



Llywodraeth Cymru
Welsh Government

Reforming Local Government Finance in Wales: Summary of Findings



February 2021

Foreword by the Minister for Finance and Trefnydd



A supported and empowered local government is vital for the delivery of local and national services to communities in Wales during normal times. In times of crisis, it supports those in urgent need and brings communities together in a coordinated response. We have seen throughout the coronavirus pandemic that we can rely on local government not only to maintain and make difficult decisions about frontline services, but also to adapt quickly and take on new challenges.

We put local government at the heart of delivering key COVID-19 responses such as shielding, housing the homeless, support for businesses and Test, Trace, Protect. We listened on short term funding matters by providing £500 million in additional funding to meet extraordinary pressures. We adapted aspects of local democracy to enable decisions to be made in a different way. We did all this in close collaboration while also navigating the UK's exit from the EU and significant uncertainty over our future relationships on the world stage.

Local government in Wales cannot do all the things it does in normal, or extraordinary, times without a robust system of financing at its core – a multi-billion pound framework which has strong principles of fairness and accountability to govern its use. But elements of the system should also be used where possible to tackle poverty, improve equity and redistribute wealth at local levels. We must also remember that the finance system supports not only principal councils, but other bodies too, such as Fire and Rescue Services, Police and Crime Commissioners, Community and Town Councils, City and Growth Deal structures and other regional partnerships.

In **Taking Wales Forward 2016-2021**, the Welsh Government made a number of commitments to review the existing arrangements for local government finance. We recognised there were improvements to be made and that there are more radical ideas to explore. Many of the legal frameworks predate devolution and require modernising. Parts of the system impinge on the Welsh Government's and local government's ability to shape fundamental change to best fit our needs. As we deliver wider reforms to local government whilst facing economic instability, inequality and a climate change emergency, there is a need to review the arrangements to ensure our communities remain resilient.

Chapter 2 outlines our achievements since 2016 which were aligned to our immediate priorities. Alongside these incremental improvements, we embarked upon an exploration of possible reforms for longer term consideration. The ideas focus on alternative forms of local taxation as these are elements which attract much of the debate. I am pleased to be drawing together the findings in this document and I am grateful to those who participated in any aspect of the programme.

The findings are for everyone to consider. This body of research provides a robust basis to inform proposals over the next Senedd term.

Rebecca Evans.

Rebecca Evans MS, Minister for Finance and Trefnydd

Table of Contents

Foreword by the Minister for Finance and Trefnydd	2
1. Introduction	5
2. Our Achievements 2016-2021	7
3. Objectives, requirements and trade-offs	8
Objectives.....	8
Trade-offs between system needs.....	9
Public attitudes to local taxes	9
Legislation and devolution	10
Local accountability	11
Digital modernisation	11
4. Our Research Programme	13
A History of Debate	15
5. Local Land Value Tax.....	17
What is a land value tax?	17
Bangor University research	18
Other research on land value tax.....	23
What we learned.....	25
6. Local Taxes Based on Income	28
What is a local income tax?	28
Research by Jennie Bunt	29
Other notable research.....	34
What we learned.....	35
7. Council Tax Reform.....	39
Benefits and Constraints of Council Tax.....	39
Institute for Fiscal Studies research.....	42
Sheffield University research	52
Other potential reforms.....	55
Valuation Methods for Domestic Dwellings	58

Council Tax Reduction Scheme	61
What we learned.....	68
8. Non-Domestic Rates Reform.....	71
Benefits and constraints of Non-Domestic Rates	71
Revaluation and Appeals.....	73
Tax Rates and Localisation	76
Relief schemes	81
Other potential reforms	86
What we learned.....	89
9. Summary of Findings	92
Annex 1. Public Attitudes to Local Taxes	99
Annex 2. Current System	102

1. Introduction

In January 2017 the Welsh Government [outlined](#) how it would consider reforms to local government finance in Wales in a phased and managed way over this current five year term. Since then, we have [published updates](#) each year on our progress. In delivering the programme and responding to the challenges of this government term, we have learned a huge amount about the existing system and the requirements for the future.

This document focuses more on the role of local taxes within the fiscal arrangements, since these are the elements which are most within our gift to modify to reach our objective of progressive and sustainable revenue-raising for local services. We have explored alternative forms such as a local land value tax, local taxes based on income, or modernising the existing council tax and non-domestic rates systems. Taxes on land and property differ from taxes on income – they do not and cannot have the same outcome. An important choice will be whether we continue to raise local revenues based on property or on other measures of wealth and ability to pay.

The amount of funding for local services is not a question explored in detail, as that remains a careful balance between our spending priorities against the constraints we experience from Wales' economic position within the UK and the wider world. We touch upon how local taxes interact with the distribution of government grant to local government and whether this would require reform under some of the options.

The magnitude of change involved if any of the ideas were to be taken forward would be significant, and this should not be underestimated. Most reforms would require new Acts of the Senedd, a body of subordinate legislation, and significant modernisation of digital and data infrastructure. Reforms would also require concerted public consultation and coproduction with partners to assess the likely impacts on people, on businesses and other ratepayers, on the workforce, on councils and other bodies.

We were pleased to showcase some of the research findings at our Virtual Conference on 'Reforming Local Taxes in Wales' on 19 November 2020, attended by over 150 participants. As we continue our work, we are guided by the principles outlined in our [Tax Policy Framework](#) and our obligations to consider the Wellbeing of Future Generations and equalities impacts. The Socio-economic Duty guides us to consider those who already experience inequalities as a result of socio-economic disadvantage.

The Partnership Council for Wales and its subgroups provide the forum for political and official level engagement between the Welsh Government and local government on a range of financial matters. There is an opportunity for further and more formalised engagement in the next Senedd term. We welcome all contributions to the evidence base to inform our future plans. Anyone can get in touch with the Welsh Government by sending an email to: LocalTaxationPolicy@gov.wales.

COLLABORATION

We created a research programme with the assistance of our expert-led Local Government Finance Reform Working Group, which comprised economists, statisticians, tax and benefit experts, equalities organisations and local authority practitioners. Throughout the course of our work we have also involved the following:

- The Finance Sub Group of the Partnership Council for Wales (the Welsh Government's partnership forum with local government);
- The Welsh Revenues and Benefits Managers Group;
- The Valuation Office Agency and the Institute for Revenues, Rating and Valuation;
- The Welsh Government's Tax Engagement Group (formerly Tax Advisory Group);
- The Ratepayers' Forum and business representative organisations;
- Other focussed working groups.



2. Our Achievements 2016-2021

Fair, progressive and better targeted local taxes

- A new Small Business Rates Relief scheme that supports our priorities;
- Lowered non-domestic rates bills by switching the annual uprating from RPI to CPI, froze the multiplier in 2021-2022;
- Consulted on changes to rates relief for independent schools and hospitals;
- Initial improvements to make council tax fairer and progressive, encouraging take up of all council tax support;
- Improved consistency in the treatment of care leavers and Severely Mentally Impaired people;
- Assessed impacts of UK welfare reform on the Council Tax Reduction Scheme;
- Explored different approaches to local taxes, eg. council tax rebanding, land value taxes, local income taxes.

Effective and proportionate local tax administration

- Non-domestic rates 2017 revaluation and transitional relief schemes;
- Improved council tax arrears management and enforcement;
- Removed the sanction of imprisonment for council tax;
- Next non-domestic rates revaluation in 2023 (work ongoing);
- Tackling non-domestic rates avoidance (to commence from 2021);
- Non-domestic rates appeals reform (work ongoing);
- Improved information sharing and capability;
- Explored modernised and more frequent property valuation resets.

