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Revaluation and reform of council tax in Wales: impacts on different councils and household types

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Revaluation and reform of council tax in Wales: impacts on different councils and household types

Council tax bands in Wales are based on property values in April 2003 – 17 years ago. That is more up to date than in England and Scotland, where they are still based on values in April 1991. But it is enough time for the relative prices of different properties to change significantly: for example, official estimates suggest average prices in Blaenau Gwent had risen by 171% by the end of 2019, compared with just 77% in Wrexham.

Moreover, while the difference in (2003) values between a property in Band A and a property in Band I is at least 9.5-fold, the difference in tax bills is just 3.5-fold. Council tax is therefore both increasingly out of date and arbitrary, and highly regressive with respect to property values. It is ripe for revaluation and reform.

This note summarises a new IFS report analysing the effect of revaluing and reforming council tax on different local authorities (LAs) and different household types in Wales. This is in the context of a commitment from the Welsh Government to make council tax 'fairer and more progressive'.

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

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

Key policy messages and findings

- 1. Council tax is out of date, regressive and distortionary. It needs to be revalued and reformed.** The values of properties in different parts of Wales have changed very differently over the 17 years since the last revaluation, increasing more than twice as much in Blaenau Gwent as in Wrexham, for example. This means properties are in increasingly arbitrary tax bands that may bear little relation to current reality: two households living in equally valuable properties in the same LA can find themselves paying tax bills hundreds of pounds different just because their properties used to be worth different amounts in 2003. Council tax is also highly regressive with respect to property value, and the 25% discount for single-adult households encourages the inefficient use of property.
- 2. Whether grant funding from the Welsh Government were adjusted alongside reforms to council tax would have a crucial effect on the reforms' impact across LAs.** If it were not, each LA would need to raise just as much council tax revenue as before if it wanted to maintain spending – implying no change in the average tax bill in each LA, even as the amounts paid by individual households went up and down. With full adjustment of funding, average bills would change to reflect changes in local tax bases. For example, making council tax proportional to up-to-date values would lead to average bills falling by more than £160 in Merthyr Tydfil, Neath Port Talbot and Blaenau Gwent. Conversely, they would rise in areas with high average property values such as Cardiff, the Vale of Glamorgan and Monmouthshire. In what follows, we assume funding is fully adjusted.
- 3. Reform could make council tax much more progressive.** Revaluation alone would have little effect on the average tax bills of different household types. But a proportional council tax would reduce net council tax bills by the equivalent of 0.5% of household income, on average, for households in the bottom fifth of the income distribution, while increasing average bills by 0.3% of income for those in the top fifth. Younger households, renters and those receiving disability benefits would also see tax reductions, on average.
- 4. While there may be particular concern about low-income losers from reforms, it is important to recognise they would be massively outnumbered by low-income winners.** For example, 21% of households in the bottom fifth of the income distribution would see their net tax bill fall by more than £200 a year under a continuous and proportional council tax, while just 3% would see it increase by more than £200 a year. Many would see little or no change because their bills are fully or largely covered by the council tax reduction scheme, which could be made more generous if the Welsh Government wanted to mitigate the impact of reforms further. The government could also consider transitional relief and deferral of payments – although getting the design of deferral schemes right is vital to avoid undermining tax revenue.
- 5. Revaluation and reform of council tax could help narrow household and geographical wealth inequalities via effects on property prices.** Economic theory and empirical evidence suggest that changes in property taxes get largely or fully reflected in rents and property prices. This means that a proportional property tax would narrow the gap in property wealth between owners of high- and low-value properties and, if accompanied by redistribution of funding from central government, between areas with low and high property values. The scale of these impacts is highly uncertain, though.

Why does council tax need revaluing and reforming?

