

IFS Briefing

Revaluation and reform: bringing council tax in England into the 21st century

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Revaluation and reform: bringing council tax in England into the 21st century

Council tax bands in England are still based on property values in April 1991 – almost 30 years ago. Since then the relative prices of different properties have changed significantly: for example, official estimates suggest the average price in London is now more than six times what it was in 1995, compared with barely three times in the North East.

Moreover, the most valuable properties in 1991 (Band H) attract just three times as much tax as the least valuable properties (Band A), despite being worth at least eight times as much in 1991 and typically even more now, since prices have risen most in areas where they were already highest.

Council tax is therefore both increasingly out of date and arbitrary, and highly regressive with respect to property values. It is ripe for reform.

This note summarises a new IFS report analysing the effect of updating and reforming council tax on different local authorities (LAs) and different household types in England. This is in the context of growing concerns about both wealth and regional inequalities, especially between the North, where property values are much lower and have risen relatively slowly since 1991, and London and the South East, where they are much higher and have risen more.

It explains why the current council tax system is not fit for purpose, and sets out a range of reform options – from the relatively modest (just revaluing properties to reflect changes in relative house prices) to our preferred, more radical approach (a tax proportional to property value). It assesses the impact of these reforms on tax bills in different parts of England and for different types of households – such as lower- and higher-income, older and younger, owning and renting. The impacts turn out to depend crucially on whether central government funding for LAs adjusts to reflect changes in tax bases. This briefing also looks at options for mitigating the impact of reform on low-income households living in high-value properties who would lose from reform – but who in any case are far fewer in number than those low-income households that would gain.

Full results for each of the reforms we consider, by LA and household type, can be found at: www.ifs.org.uk/research/english-council-tax.

Key policy messages and findings

- 1. Council tax is out of date, regressive and distortionary. It needs to be revalued and reformed.** Values of different properties have changed very differently since council tax was introduced – on average increasing more than twice as much in London as in the North East, for example – yet the tax has not changed to reflect that. This means properties are in increasingly arbitrary tax bands that may bear little relation to current reality: two households living in equally valuable properties in the same LA can find themselves paying tax bills hundreds of pounds apart just because their properties used to be worth different amounts in 1991. Council tax is also highly regressive with respect to property value, and the 25% discount for single-adult households encourages the inefficient use of property.
- 2. Whether funding from central government were adjusted alongside reforms to council tax would have a crucial effect on the reforms' impact across LAs.** If it were not, each LA would need to raise just as much council tax revenue as before if it wanted to maintain spending – implying no change in the average tax bill in each LA, even as the amounts paid by individual households went up and down. With full adjustment of funding, average bills would change to reflect changes in local tax bases. For example, making council tax proportional to up-to-date values would lead to average bills falling by more than 20% across most of the North and Midlands, where average property values are typically relatively low. Conversely, they would rise in areas where property values are high and have risen most, notably in London and nearby commuter areas. In what follows, we assume funding is fully adjusted.
- 3. Reform could make council tax much more progressive.** Revaluation alone would have little effect on the average tax bills of different household types. But a proportional council tax would reduce net council tax bills by the equivalent of 0.5–0.9% of household income, on average, for households in the bottom half of the income distribution, whilst increasing average bills by 0.7% of household income for those in the top 10%. Younger households, renters and those receiving disability benefits would see their average bills fall. However, ethnic minority households, who disproportionately live in London, would see their average bill rise, reflecting the high value of their properties compared with other regions in England.
- 4. While there may be particular concern about low-income losers from reforms, it is important to recognise they would be massively outnumbered by low-income winners.** For example, 24% of the poorest fifth of households would see their net tax bill fall by more than £200 a year under a proportional council tax, while just 4% would see it increase by more than £200 a year. Many would see little or no change because their bills are fully or largely covered by council tax support, which could be made more generous if the government wanted to mitigate the impact of reforms further. The government could also consider transitional relief and deferral of payments – although getting the design of deferral schemes right is vital to avoid undermining tax revenue.
- 5. Revaluation and reform of council tax could help narrow household and geographical wealth inequalities via effects on property prices.** Economic theory and empirical evidence suggest that changes in property taxes get largely or fully reflected in rents and property prices. This means that a proportional property tax would narrow the gap in property wealth between owners of high- and low-value properties and, if accompanied by redistribution of funding from central government, between areas with low and high property values. The scale of these impacts is highly uncertain, though.

Why does council tax need reforming?