Sound financial governance and strengthened local accountability

- Extended flexibilities to councils in relation to council tax;
- Supported the role of the Chief Finance Officer in a changing environment (continuous);
- Engaged citizens in decisions about spending priorities (continuous);
- Continuous improvement to financial governance, accounting and audit as a result of other changes described.

Supporting the wider local government finance framework

- Continuing to support City & Growth deals;
- Provided new capital financing flexibilities;
- Developed the Local Government Settlement formula in response to changing spending patterns (annually) and local tax changes;
- Developed a funding framework to enable reform and service transformation (work ongoing);
- Explored the balance of funding between locally raised and centrally provided;
- Provided additional financial support to councils during the coronavirus pandemic, including targeted rates relief.

3. Objectives, requirements and trade-offs

Objectives

Our aspirations for a future local government finance system are:

LOCAL

Strengthen not weaken local democracy, autonomy and flexibility. Complement the broader reform of local government (the Local Government and Elections (Wales) Act 2021), which enables service transformation and greater participation in local democracy.

FAIRER

Strive for more progressive revenue-raising where possible, and greater fairness in the treatment of taxpayers. Geographical equity across Wales and between socioeconomic groups should not be compromised.

SUSTAINABLE

Safeguard the future sustainability of services to communities through stable funding streams. Safeguard prosperity and growth in local economies.

SIMPLER

Strive, where possible, to reduce complexity in the design of our future systems. Local tax administration should be efficient with proportionate costs.

UNDERSTOOD

Improve public awareness and understanding of the arrangements. Modernise how systems are delivered and take advantage of digital transformation.

Trade-offs between system needs

It is important to note there are different requirements of local government finance and local tax systems. The Welsh Government must reconcile the different needs and viewpoints of many stakeholders with an interest in the arrangements. For example:

Citizens require effective public services and to contribute to the cost of these services according to their means. They should be treated fairly. They require an effective customer interface, opportunities for democratic engagement and to hold local government to account.



Businesses also require effective public services and a stake in local place-shaping. Businesses require varying types of support during difficult times to safeguard local economies, jobs and growth.



Local Government Bodies require stable revenue streams to function effectively and deliver vital services to communities, aligned to local needs. Local government requires clarity, flexibility and autonomy as key influencers of socioeconomic prosperity for future generations.

The **Welsh Government** requires effective and collaborative delivery of its national priorities set out in its Programme for Government. It bestows legal powers and functions on local government to discharge certain duties for the people of Wales. The Welsh Government expects continuous improvement in local service delivery which complements national service delivery, and a collective response to challenging times.



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Public attitudes to local taxes

The events we have seen during this term provide rich sources of information about what is important to people and businesses, and how stakeholders adapt and deliver. Around three-quarters of citizens know how to find information about their council services, but only 12% know whether their council consults with them about spending decisions ([National Survey for Wales 2019-20](#)). Awareness of and attitudes to local taxes are less clear and seldom measured. However, public acceptance of future finance systems is crucial in order for the Welsh Government to be successful in achieving the aims it sets out.

Annex 1 provides an overview of previous studies on this issue of public awareness and attitudes. It shows a wide variety of views about council tax and non-domestic rates, and about taxation in general, in relation to fairness, visibility and administration. These views varied significantly between household types, such as between younger and older people, lower and higher income households, single people and families, and homeowners compared with renters. Some people believe bills should be worked out based on property wealth, some believe it should be based on incomes and others believe it should be more directly linked to the consumption of services. Our National Survey for Wales estimates that only 47% of people correctly identify that council tax rates are set by local councils.

Local taxes draw substantial volumes of engagement with the Welsh Government, councils and other organisations, through which we find evidence of polarised views and common misconceptions. From our own experience in modifying the systems in recent years, it is unclear to what extent citizens know the circumstances of others relative to their own, and this is understandable given the complexity of arrangements. But there is no formal analysis of these aspects and it is an area for social research in the near future.

Legislation and devolution

The body of legislation spanning local government finance is extensive and highly complex. It dates back as far as the Local Government Act 1972 in its current form, with roots which date back far earlier. It has grown incrementally over time, now supporting a large body of secondary legislation. There are three main primary Acts and 11 related Acts, from which more than 280 Statutory Instruments (orders and regulations) are made. There are over 100 Wales-specific statutory instruments relating to council tax alone, and more than 130 for non-domestic rates. Over 40 statutory instruments determine the arrangements for capital finance, accounting and audit of local government bodies, also key elements of the system.

Page 12 illustrates in more detail the complex legal landscape. Due to the direct impact of the systems on personal and public sector finances, much of the legislation is highly prescriptive with a large proportion requiring Senedd agreement to changes. Even if no major reforms are proposed in the future, the body of legislation would benefit from consolidation and modernisation – a significant exercise which would take a number of years to complete. The Welsh Government also now has powers in relation to devolved taxes which create opportunities to consider the wider tax policy landscape.

Welsh Ministers possess extensive devolved powers in relation to council tax, non-domestic rates and the distribution of central grant to local government. While there are recent divergences between nations, much of the founding legislation is still common to Wales and England and predates devolution. A central element of the framework is the valuation of domestic dwellings and non-domestic hereditaments. It is the cornerstone which makes revenue-raising through local taxes possible, and defines indicators of wealth and affordability which enable the electorate to make its contribution. However, the valuation function is discharged on an England and Wales basis by the Valuation Office Agency, appointed by HM Revenue and Customs. Despite Welsh Ministers having devolved powers to determine various assumptions

and principles about valuation, in reality it is a function over which Welsh Ministers have limited control.

Local accountability

Local government in Wales adheres to the professional standards of the Chartered Institute for Public Finance and Accounting (CIPFA) as part of an extensive regime of financial governance and audit to ensure the proper use of public money. This accounting and audit framework is common to all four UK nations and is based on international standards. Audit Wales audits the financial affairs of all local government bodies in Wales (to a greater or lesser extent) on an annual basis.

The CIPFA governance framework is important because it upholds the very foundation of public bodies, which is to act in the best interests of the citizen. It also provides the leadership skills and professional qualifications for those in public office who deal with finance. Any reforms to local government finance discussed in this document will have an impact on the formal arrangements. The Welsh Government has an excellent working relationship with CIPFA as guardians of that framework.

Digital modernisation

In 2020 we undertook a Digital Discovery Review to gain insight into the administrative systems which support local government finance, known as the revenues and benefit systems. We carried out over 80 interviews with 20 councils and mapped out the complexity of the existing systems. The findings from this discovery project are an important element of the reform programme as we begin to understand more about what would be involved in implementing alternative approaches. We found that the success of administrative systems is not only dependent on regular maintenance and modernisation, it is highly dependent on the relationships between councils, suppliers, the Welsh Government and the UK Government. The discovery identified a lack of in-house technological resource within councils, though this should not be seen as solely a local government issue but one which is representative of the increasing demand for digital and automated services across the public sector. We found differences in policy rollout between suppliers and some systems-related issues around data access, reporting and correspondence with citizens. Reassuringly, we were also able to identify much innovation and good practice worthy of further investigation.

All options for local government finance reform considered in this document would involve some redesign of systems and software, from smaller-scale tweaks to complete redesign. Digital inclusion must be at the forefront of this to ensure local tax and support services are accessible. The Welsh Government is investing in a new Chief Digital Officer for Local Government and a supporting Delivery Unit, hosted by the Welsh Local Government Association. This role is crucial in working with local leaders to drive forward digital transformation within local government. If a future government opts to redesign local taxes and finance arrangements, this would be an excellent opportunity to embed digital-first principles.