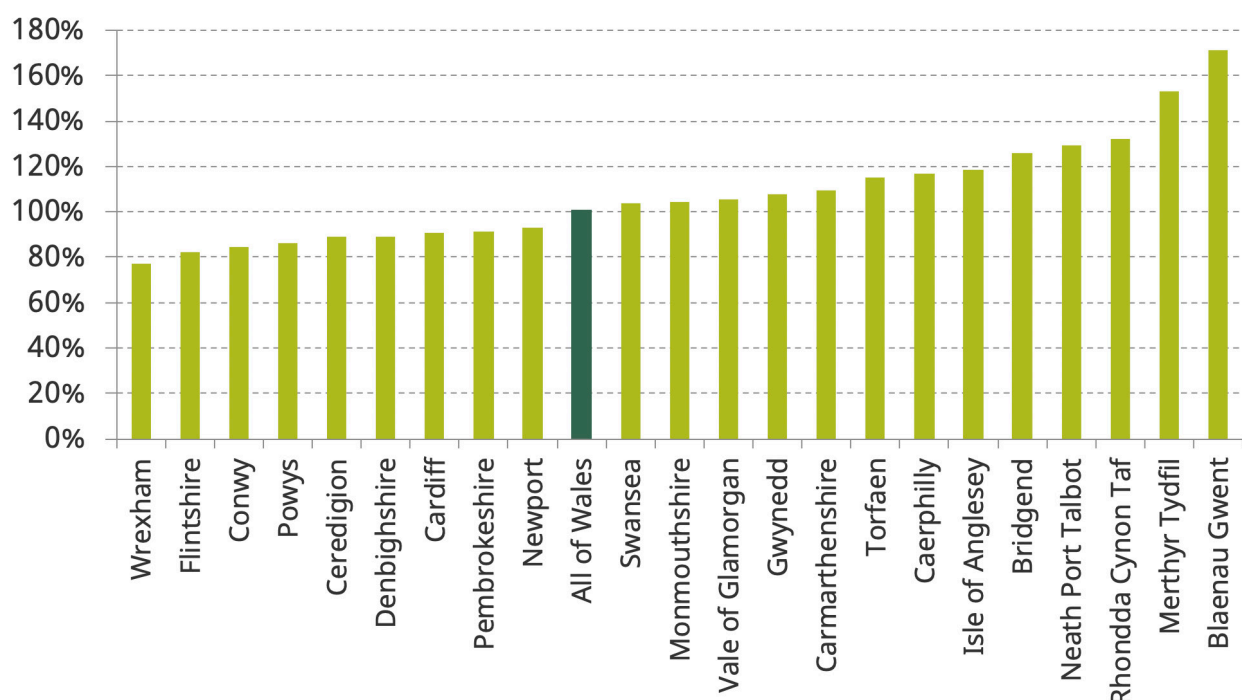
Council tax is out of date and regressive, and distorts the housing market, and is therefore in need of reform.

Council tax in Wales is still based on property valuations from April 2003. While more recent than the 1991 valuations still used in England and Scotland, valuations in Wales are now 17 years out of date.

This creates **unfairness across LAs**. Since 2003, average property prices have doubled across Wales as a whole, but the increase ranges from 77% in Wrexham to 171% in Blaenau Gwent (see Figure 1). Yet the distribution of grant funding from the Welsh Government to LAs is still based on relative property values in 2003. As a result, Wrexham council must levy more tax on a property now worth (say) £150,000 than Blaenau Gwent council, if both are to deliver the spending on services deemed necessary by the Welsh Government.

It also creates **unfairness across households within each LA**. Two households living in equally valuable properties, receiving the same services from the same council, can have different tax bills because one property was worth more than the other 17 years ago.

Figure 1. Percentage growth in average property price 2003–2019, by local authority



Source: Figure 2.3 of Adam, Hodge, Phillips and Xu (2020).

Council tax is **regressive**. Tax on a property in the highest band is 3.5 times the tax on a property in the lowest band, despite the former being worth at least 9.5 times as much (in 2003) and sometimes far more than that. There is a strong case for levying council tax in proportion to property value, particularly given the lack of VAT on housing. Making council tax less regressive (and perhaps other taxes less *progressive*) would be an efficient way to redistribute, given that property taxes cause less distortion to behaviour than most other taxes.

The banded structure also creates inequitable outcomes. It means **similar properties can attract very different tax liabilities**: 22% higher at the bottom of Band E than the top of Band D, for example. Conversely, **very different properties can attract the same tax liability**. A property at the top of Band B or C was worth almost 50% more (in 2003) than one at the bottom of the same band, but their tax bills are the same. All Band A properties in an LA attract the same tax regardless of how far below the £44,000 cut-off they were, and all Band I properties attract the same tax regardless of whether they were worth £425,000 (in 2003) or were mansions worth several million pounds.

