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P. U. Young 4

SEBG

To be aware that these are in preparation, I have agreed that the Policy Unit should offer comments to DRE directly.

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

26 February 1986

JK
28/2

Dear Mando,

MS

"PAYING FOR LOCAL GOVERNMENT": BRIEFING NOTES

We spoke the other day about my Secretary of State's wish to keep up the momentum on the successful presentation of the Government proposals on rating reform, and you suggested I write to you.

We have already done a lot to publicise the main proposals in general terms: my Secretary of State has written to all Conservative MPs; he and his Departmental Ministers are undertaking a large number of speaking engagements on the topic; there are regular briefings with interested journalists; and the message has also been transmitted via Central Office.

As the responses start coming in, it is becoming clearer which of the many issues raised are attracting concern, and which the debate is likely to centre upon. My Secretary of State has had the enclosed 5 briefing notes prepared in response to them. The notes are intended to set out clearly and persuasively the key points to be made on 5 topics: the arguments against local income tax, the shortcomings of domestic rates, the workability of the community charge, the national non-domestic rate, and the proposed new grant system. Mr Baker would like to send these notes to all Government Ministers and Parliamentary Private Secretaries.

My Secretary of State would be grateful for views on the suitability of these notes for circulation, and for advice on the best means of circulating them. I think that your office handles material to be circulated to PPS's and perhaps we can discuss mechanics on the rest. Mr Baker and his Ministers would also be happy to address meetings of Ministers and PPS's if that were thought desirable, but presumably it would be better to await the reaction to these briefing notes before setting anything up. Once the notes are finalised, we should of course make them available to Central Office for Party circulation.

I should be grateful if you could let me know the Chief Whip's views. I am copying this letter and enclosures to David Norgrove at No 10, Joan McNaughton in the Lord President's office, Andrew Lansley in the Chancellor of the Duchy of Lancaster's office, and to Robert Gordon and Colin Williams in Scotland and Wales respectively. All comments are welcome.

Yours sincerely,
Romi.

R U YOUNG
Private Secretary

WHY NOT A LOCAL INCOME TAX?

Some people argue that domestic rates should be replaced by a local income tax, rather than the flat-rate community charge proposed by the Government.

They argue that a local income tax:

- would be fair;
- could build on the present income tax system;
- would give councils independence from central government;
- would be easy to administer.

There are major objections to all these arguments.

Fairness

Ability to pay is not the only test of fairness. Domestic rates are unfair because they fall on too few shoulders:

- * out of 35 million voters in England, only 18 million - householders - are liable to pay rates.
- * so only half the electorate actually pays for the services they vote for.

This is bad for accountability. And it doesn't encourage councils to be economical or to provide value for money.

But local income tax is little better than rates on this score:

- * there are only 20 million income taxpayers, compared with 18 million ratepayers.
- * almost one in three households pay no income tax.

So local income tax would do little more than rates in spreading the cost of local services.

Building on the present income tax system

Building on the present income tax system means higher income tax:

- * replacing domestic rates with local income tax would add on average an extra 4½p to the basic rate of tax.
- * in some high spending authorities it could add up to 11p - an increase of over a third.

High rates of income tax damage incentives. That is why the Government is committed to reducing the burden of taxes on incomes. A local income tax would undermine that objective.

Minimising central government interference

Local income tax would not free local councils from central Government interference, for three good reasons:

- * income tax redistributes income; this has major implications for national economic management and social policy, which central government could not ignore;
- * sharing a tax base with local government would mean tension and conflict as central government found its room for manoeuvre on national income tax restricted by local tax rates set by councils;
- * differences in how much authorities could raise from their local taxpayers would mean keeping complicated equalising grant arrangements.

So local income tax wouldn't get central government off local government's back. And it would undermine the Government's ability to manage the economy.

A local income tax would be easy to administer

A local income tax could be made to work. But it would not all be plain sailing.

If local taxes were collected alongside national taxes it would:

- * be bad for accountability - people would not know who they were paying tax to;
- * add to employers' costs - they would have to administer all the different tax rates of their employees; a firm in central London, for example, could draw its employees from dozens of different council areas;
- * mean the Inland Revenue keeping records of where all taxpayers lived, which they do not do at present;
- * cause problems for taxing eg interest and dividends, which are presently taxed at source for most people.