Local Government Finance Act 1988

Main framework for **Non-Domestic Rates**, rateable values and national multiplier, reliefs and exemptions, local collection and recovery.

Enables **Revenue Support Grant** to be paid. Makes provision about capital expenditure and the administration of financial affairs.

Local Government Finance Act 1992

Main framework for **Council Tax**, allowing councils to set and collect according to **Budget Requirement**, including discounts, exemptions and disregarded persons.

Makes further provision about **grants** and connected purposes.

Local Government Finance Act 2012

Localises Council Tax Support in England and provides Welsh Ministers with powers to introduce **Council Tax Reduction Schemes**.



Over 280 Statutory Instruments (Regulations and Orders)

42 relating to **council tax liability**, covering chargeable dwellings, discounts, exemptions, premiums.

51 relating to **council tax administration**, billing, enforcement, valuation and appeals, calculation of the tax-base.

16 relating to the **Council Tax Reduction Scheme**, not to be confused with other reduction schemes which eased the transition for taxpayers following redrawn council boundaries in 1996.

33 dating back to 1989 about **non-domestic rates liability**, covering chargeable amounts, the multiplier, relief schemes and definitions of property.

70 dating back to 1989 about **non-domestic rates administration**, covering billing, collection, enforcement, valuation and appeals.

36 non-domestic rates contributions regulations dating back to 1989, setting out how councils pay revenue into the national pool.

13 about the **accounting and audit** requirements of local government bodies, dating back to 1974.

26 about **capital finance** with many more predating devolution.

Related Acts

Local Government (Wales) Act 2015 and the **Local Government and Elections (Wales) Act 2021**

Housing (Wales) Act 2014

Local Government Acts 1972, 1999 and **2003** make provision about capital finance and grants.

Public Audit (Wales) Acts 2004 and **2013**

Deregulation and Contracting Out Act 1994

Localism Act 2011

Local Government and Housing Act 1989

4. Our Research Programme

Our programme for reforming local government finance comprised over 20 short and medium term reforms. In parallel, we undertook a review of the existing literature about alternative approaches and drew together a plan for new areas of research, with the help of an expert-led working group and other stakeholders. We were clear the new research must focus on the practical implications of the alternative approaches, rather than present a rehearsal of existing theory and abstract models. We facilitated unique access to data on Welsh tax-bases, enabling some of the projects to create analytical assets which have never before been available.

Over the course of 2019 to 2021, we partnered with a number of organisations to deliver the following collection of new research projects. This document summarises the conclusions of the research projects which do not necessarily reflect the views of the Welsh Government, though we have tried to differentiate throughout. Chapter 9 summarises the Welsh Government's views on where to go next with the findings.

Bangor University Local Land Value Tax

Dr Rhys ap Gwilym et al studied the potential for a local land value tax as a replacement alternative design to the existing local taxes – council tax and non-domestic rates. The report was published in March 2020 and can be accessed [here](#).



Institute for Fiscal Studies Council Tax Revaluation and Reform

Stuart Adam et al undertook a hypothetical revaluation of the current council tax tax-base in Wales, comprising over 1.4 million dwellings. The findings outline some options for a more progressive band structure and more radical reforms to council tax such as a continuous unbanded system. The report was published in April 2020 and can be accessed [here](#).



Professor Leishman and Dr Stephen Hincks, University of Sheffield supported by the UK Collaborative Centre for Housing Evidence Council Tax Revaluation

Professor Leishman and Dr Hincks undertook complementary modelling on council tax revaluation. This study focuses in more detail on the physical and environmental determinants of property price, and the benefits and drawbacks of statistical models for tax-base valuation. The report was published in February 2021 and can be accessed [here](#).



Jennie Bunt, Cardiff University Local Taxes Based on Income

Jennie Bunt studied the feasibility of designing local taxes to be based more closely on local assessments of income. While this concept could apply in the domestic and non-domestic contexts, this initial study focussed on assessments of household income for the purposes of council tax. The report was published in November 2020 and can be accessed [here](#).



Other research projects were also undertaken about specific elements of the existing systems.

Government Social Research service, Welsh Government
Small Business Rates Relief:
Survey Analysis

The aims of this research were to assess the perceptions of small businesses of the effectiveness of the Small Business Rates Relief scheme from non-domestic rates. It also gathered evidence of the scheme's impact on business viability.

[The report was published on 26 January 2021.](#)



Policy in Practice

Understanding the Impact of Universal Credit on the Council Tax Reduction Scheme and Rent Arrears in Wales

Policy in Practice used council data to analyse the impact of Universal Credit on people in Wales. The research proposed options for modifications to the Council Tax Reduction Scheme to mitigate impacts and to restore parity of treatment between claimant groups.

[The interim report was published in January 2020](#) and [the final report was published in July 2020.](#)



A History of Debate

There have been many comprehensive studies of local taxes and local government finance structures, dating back to the Layfield Committee of 1976. Each study brought a unique viewpoint within its own context and as a result, the systems of the four nations have been developed, reformed and diverged over the decades. There have also been numerous internal government reviews and parliamentary (or equivalent) inquiries. Some have focussed more on the role of local democratic government, others focussed closely on taxation theory.

Many of the conclusions about alternative funding systems point to trade-offs between outcomes such as local autonomy, economic growth and social equity. Though the findings are somewhat transferrable to our context, there is yet no common view and little commentary which relates specifically to Wales' circumstances and needs. We hope this document provides a contribution. We await the findings of other reviews in progress, such as the UK Government's Fair Funding Review and Business Rates Review in England, and where Scotland and Northern Ireland might go next with their considerations.

Notable reviews

The [Lyons Inquiry](#) into Local Government 2007 is a comprehensive consideration of reforms to the funding system for local government in England, commissioned by the then UK Government in 2004. Sir Michael Lyons reports that he quickly understood that questions of finance could not be divorced from wider consideration about the purpose of local government. His report coined the concept of 'place-shaping' as a way to empower local government and celebrate local flexibility. On finance matters, the inquiry recommended a council tax revaluation and that new bands be added at the top and bottom of the scale to improve progressiveness. The inquiry was not minded to recommend a local income tax at the time. On non-domestic rates, the inquiry was not in favour of full localisation but recommended new powers for councils to add a local supplement to the national rate.

The [Mirrlees Review](#) 2010-2011 considers the characteristics of a good tax system in the 21st Century. It suggests taxes should be progressive and designed as a whole system in conjunction with the benefits system, and therefore highlights the unique challenges of Wales' policy choices within a UK and global fiscal arrangement. Chapter 16 'The Taxation of Land and Property' considers types of housing and land as consumption or investment goods, and discusses the case for land value taxation. It suggests council tax should be reformed as a consumption tax (like VAT) and brought into the savings tax regime as assets. It also suggests business property is an input into the production process and therefore should not be taxed.

The [Independent Commission on Local Government Finance 2015](#) in England advocated the decentralisation of fiscal levers and powers to subnational government to stimulate service redesign and collaborative delivery. It recommended various flexibilities regarding annual grant funding and an independent body to oversee arrangements and advise the government. In relation to local taxes, the Commission recommended ending local referenda and capping regimes for council tax, freedoms to set discounts and reduction schemes and a revaluation. It also recommended full local retention of non-domestic rates revenue.

The [Scottish Commission on Local Tax Reform 2015](#) is the most recent comprehensive review of council tax in the UK. It considered three alternatives – a more progressive property tax, a land value tax and a local income tax. With Professor Leishman and Heriot-Watt University, the Commission analysed the impact of a revaluation exercise. It also considered the practical and administrative implications of new systems in more depth than other reviews. The Commission concluded local taxes should remain as general recurrent contributions (as opposed to a charge for services) but they should be more progressive. If feasible, the future tax-base should be broadened to include income to make it fairer. The Commission viewed a land value tax as initially promising, but with many more gaps in evidence and further work required.