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

What reforms do we look at in our report?

Our report examines the impacts of six potential reform options:

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

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

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

Tax band	Existing band	Updated band	Tax rate as % of Band D rate	
			Option 1 Pure revaluation	Option 2 Proportional system
A	Up to £44,000	Up to £78,710	67%	37%
B	£44,001 to £65,000	£78,711 to £112,490	78%	54%
C	£65,001 to £91,000	£112,491 to £155,490	89%	75%
D	£91,001 to £123,000	£155,491 to £203,970	100%	100%
E	£123,001 to £162,000	£203,971 to £275,840	122%	132%
F	£162,001 to £223,000	£275,841 to £380,670	144%	178%
G	£223,001 to £324,000	£380,671 to £553,850	167%	246%
H	£324,001 to £424,000	£553,851 to £741,180	200%	348%
I	Above £424,000	Above £741,180	233%	488%

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

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

How would impacts differ across LAs?

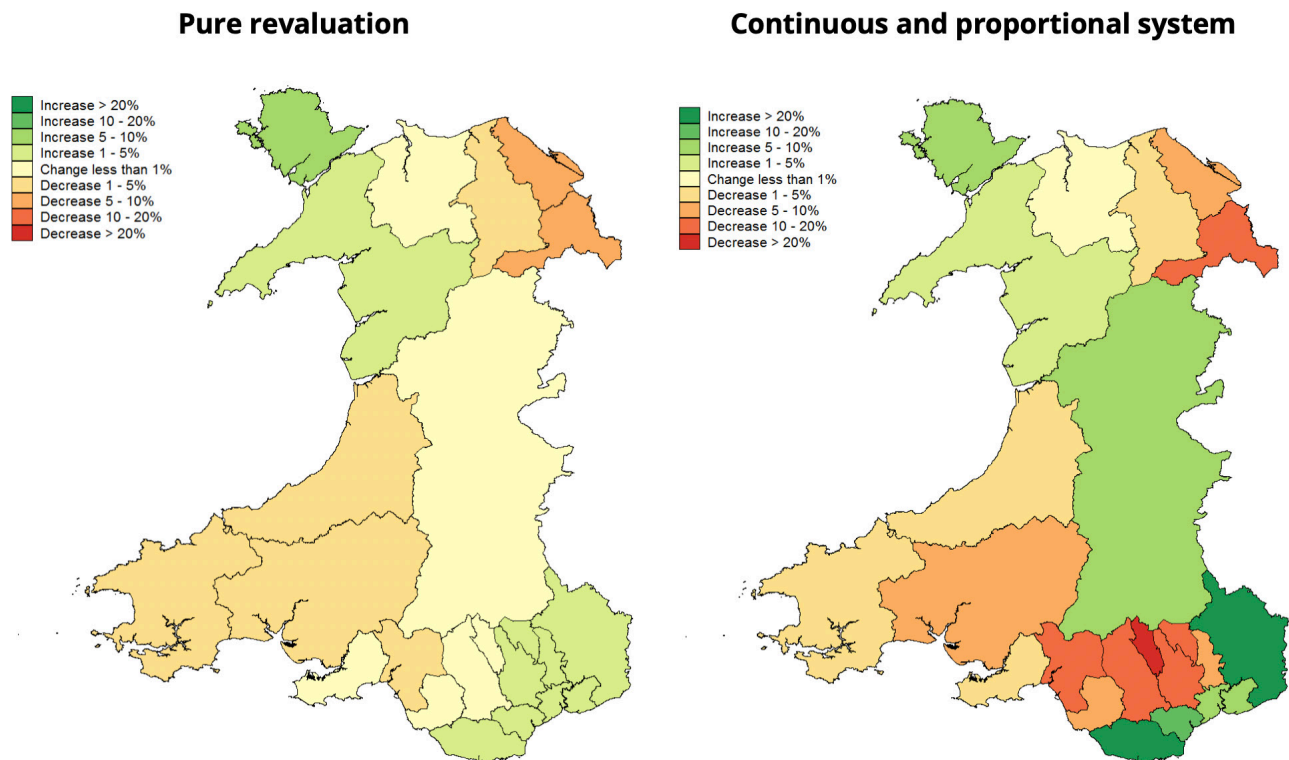
Property values differ significantly across LAs in Wales. For example, we estimate that as of Q1 2019, the average property in Blaenau Gwent was worth around £101,000, while the average property in Monmouthshire was worth around £288,000. And as already highlighted, values in Blaenau Gwent have risen more than twice as much as in Wrexham since the last revaluation in 2003. This means that council tax reform would have different effects on the tax bases of different LAs.