It would be better for accountability if local income tax were run separately by local authorities. But that would either mean the Inland Revenue passing information on residents' incomes to authorities or individuals making separate declarations to their authorities. A registration process would be needed, as for the community charge, but it would be more complicated and costly.

Conclusion

So local income tax:

- would not spread the burden of local taxes;
- would increase the basic rate of income tax by an average of 4½p, and in some areas would put it up by over a third;
- would create new conflicts between central and local government;
- would raise a great many administrative difficulties, despite the computerisation of national income tax.

WHY NOT KEEP DOMESTIC RATES?

Some people argue that domestic rates are better than any of the alternative local taxes and should be kept.

They argue that domestic rates:

- are highly visible to ratepayers and so promote local accountability;
- are fair, because property is a reasonable measure of wealth;
- are a well-established tax, and are cheap and easy to administer.

There are major objections to all these arguments.

Promoting accountability

Rates are a "visible" tax, in the sense that an explicit bill is sent to every ratepayer once a year.

But that's about as far as it goes. In other key respects, domestic rates fail the accountability test:

- * only just over half the electorate - 18 million out of 35 million in England - are actually liable to pay rates;
- * this means that 1 in 2 electors pay nothing towards any increase in local spending for which they may vote;
- * because of the way the rating and grant systems work, rate bills provide a very poor indication of what is happening to a local authority's spending.

Fair

Some people assume that a tax on property must be fair, because property values reflect people's wealth. And on the whole, it's true that people living in bigger houses are likely to be better off than people living in smaller houses. But there are many exceptions to this:

- * many pensioners go on living in the same house even though their income has fallen;
- * the rateable value of households with similar incomes can vary by up to 800%;

Nor is there any obvious justice in saying that people should pay more for local services in areas where housing is expensive than they should in areas where housing is cheap. Yet, with rates, that is just what happens:

- * average domestic rateable values vary from one part of the country to another by as much as 85%; but average incomes vary by only 25%;

- * rateable values based on the capital value of property (which is what some people suggest we should adopt, rather than the present rental value) would be no better: values would vary just as much between regions, and for individual houses the range would be even bigger than it is now.

Rates are unfair in other important ways as well:

- * a property tax cannot take account of how many people live in the household, yet about three quarters of local government spending now goes on services provided for people rather than property; the widow living alone will pay the same rates as four working adults in an identical house next door;
- * many of the poorest households have only one adult (for example, pensioner widows or single parents); they are disadvantaged by a property tax but would be better off with a per adult tax like the community charge.

A well-established tax, cheap and easy to administer

Rates are a well-established tax; and they are cheap and easy to administer. But that doesn't necessarily make them a good tax:

- * rates are unique among the major taxes in this country where the tax base (ie property values) has to be revalued at regular intervals to preserve such fairness as exists in the system; this causes dramatic changes in people's rate bills, which bear no relationship to the spending behaviour of their local council but have disruptive effects on their personal finances;
- * the local taxation system must underpin and promote the accountability of local councils to their taxpayers; as we have seen, domestic rates fail this test.

Conclusion

Domestic rates:

- * are very limited in promoting accountability - only 1 in 2 electors are liable to pay rates;
- * are unfair - differences in rateable values greatly exaggerate differences in people's ability to pay; and a tax on property takes no account of how much a household uses local services;
- * need regular revaluations to operate with any fairness at all; this is disruptive to people's finances and changes rate bills in a way which has no relation to changes in councils' spending.

CAN THE COMMUNITY CHARGE BE MADE TO WORK?

Critics of the community charge argue that:

- * registration will be difficult and will deter people from voting;
- * residence criteria will be hard to administer;
- * the charge will be difficult to enforce;
- * costs will be much higher than with domestic rates.

But inventing any new tax poses practical problems which have to be tackled. The Government believes these problems are certainly not insuperable.

Registration

- * Registers will be compiled by the local authorities which now compile the electoral register. They will be able to draw on the electoral register, but the two registers will be separate documents with different coverage.
- * Heads of household will be under a duty - backed by criminal sanctions - to register all eligible adults, just as they are under electoral law.
- * People who move often will not need to be individually registered if they live in properties covered by the collective charge, payable by the landlord.
- A local registration system works well in other countries. In Sweden for example there is not even a need for compulsory identity cards. The community charge system will not require identity cards.

