.0             |
| <b>New bands:</b>     |                 |                       |  |                                   |                   |
| Band H1               | 2.33            | £321,000 - £450,000   | 79,617   | 2,986                             | 237.7             |
| Band H2               | 3               | £451,000 - £700,000   | 20,276   | 3,839                             | 77.8              |
| Band H3               | 4               | £701,000 - £1,000,000 | 3,704  | 5,119                             | 19.0              |
| Band H4               | 5               | Over £1,000,000       | 807  | 6,399                             | 5.2               |
| <b>TOTAL</b>          |                 |                       | <b>104,404</b>   |                                   | <b>339.7</b>      |

(a) This is the number of properties after taking account of discounts and exemptions but before applying the relevant band ratio. For example, a property subject to a 50% discount would be counted as half a property.

(b) The total of 104,404 differs from the 123,000 quoted in Table C.8 because Table C.8 counts all properties once, whereas properties subject to a discount or exemption are counted as less than a whole property in this table. See footnote (a).

## Applying a point value property tax to band H properties

**C.60** The property value data provided by VOA as used for modelling a point value property tax (see separate section) indicates that the median value of a Band H property in England in 2005 was £842,000. If the mean value is assumed to be of a similar order of magnitude to the median, then the yield for 2006-07 from all 104,400 band H equivalent properties of £265 million would be raised by a national rate of 0.3 per cent of property value.<sup>14</sup> Increasing the national rate by 0.1 of a percentage point, to 0.4 per cent of property value would raise almost a further £90 million.<sup>15</sup> Table C11 shows the yields and average bills that would result from rates of 0.1 and 0.4 per cent as described above, and also 0.1 and 1.0 per cent.

<sup>14</sup> That is, 0.30% of £842,000 multiplied by 104,400 equivalent properties would produce a yield of about £265 million. It is recognised that the mean and median values are in practice likely to differ significantly, but it has been assumed that the number of properties of very high value is small enough for the results of the calculations reported here to be of approximately the correct order of magnitude.

<sup>15</sup> That is, 0.1% of £842,000 multiplied by 104,400 equivalent properties would produce a yield of about £88 million.

**Table C11: Examples of bills a point value property tax for band H properties**

| <b>National rate<br/>(% of property value<br/>at 2005)</b> | <b>Yield from the 104,400<br/>equivalent properties<br/>for 2006-07 (£m)</b> | <b>Average bill<br/>for 2006-07 (£)</b> |
|--|--|---|
| 0.10%  | 88   | 842                                     |
| 0.30%  | 264  | 2,526                                   |
| 0.40%  | 352  | 3,368                                   |
| 1.00%  | 879  | 8,420                                   |

### Borderline between bands G and H

**C.61** Those properties currently in band H are there by virtue of their value in 1991, and estimates suggest that at revaluation, one in five band H properties (some 25,000 properties) would be likely to move down to band G.<sup>16</sup> A larger number of Band G properties (58,000, or 7.5 per cent of that band) would move up to the top band. Measures that target top-banded properties might therefore seek to distinguish between those at the border of band G, and those at the top of the value scale. This has not been done in this modelling.

### Distribution of band H properties

**C.62** Table C12 shows that the vast majority of the approximately 124,000 band H properties in England are concentrated in London and the South East.

<sup>16</sup> The estimates quoted are from the National Update model, as discussed in the Interim Report.

**Table C12: Band H properties on valuation lists at 18 September 2006**

|                          | <b>Band H (1991 values<br/>over £320,000)</b> | <b>% of national total of<br/>Band H properties</b> | <b>Band H as % of total<br/>properties in England</b> |
|--------------------------|---|---|---|
| <b>England</b>           | <b>124,033</b>                                | <b>100.0</b>  | <b>0.6</b>  |
| London                   | 55,546  | 44.8  | 1.7   |
| South East               | 31,742  | 25.6  | 0.9   |
| East                     | 11,444  | 9.2   | 0.5   |
| South West               | 6,914   | 5.6   | 0.3   |
| North West               | 6,020   | 4.9   | 0.2   |
| West Midlands            | 5,172   | 4.2   | 0.2   |
| Yorkshire and the Humber | 3,062   | 2.5   | 0.1   |
| East Midlands            | 2,908   | 2.3   | 0.2   |
| North East               | 1,225   | 1.0   | 0.1   |

Source: Valuation Office Agency

**C.63** Even within the South East, band H properties are concentrated in only a few local authorities. For example:

- 23 per cent of all band H dwellings in England are concentrated in either Kensington & Chelsea, or Westminster (each contain 11 per cent of all band H properties); and
- Camden and Barnet between them contain around 6 per cent of all band H dwellings in England.

**C.64** As a proportion of total local authority tax bases, band H properties are equally concentrated in a few areas:

- band H properties in Kensington & Chelsea, and Westminster represent respectively 17 per cent and 12 per cent of the total number of dwellings in their area; and
- these are followed by eight billing authorities where that proportion varies between 3 per cent and 7 per cent (South Bucks, Elmbridge, Chiltern, Camden, Three Rivers, Waverley, Richmond-upon-Thames and Tandridge); and
- band H properties represent less than 3 per cent of all dwellings in each of the other 344 billing authority areas.

## A POINT VALUE PROPERTY TAX

### Summary of modelling work

**C.65** Modelling was done to examine the effects of introducing a point value property tax to replace council tax. It involved setting a fixed national rate, expressed as a percentage of each domestic property's capital value, to generate an amount of tax equivalent to the national council tax yield (approximately £22 billion in 2006-07).

### Main findings

**C.66** A point value property tax would achieve a perfect relationship between tax liability and property value if a universal multiplier (tax rate) were used. To achieve the same yield as produced by council tax now, the multiplier would need to be set at 0.64 pence per pound of property value.

**C.67** A point value tax would also produce a closer relationship between tax and income than current council tax bands, though it would still be regressive to income overall, before council tax benefit. Savings in the CTB bill as a result of a point value tax could be significant.

**C.68** More households would gain than would lose from the move to a point value tax, but some of those paying more would face significant increases in bills.

**C.69** The regional impact of a point value tax would show the same pattern as national revaluation (with the tax burden shifting from the north to the south and London) but, without constraints of council tax bands, the impact is even greater; and

### Data sources

**C.70** Property value data were provided by VOA. This included the median value as at 1 April 2005 for domestic properties in each band in each billing authority area.<sup>17</sup> Counts of properties in each band as recorded on valuation lists as at September 2005 were used to derive the total value of properties to calculate the national rate, or local rates, as appropriate. Data from returns to CLG and household data based on the Family Resources Survey were also used, as described in Annex B.

### Assumptions

- Tax is based on estimated property values at 1 April 2005.
- Total formula grant and local tax yield remain unchanged.<sup>18</sup>
- Bills are calculated as tax rate multiplied by value of property, less any discounts or exemptions.<sup>19</sup>

<sup>17</sup> Mean values were also used for some of the earlier work on the redistribution of Formula Grant and effects at a household level. These were consistent with a national rate of 0.62% of property value rather than the 0.64% quoted above. However median values were held to be a better indicator of the likely tax rate required, since a few high value properties might skew mean values in the top band and so overestimate the yield likely from that band, depressing the multiplier. This does not affect the validity of the distributional analysis at local authority and household level, which is based on the earlier multiplier of 0.62%.

<sup>18</sup> It was assumed for some of the modelling work that Formula Grant levels remained fixed at local authority level, but was assumed for other modelling work that it would be redistributed to take account of property values.

<sup>19</sup> This includes all existing discounts and exemptions. If a point value property tax were to be regarded as a full property tax, a case could be made for considering whether they should all continue to be granted.

- There is no ceiling on the maximum tax liability.
- Households are still eligible for CTB, as now.
- Equalisation for relative resources – and hence recalculation of Formula Grant – is needed.
- A single rate per pound value of property is payable for all non-exempt properties in billing authorities, equal to the national 2006-07 council tax yield divided by the national total property value.

## Description of the methodology

**C.71** The fixed national rate was calculated by holding the national total 2006-07 council tax yield constant across England, and dividing it by the total value of equivalent dwellings across England.<sup>20</sup> This was calculated by summing, for each council tax band, the product of the national median value for the band and the number of equivalent dwellings, taking account of information on discounts and exemptions reported on CTB1 returns.

**C.72** The average bill for a property in a particular band was calculated by multiplying the average property value for the band by the national rate. These figures were then used in conjunction with data based on the Family Resources Survey to model the impact on households of introducing a point value property tax.

## More detailed findings

**C.73** Examples of 2006-07 point value annual tax bills based on a fixed national rate of 0.64 per cent of a property's value are given in Table C13. Tax liabilities would begin to exceed current band H council tax liability at around £400,000 in capital value.

**Table C13: Examples of bills under a point value property tax**

| 2005 property value | Annual tax bill based on a national rate of 0.64%                                      |
|---------------------|--|
| £100,000            | £640   |
| £170,000            | £1,088 (approximately the average council tax bill per property for 2006-07 of £1,056) |
| £250,000            | £1,600   |
| £400,000            | £2,560 (approximately the average Band H council tax bill for 2006-07 of £2,536)       |
| £1,000,000          | £6,400   |

**C.74** The point value tax modelled has the effect of reducing bills for low value properties and increases them for high value properties. For a fixed national rate, the extent of change varies widely across bands, as shown in Table C14.

<sup>20</sup> The model assumes that all discounts and exemptions applied to council tax would continue to apply to a point value property tax. The number of equivalent dwellings is therefore number of domestic properties that are liable to council tax, taking account of discounts. For example, a property with a 25% discount is counted as  $\frac{3}{4}$  of an equivalent dwelling.

**Table C14: Average bills under a point value property tax, by existing council tax band**

|        | Actual average bill for 2006-07 | New average bill | Change in bill | % change in bill |
|--------|---------------------------------|------------------|----------------|------------------|
|        | £                               | £                | £ per week     |                  |
| Band A | 850                             | 560              | -5.59          | -34.2            |
| Band B | 987                             | 825              | -3.11          | -16.4            |
| Band C | 1,126                           | 1,065            | -1.17          | -5.4             |
| Band D | 1,272                           | 1,366            | 1.81           | 7.4              |
| Band E | 1,551                           | 1,718            | 3.20           | 10.7             |
| Band F | 1,827                           | 2,202            | 7.22           | 20.6             |
| Band G | 2,089                           | 3,078            | 19.02          | 47.4             |
| Band H | 2,355                           | 5,702            | 64.37          | 142.2            |

**C.75** The impact on bills varies widely across bands because the constraints of the existing council tax band ratios are removed. Within the current bands the most that bills can vary is by a ratio of 3 to 1 – the differential between bills in the top and bottom bands. Under a point value tax, bills could vary as widely as property values do. Average values in band H are ten times average values in band A, so it is clear that moving from the current bands to a point value tax would remove a major constraint on bills at the moment.

**C.76** More properties would gain than lose from a move to a point value property tax. As a consequence, those households who pay more would generally see a bigger difference in bills than those who pay less, in order for the total tax yield to remain the same.

**C.77** Part of the change between bills under a point value tax and those under the current system can be attributed to revaluation from 1991 to 2005 values, rather than to the point value tax property itself. This is illustrated in Table C15 below.