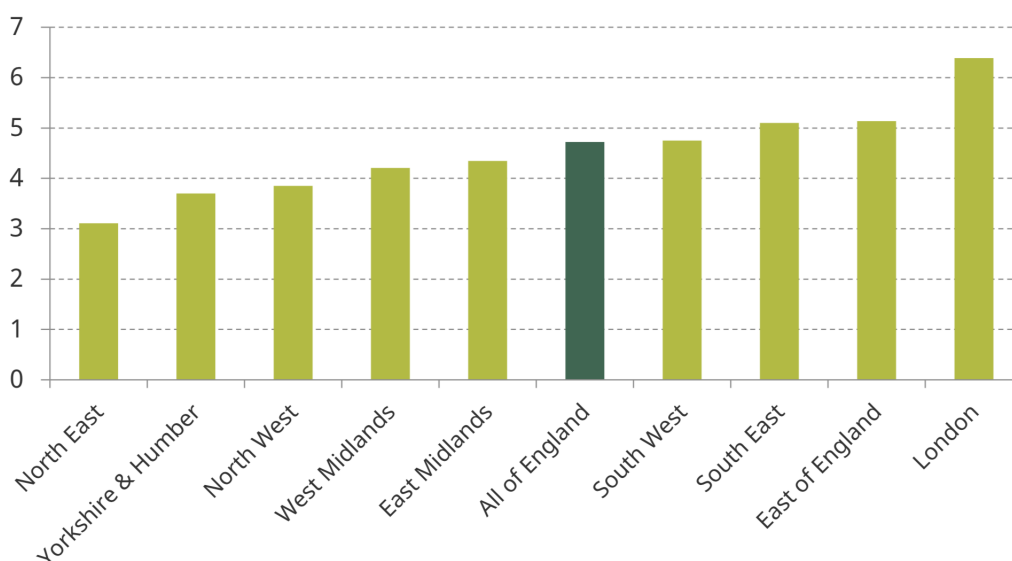
A good property tax would be a simple percentage of current property value. Council tax, in contrast, is out of date and regressive, and distorts the housing market. It is in dire need of reform.

Council tax in England, where – unlike Wales – there has not been a revaluation of properties since the tax was introduced, is still based on valuations from April 1991.

This creates **unfairness across LAs**. The average London house price is now more than six times what it was in 1995, compared with barely three times in the North East (see Figure 1). Yet the distribution of central government funding to LAs is still based on relative property values in 1991. Other things equal, this means councils in the North East must now levy more tax on a property worth (say) £250,000 than councils in London, if both are to deliver the spending on services deemed necessary by central government.

It also creates **unfairness across households within each LA**. Two households living in equally valuable properties, receiving the same services from the same council, can have different tax bills because one property was worth more than the other 29 years ago.

Figure 1. Average property price in November 2019 as a multiple of January 1995, by region



Source: Figure 2.4 of Adam, Hodge, Phillips and Xu (2020).

Council tax is **regressive**. Tax on a property in the highest band is three times the tax on a property in the lowest band, despite the former being worth at least eight times as much (in 1991) and typically even more today – it has become more regressive as prices have risen most in areas where they were already highest. There is a strong case for levying council tax in proportion to property value, particularly given the lack of VAT on housing. Making council tax less regressive (and perhaps other taxes less *progressive*) would be an efficient way to redistribute, given that property taxes cause less distortion to behaviour than most other taxes.

The banded structure also creates inequitable outcomes. It means **similar properties can attract very different tax liabilities**: 22% higher at the bottom of Band E than at the top of Band D, for example. Conversely, **very different properties can attract the same tax liability**. A property at the top of Band E was worth 36% more (in 1991) than

one at the bottom of the same band, but their tax bills are the same. All Band A properties in an LA attract the same tax regardless of how far below the £40,000 cut-off they were, and all Band H properties attract the same tax regardless of whether they were worth £320,001 (in 1991) or were multi-million-pound mansions.

Single-adult households – about a third of all households in England – receive a 25% discount on their council tax. This encourages **inefficient use of the housing stock**, with single-adult households living in bigger properties, and multi-adult households living in smaller properties, than they otherwise would.

What reforms do we look at in our report?