Residence

- * There will be a test of "main or only residence", (already used by the Inland Revenue for tax purposes), so that everybody is only registered in one place. Information such as place of work, residence of family members would decide place of main residence.
- * Deregistration on change of main residence will keep the register up to date; liability for the tax will depend on length of residence during the year (6 months residence would mean half a community charge payable).
- * There will be special rules for groups like students, with two main residences.
- * Second homes would be liable to a double community charge, to be paid by the owner.
- Rolling registration will follow precedents of the rating system, where liability changes on change of occupation.

- Similar residence test and registration procedures work effectively elsewhere.

Enforcement

- * Criminal sanctions will lie against head of household for failure to register all eligible adults - this would be punishable by a fine.
- * People will be individually liable for the charge; the only exception will be husbands and wives who would be liable for each other's charge.
- * Local authorities will use available information (electoral register, valuation list, school rolls, use of other services) to check registration. Services would not be denied to someone who had not registered, but non-registration would be followed up.
- * Local authorities will be able to devise schemes to check registration - and provide incentives to register eg through discounted rates for residents.
- * Enforcement procedures for payment will follow those already available for rates.
- * Collective charge on communally-occupied properties will cover hardest cases where recovery against individuals is impractical: the landlord will be liable and will pass the charge on.

Costs

- * there will be extra costs - but some offsetting savings from ending domestic rating procedures (£30m) and no need ever to incur the cost of a domestic revaluation. (£65m)
- * Electoral registration costs roughly £25m in England. No firm estimate of additional cost can be given for registration and enforcement before detailed discussions with local authorities. But costs will not be large when set against the major gains in accountability the new local tax arrangements will bring.

Conclusion

- * Any new tax - including a local income tax - raises practical problems which have to be tackled.
- * Taxing people not property will inevitably mean that some slip through the net; 100% registration will not be achieved.
- * But this is the price - and a price worth paying - of securing a fairer way of paying for local government and improving local accountability.

WHY WE NEED A NATIONAL NON-DOMESTIC RATE (ENGLAND AND WALES)

The case for non-domestic rates

There are good reasons for keeping non-domestic rates:

- * Industry and commerce benefit from local authority services;
- * non-domestic rates provide a major source of revenue for local government - £8 billion in 1984/85;
- * there is no satisfactory alternative business tax which could raise a comparable sum ;
- * replacing income from non-domestic rates through other taxes would mean 7p on the basic rate of income tax or an extra 10 percentage points on VAT: that would be also unacceptable.

Not a good local tax

But there are strong arguments against local authorities having control over the level of non-domestic rates:

- * local authority control has led to large variations in rates from area to area; this damages economic efficiency and distorts the competitiveness of businesses;
- * yet non-domestic ratepayers, despite their major contribution, have no sanction or control over the level of rates;
- * non-domestic rates are an unavoidable and often unpredictable overhead for companies; and excessive rate increases mean lower investment, higher prices or fewer jobs;
- * non-domestic rates are ultimately passed on - for example through higher prices - to people who may well not live in the authority levying them.
- * non-domestic rates conceal the true costs of local services to domestic ratepayers; on average, for every £10 raised in rates, £6 is paid by non-domestic ratepayers;
- * the enormous variations in non-domestic rateable value between authorities, require complex grant arrangements to iron out the differences; this weakens still further the link between changes in spending and changes in rates;

A national non-domestic rate

That is why the Government is proposing a national non-domestic rate, with the following features:

- * it will be set by the Government at a uniform level through the country;
- * initially it would be set so as to raise no more than existing non-domestic rates;
- * non-domestic rates in areas currently below average will rise, and vice versa. But transitional arrangements will ensure that changes in rates will be phased in gradually;
- * after the first year, the national non-domestic rate will rise in line with inflation;
- * the proceeds of the national non-domestic rate will be pooled and redistributed as a common £ amount per adult to all authorities, so ironing out variations in their taxable capacity (currently a major cause of complexity in the rate support grant system);
- * to keep a link between local authorities and non-domestic ratepayers, authorities might be able to levy a local non-domestic rate of up to, say, 5% of the national rate and keep the proceeds.

The benefits

These proposals will:

- * remove economically damaging variations in rate poundages;
- * provide certainty for businesses;
- * increase local accountability;
- * ensure continuity of income for local councils;
- * allow a radical simplification of the grant system.

