

## 6. The case for replacing the council tax with a land value tax

The council tax is the main source of funding for local authorities that is under their control, and accounts for around 25 per cent of their revenue. Apart from various fees charged by local authorities for certain services – which, on average, contribute around 8 per cent of revenue – the rest comes from central government. Around 45 per cent of local authority income comes from direct grants from central government, including the revenue support grant, the dedicated schools grant, and other specific and special grants. And a further 22 per cent on average comes from central government indirectly through the national non-domestic rates levied on commercial properties, which are set by central government. Though collected by local authorities, the revenue from the national non-domestic rates is pooled, and then redistributed back to local authorities on a per capita basis.

### The regressive nature of council tax

The council tax is a deeply unpopular tax. Its biggest problem is that it is severely regressive. The structure of the banding system and the difference between the levels of council tax paid in different bands means that the rate of tax actually falls the greater the value of the property on which it is levied. For example, someone in a house worth £1 million in 1991 pays only twice the amount of someone living in a house worth £70,000, and only three times the tax paid by those in the poorest accommodation.

On top of that, no account is taken of people's ability to pay the council tax, except that single person households receive a 25 per cent reduction in their council tax. This reflects the fact that the council tax is a hybrid tax, partly a poll tax and partly a property tax, and assumes a two person household. In addition, those on very low incomes are entitled to the means-tested council tax benefit, which is claimed by almost half of all households in the lowest band. However, the trouble here is that this creates a 'poverty trap' when people's incomes go up, due to the withdrawal of benefit as earnings rise above a certain level. Furthermore, the take-up of council tax benefit is only around 70 per cent, so that many people, especially pensioners, lose out from not claiming their entitlement.

### The 'gearing ratio' problem

Another problem with the council tax is the so-called 'gearing ratio'. Since council tax is the only source of funds under the control of local authorities, accounting for just 25 per cent of revenue, if a local authority wishes to raise total spending by, say, 5 per cent, it will require a council tax increase of 20 per cent, which is a gearing ratio of 1:4. For poor areas, where central government support accounts for a greater proportion of revenue – such as in the London Borough of Tower Hamlets, where the gearing ratio is 1:9 – increasing spending by 5 per cent can mean an increase in council tax of as much as 45 per cent.

In addition, the council tax has to bear the brunt of any shortfalls in revenue caused by central government deciding to cut its support if local authorities are to maintain the same levels of service.

Both factors help to explain why, since 1997, council tax, on average, has jumped by 70 per cent. This has greatly added to the unpopularity of the tax – especially as it is in your face all at once when the annual bill arrives, unlike, for example, value added tax, where the tax is practically invisible, and income tax, which is deducted from earnings on a weekly or monthly basis (though this problem is mitigated to some extent by monthly payment and direct debit arrangements, so that the bill does not actually have to be paid all at once).

### The effect of escalating property prices

Also of concern is the effect of the huge escalation of property prices since the last valuation in 1991. This could mean that some people would be in for a sharp increase in council tax. However, it should be pointed out that it is not absolute property prices that determine the level of council tax, but relative prices. Thus, following a revaluation, there would likely be winners and losers, according to whether one's property went down or up a band or two. The losers would be households in areas where house prices have risen more than the national average.

In Wales, where a revaluation has already taken place, 35 per cent of households ended up paying more, because they had moved up a band or two, and 8 per cent ended up paying less, because they had moved down a band. There was no change for 57 per cent, because their properties remained in the same band. However, such is the unpopularity of the council tax, and the uncertain effect that a revaluation might

have on households, that the government has twice postponed a revaluation in England, because it was thought to be an electoral liability.

### **Alternatives to the council tax**

The current arrangement for local authority finance is widely recognised as deeply flawed, particularly with regard to council tax.

Some have advocated replacing the council tax with a local income tax. But this is not straightforward. First, because so many people live in a local jurisdiction different from where they work, its collection would be more complex and more costly compared with council tax, especially if it included unearned income not covered by PAYE. It would also be more costly if local authorities themselves became the tax collectors instead of HM Revenue and Customs (in the unlikely event that central government would allow that). Furthermore, it would be inequitable because of the large difference between the mean income in more affluent areas and in poor areas.

On top of that, getting rid of the council tax, would get rid of Britain's only widespread wealth tax – that is, apart from the mis-named inheritance tax, which is often dubbed the 'voluntary tax' because, for those able to afford good tax advisers, it is so easy to avoid (such that, according to some estimates, only around 3 per cent of those to whom it should apply end up paying it).

Another suggestion has been to make the council tax more palatable by increasing the number of bands, especially at the top end, and raising the ratio of tax paid by those in the top band and those in the bottom, from the current 3:1 to, say, 30:1. This would make it less regressive, one of its biggest drawbacks.

But far better would be to replace the council tax with LVT. As proposed in Section 9, this could be the first step towards introducing LVT on a wider scale, nationally. However, as shown by the example of Harrisburg described earlier, even if LVT is retained only as a local tax, perhaps also replacing the national non-domestic rates levied on commercial properties, this would not only benefit the finances of local authorities, but would lead to marked improvements in the local economy, and in the general well-being of the local community.

### **The Vale of White Horse study**

In 2004-5, Oxfordshire County Council conducted a detailed study in Vale of White Horse District to test the feasibility of replacing the council tax and the national non-domestic rates with a land value tax. It demonstrated conclusively that it would be feasible. The only significant problem was that since land use has evolved historically in line with prevailing tax structures, there would be winners and losers following the change. However, as discussed in Section 9, the transition to LVT could be mitigated in a number of ways.

In this particular example, the issue of winners and losers was perhaps more prominent because the area selected for the purposes of this study was isolated from the rest of the county. In practice, if the aim was to collect the same amount of revenue from LVT as currently collected through the council tax and national non-domestic rates, the number of winners and losers in the Vale of White Horse District would be moderated by the amount of revenue collected overall at county level from localities with very high land values, such as the city of Oxford and other urban areas, including derelict or brownfield sites located in those places.