Our report examines the impacts of six potential reform options:

- 1. Pure revaluation.** Properties are revalued and placed into one of the existing eight tax bands (A to H) based on their current value, with band thresholds chosen to maintain the same proportion of properties in each band as now across England as a whole. We consider this the bare minimum that needs to be done.
- 2. Revaluation with proportional bands.** As option 1 but also making the relative tax rates assigned to each tax band proportional to the median property price in each band, rather than regressive with respect to property values as currently (see Table 1).
- 3. Revaluation with extra and proportional bands.** As option 2 but adding two extra bands at the bottom and one extra band at the top of the price distribution. This reduces the extent to which properties with quite different values can find themselves with the same tax rate as a result of tax bands being overly wide.
- 4. Revaluation with extra and less-regressive bands.** As option 3, except that the relative tax rates assigned to each tax band are made less regressive than now, but still less than fully proportional.
- 5. Revaluation with a continuous and proportional system.** Properties are revalued and a fixed percentage tax rate applied to their new value, while retaining existing discounts, premiums and exemptions.
- 6. Revaluation with a continuous and proportional system without a single-person discount.** As option 5 but with the abolition of the single-person discount. We consider this the option that would represent the biggest improvement on the current design of the council tax.

To keep things to a manageable length, however, we focus mainly on results for options 1 and 5. The impact of intermediate options (2, 3 and 4) on different LAs and different types of households are usually in between these two cases, and full results for these (and option 6) can be found in our online appendix.

We restrict attention to revenue-neutral reforms, in order to focus on the structure of the system, rather than the question of the overall level of taxation. If local or national government wanted to raise more (or less) revenue than now under any of these options, tax rates could be increased (or decreased).

Table 1. Council tax bands and relative tax rates currently and under reforms 1 and 2

Tax band	Existing band	Updated band	Tax rate as % of Band D tax rate	
			Option 1. Pure revaluation	Option 2. Proportional system
A	Up to £40,000	Up to £142,000	67%	29%
B	£40,001 to £52,000	£142,001 to £204,560	78%	49%
C	£52,001 to £68,000	£204,561 to £301,810	89%	71%
D	£68,001 to £88,000	£301,811 to £415,120	100%	100%
E	£88,001 to £120,000	£415,121 to £571,050	122%	136%
F	£120,001 to £160,000	£571,051 to £794,420	144%	187%
G	£160,001 to £320,000	£794,421 to £1,769,840	167%	284%
H	Above £320,000	Above £1,769,840	200%	680%

All reforms are modelled on the basis of Q1 2019 property values, which we estimate based on the relationship between property characteristics and values either as reported by respondents to a household survey (for our household-level analysis) or as recorded by the Land Registry for properties that have actually transacted (for our LA-level analysis).

How would impacts differ across LAs?

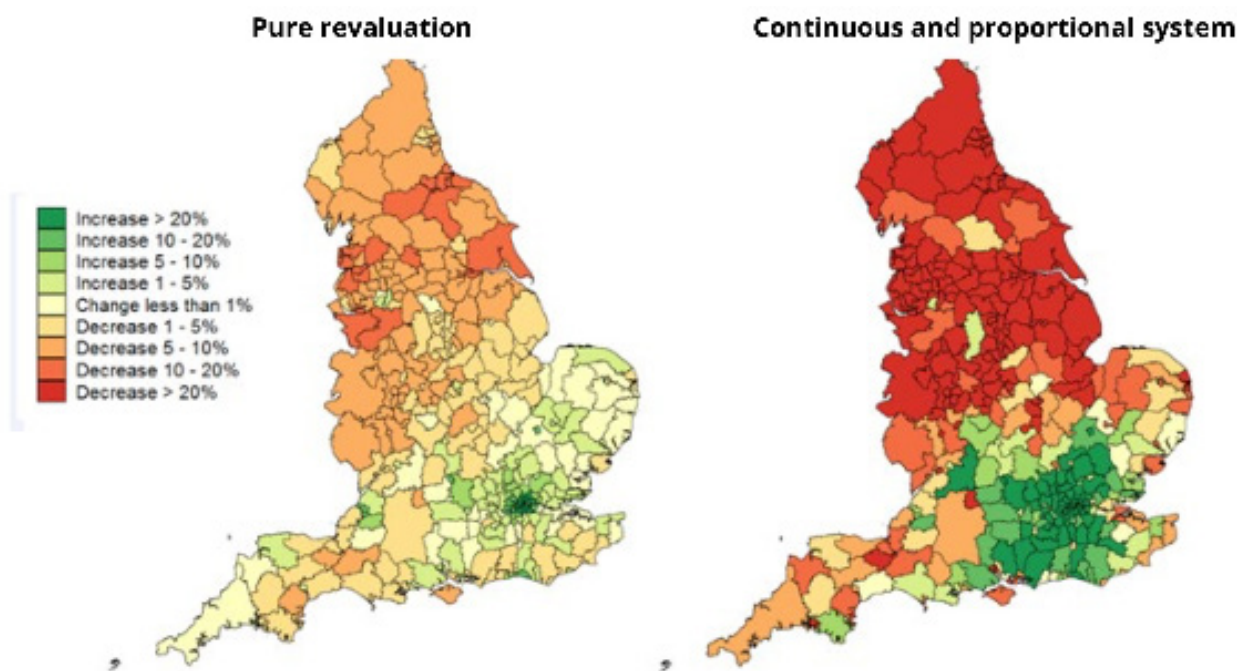
Property prices differ significantly across LAs in England. For example, we estimate that as of Q1 2019, the average property in Kingston upon Hull was worth around £101,000, while the average property in Kensington & Chelsea was worth around £1,536,000, over 15 times as much. And as already highlighted, prices in London have risen more than twice as much as in the North East of England since 1995, the first year comparable figures are available. This means that reform of council tax would have different effects on the tax bases of different LAs.

