

Reforming Council Tax Benefit: Options for Wales

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Executive Summary

1. Introduction

- The UK Government is proposing to devolve responsibility for providing support for low-income families with their council tax from 2013–14, and to cut funding for it by 10%. This report examines the likely impacts of this policy in Wales and the options available to the Welsh Government.
- 2. Council tax and Council Tax Benefit in Wales
- Council Tax Benefit (CTB) is received by 328,000 families in Wales, more than any other means-tested benefit or tax credit. But it still reaches only about two-thirds of those for whom it is intended, as many are not aware they are entitled and/or find it too difficult or stigmatising to claim.
- In cash terms, average council tax liability rises with income, as higherincome 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 the CTB to which they were entitled, net council tax liabilities would be a smaller share of income for lowincome households than for middle-income households. But given actual patterns of take-up, council tax is regressive across the whole income distribution, even once CTB is taken into account.
- The means-testing of CTB weakens incentives for individuals to enter paid work and for those in paid work to increase their earnings. Although small on average, these effects are more significant for certain groups, particularly those with low levels of earnings. CTB also weakens incentives to save, and creates an artificial incentive for low-income families to live in bigger properties than they would otherwise choose, since part of the cost of upsizing a bigger council tax bill is covered by the Government.
- 3. The proposed reforms to Council Tax Benefit
- The UK Government is proposing to localise council tax support from 2013–14, abolishing CTB across Britain and giving local authorities (LAs) in England, and the Scottish and Welsh Governments, grants to create their own systems for rebating council tax to low-income families. At the same time, the UK Government is cutting by 10% the funding it provides.

- The Welsh Government proposes to operate a single rebate scheme across the whole of Wales, rather than following the English example and requiring each LA to devise and run their own scheme. LAs in Wales will administer this uniform scheme, as they do with CTB currently, but will now be given fixed grants to run the schemes rather than having the actual costs of providing council tax support refunded by central government.
- The fact that LAs in Wales will receive fixed cash grants rather than having the actual costs of providing council tax support refunded will add risk to their finances. It will also give them an incentive to reduce the cost of rebates whether by promoting employment and growth in the local economy, discouraging low-income families from living in the area, or doing less to encourage take-up of support. The strength of these incentives will depend on how LAs expect grant allocations to be adjusted in future one of the most important decisions the UK and Welsh governments have yet to take about the policy.
- Spending on CTB in Wales was £238 million in 2010–11, so a 10% cut in funding means that there will be an estimated shortfall of around £24 million relative to the cost of the current CTB system (or more if the cost of CTB is forecast to increase between 2010–11 and 2012–13). That is equivalent to an annual cut of around £74 per CTB claimant or £17 per dwelling in Wales. The cut in funding is roughly equivalent to and could be absorbed by a 2.2% increase in council tax rates or a 0.2% cut in Welsh Government spending. However, the Welsh Government has decided to respond to the cut in funding by reducing the cost of council tax support by 10%.
- 4. Options for the Welsh Government
- There are numerous ways in which new rebate schemes could be designed to make savings: we examine several possibilities in detail. Since 80% of CTB in Wales goes to the lower-income half of households, and 43% of CTB goes just to the lowest-income fifth, any cuts to it are bound to hit predominantly poorer families. Making a means-tested benefit smaller also tends to reduce the extent to which it discourages work and saving. Nevertheless, there are significant differences between the reforms we examine.
- As ever, there is a trade-off between protecting those with the lowest incomes and the impact of reforms on incentives to work, and reforms that means-test support for council tax more aggressively lead to weaker work incentives than those which reduce support for all claimants. Reforms that save the full 10% typically involve reducing

support for those currently entitled to maximum CTB – those on the lowest incomes. And those options that do protect the poorest claimants either fail to generate large savings, or significantly weaken work incentives, or both.

- Reducing entitlements for all claimants slightly strengthens work incentives but imposes significant losses on even the poorest households. Such a policy would mean that all households, even those on the lowest incomes, would have to pay some council tax. The poll tax experience showed how difficult it can be to collect small amounts of tax from low-income households that are not used to paying it.
- Reducing or eliminating support for occupants of properties in higher council tax bands also involves starting to collect council tax from some households with little or no private income. But only households in higher-band properties (disproportionately families with children) are affected, and in general these reforms are less regressive than across-the-board cuts. Reforms of this kind slightly strengthen work incentives, and also affect people's incentives to occupy properties in higher council tax bands.
- Means-testing support for council tax more aggressively protects the very poorest altogether, with the losses particularly concentrated on low-to-middle-income households. Working lone parents are particularly likely to be among the low-income working families that lose from means-testing support more aggressively. Reforms of this kind generally have ambiguous effects on work incentives. But to save the full 10% purely from means-testing more aggressively would probably require the means test to be so severe that some people would be worse off after a pay rise.
- One option available to the Welsh Government would be to reduce the single-person discount in council tax. A reduction from 25% to 20% would raise an amount equal to 10% of spending on CTB, and is the only reform we consider that raises revenue predominantly from those with higher incomes. It would slightly weaken work incentives, but reduce the current distortionary incentive for people living alone to occupy larger properties.
- However, the Welsh Government's task is not only to save money by finding tweaks to the current system for determining entitlements to council tax support. Like the Scottish Government and LAs in England, the Welsh Government will also have to consider the complex question of how council tax rebates will work alongside the new Universal Credit when it starts to be phased in from October 2013.

1. Introduction

The UK benefit system is about to undergo its most radical restructuring since the 1940s. Six of the seven main means-tested benefits and tax credits are being replaced by a single Universal Credit. The seventh is Council Tax Benefit (CTB). Contrary to the whole thrust of Universal Credit, support for council tax is being localised, with responsibility for designing council tax rebates passing to LAs in England and to the devolved administrations in Wales and Scotland. At the same time, the grants being provided by the UK Government to fund these new rebates will be 10% less generous than the existing CTB scheme – one small part of the UK's ongoing fiscal consolidation. There is no obligation for English LAs and the Scottish and Welsh Governments 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 for non-pensioners as well as pensioners and find the necessary savings elsewhere, or even to cut entitlements by more and use the surplus for other purposes.

These reforms are being implemented differently in the three nations of Great Britain. In England, responsibility is being passed to LAs to design their own schemes for those of working age, but entitlements for pensioners will still be set centrally and maintained at their existing level. If LAs choose not to make up the shortfall from elsewhere, this means that support for those of working age will have to be cut by more than 10%. The Scottish Government has decided to maintain entitlements at their existing levels for all claimants in 2013–14, with the funding shortfall being made up by contributions from elsewhere in Scottish Government and LA budgets. The Welsh Government is also planning to run a national scheme of council tax rebates, but unlike in Scotland it is intending to pass on the funding cut in full to claimants of council tax support, reducing the cost of support by 10%. However, it has not yet decided where entitlements should be reduced.

This report examines the options available to the Welsh Government to make savings in the cost of council tax support and the consequences of different options. We begin by describing the existing system of council tax and CTB in Wales in section 2, providing some facts and figures on who receives CTB in Wales and its effects on work incentives. In section 3 we give more details of the policy changes, before examining different options available to the Welsh Government to reduce spending on council tax rebates in section 4, showing their distributional and work incentive impacts. Section 5 concludes.

This report draws heavily on analysis in a separate report by the same authors looking at the reform of CTB across Great Britain.¹ We focus here on analysis for Wales, which is different from that for Britain as a whole; where the issues are essentially the same, we refer readers to the relevant section of the earlier report.

2. Council tax and Council Tax Benefit in Wales

Council tax is the only tax with its own benefit. CTB stands at the junction of the tax and benefit systems, and it must be understood both as part of the council tax system and as part of the benefit system. We begin this section by describing the essential features of council tax and some key facts and figures. We then do the same for CTB, before turning to a detailed assessment of its distributional impact and its impact on work incentives in Wales.²

2.1. Council tax

Council tax and CTB were introduced on 1 April 1993. Each property in England, Scotland and Wales was allocated to one of eight valuation bands according to an assessment of its value in 1991, though the cut-off points between bands were different in each country.³ In Wales (though not in England and Scotland, where the 1991 bandings still apply) a revaluation came into effect on 1 April 2005, based on property values as at 1 April 2003 (with the cut-off points between bands correspondingly uprated to take account of growth in house prices since 1991), and at the same time a ninth band was added (Band I).

LAs in Wales set the overall level of council tax by choosing a rate for Band D properties, with the levels for other bands then determined as ratios of the Band D rate. The ratios, set centrally by the Welsh Government, are set out in Table 2.1. Those in the lowest band (A) pay two-thirds of the Band D rate, while those in the top band (I) pay $2\frac{1}{3}$ times the Band D rate.

¹ S. Adam and J. Browne (2012), 'Reforming Council Tax Benefit', IFS Commentary no. 123 (<u>http://www.ifs.org.uk/publications/6183</u>).

² The descriptions in sections 2.1 and 2.2 draw on and update those in S. Adam, C. Emmerson and A. Kenley (2007), 'A Survey of UK Local Government Finance', IFS Briefing Note no. 74 (<u>http://www.ifs.org.uk/bns/bn74.pdf</u>).

³ Northern Ireland has a different system, domestic rates, which we do not discuss further in this report. The Government's proposed reforms to localise CTB do not directly apply there, although the consequential cut in funding does.

Band	2003 property value	Tax rate relative to Band D
А	Up to £44,000	و/ ⁶
В	£44,001 to £65,000	⁷ / ₉
C	£65,001 to £91,000	⁸ / ₉
D	£91,001 to £123,000	1
Е	£123,001 to £162,000	¹¹ / ₉
F	£162,001 to £223,000	¹³ / ₉
G	£223,001 to £324,000	¹⁵ / ₉
Н	£324,001 to £424,000	2
I	Above £424,000	²¹ / ₉

Table 2.1: Council tax bands and billing ratios in Wales

Just under 60% of properties in Wales are in Bands A to C; fewer than 5% fall in Band G or above. Despite average property values in Wales being lower than in England and around the same as in Scotland, there are fewer properties in the lowest council tax bands in Wales as a result of the different band cut-off points in the three nations of Great Britain.



Figure 2.1: Distribution of properties across bands

Sources: England and Wales as at 31 December 2011 from Valuation Office Agency, <u>http://www.voa.gov.uk/corporate/statisticalReleases/120112 CouncilTaxValuationList</u> <u>Summary.html</u>, Scotland as at 5 September 2011 from Scottish Government, <u>http://www.scotland.gov.uk/Topics/Statistics/Browse/Local-Government-Finance/DatasetsCouncilTax</u>.

Since most properties are below Band D, most households pay less than the Band D rate. Because of this, and also because of discounts and incomplete collection (see below), the average Band D rate in Wales for 2012–13 is £1,188, but the average amount paid by households is only £1,036. The level of council tax varies both between the nations of Great Britain and within each nation. The average Band D rate in Wales is much lower than that in England (£1,444), but slightly higher than in Scotland (£1,149). Across Wales, Band D rates range from £945 in Pembrokeshire to £1,463 in Blaenau Gwent. In England, the lowest Band D council tax rate is in Wandsworth in London (£684), while the highest is in Rutland in the East Midlands (£1,696), whereas in Scotland, Band D rates vary much less, ranging from £1,024 in Eilean Siar to £1,230 in Aberdeen City.⁴

⁴ Sources: As for Figure 2.1.





Sources: England from Communities and Local Government, http://www.communities.gov.uk/localgovernment/localregional/localgovernmentfinan ce/statistics/counciltax/; Scotland from Scottish Government, http://www.scotland.gov.uk/Topics/Statistics/Browse/Local-Government-Finance/DatasetsCouncilTax; Wales from Welsh Government (http://wales.gov.uk/docs/statistics/2012/120322sdr472012en.pdf) and StatsWales (http://www.statswales.wales.gov.uk/TableViewer/tableView.aspx?ReportId=877). Great Britain figures calculated as averages of England, Scotland and Wales weighted by the number of dwellings as per Figure 2.1.

Council tax bills are reduced by 25% if only one taxable adult lives in the household. In Wales, second and long-term empty properties attract discounts of between zero and 50% at LAs' discretion, with some kinds of property exempt altogether. Properties adapted for use by disabled people are moved down one council tax band (including Band A properties: these are reduced to 'Band A-', charged five-ninths of the Band D rate).

Some groups of adults are ignored for the purposes of counting the number of taxable adults in a residence. The largest such group is students undertaking full-time educational courses with a higher-education institute; others include people in detention, carers, the severely mentally impaired, 18- and 19-year-olds in full-time (non-higher) education, members of religious communities, resident care-home and hospital patients, and residents of hostels or night shelters.

Legal liability for council tax usually rests with the occupants, though in certain circumstances (such as unoccupied homes) the owner is liable. If a property has more than one occupant, liability is shared between them, although in owner-occupied homes only the owner(s) is/are liable, not (for example) a lodger or an elderly relative living in the property. If a couple share a dwelling, they are both liable, even if there is only one name on the bill. Regardless of how many people share liability, only one council tax bill is issued for each property.

In Wales, council tax and CTB are administered by the 22 unitary authorities. However, while the unitary authorities administer council tax, 'precepting authorities', namely community councils and police authorities, can instruct the unitary authority to collect and pay over an addition to the council tax rate it sets. Thus the Band D rate applying in a particular area is the sum of that set by the unitary authority and those set by precepting authorities.

Collection rates have improved since the introduction of council tax, with in-year collection rate in Wales increasing from 94.7% in 1996-97 to 96.6% in $2010-11.^5$

Council tax is not one of the biggest taxes people pay: the £26.3 billion it is expected to raise (net of CTB) across Britain in 2012–13 represents just 4.4% of total UK Government revenue.⁶ Nor is it the main source of LAs' revenue: in 2012–13 council tax (without deducting the part of CTB refunded by central government) is expected to account for just 22% of LAs' income in Wales, with the bulk of revenue provided in grants from the Welsh Government.⁷ Nevertheless, council tax attracts far more attention than its relatively limited revenue yield might lead us to expect, partly because for the vast majority of people it is one of the only taxes they are asked to remit themselves.⁸

⁵ Source: StatsWales Local Government Finance Statistics (<u>http://www.statswales.wales.gov.uk/ReportFolders/reportfolders.aspx?IF_ActivePath</u> <u>=P,324,325,352</u>).

⁶ Source: Table 4.7 of Office for Budget Responsibility, *Economic and Fiscal Outlook*, March 2012 (<u>http://budgetresponsibility.independent.gov.uk/economic-and-fiscal-outlook-march-2012/</u>).

⁷ Source: StatsWales Local Government Finance Statistics (<u>http://www.statswales.wales.gov.uk/TableViewer/tableView.aspx?ReportId=3722</u>).

