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# Reforming Council Tax Benefit: Options for Wales

Stuart Adam and James Browne

Cardiff, 31 May 2012



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Fiscal Studies

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# The existing system and the reform

Stuart Adam

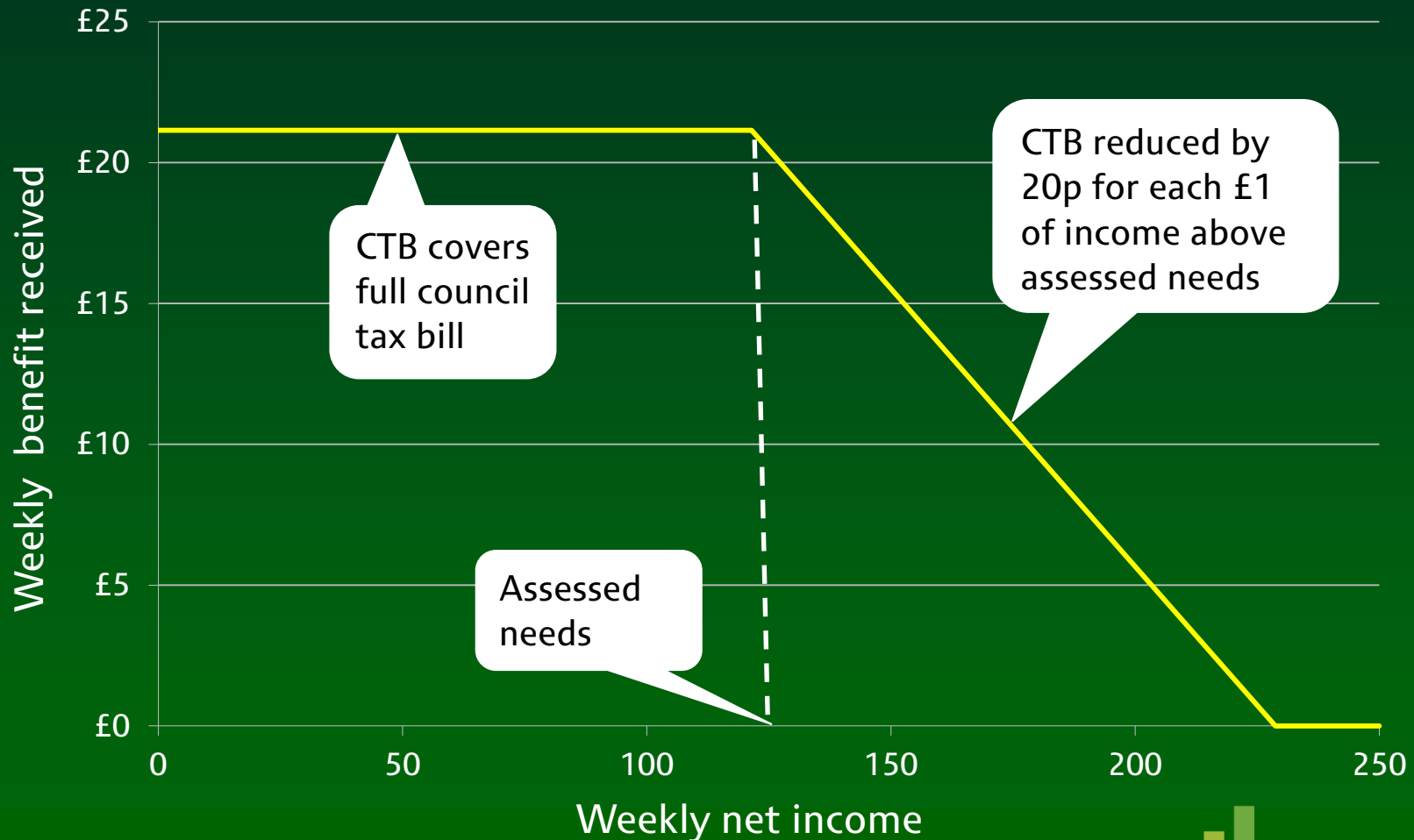
# Two reports

- *Reforming Council Tax Benefit*
  - Funded by Joseph Rowntree Foundation
  - [www.ifs.org.uk/publications/6183](http://www.ifs.org.uk/publications/6183)
- *Reforming Council Tax Benefit: Options for Wales*
  - Funded by the Welsh Government
  - <http://www.ifs.org.uk/publications/6204>

# Council Tax Benefit – the key facts

- 328,000 recipients in Wales
  - More than any other means-tested benefit or tax credit
  - But only two-thirds of those entitled to it
- £243 million total cost in 2012-13
  - £4.9 billion across Britain: 2.4% of total benefit and tax credit expenditure
  - £15.69 per claimant per week is not large relative to other benefits
- Administered by local authorities but rules set by UK Government
- Maximum entitlement is the household's council tax bill
  - Reduced by 20p per £1 of net income above a threshold
  - 70% of claimants 'passported' to full entitlement by receipt of another benefit

# An example of CTB entitlement by income



# Who receives CTB?

Households containing:	Proportion of CTB spending	Proportion of households
a pensioner	40%	31%

# Who receives CTB?

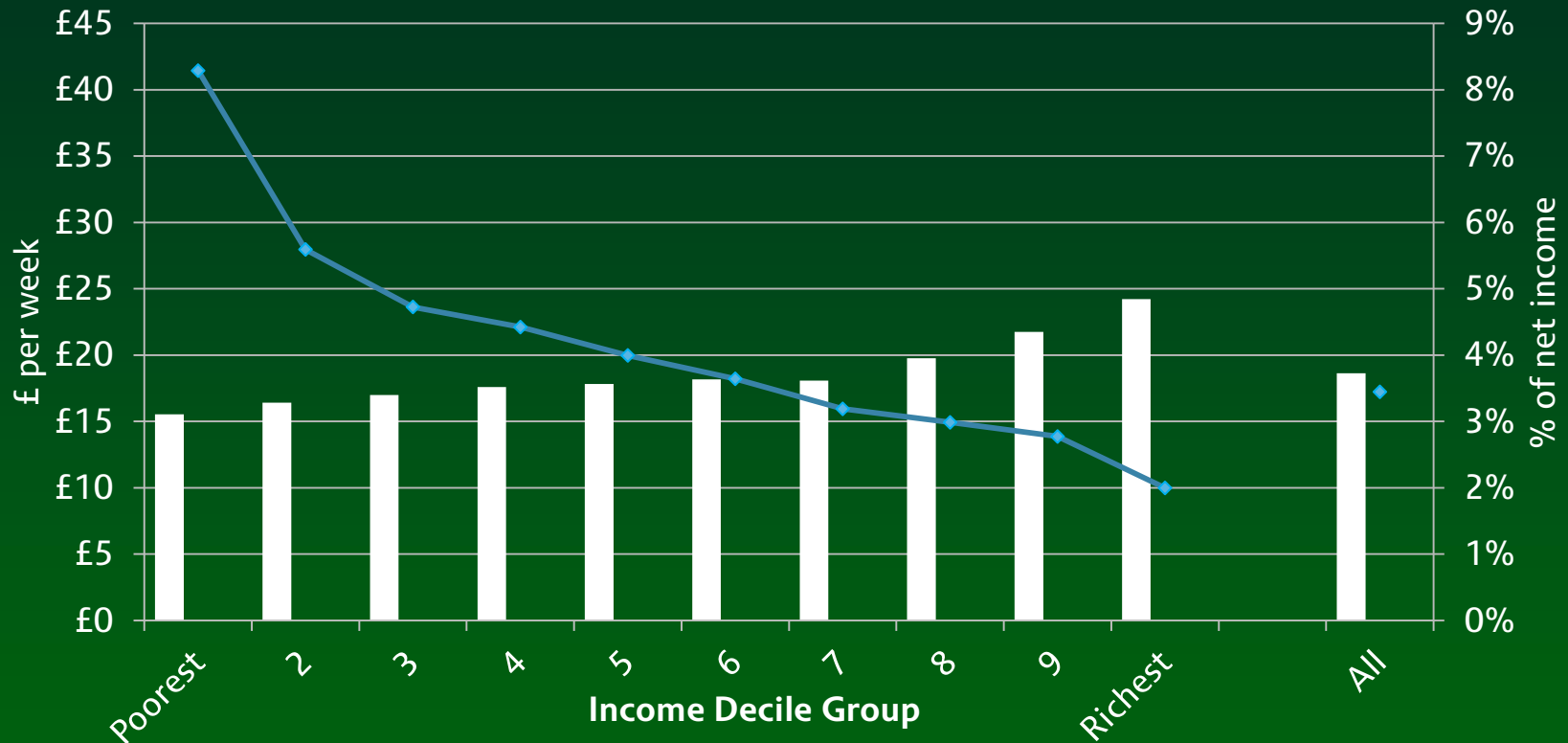
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# Who receives CTB?