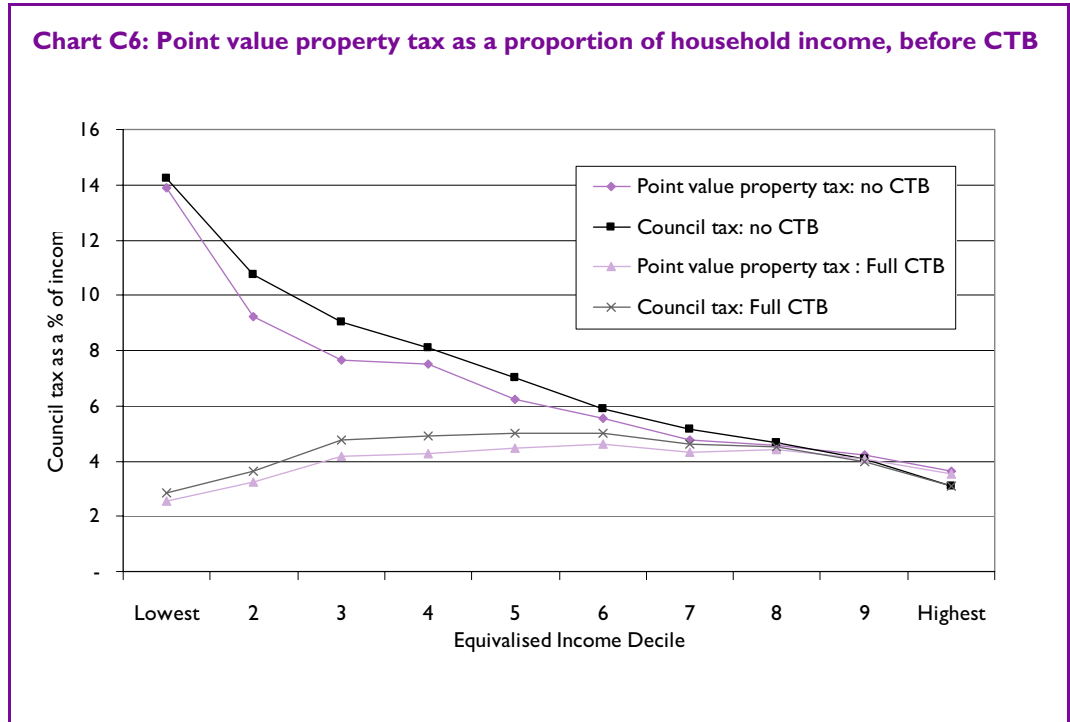
**C.78** Most households would pay less under point value property tax than under council tax, with almost six in ten households paying at least £52 per year (or £1 per week) less than now. Around 40 per cent would pay at least £3 per week less than now. More than a quarter of all households would, however, pay at least £1 per week more than now, and around 18 per cent would pay more than £3 more than now.<sup>21</sup>

<sup>21</sup> The figures quoted are broad estimates, based on the assumption that all the properties in a particular band in a particular local authority area would face the same change in weekly bill as a property of the average value for that particular band and local authority. They do not take account of actual variations in council tax bills between local authority areas.



## Household impacts

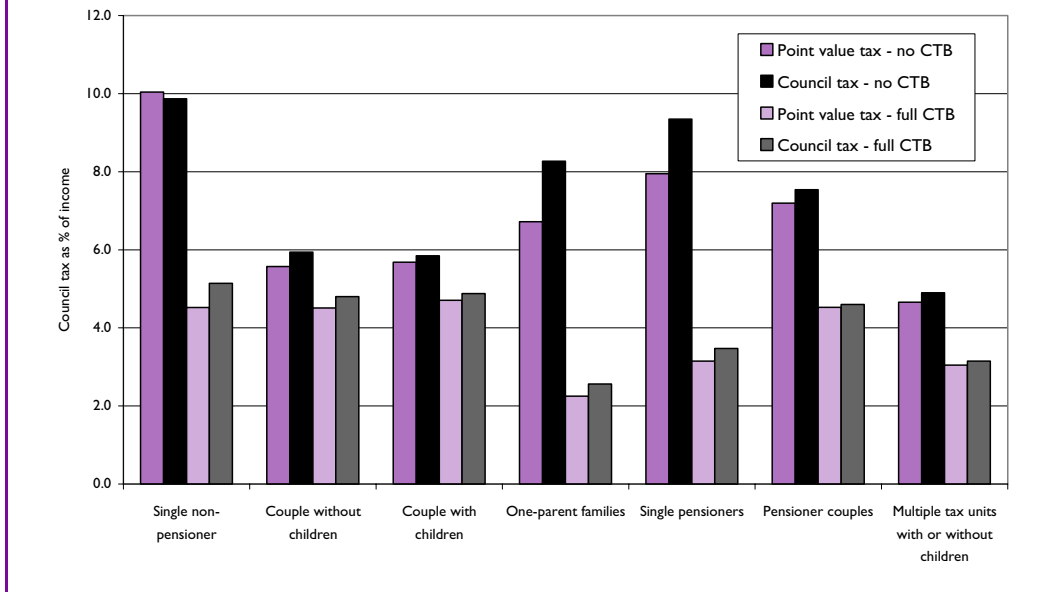
**C.79** Chart C6 shows that a point value property tax would reduce the proportion of income spent on council tax in the lowest income groups by around 15 per cent and would increase the proportion of income spent on council tax in the top income group by around 20 per cent. A point value tax would be significantly more progressive to income than council tax, though still regressive overall.<sup>22</sup>



**C.80** Under the current system, council tax bills are also broadly regressive to property value. In particular, most properties are in bands A to C, for which a higher percentage of property value is currently paid than in the higher bands. Under a point value property tax the effective rate of tax would be the same for all properties.

**C.81** Chart C7 shows that all household types would pay less than at present on average – except for pensioner couple households when full take-up of CTB is modelled. This is consistent with the fact that more households would gain than lose overall from a point value tax.

<sup>22</sup> They are all based on an early data set, based on mean property values in each local authority area, rather than median figures which were used for the higher-level analyses.

**Chart C7: Local tax as a percentage of household income, by household type**

## Regional impact

**C.82** It is known that revaluation from 1991 to more recent prices, retaining a band system, would result in the tax burden shifting broadly from the north to the South East. This is because property values in the South East have, on average, increased more since 1991 than those in the north. Moving to a point value property tax would lead to a similar shift in the local tax burden. Table C15 shows the effect of moving to point values (with a fixed national rate) to be separately identified by comparing results with 2006-07 if the national update revaluation had taken place.

**Table C15: Regional changes in local tax yield under a point value property tax****Comparison of yields for 2006-07**

|                              | Actual council tax yield 2006-07 | National update revaluation 2006-07 |                            | Point value estimates 2006-07 |                            | Difference (Point value - national update revaluation) |                               |
|------------------------------|----------------------------------|-------------------------------------|----------------------------|-------------------------------|----------------------------|--|-------------------------------|
|                              | £ billion                        | £ billion                           | % change over actual yield | £ billion                     | % change over actual yield | £ billion  | % point difference in changes |
| East of England              | 2.633                            | 2.606                               | -1.0                       | 2.611                         | -0.8                       | 0.004  | 0.2                           |
| East Midlands                | 1.802                            | 1.870                               | 3.8                        | 1.534                         | -14.9                      | -0.336   | -18.6                         |
| London                       | 3.505                            | 3.616                               | 3.2                        | 4.630                         | 32.1                       | 1.014  | 28.9                          |
| North East                   | 1.028                            | 1.047                               | 1.8                        | 0.792                         | -23.0                      | -0.255   | -24.8                         |
| North West                   | 2.834                            | 2.816                               | -0.6                       | 2.329                         | -17.8                      | -0.488   | -17.2                         |
| South East                   | 4.083                            | 4.162                               | 1.9                        | 4.503                         | 10.3                       | 0.340  | 8.3                           |
| South West                   | 2.421                            | 2.338                               | -3.4                       | 2.438                         | 0.7                        | 0.100  | 4.1                           |
| West Midlands                | 2.179                            | 2.070                               | -5.0                       | 1.955                         | -10.3                      | -0.115   | -5.3                          |
| Yorkshire & the Humber       | 1.968                            | 1.928                               | -2.0                       | 1.663                         | -15.5                      | -0.265   | -13.5                         |
| <b>England<sup>(a)</sup></b> | <b>22.453</b>                    | <b>22.453</b>                       | <b>0.0</b>                 | <b>22.453</b>                 | <b>0.0</b>                 | <b>0.000</b>   | <b>0.0</b>                    |

(a) The national totals have been scaled as necessary to equal the precise total for 2006-07. Some of the underlying modelling was based on different totals.

**C.83** Whilst the same overall yield would be raised from a point value tax as from council tax, tax bases that more closely reflected property values would mean the regional distribution of the tax burden would change, with a smaller proportion of all tax being raised in the North West, North East, Yorkshire & the Humber and the East Midlands, and a greater proportion raised in London and the South East, where capital values are highest.<sup>23</sup>

## Impact on local authorities

**C.84** The impact of a banded system is that differences in property values are not fully reflected in tax bills, which are compressed towards the band D average. This means that banding also flattens the differences in tax base between authorities. A point value tax would reflect the true value of properties in each authority area, so that tax bases would be much more variable than now. Assuming that the Formula Grant system continued to adjust for differences in tax-raising potential between authorities, the equalisation system would have to play a much greater role to accommodate a point value tax than the current banded model.

**C.85** In principle, the distribution of Formula Grant should take account of each authority's point value tax base. In practice, the Inquiry Team modelled this by applying a notional single tax rate to every authority. Formula Grant has been redistributed by taking total property values into account in the resource equalisation block and assuming a fixed national rate. As usual, the figures are before floor damping.

**C.86** Redistributing Formula Grant would result in a significant shift in Formula Grant from London and the South East towards the northern regions, with around three

<sup>23</sup> The regional picture would be likely to vary over time, because regional growth rates differ and the gap between London and the South East and the other regions tends to fluctuate. With regular revaluations a point value tax would reflect those fluctuations.

quarters of all authorities seeing a change of more than 5 per cent upwards or downwards.<sup>24</sup> The changes in Formula Grant represent a mirror image of the regional pattern of changes in tax yield, as discussed above. This is as might be expected, given that the system ensures that higher amounts of grant are given to areas with lower capacity to raise its own tax and vice versa.

**C.87** Seven authorities would theoretically be in receipt of ‘negative grant’ before floor damping.<sup>25</sup> That is, their tax yield, at a rate of 0.64 per cent of property value on all residential properties in the area, would be greater than their total budget requirement. In practice, the government would have to either take powers to reclaim some of the extra revenue for redistribution to other authorities, or provide extra Formula Grant if it were to ensure that no local authority received less funding overall than currently.

### CTB costs

**C.88** Because most of the low-income households that qualify for CTB are concentrated in lower value properties, any reform that reduced the liability of those properties would also reduce the amount of tax that must be paid for through CTB. A point value property tax would do more than any of the other council tax reform options modelled to reduce the tax burden on those households, and so would also produce the greatest savings in the benefit bill. Estimates suggest that a point value property tax would reduce the number households eligible for CTB by up to 700,000, and reduce the cost of CTB by up to £1 billion, assuming full take-up.<sup>26</sup>

## A LOCALLY-VARIABLE POINT VALUE PROPERTY TAX

### Summary of modelling work

**C.89** Modelling was done to examine the effects of each billing authority setting its own point value tax rate, assumed to be the level at which a point value tax would raise the same amount yielded by council tax in the authority area in 2006-07.