⁸ The other is vehicle excise duty. In 2006–07 some 88% of all tax was remitted by businesses (see J. Shaw, J. Slemrod and J. Whiting (2010), 'Administration and compliance' in J.A. Mirrlees et al. (eds), *Dimensions of Tax Design: The Mirrlees*

2.2. Council Tax Benefit

CTB is a means-tested social security benefit. As of January 2012, it was being paid to 328,000 claimants in Wales – more than any other meanstested benefit or tax credit.⁹ Claimants in Great Britain as a whole were receiving an average of £15.69 per week, not a particularly large amount relative to other benefits.¹⁰ Across Britain the government expects to spend £4.9 billion on CTB in 2012–13, some 2.4% of total social security benefits and tax credits; in Wales total CTB payments were £238 million in $2010-11.^{11}$ CTB is administered by LAs, but in contrast to council tax, its level is set by the UK Government and it is financed almost entirely by the UK Government.¹²

Review, Oxford: Oxford University Press for the Institute for Fiscal Studies, <u>http://www.ifs.org.uk/mirrleesReview</u>).

⁹ This figure excludes recipients of second adult rebate, described below. Source: Table 10 of Department for Work and Pensions (DWP) *Housing Benefit and Council Tax Benefit Summary Statistics: January 2012* (http://statistics.dwp.gov.uk/asd/asd1/hb ctb/hbctb release apr12.xls).

¹⁰ For comparison, around the same time average receipt of Housing Benefit was £86.91, Income Support £82.71, Jobseeker's Allowance £64.04, Employment and Support Allowance £84.10, Disability Living Allowance £74.24, Pension Credit £57.34 and Basic State Pension £111.07. Sources: CTB and Housing Benefit figures for December 2011 from DWP *Quarterly Statistical Summary*, March 2012 (<u>http://statistics.dwp.gov.uk/asd/asd1/stats_summary/stats_summary_mar12.pdf</u>); all others for November 2011 from DWP Tabulation Tool (http://statistics.dwp.gov.uk/asd/index.php?page=tabtool).

¹¹ Sources: CTB spending from DWP, *Benefit Expenditure Tables – medium-term forecast* (<u>http://research.dwp.gov.uk/asd/asd4/index.php?page=medium_term</u>); total benefits and tax credits (which excludes Northern Ireland benefits and company tax credits) from Table 4.7 and Supplementary Tables 2.11 and 2.12 of Office for Budget Responsibility (2012).

¹² 'Almost entirely' because central government does not fully reimburse LAs for certain types of overpayments and duplicate payments of CTB. For example, when an LA pays CTB to a claimant who is then found to have made an error or committed fraud in their application, central government will only reimburse 40% of this outlay. The rules are different where overpayments arise for other reasons; details are set out in DWP's *Housing Benefit and Council Tax Benefit Subsidy Guidance Manual*, available at <u>http://www.dwp.gov.uk/local-authority-staff/housing-benefit/performance-andgood-practice/subsidy-guidance-manuals/</u>. The government estimates that 97.4% of CTB costs were met by central government in 2011–12 (source: DWP, *Benefit Expenditure Tables – medium-term forecast*

http://research.dwp.gov.uk/asd/asd4/index.php?page=medium_term).

The maximum CTB that a family can receive is their council tax liability.¹³ Families receiving a means-tested out-of-work benefit – that is, Income Support, income-based Jobseeker's Allowance, income-based Employment and Support Allowance or Pension Credit Guarantee Credit¹⁴ – automatically qualify for maximum CTB. In practice this accounts for around 70% of claimants in Wales.¹⁵ Those who are not 'passported' onto full CTB in this way must undergo a separate means test, which compares the family's income with a centrally determined measure of minimum needs. If the family's income is below their assessed needs, they qualify for maximum CTB; otherwise, their CTB entitlement is reduced by 20p for each £1 of income in excess of their assessed needs. This basic structure is illustrated in Figure 2.3.

¹³ The weekly cost of council tax is worked out as the annual bill divided by the number of days in the year and multiplied by seven. If there is more than one person in the house eligible to pay council tax, the maximum benefit is the *share* of the total bill that each benefit unit is eligible for. So, for example, if there were a married couple and a third person all eligible to pay council tax for a given property, one member of the couple would be entitled to claim up to a two-thirds share of the weekly tax, and the third person could claim a one-third share.

¹⁴ For brief descriptions of these benefits, see W. Jin, P. Levell and D. Phillips (2010), 'A survey of the UK benefit system', IFS Briefing Note no. 13, <u>http://www.ifs.org.uk/bns/bn13.pdf</u>; for full details, see Child Poverty Action Group (2007) 'Welfare benefits and tax credits handbook', London: Child Poverty Action Group.

¹⁵ Source: DWP *Quarterly Statistical Summary*, March 2012 (<u>http://statistics.dwp.gov.uk/asd/asd1/stats_summary/stats_summary_mar12.pdf</u>).

Figure 2.3: An example of CTB entitlement by income



Note: Assumes family lives in a Band B property in an LA with average council tax rate and no single-person discount.

When measuring 'income' for the purposes of the CTB means test:

- Income is measured after deducting income tax and National Insurance contributions;
- Some other social security benefits and tax credits (such as the State Pension, contributory Jobseeker's Allowance and Employment and Support Allowance, Carer's Allowance and tax credits) count as income for the CTB means test, while others (including Child Benefit, Housing Benefit and Disability Living Allowance) do not. The out-of-work benefits listed above do not count as income, though this does not matter under current rules as receipt of those is a passport to maximum CTB entitlement;
- A small amount of earnings is disregarded £25 for lone parents, £20 for those who qualify for certain of the disability premiums listed in Table 2.2, £10 for other couples and £5 for other single people – in all cases increased by £17.10 if the family qualifies for Working Tax Credit;
- Childcare costs of up to £175 per week for one child or £300 for two or more children can be deducted from income if the adults in the family all work 16 or more hours per week;

- Child maintenance received, and the first £15 of spousal maintenance, do not count as income;
- Pension income is included (and half of any pension contributions are deducted); income from other savings is not, but non-pension savings (other than in housing or other physical assets) above £6,000 (£10,000 for pensioners) are assumed to generate income of £1 a week for each £250 of savings (£500 for those aged 60 or over), and savings above £16,000 eliminate entitlement altogether.

'Needs' are expressed as an 'applicable amount', the sum of various allowances and premiums which depend on age, whether single or in a couple, number of children and any disability, as set out in Table 2.2. In most cases this is identical to the level to which out-of-work benefits top up families' income, so claimants start having their CTB withdrawn at the same point that their income is high enough to disqualify them from outof-work benefits. For families with children, CTB starts to be withdrawn at a higher level of income than out-of-work benefits run out, because the applicable amount includes an element equivalent to Child Benefit rates despite Child Benefit not being counted as income in the CTB means test. Since recipients of out-of-work benefits would have low enough income to receive full CTB anyway, 'passporting' them onto full CTB entitlement largely serves to save the administration of a separate assessment, rather than changing the amount to which people are entitled.

Box 2.1. The origins of council tax and Council Tax Benefit

Council tax was introduced in 1993 to replace the community charge ('poll tax'), a tax levied at a flat rate on each individual. The poll tax had itself replaced the long-standing system of domestic rates – a tax proportional to the assessed market rental value of each property – only recently, in 1990 in England and Wales following a one-year trial in Scotland, but widespread resentment of the perceived unfairness of the tax was associated with non-compliance on a scale rarely seen in the UK; the tax became unworkable and the government quickly announced that it would be replaced.¹⁶ Council tax was to some extent a compromise between domestic rates and the poll tax: liabilities were related to property values (albeit less closely than under domestic rates), but some of the 'perperson' character of the poll tax was retained in the form of a 25% discount for single-adult households.

One aspect of the poll tax that proved particularly problematic was that even the poorest people were required to make some contribution. Community Charge Benefit existed to help low-income families with the cost of their poll tax bill, but - unlike rates rebate, its predecessor -Community Charge Benefit was capped at a maximum of 80% of the bill, with the benefit recipient liable for the remainder. This cap was introduced to reflect the government's view that everyone who could vote for, and benefit from, higher local spending should pay something towards its cost. To compensate for the introduction of this 80% cap on support, national Income Support rates were increased by 20% of what the government assessed that a 'standard' poll tax bill should be. But since the actual tax rates set by LAs varied across the country (with most setting rates substantially higher than the 'standard' rate), this did not fully compensate many low-income households for the bills they faced. LAs were thus left trying to collect small amounts of tax from people with very low incomes (often entirely from social security benefits) who were not accustomed to paying it. This proved extremely expensive for LAs as well as unpopular among those affected and the wider population. When council tax was introduced to replace the poll tax, Council Tax Benefit reverted to the previous approach of covering up to 100% of claimants' liabilities.

¹⁶ A. Butler, A. Adonis and T. Travers (1994) 'Failure in British Government: The Politics of the Poll Tax', Oxford: Oxford University Press is an excellent study of the poll tax experience. T. Besley, I. Preston and M. Ridge (1997) 'Fiscal Anarchy in the UK: Modelling Poll Tax Noncompliance', *Journal of Public Economics* vol. 64, pp. 137–152 analyses the determinants of non-payment of poll tax bills.

Personal allowance – single person:	Aged 18–24	56.25ª
	Aged 25–PC age ^b	71.00
	PC age ^b -64	142.70
	Aged 65 or over	161.25
Personal allowance – couple:	Aged 18–PC age ^b	111.45
	Elder one between PC age ^b and 65	217.90
	One or both aged 65 or over	241.65
Dependent child allowance: ^c	(per child)	64.99
Family premium:	(per family with dependent children)	17.40 ^d
Disability-related premiums:	Disabled child (each)	56.63
	Disability: single	30.35
	couple	43.25
	Enhanced disability: ^e child (each)	22.89
	Single	14.80
	couple	21.30
	Severe disability	58.20 ^f
	Carer	32.60 ^f
	ESA support component	34.05
	ESA work-related activity component	28.15

Table 2.2: Council Tax Benefit applicable amounts in 2012–13, £ per week

^a This rate does not apply to lone parents or those on main phase ESA. They receive £71.00, the same rate as single people aged 25–59, even if they are aged under 25.

^b The qualifying age for Pension Credit, which is in the process of increasing in line with the female State Pension age and will be between 61 and 61½ during 2012–13.

^c An individual is classed as a child until the September following their 16th birthday (or until their 20th birthday if they are in full-time, non-advanced education). ^d An additional £4.80 premium is payable to lone parents who have been lone

parents and claiming the addition since April 1998.

^e The enhanced disability premium is payable where the claimant or a family member receives the highest rate of Disability Living Allowance (care component) and is below the qualifying age for Pension Credit, or if an adult qualifies for the support component of Employment and Support Allowance.

This amount is doubled if both partners qualify.

'Non-dependant deductions' reduce the householder's CTB to take account of incomes of other adult residents of the household who are assumed to make a contribution towards the bill. No deductions are made in respect of residents who share liability for the council tax bill (see p.11) or who pay rent to the householder on a commercial basis: typically, non-dependant deductions are made in respect of adult children or elderly relatives living with a home-owner. In 2012–13 the deduction is £3.30 per week for each non-dependant (or non-dependant couple), but is higher for nondependants who are in full-time paid work and have an income of £183 or more per week.¹⁷ No deductions are made in respect of non-dependants who are ignored for council tax purposes (see p. 5) or who are receiving an out-of-work benefit, since they are assumed not to contribute towards the bill.

Second adult rebate

Second adult rebate (SAR) is an alternative to the 'main' CTB: a claimant who is entitled to both receives whichever is larger. SAR is payable where only one person is liable for a household's council tax bill (see above) and there is a low-income non-dependant ('second adult') living in the household. A non-dependant for this purpose is defined as for nondependant deductions (see above), and so excludes anyone paying rent as well as anyone jointly liable for the council tax bill. SAR reduces the household's council tax bill by 25% - irrespective of the income of the council tax payer - if the second adult is on Income Support, income-based Jobseeker's Allowance, income-related Employment and Support Allowance or Pension Credit, and is reduced as the second adult's income rises, to the point where it disappears if the second adult has gross weekly income of £235 or more. The logic behind SAR is that a low-income second adult could not be expected to contribute to the council tax bill, so the liable person should receive a 25% discount as if he or she were the only resident, with this discount removed as the second adult becomes more able to contribute.¹⁸ Without SAR, people would have a disincentive to let a low-income non-dependant live in the household, as they could lose their 25% single-person discount by doing so. In practice, SAR is received by far

¹⁷ The deduction is £6.55 if the non-dependant's income is £183–£315.99, £8.25 if their income is £316–£393.99 and £9.90 if their income is £394 or more.

¹⁸ This logic is not quite consistent, however: an owner-occupier is eligible for SAR if he or she lives with both a commercial lodger and a low-income non-dependant, even though the owner-occupier would not receive the 25% single person discount for council tax if the low-income non-dependant were not resident.

fewer people than main CTB – only 40,000 in the whole of Great Britain in $2006\text{--}07.^{19}$

Income Support (and other benefits such as income-based Jobseeker's Allowance and Pension Credit Guarantee) aims to provide a national minimum income for all. CTB aims to ensure that this minimum income is maintained even after council tax has been paid.²⁰ The reason that council tax is the only UK tax with a specific benefit attached to it is that it is the only significant tax that varies locally. Poor households cannot be easily compensated for local variations in tax through nationally uniform benefits: without CTB, we would observe variations in the incomes of the poorest across LAs. While it may be argued that those whose LAs spend more receive more benefits in terms of local services, particular local services provided may not benefit a particular CTB claimant or reduce his or her need for disposable income.

2.3. The distributional impact of Council Tax Benefit

In this sub-section, we examine who is entitled to CTB, who claims their entitlements to CTB and the impact of CTB on the distribution of income.²¹

Comparing Wales with the other nations of Great Britain and the regions of England, we can see that entitlement rates to CTB are higher in Wales than in Scotland or England (Figure 2.4). This is unsurprising as Wales is the poorest of the three nations.²² Wales has a similar level of entitlement to CTB to some of the poorer parts of England such as the North West of England, Yorkshire and the West Midlands. However, take-up of CTB in Wales is relatively low: the proportion of families actually receiving CTB is lower than that in Scotland, despite the proportion of households entitled to CTB being higher in Wales than in Scotland.

In order to look at the distribution of entitlements and receipt of CTB within Wales, in the remainder of this section we pool three years of data

¹⁹ Source: DWP, *Income Related Benefits: Estimates of Take-Up in 2006–07* (<u>http://statistics.dwp.gov.uk/asd/income_analysis/jun_2008/0607_Publication.pdf</u>). Later versions of this publication do not include second adult rebate.

²⁰ Housing benefit similarly seeks to ensure that the same minimum income is available after rent has been paid.