Households containing:	Proportion of CTB spending	Proportion of households
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an adult receiving a disability benefit	57%	23%



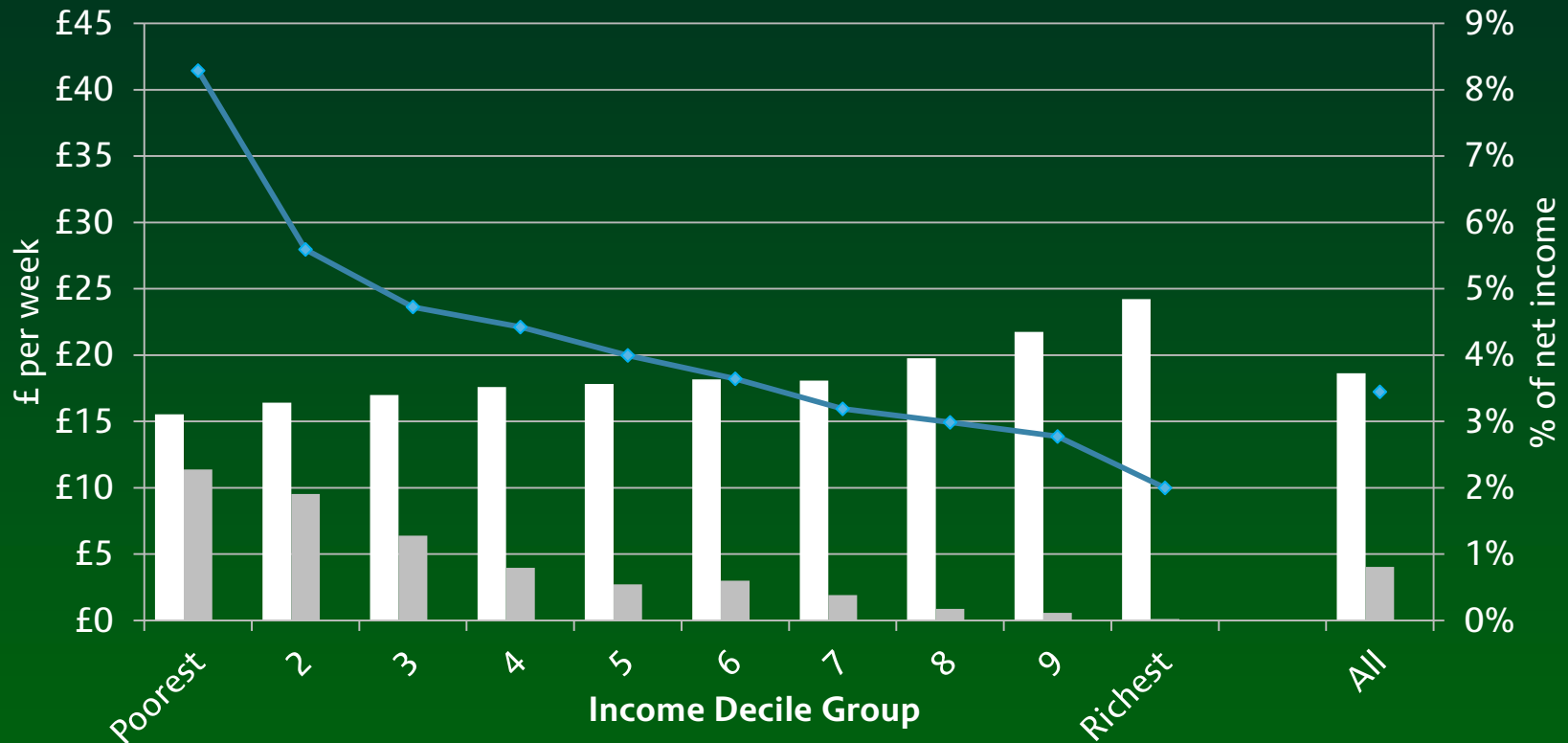
# Distributional impact of council tax and CTB



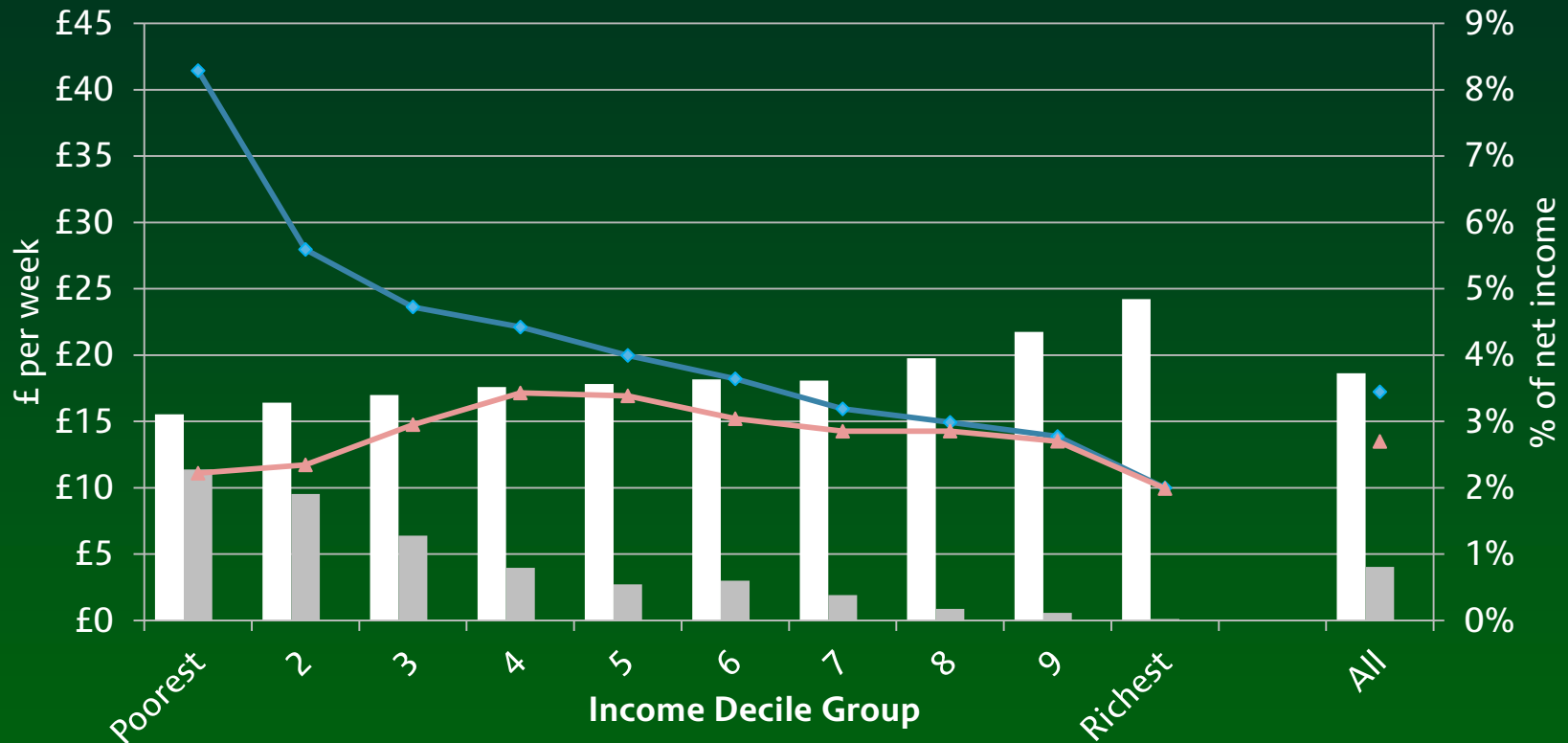
- Average council tax (left axis)
- Average CTB entitlement (left axis)
- Average CTB received (left axis)
- ◆ Gross council tax liability (right axis)
- Net council tax liability, with non take-up of CTB (right axis)
- Net council tax liability, full take-up of CTB (right axis)



