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E(LF)(85) 5th Meeting COPY NO 44

CABINET

MINISTERIAL COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON LOCAL GOVERNMENT FINANCE

MINUTES of a Meeting held in
10 Downing Street on
TUESDAY 12 NOVEMBER 1985 at 9.30 am

PRESENT

The Rt Hon Margaret Thatcher MP
Prime Minister

The Rt Hon Viscount Whitelaw
Lord President of the Council

The Rt Hon Leon Brittan QC MP
Secretary of State for Trade and Industry

The Rt Hon Douglas Hurd MP
Secretary of State for the Home Department

The Rt Hon Sir Keith Joseph MP
Secretary of State for Education and Science

The Rt Hon George Younger MP
Secretary of State for Scotland

The Rt Hon Nichlas Edwards MP
Secretary of State for Wales

The Rt Hon Norman Fowler MP
Secretary of State for Social Services

The Rt Hon Norman Tebbit MP
Chancellor of the Duchy of Lancaster

The Rt Hon Nicholas Ridley MP
Secretary of State for Transport

The Rt Hon Kenneth Baker MP
Secretary of State for the Environment

The Rt Hon John MacGregor MP
Chief Secretary, Treasury

The Rt Hon John Wakeham MP
Parliamentary Secretary, Treasury

The Hon William Waldegrave MP
Ministry of State, Department of the Environment (Minister for the Environment, Countryside and Local Government)

2

THE FOLLOWING WERE ALSO PRESENT

Mr Michael Ancram MP
Parliamentary Under-Secretary of State, Scottish Office

The Hon Alan Clark MP
Parliamentary Under-Secretary of State
Department of Employment

SECRETARIAT

Sir Robert Armstrong
Mr J B Unwin
Mr A J Langdon
Mr J E Roberts

SUBJECT

THE LOCAL DOMESTIC TAX

CONFIDENTIAL

THE LOCAL DOMESTIC TAX

The Sub-Committee considered a Memorandum by the Secretary of State for the Environment about the distributional impact of local tax proposals (E(LF)(85) 15); a Memorandum by the Secretary of State for Scotland about a number of distinctive Scottish issues (E(LF)(85) 18); a Memorandum by the Secretary of State for Wales about how a new local domestic tax could be introduced with the minimum of dislocation (E(LF)(85) 17); and a Memorandum by the Secretary of State for the Environment about property valuation issues (E(LF)(85) 16). Their discussions and conclusions are recorded separately.

Cabinet Office

13 November 1985

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CABINET

MINISTERIAL STEERING COMMITTEE ON ECONOMIC STRATEGY

SUB-COMMITTEE ON LOCAL GOVERNMENT FINANCE

LIMITED CIRCULATION ANNEX
E(LF)(85) 5th MEETING MINUTES
TUESDAY 12 NOVEMBER 1985 at 9.30 am

CONFIDENTIAL

THE LOCAL DOMESTIC TAX

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THE SECRETARY OF STATE FOR THE ENVIRONMENT said that the Sub-Committee had already agreed a number of issues arising from the Local Government Finance Studies, including the proposals to introduce a pooled, national non-domestic rate, to introduce a new lump sum Exchequer Grant, and to have a safety-net grant so that no local authority would lose resources at the outset of the new system. The key issue remaining was the form of the local domestic tax. He had set out in the paper E(LF)(85) 15 exemplifications showing the effect on the income of households and of tax units of a local domestic tax comprising a community charge levied on every adult and a property element, first in the ratio 50:50 and second 70:30. It was proposed that the division should be 50:50 initially, moving to 70:30 in the third year. Because of the arrangements which had been agreed for grants, there were now no transfers of resources between local authority areas, and the distributional effects depended entirely on household composition. As a result, the scale of the changes was now much smaller, and 98 per cent of households would either gain or would lose no more than 2 per cent of their net income even on the basis of a 70:30 tax. Single person households would also gain, while those comprising three or more adults would lose.

In total, some 51 per cent of households would gain, 10 per cent by more than £2 per week. 144,000 tax units would gain by more than 5 per cent of their net income: most were single adults or pensioners, and many were on low incomes. The main losers were single non-householders, who would be paying a local tax for the first time: the majority were 18-24 year olds, although some were elderly people living with relations. 9 per cent of households would lose more than £2 per week. The effect on two adult householders would be broadly neutral.