²¹ In this and the following section, as well as calculating entitlements to CTB using the IFS tax and benefit microsimulation model, TAXBEN, we also allow for non-take-up of CTB using information on who is actually claiming CTB in our FRS data.

²² This is true on a variety of measures, such as average household net income and gross value added per household.

from the Family Resources Survey to ensure that our sample of families in Wales is large enough to conduct robust analysis.

Figure 2.4: Proportion of households entitled to, and receiving CTB by region of England and nation of Great Britain, 2012-13



Source: Authors' calculations using TAXBEN run on the 2009–10 Family Resources Survey.

Figure 2.5 shows how the distribution of entitlements and receipt of CTB within Wales varies according to the Index of Multiple Deprivation, measured at the LA level.²³ It shows the proportion of families entitled to, and the proportion receiving, CTB by quintile of the IMD (i.e. the left-hand bar contains all those living in the most-deprived fifth of LAs in Wales). As we would expect, a higher proportion of people are receiving CTB in more deprived areas, though there is no clear trend in the take-up rate across the distribution of the IMD.

²³ The IMD gives a summary measure of several different aspects of deprivation. The most recent data for Wales is from 2011. There are some families in our data who are not entitled to CTB at the time they were surveyed but are entitled under the current (2012–13) system. We randomly assign non-take-up to some of these families in such a way that the take-up rate is the same as in 2009–10. Our analysis suggests that some households in our FRS data do not declare the CTB they receive in the survey, as our results imply that the take-up rate in Wales in 2009–10 was around 56%, which compares with DWP estimates for Great Britain as a whole of between 62% and 69%.



Figure 2.5: Proportion of families receiving, and entitled to CTB in Wales by IMD quintile of local authority, 2012–13

Notes: IMD quintiles are derived by dividing local authorities in England into 5 equalsized groups according to their overall IMD score. Quintile group 1 contains the leastdeprived fifth of local authorities in each country, quintile group 2 the second leastdeprived, and so on up to quintile group 5, which contains the most-deprived fifth. Source: Authors' calculations using TAXBEN run on uprated Family Resources Survey data from 2007–08 to 2009–10.

Figure 2.6 shows gross council tax liability as a proportion of income in Wales by income decile group, and how this is altered when CTB is taken into account, under the assumptions of full take-up, and using observed take-up behaviour in our data. As we would expect, higher-income households have higher council tax liabilities as they tend to live in highervalue properties. But council tax represents a larger share of income for low-income families than for those on higher incomes, at least in part because council tax is set at a higher proportion of property values for low-value properties than for high-value properties. As Figure 2.6 below shows, the existence of CTB significantly reduces the burden of council tax for low-income families, though this impact is undermined by the high level of non take-up of CTB. Take-up of CTB is lower in the lower income deciles: receipt of CTB is only around half of entitlement for the two lowest income deciles compared to 67% and 63% respectively for the next two income deciles - though this is partly because not taking up their CTB entitlements is what leads some families to be in a lower income decile than they otherwise would. If everyone took up their CTB entitlements, net council tax would be a lower percentage of income for poorer households than for middle-income households. Given actual patterns of take-up, net council tax bills remain regressive across the whole of the income distribution, albeit much less so than gross council tax.



Figure 2.6: Council tax liability and CTB entitlement in Wales, by income decile group

Notes: Income decile groups are derived by dividing families in Wales into 10 equalsized groups according to income adjusted for family size using the McClements equivalence scale. Decile group 1 contains the poorest tenth of the population, decile group 2 the second poorest, and so on up to decile group 10, which contains the richest tenth.

Source: Authors' calculations using TAXBEN run on uprated Family Resources Survey data from 2007–08 to 2009–10.

Figure 2.7 shows the proportion of households who are receiving CTB, entitled to CTB, and not entitled to CTB, by income decile within Wales. It also shows that a small number of households are not liable for council tax; these are predominantly students, and are found mainly in the bottom income decile. Around a third of households are entitled to CTB; as we would expect, this figure is higher at lower income levels, though there are households in the top half of the income distribution – mainly pensioners – who are entitled.²⁴ The proportion of households actually receiving CTB is

²⁴ Entitlement to CTB extends much further up the income distribution among pensioners than those of working age because of their much higher allowances, as shown in Table 2.2. The allowances are high so that CTB does not start to be withdrawn until entitlement to the Savings Credit component of Pension Credit is exhausted.

also higher among lower-income households, despite the fact that their take-up rates are lower: in our data nearly half of those in the lowest income decile who are entitled to CTB are not receiving it.²⁵ (Indeed, as mentioned above, one of the reasons some households are in the bottom income decile in this analysis is because they do not claim the CTB to which they are entitled.²⁶)



Figure 2.7: Proportion of households in Wales entitled to, and receiving, CTB by income decile

Notes and sources: As for Figure 2.6.

We may also be interested in the number of claimants in each council tax band in Wales. In Figure 2.8, we show the number of households entitled to and receiving CTB according to their council tax band. The highest levels of entitlement are in the lower-value bands, as we would expect, though there are households in all bands who have some entitlement: these are households with high levels of housing wealth but low current income. However, households in higher council tax bands are much less likely to take up their entitlement to CTB: the proportion of households entitled to

²⁵ Note, however, that the 59% take-up rate shown in Figure 2.7 for all households is lower than the DWP estimates cited above, which are based on administrative data on CTB actually paid rather than self-reported receipt.

²⁶ It is also possible that some households do not report all of their private income in the Family Resources Survey. In this case they may be wrongly placed in the bottom income decile and their CTB entitlement may be wrongly calculated.

but not receiving CTB is roughly the same in each council tax band despite the higher levels of entitlement among those in lower bands.



Figure 2.8: Proportion of households in Wales entitled to, and receiving, CTB by council tax band

Source: Authors' calculations using TAXBEN run on uprated Family Resources Survey data from 2007–08 to 2009–10.

Table 2.3 shows the characteristics of CTB recipients according to the type of household they live in. The top panel shows a split by detailed household type according to whether the family living there includes a single adult or a couple and whether they are working, have dependent children, or at least one person is over State Pension age. Households containing more than one family unit are shown separately (a 'family' here - strictly, a 'benefit unit' - means an individual, their partner if they have one, and any dependent children; multi-family households therefore include households where people live with their adult children, elderly relatives or flatmates, for example). We can see that, for example, more than a quarter of CTB goes to single pensioners living alone. Pensioner couples are much less likely to take up their entitlements. The highest rates of entitlement are found among non-working families of working age - single people, lone parents and couples with children (though interestingly not couples without children, who are frequently people who have taken early retirement with generous pensions) - and these groups are also the most likely to take up their entitlements, with over 80% of them doing so, so overall they are much more likely than other groups to be receiving CTB. So although these three groups (i.e. single people, lone parents and couples with children who are not in paid work) are small, together making up only 11% of households, they account for more than 40% of CTB expenditure in Wales.

The bottom half of the table divides households into broader categories, revealing the following:

- Non-working households are 13 times as likely to be receiving CTB as working households. Non-working households are twice as likely as working households to claim CTB if they are entitled to it.
- 40% of total CTB spending goes to households containing someone above the State Pension age.
- More than half of all CTB is paid to households where an adult is claiming a disability-related benefit (Disability Living Allowance, Attendance Allowance, Severe Disablement Allowance, Incapacity Benefit, Income Support with a disability premium, or Employment and Support Allowance). This figure would be even higher if it included those with a disabled child in the household.
- Only a quarter of owner-occupiers are entitled to CTB, and of those who are entitled less than half take it up. In contrast, nearly three-quarters of those in social rented housing are entitled to CTB, and of those more than 80% claim their entitlement.

		% who are			
<i>c</i>		Entitled	Not	% of CTB	% of
Group	Receiving	but not	entitled	expenditure	households
	CIB	receiving	to CTB		
Single, not working	65%	13%	23%	17%	5%
Single, working	3%	5%	91%	1%	8%
Lone parent, not working	86%	7%	7%	15%	3%
Lone parent, in work	10%	18%	72%	1%	3%
0-earner couple, no children	33%	13%	54%	5%	3%
0-earner couple, children	84%	13%	3%	9%	2%
1-earner couple, no children	2%	12%	87%	0%	5%
1-earner couple, children	6%	24%	69%	1%	5%
2-earner couple, no children	1%	1%	98%	1%	11%
2-earner couple, children	0%	1%	99%	0%	11%
Single pensioner	33%	27%	40%	24%	16%
Couple pensioner	17%	23%	61%	12%	12%
Multi-family household, no					
children	14%	18%	68%	8%	11%
Multi-family household with					
children	15%	15%	70%	4%	5%
With someone working	3%	9%	88%	8%	59%
With no-one working	42%	22%	36%	92%	41%
When no one working	12 /0	LL /0	5070	5270	1170
With children	19%	11%	70%	31%	29%
Without children	19%	16%	65%	69%	71%
Containing a pensioner	26%	26%	48%	40%	31%
Not containing a pensioner	16%	9%	75%	60%	69%
Containing an adult receiving	4.504	4.004	2.60/	570/	220/
a disability benefit	46%	18%	36%	57%	23%
Not containing an adult	110/	120/	760/	120/	770/
receiving a disability beliefft	1170	1570	7070	45%	1170
Owner-occupiers	9%	15%	76%	35%	73%
Private renters	27%	13%	59%	18%	11%
Social renters	61%	12%	27%	48%	16%
All	19%	14%	67%	100%	100%

Table 2.3: Characteristics of CTB recipients in Wales, 2012–13

Source: Authors' calculations using TAXBEN run on uprated Family Resources Survey data from 2007–08 to 2009–10.

2.4. Weaknesses of Council Tax Benefit

2.4.1. Complexity and non take-up

As with other means-tested benefits, CTB is criticised because its complexity and the stigma attached to it mean that many potential

beneficiaries either do not know that they are entitled or are unwilling to claim it: as we have seen, around a third of eligible families appear not to claim their entitlement.

If the hassle and stigma of claiming are enough to put people off, we can infer that some people who do claim nevertheless suffer from the time, effort and other psychological costs involved in doing so, offsetting part of the financial benefit they get in return.

But a major reason for non take-up is that people do not know they are entitled. This might be a particular problem for take-up among those in paid work, for example, which is especially low: Turley and Thomas (2006) found that many people simply did not know that CTB was available to people in work. Take-up also appears to be lower among pensioners than those of working age, which may similarly reflect a lack of awareness of CTB: many pensioners will never have been eligible for a means-tested benefit before hitting State Pension age.

2.4.2. The impact of Council Tax Benefit on work incentives

As with all means-tested benefits, CTB affects individuals' work incentives. We can distinguish between two aspects of financial work incentives: the incentive to be in paid work at all and the incentive for those in work to earn a little more. We measure the incentive to be in paid work at all by the participation tax rate (PTR), the proportion of total earnings taken in tax and withdrawn benefits. For those in work, we measure the incentive to increase earnings slightly by the effective marginal tax rate (EMTR), the proportion of a small increase in earnings taken in tax and withdrawn benefits. In both cases, higher numbers mean weaker incentives. Appendix A explains in more detail how we calculate these effective tax rates.

CTB weakens both the incentive to be in paid work and the incentive for those in work to increase their earnings. It weakens the incentive for individuals to undertake paid work as they see some of their earnings lost to reduced entitlement to support for council tax. And it also weakens the incentive for some of those who are in paid work (namely, those on the CTB taper) to increase their earnings, as each additional pound of earnings reduces their entitlement to CTB by 20p.

Figure 2.9 shows the relationship between hours worked and net income – the 'budget constraint' – for one example low-wage lone parent. The uppermost (black) component shows CTB entitlement. If the lone parent is not working, this lone parent has their full council tax liability of £15.77 per week covered by CTB. If the lone parent works 16 hours or more per week, their income is high enough for the CTB to start being withdrawn, and their entitlement is exhausted at just under 30 hours per week. This

illustrates how CTB weakens work incentives in both respects. CTB adds more to a lone parent's income if they are out of work than if they work 16 to 30 hours per week. CTB adds nothing at all if the lone parent works 30 hours or more per week. Therefore, with this example, CTB weakens the incentive for this lone parent to take paid work. If this lone parent is on the CTB 'taper' between 16 and 30 hours per week, additional earnings reduce their CTB entitlement, so the budget constraint is flatter than it would be without the CTB component.



Figure 2.9: Composition of an example budget constraint in 2012–13

Notes: Example is for a lone parent, with two children aged between 1 and 4, earning $\pounds 6.50$ per hour, with no other private income, no childcare costs and no disabled family members, paying $\pounds 80$ per week in rent to live in a council tax Band B property in a local authority setting council tax rates at the national average. 'Net earnings less council tax' means earnings after deducting income tax, employee NICs and council tax. Figure does not show negative amounts for 'net earnings less council tax' on the left-hand side where council tax exceeds net earnings: with zero earnings, 'net earnings less council tax' is - $\pounds 15.77$, with Child Benefit making up the difference from what is shown. Source: Authors' calculations using TAXBEN.

But Figure 2.9 is just one example. To show how CTB affects incentives to be in paid work across the whole population of Wales who are of working age, Table 2.4 shows the mean and various percentile points of the distribution of PTRs for different types of individual, and how these are affected by CTB.²⁷ For each statistic, the table shows its value in 2012–13,

²⁷ The percentiles of the distribution of PTRs give the PTR of the person who has a higher PTR than the given percentage of the population. For example, the tenth

and the impact CTB has on it: so, for example, the mean PTR among all working-age adults in Wales is 37.3%, 1.4 percentage points higher than it would be without CTB. Although this average effect on PTRs is quite small - an increase of just 1.4 percentage points - we can see that CTB particularly weakens work incentives for those with the weakest incentives to do paid work. CTB raises the 90th percentile of PTRs by 3.6 percentage points: one in ten working-age adults in Wales has a PTR in excess of 70.9%, whereas in the absence of CTB one in ten would have a PTR in excess of 64.4%. Lone parents and those with non-working partners have the weakest financial incentives to be in paid work, and see their PTRs increased most by CTB. The table also shows the number of people who see their PTR increased by CTB. In total around 36% of the working-age population see their incentive to do paid work weakened by the existence of CTB. This is larger than the proportion claiming CTB as many of those who are in paid work and are not currently entitled to CTB would be entitled if they left paid work. However, a considerable number of those currently in paid work would still not be entitled to CTB if they left work. These are mainly those whose partner is in paid work, but also those with considerable unearned income: in both cases, the family income of such individuals would be sufficiently high to mean that they were not entitled to CTB even if they were not in paid work themselves.

percentile is the PTR of the person who has a higher PTR than 10% of the population and a lower PTR than the remaining 90%.