# Distributional impact of council tax and CTB



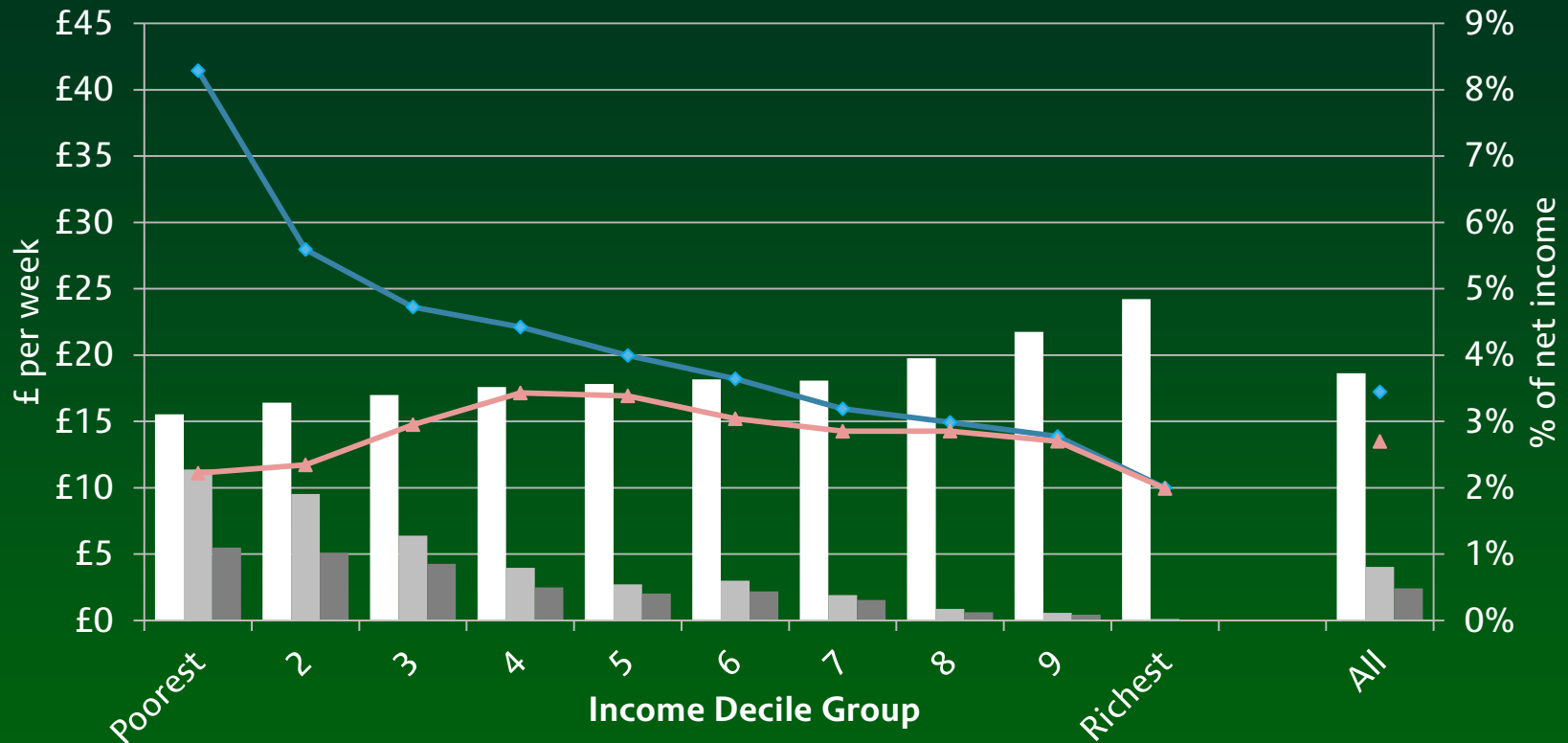
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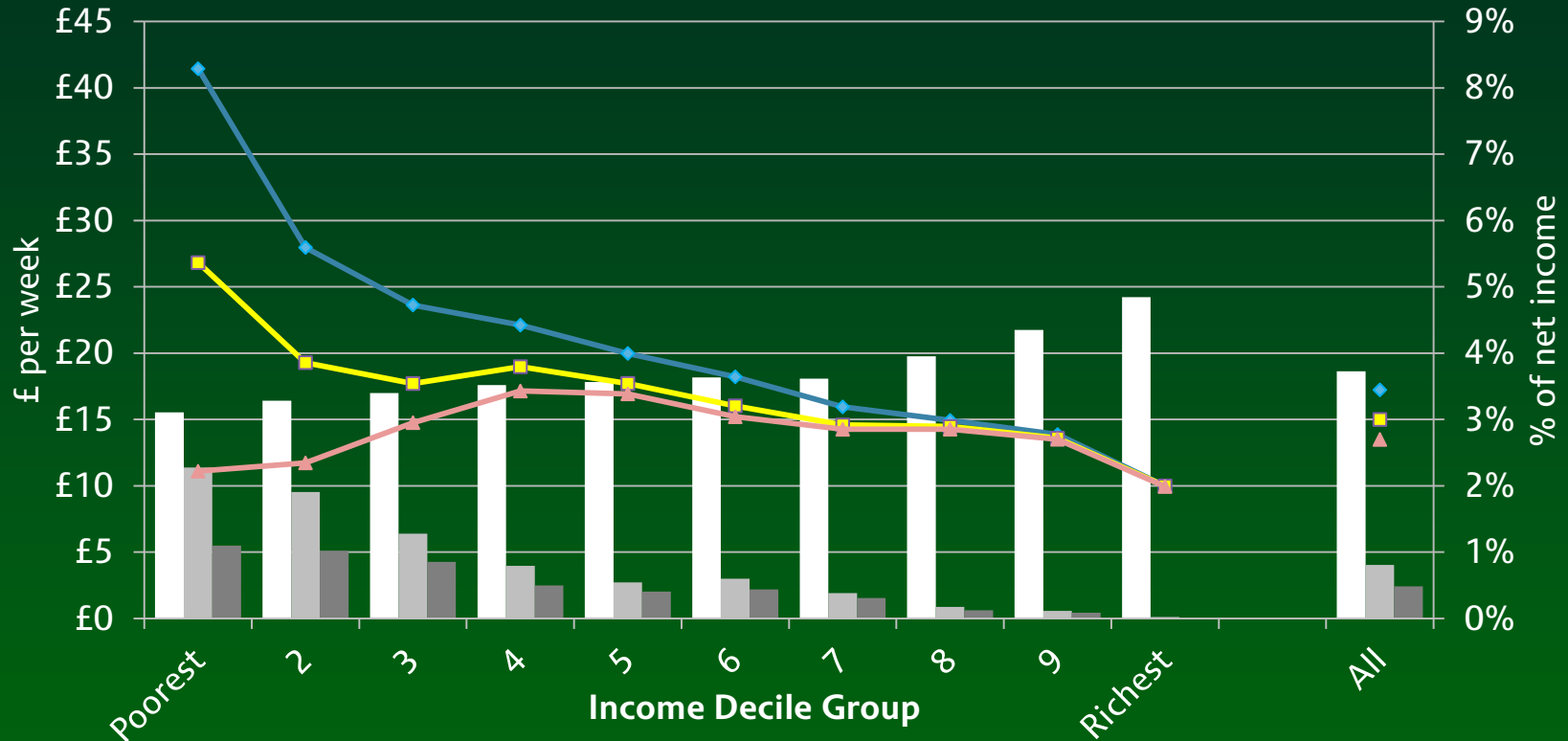
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# Distributional impact of council tax and CTB



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# Criticisms of CTB

- Complexity and non-take-up
  - One in three eligible families do not claim their entitlement
- Weakens incentives to work
  - Small effect on average; more significant for some groups
- Weakens incentives to save in certain forms
- An artificial incentive for claimants to live in bigger properties
- Weakens local accountability and distorts LAs' incentives
  - Spending an extra £1 requires raising less than £1 from local residents

# The policy

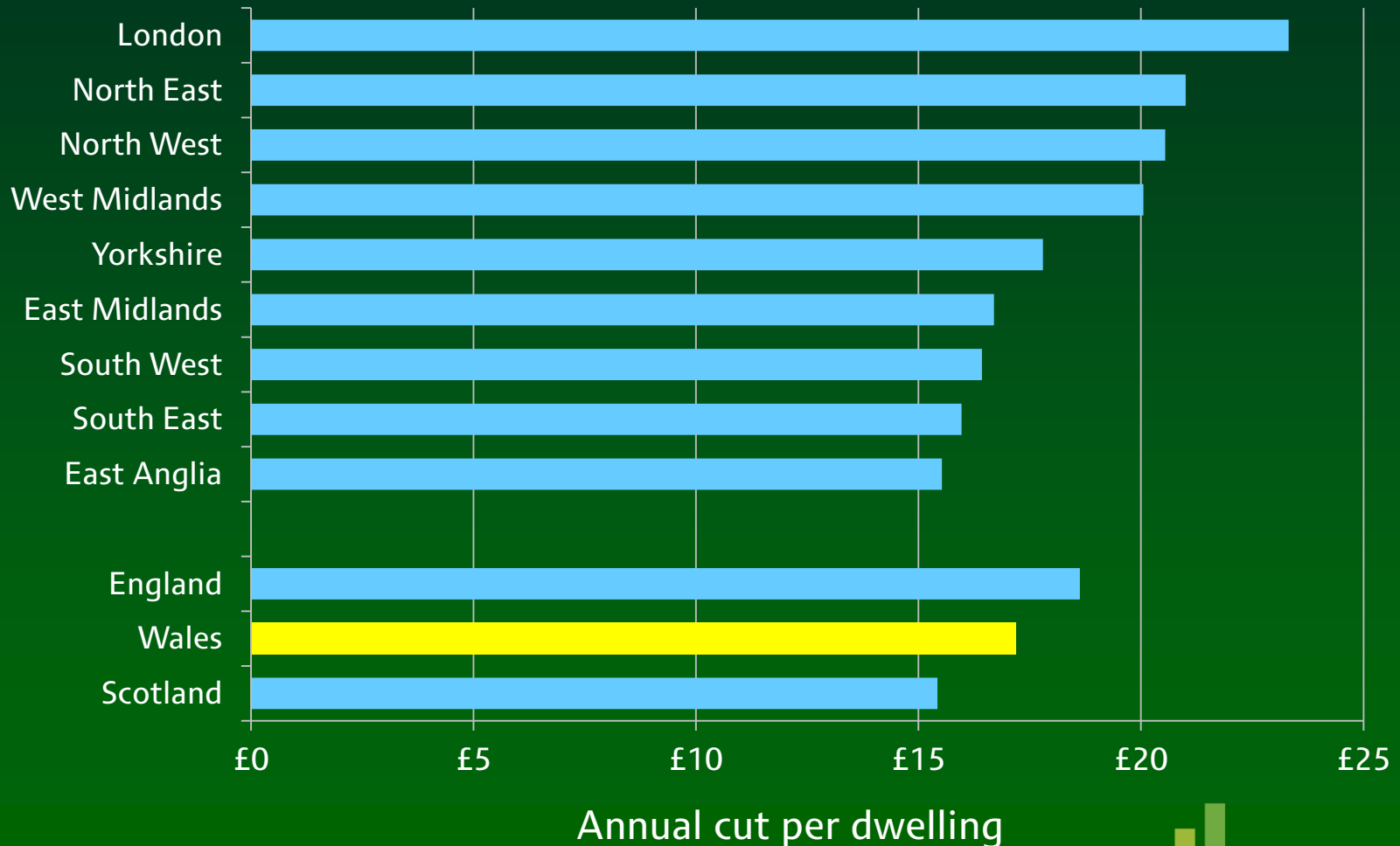
- CTB will be abolished from April 2013
- LAs in England, and the Scottish and Welsh Governments, given grants to run their own rebate schemes instead
- Grants based on 90% of what unreformed CTB would have cost in each area
  - No obligation to spend exactly this amount on replacement schemes
- England:
  - Pensioners will continue to get current, nationally set, entitlements
  - Individual LAs currently designing schemes for working-age claimants
- Scotland:
  - Maintain existing entitlements for all claimants
  - Make cuts elsewhere in Scottish Government and LA budgets instead

