

FINDINGS

REFORMING COUNCIL TAX BENEFIT

The government proposes to abolish Council Tax Benefit (CTB) across Britain from 2013–14 and give grants to local authorities in England, and the Scottish and Welsh governments, to design their own systems for rebating council tax to low-income families. The government is also planning to cut funding for council tax support by 10 per cent.

This study examines the likely effects of this policy and the options available to councils.

Key points

- Localisation will strengthen councils' incentives to promote employment and growth, but will also give them an incentive to discourage low-income families from living in the area, and a disincentive to encourage take-up of support. Having schemes that vary across the country will reduce transparency and increase bureaucracy.
- The grant for each local authority will be based on 90 per cent of what would have been spent on CTB in that area. Unless councils find additional money from elsewhere, a requirement to protect pensioners in England will imply a 19 per cent cut in support for working-age claimants, on average. Those local authorities where pensioners account for an above-average share of CTB expenditure would need to make larger percentage cuts to support for working-age claimants: for one in ten English local authorities, it would be more than 25 per cent.
- Reforms that would save councils the full 10 per cent typically involve reducing support for the poorest claimants. The poll tax experience showed how difficult it can be to collect small amounts of tax from low-income households. Options that protect the poorest claimants either fail to generate large savings, or significantly weaken work incentives, or both.
- Having a separate means test for council tax support, varying across the country, could easily undermine the simplification and rationalised work incentives that were central to the idea of Universal Credit.

The research

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MAY 2012

BACKGROUND

Council Tax Benefit (CTB) provides nearly £5 billion of support to low-income families. It has 5.9 million recipients, more than any other means-tested benefit or tax credit. But it still reaches only about two-thirds of those intended; many are not aware they are entitled, or find it too difficult or stigmatising to claim. It also discourages work and saving, and provides recipients with an incentive to live in bigger properties.

Figure 1 shows that in cash terms, average council tax liability rises with income, as high-income households tend to live in higher-band properties. But it is a lower share of income for high-income households, at least partly because council tax is a lower proportion of property value in the higher bands. If everyone claimed their CTB entitlement, net council tax liabilities would be a smaller share of income for low-income households than middle-income households. But given actual patterns of take-up, net council tax is regressive across the whole income distribution.

Figure 1: Council tax liability and CTB entitlement by income decile group



Notes: Income decile groups are derived by dividing all households into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale.
Source: Authors' calculations using TAXBEN run on updated data from the 2009–10 Family Resources Survey.

Localising support for council tax

The government is proposing to localise support for council tax from 2013–14. CTB will be abolished, and local authorities in England – and the Scottish and Welsh governments – must design their own systems for rebating council tax to low-income families. Entitlement rates for pensioners in England will still be set nationally and maintained at their existing level. The objectives are to allow support to vary across the country to reflect local priorities, and to strengthen local authorities' incentives to promote employment and growth. These are laudable aims, but it remains to be seen how far councils actually respond to these incentives. Variation across the country should also allow local authorities to learn from others' experiences what is successful.

Having schemes that vary across the country will reduce transparency and increase bureaucracy. Giving local authorities fixed grants rather than refunding the actual cost of providing council tax support will add risk to their finances. It will also give them an incentive to discourage low-income families from living in the area, and a disincentive to encourage take-up of support. The strength of all of these changes in incentives – good and bad – will partly depend on how local authorities expect grant allocations to be adjusted in future. How they will actually be adjusted in future is one of the most important decisions the government has yet to take about the policy.

Cutting support for council tax

As well as localising support for council tax, the government is also planning to cut funding for it by 10 per cent, giving each local authority a grant based on 90 per cent of what would have been spent on CTB in that area – meaning a larger cash funding cut in areas where CTB spending is higher.

There is no obligation on local authorities to spend exactly the amount of this new grant on council tax support: they may, for example, choose to maintain support at its existing level and find the necessary savings elsewhere, or even cut entitlements by more and use the surplus for other purposes. The Scottish and Welsh governments – which will operate centralised council tax rebates – have made contrasting choices. Wales has chosen to respond to this cut in funding by reducing council tax support by 10 per cent (though it has not yet decided how) while Scotland has opted to maintain existing levels of support and make savings elsewhere. It will be interesting to see which of these approaches most councils in England follow.