		Percentile point of distribution of PTRs											% with higher
	10t	h	25t	h	501	th	75t	h	90t	h			PTR
Single, no children	6.4%	+0.1	28.1%	+0.8	37.6%	+0.9	51.2%	+2.2	66.7%	+4.0	39.1%	+1.4	38%
Lone parent	22.7%	+1.4	41.3%	+5.0	55.3%	+3.6	64.7%	+3.0	71.7%	+3.2	51.3%	+3.7	83%
Couple with children, partner in paid work	11.6%	+0.5	22.4%	+0.3	35.0%	+0.8	45.6%	+1.9	56.3%	+1.6	34.3%	+0.8	28%
Couple with children, partner not in paid work	38.3%	+3.6	53.5%	+3.6	69.5%	+3.6	78.0%	+4.2	90.9%	+4.8	67.2%	+3.3	83%
Couple, no children, partner in paid work	9.3%	+0.3	17.7%	+0.3	22.3%	+0.2	27.5%	+0.3	38.0%	+1.2	23.2%	+0.4	11%
Couple no children, partner not in paid													
work	19.8%	+2.6	28.9%	+1.2	42.9%	+1.9	61.2%	+3.5	75.3%	+4.8	44.3%	+2.5	58%
All	11.3%	+0.5	22.0%	+0.3	35.0%	+0.7	50.1%	+2.1	67.7%	+4.1	37.1%	+1.3	36%

Table 2.4: Impact of CTB on the distribution of participation tax rates in Wales, 2012–13

Notes: Excludes employer NICs and indirect taxes and most 'business taxes' (notably corporation tax and business rates) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Excludes those over State Pension age.

Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated Family Resources Survey data from 2007–08 to 2009–10.

Figure 2.10 shows how the impact of CTB on the PTRs of those of working age in Wales varies by annual earnings (note that this again includes those not currently in paid work, at their predicted level of earnings were they to enter paid work). The impact is low at very low levels of earnings as CTB only starts to be withdrawn when income exceeds a certain level, but it peaks at an annual earnings level of around £10,000. Beyond this level, the impact of CTB declines as the CTB lost on entering paid work becomes gradually smaller as a percentage of earnings.



Figure 2.10: Impact of CTB on average PTR by earnings level in Wales, 2012–13

Notes: Excludes employer NICs and indirect taxes and most 'business taxes' (notably corporation tax and business rates) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Excludes those over State Pension age. Non-parametric (lowess) regression estimates for PTRs.

Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated Family Resources Survey data from 2007–08 to 2009–10.

Table 2.5 shows the mean EMTR in Wales among different groups of individuals in paid work, and the impact that CTB has on this.²⁸ It also shows the proportion of each group that is on the CTB taper and thus has a higher EMTR than they would do in the absence of CTB. The withdrawal of CTB contributes to the very high EMTRs faced by low earning groups, in

²⁸ We do not show the impact of CTB on different points of the distribution: since large numbers of people have the same EMTR (for example, all employees who are contracted in to the second State Pension, are basic rate taxpayers and are not entitled to any means-tested benefits or tax credits have an EMTR of 32%), changing the EMTRs of the relatively small number of people on the CTB taper does not change the various percentile points of the distribution of EMTRs.

particular lone parents and those in couples with children whose partner is not in paid work.

	Mean E	MTR	Proportion on CTB taper			
Single, no children	32.5%	+0.5	3%			
Lone parent	63.1%	+2.7	16%			
Two-earner couple with children	36.8%	+0.0	<1%			
Single-earner couple with children	57.2%	+2.7	26%			
Two-earner couple without children	29.9%	+0.0	<1%			
Single-earner couple without children	41.0%	+0.9	9%			
All	36.1%	+0.5	4%			

Table 2.5: Impact of CTB on EMTRs of those in paid work in Wales, 2012–13

Notes: Excludes employer NICs and indirect taxes and most 'business taxes' (notably corporation tax and business rates) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Excludes those over State Pension age.

Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated Family Resources Survey data from 2007–08 to 2009–10.

Figure 2.11 shows how the impact of CTB on the EMTRs of people in paid work in Wales varies by annual earnings. The average effect of CTB on EMTRs for the working population as a whole is highest at the lowest levels of income and declines steadily at higher income levels until it is virtually zero by an annual income level of £35,000. This partly reflects the fact that there are simply far more CTB claimants at low levels of earnings. Among just those workers who are on CTB, the figure shows an impact on EMTRs peaking at annual earnings of between £4,000 and £10,000. This is because at the lowest income levels most claimants are receiving full CTB, which does not affect their EMTR. As incomes rise, more claimants are on the taper, and therefore have their EMTR increased by CTB. And then as income rises further, being on the taper adds less to people's EMTR as they are more likely to be paying income tax, facing tax credit withdrawal, etc.



Figure 2.11: Impact of CTB on average EMTR in Wales by earnings level, 2012–13

Notes: Excludes employer NICs and indirect taxes and most 'business taxes' (notably corporation tax and business rates) and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Excludes those over State Pension age and those not in paid work. Non-parametric (lowess) regression estimates for EMTRs.

Source: Authors' calculations using the IFS tax and benefit microsimulation model, TAXBEN, run on uprated Family Resources Survey data from 2007–08 to 2009–10.

The effect of CTB in weakening work incentives can be exacerbated by the complexity alluded to above: since many out-of-work families are unaware that they could continue to claim CTB if they moved into low-paid work,²⁹ people might be discouraged from working by a perception of lost entitlements that exceeds the reality. One of the reasons that the government has decided to integrate all the other existing means-tested benefits and tax credits into Universal Credit is to reduce these misconceptions about how the benefits system works: having a single payment with simpler rules should mean that more people understand how their benefit entitlements will change if they enter paid work or increase their earnings. In section 4.9, and more fully in section 7 of Adam and Browne (op. cit.), we discuss the implications of not including CTB within this integration.

²⁹ C. Turley and A. Thomas (2006), 'Housing Benefit and Council Tax Benefit as In-Work Benefits: Claimants' and Advisors' Knowledge, Attitudes and Experiences', Department for Work and Pensions Research Report 383, Leeds: CDS (http://research.dwp.gov.uk/asd/asd5/rports2005-2006/rrep383.pdf).

2.4.3. Incentives to save

Certain forms of savings reduce or eliminate families' entitlement to CTB, as set out in section 2.2 – another feature it shares with other means-tested benefits.

The rationale for this is that we might think that people with substantial assets are not really 'poor' and do not need support even if they have low income in the current week or year. Consistent with this, while pension income and non-pension financial assets reduce CTB entitlement, forms of savings that are difficult to access – accrued pension rights, owner-occupied housing and other physical assets – do not, reflecting the fact that people with these forms of wealth may still have difficulty finding the cash to pay their council tax bill.

However, means-testing CTB against people's savings (or their income from savings) undoubtedly discourages saving to some extent among those who think they might be on CTB in future. By discouraging saving, it also discourages work in so far as people work to earn money for the future rather than to spend today (note that this effect is not included in the analysis of work incentives in the previous sub-section as it is difficult to quantify). Moreover, it is not just a general disincentive to save (and work): the particular way in which savings are treated discourages saving to different degrees for different assets, amounts and timings, which distorts the form and timing of saving:

- a) Owner-occupied housing is completely disregarded for the CTB means test, so saving by buying a (more expensive) property, or paying down a mortgage, is not discouraged at all (and indeed living in a more expensive property whether owned or rented is actively encouraged, as discussed in the next sub-section).
- b) The first £6,000 (£10,000 for pensioners) of non-pension financial saving is also disregarded. But having savings above this threshold is quite strongly discouraged by the asset test. Each £250 (£500 for pensioners) of assets above the threshold is assumed to yield £1 a week of income, an imputed annual interest rate of 23.1% (10.9% for pensioners). And by far the biggest disincentive is to cross the £16,000 ceiling, since crossing that threshold means that savings, rather than reducing weekly entitlement by at most £8,³⁰ or £2.40 for pensioners, eliminates it completely. Of course, once above the

³⁰ 20% x ((£16,000 – £6,000)/£250) = £8. For pensioners, 20% x ((£16,000 – £10,000)/£500) = £2.40.

£16,000 threshold there is zero CTB entitlement so further saving is not discouraged.

c) Pension *income* is counted in full, so pension saving is discouraged for those who expect to be on CTB when the pension is in payment; but pension *assets/rights* are ignored completely, so pension saving is not discouraged at all for those who expect to be on CTB only before the pension is in payment.³¹

There is also an incentive to make pension contributions while on the CTB taper (rather than saving in other forms, at other times, or not at all), as assessed income is reduced by half the value of contribution (so CTB entitlement increases by 10% of any pension contribution for those facing 20% withdrawal) – though it seems doubtful that many people change their behaviour in order to take advantage of this, as people generally claim CTB at times when their income is low, when we would expect them to be less likely to be contributing to a pension.

CTB is far from the only mean-tested benefit that affects saving incentives, and is probably not the most important: Pension Credit, for example, is likely to be a bigger influence on people's saving decisions. Nevertheless, the incentives described above are real. Discouraging saving is not an aim that most policy-makers would openly espouse, though the desirability of asset tests in means-tested benefits is a hotly debated issue in the economics literature.³² But distorting the form in which people save in this arbitrary and peculiar way seems particularly undesirable.

2.4.4. Incentives to live in bigger properties

CTB creates an artificial incentive for low-income families to live in bigger properties than they would otherwise choose, since part of the cost of

³¹ There is also an incentive to defer taking the pension if one is on CTB at the time, and to start taking it as soon as possible if one expects to be on CTB later. And when using a pension pot to buy an annuity, there is an incentive to buy an annuity that is fixed in cash terms if one expects to be on CTB late on in retirement, and an incentive to buy an annuity that starts lower but then increases if one expects to be on CTB early in retirement.

³² M. Golosov and A. Tsyvinski (2006), 'Designing Optimal Disability Insurance: A Case for Asset Testing', *Journal of Political Economy*, vol. 114, pp.257–79, make the case for asset tests in the context of disability benefits; this is brought within a broader analysis of the appropriate taxation of savings by J. Banks and P. Diamond (2010), 'The Base for Direct Taxation', in J. Mirrlees et al (eds.), *Dimensions of Tax Design: The Mirrlees Review*, Oxford University Press for the Institute for Fiscal Studies and by J. Mirrlees et al. (2011), *Tax by Design: The Mirrlees Review*, Oxford University Press for the Institute for Fiscal Studies (both available at <u>http://www.ifs.org.uk/mirrleesReview</u>).

upsizing – a bigger council tax bill – is covered by the government. Otherwise put, it incentivises inefficient use of the housing stock and inefficient consumption patterns, with poorer people living in bigger houses and consuming less of other goods and services (and so richer people living in smaller houses and consuming more of other goods and services) than they otherwise would.

While the incentive is undoubtedly there, it is difficult to know how big an effect it has on people's behaviour in practice. But to say that it has some effect is just to say that the price of housing affects how much housing people consume – it would be surprising if this were not true to some extent, and indeed there is some empirical evidence that this effect is significant.³³

2.4.5. Local accountability and LAs' incentives

Broadly speaking, council tax (and local government finance generally) is structured so that an LA that wishes to spend an extra £1 must raise an extra £1 from local taxpayers. This ought to give LAs appropriate incentives overall when they are held to account at the ballot box (though if people do not realise that council tax accounts for only 16% of LAs' income, they may feel aggrieved that a 1% increase in local spending requires a 6% increase in council tax).³⁴

However, the way CTB is funded means that it is not quite true that an extra £1 of spending requires an extra £1 from local taxpayers. Since CTB is refunded by central government, spending an extra £1 on public services costs local residents less than £1: part of the council tax revenue received by the LA comes from taxpayers in the rest of the UK rather than from local taxpayers. LAs therefore have an incentive to spend slightly more than is optimal from the point of view of society as a whole. This problem is bigger the more CTB claimants there are in that area. To take this argument to its extreme, we can imagine an LA in which all residents are receiving CTB. In that case the LA could increase council tax rates indefinitely with impunity as it would cost local residents nothing: it

³³ See, for example, J.F. Ermisch (1996), 'The Demand for Housing in Britain and Population Ageing: Microeconometric Evidence', *Economica*, vol. 63, pp.383–404, and J.F. Ermisch, J. Findlay and C. Gibb (1996), 'The Price Elasticity of Housing Demand in Britain: Issues of Sample Selection', *Journal of Housing Economics*, vol. 5(1), pp.64–86.

³⁴ Note too that the extra money must come entirely from council tax, which bears particularly heavily on those groups (such as pensioners) with high property values relative to their incomes and hence limits LAs' willingness to increase expenditure.

would simply be a way for the council to extract money from central government to spend on local services.³⁵

Equally, CTB recipients have an incentive to press/vote for increases in spending on local services and no incentive to hold their elected local officials to account for wasteful spending, since additional spending costs them nothing personally.

2.5. Conclusions

CTB provides valuable support to 328,000 recipients in Wales, more than any other means-tested benefit or tax credit. But there are costs to providing this support, beyond the £238 million of Exchequer funds paid out to claimants. CTB reaches only about two-thirds of those for whom it is intended, as many are not aware they are entitled or find it too difficult or stigmatising to claim. It discourages work and saving, and provides recipients with an incentive to live in bigger properties than they otherwise would. And it distorts recipients' and LAs' decisions over the appropriate levels of council tax and spending.

3. The proposed reforms

The October 2010 Spending Review announced that 'The Government will reduce spending on Council Tax Benefit by 10% and localise it from 2013–14 while protecting the most vulnerable'.³⁶

Little more was announced about this policy in the subsequent nine months – a delay described as 'regrettable' by the Communities and Local Government Select Committee.³⁷ The UK Government then issued a

³⁵ In 1999–2000 the then Labour government introduced the Council Tax Benefit Subsidy Limitation Scheme to try to limit this problem. Under the scheme, LAs that introduced council tax rises deemed excessive by central government would have only part of the resulting extra CTB expenditure refunded by central government, leaving the LA to meet the remaining additional cost itself. In practice the scheme became enormously complicated and beset by anomalies, and it was abolished from 2002–03. For brief details see <u>http://www.cipfa.org.uk/pt/pt_details_l.cfm?news_id=5189</u> and <u>http://www.cipfa.org.uk/members/spreadsheet/feb02/news_details_feb02.cfm?news_id=11954</u>.

³⁶ HM Treasury (2010), *Spending Review 2010*, Cm 7942, London: TSO (<u>http://cdn.hm-treasury.gov.uk/sr2010_completereport.pdf</u>), paragraph 2.42.

³⁷ Communities and Local Government Committee (2011), *Localisation Issues in Welfare Reform: Fifth Report of Session 2010–12*, HC 1406, London: TSO (http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcomloc/1406/1406 .pdf), paragraph 56.

consultation document on the policy in August 2011 and a response to the outcome of the consultation in December 2011. Three days later, the UK Government introduced the Local Government Finance Bill, which at the time of writing is making its way through Parliament, and an impact assessment.³⁸ Together these have gradually fleshed out what the reform will entail.