# The policy in Wales

- CTB spending in Wales is £243m in 2012-13
  - May change by 2013-14
- £24m funding cut = £17 per dwelling



# Annual funding cut per dwelling, by region



# The policy in Wales

- CTB spending in Wales is £243m in 2012-13
  - May change by 2013-14
- £24m funding cut = £17 per dwelling
  - Equivalent to 2.1% increase in council tax rates or 0.2% cut in Welsh Government spending
- Welsh Government has decided to pass this on fully to CTB claimants
  - Cut of £74 per CTB claimant per year
  - Where might the reductions be made?
- A uniform scheme across the whole of Wales
- Operated by LAs from fixed cash grants

# A uniform scheme across Wales

- Devolving to individual LAs would have allowed schemes to reflect local priorities
- But would have reduced transparency and increased bureaucracy
- Localisation in England may allow the Welsh Government to learn from a wider variety of experiences

# Adding risk to local authority finances

- LAs will receive fixed grants instead of having actual costs refunded
- So face shortfall (surplus) if cost higher (lower) than expected
  - eg change in unemployment or take-up
- If shortfall, only option is to draw on reserves
  - Cannot borrow or increase council tax in-year
  - If insufficient reserves, would have to cut spending for rest of the year
  - LAs with low reserves may want to budget with extra caution
- Risk accentuated if business rates also localised
  - eg closure of major local employer brings two sets of costs
  - (Partially) happening in England
  - Relevant for evaluating Morgan Review proposals
- Practical importance depends on levels of risk and of reserves

# Incentives for local authorities (1)

- LAs will receive fixed grants instead of having actual costs refunded
- So they have an incentive to reduce the cost of rebates
- There are many ways to do this
  - Try to increase employment and incomes among claimants
  - Discourage claimants from living in the area
  - Discourage development of low-value properties
  - Don't promote take-up of rebates
  - Reduce payments made due to error and fraud
  - Reduce council tax rates
- Some of these remove undesirable distortions; others create them
- Difficult to say how far LAs will act on these incentives

## Incentives for local authorities (2): future grants

- Strength of incentives will depend on how grants set in future
  - UK and Welsh Governments not yet decided this
- If grants adjust to reflect changing cost of rebates, gain from reducing costs only temporary
  - More frequent adjustments → weaker incentives
- Fixing grants for long periods targets changing needs less closely
- Fixing grants gives LAs more certainty how much they will receive
  - But predictable adjustments may give more certainty in overall budget
- One of the most important decisions to be taken



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# Options for the Welsh Government

James Browne

# Options available to the Welsh Government

- We look at six options
  - 1) Reduce entitlement by 10% across the board
  - 2) Only refund 91% of council tax liability
  - 3) Restrict support to the level for Band B property
  - 4) Remove entitlement from Bands E and above
  - 5) Increase withdrawal rate to 30%
  - 6) Reduce single person discount to 20%
- All except 4) and 5) reduce expenditure on support for council tax in Wales by around 10%
  - 4) reduces expenditure by 8.7% and 5) by 4.5%
- No ‘vulnerable groups’ protected in our analysis

Reduce entitlement for all claimants

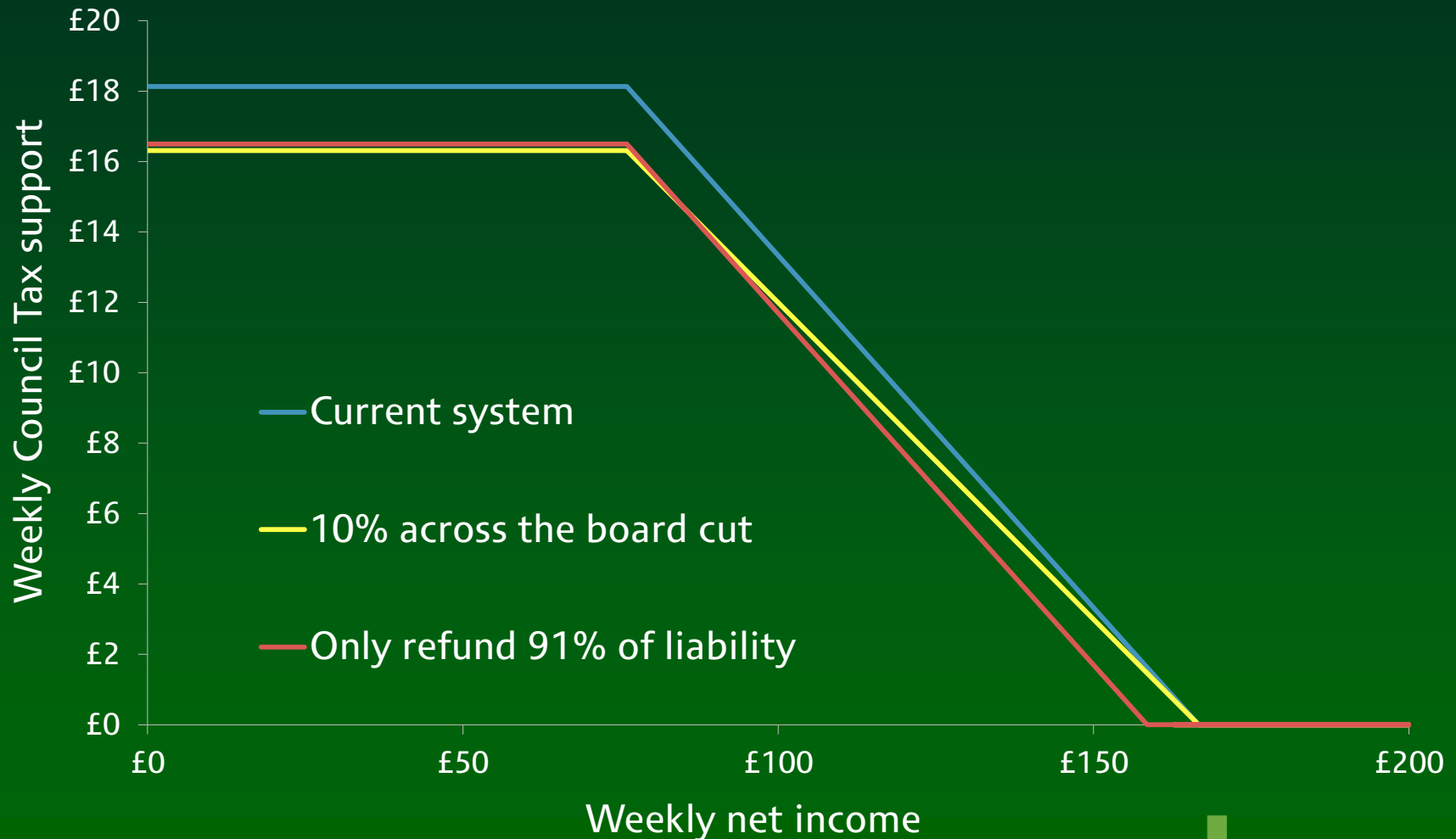
Reduce entitlement for those in higher bands



# Reducing support for all claimants

- 2 policies we consider:
  - 1) Across the board 17% cut
  - 2) Only refund 85% of council tax liability