However, if the amount of central government funding different LAs receive is left unchanged, they would each need to raise the same from council tax as now if they wanted to maintain spending levels. And unchanged council tax revenues would imply each LA charging the same average council tax bill – even if the bills for individual households went up or down.

Reform would only directly affect the average council tax bill charged by each LA if central government funding were adjusted to reflect the changes in tax bases that took place. Without such adjustments to central government funding, reform would redistribute tax bills *within* LAs, but not *across* them. Decisions on central government funding would therefore play a key role in determining the impact of revaluation on people living in different LAs – and hence on different population groups, who are not completely evenly distributed around the country (for example, a large share of individuals from an ethnic minority background and relatively few pensioners live in London).

Figure 2 shows the estimated change in average net council tax bills by LA that our two main reform options would lead to if central government funding were fully adjusted to reflect changes in tax bases and councils decided to set tax rates to maintain spending levels.

Figure 2. Changes in average net tax bills, by council area, if general central government funding is fully adjusted



Source: Figure 4.7 in Adam, Hodge, Phillips and Xu (2020).

The left-hand panel shows that a **pure revaluation** would lead to average tax bills rising in Greater London and its environs and in a few other areas such as Bristol and parts of Greater Manchester, where property values have risen more than average since 1991, and falling in much of the North, Midlands and South West of England, where values have risen less than average. But the impacts on the average bill in an LA would generally be less than 10% in either direction. Exceptions include Hackney (+45%), Wandsworth (+34%) and Lambeth (+30%) in Greater London, where property values have increased particularly rapidly since 1991, and Fylde (-15%), Wyre (-15%) and Ribble Valley (-13%), where property values have increased particularly slowly.

The right-hand panel shows that the impact of **revaluation and a continuous and proportional council tax** would be more significant, with average bills falling in areas with low average property values, and increasing in areas where values are high. Average bills in most northern and Midlands LAs would fall by more than 20% – indeed more than 40% in many cases – reflecting the low average property values in these areas. We estimate the biggest reductions would be in Kingston upon Hull (-60%), Stoke-on-Trent (-57%) and Blackpool (-56%). Conversely, average bills in Greater London and its environs would generally rise by more than 20% – and more than 100% in a few instances, reflecting the high average property values in these areas. The biggest increases would be in Westminster (+410%), Kensington & Chelsea (+358%) and Wandsworth (+166%), with Elmbridge in Surrey (+81%) the biggest outside London.

The **changes in central government funding** that would be needed to fully offset the changes in tax bases would vary significantly between policy reform options. For example:

Under a **pure revaluation**, the changes would amount to no more than 10% of existing general central government funding for three-quarters of LAs, with the only region where the average exceeded this level being London (-13.4%). Central government funding would be redistributed from South to North, with reductions in the South East

(-2.9% on average) and East of England (-3.8%) as well as London, and increases in the Midlands (around 5%) and North (around 7%). These changes – and the changes in average tax bills that would likely result – could contribute to the government’s ‘levelling up’ agenda, which seeks to increase funding and living standards in the Midlands and North in particular.

Under a **continuous and proportional council tax**, the changes would amount to *more* than 10% of existing general central government funding for over four-fifths of LAs. Most LAs in the East, South East and especially London would be expected to rely more on their own council tax revenues given their high property values and larger tax bases under such a system: their central government funding would be reduced by 13%, 34% and 64%, respectively, on average. Conversely, LAs in the North and Midlands would be expected to raise less from their residents via council tax, and would see increases in their central government funding of between 30% and 40%, on average. This could make an even bigger contribution to the ‘levelling up’ agenda.