### Main findings

**C.90** Locally-set rates would introduce an element of local discretion that would not be present in a point value tax with a single fixed multiplier. However this would mean that the effective rate of tax on property would vary between different authority areas (as is already to some extent the case under council tax).

### Assumptions

- The locally-set rate option assumes that each billing authority sets its own rate per pound value of property for its area, payable by all non-exempt properties. This equals the 2006-07 council tax yield for its area divided by the total property value in its area.

<sup>24</sup> This modelling was based on mean property values from an earlier dataset.

<sup>25</sup> This would occur when an authority’s relative resource block, calculated under the four-block model, exceeded the sum of the relative needs and central allocation blocks. The council tax yield that would need adding to the Formula Grant figure so that they summed to the authority’s budget requirement would therefore need to be bigger than the budget requirement itself.

<sup>26</sup> The estimates of CTB costs were based on earlier data, using mean, rather than median, property values. Any figures derived from the later data are unlikely to be very different, however, particularly given that the biggest data changes were for higher bands, where CTB eligibility is relatively low.

- The locally-set rate includes tax required by county councils, the Greater London Authority, police and fire authorities, as well as billing authorities.<sup>27</sup>
- Each authority's level of spending on services for 2006-07 – as measured by its budget requirement – is fixed, regardless of changes to Formula Grant.
- Each authority's council tax yield is recalculated as the difference between its budget requirement and Formula Grant.<sup>28</sup>

## Description of methodology

**C.91** Locally-set rates were calculated by holding the 2006-07 area council tax yield constant in each billing authority area and dividing it by the total value of equivalent dwellings within the billing authority's area. The area council tax yield includes tax raised for county councils, GLA, police and fire authorities (i.e. major precepting authorities), as well as the billing authority. In practice, the rate-setting process may need to involve the major preceptors as well as the billing authority, and a method would need to be established for allocating amounts of tax between the tiers.

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<sup>27</sup> The modelling examined total bills for an area and so did not involve sharing amounts between tiers, although that would need to be done in practice.

<sup>28</sup> Taking account of other relevant items, as described in Annex B.

## Detailed findings

**C.92** If a point value tax were introduced to raise the same amount of money locally as council tax, the necessary rate of tax would vary to reflect authorities' different property tax bases. In that case the necessary multiplier would range from 0.22 per cent to 1.17 per cent at the extremes. In practice, it would be reasonable to assume that the grant system would equalise for the new property tax base rather than the old council tax base. The resulting changes in bills, compared with under council tax based on 1991 bandings, are smaller for a locally-set rate than for a fixed national rate, as shown in Tables C14 and C16.

**Table C16: Average bills under a locally-set point value property tax**

|        | Actual average<br>bill for 2006-07 | New average<br>bill | Change in bill | % change in bill |
|--------|------------------------------------|---------------------|----------------|------------------|
|        | £                                  | £                   | £ per week     |                  |
| Band A | 850                                | 673                 | -3.40          | -20.8            |
| Band B | 987                                | 892                 | -1.83          | -9.6             |
| Band C | 1,126                              | 1,086               | -0.77          | -3.6             |
| Band D | 1,272                              | 1,333               | 1.17           | 4.8              |
| Band E | 1,551                              | 1,641               | 1.73           | 5.8              |
| Band F | 1,827                              | 2,045               | 4.19           | 11.9             |
| Band G | 2,089                              | 2,691               | 11.58          | 28.8             |
| Band H | 2,355                              | 4,097               | 33.50          | 74.0             |

Note: without recalculation for Formula Grant

Source: Lyons Inquiry analysis

## OPTIONS FOR REFORM OF COUNCIL TAX BENEFIT

### Summary of modelling

**C.93** The Inquiry examined a range of options for changing the eligibility criteria for council tax benefit (CTB), with a view to establishing the costs and likely impact of such measures. In particular, modelling focused on:

- changes to the savings thresholds for CTB eligibility, or ‘capital limits’;
- changes to the income thresholds, or ‘applicable amounts’; and
- other options for providing rebates on council tax, including an income-related rebate as a supplement to CTB, and CTB for households not paying income tax.

**C.94** The Inquiry also examined options for reform of CTB delivery as a means of improving take-up. These are not covered here, since no separate modelling was required for that analysis, which is covered fully in Chapter 7.

### Description of the methodology

**C.95** The Inquiry team conducted analysis using the Inter-Governmental Tax Benefit Model (IGOTM) and the Department for Work and Pensions (DWP) Policy Simulation Model (PSM). Both are static micro-simulation models of the UK tax and income related benefit system and can be used to estimate the impact of changes on different types of household and on the overall government budget.

**C.96** Both simulation models use Family Resources Survey (FRS) data and calculate household or benefit unit liability for taxes and entitlement to benefits. Although similar the models are not identical and each has particular strengths for different areas of the tax and benefit system.

**C.97** PSM was used to produce the costings presented on options for changing applicable amounts and capital limits, in order to achieve more fine-grained analysis of the likely costs of change. Figures on households gaining by these measures were also generated in PSM. Due to sampling errors, the total caseloads reported are subject to some statistical uncertainty and do not match exactly the published CTB statistics.

**C.98** Other analysis, including charts showing council tax as a proportion of income before and after benefit, and the assessment of a ‘circuit-breaker’ rebate, was done using IGOTM, which looks across the tax and benefit system.

### Assumptions

- The PSM models the current policy year (2006-07) using the latest FRS data (2004-05), by up-rating the FRS to represent the appropriate policy year.
- Policy changes would apply on a Great-Britain basis, and are costed to include Scotland and Wales. This reflects that council tax benefit operates on a GB-wide basis and is not devolved.
- The analysis assumes full take-up of income related benefits in the current policy year (2006-07) (except where otherwise specified).

- All who face an increase in their CTB (as opposed to those who become newly eligible) are already recipients of Second Adult Rebate (an alternative to CTB). This is assumed to be uprated to full CTB.
- Some of the rules for income-related benefit receipt are linked to the female state pension age. For the purposes of this work pensioner benefit units are defined as households with any adult over 60, while working age benefit units are households with all adults under 60.<sup>29</sup>
- Capital limits in CTB
- The Inquiry considered the following options:
  - Increasing the upper capital limit in CTB (and Housing Benefit) to £50,000 for pensioners;
  - Increasing the upper capital limit in CTB to £50,000 and the lower capital limit to £10,000 in CTB (and HB) for pensioners;
  - Abolishing the upper capital limit in CTB (and HB) for pensioners; and
  - Increasing the upper capital limit in CTB (and HB) to £50,000 for working age households.
- The costs of each option were assessed at both full take-up (the total value of the new CTB eligibility that would be created if these measures were adopted), and at current levels of take-up (as an indication of likely real costs to government). Housing Benefit (HB) and CTB are currently closely linked and administered through local authorities. The costs of applying the same measures in HB are shown for completeness.

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<sup>29</sup> They may actually be working or not be receiving other benefits as 'pensioners'. This definition is used because housing benefit and council tax benefit are more generous for this group.



**Table C17: Costs of changing capital limits in CTB and HB**

| Option  | Cost of policy change<br>Full take-up (£ million) |     | Cost of policy change<br>Current take-up (£ million) |    |
|---|---|-----|--|----|
|   | CTB   | HB  | CTB  | HB |
|   | 1. Upper capital limit<br>£50k for pensioners     | 195 | 100  | 60 |
| 2. Upper capital limit<br>£50k and lower capital<br>limit £10k for pensioners | 260   | 130 | 80   | 65 |
| 3. Abolish upper capital<br>limit for pensioners                              | 220   | 105 | 65   | 55 |
| 4. Upper capital limit<br>£50k for working age<br>households                  | 20  | 15  | 10   | 5  |

**Table C18: Impact on households of changing capital limits in CTB and HB**

| Option  | Number of households likely<br>to benefit     |         | Average weekly gain<br>(CTB only)  |                                    |
|---|---|---------|------------------------------------|------------------------------------|
|   | CTB   | HB      | Already<br>entitled to<br>some CTB | Newly-<br>entitled after<br>reform |
|   | 1. Upper capital limit<br>£50k for pensioners | 370,000 | 50,000                             | n/a                                |
| 2. Upper capital limit<br>£50k and lower capital<br>limit £10k for pensioners | 1,040,000                                     | 350,000 | £1.20                              | £10.00                             |
| 3. Abolish upper capital<br>limit for pensioners                              | 420,000                                       | 54,000  | n/a                                | £10.00                             |
| 4. Upper capital limit<br>£50k for working age<br>households                  | 35,000  | 9,000   | n/a                                | £12.20                             |

**C.99** Raising the upper savings limit to £50,000 has the potential to benefit large numbers of pensioner households, benefiting 370,000 pensioner households who are currently ineligible for CTB. Abolishing the upper limit brings a further 50,000 households into CTB eligibility. In both scenarios, the average gain per household would be approximately £10 per week.

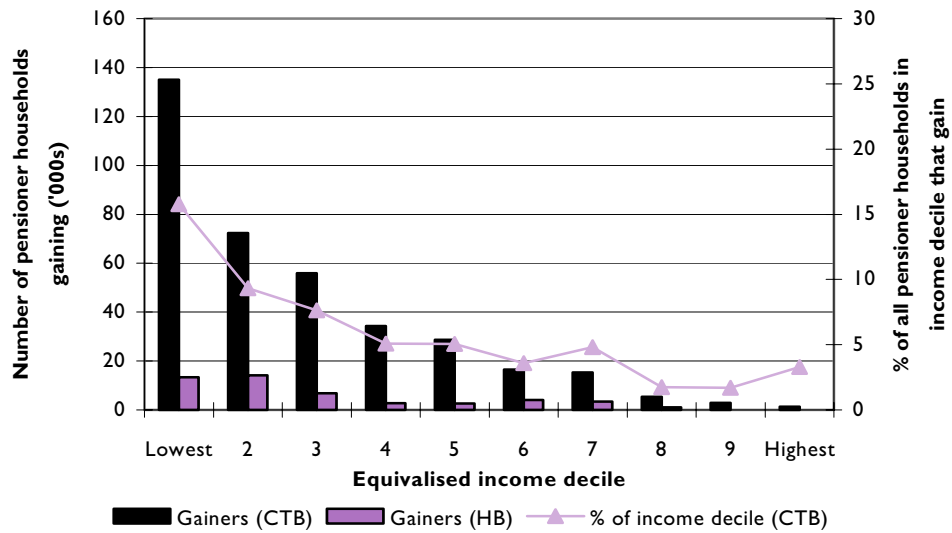
**C.100** Most of those gaining by an increase in the upper capital limits would be in the lowest income deciles. Increasing the upper limit to £50,000 would bring 370,000

pensioner households into CTB eligibility, of which 135,000 are in the bottom income decile.

**C.101** Raising the lower capital limit as well as the upper limit benefits around three times as many households. However the average benefit gained by these additional households is small at just £1.20 per week.