A NEW SYSTEM OF GRANTS TO LOCAL AUTHORITIES (ENGLAND AND WALES)

What's wrong with the present system?

Government grants to local authorities in England at present amount to about £12 billion. They provide about half of local government's income.

The main grant - block grant - is designed to iron out differences in the income which authorities can raise from their ratepayers and differences in what they have to spend to meet local needs and circumstances.

Yet the way block grant is distributed has attracted a lot of criticism, because:

- * it is unpredictable; authorities find it difficult to predict how much grant they will get because this depends not only on what they spend but on what all other authorities spend. This leads to distortions in the link between the rates authorities levy and their expenditure decisions;
- * it is unstable; changes in the way grant allocations are calculated also mean constant changes in allocations from year to year which have nothing to do with how much an authority is spending; this further distorts the link between changes in spending and changes in rates;
- * it is very complex; compensating for differences in authorities' ability to raise rate income transfers large sums around the country in a way that people neither perceive nor understand, and produces wide variations in rate bills between councils, even for the same standard of service.

A new system

The Government will continue to compensate authorities for differences in their needs and circumstances.

But the Green Paper proposals for reforming non-domestic rates and replacing domestic rates with a flat-rate community charge mean that the complex and distorting arrangements for compensating for differences in authorities' ability to raise rate income can be abandoned.

This paves the way for a much simpler grant system, with these features:

- * a needs grant, compensating authorities for differences in what they need to spend to provide a standard level of service;
- * a standard grant, distributing the remaining grant to all authorities as a common amount per adult;

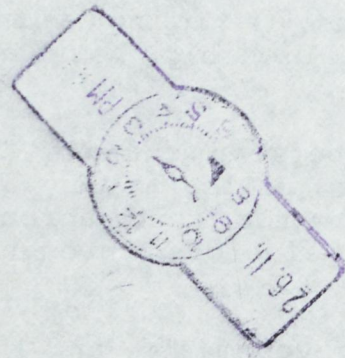
- * grant allocations fixed at the start of the year, and unaffected by what authorities spent.

The benefits

A system on these lines would:

- * be much simpler and more understandable;
- * give authorities greater certainty and stability about their grant allocations, removing a major source of distortion in the relationship between spending and local taxes;
- * provide a clear link between changes in spending and changes in local tax bills; every £ increase or reduction in spending would feed through clearly and directly to all local electors through the community charge.

This would benefit local government and improve local accountability.





NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

cc: BG ✓

Robin Young Esq
Private Secretary to the
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1P 3EB

NBM 20 March 1986

Dear Robin

"PAYING FOR LOCAL GOVERNMENT" BRIEFING NOTES

I understand you were enquiring if we had any comment on your letter of 26 February to Murdo MacLean. Our Ministers are content for the circulation of the briefing notes to go ahead as you propose. As Mr Baker will know, however, my Secretary of State and Michael Ancram have been making their own arrangements to give the Cmnd 9714 proposals publicity in Scotland by meetings, speaking engagements and the like, employing as appropriate the text and the graphics of the "briefing pack" prepared for the media at the Scottish launch of the Green Paper; a copy of this material was given to your people at the time.

A copy of this letter goes to recipients of yours, namely David Norgrove at No 10, Joan McNaughton in the Lord President's office, Andrew Lansley in the Chancellor of the Duchy of Lancaster's office, Colin Williams in Wales, and Murdo MacLean at the Chief Whip's.

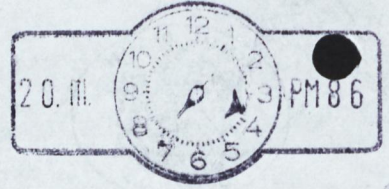
Yours ever

Robert Gordon

ROBERT GORDON
Private Secretary

LOCAL GOVERNMENT

Relations PE 29





Prime Minister ²

2 MARSHAM STREET
LONDON SW1P 3EB

01-212 3434

My ref:

Your ref:

fair enough - but my guess
is that Mr Baker also wants to
make absolutely sure that he will
not be asked to take legislation
through next session. He will not
be unhappy about this extension.

14 March 1986

In White

DK
17/3

ms

"PAYING FOR LOCAL GOVERNMENT": CONSULTATION

In my letter of 13 February I explained that, in line with your agreement to an extension into the autumn, I had offered the local authority associations an extension of the consultation period on the Green Paper to 1 October.