If a community charge were included in the local domestic tax, the Government would face criticism that they had introduced an additional, unpopular tax. It had to be recognised, however, that if the other elements of the reform package were proceeded with the local domestic tax would bear the whole of the pressure of marginal spending and the existing rating system would not be able to cope. The proposed new community charge would increase the tax base from the present 18 million registered households (of whom only some 12 million currently paid rates) to 36 million; and the Sub-Committee had decided that mechanisms such as sales charges or a local income tax were not acceptable, and had therefore concluded that a community charge based on residence was the only remaining alternative. It might be introduced over a long transitional period, on the lines suggested by the Secretary of State for Wales, or could be based on a system or rebates and surcharges on the existing rates bills, but inevitably there would have to be some system of registering all adults.

So far as the register was concerned, his proposal was that there should be a duty on each householder to register all adults living with him at his normal main place of residence. Each adult would then be liable to pay a community charge in respect of his or her main or only residence. Husbands and wives would be jointly and severally liable. In addition to the Community charge, the householder would also be responsible for the property element. Second homes would be charged the property element and one community charge. Students would be deemed to live at their term-time address, and would pay a community charge.

There would be particular problems in registering and collecting a charge from those living in houses in multiple occupation and institutions. It was therefore proposed to introduce a 'collective charge' which would be levied on the owner of the property in respect of the total number of people living there: it would be up to the owner to recover the cost through rents. Old peoples' homes and halls of residence would pay the collective charge, but hotels would be treated as businesses.

THE SECRETARY OF STATE FOR WALES said that although the distributional effects of the proposals had been much reduced, many people would be brought into the local tax net for the first time. Since they were likely to be vocal in their opposition, he thought it important that means should be found to introduce the community charge on a gradual basis. He had therefore set out a scheme by which initially the community charge would be set nationally at a reasonably low level - perhaps £50 or £75. This would enable rate bills to be reduced, on average by about twice the amount. Rate bills would then be frozen at this reduced level, and any increased in local tax in future years would fall entirely on the community charge. The property element would therefore effectively wither on the vine, and over time the community charge element would assume a greater proportion.

THE MINISTER OF STATE, DEPARTMENT OF THE ENVIRONMENT (MINISTER FOR THE ENVIRONMENT, COUNTRYSIDE AND LOCAL GOVERNMENT) said that if it were proposed to retain a property element in the local domestic tax, it was necessary to address a number of issues concerning the valuation base. It had not been possible to identify any realistic alternative to the present annual rental values system as the basis of rateable values. To the extent that rateable values would no longer influence the distribution of resources between areas, but only the level of tax bills within each local authority area, it would be acceptable to allow the present 1973 based values to stand as a suitable index. No general revaluation would therefore be necessary. But there were extensive anomolies in current valuations in cases where physical changes had not been reflected in rateable values. He therefore proposed a system whereby rateable values would be reassessed to allow for such changes on the change of occupation of properties.

The Government had already announced its general intention to hold a non-domestic revaluation. In order to retain the option of introducing the new valuation lists by April 1989, it was necessary to announce before Christmas the intention to set work in hand so that the Inland Revenue Valuation Office could recruit the necessary staff.

In discussion the following points were made -

a. the distributional effects of the package were much reduced following the introduction ofthe safety-net grant, and were now generally acceptable. This was at the expense of a clearer relationship between present high spending andthe level of the community charge, but the main feature that any additonal expenditure would result in a sharp increase in the community charge had been preserved.

b. Some pensioner couples living in property with a low rateable value might face a significant loss in net income as a result of the changes. It was important to be aware of the extent of this problem, and also to consider the inter-action between the local government reform proposals and the social security review.

c. There would be a substantial increase in housing benefit workload as some of those being brought into the local tax net for the first time would be eligible for rebates. It would be possible to avoid this problem by continuing to levy the local tax on the householder, even if the amount payable reflected the number of adults living with him or her. Such levies, however, damaged the basic principles at stake.