From April 2013, CTB will cease to exist across Great Britain. In England, LAs will be given grants and required to make their own arrangements for rebating council tax to low-income families as they see fit. The only restriction is that LAs in England are obliged to give pensioners the same support as they are entitled to under the current CTB system: pensioners' entitlements will continue to be set nationally.³⁹ In Wales and Scotland, the devolved governments will receive an increase in their block grant (the general, non-ringfenced funding they receive to cover their expenditure) and can make their own decisions about what should replace CTB, without the requirement to protect pensioners that is being imposed on English LAs.⁴⁰ The total value of the grants to the devolved governments and English LAs will be only 90% of forecast spending under the current CTB system, which is expected to save the UK Government £480 million per year across Britain.^{41, 42} Note that the two aspects of this reform, namely

<u>http://www.communities.gov.uk/publications/localgovernment/lgfblocalisingcouncilta</u> <u>x</u>.

³⁹ 'Pensioners' here means those (both men and women) over the female State Pension age, which is also the qualifying age for Pension Credit. That age threshold is in the process of rising gradually from 60 in April 2010 to 66 in April 2020; in April 2013, when the reform to council tax support comes into effect, it will be 61 years and 6 months.

⁴⁰ CTB as such does not exist in Northern Ireland, but the UK government's funding of domestic rates rebates will be replaced by a new grant in much the same way.

⁴¹ This figure is based on the Department for Work and Pensions' latest estimate of spending on council tax support in 2013–14, which excludes Northern Ireland. Spending on rates rebates in Northern Ireland is around £130 million, which would imply further savings of £13 million.

⁴² Throughout this report we assume that grants will be 90% of CTB spending in each of England, Scotland, Wales and Northern Ireland individually. At the time of writing, no definitive announcement has been made on this. In particular, it is not clear whether the new grant falls within the scope of the 'Barnett formula' for allocating spending increases between the nations of the UK. If it did, that would imply a rather different

³⁸ These documents can be found at

<u>http://www.communities.gov.uk/publications/localgovernment/localisingcounciltaxco</u> <u>nsult</u>,

<u>http://www.communities.gov.uk/publications/localgovernment/localisingtaxresponse,</u> <u>http://services.parliament.uk/bills/2010-11/localgovernmentfinance/documents.html</u> and

localisation and cuts, are quite distinct. Either could have been done without the other. The UK Government could have made cuts to the existing CTB system at the UK level, or could have localised responsibility for council tax support and given the Scottish and Welsh Governments and English LAs the full amount that would have been spent under the current CTB system.

English LAs and the Scottish and Welsh Governments do not have the legal authority to introduce social security benefits; the schemes they run must therefore be council tax reductions (rebates or discounts) rather than benefits. Whether CTB itself is a tax rebate or a social security benefit is debatable: it has characteristics of both. Its name suggests it is a benefit; claimants must apply for it like a benefit; and it provides support to those with low family (as opposed to individual) income and high needs, as means-tested benefits do. On the other hand, entitlements are related to (and can never exceed) the council tax bill households face; claimants experience it as a requirement to pay less (or no) council tax, rather than receiving a cash benefit payment, which they can use to pay their council tax; and in the public finances it counts as a reduction in tax receipts, not as net expenditure.⁴³ But under the current system this is essentially a matter of semantics, whereas the fact that the new schemes must be council tax rebates rather than benefits will have practical consequences in restricting how schemes can be designed: for example, schemes cannot give claimants more in support than their total council tax bill.

English LAs and the Scottish and Welsh Governments could choose to spend more on council tax support than the funding they are given for that purpose – for example, to maintain support at existing levels for all

distribution of grant, with the Scottish and Welsh Governments and the Northern Ireland Executive receiving the same cash grant per head of population as in England irrespective of CTB spending – a distribution that would be more favourable to Scotland in particular than receiving 90% of CTB spending there, since (as we saw in section 2) Scotland's low average Band D rate means that it has lower CTB spending per person than the rest of the UK. However, while the technical position is unclear, all the policy documents so far released by the UK, Scottish and Welsh governments are written on the basis that the grant will be 90% of CTB spending in each nation rather than equal per-person grants, so we proceed on that basis.

⁴³ In fact in the public finances it is counted both as a reduction in tax receipts (the CTB figure in Table 4.7 of Office for Budget Responsibility (OBR) (2012), 'Economic and fiscal outlook: March 2012', Cm 8303, London: TSO,

<u>http://budgetresponsibility.independent.gov.uk/economic-and-fiscal-outlook-march-2012/</u> is after deducting CTB) *and* as a social security benefit (ibid., Table 4.17); but it is then deducted from LAs' spending ('locally financed current expenditure' in Table 4.17 is after deducting CTB from the council tax revenues that LAs spend) so overall it does not add to net public spending. Source: Authors' communication with the OBR.

claimants and fill the funding shortfall in some other way – or indeed to spend less on council tax rebates than the funding they receive and use the surplus for some other purpose.⁴⁴ Thus while central Government will provide 10% less in grants than it spent on CTB, it is by no means clear that 10% less will be spent on support for council tax. Part of the £480 million saving might well be found through cuts elsewhere (or council tax rises); where the axe falls will be decided by English LAs and the Scottish and Welsh Governments, not by UK central government.

The Welsh Government set out its views on replacing CTB in a consultation document in February 2012, and the Scottish Government announced its policy in April 2012.⁴⁵ Both chose not to adopt the approach taken in England of asking each LA to design its own system of council tax support. Rather, in both Scotland and Wales, LAs will be required to operate a scheme set centrally by the devolved administrations. Explicitly rejecting the UK Government's argument for devolving decisions on providing council tax rebates to LAs, the Welsh Government said that it:

'does not agree that each authority should develop and determine arrangements to provide council tax support on an individual basis. The Welsh Government accepts its responsibility to provide leadership and direction so that a clear, nationally-defined framework scheme, which supports the Welsh Government objectives as far as possible, should be developed. The scheme will also allow local authorities some flexibility to determine how it is set up and run at a local level.' ⁴⁶

⁴⁴ While this is a specific policy decision for England, it is automatically true in the other nations of the UK: CTB will simply cease to exist, while extra grants for English LAs automatically trigger extra funding for the devolved Scottish and Welsh administrations under the Barnett formula. This is simply extra block grant: there is no requirement for them to spend exactly that amount on council tax rebates – or indeed (unlike with English LAs) a requirement to provide council tax rebates at all, though unsurprisingly they have both chosen to make up for the removal of CTB by introducing their own replacement schemes, as we detail below.

⁴⁵ See Welsh Government, *Consultation on Providing Support for Council Tax in Wales* (<u>http://wales.gov.uk/consultations/localgovernment/ctsupport/?lang=en</u>) and Scottish Government, *Council Tax Support to be Protected*

^{(&}lt;u>http://wales.gov.uk/consultations/localgovernment/ctsupport/?lang=en</u>) respectively. A planned consultation in Scotland was shelved at the same time the policy was announced, presumably on the grounds that no consultation was needed if there was to be no change in families' entitlements.

⁴⁶ Source: Welsh Government, *Consultation on Providing Support for Council Tax in Wales* (<u>http://wales.gov.uk/consultations/localgovernment/ctsupport/?lang=en</u>).

The 'flexibility' that LAs will have simply mirrors that under the current system, under which they can make additional discretionary payments, continue paying benefits for a period after claimants move into paid work, etc.: it will not include significant discretion over setting entitlements for different groups.⁴⁷

But unlike with the current CTB system, LAs will not have their actual spending on council tax support reimbursed; rather, they will receive fixed cash grants from the Scottish and Welsh Governments (in a similar way as English LAs will from the UK Government). These may or may not cover the *expected* cost of council tax support in each LA – the way that grants will be allocated between LAs has not yet been decided in either nation – but they will not cover the *actual* cost of council tax rebates in each LA.⁴⁸ The fact that, as in England, LAs in Wales and Scotland will receive fixed grants rather than having the actual cost of providing council tax support refunded has two notable implications:

- First, LAs will bear the financial risk of unexpectedly high (or low) demand for support in a given year. This added risk to LAs' finances will make them more reliant on the reserves they maintain to deal in-year with unexpected contingencies such as weaker than expected economic performance.⁴⁹
- Second, LAs will have an incentive to reduce the cost of rebates. This could manifest itself in any of a number of ways, some more desirable than others. One effect, emphasised by the Government, will be to strengthen LAs' incentives to promote employment and growth in the local economy. But it will also reduce their incentive to increase council tax rates, reduce their incentive to facilitate low-value housing development, give them an incentive to discourage low-income families from living in the area, give them a disincentive to encourage take-up of support, and strengthen their incentive to reduce error and fraud. It remains to be seen how far councils will

⁴⁷ Authors' communications with the Welsh Government.

⁴⁸ The policy of giving fixed cash grants to LAs rather than reimbursing their actual spending on council tax support may partly reflect the limits to the legal authority of the Scottish and Welsh Governments under the devolution settlement mentioned in the text. This is in contrast to the position in England, where moving to fixed cash grants is part of the policy objective.

⁴⁹ Note, however, that the Welsh Government would be just as constrained as LAs in their ability to manage this budgetary risk, since neither can borrow nor increase taxes in-year to deal with an unexpected funding shortfall. The key point is that neither LAs nor the Welsh Government are as well placed to manage this risk as the UK Government.

respond to all these different incentives. The strength of all of these changes in incentives – good and bad – will partly depend on how, and how often, LAs expect grant allocations to be adjusted in future. How they will actually be adjusted in future is one of the most important decisions the UK and Welsh Governments have yet to take about the policy.

These issues are discussed in detail in sections 4.2 and 4.3 respectively of Adam and Browne (op. cit.), and the issues are very similar in Wales, so readers are referred there for further analysis: we do not repeat that discussion here.⁵⁰

While both Scotland and Wales opted for centrally designed systems, however, the nature of these schemes differs sharply between them.

In Scotland, the system of council tax support in 2013–14 will look identical to the existing CTB system from the claimant's point of view: all entitlements will be the same as they are under the current system. (This leaves open the question of how entitlements will be determined once Universal Credit is introduced, which we discuss briefly in section 4.9 and in detail in section 7 of Adam and Browne, op. cit.) The Scottish Government declared: 'We will not allow them [CTB recipients] to be victims of UK cuts'.⁵¹ Instead, the money will be found elsewhere: of the £40 million total savings required, £23 million will be found by the Scottish Government and £17m by LAs. This policy is initially for one year only: no decision has yet been announced on council tax support in 2014–15 and beyond.

The Welsh Government, by contrast, argued that 'Due to other cuts in funding, the Welsh Government is not in a position to make up any shortfall in funding'. It intends to design a council tax support scheme that costs 10% less than the existing CTB, and is consulting on how the scheme should be designed. In the next section we examine options for making savings in the design of a rebate scheme for Wales.

⁵⁰ One difference in Wales is that, unlike in England, LAs will not be able to use the design of council tax rebates as a way to pursue these objectives. Section 4 of S. Adam and J. Browne (op. cit.) discusses two other issues that do not apply within Wales: first, the pros and cons of having locally varying support (Wales will of course be different from England and Scotland, but there will be no variation within Wales); and the incentive for LAs in two-tier areas to focus disproportionately on reducing administrative costs (local government consists of a single tier right across Wales, albeit with some precepting authorities as discussed in section 2).

⁵¹ Local Government Minister Derek Mackay, quoted in *Scottish Government*, op. cit.

Spending on CTB in Wales was £238 million in 2010–11, so a 10% cut in funding means that there will be an estimated shortfall of around £24 million relative to the cost of the current CTB system (or more if the cost of CTB is forecast to increase between 2010–11 and 2012–13). That is equivalent to an annual cut of around £74 per CTB claimant or £17 per dwelling in Wales.⁵² To give a sense of scale, total council tax revenue (net of CTB) in Wales was around £1.1 billion in 2010–11, while the Welsh Government's total budget is around £15 billion per year.⁵³ Thus the cut in funding is roughly equivalent to – and could be absorbed by – a 2.2% increase in council tax rates,⁵⁴ or a 0.2% cut in Welsh Government spending.

4. Options for the Welsh Government

In this section we discuss options available to the Welsh Government to reduce expenditure on council tax rebates. These are on the whole tweaks to the existing system of CTB that make it less generous, although we also examine reducing the single-person discount in council tax, which is not part of CTB.

The particular reforms we examine, and the savings they bring to spending on council tax rebates in Wales, are as follows:

- 1. An across-the-board cut of 10% for all claimants. *Reduces cost by 10.2%*.
- 2. Only refunding 91% of a family's council tax liability rather than the full amount. *Reduces cost by 10.2%.*
- 3. Restricting the amount of support to the level of council tax paid for a Band B property. *Reduces cost by 9.8%.*
- 4. Removing entitlement from those in Bands E and above. *Reduces cost by 8.7%.*

⁵² Source: authors' calculations using Department for Work and Pensions (2012), Benefit Expenditure by Country, Region and Local Authority 2000–01 to 2010–11, <u>http://statistics.dwp.gov.uk/asd/asd4/index.php?page=expenditure</u>, Table 1 of Housing Benefit and Council Tax Benefit Summary Statistics (September 2010), <u>http://statistics.dwp.gov.uk/asd/asd1/hb_ctb/index.php?page=hbctb_arc</u>, Valuation Office Agency (2010), Council Tax Valuation Lists Wales (2005), 23 September 2010.

⁵³ Sources: Welsh Government (2011), *Council Tax Collection Rates, 2010–11* (<u>http://wales.gov.uk/docs/statistics/2011/110616sdr1012011en.pdf</u>); Welsh Government (2011), *Draft Budget 2012–13* (http://wales.gov.uk/docs/finance/report/111004megsen.pdf).

⁵⁴ Note that this calculation takes into account the impact of higher council tax rates on spending on council tax rebates.

- 5. Increasing the withdrawal rate for support for council tax from 20% to 30%. *Reduces cost by 4.5%.*
- 6. Reducing the single-person discount from 25% to 20%. *Raises an amount equivalent to 10.4% of the current cost of CTB.*

The reforms can be grouped into four categories:

- reforms that reduce the amount of support for all claimants (Reforms 1 and 2);
- reforms that reduce the amount of support for council tax received by those living in higher-banded properties (Reforms 3 and 4);
- reforms that means-test support for council tax more aggressively (Reform 5); and
- reforms that change underlying council tax liabilities (Reform 6).

In this section we discuss each of the six reforms listed above in turn, considering who would lose out from it, its impact on work incentives, and other effects it might have. We then briefly consider some other possible reforms that we do not analyse in detail because they either save very little or create obvious major problems. We present a summary comparison of the reforms in sub-section 4.10. Finally, we discuss how council tax rebates could be made to be work alongside Universal Credit, which is being introduced from October 2013.