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

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

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

Figure 2. Changes in average net tax bills, by LA area, if grants are fully adjusted



Source: Figure 4.6 in Adam, Hodge, Phillips and Xu (2020).

The left-hand panel shows that a **pure revaluation** would lead to average tax bills increasing in the south-east and north-west of Wales, where values have risen more than average since the last revaluation, and falling in the south-west and north-east of Wales, where values have risen less than average. But the impacts on the average bill in an LA would generally be less than 5% in either direction, with Anglesey (up 5%), Wrexham (down 7%) and Flintshire (down 6%) being the three exceptions.

The right-hand panel shows that the impact of **revaluation and a continuous and proportional council tax** would be more significant, with average bills falling in areas with low average property values, and increasing in areas with high average property values. Average bills in most Valleys council areas would fall by more than 10% – and more than 20% in the case of Merthyr Tydfil – reflecting the low average property prices in these areas. Conversely, average bills in the Vale of Glamorgan and Monmouthshire would rise by 25% and 32% respectively, reflecting the high average property values in these areas.

The **changes in grant funding** that would be needed to fully offset the changes in tax bases are relatively small in the context of overall grant funding levels for Welsh councils. For example, under a **pure revaluation**, we estimate that only one LA would see its grant funding change by more than 2%: Monmouthshire. Most would see a change of less than 1%.

Under a **continuous and proportional council tax**, while the necessary changes would be larger, only in one case would it exceed 10% of current Revenue Support Grant and redistributed business rates funding. Under this reform:

- Grant funding would be reduced in those parts of Wales where average property values are highest – most notably Monmouthshire (–14.4%), the Vale of Glamorgan (–8.5%) and Cardiff (–4.8%). This reflects the fact that under a proportional council tax system, their high average property values would translate into significantly bigger tax bases than under the current regressive council tax system; these LAs would therefore be expected to rely more on council tax for their funding, and less on grant funding.
- On the other hand, in order to offset changes in tax bases, grant funding would have to increase for Valleys LAs, where average property prices are the lowest. Rhondda Cynon Taf would need the biggest cash-terms increase (£14.2 million), while Merthyr Tydfil would require the biggest percentage increase (4.2%). These and other Valleys LAs would rely more on grant funding, as they would be expected to raise less from their residents via council tax.

Of course, zero and full adjustment of grant funding are not the only options available to the Welsh Government: it could choose to **partially adjust grants** to reflect changes in tax bases if it wanted to.

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

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

How would impacts differ across household types?

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

As with impacts across LAs, the effects on different types of households would depend on whether grant funding for LAs is adjusted to reflect changes in tax bases. Here we focus on estimates of the impact of a 'full adjustment' scenario, but, as discussed previously, partial (or indeed no) adjustment would be possible.