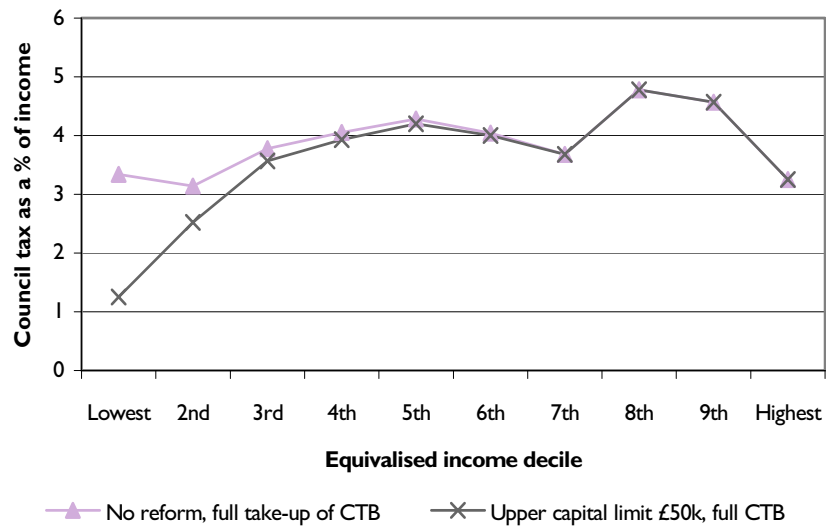
**C.102** Altering capital limits for working age households affects only a small number of households, as pensioner households hold most savings. These figures should be treated as indicative only, since the sample sizes involved are not large enough to provide precise estimates.

**Chart C8: Pensioner households gaining by an increase in the upper capital limit in CTB and HB to £50,000**



Source: Lyons Inquiry

**Chart C9: Council tax as a percentage of income for pensioner households, before and after reform of upper capital limits in CTB**



Source: Lyons Inquiry analysis

### Income thresholds in CTB

**C.103** The Inquiry considered the following options for both CTB and HB eligibility:

- increasing applicable amounts by 5 per cent for working age households;
- increasing applicable amounts by 10 per cent for working age households;
- increasing applicable amounts by 5 per cent for pensioner households; and
- increasing applicable amounts by 10 per cent for pensioner households.

**Table C19: Costs of changing applicable amounts in CTB and HB**

| Option                          | Cost of policy change<br>Full take-up (£ million) |     | Cost of policy change<br>Current take-up (£ million) |     |
|---------------------------------|---|-----|--|-----|
|                                 | CTB   | HB  | CTB  | HB  |
|                                 | 5. 5% increase for working age                    | 60  | 180  | 35  |
| 6. 10% increase for working age | 125   | 360 | 70   | 195 |
| 7. 5% increase for pensioners   | 180   | 160 | 55   | 80  |
| 8. 10% increase for pensioners  | 340   | 285 | 100  | 140 |

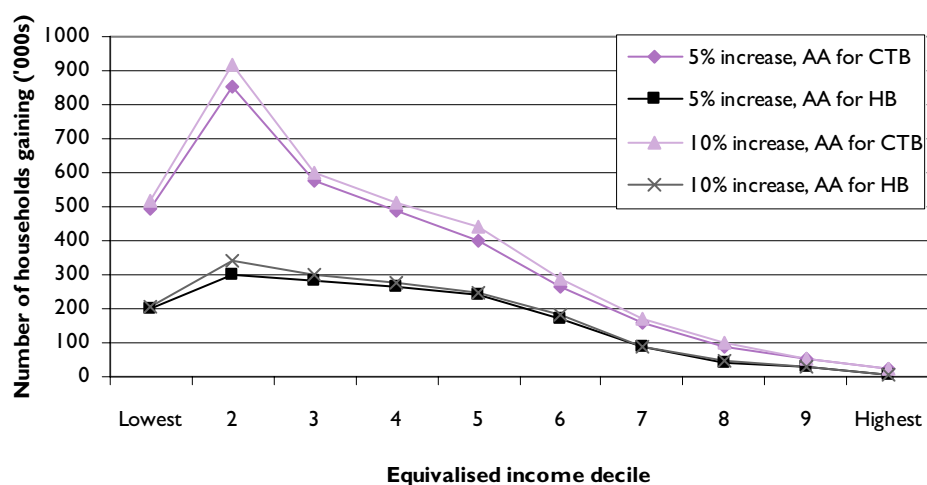
**Table C20: Impact on households of changing applicable amounts in CTB and HB**

| Full take-up<br><br>Option      | Number of households likely to benefit |         | Average weekly gain<br>(CTB only) |                             |
|---------------------------------|--|---------|-----------------------------------|-----------------------------|
|                                 | CTB                                    | HB      | Already entitled to some CTB      | Newly-entitled after reform |
| 5. 5% increase for working age  | 975,000                                | 900,000 | £1.20                             | £0.90                       |
| 6. 10% increase for working age | 1,100,000                              | 975,000 | £2.30                             | £1.70                       |
| 7. 5% increase for pensioners   | 2,400,000                              | 725,000 | £1.50                             | £0.80                       |
| 8. 10% increase for pensioners  | 2,500,000                              | 745,000 | £2.70                             | £1.70                       |

**C.104** Changes to applicable amounts would benefit very large numbers of households, although the average amounts gained would be small. Working age households would be more likely than pensioner households to gain from parallel changes in HB.

**C.105** Increases of 5 per cent across all households (the combined impact of options 1 and 3) would result in gains for significant numbers of households in all but the top three income deciles. Around 40 per cent of those gaining would be in the bottom two deciles. Particularly large numbers of households in the second income decile would benefit from increased income thresholds for CTB.

**C.106** More generous increases of ten per cent do not alter this profile significantly, suggesting the same households would gain in either case.

**Chart C10: Number of households gaining when increasing the Applicable Amount by 5% and 10% for all households**

Source: Lyons Inquiry analysis

**C.107** The options modelled suggest that while changes to the income thresholds would affect large numbers of households, targeting the savings thresholds would provide more substantial benefits to those households gaining, and could be particularly important for pensioner households, including many of the poorest pensioners.

## INTRODUCTION OF AN EXEMPTION FOR NON-IT PAYERS

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### Summary

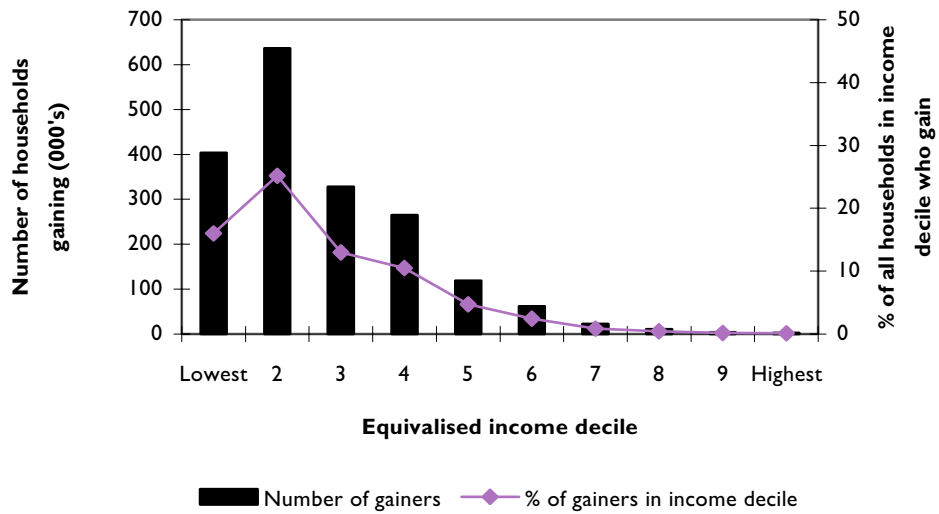
**C.108** Some commentators, including the New Policy Institute and the Local Government Information Unit, have asked whether it is right, in principle, that households whose incomes are below the threshold at which income tax is paid, should nonetheless pay council tax. While in principle property taxes and income taxes might reasonably begin at different levels, the Inquiry has examined the cost of making full CTB available to all households who pay no income tax. This option achieves that end by providing a full council tax exemption for any household in which no individual pays income tax.

### Main findings

**C.109** Approximately 5.2 million households would be exempt from council tax under this option. An estimated 3.7 million of these households are already eligible for CTB and so pay no council tax already (although in practice, some will not have taken up their CTB entitlement so still pay council tax). Another 1.2 million households would receive partial CTB and 346,000 households would receive no CTB. Hence, this option will increase net income for about 1.6 million households.

**C.110** The total cost of introducing an exemption of this kind would be approximately £700 million. As such it was judged unlikely to be affordable in the short term, though it has some advantages as an option for targeting support towards low-income households.

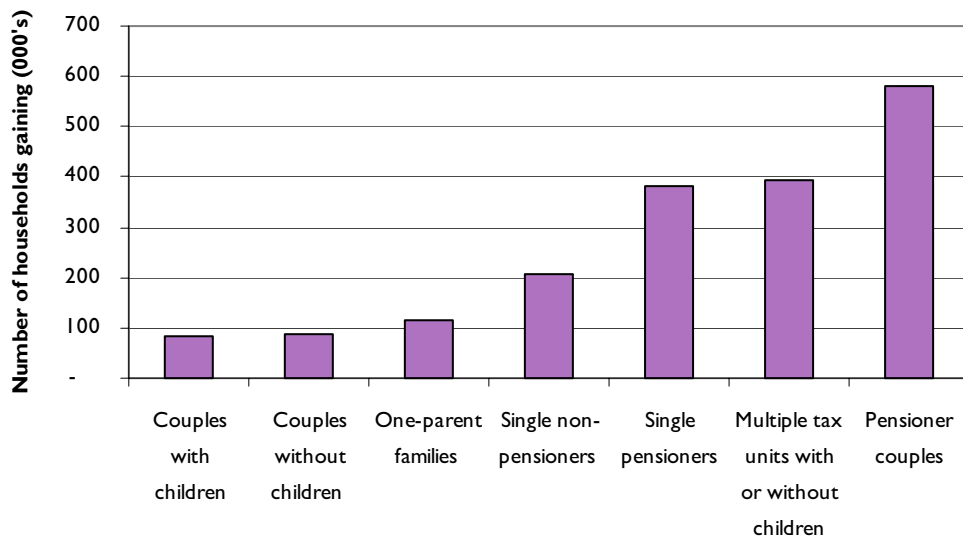
**Chart CI I: Number of gainers and percentage of total households gaining, by income decile**



Source: Lyons Inquiry

**C.III** Approximately 35 per cent of those who gain are in the second income decile, because although the lowest decile households are more likely to be exempt from income tax they are also more likely to already receive some full or partial CTB. Just over half of those who would gain are pensioners.

**Chart CI2: Number of households gaining, by household type**



## CTB: INTRODUCING A ‘CIRCUIT BREAKER’ REBATE

### Summary of modelling work

**C.112** Modelling was undertaken to examine the costs and impact of ensuring that no household paid more than a certain percentage of its net income before housing costs on council tax. Three particular ‘circuit breaker’ options were considered, with thresholds at 8 per cent, 10 per cent and 12 per cent of household income. The household would receive a rebate to cap its net council tax bill at the chosen level of circuit breaker.