The [Independent Commission on Local Government Finance in Wales 2016](#) considered possible reforms with objectives of greater self-sufficiency, growth and innovation but also revenue stability. Its recommendations included local retention of non-domestic rates revenue, a review of the distribution of central grant, dehypothecation of grants and a council tax revaluation. It concluded council tax was largely fit for purpose and there is no need to abolish it, given that it “provides the most suitable compromise between taxing property and taxing people”. It did recommend revaluations and rebanding every 5 years (or more regular) and a full review of discounts and exemptions.

An [Evidence Review: Systems of Local Government Finance, Local Taxation and Resource Allocation in Wales in 2016](#) considered the future needs of the local government finance system in light of the previous intention for council mergers. Bennett, Allen and Grace (2016) considered revenue-raising ability and the balance of funding (between centrally provided and locally raised). They concluded that effective reform needs to respond to the interdependencies and relationships between form, function and finance, taking a whole system approach. It also suggested that reviewing the balance of funding is fundamentally connected to questions of wider governance and accountability, and that no single tax can embody all ideal properties or objectives.

5. Local Land Value Tax

In this chapter we discuss:

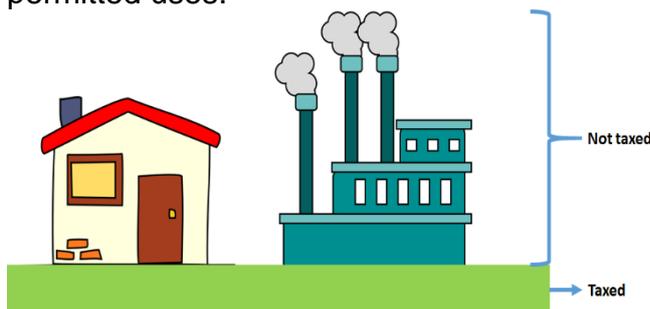
- What a land value tax is
- Bangor University research
- Other notable research
- What we learned and areas for further work.

Taxes based on the value of land have been explored over the decades as alternatives to various national and local taxes. Forms of land value tax (LVT) exist in Denmark, New Zealand, and some parts of Australia and the United States. Proponents outline various objectives for replacing traditional property taxes with an LVT, such as more efficient use of land or to better capture economic uplifts for public benefit. The Welsh Government opted to explore this concept and apply it to council tax and non-domestic rates due to its purported progressive distribution of tax burdens. Our primary aim is to raise stable revenue for local services in the fairest way, with other advantageous outcomes considered where possible.

Though the concept is broadly applicable, there is little formal research relating specifically to Wales' local tax landscape. In 2019 we commissioned a new area of research exploring the feasibility of a locally-based LVT to replace council tax, non-domestic rates, or both. To safeguard and strengthen local democratic accountability, we were clear a local LVT should continue to be raised and collected by councils. LVT is not considered here as an additional form of local taxation, or raising significantly more or less revenues than currently, or as a national concept. The constitutional basis for local taxation in Wales means any replacement local tax, including an LVT, must continue to fund local government expenditure.

What is a land value tax?

A tax on the value of land disregards the value of any property, structure, plant or machinery which exists on the land. In theory, two identically-sized pieces of land in the same location with the same permitted uses, would pay the same tax regardless of the property built upon it. LVT therefore condenses the number of factors which can influence tax bills down to mainly the desirability of location, the size of land, and its permitted uses.



Source: Bangor University Report.

The reported benefits of LVT compared to other types of tax are:

- More efficient use of land as a natural asset because it becomes less beneficial for landowners to hold onto unused land which does not provide a financial return;
- Capturing, and therefore taxing, the uplift in value gained by landowners as a result of decisions made by wider society, eg. surrounding infrastructure investment and public service provision, so that the financial benefits can be shared by everyone;
- Fairer and more progressive distribution of tax liability amongst taxpayers;
- Economically efficient with less disincentive effects on investment;
- Increasing diversity in the ownership of land, and unlocking areas of 'land banking' for the sole purpose of asset appreciation, though the scale and evidence of this in Wales is not known.

Bangor University research

Bangor University used a combination of statistical analysis, a call for evidence, literature review and semi-structured interviews with experts to conduct an initial feasibility study, focussing on the practical considerations. The researchers had access to the complete valuation lists for the existing council tax and non-domestic rates tax-bases in Wales, combining these with GIS spatial information and transactional price data from HM Land Registry. The detailed report was published in March 2020 and can be accessed [here](#).

Land cover and ownership

The study provides a detailed evaluation of the available inventories of land cover and land use, including the European Union's CORINE (Coordination of Information on the Environment) database and Ordnance Survey. Perhaps strikingly, these databases show that **agriculture, forestry and land in its natural state accounts for over 90% of Wales' surface area**. In relation to land ownership, which would be critical information for a local LVT, the researchers found 18.6% of land in Wales is unregistered (as of November 2019), and this is spread unevenly across the country. The most unregistered land is located in Anglesey, Gwynedd, Pembrokeshire and Flintshire. Most of it is agricultural or natural land and only 1.3% of unregistered land is in residential use.

The researchers conclude there is currently no straightforward way of linking the various sets of information needed to produce a comprehensive cadastral database, and a greater degree of precision is required for the purposes of taxation.