A number of LAs in London, the South East and East of England would require reductions in general central government funding of more than 100% under a continuous and proportional system, if changes in tax bases were fully adjusted for. The government would therefore have to decide whether to reduce other funding streams or only partially account for changes in tax bases for these LAs.

The option of partially adjusting central government funding to reflect changes in tax bases would, of course, be available more generally. Partial adjustment would lead to less redistribution of funding from London to the Midlands and North, for example. As a result, it would reduce the number of LAs in London seeing large increases and the number of LAs in the Midlands and North seeing large decreases in average council tax bills following reform.

Whether the government should partially or fully adjust its funding for LAs alongside council tax reform depends on what it is trying to achieve with the local government finance system. If it wanted to continue with the principle historically underlying the system – that residents of similar-value properties in different areas should face the same tax bill unless their LA decides to spend more or less than the government deems necessary – it should fully adjust its funding following reform. If, on the other hand, it wanted to limit the extent to which average bills were higher in areas with higher property values, partial equalisation could make sense.

If the latter concern wins out, partial adjustment of funding would be better than another policy sometimes suggested: setting different tax bands in different regions. Doing that would make decisions about how to allocate central government funding for LAs more opaque and less flexible than sticking with national tax bands and directly varying the degree to which funding takes account of LAs’ tax bases.

How would impacts differ across household types?

The effects of revaluation and reform would also vary across different types of household. This reflects differences in the value of the properties they live in, and the fact that different types of households are more likely to live in different parts of the country.

As with impacts across LAs, the effects on different types of household would depend on whether central government funding for LAs were adjusted to reflect changes in tax bases. Here we focus on the ‘full adjustment’ scenario, but, as discussed previously, partial (or indeed no) adjustment would be possible.

Reforming council tax would create both winners and losers. Under a **pure revaluation**, most households (61%) would see changes in their council tax of less than £50 a year. However, 2.6 million households (11%) would gain by more than £200 a year, while a similar number would lose by more than £200 a year.

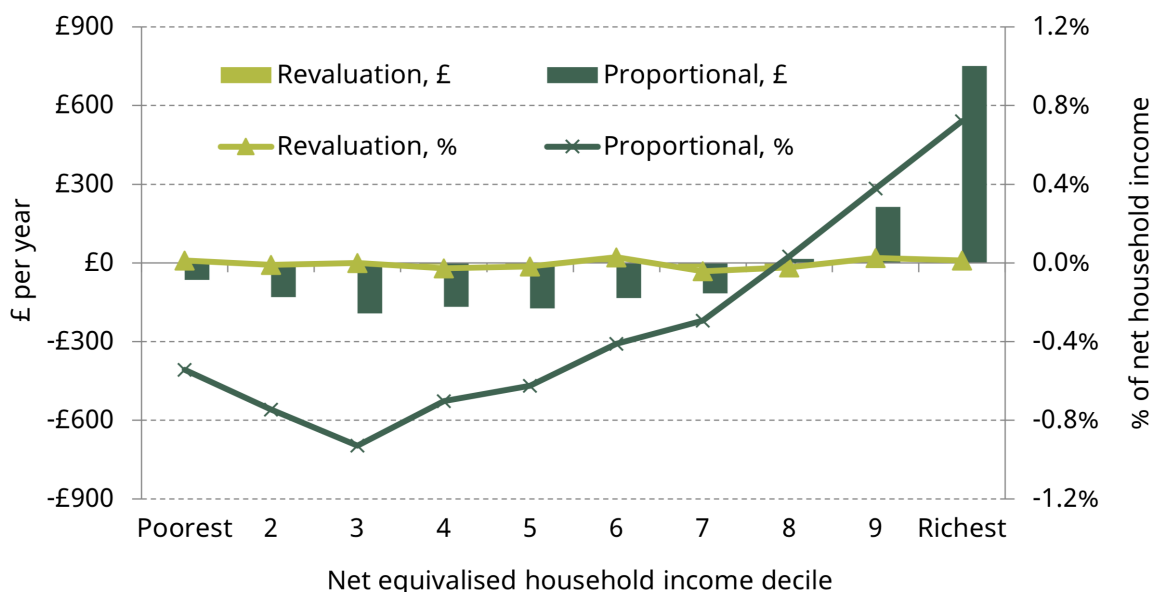
A **continuous and proportional council tax system** would lead to larger changes in council tax bills. Many more households would benefit substantially from the reform than would lose out, with 10.1 million households gaining more than £200 a year, compared with 4.2 million losing more than £200 a year. But those who lost from the reform would lose more, on average.