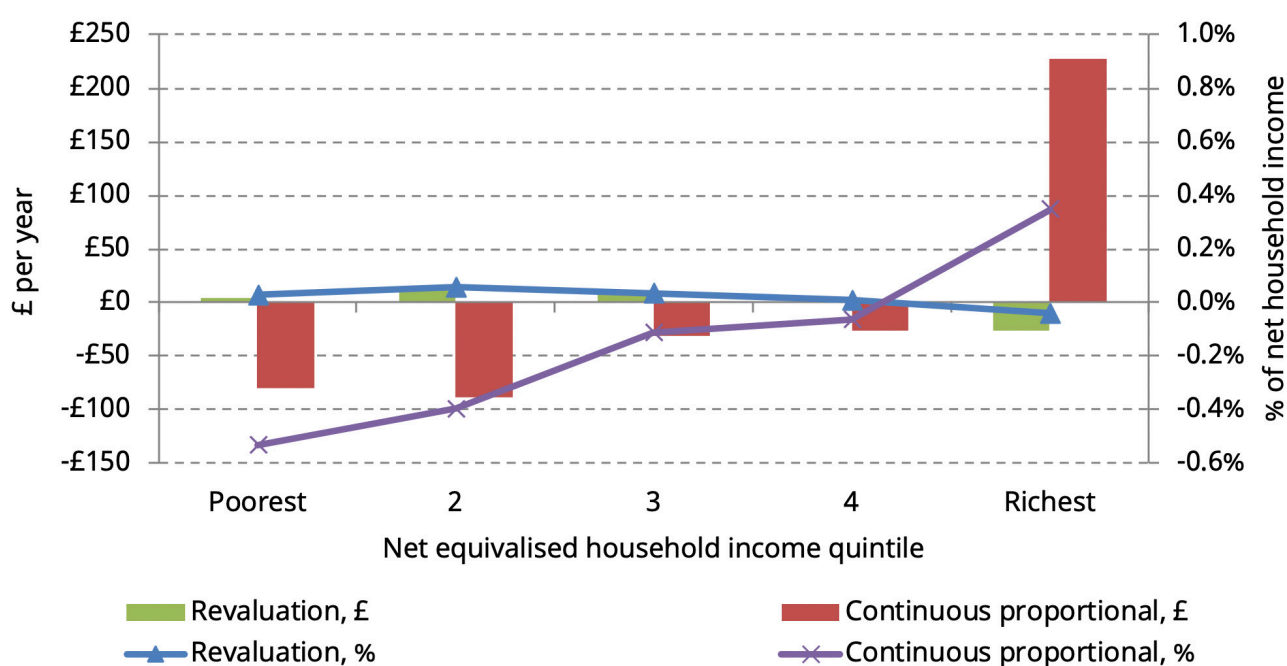
Reforming council tax would create both winners and losers. Under a **pure revaluation**, most households (55%) would see changes in their council tax of less than £50 a year. However, 0.2 million households (13%) would gain by more than £200 a year, while a similar number would lose by more than £200 a year.

A **continuous and proportional council tax system** would lead to larger changes in council tax bills. Many more households would benefit substantially from the reform than would lose out, with 0.5 million households gaining more than £200 a year, compared with 0.2 million losing more than £200 a year. But those who lost from the reform would lose more, on average.

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

- A **pure revaluation** would have little effect on the average tax council tax bills of different household income groups. This reflects the fact that while we estimate around a quarter of properties would move up at least one band and another quarter would move down at least one band, there is no systematic pattern of up or downwards movements for households in different parts of the income distribution. However, fewer poor households than rich households would see big changes (in either direction) in how much council tax they have to pay. This is because many have their bills partially or fully covered by the council tax reduction scheme (CTRS).
- A **continuous and proportional council tax system** would be more progressive relative to income and, of course, property values. Assuming households take up the support from the CTRS to which they are entitled, the lowest-income fifth of households would see their average net tax bill fall by £80 a year, equivalent to 0.5% of household income. The average net bill would fall by £90 a year (0.4% of income) among the next-poorest fifth and rise by £230 (0.3% of income) a year among the highest-income fifth of households.