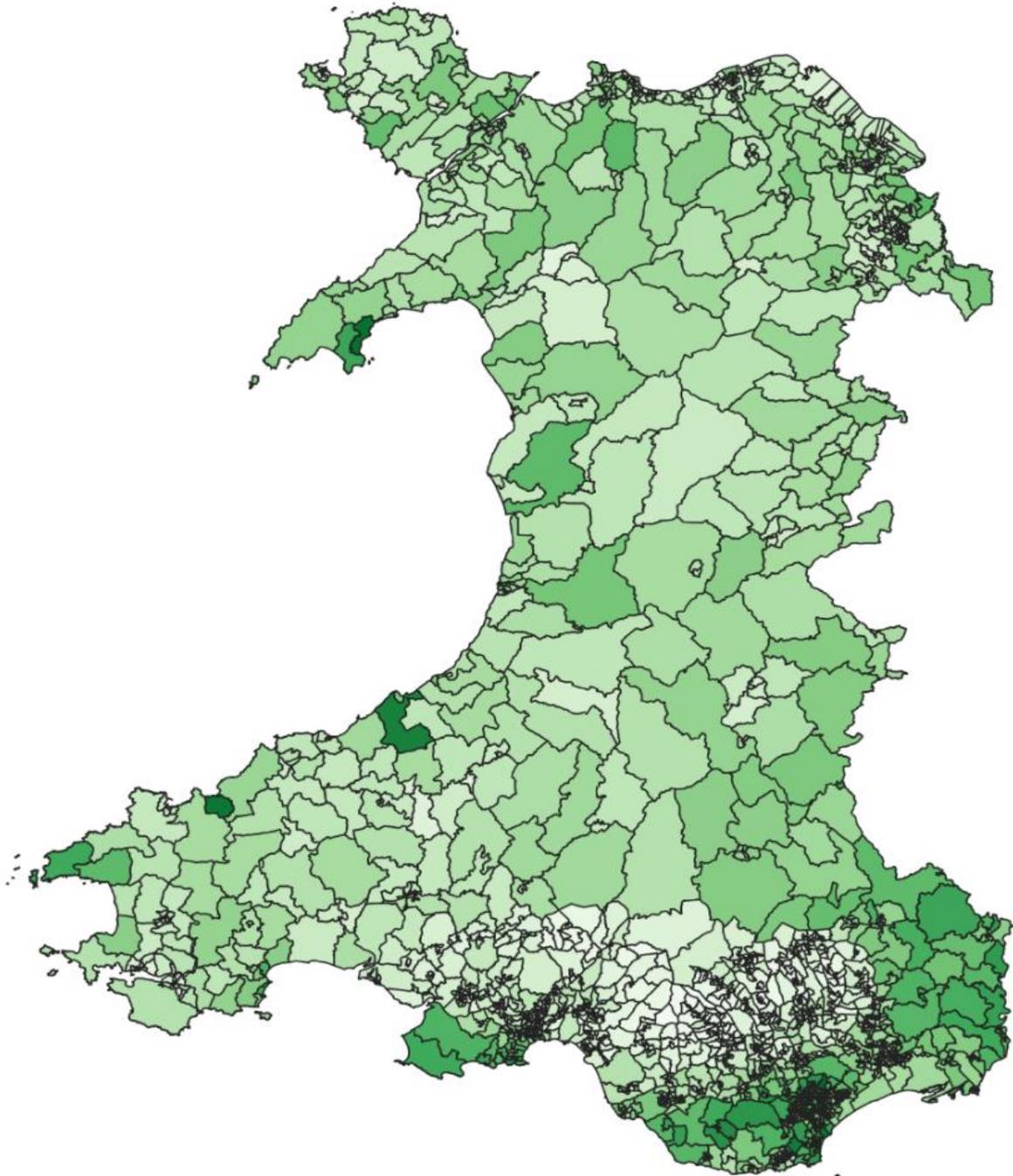
Land values

Bangor University estimated the total value of **residential** land underlying properties which currently pay council tax at **£113.4 billion**. Land represents 48% of total residential property values, however, this varies significantly between locations. At council level, land value represents just 21% of property values in Blaenau Gwent, yet

63% in Vale of Glamorgan. Figure one illustrates land values of small geographical areas of Wales (Lower Super Output Area, LSOA), with darker shades being the highest value.

The residential tax-base under an LVT would increase the most in Cardiff, Vale of Glamorgan and Monmouthshire, and decrease the most in areas such as Rhondda Cynon Taf, Neath Port Talbot and Carmarthenshire.

Figure one: Residential land values per metre square at LSOA level



Source: Bangor University report.

The total value of **non-residential** land underlying properties which currently pay non-domestic rates was estimated at **£27.6 billion**. It is important to note the researchers found it more challenging to conduct analysis for non-residential land due to a lack of available information on property characteristics, and so these estimates should be treated with caution.

At council level an LVT would again shift the tax-base from less affluent to more affluent areas of Wales. The non-residential tax-base under an LVT would increase the most in Cardiff, Vale of Glamorgan and Monmouthshire, and decrease the most in areas such as Rhondda Cynon Taf, Flintshire, Newport and Neath Port Talbot.

Valuation methods

Bangor University notes three broad methods of valuation for taxation; 1) professional valuation, 2) a formulaic or statistical approach, and 3) self-assessment, with the existing local tax method being a hybrid of the first two. However, the researchers conclude there is no clear view of which method would be appropriate for the valuation of land for an LVT, and recommends a separate study on this element is required. Interviews with valuation experts discussed technological advancements, suggesting Estonia and Denmark's methods could be considered. Bangor concludes '*there is significant scope for updating the valuation system and increasing the use of technology in valuation, with the potential for producing real-time valuations*'. The researchers highlight reasonableness, transparency and consistency are of higher importance than accuracy.

The report also provides an evaluation of concepts used in land valuation such as improved versus unimproved, highest and best use, hope value and site value, suggesting that '*site value should form the conceptual basis for the valuation of land in Wales*' and therefore Site Value Tax could be a more appropriate term than land value tax.

The Welsh Government does not currently have a firm view on how land should be valued under a local LVT and this would involve a significant set of decisions. We agree a separate detailed study of the concepts and methods would be a key next step. As well as taking advantage of technological opportunities, public acceptance of the method would be a key consideration in developing an LVT.

Tax rates

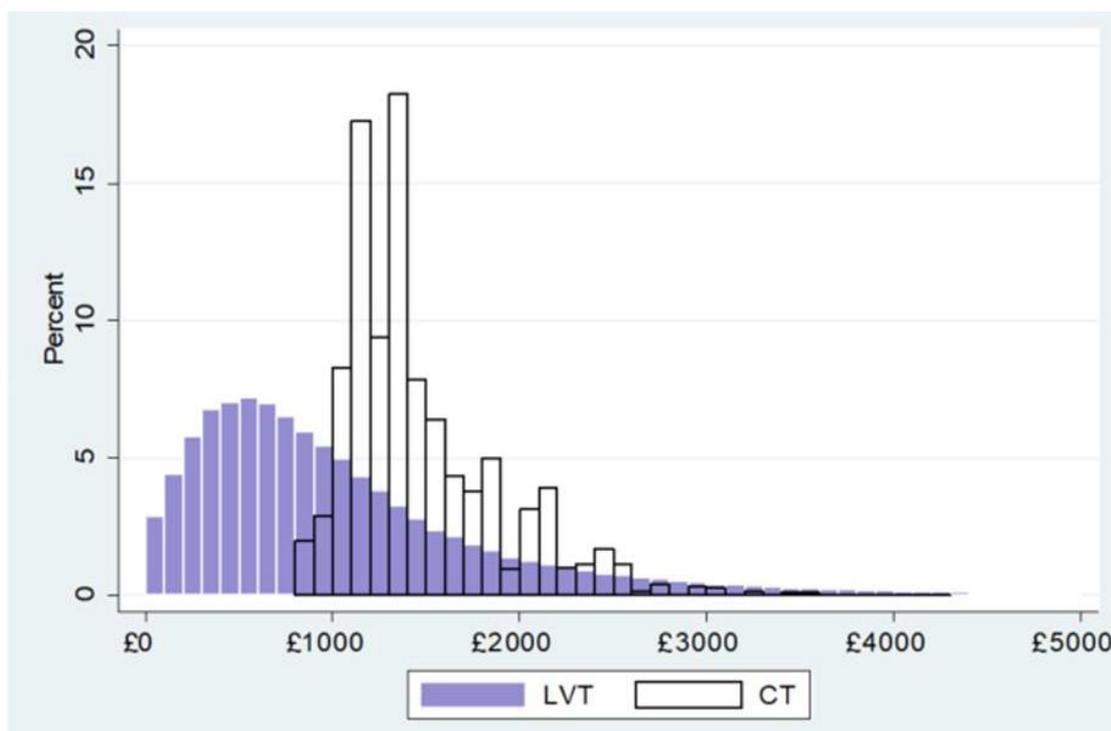
There are choices about whether rates would be set locally (like council tax), nationally (like non-domestic rates), or even regionally (like the police precept for example) or by smaller area (like the town and community council precept, for example). There are also choices about whether the same tax rate should apply in domestic and non-domestic contexts, or whether there is a rationale to charge different rates for each. The decision balances local accountability, visibility, simplicity, efficiency and equity. The Bangor study did not propose a particular choice.

As a guide however, based on the modelled land value estimates, the Bangor study suggests a uniform national tax rate of **1.41%** on **residential** land would be sufficient to raise the same revenues as are currently raised by council tax. A uniform national

rate of **3.9%** charged on **non-residential** land would be sufficient to replace the revenue currently raised from non-domestic rates. This is an interesting finding and is based on the land which underlies properties that are currently liable for local taxes. It also highlights the difference in the size of the domestic and non-domestic property tax-bases, as there are 1.4 million dwellings liable for council tax and 120,000 properties liable for non-domestic rates. Further work could consider whether there are other types of land which would be brought into the tax-base, depending on the chosen definition of LVT.