# Options that reduce entitlements for all claimants

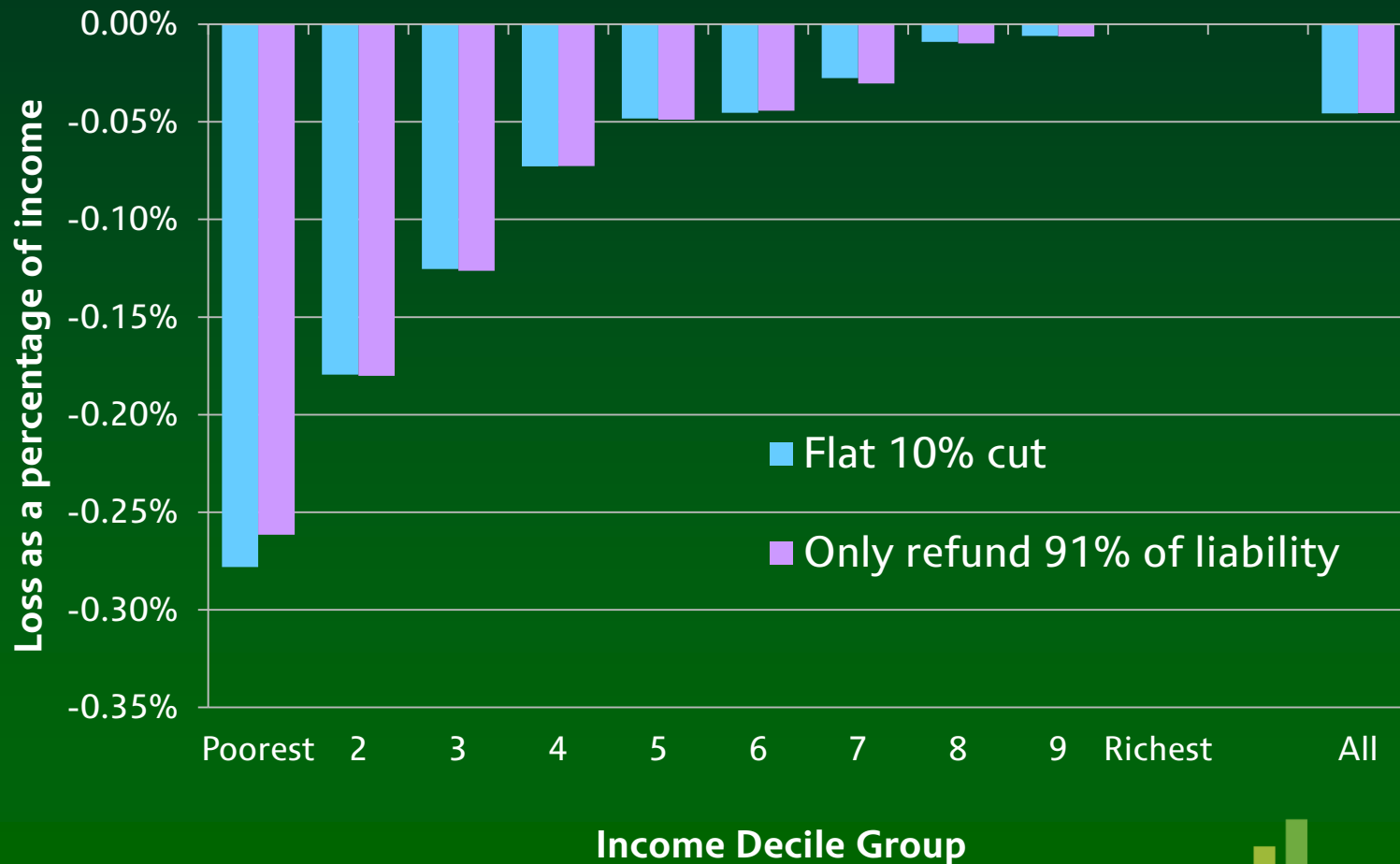


Note: assumes single adult in Band C property

# Reducing support for all claimants

- 2 policies we consider:
  - 1) Across the board 10% cut
  - 2) Only refund 91% of council tax liability
- Both require LAs to collect some council tax from those with very low incomes
  - Poll tax experience suggests this might be difficult
- As with all reforms that reduce council tax rebate entitlement, poor lose most
  - Reducing maximum entitlement to 91% of council tax liability involves slightly lower losses for poorest tenth and slightly higher losses for those slightly richer

# Distributional impact of options that reduce entitlements for all claimants



# Reducing support for all claimants

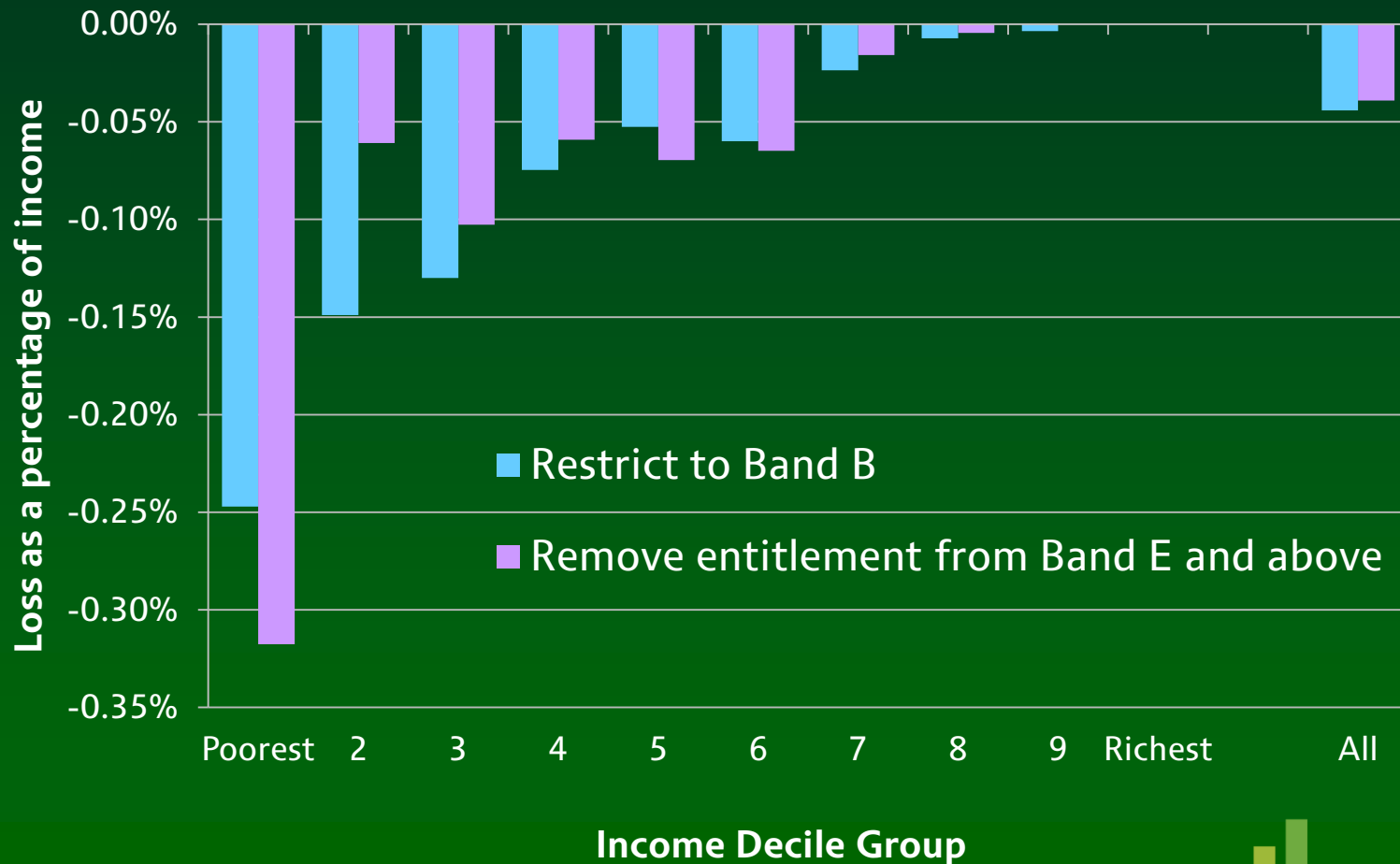
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- As with all reforms that reduce council tax rebate entitlement, poor lose most
  - Reducing maximum entitlement to 91% of council tax liability involves slightly lower losses for poorest tenth and slightly higher losses for those slightly richer
- Reducing means-tested benefit tends to strengthen incentive to do paid work, particularly for those with the weakest incentives
- Reduce expenditure by around 10% in Wales



# Reducing support for those in high-band properties

- 2 policies we consider:
  - 1) Restrict support to the level for a Band B property
  - 2) Remove entitlement from those in Band E and above
- Restricting support to the level for a Band B property reduces cost of council tax support in Wales by 10%
- Removing entitlement from those in Band E and above only reduces cost by 8.7%
- Affects those living in more expensive areas or larger properties
  - Tend to be families with children
  - Slightly less regressive than reducing support for all claimants