More detailed results from the modelling of these reforms are brought together for convenience in Appendix A, to which we refer throughout this section.

Unlike the requirement for LAs in England to protect pensioners, the UK Government has not placed any restrictions on the design of council tax support in Wales, and the Welsh Government itself is still considering whether pensioners or any other specific groups will be protected. Throughout this analysis we therefore assume that no specific groups are singled out for protection. Were the Welsh Government to decide to protect certain groups, that would clearly mean bigger cuts were needed for other groups in order to save 10% overall. Table 2.3, which shows the shares of CTB expenditure received by different demographic groups, gives a rough idea of how much lower the savings might be if the cuts did not apply to certain groups.

4.1. Reform 1: Across-the-board cut of 10%

All CTB recipients would receive less support for council tax under this proposal. The impact of these reforms on the amount of support for

council tax received by a single adult without children is shown in Figure 4.1 below:



Figure 4.1: Amount of council tax rebate received by a single adult without children by income

Notes: Assumes individual lives in Band C property in a local authority with average Band D rate.

This reform would mean that those of working age would never be entitled to have all of their council tax rebated, meaning that LAs would have to collect some council tax from families with very low incomes. Tables A.1 and A.2 in Appendix A show that the poorest three income deciles, who receive most CTB at the moment, correspondingly lose most from a proportional cut in all entitlements: while the average loss from this reform across the whole population is only 0.05% of income, for these three decile groups it is 0.28%, 0.18% and 0.13% respectively, corresponding to £26.03, £26.85 and £23.45 per year on average. On the other hand, the reduction in out-of-work incomes would tend to strengthen the incentive for individuals to do paid work. The average change is not large, as the reduction in out-of-work income is relatively modest – as Table A.7 shows, the mean PTR falls slightly from 37.1% from 37.0% – but the reduction is larger where incentives are currently weakest (a reduction of 0.5 percentage points at the 90th percentile) and so where reductions are most valuable. Furthermore, the lower taper rate implied by this option (losing 18p of rebate, rather than the current 20p, for each extra £1 of income) would strengthen the incentive for the 41,000 working individuals in Wales who are on the taper to increase their earnings (see

Table A.10). It would also slightly strengthen incentives to save in non-pension financial assets.

This reform would weaken the incentive for low-income families to occupy larger properties in higher bands, but the change would be small: although not all of the additional council tax involved in doing so would be refunded through council tax rebates, the majority would be.

4.2. Reform 2: Only refunding 91% of a family's council tax liability

This reform is very similar to the previous one and reduces expenditure on council tax rebates by a similar amount, as shown in Figure 4.2 below. Like a 10% across-the-board cut, it would reduce support for all claimants (leaving LAs needing to collect some council tax from even the poorest), it would be highly regressive but slightly strengthen incentives to work and save, and slightly reduce incentives to live in bigger properties. The key difference between the two reforms is that reducing maximum entitlement does not involve an effective reduction in the taper rate like a uniform percentage cut in entitlements does, and so this option can raise a similar amount of revenue with a smaller reduction (9% rather than 10%) in the level of support for those with no private income. Thus it is slightly less regressive: as Table A.1 shows, the lowest income decile loses less (£24.47 per year on average rather than £26.03) while higher income groups lose more. Because this option does not involve reducing the withdrawal rate, those on the taper do not see an increased incentive to increase their earnings; but under this option entitlement runs out at a slightly lower income level (see Figure 4.2), so the number of people in Wales who are in paid work, subject to the means test and facing a resulting disincentive to increase their earnings falls by around 4,000 (see Table A.10).



Figure 4.2: Amount of council tax rebate received by a single person without children by income

Notes: Assumes individual lives in Band C property in a local authority with average Band D rate.

4.3. Reform 3: Restricting support for the level for a Band B property

From 1998–99 to 2003–04 inclusive, maximum CTB entitlement was restricted to that for a Band E property. Those in Band F or above had their maximum CTB entitlement set equal to what their council tax liability would be if their property were in Band E, and then the means test applied as normal. Wales could choose to reintroduce a similar system. The reform we illustrate involves setting maximum entitlement at that for a Band B property, which would reduce the cost of council tax support by around 10% in Wales.

Clearly, the people who would lose out from this reform are those currently claiming CTB and living in properties in Bands C and above. As Tables B.4 and B.5 in Appendix B show, these are disproportionately families with children, as families with children tend to occupy larger properties which are in higher council tax bands. For people in Bands C and above, this reform is a reduction in maximum entitlement exactly like that analysed as Reform 2 above, and would have similar effects, strengthening work incentives and reducing the number of families entitled to council tax rebates.

As with the previous two reforms, the losers include some of those with the lowest incomes and LAs would have to collect small amounts of tax from them – although the fact that they live in higher-band properties may to some extent (and acknowledging geographical variation in property prices) indicate that they are not as poor in terms of lifetime resources as their current income might suggest.

An attractive feature of this policy is that it would mean that families entitled to council tax rebates had to pay more of the marginal cost of occupying a higher-band property, significantly reducing the current artificial incentive for low-income families to occupy higher-value properties than they otherwise would.

4.4. Reform 4: Removing entitlement from those in Bands E and above

A more radical alternative to restricting maximum entitlement to that for a particular band would be to remove entitlement completely from those in higher bands. The example we model is removing entitlement from those in Band E or above. This reform raises a little less than the previous one, reducing expenditure on council tax rebates by 8.8% in Wales. This is because although the average loss among those who do lose is much larger, at a whopping £969 per year compared to the £189 from Reform 3, the number of households who lose out is smaller: only 1% of households are affected by this reform compared to the 6% who lose from Reform 3 (see Table 4.1). The average loss is so much higher because those affected lose all their entitlement to council tax rebate, rather than just seeing it restricted to Band B, and because those in Bands E and above almost by definition have unusually large council tax liabilities, which would no longer be covered. These families would have to pay council tax in full despite in some cases having very low current incomes.

Because the losses from this reform are more concentrated on families living in higher-band properties and such families tend to be better off, this reform is less regressive than restricting support to that for a Band B property: the second, third and fourth income deciles lose less on average and the fifth and sixth income deciles lose more from this reform than any of the previous three (see Tables A.1 and A.2). Removing entitlement completely from those in Bands E and above would also significantly reduce the total number of households entitled to support with their council tax, from 413,000 to 359,000 (see Table A.11). As with the previous reform, this would affect families with children more than families without children.

This reform would not change the incentive to live in bigger properties within Bands A to D, and it would remove the incentive to live in bigger properties within Bands D to I. But the 'cliff-edge' structure of the policy, whereby those living in Band D properties receive a full council tax rebate if they have a sufficiently low income whereas those in Band E properties receive no rebate at all, creates an artificial incentive to live in lower-band properties. The problem with the existing system is that CTB recipients, unlike others, do not have to pay the extra council tax that goes with a higher-value property, so there is an incentive for CTB recipients rather than others to occupy high-value properties. This reform would create the opposite problem: while non-claimants moving to a bigger property would be faced with an increase from (say) Band D council tax to Band E council tax, claimants making the same move would now see their liability increase from zero (in the Band D property) to full Band E council tax. With an average Band E rate in Wales of £1,452, that is a large artificial incentive for low-income families not to move into a property in Band E or above, and for those in higher-band properties to downsize to Band D.

4.5. Reform 5: Increasing the taper rate from 20% to 30%

Increasing the taper rate protects those entitled to full CTB and reduces the amount of support for council tax received by those with higher incomes, though the largest losses are still towards the bottom of the income distribution (households in the second and third income deciles lose £12.26 and £10.85 per year on average respectively, as shown in Table A.1). Means-testing support for council tax more aggressively mainly affects claimants who are in work but have low levels of earnings – a particularly common situation for working lone parents.

Perhaps surprisingly, this reform would not reduce the cost of council tax rebates by very much if introduced nationally. We estimate that increasing the taper to 30% would reduce expenditure by only around 4.5% in Wales. This is because the vast majority of CTB goes to those not in paid work, as we saw in Table 2.1.

Figure 4.3: Effect of Reform 5 on the amount of council tax rebate received by a single person without children by income



Notes: Assumes individual lives in Band C property in an LA with average council tax rate.

Means-testing more aggressively leaves families' out-of-work income unchanged while reducing the support received at low levels of earnings. It therefore reduces the incentive for families to have someone in low-paid work. However, it can strengthen the incentive for some families to have a second adult in work: if the first partner's earnings put the family on the CTB taper, this reform will reduce the family's income with just that person in work and mean there is less support left to be withdrawn if the second partner works. Hence Table A.8 shows average PTRs falling for people with working partners while rising for people without working partners.

Increasing the taper rate also has ambiguous effects on the incentive for those in work to increase their earnings. People who remain on the taper after the reform stand to lose 30p rather than 20p for each extra pound they earn, weakening their incentive to earn more. But the higher taper rate means that support runs out at a lower income level (see Figure 4.3) so around 19,000 fewer people in Wales are on the taper and facing this 30% withdrawal rate than face the current 20% withdrawal rate. Taking into account taxes and withdrawal of other means-tested benefits and tax credits, the overall mean EMTR increases by 0.1 percentage points, but within this there are around 8,000 fewer people with EMTRs between 80% and 90%: 7,000 more above 90% and 1,000 more below 80% (see Table A.10). In assessing this, bear in mind that the distortion caused by

taxes rises more than proportionately to the tax rate, so it is generally preferable to have two people on EMTRs of 85% than one at 75% and one at 95%.

Increasing the taper rate has clear attractions as a way to save money. It would protect the poorest claimants. Unlike the other reforms considered so far in this section, it would not require LAs to collect council tax from anyone currently receiving full CTB. It would reduce the number of people entitled to support and subject to means-testing. Its principal disadvantages are that it would not reduce expenditure by the full 10%, and that it would reduce the incentive for families to have someone in work and further increase EMTRs for some of those already facing the weakest incentives to increase their earnings.

The consequences for work incentives suggest that the Welsh Government should not increase the taper rate much above 30%. With Housing Benefit tapered at a rate of 65% on the same measure of income, the current CTB taper rate of 20% already means that claimants can lose a total of 85p in these benefits for each extra pound earned. Increasing the taper rate for council tax rebates to 30% would mean some claimants losing 95p for each extra pound earned. And if council tax rebates were tapered at a rate in excess of 35%, some claimants would face an EMTR above 100%: they would be made worse off by increasing their earnings. That cannot be desirable.⁵⁵ Note that this calculation will change somewhat when Universal Credit is introduced. As discussed in Adam and Browne (op. cit.) and in sub-section 4.10 below, one option would be to have a council tax rebate system with a high withdrawal rate such that entitlement was exhausted before Universal Credit started to be withdrawn.

4.6. Reform 6: Reducing the single-person discount

This reform is rather different from the others we have analysed. Rather than changing how entitlements to support are calculated, it involves changing the underlying council tax liabilities. At present, one-adult households receive a 25% council tax discount. We model reducing this to 20%. This reform would actually increase the cost of council tax support per se, since low-income single-adult households would be entitled to more support to cover their higher council tax bills. But for those households the higher council tax and the higher rebates would cancel each other out (i.e. they would continue to pay little or no council tax),

⁵⁵ A result from optimal tax theory demonstrates that it is always possible to improve on a system that involves EMTRs above 100%. See J.A. Mirrlees (1971) 'An exploration in the theory of optimum income taxation', *Review of Economic Studies* vol. 38, pp.175–208 for a formal proof.

higher-income one-adult households would simply pay more council tax so total council tax revenue, net of council tax rebates, would increase.

Reducing (or even eliminating) the single-person discount has some strong attractions. Whether the Welsh Government wishes to redistribute away from single-adult households towards the rest of the population is partly a matter of political preference, a value judgement we are not in a position to make. But from an economic efficiency point of view, offering a 25% council tax discount to single-adult households is clearly distortionary, leading to inefficient use of the housing stock as single-adult households occupy bigger properties, and other households occupy smaller properties, than they otherwise would.

The losers from reducing the single-person discount would be single-adult households who are not entitled to means-tested council tax rebates.⁵⁶ Those claiming council tax rebates would see their entitlement increase by an amount equal to their additional council tax liability, and some who are not currently entitled to support would become entitled. Unlike the other reforms we have modelled, the top half of the income distribution would therefore lose more in cash terms than the bottom half (see Table 3.1). Nevertheless, Table 3.2 shows that the bottom half would lose a larger percentage of their income than the top half. But that is for different reasons than the other reforms that we model: not because the revenue comes from low-income households who see their entitlements reduced. but because council tax itself is regressive, with gross liabilities increasing less than proportionally to property values and incomes, as discussed in section 2. Non take-up of council tax rebates also reduces the extent to which the poor are protected by this reform. Increasing single people's liabilities by a given percentage, even excluding those who claim meanstested support, is making a regressive tax bigger.

Making council tax bigger would correspondingly slightly expand the scope of council tax rebates, extending means-tested support to 3,000 more people in Wales. Therefore, 3,000 more people would face losing 20p of support for each extra pound of net earnings. And with net council tax still zero for those with no private income but now higher for single people in well-paid work, the incentive for single people to do well-paid work would be reduced – though this effect is scarcely detectable, with average PTRs rising by just 0.1 percentage points for lone parents and by less than this for single adults without children.

⁵⁶ It may be surprising to see that the loss from this reform among couples is not zero (Tables 6.3 and 6.4). This reflects the fact that students are not counted as 'visible adults' for the purposes of assessing council tax liability, so couples where one person is a student are entitled to the single person discount.

We estimate that reducing the single-person discount to 20% would strengthen Welsh LAs' finances by an amount equivalent to 10.4% of current CTB expenditure, more than offsetting the reduction in grants to pay for council tax rebates.