Figure two from the Bangor report shows a more progressive distribution of tax liability under an LVT compared with council tax. However, the authors acknowledge this comparison is *'fraught with difficulties'* and is for illustrative purposes only, due to the wide range of discounts which currently apply to council tax payers. The following figure is based on gross liability, yet only around 55% of households in Wales pay a full council tax bill, ie. net liability would look quite different. Nevertheless, LVT begins to look promising in relation our primary objective and is a basis for further quantitative analysis, particularly by council area and socioeconomic group. Encouragingly, the estimates of land values at the LSOA level are correlated with the Welsh Index of Multiple Deprivation.

Figure two: Distributions of gross tax liabilities under LVT and CT



Source: Bangor University Report.

Collection and administration

The interviews conducted by Bangor University helped to bring out the practical considerations of LVT administration and solidify views about local democratic accountability. Interviewees recognised the current high collection rates of council tax

and non-domestic rates, and the importance of local expertise in its high degree of efficiency. An effective appeals system is a key element of any future LVT proposal.

The research notes there are other mechanisms of tax collection existing such as PAYE and collection through utilities. However, the devolution settlement means these methods are not available for a local LVT, and would weaken democratic accountability.

Conclusions

The Bangor University study made the following conclusions and recommendations.

Primary findings

- **A local LVT in Wales could raise sufficient revenues to replace the current local taxes.** Changing to LVT would have a significant impact on the distribution of household and business liabilities, and on the revenue raised in each area, but it would be significantly more progressive than the existing local tax regime.
- **The data requirements for implementing a local LVT in Wales are not currently met.** Mapping data, property characteristics data and property transactions data are currently collected by different government agencies. There is currently no straightforward way of linking the geographical information in the OS land use database to Land Registry or to VOA data. The data currently available provides a useful starting point, but the implementation of a local LVT would require richer data on property characteristics, and the ability to link this with more precise mapping data as well as transactions data.

Recommendations

- **A cadastral database for Wales should be established under the control of a single agency.** This would bring together the land registration, mapping and valuation functions within a single entity, as has been successfully achieved in Northern Ireland. The database should take advantage of modern GIS techniques, as well as modern valuation methodologies (which, in turn, should ensure consistency and transparency in valuation). This would greatly facilitate the implementation of a local LVT but would likely have significant benefits beyond local taxation, in areas such as planning and agriculture, by ensuring consistency and compatibility of data. Initial work should be carried out to assess the costs and benefits of such a cadastre.
- **A local LVT should place financial liability on the landowner rather than occupier.** There is overwhelming evidence that the economic incidence of property taxes falls on the property owner rather than the occupier. Changing the financial liability of property taxes to coincide with their economic incidence would significantly improve the transparency of the tax system. Shifting the financial liability from tenants to landlords would mitigate against arguments in favour of widespread exemptions. The Welsh Government notes however, the extent to which this will be felt in practice could be limited if landlords pass on this liability in the form of higher rents.

- **A local LVT should minimise the use of reliefs and exemptions.** The progressive and continuous nature of LVT significantly reduces the need for reliefs to support lower-income households. An LVT could therefore significantly reduce the costs of exemptions and reliefs. Broadening the tax-base in this way can significantly reduce the tax rates required to raise the same amount of revenue. Where necessary, payment difficulties relating to an LVT should be dealt with via deferrals or charges on the land.
- **The Welsh Government should consider what structure of rates would be appropriate.** For simplicity and clarity the Bangor report models tax rates at a uniform national rate for residential land and a separate uniform national rate for non-residential land. Graduated rates through the use of tax-free allowances could be used to increase the progressiveness of LVT. Separate national and local rates could be used to enhance the fiscal accountability of local government. There is no compelling economic argument for taxing residential and non-residential land at different rates.
- **Any new local tax regime should explicitly link local control over services with local accountability via the decentralisation of tax powers.** An LVT would shift the tax-base away from councils in less affluent areas of Wales towards more prosperous areas. This is an inevitable result of the high progressiveness of LVT. The Welsh Government would have an important role in ensuring that fiscal transfers compensate for this unevenness in the tax-base. However, the importance of national equity should be balanced against the need for local accountability. Any LVT regime should ensure that local government has a level of responsibility over the setting of tax rates which matches its policy powers.
- **Further work should be done to gather evidence on agricultural land ownership in Wales.** There is no overwhelming economic rationale for exempting agricultural land, forestry or land in its natural condition from LVT. Valuing agricultural land was beyond the scope of the report but remains a crucial element to explore.

Other research on land value tax

Scottish Land Commission

The **Scottish Land Commission** collaborated with the [University of Reading in 2018](#) and with [Alma Economics in 2020](#) to consider options to reform existing land and property taxes. These included widening the existing non-domestic rates tax-base, making council tax and non-domestic rates more progressive with more regular revaluations, a single LVT alongside existing taxes to capture excluded parts of the tax-base, or a single LVT to replace all existing land and property taxes.

The options put forward are numerous and are assessed against the specific objectives of the Scottish Government and Scottish Land Commission. These objectives are different from the primary aim of the Welsh Government in considering local tax reform. The University of Reading report concludes that *'no option could*

provide a complete solution to the SLC's objectives and that no option has been developed in sufficient detail so as to form a basis for recommendation for implementation.' The Commission has established an Expert Advisory Group on Tax on Land and Property to help shape the recommendations it will make to the Scottish Government in late 2021.

Mirrlees Review

The [Mirrlees review](#) in 2010-2011 suggested business property is an input to the productive process of the economy and therefore should not be taxed. It views non-domestic rates as an inefficient tax because it can distort the choices businesses make, skewing away from property-intensive production. However, Mirrlees concedes that non-domestic rates are to some extent a tax on land values which is desirable, and that abolishing rates entirely creates an undesirable windfall gain to wealthy land and property owners. The report therefore suggests non-domestic rates should be replaced by a land value tax via a gradual transition. Mirrlees makes the same recommendation as the Bangor University report that agricultural land should be brought into an LVT tax-base, even if it is of low value and subject to little or no tax. It suggests a tax rate of 4% of land value.

All-Party Parliamentary Group on Land Value Capture Inquiry

[The All Party Parliamentary Group on Land Value Capture](#) held in 2018 developed proposals to capture increases in land value for the public benefit. The group launched an inquiry focused on three related areas of land value capture: the role of land value capture in devolved tax proposals; the 1961 Land Compensation Act, public land banks and compulsory purchases; and economic efficiency, fiscal stability and the inter-generational equity of shifting tax from income to assets. Its report offered four conclusions to address these issues. Of most relevance to this document, the report proposes it is necessary to undertake a reform of non-domestic rates where the four pillars of the reform are:

- that all buildings, equipment and other capital components be exempt so that the basis of the rating is the site only;
- that the base of the tax be extended to all land in the UK (but with land used for domestic dwellings on which council tax is levied should be zero rated);
- that the tax falls on the owner rather than the occupier; and
- the basis of the valuation of the land should be the optimum permitted use.

The report also called for transitional reform of council tax to move towards assessment based on land rental values. On this proposal, precepts collected by Mayoral councils in England should be assessed on the basis of land rental values only, excluding improvements thereafter. Council tax bands should be extended as a transitional step towards assessment on land rental values only. Councils should transition to a land value tax over a five-year period, beginning with the highest banded properties, rental property, second homes and undeveloped land in the first year.