Figure 3 shows our estimates of the impact of our two main reform options across the household income distribution. It shows that:

A **pure revaluation** would have little effect on the average council tax bills of different income groups. This reflects the fact that the numbers of winners and losers would roughly balance out right across the income distribution. However, fewer poor households than rich households would see big changes (in either direction) in how much council tax they have to pay. This is because many have their bills partially or fully covered by council tax support (CTS).

A **continuous and proportional council tax system** would be more progressive with respect to income and, of course, property value. The lowest-income 10% of households would see their average tax liability (net of CTS entitlement) fall by £60 a year, equivalent to 0.5% of household income. Households in the third decile group would see the largest fall in average bills, by £190 a year (0.9% of income), as they are less insulated from changes in council tax by CTS. The highest-income 10% of households would see their average bill rise by £750 (0.7% of income) a year.

Figure 3. Average change in net council tax bill, by household income decile

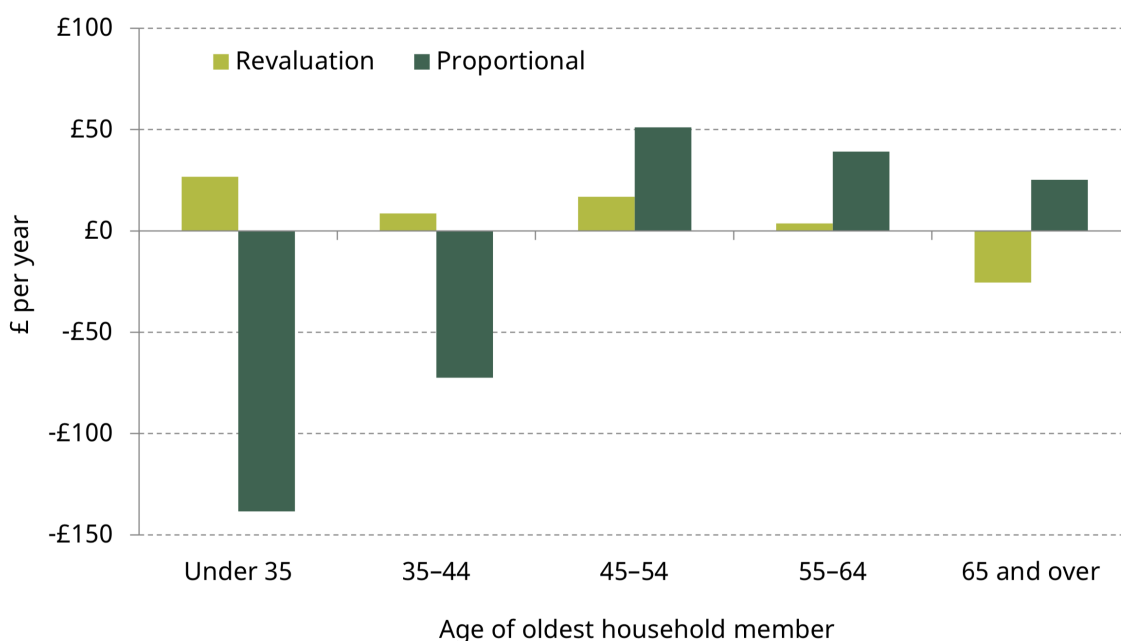


Source and note: Figure 5.4 in Adam, Hodge, Phillips and Xu (2020).

A **continuous and proportional council tax system** would also redistribute from older households towards younger ones, as shown in Figure 4. Households in which the oldest person is under 35 would see their net council tax liability fall by £140 a year on average, and those in which the oldest person is 35–44 would see their council tax bill fall by £70 a year. Average council tax bills would rise by £40–£50 among middle-aged households (45–64) and by £30 among pensioner households (65 and over). This reflects the fact that older people tend to live in more valuable properties.

In contrast, a **pure revaluation** – maintaining the regressivity of the current system – would benefit older households at the expense of younger households, at least if grant funding were adjusted. This is because whilst older households tend to live in more expensive properties, they are less likely to live in areas – such as London – where property prices have risen a lot since 1991.

Figure 4. Average change in net council tax bill, by age of oldest household member



Source and note: Figure 5.10 in Adam, Hodge, Phillips and Xu (2020).