# Distributional impact of options that reduce entitlements for all claimants



# Reducing support for those in high-band properties (2)

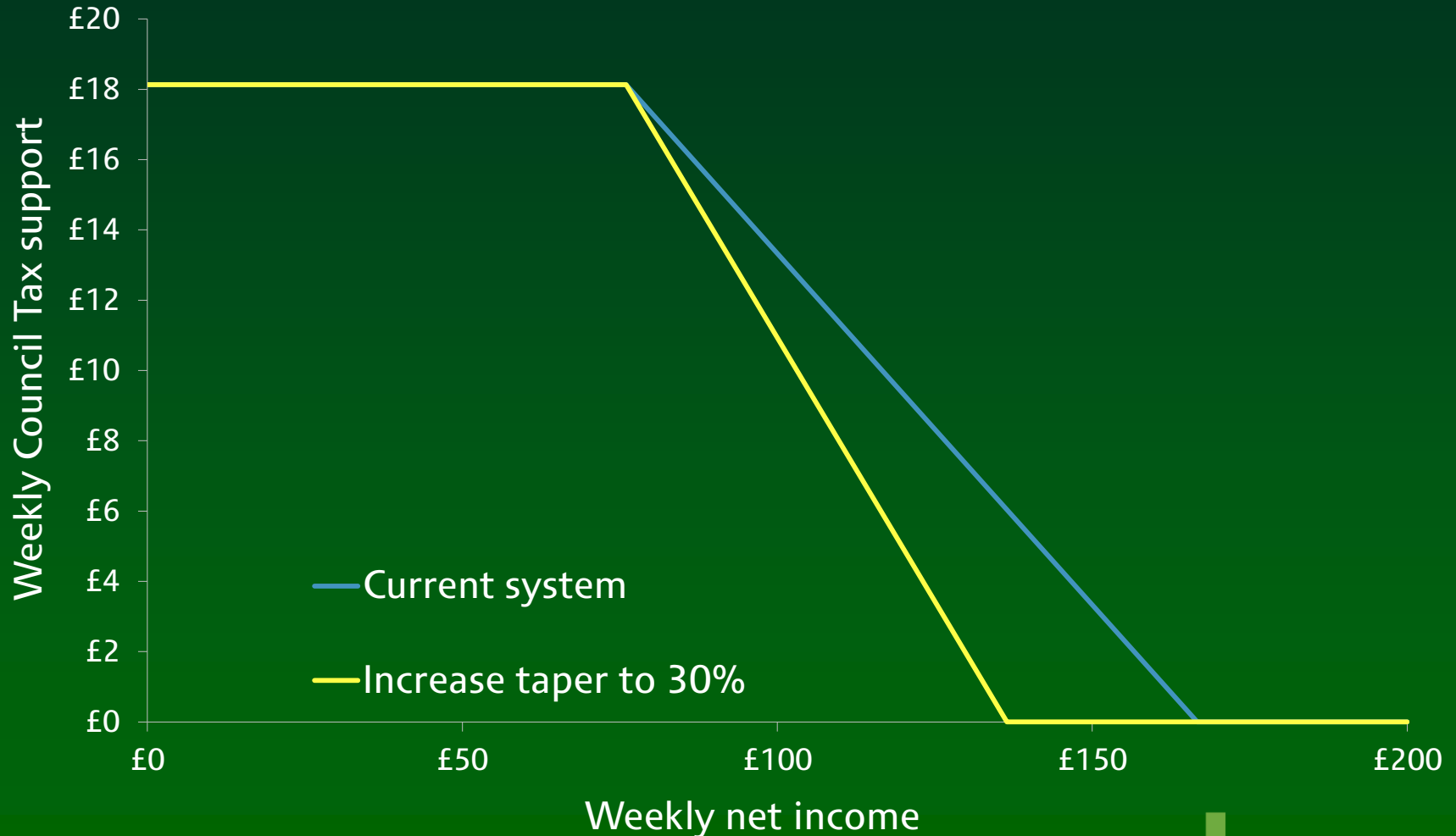
- Requires LAs to collect some council tax from those with very low incomes living in more expensive properties
  - Though as living in expensive properties, may not be as poor as low current income suggests in all cases
  - Strengthens work incentives for those affected
- Restricting to Band B means families have to pay full cost of living in more expensive properties
  - Attractive feature of policy
- Removing entitlement from Band E and above means very strong disincentive to move from Band D to E
  - But doesn't affect incentive to move from bands A–C to D
  - And those affected lose significantly: average loss among losers £968



# Increasing withdrawal rate

- Increase rate at which support for council tax is withdrawn as income rises from 20% to 30%

# Increasing withdrawal rate to 30%



Note: assumes single adult in Band C property

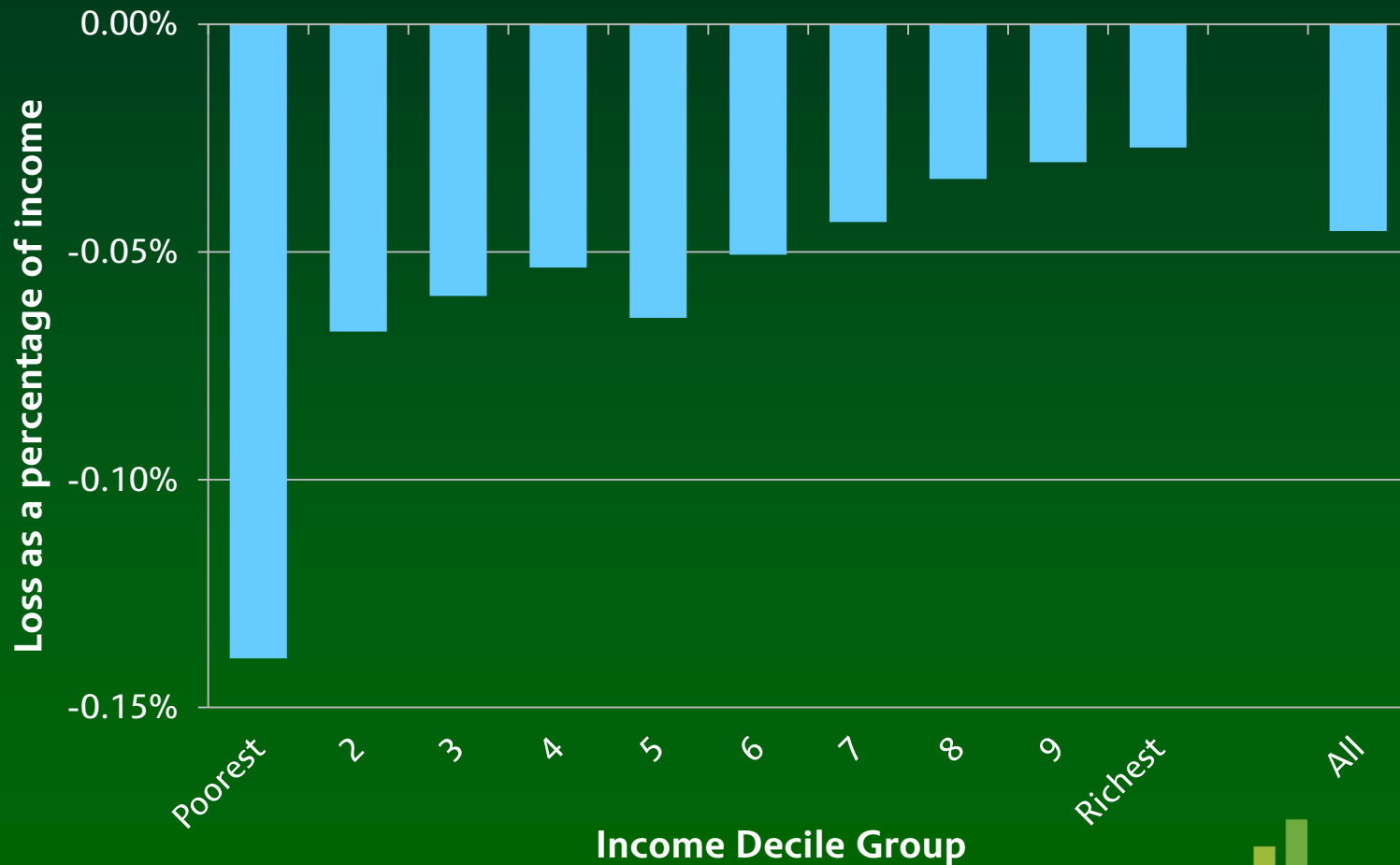
# Increasing withdrawal rate

- Increase rate at which support for council tax is withdrawn as income rises from 20% to 30%
- Protects the poorest claimants
  - Low earners and pensioners with small private pensions lose
- Because take-up among those on the taper is low, only reduces expenditure on support for council tax by 4.5%
- Ambiguous effects on work incentives
  - Unlike previous reforms which unambiguously strengthened them
  - Incentives for those without a partner in paid work weakened, but incentives strengthened for some second earners in couples
  - Incentive to increase earnings weakened for those who remain on the taper, but strengthened for those no longer entitled