### Main findings

**C.113** The more generous circuit breakers would be more costly, with much of the cost of a generous circuit breaker being spent on rebates to middle income households. The estimated costs are:

- £240 million for an 8 per cent circuit breaker;
- £95 million for a 10 per cent circuit breaker; and
- £50 million for a 12 per cent circuit breaker.

### Data sources

**C.114** The modelling used figures for actual 2006-07 council tax levels, as reported on BR returns, and data on households, based on the Family Resources Survey.

### Assumptions

- The 2006-07 council tax levels for each local authority area were as actually set, reflecting the distribution of Formula Grant after floor damping.
- There is a 100 per cent take-up of CTB. It is assumed that people could apply for a ‘circuit breaker’ rebate only after applying for any CTB to which they are entitled.
- Eligibility is assessed against gross household income.<sup>30</sup>

### CTB costs

**C.115** Although the total cost of a circuit breaker has been estimated on the assumption that there is full take-up of CTB, the cost of a circuit breaker would in practice be closely linked to the level of circuit breaker take-up and its effect on CTB take-up, which is currently low, at between 65-71 per cent on an expenditure basis. Although it is possible that a circuit breaker may, in reality, encourage more households to claim CTB, it is very difficult to estimate the effect that a circuit breaker would have on take-up.

**C.116** The two extreme cases would be i) if more households claimed the circuit breaker than currently claim conventional CTB; or ii) it might have no effect on take-up rates, and so only those currently receiving CTB would be affected. Given that the

<sup>30</sup> While most other analysis in this annex looks at net household income after housing costs, this option assumes that any rebate would need to apply before housing costs, since verifying these as part of the claims process, would add a further degree of complexity which might make such a rebate difficult to implement, and could create some perverse incentives at the margins.

modelling work has assumed 100 per cent take-up of benefit of those currently eligible, the cost estimate for the first case above would be likely to be an underestimate of total Exchequer costs because it does not take account of additional conventional claimants. In the second case, the estimate would be overstated. The results presented are based on full take-up of CTB and therefore provide an estimate of the maximum costs of the circuit breaker.

## Impact on households by income decile

**Table C21: Impact of a circuit-breaker rebate, by income decile**

| Decile  | No circuit breaker             | 12% circuit breaker            |                               |                | 10% circuit breaker            |                               |                | 8% circuit breaker             |                               |                |
|---------|--------------------------------|--------------------------------|-------------------------------|----------------|--------------------------------|-------------------------------|----------------|--------------------------------|-------------------------------|----------------|
|         | Council tax as % of net income | Council tax as % of net income | Number of households assisted | Average rebate | Council tax as % of net income | Number of households assisted | Average rebate | Council tax as % of net income | Number of households assisted | Average rebate |
|         |                                |                                | thousand                      | £ per week     |                                | thousand                      | £ per week     |                                | thousand                      | £ per week     |
| Lowest  | 3.0                            | 2.5                            | 107                           | 7.15           | 2.3                            | 161                           | 7.21           | 2.1                            | 224                           | 7.90           |
| 2       | 3.7                            | 3.6                            | 32                            | 3.89           | 3.6                            | 87                            | 4.00           | 3.4                            | 190                           | 4.91           |
| 3       | 4.8                            | 4.8                            | 15                            | 3.43           | 4.8                            | 50                            | 3.88           | 4.6                            | 152                           | 4.29           |
| 4       | 4.9                            | 4.9                            | 7                             | 2.54           | 4.9                            | 32                            | 3.45           | 4.8                            | 130                           | 3.75           |
| 5       | 5.0                            | 5.0                            | 2                             | 1.66           | 5.0                            | 16                            | 2.33           | 4.9                            | 102                           | 3.32           |
| 6       | 5.0                            | 5.0                            | 0                             | 0.00           | 5.0                            | 9                             | 2.50           | 5.0                            | 72                            | 3.22           |
| 7       | 4.6                            | 4.6                            | 0                             | 0.00           | 4.6                            | 3                             | 2.77           | 4.6                            | 26                            | 3.86           |
| 8       | 4.5                            | 4.5                            | 0                             | 0.00           | 4.5                            | 0                             | 0.00           | 4.5                            | 10                            | 1.73           |
| 9       | 4.0                            | 4.0                            | 0                             | 0.00           | 4.0                            | 0                             | 0.00           | 4.0                            | 0                             | 2.19           |
| Highest | 3.0                            | 3.0                            | 0                             | 0.00           | 3.0                            | 0                             | 0.00           | 3.0                            | 0                             | 0.00           |
| Overall | 4.3                            | 4.2                            | 163                           | 5.90           | 4.2                            | 358                           | 5.25           | 4.1                            | 907                           | 5.00           |

Source: Lyons Inquiry

**C.117** Table C21 shows that a circuit breaker could be particularly effective in assisting those low-income households for whom a large percentage of income is absorbed by council tax.

**C.118** The 12 per cent circuit breaker would almost exclusively affect the lowest income decile. At the other end of the range, and for a much higher cost to government, the 8 per cent circuit breaker would benefit some middle-income earners without bringing proportional further benefits at the lower end of the scale.

**C.119** Households in the lower income deciles would receive, on average, £7 to £8 per week in rebate payments under all three options. As well as paying benefit to more households at the higher income levels, the more generous circuit breakers would pay a higher rebate to all recipients – albeit only slightly higher amounts at the lower income bands.



## Impact on households by household type

Table C22: Impact of a circuit-breaker rebate, by household type

| Decile                  | No circuit breaker             | 12% circuit breaker            |                               |                | 10% circuit breaker            |                               |                | 8% circuit breaker             |                               |                |
|-------------------------|--------------------------------|--------------------------------|-------------------------------|----------------|--------------------------------|-------------------------------|----------------|--------------------------------|-------------------------------|----------------|
|                         | Council tax as % of net income | Council tax as % of net income | Number of households assisted | Average rebate | Council tax as % of net income | Number of households assisted | Average rebate | Council tax as % of net income | Number of households assisted | Average rebate |
|                         |                                |                                | thousand                      | £ per week     |                                | thousand                      | £ per week     |                                | thousand                      | £ per week     |
| Household type          |                                |                                |                               |                |                                |                               |                |                                |                               |                |
| Single non-pensioner    | 5.2                            | 5.1                            | 29                            | 5.77           | 5.1                            | 71                            | 4.19           | 5.0                            | 184                           | 3.85           |
| Couple without children | 4.8                            | 4.8                            | 28                            | 7.10           | 4.7                            | 67                            | 5.83           | 4.6                            | 185                           | 5.56           |
| Couple with children    | 4.9                            | 4.9                            | 2                             | 9.66           | 4.9                            | 5                             | 7.57           | 4.9                            | 27                            | 5.52           |
| One-parent families     | 2.6                            | 2.5                            | 1                             | 19.03          | 2.5                            | 1                             | 20.54          | 2.5                            | 3                             | 8.27           |
| Single pensioners       | 3.5                            | 3.4                            | 66                            | 4.89           | 3.3                            | 122                           | 4.99           | 3.2                            | 263                           | 4.81           |
| Pensioner couples       | 4.6                            | 4.5                            | 32                            | 5.26           | 4.5                            | 80                            | 5.23           | 4.4                            | 213                           | 5.39           |
| Multiple tax units      | 3.2                            | 3.2                            | 6                             | 12.20          | 3.2                            | 11                            | 8.97           | 3.1                            | 32                            | 6.60           |
| Overall average         | 4.3                            | 4.2                            | 163                           | 5.90           | 4.2                            | 358                           | 5.25           | 4.1                            | 907                           | 5.00           |

Source: Lyons Inquiry

**C.120** Table C22 shows that pensioner households – and particularly pensioners living alone - would receive the most help from a circuit breaker. Single non-pensioners would also receive significant help. Typical high-earning households and one-parent families would receive the least help. The latter type of household tends to be receiving other benefits, such as housing benefit to cover rent. The very small number of one-parent families qualifying for the rebate may be because these households would tend already to be receiving conventional CTB.

**C.121** The most generous circuit breaker (the 8 per cent option) would pay a lower average rebate for most household groups, although it would be paying many more households in each group. The high average rebate for one-parent families is due partly to the low number of households receiving the payment, who will have failed to qualify for conventional benefit, but have a high tax burden.

## LOCAL INCOME TAX AS A REPLACEMENT FOR COUNCIL TAX

### Summary of modelling

**C.122** Modelling was conducted to examine the impact of replacing all or part of council tax with a local income tax (LIT). Two scenarios were modelled: full replacement of council tax with a LIT, and partial replacement at a level that raised half the required revenues from council tax and half from a LIT. In particular, this work focused on:

- the LIT rate required to generate a given amount of revenue;
- the impact of a LIT on households' tax liability; and
- the implications of a LIT for local government finance, including the impact on tax bases between areas and over time.

**C.123** The model applies a LIT as a fixed increase in the basic rate of income tax. This reflects a judgement by the Inquiry that basic rate income tax is the most appropriate local tax base. The higher rate of income tax provides a less even tax base across the country, since higher rate taxpayers are not as evenly distributed as basic rate taxpayers. Applying a LIT to all rates of income tax also provides a less even tax base than basic rate alone. Revenues from the starting rate are modest and were judged too small to be a viable replacement for council tax.

**C.124** A number of policy judgements were taken in designing the local income tax model, so the outputs described below should be considered illustrative rather than definitive. The Government would need to take its own decisions about elements of policy design in implementing any local income tax, and might choose to pursue a different model to this one.

**C.125** For example, it was decided to model only the basic rate of income tax because that leads to greater evenness of tax bases between areas than the additional use of the higher and standard rates of tax. Judgements were also made, particularly in the partial replacement LIT option, about the respective roles of counties and districts in two-tier areas. For the sake of reducing complexity in the model, it was assumed that upper-tier authorities would set a single LIT rate across their area, with districts retaining control of council tax rates. This might also have some policy advantages in reducing complexity for taxpayers and employers, but this would be a matter of choice for government. Also in the partial replacement model, a set of assumptions were made about the balance between LIT and council tax – again these would be a matter of choice if such a partial replacement were to be implemented.

## Data sources

**C.126** Figures for the amounts raised from the basic rate of income tax for each local authority area were taken from the Survey of Personal Incomes (SPI) for 2003-04 from HMRC and uprated to 2006-07 in line with Budget 2006 assumptions. These figures do not include any behavioural response to the changes nor do they project any population changes due to migration. In addition, figures from BR returns for 2006-07 and the FRS data set were used for modelling.<sup>31</sup>

## Main findings

**C.127** A LIT rate of 7.7 pence on the basic rate of income tax would raise £22 billion in 2006-07 – approximately the amount necessary to replace council tax. If, however, the £3.15 billion saved in CTB (based on budgeted expenditure for 2006-07) were added to the national total of Formula Grant, the amount of yield required would drop to around £19 billion, implying a LIT rate of 6.6 pence on the basic rate of income tax.

**C.128** A local income tax of this kind would be more progressive to income than council tax even with full take-up of CTB. A LIT on the basic rate would be progressive to income for all but the top ten per cent of earners, since the tax paid on earnings in the higher rate bracket would be unchanged.