4.7. Other possible reforms

Reforms that we do not analyse further in this section, but which the Welsh Government could choose to introduce, include the following:

- **Increasing non-dependant deductions.** 'Non-dependant deductions' reduce the householder's CTB to take account of incomes of other adult residents of the household who are assumed to make a contribution towards the bill (see section 2.2 for more details). In practice, these apply to relatively few households so it is unlikely that much could be raised by increasing them in this way.
- Abolishing second adult rebate (SAR). SAR is payable where only one person is liable for a household's council tax bill and there is a low-income non-dependant ('second adult') living in the household (see section 2.2 for more details). Again, there are very few claimants of SAR (only 40,000 in the whole of Great Britain in 2006–07), meaning that this would save very little.
- **Tightening the asset test.** The Welsh Government could choose to treat capital more harshly than the current CTB system, either reducing the amount of savings that is disregarded (currently £6,000), increasing the amount of income each pound of savings is deemed to yield (currently each £250 of assets above the £6,000 disregard is deemed to yield £1 of income per week) or reducing the level of savings above which claimants receive no support (currently £16,000). In practice, none of these would significantly reduce expenditure on council tax rebates as few claimants have high levels of non-pension financial wealth.
- **Reducing applicable amounts.** The Welsh Government could reduce the income threshold at which council tax support started to be withdrawn. As discussed in section 2, this threshold is currently set so that, in general, CTB starts to be withdrawn at the same income level as entitlement to out-of-work benefits is exhausted.⁵⁷

⁵⁷ As noted in section 2, this is not true for families with children as the applicable amount includes an element equivalent to Child Benefit rates despite Child Benefit not being counted as income in the CTB means test. This element could be removed from the applicable amount (or, equivalently, Child Benefit could be counted as income) without creating a 'cliff-edge' in the way that reducing applicable amounts otherwise would. This option is discussed in section 6.7 of Adam and Browne (op. cit.). Like increasing the taper rate (reform 5), it is a way to means-test more aggressively, protecting the poorest while reducing entitlements to low-to-middle income claimants

This would no longer be the case if applicable amounts were reduced. Those receiving a small amount of an out-of-work meanstested benefit would continue to receive a full council tax rebate through passporting; but claimants would face a 'cliff-edge' were they to increase their incomes from just below to just above the point at which entitlement to out-of-work benefits is exhausted, similar to that which they would face under Reform 6. This would leave some claimants worse off if they were to increase their earnings, creating a strong disincentive for them to do so.

- Introducing a 'band' structure for council tax rebates, e.g. giving a 100% rebate to those with incomes below £100 per week, a 75% rebate to those with incomes between £100 and £200 per week etc. Depending on the design of the scheme this could cost more or less than the current system, and would certainly be simpler. The problem would again be that the 'cliff-edge' reduction in support at the boundaries of bands would mean that some individuals would be worse off if they increased their earnings from just below a threshold to just above it; a strong disincentive for them to increase their earnings.
- **Removing entitlement from certain groups of claimants.** In this section we have considered removing entitlement altogether from claimants occupying properties in Bands E and above. The Welsh Government might instead identify other groups that might have their entitlement removed completely: in our accompanying report, which considers Great Britain as a whole (Adam and Browne, op. cit.), we consider removing entitlement from all non-passported claimants. Since 30% of spending in Great Britain goes to nonpassported claimants, if entitlement were removed from this group, the saving would be far greater than 10% of existing CTB expenditure. However, this reform would significantly weaken work incentives for some groups: a particular concern with this policy is the 'cliff-edge' whereby people would immediately lose all of their council tax support as soon as they worked just enough to disqualify them from out-of-work benefits. Removing all entitlement from non-passported claimants drastically reduces the incentive to cross the threshold at which entitlement to out-of-work benefits runs out. Once above this threshold, however, council tax support would no longer provide any disincentive to increase earnings. EMTRs would unambiguously fall under this reform: as claimants would either get all of their council tax rebated or nothing, there would be no-one on the taper.

and with mixed effects on work incentives. It would save less than 2% of the cost of CTB.

- **Reforming band ratios.** Since those in lower-band properties are more likely to be entitled to CTB, one way of reducing the cost of council tax support would be to reform the band ratios in council tax to reduce council tax liabilities for low-band properties and increase them for high-band properties. This would have considerable merit in its own right. As the Mirrlees Review of the Tax System argued, a sensible reform to the taxation of domestic property would be to make council tax proportional to property values.⁵⁸ Since council tax is currently regressive with respect to property values, a reform that reduced council tax liabilities for low-value properties and increased them for high-value properties would move council tax closer to this ideal.
- More radical reforms to the structure of council tax rebates. Over the longer term, the Welsh Government could choose to introduce council tax rebate schemes that look completely different from the existing CTB. Each of these would have its own pros and cons. For example, some EU countries provide no means-tested support and instead give non-means-tested exemptions from property tax to certain vulnerable groups; that is much simpler and has all the advantages of avoiding means-testing, but would only generate savings if the 'vulnerable groups' were defined very narrowly, leaving many low-income families paying council tax in full. Some US states have a 'circuit breaker' system, which caps property tax liabilities at a certain percentage of income, in effect converting the property tax into an income tax for those who qualify for the circuit breaker; while perhaps sounding simpler than the current means test it would mean collecting some net council tax from the poorest households, while giving money away to those middle-income households who do not currently qualify for CTB but whose council tax exceeds the relevant percentage of income.59 Other, similarly radical, schemes could be devised. But given the short timescale for the Welsh Government to put a scheme in place for 2013–14, such radical reforms would seem unlikely in the short run.

⁵⁸ See Chapter 16 of J.A. Mirrlees et al. (2011), *Tax by Design: the Mirrlees Review*, Oxford: Oxford University Press for the Institute for Fiscal Studies (<u>http://www.ifs.org.uk/mirrleesReview</u>).

⁵⁹ These two proposals are examined by T. Clark, C. Giles and J. Hall (1999), *Does Council Tax Benefit Work?*, IFS Report no. 61.

4.8. Comparing the reforms

Table 4.1 presents some comparable statistics for the different reforms, while Table 4.2 summarises our analysis. Most of the reforms that we have examined have a certain amount in common. Since 80% of CTB in Wales goes to the lower-income half of households and 43% goes to the lowest-income fifth, it is unsurprising that making it less generous tends to hit predominantly poorer households. Making a means-tested benefit smaller also tends to reduce the extent to which it discourages work and saving. Nevertheless, there are significant differences between them.

Reforms 1 and 2, which reduce support for all claimants, impose the biggest losses on low-income households as a group (though reducing maximum entitlement to 91% of council tax is slightly less regressive than a 10% across-the-board cut). Reforms 3 and 4, which respectively reduce and eliminate support for those in higher-band properties, also involve starting to collect council tax from some households with little or no private income - indeed, they impose bigger losses on affected low-income households than across-the-board cuts - but only households in higherband properties (disproportionately families with children) are affected. and in general these reforms are less regressive than across-the-board cuts. Means-testing support for council tax more aggressively by increasing the taper rate (Reform 5) protects the very poorest, with the losses particularly concentrated on low-to-middle income households. Working lone parents are particularly likely to be among the low-income working families that lose from means-testing support more aggressively. But Reform 5 saves less than half of the amount by which funding is being cut. The only reform considered here that significantly affects those in higher income groups is reducing the single-person discount (Reform 6), because this discount is not means-tested: indeed, those in lower income groups who claim support with their council tax are protected from this reform as their support rises to cover higher council tax liabilities. But it is still lower-income households that lose the most from this reform as a percentage of their income.

Table 4.1: Summary statistics for the different ref	orms
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				Reform		
	1. 10% across- the-board cut	2. Only refund 91% of council tax liability	3. Restrict to Band B	<i>4. Remove entitlement from Band E and above</i>	5. Increase taper to 30%	6. Reduce single- person adult discount
% of households losing	18%	18%	6%	1%	5%	25%
Average loss among losing households	£68	£68	£187	£968	£105	£50
Change in number entitled	-1,000	-14,000	-20,000	-54,000	-46,000	+3,000
Change in average PTR	-0.1%	-0.1%	-0.2%	-0.2%	-0.0%	+0.0%
Change in average EMTR	-0.0%	-0.0%	-0.1%	-0.0%	+0.0%	+0.0%
% saving in Wales	10.2%	10.2%	9.8%	8.7%	4.5%	10.4%

Table 4.2: Comparing the reforms

Reform	Who loses?	Need to collect tax	Effect on work incentives	Other effects	% saving in
		from those with no			cost of
		private income?			support in Wales
1. 10% across-the-			Slightly strengthens incentive		-10.2%
board cut	All claimants	Yes	to do paid work and incentive to increase earnings		
2. Only refund 91% of council tax liability	All claimants	Yes	Slightly strengthens incentive to do paid work and incentive to increase earnings		-10.2%
3. Restrict to Band B	Claimants in bands C and above	Yes	Slightly strengthens incentive to do paid work and incentive to increase earnings	Reduces artificial incentive to occupy larger properties	-9.8%
4. Remove entitlement from Band E and above	Claimants in bands E and above	Yes	Strengthens incentive for those in Bands D and above to do paid work and to increase earnings	'Cliff-edge' removal of support is a large disincentive to occupy higher-band properties	-8.7%
5. Increase taper to 30%	Claimants on the taper	No	Strengthens incentives for some, weakens for others		-4.5%
6. Reduce single- person discount	Single-adult households not entitled to support	No	Slightly weakens incentive for single-adult households to do paid work and to increase earnings	Reduces housing market distortion	-10.4%

Most of these reforms strengthen the incentive for individuals to do paid work on average, though the impact is small: the most any reform reduces the mean PTR is 0.2 percentage points. The reforms we model here that reduce the average PTR involve cutting the maximum council tax rebate a family can receive (Reforms 1 to 4), since reducing their out-of-work income increases the difference between their income in and out of work. Although the reduction in average PTRs is small even for these reforms, PTRs fall most for those with the weakest incentives to work under the current system. Not all of the reforms reduce average PTRs, however. Increasing the taper rate does not affect the average PTR, although it increases PTRs for some and reduces them for others. Increasing the taper rate weakens the incentive for families to have one person in paid work, but often strengthens incentives for both members of a couple to undertake paid work rather than just one. Reducing the single-person discount (Reform 6) slightly weakens the incentive for single people (with or without children) to be in paid work, as the reform increases the council tax they must pay if they earned enough to disqualify them from meanstested support.

Reforms 1 to 4 unambiguously strengthen the incentive for those in work to earn more; Reform 6 unambiguously weakens it, while Reform 5 has offsetting effects on different groups.

Finally, some of the reforms would have effects on patterns of housing occupation. Restricting entitlement to that for a Band B property (Reform 3) would reduce the incentive for claimants to occupy larger properties, while reducing the single-person discount (Reform 6) would reduce the incentive for non-claimants living alone to occupy larger properties. Both of these alleviate existing distortions. Removing entitlement altogether from those in Bands E and above would remove the incentive for claimants to live in bigger properties within Bands E to I, but more importantly would introduce a new distortion: a big incentive for claimants to live in properties below Band E.

4.9. Integration with Universal Credit

A key consideration for the Welsh Government in designing a new council tax support scheme will be how to make it work alongside Universal Credit as smoothly as possible. Universal Credit is intended to simplify the benefit system by reducing the number of different benefits, interacting in complicated ways that claimants and administrations must contend with. Keeping council tax support separate – and indeed allowing it to vary across Great Britain – 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. 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.

Achieving coherence between council tax rebates and Universal Credit is complex and means that rebates cannot simply mirror the existing CTB system. We analyse this challenge in depth in an accompanying report.⁶⁰ Since the issues are essentially the same in Wales as in the rest of Britain, we give only a brief summary here; readers are referred to section 7 of the accompanying report for the full analysis.

One of the key issues 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 was counted as income for the means test (assuming the current 20% withdrawal rate). It would also mean that income from private pensions, contributory benefits and spousal maintenance (which will reduce Universal Credit entitlement pound-forpound) would actually make some recipients worse off unless these income sources were ignored when calculating council tax rebates, which would be expensive. 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 withdrawn by the time Universal Credit started to be withdrawn. As well as avoiding very high effective tax rates, limiting maximum entitlements and means testing aggressively in this way would save councils a great deal of money 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 is that the particular working-age benefits that are currently used to 'passport' people automatically to maximum CTB entitlement will cease to exist, subsumed within Universal Credit. Since there is nothing in the Universal Credit system which will make it straightforward to identify those who should be passported to a full council tax rebate, running a council tax rebate scheme based closely on the current system could be extremely challenging administratively for LAs. At present, 70% of CTB recipients in Wales are passported to full

⁶⁰ S. Adam and J. Browne (op. cit.).

entitlement. If all these people needed to go through a full means test in order to receive support, the burden on both claimants and LAs would increase substantially. One way to mitigate this would be for UK central government to transfer Universal Credit data to LAs, so that they could use it in their means tests without having to ask claimants for the information again – if the IT systems can be set up to achieve this data transfer in a timely and efficient way.

4.10. Conclusions

There are many different ways in which the Welsh Government could reform council tax support to reduce its cost. In this section we have focused on some reforms that take the existing system of CTB as a starting point and introduce changes that make the system less generous. These are by no means an exhaustive list of possible changes that could be made to the current system, and of course the Welsh Government could introduce more radical changes to the structure of support for council tax. Nevertheless, given the progressive nature of CTB it is difficult to find money-saving options that would not primarily hit poorer households: indeed, the only reform we consider that raises revenue predominantly from those with higher incomes is reducing the 25% single-person discount in council tax. Some options would reduce support for those with the lowest incomes, leaving Welsh LAs with the unenviable task of collecting small amounts of council tax from those with very low incomes something that proved famously difficult under the poll tax. Increasing the withdrawal rate for council tax support moderates the impact on those with the very lowest incomes but, as ever, there is a trade-off between protecting those with the lowest incomes and the impact of reforms on incentives to work. Reforms that means-test support for council tax more aggressively lead to weaker work incentives than those which reduce support for all claimants. Whichever option the Welsh Government chooses for making savings in the current system, it will also have to consider how its proposed rebate scheme will work alongside Universal Credit.

5. Conclusions

CTB provided £238 million of support to low-income families in Wales in 2010–11. With 328,000 recipients, it is more widely claimed than any other means-tested benefit or tax credit. But it still reaches only about two-thirds of those for whom it is intended, as 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 than they otherwise would.

The UK Government is proposing to localise support for council tax from 2013–14, abolishing CTB across Britain and charging LAs in England and the Scottish and Welsh Governments with designing their own systems of council tax support for low-income families. As well as localising support for council tax, the government is also planning to cut funding for it by 10%, giving each LA in England, and the Scottish and Welsh Governments, funding equal to 90% of what would have been spent on an unreformed CTB in that area. The Welsh Government has indicated that it intends to make a 10% saving in the cost of council tax rebates in response to this funding cut.

In this paper, we have compared some reforms that the Welsh Government could introduce to reduce the cost of council tax rebates by 10%. There are several ways in which savings could be made. The Welsh Government could, for example, limit the maximum amount of council tax to be rebated, means-test support more aggressively, reduce or remove entitlements for those living in higher-value properties, simply cut entitlements by a set percentage across the board, or some combination of these – though given the tight timescale before implementation, it might be difficult to adopt more radical proposals in the first year of the policy. But the choice is a difficult one. Since 80% of CTB in Wales goes to the lowerincome half of households, and 43% 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% (the amount by which funding is being cut) typically involve reducing support for those currently entitled to maximum CTB – those on the lowest incomes. The poll tax experience showed how difficult it can be to collect small amounts of tax from lowincome households who are not used to paying it. One option available to the Welsh Government – in the longer term if not immediately – would be to reduce the single-person discount in council tax: a reduction from 25% to 20% would raise an amount equal to 10% of spending on CTB, reducing a distortion in the housing market and with the majority of the revenue coming from higher-income groups.