Single-adult households would also see their average tax bills fall under a **continuous and proportional council tax system**. This means there could be an opportunity to abolish the distortionary single-person discount at the same time, as the package as a whole would avoid the large average losses for single-person households that abolition of the single-person discount on its own would cause. If the single-person discount were abolished alongside a move to a proportional system, average council tax bills among single-adult households would rise by only around £20–£40 a year compared with the current system. Abolishing the single-person discount would also shield larger households from the rise in average tax bills that would result from a proportional system. Households with two adults would benefit slightly from the combined reform relative to the current system, since the council tax rates required to raise as much revenue as now would be lower if the single-person discount were abolished.

How might rents and property prices respond?

The analysis so far has focused on changes in tax bills. However, economic theory and evidence from a range of studies in the UK and overseas suggest that changes in council tax are likely to be reflected to a large extent in private-sector rent levels and property values. How important could these effects be?

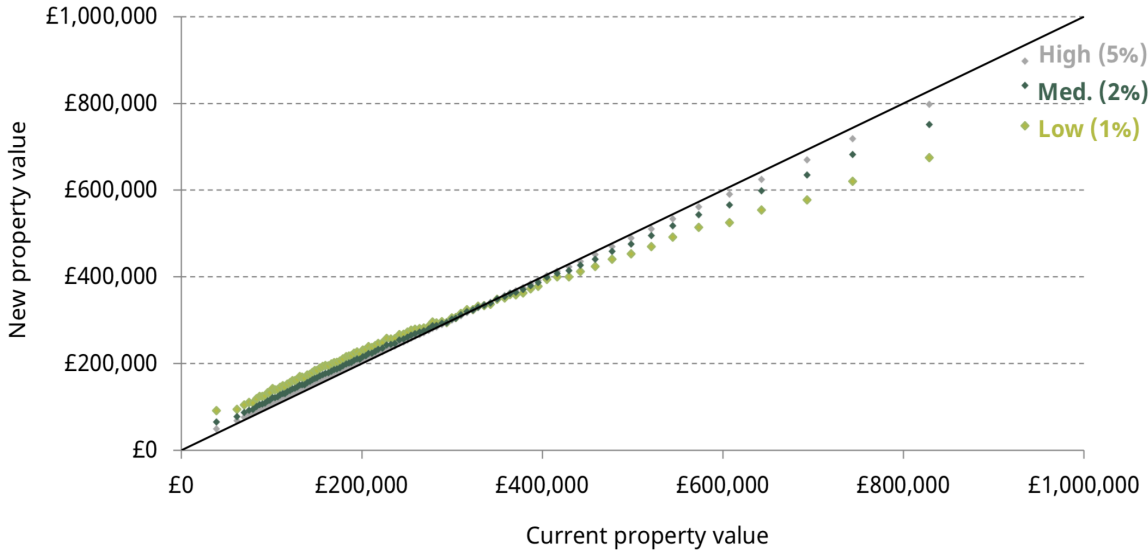
One obvious implication is that it is private landlords rather than tenants who would ultimately be made better or worse off as a result of changes in council tax, as the amount they can charge in rent went up or down. For example, our analysis shows that under a **continuous and proportional system**, council tax bills among households that rent privately would fall by £90 a year on average; if landlords were able to put up their rent by that amount, households in private rental accommodation would see no change in their disposable incomes, and the average gain of £90 would go to landlords instead.

Similarly, changes in the tax bill attached to a property (or the rent that could be charged on it) would affect how much potential buyers were willing to pay for it.

While a **pure revaluation** would lead to falls in the value of properties where the tax bill is increased and rises in the values of properties where the tax bill is reduced, it would have little effect on the overall distribution of property values.

However, a **continuous and proportional system** would increase the value of low-value properties and reduce the value of high-value ones, narrowing the distribution of values and reducing wealth inequality among homeowners. Exactly how much it would do so is highly uncertain, though, and among other things would depend on how much households care about future tax payments. The more households discount future payments (the higher the discount rate), the smaller the effect on house prices, as shown in Figure 5.

Figure 5. Effect of a continuous and proportional system under different annual discount rates



Source and note: Figure 6.3 in Adam, Hodge, Phillips and Xu (2020).

A **continuous and proportional system** would also narrow gaps in property values between LAs and between regions if central government funding were fully adjusted. Under our baseline assumptions (including a 2% annual discount rate), we estimate that average prices in the North East would rise by around 17%, whilst average prices in London would fall by 8%. This would see the ratio of house prices in London to house prices in the North East fall from four times as high to three times as high, narrowing geographical inequalities in wealth among homeowners. The true effects could be larger or smaller than these, however.