**C.129** A local income tax would be naturally ‘buoyant’. It is estimated that revenues would grow over time, but that this growth may be more modest than would have been expected from council tax. (The issue of buoyancy in income tax is explored in more detail in Annex E.)

**C.130** A LIT rate of 3.9 pence on the basic rate of income tax would be sufficient to replace approximately half of council tax. Average band D council tax could be reduced in that case to £629 per year in 2006-07, before council tax benefit.

## Assumptions

- A LIT would be expected to raise £22 billion, approximately the amount that authorities budgeted to raise from council tax for 2006-07
- Each local authority’s level of spending for 2006-07 – as measured by its budget requirement – is unchanged
- Formula Grant is redistributed, to reflect the changed tax base, with the national total for 2006-07 remaining unchanged. Floor damping is not applied. Comparisons with the existing grant distribution for 2006-07 refer to grant before floor damping.<sup>32</sup> Total Formula Grant is unchanged.
- CTB is not payable. The resulting saving is not assumed to be recycled into Formula Grant; a local income tax would be expected to replace gross, not net council tax

<sup>31</sup> Some differences between SPI and FRS figures for the yield from the basic rate of income tax were identified, with those from the SPI tending to be higher than those from the FRS. No definitive explanation for the differences was found, but they were likely to be due partly to differences resulting from different sampling errors in the SPI and the FRS, which in turn are affected by their different sample sizes: over 400,000 for the SPI compared with about 20,000 for the FRS. The differences are also likely to be due partly to the assumptions made when updating the SPI figures from 2003-04 and partly to the fact that the FRS is more focused on households receiving benefits and people at the lower end of the income scale than on taxpayers in general.

<sup>32</sup> For an explanation of floor damping within the current grant system, see Annex A

- LIT rates vary across billing authority areas so that the correct LIT yield can be raised, taking account of each authority's budget requirement and level of redistributed Formula Grant.<sup>33</sup>
- LIT is levied through a fixed amount on the basic rate based on earnings income. The other elements of the tax system, such as personal allowances, are the same as under the national income tax system.

## Description of the methodology

**C.131** The Inquiry team modelled a full replacement LIT as an increase in the basic rate of income tax in 2006-07. Formula Grant figures were recalculated to take account of changes in tax base, and the resulting local tax yield and average bills were calculated for each billing authority area.

**C.132** The impact at a household level was modelled, with the tax rate calculated at a local authority level being applied to the earned income associated with each household. The bills calculated at a household level by using FRS data on household income that would be subject to a LIT.<sup>34</sup>

## Detailed findings

**C.133** Under LIT, bills would be significantly reduced for very low-income households, making a local income tax progressive overall, except in the top income decile. Average bills for households in the top income decile would, however, be around twice those paid by that group under council tax.

**C.134** LIT is, as might be expected, is more progressive with income than council tax, as shown in Table C23. Under a council tax system, higher earners pay proportionally less tax than the middle-income families, but LIT is regressive only at the very top band in the modelling results. This is because earnings in the higher rate tax bracket are not subject to LIT, due to the LIT model being based on only the basic rate of income tax.

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<sup>33</sup> This differs from the treatment of two-tier areas in modelling of the partial replacement LIT, where it is assumed that a standard LIT rate would be applicable across each county area, with the resulting variation in local tax requirement being taken into account in the setting of council tax levels.

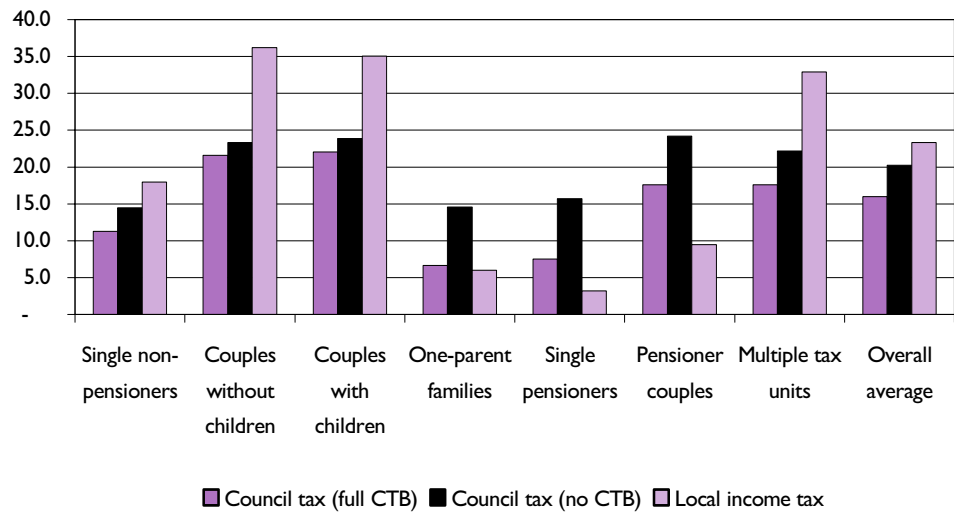
<sup>34</sup> For the purposes of the model, figures on taxable income were scaled back as survey data tends to overestimate yield from LIT compared with data from HMRC.

**Table C23: Local income tax as a percentage of net household income**

| Equivalised Income Decile | LIT  | CT (full CTB) | CT (no CTB) |
|---------------------------|------|---------------|-------------|
| Lowest                    | 0.27 | 2.87          | 14.6        |
| 2                         | 1.19 | 3.69          | 10.98       |
| 3                         | 2.03 | 4.84          | 9.27        |
| 4                         | 2.69 | 4.99          | 8.28        |
| 5                         | 3.85 | 5.09          | 7.16        |
| 6                         | 5.23 | 5.09          | 6.04        |
| 7                         | 6.14 | 4.72          | 5.25        |
| 8                         | 7.43 | 4.59          | 4.71        |
| 9                         | 8.23 | 4.05          | 4.12        |
| Highest                   | 7.34 | 3.1           | 3.12        |
| Overall Average           | 4.46 | 4.31          | 7.32        |

Source: Lyons Inquiry analysis

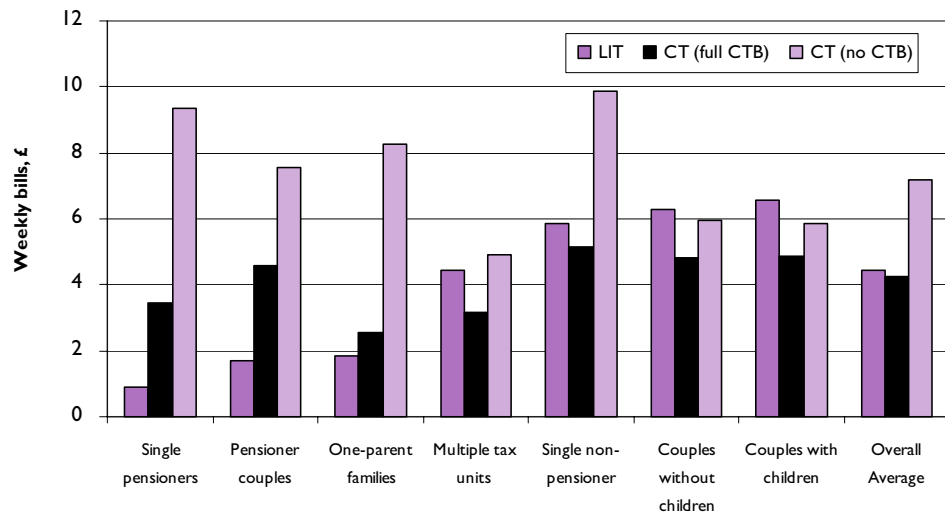
**Chart C13: Average weekly bills under a local income tax, by household type**



Source: Lyons Inquiry analysis

**C.135** As shown in Chart C13, couples with or without children, single non-pensioners and multiple tax units would pay a higher percentage of net household income on local tax with LIT compared to council tax with full CTB. The proportion of income payable by pensioners is on average about a third as much as with council tax, even assuming full CTB take-up. One-parent families would experience a reduction of about 40 per cent on average, compared with council tax with full CTB take-up. Since not all CTB entitlement is taken up at present, many households would in practice see larger gains from a local income tax than suggested above.

**Chart C14: Local income tax as a percentage of net household income, by household type**



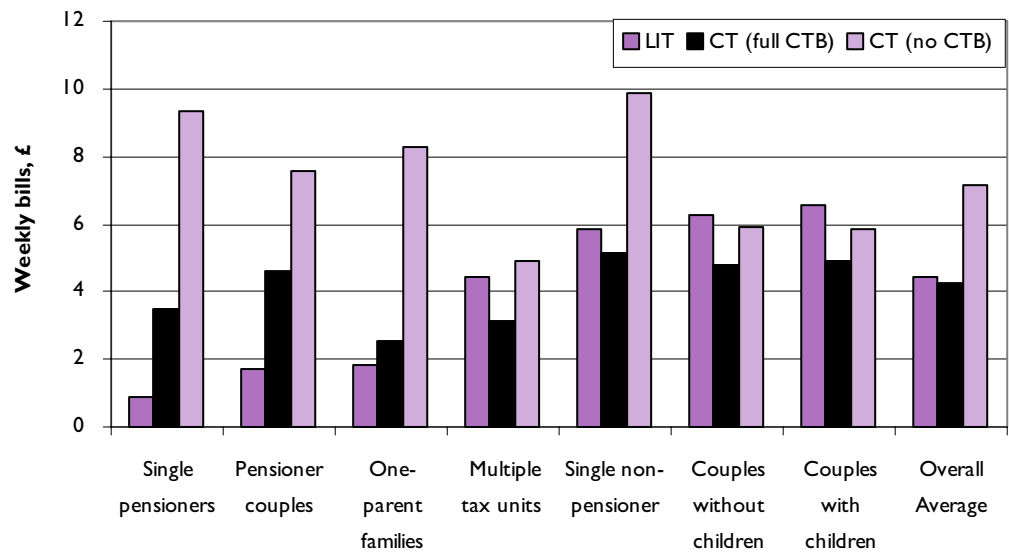
Source: Lyons Inquiry analysis

## Regional impact on local taxes

**C.136** Chart C15 compares the regional distribution of yields from council tax and LIT. The yields in the North East, the East of England, London and the South East would be greater under LIT than under council tax. It also shows how the average LIT rate by region would vary around the 7.8p average, from 7.6p in the East Midlands and West Midlands to 8.8p for the North East if the local tax requirement for each local authority area had been held constant.<sup>35</sup> This reflects the fact that income tax bases are more variable at the regional level than council tax bases (under the existing bands).

<sup>35</sup> The average LIT rate for a region has been calculated as the income tax yield for the region divided by the total yield from 1p on the basic rate of income tax for the region. The LIT yields have been scaled to sum exactly to the total council tax yield of £22.453 billion.

**Chart C15: Impact of LIT on local tax yield, by region**



Source: Lyons Inquiry analysis

**C.137** London would face the greatest increase in bills, whereas the South West and North East would see the biggest reductions. This is consistent with the distribution of income across the country.