However, the Welsh Government's task is not only to save money by finding tweaks to the current system for determining entitlements for council tax support. As with the Scottish Government and LAs in England, the Welsh Government will also have to consider the complex question of how council tax rebates will work alongside Universal Credit.

Appendix A. Modelling results for section 4

A.1. Distributional impacts

Table A.1: Average annual loss from these reforms by income decile group

Reform		Income decile group									
	1	2	3	4	5	6	7	8	9	10	
1. 10% across-the board cut	-£26.03	-£26.85	-£23.45	-£15.03	-£11.08	-£11.83	-£8.13	-£3.09	-£2.43	£0.00	-£12.80
2. Only refund 91% of council tax liability	-£24.47	-£26.95	-£23.62	-£15.00	-£11.21	-£11.55	-£8.92	-£3.36	-£2.52	£0.00	-£12.77
3. Restrict to Band B	-£23.13	-£22.30	-£24.30	-£15.43	-£12.06	-£15.64	-£6.94	-£2.49	-£1.42	£0.00	-£12.38
4. Remove entitlement from Band E and above	-£29.74	-£9.10	-£19.19	-£12.23	-£15.97	-£16.94	-£4.64	-£1.49	£0.00	£0.00	-£10.94
5. Increase taper to 30%	-£5.09	-£12.26	-£10.85	-£6.82	-£4.70	-£4.52	-£7.88	-£2.14	-£1.27	£0.00	-£5.55
6. Reduce single-person discount	-£13.03	-£10.09	-£11.15	-£11.04	-£14.79	-£13.21	-£12.79	-£11.68	-£12.35	-£17.07	-£12.72

Notes: Income decile groups are derived by dividing all households in Wales into 10 equal-sized groups according to income adjusted for household size using the McClements equivalence scale. Decile group 1 contains the poorest tenth of the population, decile group 2 the second poorest, and so on up to decile group 10, which contains the richest tenth.

Reform					Income de	cile group)				All
	1	2	3	4	5	6	7	8	9	10	
1. 10% across-the-board cut	-0.28%	-0.18%	-0.13%	-0.07%	-0.05%	-0.05%	-0.03%	-0.01%	-0.01%	0.00%	-0.05%
2. Only refund 91% of council tax liability	-0.26%	-0.18%	-0.13%	-0.07%	-0.05%	-0.04%	-0.03%	-0.01%	-0.01%	0.00%	-0.05%
3. Restrict to Band B	-0.25%	-0.15%	-0.13%	-0.07%	-0.05%	-0.06%	-0.02%	-0.01%	0.00%	0.00%	-0.04%
4. Remove entitlement from Band E and above	-0.32%	-0.06%	-0.10%	-0.06%	-0.07%	-0.06%	-0.02%	0.00%	0.00%	0.00%	-0.04%
5. Increase taper to 30%	-0.05%	-0.08%	-0.06%	-0.03%	-0.02%	-0.02%	-0.03%	-0.01%	0.00%	0.00%	-0.02%
6. Reduce single-person discount	-0.14%	-0.07%	-0.06%	-0.05%	-0.06%	-0.05%	-0.04%	-0.03%	-0.03%	-0.03%	-0.05%

Table A.2: Average loss from these reforms by income decile group as a percentage of net income

Notes and sources: As for table A.1.

Table A.3: Proportion of households that lose out from these reforms by income decile group

Reform				Inc	ome de	ecile gr	oup				All
	1	2	3	4	5	6	7	8	9	10	
1. 10% across-the-board cut	36%	40%	34%	22%	16%	16%	14%	6%	4%	0%	19%
2. Only refund 91% of council tax liability	36%	40%	34%	22%	16%	16%	14%	6%	4%	0%	19%
3. Restrict to Band B	11%	14%	14%	7%	5%	7%	4%	2%	1%	0%	7%
4. Remove entitlement from Band E and above	3%	1%	2%	1%	2%	2%	1%	0%	0%	0%	1%
5. Increase taper to 30%	7%	13%	8%	6%	4%	5%	7%	2%	1%	0%	5%
6. Reduce single-person discount	27%	22%	24%	24%	30%	27%	26%	24%	22%	27%	25%

Notes and sources: As for table A.1.

Table A.4: Average annual loss from	n these reforms by household type
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Household type	Reform								
	1. 10% across-the- board cut	2. Only refund 91% of council tax liability	<i>3. Restrict to Band B</i>	<i>4. Remove entitlement from Band E and above</i>	5. Increase taper to 30%	6. Reduce single-person discount			
Single, not working	-£39.92	-£36.88	-£16.42	-£4.94	-£5.31	-£14.15			
Single, working	-£1.65	-£1.84	-£1.51	-£4.09	-£1.09	-£48.27			
Lone parent, not working	-£57.74	-£52.05	-£40.45	-£43.32	-£0.46	-£4.23			
Lone parent, in work	-£4.78	-£5.74	-£3.29	£0.00	-£5.25	-£44.48			
0-earner couple, no children	-£26.99	-£27.76	-£37.12	-£38.89	-£16.30	-£0.77			
0-earner couple, children	-£69.72	-£65.84	-£56.24	-£10.11	-£17.19	£0.00			
1-earner couple, no children	-£0.47	-£0.65	-£0.90	£0.00	-£0.83	-£3.15			
1-earner couple, children	-£3.13	-£3.72	-£4.47	-£0.08	-£2.67	-£2.67			
2-earner couple, no children	-£0.61	-£0.55	-£0.61	£0.00	£0.00	-£1.03			
2-earner couple, children	-£0.02	-£0.19	-£0.19	-£0.19	-£0.19	-£0.53			
Single pensioner	-£19.45	-£19.69	-£18.49	-£12.53	-£10.93	-£36.09			
Couple pensioner	-£12.05	-£13.66	-£19.22	-£22.87	-£12.01	-£0.24			
Multi-family household, no children	-£10.88	-£11.04	-£10.66	-£13.03	-£5.22	-£1.55			
Multi-family household, children	-£12.14	-£12.26	-£23.52	-£27.50	-£5.97	-£4.70			
All	-£12.80	-£12.77	-£12.38	-£10.94	-£5.55	-£12.72			

Household type	Reform						
	1. 10% across-the- board cut	2. Only refund 91% of council tax liability	<i>3. Restrict to Band B</i>	4. Remove entitlement from Band D and above	<i>5. Increase taper to 30%</i>	6. Reduce single-person discount	
Single, not working	-0.37%	-0.34%	-0.15%	-0.05%	-0.13%	-0.05%	
Single, working	-0.01%	-0.01%	-0.01%	-0.01%	-0.24%	-0.02%	
Lone parent, not working	-0.35%	-0.31%	-0.24%	0.00%	-0.03%	-0.26%	
Lone parent, in work	-0.02%	-0.03%	-0.01%	-0.02%	-0.20%	0.00%	
0-earner couple, no children	-0.13%	-0.13%	-0.17%	-0.08%	0.00%	-0.18%	
0-earner couple, children	-0.32%	-0.30%	-0.26%	-0.08%	0.00%	-0.05%	
1-earner couple, no children	0.00%	0.00%	0.00%	0.00%	-0.01%	0.00%	
1-earner couple, children	-0.01%	-0.01%	-0.02%	-0.01%	-0.01%	0.00%	
2-earner couple, no children	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
2-earner couple, children	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
Single pensioner	-0.13%	-0.13%	-0.12%	-0.07%	-0.23%	-0.08%	
Couple pensioner	-0.05%	-0.05%	-0.07%	-0.05%	0.00%	-0.09%	
Multi-family household, no children	-0.03%	-0.03%	-0.03%	-0.01%	0.00%	-0.03%	
Multi-family household, children	-0.03%	-0.03%	-0.06%	-0.01%	-0.01%	-0.07%	
All	-0.05%	-0.05%	-0.04%	-0.04%	-0.02%	-0.05%	

Table A.5: Average annual loss from these reforms as a percentage of net income by household type

Household type	Reform								
	1. 10% across-the- board cut	2. Only refund 91% of council tax liability	3. Restrict to Band B	<i>4. Remove entitlement from Band D and above</i>	5. Increase taper to 30%	6. Reduce single-person discount			
Single, not working	64%	64%	13%	1%	10%	31%			
Single, working	3%	3%	0%	0%	1%	97%			
Lone parent, not working	86%	86%	29%	4%	1%	9%			
Lone parent, in work	10%	10%	4%	0%	3%	92%			
0-earner couple, no children	32%	32%	12%	3%	8%	1%			
0-earner couple, children	84%	84%	32%	1%	14%	2%			
1-earner couple, no children	1%	1%	1%	0%	1%	7%			
1-earner couple, children	5%	5%	3%	1%	2%	5%			
2-earner couple, no children	1%	1%	0%	0%	0%	2%			
2-earner couple, children	0%	0%	0%	0%	0%	1%			
Single pensioner	33%	33%	12%	1%	13%	71%			
Couple pensioner	16%	16%	8%	2%	9%	0%			
Multi-family household, no children	13%	13%	4%	1%	6%	3%			
Multi-family household, children	14%	14%	9%	3%	3%	10%			
All	19%	19%	7%	1%	5%	25%			

Table A.6: Proportion of households that lose out from these reforms by household type

A.2. Impact on work incentives

	Percentile point					
	10th	25th	Median	75th	90th	Mean
Current system	11.3%	22.0%	35.0%	50.1%	67.7%	37.1%
1. 10% across-the-board cut	11.3%	21.9%	35.0%	49.9%	67.2%	37.0%
2. Only refund 91% of council tax						
liability	11.3%	21.9%	35.0%	49.9%	67.4%	37.0%
3. Restrict to Band B	11.2%	21.9%	34.9%	49.7%	67.4%	36.9%
4. Remove entitlement from						
Band E and above	11.1%	22.0%	34.8%	49.8%	67.6%	36.9%
5. Increase taper to 30%	11.3%	21.9%	35.0%	50.0%	67.8%	37.1%
6. Reduce single-person discount	11.3%	22.0%	35.1%	50.1%	67.8%	37.1%

Table A.7: Percentile points of the distribution of participation tax rates under different reforms

Note: Only includes those aged below State Pension age. In-work incomes for nonworkers calculated using the methodology specified in Adam and Browne (2010). Source: Authors' calculations using TAXBEN run on Family Resources Survey data from 2007–08 to 2009–10.

	Single, no children	Lone parent	Couple with children, partner works	Couple with children, partner doesn't work	Couple without children, partner works	Couple without children, partner doesn't work	All
Current system	39.1%	51.3%	34.3%	67.2%	23.2%	44.3%	37.1%
1. 10% across-the- board cut	38.9%	51.0%	34.2%	66.9%	23.2%	44.1%	37.0%
2. Only refund 91% of council tax liability	38.9%	51.1%	34.1%	67.0%	23.2%	44.1%	37.0%
3. Restrict to Band B	38.9%	51.1%	34.0%	66.9%	23.1%	44.1%	36.9%
4. Remove entitlement from Band E and above	38.9%	51.2%	34.0%	66.9%	23.1%	44.2%	36.9%
5. Increase taper to 30%	39.1%	51.6%	34.1%	67.5%	23.2%	44.4%	37.1%
6. Reduce single- person discount	39.1%	51.5%	34.3%	67.2%	23.2%	44.3%	37.1%

Table A.8: Average participation tax rates for different groups under these reforms

Note: Only includes those aged below State Pension age. In-work incomes for nonworkers calculated using the methodology specified in Adam and Browne (2010). Source: Authors' calculations using TAXBEN run on Family Resources Survey data from 2007–08 to 2009–10.

	Single, no children	Lone parent	Couple with children, partner	Couple with children, partner	Couple without children, partner	Couple without children, partner	All
			works	doesn't work	works	doesn't work	
Current system	32.5%	63.1%	36.8%	57.2%	29.9%	41.0%	36.1%
1. 10% across-the- board cut	32.5%	62.9%	36.8%	57.0%	29.9%	40.9%	36.1%
2. Only refund 91% of council tax							
liability	32.5%	63.0%	36.7%	57.1%	29.9%	40.8%	36.1%
3. Restrict to Band B	32.4%	62.8%	36.7%	56.9%	29.9%	41.0%	36.1%
4. Remove entitlement from							
Band E and above	32.5%	63.1%	36.8%	57.2%	29.9%	41.0%	36.1%
5. Increase taper to 30%	32.5%	63.2%	36.8%	57.8%	30.0%	40.7%	36.2%
6. Reduce single- person discount	32.5%	63.2%	36.8%	57.2%	29.9%	41.0%	36.2%

Table A.9: Average effective marginal tax rates for different groups under these reforms

Note: Only includes those in paid work aged below State Pension age. Source: Authors' calculations using TAXBEN run on Family Resources Survey data from 2007–08 to 2009–10.

	Number with EMTPs (thousands):								
			NUM	ber with EN	ATRS (THOUS	sanas):			-
	Below	50%-	60%–	70%–	80%-	90%–	100%	Rise	Fall
	50%	59.99%	69.99%	79.99%	89.99%	99.99%			
Current								N	/A
system	1,065	28	23	91	13	15	10		
1. 10% across-									
the- board cut	1,065	28	22	91	13	14	10	0	41
2. Only refund									
tax liability	1,065	28	23	91	13	15	10	0	4
3. Restrict to Band B	1,066	27	23	90	13	15	10	0	9
4. Remove entitlement from Band E and above	1,066	26	24	90	12	14	10	0	9
	.,	20						Ŭ	,
taper to 30%	1,062	31	26	88	5	21	10	21	19
6. Reduce single-person discount	1066	26	24	90	12	14	10	1	0

Table A.10: Distribution of EMTRs in Wales under the current system and different reforms

Note: Only includes those in paid work aged below State Pension age. Source: Authors' calculations using TAXBEN run on Family Resources Survey data from 2007–08 to 2009–10.

A.3. Effects on numbers entitled to full and to partial support

Table A.11: Number of households entitled to maximum support and on the taper under the different reforms

	Number of households entitled to maximum council tax	Number of households on	Total
	support	taper	
Current system	204,000	209,000	413,000
1. 10% across-the-board			
cut	204,000	208,000	412,000
2. Only refund 91% of			
council tax liability	204,000	194,000	399,000
3. Restrict to Band B	204,000	189,000	393,000
4. Remove entitlement			
from Band E and above	185,000	173,000	359,000
5. Increase taper to 30%	204,000	163,000	367,000
6. Reduce single-person			
discount	204,000	213,000	416,000

Note: All figures rounded to nearest thousand. Does not account for non-take-up. Source: Authors' calculations using TAXBEN run on Family Resources Survey data from 2007–08 to 2009–10.