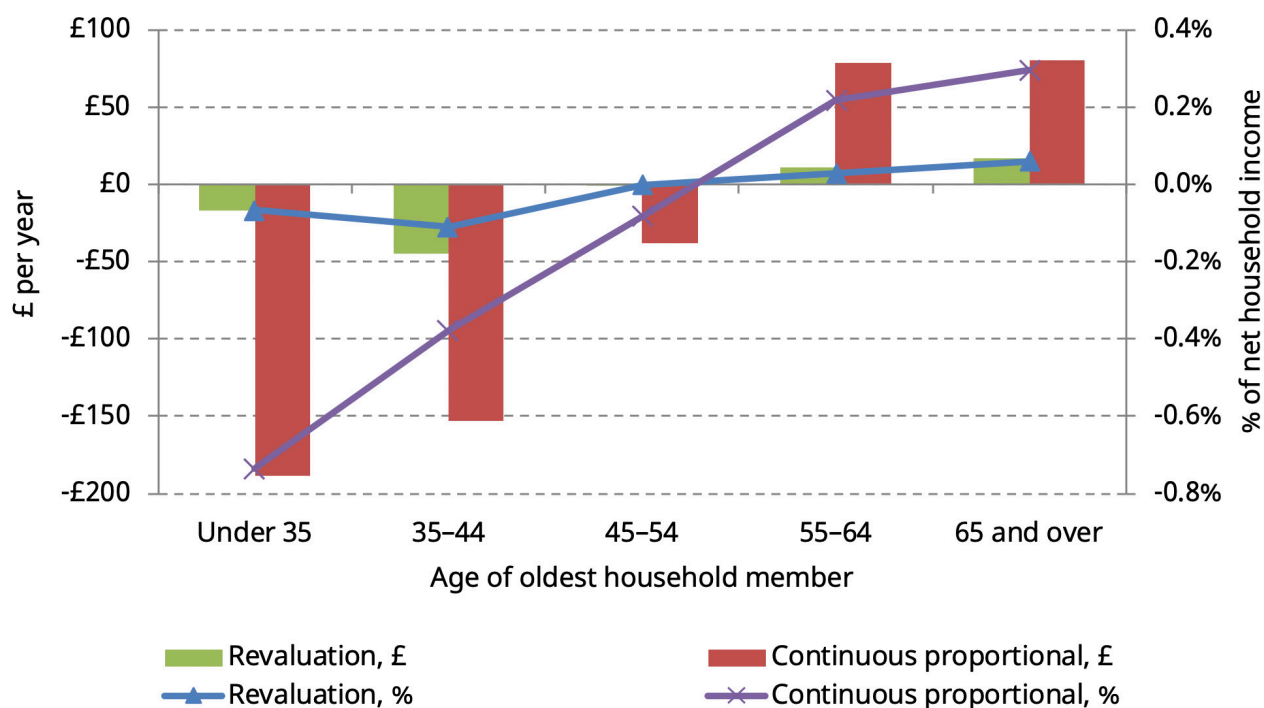
Figure 3. Average change in net council tax bill by household income quintile



Note and source: Figure 5.4 in Adam, Hodge, Phillips and Xu (2020).

A **continuous and proportional council tax system** would also redistribute from older households towards younger ones, as shown in Figure 4. Households in which the oldest person is under 45 would see their net council tax bill fall by £150–£190 a year on average (assuming full take-up of CTRS) and the oldest two age groups would see their net council tax bill rise by around £80 a year on average. These patterns reflect the fact that younger people tend to live in cheaper properties than older people. Under the current regressive council tax, young people face tax rates that are higher as a proportion of property value than older people: a continuous and proportional council tax would see them face the same tax rate.

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



Note and source: Figure 5.10 in Adam, Hodge, Phillips and Xu (2020).

Single-adult households would also see their average tax bills fall under a **continuous and proportional council tax system**. This means there could be an opportunity to abolish the distortionary and inefficient single-person discount at the same time, as the package as a whole would avoid the large losses to single-person households that abolition of the single-person discount on its own would cause. Indeed, we estimate that single working-age adults and lone parents would pay similar levels of council tax on average to those under the current system, although single pensioners would face higher tax bills on average, reflecting the fact that they live in more expensive properties than other groups entitled to the single-person discount. Abolishing the single-person discount would also shield larger households from the rise in average tax bills that would result from a proportional system. Households with two adults would benefit slightly from the combined reform relative to the current system, since the council tax rates required to raise as much revenue as now would be lower if the single-person discount were abolished.

How might rents and property prices respond?