Since then, the leaders of the associations have argued forcibly that this extension is less helpful than it might seem, since it does not allow them time for a full cycle of meetings after the summer break, or an opportunity to debate the proposals at their annual conferences which take place during October. They have pressed once again for an extension to 31 October.

I was reluctant to agree to this. However, the associations have also made clear that they are willing to engage in detailed discussions with the Department on the practical issues arising from our proposals. This will be a great help to us in designing a workable system; and I would expect to get results from these discussions well before October, even though we shall not have the associations' formal views.

I would not wish to jeopardise this cooperation for the sake of clinging to a precise date for the close of formal consultation. I therefore told the association leaders when I met them on 12 March that I could live with an extension to 31 October, but no further. I would not expect this to delay the issue of a White Paper around the turn of the year as planned.

I am copying this to the Prime Minister, to other members of E(LF) and to Sir Robert Armstrong.

Kenneth Baker
[Signature]

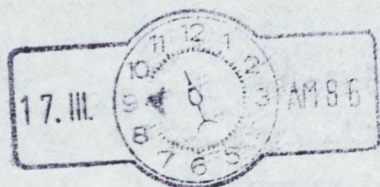
KENNETH BAKER

The Rt. Hon Viscount Whitelaw CH MC

LOCAL GOVT

RELATIONS

PT 29





Chancellor of the Duchy of Lancaster

CABINET OFFICE,
WHITEHALL, LONDON SW1A 2AS

Tel No: 233 3299
7471

6 March 1986

Brian Leonard Esq
Private Secretary to the
Secretary of State for the
Environment
Department of the Environment
2 Marsham Street
LONDON
SW1P 3EB

NBEN

Dear Brian,

Thank you for the copy of your letter of 26 February to Murdo Maclean. The Chancellor of the Duchy has seen the proposed briefing notes on 'Paying for Local Government' which were enclosed with your letter. He thinks that these will prove extremely useful for briefing Ministers and Conservative Members of Parliament on the main issues raised by the Rates Green Paper.

He does, however, have two points which your Secretary of State might like to consider.

First, should not more be said to refute the powerfully argued case for a Local Income Tax? He recalls that a figure of some 12,000 extra Civil Servants was estimated in 1981 to be necessary to administer such a tax; and he notes that the point should be made that a one line deduction on a pay slip is not a good way to strengthen local accountability.

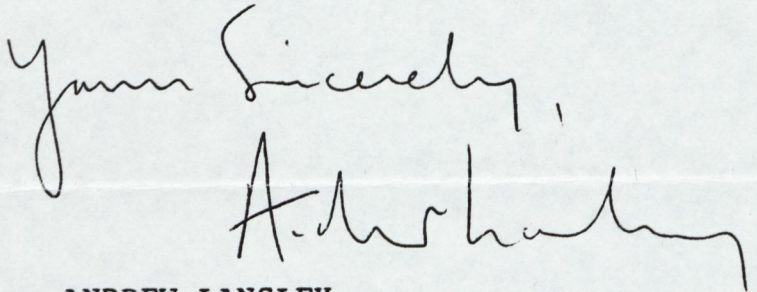
Secondly, the Chancellor of the Duchy believes that the note on National Non-Domestic Rates should pay greater attention to the argument that our proposals imply greater central control; and he suggests that the note might have particular regard to the implications for some existing business rates in the South as these climb to reach the national average figure, on which we can draw attention to the proposal for index-linking with inflation.

In addition, there are two points of drafting: both relate to the first page of the section entitled "Can the Community Charge be made to work". The Chancellor would suggest removing the sentence referring to the lack of identity cards in Sweden. Later on the same page, a point reads: "Second homes would be liable to a double community charge, to be paid by the owner". As it stands, this

does not make the position very clear. Could it be expressed more fully, to make the position clear?

The Chancellor has also asked me to confirm that Central Office will indeed be playing its part in putting the message of the Rates Green Paper across to the country.

I am sending a copy of this letter to David Norgrove at No 10, Joan MacNaughton in the Lord President's Office, Colin Williams (WO), Robert Gordon (SO) and to Murdo Maclean.

Yours Sincerely,


ANDREW LANSLEY
Private Secretary

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PT 29