House of Commons' Housing, Communities & Local Government Committee inquiry

Similarly in 2018 the [Housing, Communities and Local Government Committee conducted research](#) on the 'significant increases' that arise from the granting of planning permission by local planning authorities in England and from public investment in infrastructure. It notes such increases can be substantial and, given these are created by the powers of the state, it is fair that a significant proportion of this uplift be available to the state with the potential to invest in new infrastructure and public services. The inquiry distinguishes between the land value capture which relates to increases in land value which arise from the planning permissions and new infrastructure, and Land Value Taxation 'which concerns the taxation of all development according to ongoing changes in land values'.

Following a review of historic mechanisms (the Development Charge, the Betterment Levy and the Development Gains Tax) as well as existing mechanisms for capturing the uplifts in land values (Section 106 agreements, the Community Infrastructure Levy and Stamp Duty), the Committee considered improving existing mechanisms as well as understanding possible new mechanisms for land value capture. While much of the Committee's report focusses on broader reform of planning policy, it briefly considers other financial levers to capture land value that relate to implementing a land value tax. LVT was highlighted in several submissions to the Committee.

What we learned

Working Group

The **Local Government Finance Reform Working Group** discussed the benefits and drawbacks of a local LVT in Wales in 2018 ahead of the Bangor work being commissioned. The group noted there are good reasons for introducing LVT as a replacement local tax, though there were some views about potentially significant market shifts and falls in land prices. The group felt a mechanism to redistribute revenue amongst councils would still be required given some areas would raise an insignificant amount of tax from an LVT. On practical requirements, the group discussed the characteristics of unregistered land (was it always lower value?) and the variable volume of transactions for certain types of land, advocating the need for detailed research on these points. On valuation, members agreed that land is more homogeneous than property, potentially making it easier to value. Members suggested whether land and property as two elements of a valuation could be diverged over time for a more gradual shift to LVT.

Planning system

In the available literature and from our many discussions we found differing views as to whether the planning system requires fundamental changes to be able to support a land value tax. The views centre on the differing definitions of land value and types of LVT, 'site value rating' or 'land value capture'. We were unable to assess this more fully without setting some initial parameters for a future tax, for example, would we

wish to tax the 'improved' or 'unimproved' value of land and would we wish to capture the value of amenities and infrastructure.

Some forms of LVT are thought to require an advanced zoned planning framework, which is not the approach taken in the UK. The planning system in Wales is based on consents and operates largely independently from the local tax systems, ie. a domestic or non-domestic use in one system does not imply the same in the other. The Bangor report concluded that a major overhaul of planning in Wales is not required for a local LVT under the form it proposes, but recommended further thought be given to incentives / disincentives for land being brought forward for development. The choice of what point in the process to begin charging an LVT is a crucial factor.

Conclusions

The study by Bangor University represents the first detailed consideration of a local LVT in Wales with a focus on the practicalities of implementation, rather than conceptual ideas. This should be considered initial feasibility work due to its scope, with much more work to do if the Welsh Government were to move forward with proposals in the future. However, the Bangor report and other studies have greatly furthered our understanding of what would be required, and there is a lot to learn from other countries. The following summarises the key points which resonated with us.

Design choices: the policy choices within a broad LVT design are numerous and intricate. To begin narrowing these down to set a clear framework requires some initial decisions about objectives and scope. These should remain consistent over the lengthy time it would take to design, legislate for and implement a local LVT.

Land values and tax rates: modelled land values and tax rates are very useful and important findings. However, there are many factors which would influence the outcomes. More in-depth (if possible) and longitudinal analysis is required and at a closer proximity to the timeframe for implementation. It is unlikely the Welsh Government would be able to fully quantify all impacts.

Data requirements: land value is already inherent in the current property tax valuations and it is not easy to separate out the two factors. The volume and quality of data on land is poorer compared to what exists for property. We would not fully know true land values until a full valuation exercise of all land in Wales were completed. The current lack of linkable, precise and complete information has serious implications for the practical viability of a local LVT in Wales. However, technological advancements provide an opportunity to modernise the systems, which could have wider uses in public policy and delivery than for local taxes alone.

Legislative requirements: replacing council tax, non-domestic rates or both with a local LVT is a fundamental departure from centuries-old statute, and would most likely require several Acts of the Senedd. This would be a complex and lengthy exercise but it could bring about opportunities for modernisation and consolidation of the law.

Constitutional obstacles: the Government of Wales Acts confirm 'local taxes to fund council expenditure' and local government finance are devolved matters. However, the quasi-devolved nature of the valuation function means the Welsh Government

must seek permission from the UK Government to change the valuation function in any significant way. A replacement tax which has an impact on crown estates requires Crown Consent. There are issues with the land registration procedures in the UK, over which the Welsh Government has no control. Given the breadth of the legislative change required there may be other constitutional obstacles.

Roles and functions: it is possible a local LVT would require the establishment of new functions, bodies or agencies, or the significant repurposing of existing ones. These might relate to valuation, information and administration. Deciding the appropriate governance arrangements for the various functions would be of primary importance.

Public engagement: awareness of land value tax could be low but this requires investigating. Proposals for a replacement local tax need a clear link to an objective, and a clear path to implementation, or they will not be accepted and understood. The Welsh Government's ways of working would advocate coproduction with partners and taxpayer involvement.

Timeframe: based on all of these considerations, it would be prudent to consider a development and implementation timeframe of more than a single five-year Senedd term.

A local LVT has the potential to meet our primary objective of raising revenues for local services in a more progressive way. There is an enormous amount of policy choice, and a significant task in creating the legal framework and database infrastructure. However, developing these could also bring about a number of opportunities and wider benefits. It is less clear how we could definitively evidence whether a local LVT is overall a better regime than the existing local taxes, and whether the benefits justify the vast resource required in the interim.

Areas for further work

The key areas for further consideration would be:

- Outline the requirements for a comprehensive cadastral database. Discuss with relevant partners feasibility, timeframes and costings. Consider opportunities for links with the wider devolved taxes agenda;
- Understand the implications of land ownership and land use. Consider whether changes to the planning system are required (and are desirable / achievable). Conduct statistical analysis of agricultural land;
- Undertake a fuller analysis of legislative and devolution requirements. Continue discussions with UK Government departments;
- Consider what information is required to assess more fully the financial impacts on taxpayers and local government, including the impact on the tax regime of economic shocks such as COVID-19;
- Work with local government to assess appetite for greater decentralisation / fiscal autonomy, or the ability to develop the necessary capability in the future.

6. Local Taxes Based on Income

In this chapter we discuss:

- What a local income tax is
- Research by Jennie Bunt
- Other notable research
- What we learned and areas for further work.

Taxes based on income are commonly applied across the world as major sources of revenue at national levels but they can also be applied at sub-national levels by localised governments, states or municipalities. Local income taxes (LIT) have been proposed as alternatives to property and land based taxes for some time, as a closer measure of practical ability to pay and therefore in theory, fairer and more progressive. Due to this alignment with our primary objective, the Welsh Government couldn't ignore this as an idea, and opted to explore whether this concept could be applied in some form to local taxes in Wales.

There are fiscal and constitutional constraints which mean the usual concept of an LIT, normally collected through national PAYE systems, is not possible as a replacement local tax in Wales. It also means the previous studies on this subject are not wholly transferrable. We have therefore modified the concept based on broadening-out local government's existing wealth of expertise in assessing incomes, and have been clear such a tax would be raised and collected locally. Local government in Wales already receives a portion of funding from Welsh Rates of Income Tax and UK income tax indirectly via our £3.5 billion Revenue Support Grant, which is local government's largest single source of annual revenue.