The reform would increase property values among owner-occupiers in the bottom 70% of the household income distribution, who would see their property values rise by 3% on average under our baseline assumptions. The reverse holds for high-income owner-occupiers: property values for those in the top 10% of incomes could fall by 7% on average. Private landlords tend to live in high-value properties but rent out low-value properties, so the reduced value of their own home would be somewhat offset by a rise in the values of the properties they rent out.

How could losses for vulnerable groups be mitigated?

Revaluation and reform of council tax would not be without its challenges. It would mean losers as well as winners, and the losers may be more vocal. There may be particular concern about the impact on low-income losers – both those who own valuable properties but have low current incomes (typically pensioners) and those who rent (particularly in social housing) in expensive parts of the country.

Figure 6 shows that low-income households would, in fact, be far more likely to gain than lose from moves to a **continuous and proportional system**. Nearly 1.14 million (24% of) households in the bottom fifth of the income distribution would see their net tax bill fall by over £200 a year, with 0.18 million (less than 4%) seeing it increase by more than £200 a year. This reflects the fact that most low-income households live in relatively low-value properties and would see cuts in their gross council tax bill under a proportional tax. In London, however, high property values mean the situation would be reversed, with around 17% of households in the bottom fifth of the income distribution seeing their net tax bill increase by more than £200 a year, compared with just 2% seeing it fall by more than £200.

Figure 6. Proportion of households seeing net council tax bills decrease or increase under a fully proportional council tax, by household income quintile



Source and note: Table 7.1 in Adam, Hodge, Phillips and Xu (2020).

The scale of gains and losses would be much smaller than this for a pure revaluation, or if central government funding were not fully adjusted, or if reforms to make council tax less regressive were accompanied by offsetting reforms to make other taxes less progressive. But even under the radical option of a proportional council tax, nearly half (48%) of low-income households would see their net council tax bill change by less than £50 a year. As discussed earlier, this reflects the fact that many are entitled to CTS, which insulates them (in some cases fully) from changes in their gross council tax bills. One way to help low-income losers would be to increase the generosity of CTS and/or put in place measures to increase take-up among groups where take-up has historically been low.

Other policies that could help mitigate the impacts of revaluation and reform on those facing increased tax bills include:

Transitional relief, which would phase in increases in tax bills gradually. This could be paid for by central or local government, or by similarly phasing in reductions for those whose bills fall.

Deferred payment, which would allow at least some owner-occupiers to defer paying part or all of their bill – until sale or death, or for some other limited period – in effect taking out a loan to cover the part they do not pay immediately. Getting the design of such a scheme right would be important, and especially ensuring people have no reason to believe a future government might write off the deferred bills.

What next?

We believe that the government must revalue council tax, and should make it more proportional to value and less distortionary. Reform would undoubtedly be politically challenging. But it must be done at some stage: we cannot still be basing council tax in 2091 on relative property values in 1991. And with a secure majority and a mandate to 'level up' and tackle the significant inequalities that have grown between London and its environs and the rest of the country, the current government is in a good position to grasp this opportunity over the next few years.

In doing this, the government would need to consider at least four key issues as it plans and implements reforms.

First is the extent to which central government funding is adjusted alongside revaluation and reform of council tax. If the government wants to temper changes in tax bills, and in particular the tax rises that many households in London would otherwise face, it may want to only partially adjust this other funding. On the other hand, more significant adjustment could contribute to its agenda of 'levelling up' economic opportunity, by redistributing funding to areas with low property values in the North and Midlands.

Second is what measures should be put in place to ease the transition to a new regime, and mitigate the adverse impacts on particular households or places, such as people with low incomes living in properties with high and/or significantly increased values. Getting the design of such schemes right is important.

Third is how to estimate up-to-date property values. Information technology is far more developed than when properties were valued the first time round for council tax. The government and the Valuation Office Agency (VOA) should examine whether computerised statistical valuation techniques, broadly of the kind we have used in our analysis, are robust enough to apply in a real revaluation.

Fourth, the government should legislate for regular revaluations – every three years, for example, or even annually – to take place, as they do with business rates. This would allow for more frequent but smaller changes in tax bills, which would almost certainly be less politically difficult to implement than large, unexpected, one-off reforms. And it would ensure the country does not find itself in a similar situation to now in another 30 years.

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