d. The proposal to retain a property element in the local domestic tax had arisen in order to reduce turbulence and because of the extreme distributional effects evident before the safety-net grant had been introduced. There were also arguments for the property element in principle, including the fact that some local services were property related and the broad relationship between ability to pay and type of house occupied. The housing benefit system, however, provided a better means of assisting those with limited ability to pay than retaining rates.

e. There was considerable public pressure to see the property element eliminated completely from local taxation.

f. Owners of second homes, who would pay only the property element plus one community charge in respect of their second home, would be considerably better off as a result of the proposals. There might be a case for requiring such families to register and pay the community charge in respect of both their main and second homes.

g. Overseas residents maintaining a second home in Great Britain would stand to gain substantially from the abolition of rates. Some special arrangement might be necessary to ensure that they paid a fair contribution for local services.

h. There were many attractions in the transitional arrangement proposed by the Secretary of State for Wales. This would be simple to present, and could be consistent with a commitment to the eventual elimination of the property element.

i. In addition to the enforcement procedures, it would be important to have incentives for people to register for and pay the community charge. Local authority benefits and services might be made conditional on providing proof of payment, or alternatively registered local residents might be given a discount in using sports and leisure and other facilities.

j. Enforcement of the community charge among poor transient inner city populations was likely to prove difficult. The charge could discourage electoral registration in such areas, and deter people from contacting official agencies.

k. Requiring houses to be revalued on changes of ownership might cause great difficulty for the housing market.

l. Special arrangements might be necessary in the Orkneys and Shetlands, where the rate income from Sullom Voe provided a substantial proportion of local revenue which would be lost when the yield of the non-domestic rate was pooled.

THE PRIME MINISTER, summing up the discussion, said that the Sub-Committee were grateful to the Secretary of State for the Environment for the further work he had done. It was clear that the more extreme effects of the earlier proposals had been moderated by introducing the safety-net grant, and in particular the redistribution of resources from the North to the South had been eliminated. The pattern of gains and losses suggested by the latest exemplifications was in general acceptable, although the Sub-Committee noted that some people, particularly pensioner couples, could face substantial losses if a community charge were introduced, and the interaction with the Social Security Review needed to be considered further.

The Sub-Committee recognised that there would be difficulties in registering all adults and in enforcing payment of a community charge, but nevertheless considered that it could be made to work and endorsed it in principle. Further consideration would need to be given to the taxation of second homes (particularly those owned by foreign residents), hotels, and the details of the community charge.

The Sub-Committee had been unable to identify any acceptable valuation basis for a property tax in the longer term. It was clear that there was no longer a sufficient rental market to update annual rental values, and no general revaluation could be contemplated. Nor was it acceptable that there should be revaluation to take account of physical changes whenever a property changed hands: even on that basis there would be some 2 million revaluations a year. The Sub-Committee would therefore wish to see movement towards significant reduction in the extent to which the property element contributed to the local domestic tax.

There were great attractions in the proposal put forward by the Secretary of State for Wales, which would introduce the community charge at a relatively low level while first reducing and then freezing the property element. The amount of revenue raised through the property element would then steadily diminish, and indeed the point might be reached at which it could be eliminated altogether. The Secretary of State for the

Environment, in conjunction with the Secretary of State for Scotland and the Chancellor of the Exchequer, should consider further the details of the scheme with the Secretary of State for Wales, and should bring forward proposals in the draft Green Paper. This should indicate how the importance of a property element would be diminished over a transitional period that should not be more than 10 or 12 years, although it would be acceptable for the transitional period in Scotland to be shorter than that in England and Wales.

The Green Paper should cover the whole of Great Britain, but with sections within it explaining the particular circumstances of Scotland and Wales. The draft would be considered first by the Sub-Committee in mid-December, and then by the Cabinet very early in the New Year, with a view to publication before the second reading of the Social Security Bill.

The Sub-Committee did not agree that the arrangements for the non-domestic revaluation should be announced in advance of the Green Paper, and indeed saw advantage in the new valuation list being implemented in 1990 at the same time as the next revaluation was due in Scotland.

The Sub Committee -

Took note, with approval, of the Prime Minister's summing up of their discussion, and invited the Secretary of State for the Environment and other Ministers concerned to proceed accordingly.

Cabinet Office

13 November 1985