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

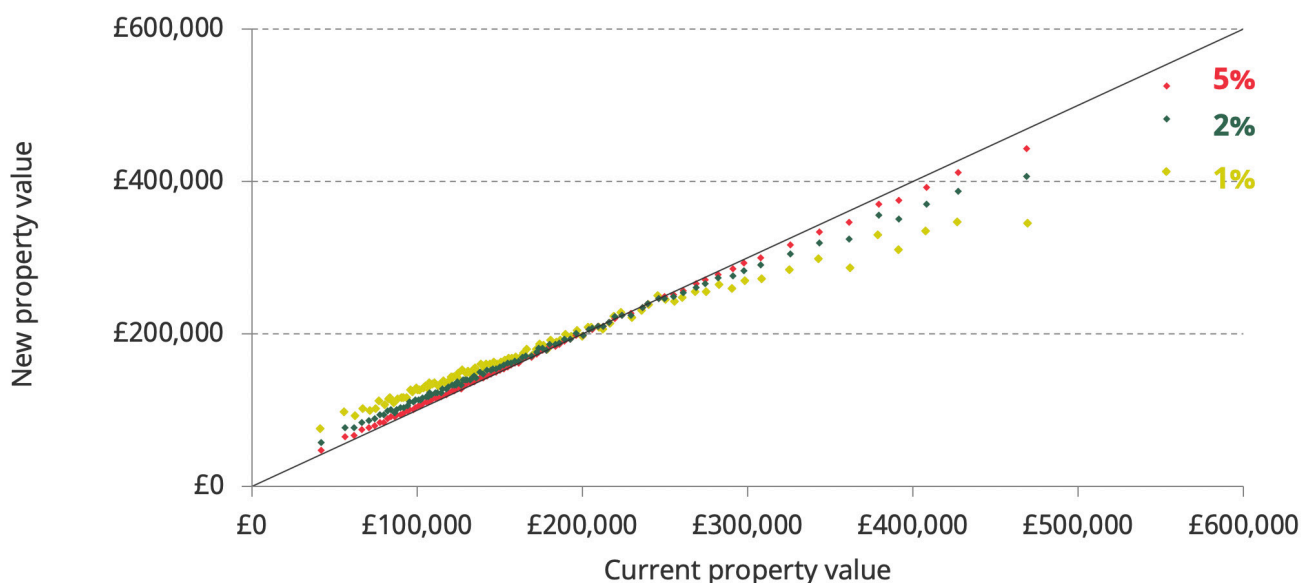
One obvious implication is that it is private landlords rather than tenants who would ultimately be made better or worse off as a result of changes in council tax, as the amount they can charge in rent went up or down. For example, our analysis shows that under a **continuous and proportional system**, council tax bills among households that rent privately would fall by £150 a year on average. (They would change little, on average, under a pure revaluation.) If landlords were able to put up their rent by that amount, households in private rental accommodation would see no change in their disposable incomes, and the gain of £150 would go to landlords instead.

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

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

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

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



A **continuous and proportional system** would also narrow gaps in property values between LAs if grant funding were fully adjusted. Under our baseline assumptions (including a 2% annual discount rate), we estimate that average prices in Blaenau Gwent would rise by around 8.1% (£8,200), whilst average prices in Monmouthshire would fall by around 8.8% (£25,300). This would see the ratio of property values in Monmouthshire to property values in Blaenau Gwent fall from 2.9 times as high to 2.4 times as high, narrowing geographical inequalities in wealth among homeowners. The true effects could be larger or smaller than these, however.