If councils do not find additional money from elsewhere, the requirement to protect pensioners will mean that those local authorities in England where pensioners account for an above-average share of CTB expenditure (typically less-deprived areas) will see a bigger shortfall in the grant left over (after providing support to pensioners) as a percentage of current spending on CTB for non-pensioners. Although total grants will be 90 per cent of what would have been spent on an unreformed CTB, after providing rebates for pensioners it will cover only 81 per cent of the cost of CTB for working-age claimants nationally. The study estimates that for one in ten English local authorities that figure will be less than 75 per cent, with the lowest value being 67 per cent in East Dorset and in Craven, North Yorkshire.

Councils that decide to adopt schemes that are less generous than existing CTB have many options for how to make savings: they could, for example, limit the maximum amount of council tax to be rebated; means-test support more aggressively; reduce or remove entitlements from those living in higher-value properties; or simply cut entitlements by a set percentage across the board – though given the tight timescale before implementation, it might be difficult for councils to adopt more radical proposals in the first year of the policy. Since 85 per cent of CTB goes to the lower-income half of households, and almost half of CTB goes just to the lowest-income fifth, any cuts to it are bound to hit predominantly poorer families. Reforms that save the full 10 per cent typically involve reducing support for those currently receiving maximum CTB – those on the lowest incomes. The poll tax experience showed how difficult it can be to collect small amounts of tax from low-income households who are not used to paying it. And those options which do protect the poorest claimants either fail to generate large savings, or significantly weaken work incentives, or both.

The government hopes councils will design schemes that protect vulnerable groups beyond just pensioners, and which maintain strong work incentives. But there is a trade-off between those two objectives: those designs that protect the poorest claimants are those that lead to the weakest work incentives. By giving councils autonomy in designing schemes, central government has relinquished control over whether those objectives are met by local authorities which may have different priorities. Small district councils in particular, which largely collect council tax on behalf of higher-spending precepting authorities, will have an incentive to focus disproportionately on making schemes cheap to administer, at the expense of other objectives. How far they act on this incentive will partly depend on their relationship with precepting authorities as well as on the importance they place on other objectives.

Council tax rebates and Universal Credit

By localising council tax support, the government has forgone the opportunity to integrate it fully with Universal Credit. Universal Credit is intended to simplify the benefit system by reducing the number of different benefits. Keeping council tax support separate – and allowing it to vary across the country – undermines this simplification. Universal Credit is also intended to rationalise work incentives by replacing a jumble of overlapping means tests with a single one, ensuring that overall effective tax rates cannot rise too high; again, separate means tests for council tax support could undermine this, with the potential to reintroduce some of the extremely weak work incentives that Universal Credit was supposed to eliminate.

English local authorities and the Scottish and Welsh governments must now try to make their council tax rebate schemes work alongside Universal Credit. This poses a number of questions. One is whether to count Universal Credit as income in the means test for council tax rebates. It would be simpler not to. However, this would mean that people facing withdrawal of both Universal Credit and council tax rebate (as well as paying income tax and National Insurance contributions) would stand to lose 90p of each extra £1 earned, compared to 81p if Universal Credit were counted as income for the means test (assuming the current 20 per cent withdrawal rate for council tax support).

One way to avoid any overlap between the means test for council tax rebates and that for Universal Credit would be to withdraw rebates rapidly as soon as income rose above zero, and to limit maximum rebates so that they were already completely removed by the time Universal Credit started to be withdrawn. As well as avoiding very high effective tax rates, this option would save councils a great deal of money – on average more than the 10 per cent by which funding is being cut – but would cut support very severely for some, notably single people without children, from whom Universal Credit starts to be withdrawn at a very low income level.

A second issue raised by the introduction of Universal Credit is that particular benefits currently used to 'passport' people automatically to maximum CTB entitlement will cease to exist as they are subsumed within Universal Credit. At present two-thirds of CTB recipients are passported in this way, and if all these people need to go through a full means test, the burden on both claimants and local authorities would increase substantially. One way to mitigate this would be to transfer Universal Credit data to local authorities, to avoid having to ask claimants for the information again – if IT systems can be set up to transfer data in a timely and efficient way.

Conclusion

Cutting support for council tax and localising it are two distinct policy choices: either could have been done without the other. Whether cutting council tax support for low-income families is the best way to reduce government borrowing by £500 million per year is a question that requires value judgements on which the study does not take a position. But while there may be advantages in providing local authorities with more control over various aspects of their finances, the advantages of localising support for council tax seem to be strongly outweighed by the disadvantages, particularly in the context of the introduction of Universal Credit.

FOR FURTHER INFORMATION

The main report, **Reforming Council Tax Benefit** by Stuart Adam and James Browne is published by the Institute for Fiscal Studies with support from the Joseph Rowntree Foundation. The full report is available free at www.ifs.org.uk

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ISSN 0958-3084

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