# Reducing single person discount

- Single people get 25% reduction in council tax liability
  - Change to liability rather than CTB entitlement
- Reduction from 25% to 20% would raise the equivalent of 10.4% of CTB spending in Wales
- Those on CTB protected: rebate rises to cover additional liability
- Only reform we consider where most revenue comes from higher income groups
  - Though non take-up of rebates means poorest tenth lose most as a percentage of income

# Distributional impact of reducing single person discount to 20%



# Reducing single person discount

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- Those on CTB protected: rebate rises to cover additional liability
- Only reform we consider where most revenue comes from higher income groups
  - Though non take-up of rebates means poorest tenth lose most as a percentage of income
- Slightly weakens incentive to work for single people
- Single person discount encourages inefficient use of housing stock
  - Single people living in more expensive properties than they otherwise would

## Summary so far

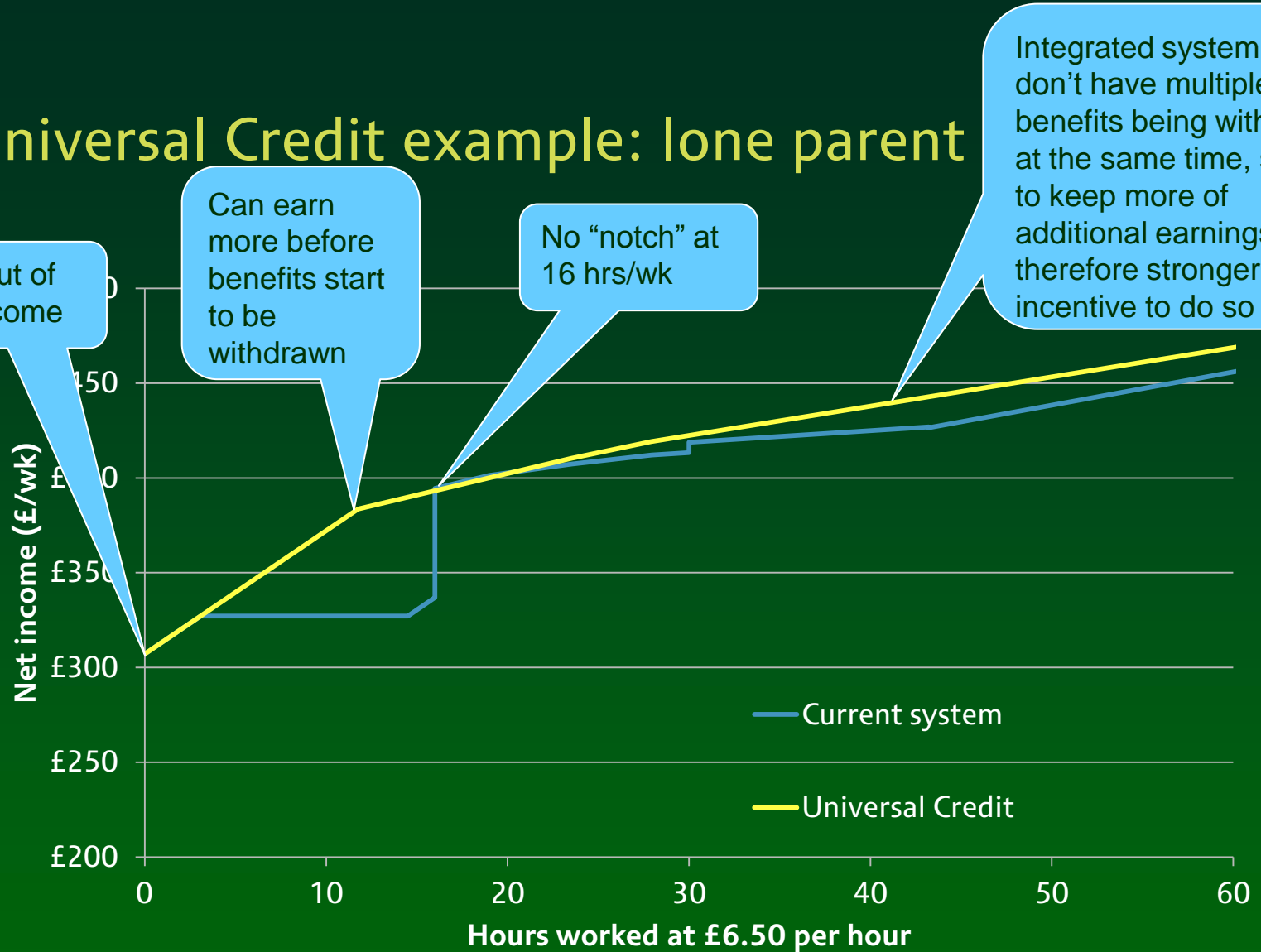
- All options for cutting support for council tax tend to hit poor the most
  - Unsurprising: poorest half receive 80% of CTB spending in Wales, poorest fifth receive 43%
- Reforms that save 10% typically involve reducing support for those entitled to maximum amount
  - Require councils to collect some tax from those with lowest incomes
- More aggressive means-testing can protect poorest
  - But saving full 10% through more aggressive means-test would probably require it to be so severe that some worse off after a pay rise
- Reducing single person discount has different effects
  - Only option where most revenue comes from richer half of population
  - Reduces distortion in housing market
  - Only slightly weakens work incentives

# What is Universal Credit?

- Replacing six of the seven main means-tested benefits for those of working age
  - Income Support, income-based Job-Seeker's Allowance, income-based Employment and Support Allowance, Housing Benefit, Child Tax Credit and Working Tax Credit
- CTB is the seventh
- Two key advantages are simplification of benefit system and strengthening work incentives



# Universal Credit example: lone parent



Assumes: £6.50/hr, £80 rent



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- CTB is the seventh
- Two key advantages are simplification of benefit system and strengthening work incentives
  - Keeping council tax rebates separate definitely undermines the first
  - How much it undermines the second depends on choices made by Welsh and Scottish Governments and English LAs

# Integration with Universal Credit

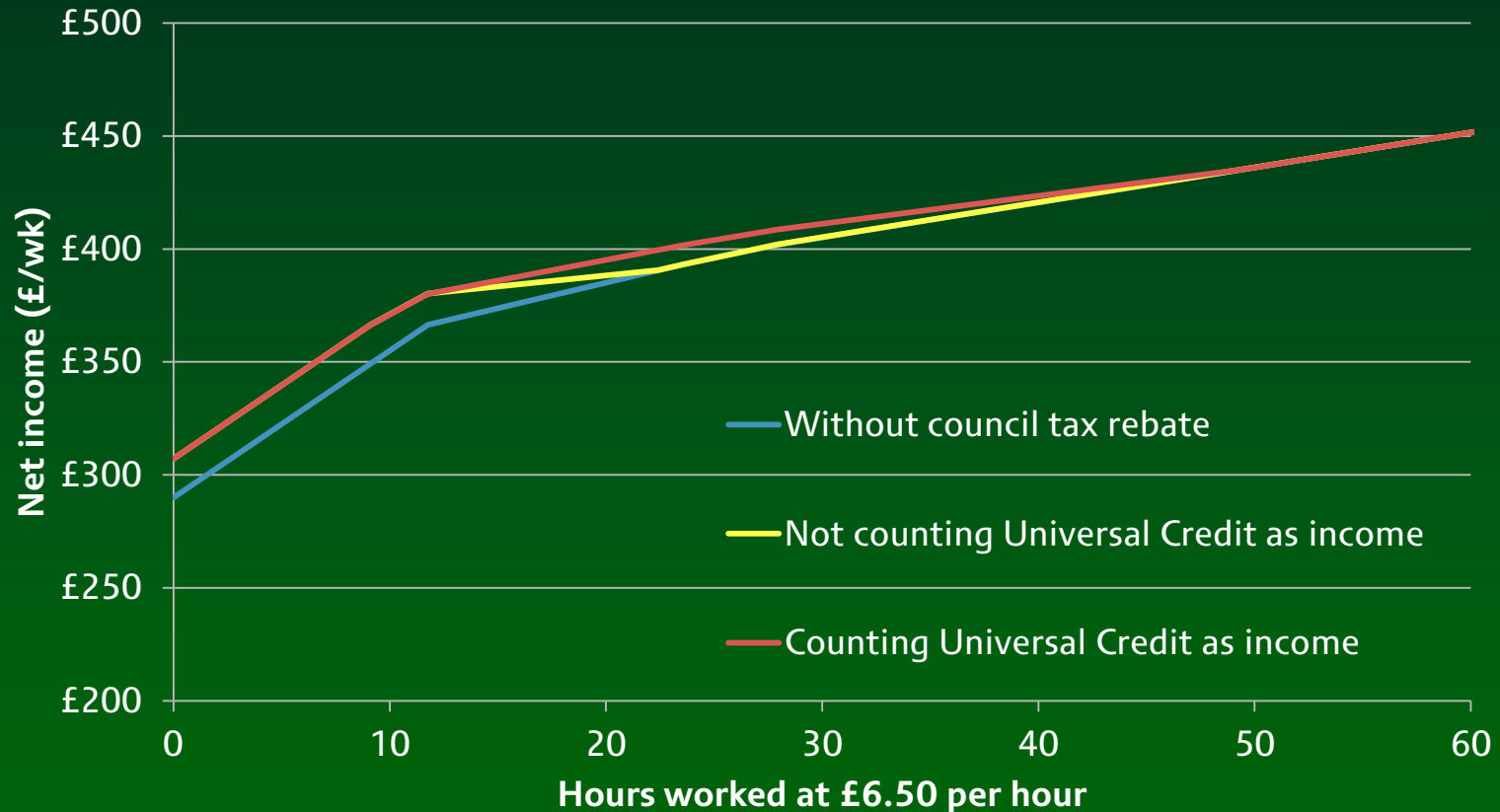
Two key questions:

1. Count Universal Credit as income in means test for council tax rebates?
2. What to do about passporting when separate out-of-work benefits abolished?