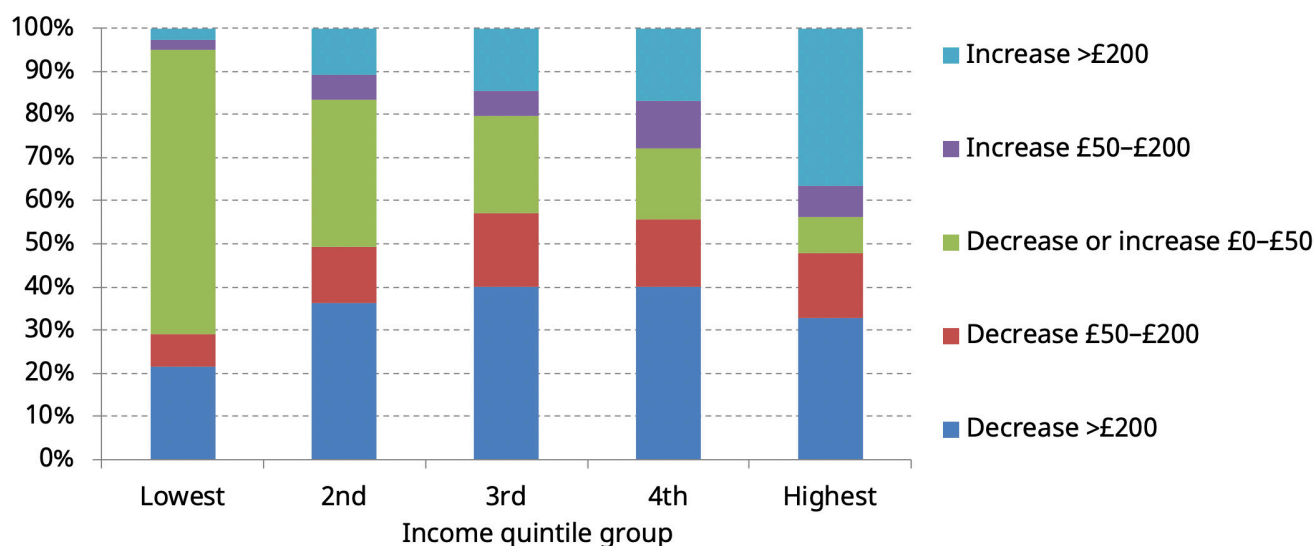
The reform would also increase property values among owner-occupiers in the bottom 20% of the household income distribution, who could see their property values rise by 3% on average. The reverse holds for high-income owner-occupiers: property values for those in the top 20% of incomes could fall by 5% on average. Private landlords tend to live in high-value properties but rent out low-value properties, so the reduced value of their own home would be somewhat offset by a rise in the values of the properties they rent out.

How could losses for vulnerable groups be mitigated?

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

Figure 6 shows that low-income households would, in fact, be far more likely to gain than lose from moves to a **continuous and proportional system**. One in five households with incomes in the bottom fifth of the distribution would see their net tax bill fall by over £200 a year, with less than 3% seeing it increase by more than £200 a year. This reflects the fact that most low-income households live in relatively low-value properties and would see cuts in their gross council tax bill under a proportional tax.

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



The scale of gains and losses would be much smaller than this for a pure revaluation, or if grant funding were not fully adjusted, or if reforms to make council tax less regressive were accompanied by offsetting reforms to make other taxes less progressive. But even under the radical option of a proportional council tax, two-thirds (66%) of low-income households would see their net council tax bill change by less than £50 a year. This reflects the fact that many are entitled to support from the council tax reduction scheme (CTRS), which insulates them (in many cases fully) from changes in their gross council tax bill. One way to help low-income losers would be to increase the generosity of the CTRS and/or put in place measures to increase take-up among groups where take-up has historically been low.

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

- **Transitional relief**, which would phase in increases in tax bills gradually. This could be paid for by the Welsh Government or LAs, or by similarly phasing in reductions for those whose bills fall.
- **Deferred payment**, which would allow at least some owner-occupiers to defer paying part or all of their bill – until sale or death, or for some other limited period – in effect taking out a loan to cover the part they do not pay immediately. Getting the design of such a scheme right would be important, and especially ensuring people have no reason to believe a future government might write off the deferred bills.

What next?

If the Welsh Government does take forward revaluation and reform of council tax – which there is a strong case to do – it would need to consider at least four key planning and implementation issues.

First is the extent to which grant funding for LAs is adjusted alongside revaluation and reform of council tax. If the government wants to temper changes in tax bills, and in particular the tax rises that many households in more expensive parts of Wales could face, it may want to only partially adjust this funding. On the other hand, more significant adjustment would mean that the grant funding provided to LAs would more closely reflect the size of their tax bases, thereby providing a bigger boost to funding for the Valleys and north-east Wales.

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

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

Fourth, the Welsh Government should consider legislating for regular revaluations – every three years, for example, or even annually – to take place, as they do with business rates. This would allow for more frequent but smaller changes in tax bills, which would almost certainly be less politically difficult to implement than large, unexpected, one-off reforms. And it would ensure Wales does not find itself in a similar situation to now in another 17 years.

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