## LIT AS A PARTIAL REPLACEMENT FOR COUNCIL TAX

### Summary of modelling work

**C.138** The Inquiry team modelled a partial replacement LIT, which was assumed in this case to replace approximately half of council tax. This was done by assuming that only half of the national council tax yield for 2006-07 of £22 billion had been funded from council tax, with the remaining £11 billion being funded from a LIT.<sup>36</sup> As in the modelling of a full replacement LIT, the model recalculated Formula Grant to reflect the changed tax base. This new tax base is then used to inform the setting of LIT rates, the consequent calculation of bills and the impact on households.

### Assumptions

- A LIT would be expected to raise £11 billion, approximately half the amount that authorities budgeted to raise from council tax for 2006-07. Each authority’s spending levels – as measured by its budget requirement – is unchanged.
- Formula Grant is redistributed, to reflect the changed tax base, with the national total for 2006-07 remaining unchanged. Floor damping is not applied. Comparisons with the existing grant distribution for 2006-07 refer to grant before floor damping. Total Formula Grant is unchanged.

<sup>36</sup> Rounded to the nearest £1 billion.

- CTB is not payable against the LIT element of local taxes. Savings from reductions in council tax are not assumed to be recycled into Formula Grant; a LIT is assumed to replace half of gross, not net council tax.
- There is one tier of LIT-raising authority in each area: county councils in two-tier areas; unitary councils in unitary areas; metropolitan districts in metropolitan areas; and London boroughs and the City of London in London.
- Each LIT-raising authority would set its own LIT rate, rather than there being a single fixed rate applicable to all LIT-raising authorities. The LIT rate would therefore vary for each LIT-raising local authority instead of being fixed across them all.
- Nationally, for authorities permitted to raise LIT, the gap between local authorities' budget requirements and Formula Grant (the local tax requirement) would be funded 50 per cent from LIT and 50 per cent from council tax in the first year of operation.
- Variants were modelled with and without the single person council tax discount. This reflects that the Government could choose to treat the remaining council tax as a pure property tax, with the LIT element implicitly taking account of the number of earners and service-users living in a property. In that case the single person discount might no longer apply.

## Description of the methodology

**C.139** The overall approach taken was to model local authority level figures for 2006-07, including the redistribution of Formula Grant, with resource equalisation taking account of both council tax and local income tax bases. For grant purposes a 50/50 council tax/LIT split was assumed at a national level, whilst allowing each LIT-raising authority some discretion over its relative level of revenue from each tax, in the light of the different relative strength of the two tax bases in different areas.

**C.140** This was considered preferable to two possible alternative approaches:

- imposing a 50/50 split at local authority level, when equalising for Formula Grant and when tax-setting;<sup>37</sup> or
- continuing to distribute grant according to resource equalisation for council tax only, leaving Formula Grant figures for 2006-07 unchanged. However this would imply a policy choice not to equalise for LIT resources, and so was not built into the model.

**C.141** The model operates as follows:

- the distribution of Formula Grant is recalculated, on the basis that, nationally, 50 per cent of revenue would be raised from council tax and 50 per cent from LIT.
- in that context, applying an 'assumed national council tax' (ANCT) rate at such a level that, if adopted by all authorities, 50 per cent of the previous

<sup>37</sup> This approach could constrain authorities' ability to reach the optimum balance between LIT and council tax in their area, and might therefore distort the rates applied where one taxbase is particularly weak or strong compared with the other. An exact 50/50 split for each local authority (i.e. requiring exactly the same yield to be raised from council tax and LIT in an area) would, in any case, be almost impossible to achieve in practice because of the unpredictability of income tax revenue.



assumed national council tax revenue would be raised.<sup>38</sup> Similarly, set an ‘assumed national local income tax’ (ANLIT) rate at a level that results in equal amounts of revenue raised nationally from LIT and council tax. It is therefore not assumed that each local authority would raise an equal amount in LIT and council tax in practice; local authorities with tax bases skewed towards one tax would be able to realise their potential to raise tax from one source whilst not raising as much revenue from the other;

- calculate a local tax yield for each authority;
- each major precepting authority then precepts its constituent billing authorities. This is done by requesting a cash amount equal to each billing authority’s share of the major precepting authority’s local tax requirement, apportioned in proportion to the tax bases of the billing authorities (e.g. a county council’s precept is apportioned between its district councils in line with their tax bases);
- the collected revenue received by each billing authority is divided between the major preceptors in proportion to their precepted amounts;
- billing authorities each set their own LIT and council tax rates independently of any other authority;<sup>39</sup>
- the setting of rates in two-tier shire areas follows this principle as closely as possible, but would be constrained by the requirement for there to be a common LIT rate across a county area;<sup>40</sup>
- each authority’s band D council tax is calculated by dividing its council tax yield by the tax base;
- each local authority’s LIT requirement is expressed in terms of pence on the basic rate, by dividing the authority’s LIT requirement by the amount generated by 1 pence, using HMRC figures;
- area council taxes for each billing authority area are calculated as described in Annex B; and
- household level bills and the effects on CTB costs are modelled using IGOTM. Two scenarios were examined for their impact on households: one in which all existing discounts and exemptions are retained, and a second in which the single adult discount is abolished.

<sup>38</sup> The use of an assumed national council tax is consistent with the method of carrying out resource equalisation in local government finance settlements before 2006-07.

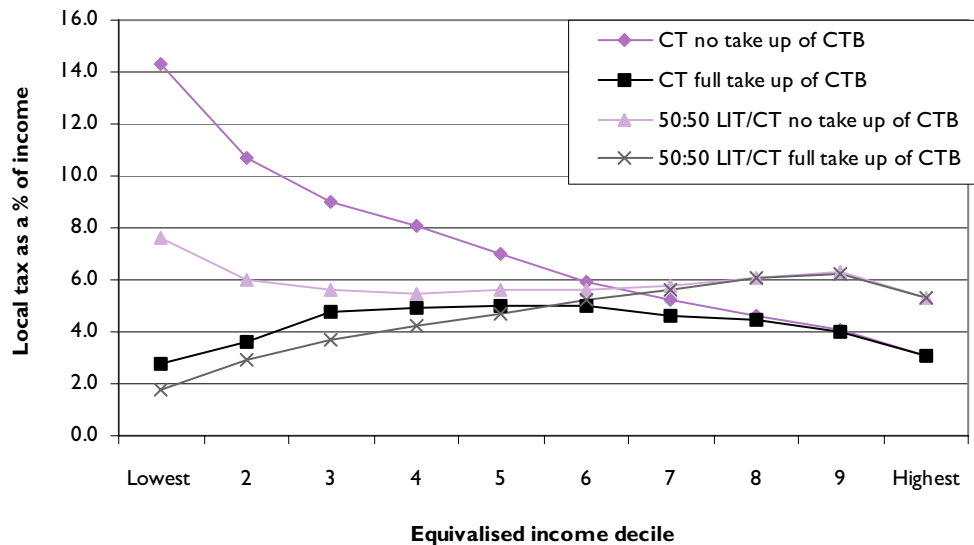
<sup>39</sup> In practice, these authorities might have significant freedom to set LIT and council tax rates which would result in a wide variation between the two rates, but the modelling assumed that authorities would stick as closely as possible to the assumed national rates. If the assumed national rates are not sufficient to raise the required revenue, then each rate is increased by the same proportion – that is, the ratio of LIT and council tax rates, for modelling purposes, will be equal to the ratio of the assumed rates for all authorities.

<sup>40</sup> LIT rates for a county are set so that the average council tax rate across the county and the county-wide LIT rate are in the same ratio as the tax rates assumed in the Formula Grant calculation. For two-tier areas, LIT rates would be set before council tax rates, due to the requirement for county-wide consistency. This might constrain the districts’ choice of council tax rates.

## Detailed findings

**C.142** Under a 50/50 LIT/council tax hybrid, bills before CTB would be significantly reduced for very low income families who would pay very little towards the LIT element of the tax.<sup>41</sup> It would be much more progressive than council tax, both before and after CTB. Bills would be around 50 per cent higher for the top 20 per cent of earners.

**Chart C16: Partial replacement LIT (50/50) as a percentage of household income**



Source: Lyons Inquiry analysis

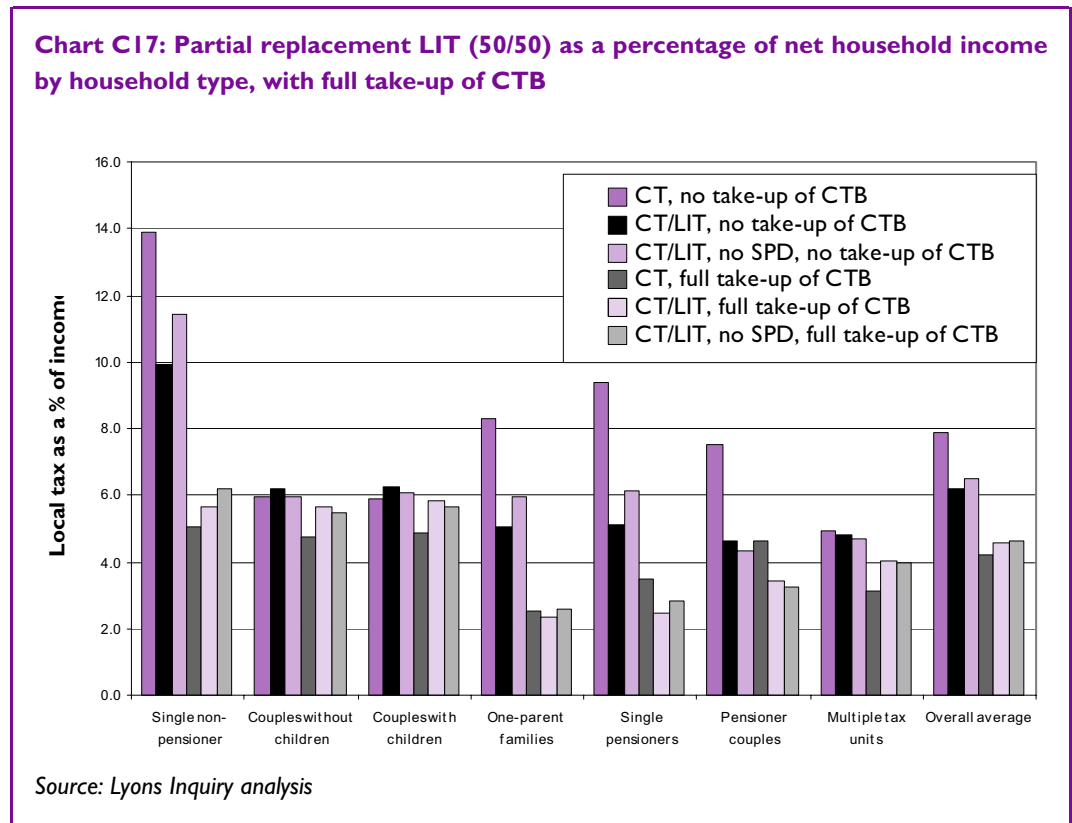
**C.143** The 50/50 LIT/council tax hybrid tax is more progressive than council tax. Under council tax, higher earners pay proportionally less tax than the middle income families, but LIT is modelled as being regressive to income only at the very top income group, because earnings in the higher rate tax bracket are not subject to LIT in the model.

**C.144** The average percentage of net household income payable on local tax after CTB would be higher under a LIT, in general, due to the overall drop in CTB payments referred to above. Lower income families would therefore receive less CTB, but would have much lower LIT bills than higher earners.