# Should Universal Credit be counted as income for council tax rebate means test?

- Some benefits being replaced by Universal Credit are counted as income in CTB at the moment, while others are not
  - Tax credits are counted as income
  - Income Support, income-based JSA and ESA and Housing Benefit are not
- This means that some changes will have to be made whatever is chosen

# Budget constraint for example lone parent with these council tax rebates



Assumes: £6.50/hr, £80/week rent.



# Should Universal Credit be counted as income for council tax rebate means test?

- Simpler not to count Universal Credit as income, but leads to higher maximum effective marginal tax rate (EMTR)
  - Additional £1 of income reduces Universal Credit entitlement by 65p
  - If Universal Credit is counted as income, this means income for purposes of council tax rebate means test goes up by less...
  - ...and hence council tax rebate falls by less
- Maximum EMTR is 89.9% if not counted as income compared to 81.0% if counted as income
- But there is a trade off: highest EMTRs applies over a wider range of income in the case where UC is counted as income

# Should Universal Credit be counted as income for council tax rebate means test?

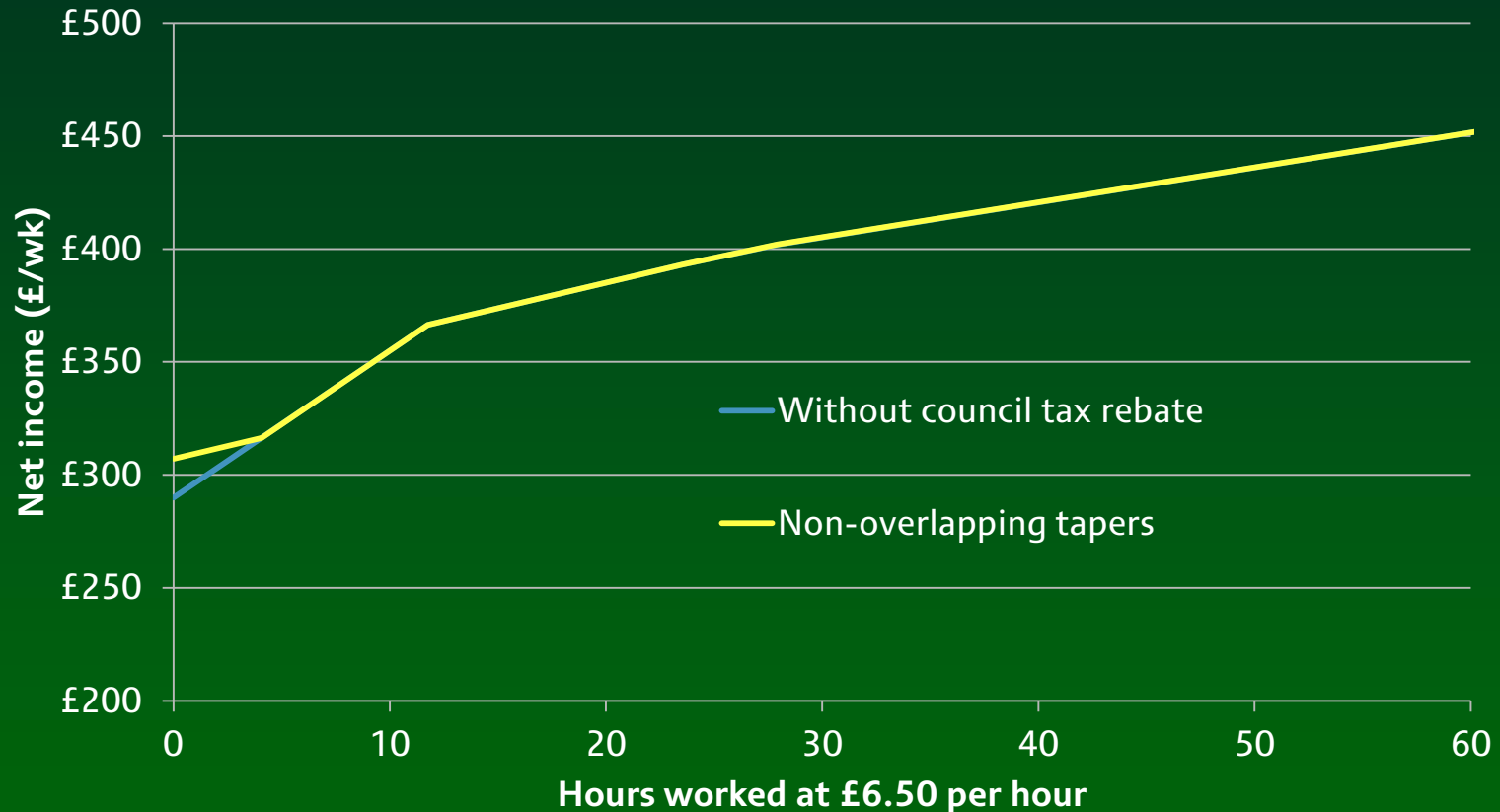
- Not counting Universal Credit as income in the means test raises other issues
  - Each £1 of unearned income reduces Universal Credit entitlement by £1
  - And currently reduces CTB entitlement by 20p
  - If this was retained in new council tax rebates, would lose £1.20 of support for each additional £1 of income
  - Could not count unearned income in means test for council tax rebate, but expensive giveaway
- These issues do not arise if Universal Credit is counted as income
  - Additional £1 of unearned income reduces Universal Credit by £1
  - Thus income for the council tax rebate means test is unchanged
  - And hence level of council tax support unchanged
- Level of support for childcare also depends on whether Universal Credit counted as income: see our JRF report

# Avoiding overlapping tapers

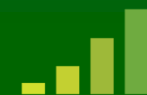
- Ensure that entitlement to council tax rebates is exhausted by the point Universal Credit starts to be withdrawn
- To do this:
  - Start withdrawal from the first pound of earnings
  - Increase taper rate to 65%
  - Set maximum levels of support so that entitlement to council tax rebate exhausted by the point Universal Credit starts to be withdrawn



# Budget constraint for example lone parent with non-overlapping tapers



Assumes: £6.50/hr, £80/week rent.



# Avoiding overlapping tapers

- Ensure that entitlement to council tax rebates is exhausted by the point Universal Credit starts to be withdrawn
- To do this:
  - Start withdrawal from the first pound of earnings
  - Increase taper rate to 65%
  - Set maximum levels of support so that entitlement to council tax rebate exhausted by the point Universal Credit starts to be withdrawn
  - This affects most single people without children but not other groups
- This option reduces cost of council tax rebates by more than 10%
  - Unlike previous ones which cost around the same as the current system

# Passporting under Universal Credit

- Currently 70% of Welsh CTB recipients are passported on to full CTB through receipt of an out-of-work means-tested benefit
  - Income Support or income-based JSA or ESA
- These benefits will be abolished when Universal Credit is introduced
  - No obvious ‘yes/no’ indicator to give some people maximum rebate
- Requiring all these claimants to go through a full means test would significantly increase burden for claimants and local authorities
- One way to mitigate this would be for DWP to share information from Universal Credit claims with local authorities
  - Contains the information needed to calculate council tax rebate entitlement
  - But transferring data to LAs would only add to the complexity of an already difficult IT project for DWP

# Summary

- Welsh Government will need to consider carefully how their council tax rebates systems will work alongside Universal Credit
- Key issues are whether to count Universal Credit as income and what to do about passporting
  - Simpler not to count Universal Credit as income, but leads to higher maximum EMTR
  - Also creates problems with what to do about unearned income
  - Abolition of benefits used to identify those entitled to maximum CTB could create major administrative headache

# Overall conclusions

- Welsh Government responding to funding cut by reducing cost of council tax support by 10%
- Will inevitably hit poor hardest
  - 80% of CTB in Wales goes to lower-income half of households and 43% to the lowest-income fifth
- Schemes that save full 10% tend to require collecting small amounts of council tax from those with very low incomes
  - Poll tax experience showed how difficult this can be
- Trade-off between protecting the poorest and strengthening work incentives
- Welsh Government also needs to consider complex task of how to achieve coherence with Universal Credit

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