**C.145** Overall, bills after CTB would be higher than at present, because of the overall drop in CTB payments. Looking at particular household types, pensioners would tend to experience lower bills if full CTB take-up is assumed. Typical high-income households (such as couples with and without children and multiple tax units) would face higher average bills under a hybrid system. Single non-pensioners would also experience higher average bills, particularly if the single person discount were abolished.

<sup>41</sup> The IGOTM model predicts higher LIT revenue than expected from the HMRC figures; the LIT element is therefore scaled down to match the expected total. This highlights the unpredictable element of income tax revenue at local authority level, which is one practical problem of the tax. Bills after CTB are higher under a LIT, in general, because of the overall drop in benefit payments as a result of these being payable only for the council tax element of the tax.

**C.146** Chart C17 shows how local tax, as a percentage of net household income, would vary by household type.



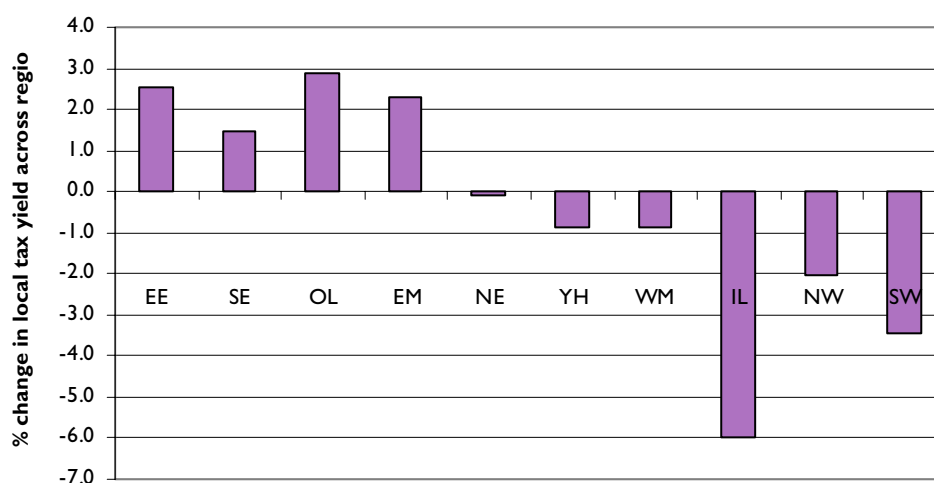
**C.147** Couples with and without children, single non-pensioners and multiple tax units would tend to pay more local tax as a proportion of income under this option, compared with council tax (before or after CTB is taken into account). Pensioners would, on average, experience a reduction in their local tax as a proportion of income, of around 1 percentage point compared with council tax and full take-up of CTB. Since pensioner take-up of CTB is particularly low, it would be realistic to expect average real gains to be somewhat larger than this.

**C.148** In general, local tax as a percentage of net household income would again increase under a hybrid system because of the reduction in CTB. The proportion of income paid would increase fairly consistently across the country, although London would face the greatest increase and the South West would face only a small increase.

**Regional impact**

**C.149** Outer London, the East of England, the East Midlands and the South East would experience the biggest increases in local tax yield and hence the biggest decreases in Formula Grant. In London, tax-raising capacity would drop on average in the Inner London Boroughs, and rise in the Outer London boroughs, resulting in a shift in grant towards Inner London. The South West and the North West would also see significant increases in Formula Grant, reflecting their relatively low income tax bases. Chart C18 shows the regional changes in local tax requirement.

**Chart C18: Changes in local tax requirement by region, under a partial replacement LIT**



Source: Lyons Inquiry analysis

## Impact at local authority level

**C.150** LIT rates (expressed as pence in the £) would need to vary widely to raise 50 per cent of a local authority's local tax revenue. The national average for 2006-07 would be 3.9p, but figures at local authority level would vary from 1.0p for the Isles of Scilly and 1.4p for Westminster to 4.7p for Richmond-upon-Thames and 5.5p for the City of London. Council tax levels would need to vary similarly to raise 50 per cent of an authority's local tax revenue. The national Band D average for 2006-07 would be £629, but figures at local authority level would vary from £159 for the Isles of Scilly and £231 for Westminster to £773 for Sedgefield and £876 for the City of London.

**C.151** Looked at another way:

- 75 per cent of authorities would have a LIT rate between 3.6p and 4.3p; and
- around 95 per cent would be between 3.3p and 4.5p;
- 75 per cent of billing authorities would have a Band D council tax between £570 and £690; and
- about 95 per cent would be between £525 and £750.

**C.152** The extent to which these figures are realistic depends on the level of discretion offered to local authorities – if significant discretion were offered it would be impossible to predict the LIT/council tax mix in this way.

**C.153** Holding budget requirements at their actual 2006-07 level would lead to authorities with decreased Formula Grant needing to set an increased local tax requirement. The pattern of changes in local tax yield is summarised in Table C24 below.

**Table C24: Percentage changes in local tax requirement at local authority level under a LIT/council tax hybrid**

| Percentage change in tax requirement | Number of authorities |
|--------------------------------------|-----------------------|
| Less than 5%                         | 249                   |
| More than 5% but no more than 10%    | 123                   |
| More than 10% but no more than 15%   | 51                    |
| Over 15%                             | 33                    |
| <b>Total</b>                         | <b>456</b>            |

**C.154** The Isles of Scilly, Westminster and Kensington & Chelsea would see the biggest percentage decreases in tax requirement (67 per cent, 54 per cent and 26 per cent respectively), due largely to their large grant increases, whereas the City of London, Vale of White Horse and Tamworth would see the largest percentage increases in local tax requirement (47 per cent, 24 per cent and 23 per cent respectively).

**C.155** Assuming that authorities set their council tax and LIT rates at the assumed national rates (so that nationally, 50 per cent of total revenue is raised from each tax) then 80 per cent of authorities would be closer than a 55:45 split, and 98 per cent would be closer than 60:40. This is because of the high degree of correlation between income tax yield and council tax base. The City of London would have the most bias towards income tax revenue with a ratio of 72:28. In practice, this balance would depend upon the extent to which rate-setting was left to individual authorities' discretion.

**C.156** Looked at another way, there would be widely-varying variations in the difference between the local tax requirement for a local authority area as set for 2006-07, and the total yield for that area from LIT and council tax if they were each set in line with the national average rate (of 3.9p and £629 per band D property respectively). The biggest percentage shortfall would be -28 per cent for the City of London, with a local tax yield for 2006-07 of £17.5 million but a yield from the national average LIT and council tax rates of £12.6 million. Other than for the City, figures would vary from a shortfall of -16 per cent for Rutland to surpluses of 53 per cent for Wandsworth, 172 per cent for Westminster and 297 per cent for the Isles of Scilly.

**C.157** After equalising for each local authority's ability to raise a combined LIT and council tax, the authorities which would experience a large reduction in Formula Grant are those which have a high income tax base relative to the council tax base (e.g. Wokingham at -64 per cent and Surrey at -37 per cent). Conversely, the authorities which would experience a large increase in Formula Grant are those which have a low income tax base relative to the council tax base, such as Dorset (32 per cent) and East Sussex (24 per cent).

**C.158** Changes would be small for most authorities, however, because there is quite a high correlation between income tax base and council tax base. To give an idea of the scale of changes, 55 per cent of local authorities would experience grant changes within 5 per cent of the present level. The analysis ignores floor damping, however, and any transitional scheme could minimise these effects.

## Removing the single person discount

**C.159** The analysis presented above has been based on the retention of the single person discount. It could be argued that it would no longer be needed if council tax related only to the property, with LIT taking account of the occupants. If the single person discount were abolished together with the introduction of a LIT, the picture at local authority level would be very similar to that already presented:

- the vast majority of authorities would experience no more than a 5 per cent change in Formula Grant;
- the regional shift of Formula Grant would be roughly the same as if the discount were retained;
- the deviation from a 50:50 split would be roughly the same assuming that authorities showed no policy preference for either tax;
- the average council tax would be 8 per cent lower than £629 at £577, since council tax bases would increase; and
- the majority of differences would be seen at a household, rather than local authority, level. This is discussed further below.

## CTB costs and local income tax

**C.160** Because CTB would be payable only in respect of the 50 per cent of local tax that would remain as council tax, and no comparable benefit was assumed to be payable for the LIT element, total CTB costs would significantly decrease from current levels at both full and current take-up.

**C.161** CTB costs, based on actual take-up, have been modelled to be:

- |  |              |
|--|--------------|
| • Council tax only                                     | £3.1 billion |
| • 50/50 LIT/council tax                                | £1.3 billion |
| • 50/50 LIT/council tax with no single person discount | £1.4 billion |

**C.162** If there were full CTB take-up, CTB expenditure would drop by more than half under a hybrid system, from £4.7 billion to about £2 billion. Since the model is revenue neutral at a Formula Grant level, this additional saving to the government means that bills would, on average, be higher under the new system.

**C.163** It is difficult to estimate the effect that the new system would have on take-up rates but, assuming current take-up, the size of the saving to central government from reduced benefit payments would be around £1.8 billion (or £1.7 billion with the abolition of the single person's discount) of the current actual spend of £3.1 billion. This could be added to Formula Grant to make the system more truly revenue neutral. £1.7 billion is equivalent to the revenue raised from 0.6p on the basic rate of income tax.

## FORECASTING BUOYANCY IN A LOCAL INCOME TAX

### Summary of the modelling

**C.164** Modelling was conducted to test the sustainability of using a LIT on the basic rate as an alternative to council tax. In particular, the modelling aimed to explore whether the natural buoyancy of LIT revenues would be sufficient to support a realistic level of local spending growth, or whether future rate increases might be necessary.

**C.165** Modelling of a full replacement LIT, above, suggests that an increase of 7.8 pence on the basic rate would be enough to replace council tax in year one (2006-07). From that base year, the Inquiry team projected two scenarios based on different assumptions about how fast yield from council tax might have been expected to grow from that point, and what LIT rate would be necessary to deliver the same yield:

- scenario one assumes that council tax yield grows in line with the average rate of growth since 1993, of 7.4 per cent per year (nominal); and
- scenario two assumes that council tax yield will grow at a rate consistent with 4.5 per cent annual increases in bills, plus taxbase growth of 0.8 per cent per year, giving yield increases of 5.3 per cent per year (nominal).

**C.166** Both scenarios were based on the use of factors based on the Survey of Personal Incomes to forecast the growth in yield from the basic rate of income tax.

### Main findings

**C.167** Table C25 below shows that in either scenario, LIT rates would need to increase from 7.8 pence over time. However the rate at which this would happen is very sensitive to the assumptions made about future council tax growth.

**Table C25: Projected LIT rates necessary to support a given rate of yield growth**

|               | Scenario 1 | Scenario 2 |
|---------------|------------|------------|
| 2006-07       | 7.8p       | 7.8p       |
| 5 years time  | 8.7p       | 7.9p       |
| 10 years time | 9.7p       | 8.0p       |
| 20 years time | 11.9p      | 8.1p       |

**C.168** It therefore appears that while basic rate income tax would be a buoyant source of revenue for local government, that buoyancy might be relatively modest, so that a fixed LIT rate would not be consistent with spending growth in line with either of the scenarios modelled.