The initial work we commissioned during this term focussed on a replacement council tax in the first instance. The LIT concept could also be applied to non-domestic rates perhaps as a turnover, output or profit-based affordability tax for ratepayers. Separate research is required for income-based alternatives to non-domestic rates.

What is a local income tax?

Local Income Tax (LIT) as a concept has been widely rehearsed in the UK throughout the first part of the 21st Century, most notably by the [Lyons Inquiry](#) in England and the [Burt Review](#) in Scotland. In 2015, the [Scottish Commission on Local Tax Reform](#) assessed possible new approaches to local taxation with a detailed focus on LIT. It is a form of tax which ignores the market value of property and land assets and instead distributes the tax burden based on actual gross or net incomes. Most income tax systems are designed in bands which attract increasing tax rates, often with a base portion of income that is tax free. Some income taxes are personal to an individual, some are household based and others include conditionality about both elements.



Research by Jennie Bunt

In April 2020 a doctoral student from Cardiff University was tasked with researching whether council tax could be charged on the basis of household income rather than property value. *An assessment of the feasibility of a local income tax to replace council tax in Wales* by Jennie Bunt was published in November 2020 and can be accessed [here](#).

The research comprised a literature review on the use of local income taxes in other countries, seeking to understand where and how it is used, as well as any issues it presents as a form of local taxation. The second stage used key themes as the basis for interviews with stakeholders who had expertise or experience of local taxation, socioeconomics and household finance. Findings from the literature review and interviews were compiled to define key considerations in developing an LIT for Wales.

International comparisons

From the outset, it was accepted that it was unlikely another international system could be directly applied to Wales, because of the unique cultural and economic characteristics of Wales as a devolved nation of the UK. Nevertheless, the research usefully sets out its operation elsewhere in the world. Eighteen out of 37 OECD (Organisation for Economic, Co-operation and Development) countries use some form of LIT. Evidence suggests that in all of these countries the tax is collected at source through the equivalents of pay-as-you-earn and HMRC. Local income taxes make up a small proportion of local revenues – less than 20% in some countries such as the United States, Spain and Korea, whereas it represents **more than 90% of local revenues in Finland and Sweden**. At least six of the eighteen countries require universal self-assessment tax returns for all taxpayers; local discretion over tax rates is common, but varies in terms of the range of tax rates; and there were some useful lessons to be learnt about funding equalisation between areas from Denmark and Sweden.

The research found no current international examples of an LIT assessed and collected at the local level, though Welsh Government is aware of some local examples in US cities. This has implications for its consideration as a replacement local tax for Wales, where one of our objectives is to safeguard local democratic accountability. With limited benchmarks that could otherwise be used to help us understand the key practical requirements of an LIT administered and collected by councils, it is more difficult to fully grasp how this sort of tax could be implemented in practice.

What constitutes 'ability to pay'?

The report deliberates this important question in great detail and concludes that careful consideration would need to be made regarding indicators of ability to pay. Not only would any indicators need to be reliable and accurate, but there are many types of income and wealth that could influence someone's ability to pay. We agree with this conclusion: deciding which to include may be one of the most challenging aspects of designing a local LIT. Whilst income from employment will be the major indicator of ability to pay for individuals and households, a move towards variable working over the past decade could make income more complicated to assess. Such challenges are exacerbated by the matter of self-employed income, in that the different chronology of taxation of self-employed income could present its own challenges. Complications could also arise when categorising the multitude of savings and investments as either taxable or non-taxable income. Whilst none of these questions are insurmountable, they would require a great deal of further work, not least to understand any unintended consequences of making certain decisions, such as the risk of income being hidden.

In addition, the inclusion of income from Universal Credit or other benefits prompts consideration of a minimum income threshold for a local LIT. We also note the finding that taxation of pensioners may be crucial in the perception of a local LIT. On the one hand, excluding pensioners from an LIT could help address the 'asset rich, cash poor' debate which frequently arises in discussions about making council tax more progressive or implementing a local land value tax. On the other, it raises practical challenges around raising revenue. Currently, pension-age households do pay council tax and low-income pensioners are supported by the Council Tax Reduction Scheme. We recognise that if pension income were to be excluded in the scope of an assessment of ability to pay, this would shift the burden of taxation onto the working-age population.

We also agree one of the key benefits of a local LIT may be the ability to design in from the outset matters which are normally dealt with through discounts and exemptions, such as low income or student status. This relates to the idea of a tax-free allowance, which could cause many who currently receive discounts and exemptions to fall out of the tax system automatically. It is widely contended the current council tax system, which includes an array of discounts and exemptions and incorporates the Council Tax Reduction Scheme, is unwieldy. Whilst these are all key mechanisms for reducing the regressive nature of the tax, designing in from the outset such mechanisms is appealing, from an administrative perspective as well as a take-up angle.

Individual or household level assessment?

The report highlights a decision would need to be made between continuing to use the household as the unit of taxation, or to issue bills to each adult (meaning one household could receive multiple bills). We are reminded the Community Charge was linked to individual liability and the experience of administering that tax found a large number of individuals relocate each year, potentially to new council areas.

Interviewees felt a household level tax would be most appropriate because of the way in which services are experienced, however they recognised the administrative challenges for households with a number of adults. For example, whilst keeping the chargeable unit as the household would be in line with the approach taken to Universal Credit entitlement, houses in multiple occupancy could pose unique challenges, particularly where one occupant was a very high earner. The research finds internationally, it is most common for countries who use an LIT to charge each individual, rather than the household. This overlaps with, and is to some extent reliant upon, the tendency to require universal self-assessment tax returns and the fact that local income tax is deducted from wages at source.

In their modelling of the potential of LIT, both the Scottish Government and the Lyons Inquiry in England made the assumption that the tax would be linked to the address on the basis that this would preserve the strong link between tax paid and services delivered in the area in which people live and vote. However, both pieces of research were primarily focused on local income tax collected at source through PAYE. Overall, a distinction would need to be made between a tax which is linked to someone's address, in which each adult at the address would be individually billed, and one where collective affordability would be assessed and a household level bill issued. Further work on this would be required.

How to assess ability to pay

It is clear from the research that data-sharing between agencies such as HMRC or the Department for Work and Pensions and councils may need to be explored and progressed at pace to deliver a local LIT system. Whilst this presents challenges, the alternative would be that councils would have to collect this information themselves periodically to assess liability. Either option presents its own novel obstacles.

We already know councils in Wales carry out detailed assessments of household income and other circumstances on a sizeable subset of the council tax tax-base, eg. to identify almost 300,000 low-income households eligible for the Council Tax Reduction Scheme. Passporting from benefits systems helps to identify eligibility but there is an array of other information also taken into account. Councils are also experienced in assessing household incomes and circumstances when considering applications for discretionary hardship relief, carrying out enforcement and debt recovery activities, and when considering applications for discounts, disregards and exemptions. Councils also carry out related means-tests for a range of other local services. However, the notion of extending a means-test to all 1.4 million domestic dwellings in Wales for the purposes of charging local taxation provoked interesting debate amongst stakeholders interviewed as part of the study.

The scale of the potential 'ask' from councils to administer and collect a local LIT was a concern raised by a number of interviewees who took part in the research. The time period over which to assess income was another important factor as this influences the chronology of collections as well as the predictability of revenue. If income is self-reported, this introduces an additional risk of inaccurate reporting and would likely require some form of auditing. On this note, we agree with the research findings that **'there is a need to be realistic about how large a change a local income tax would be in terms of requiring reporting of income, given that most people in Wales**

currently have very little direct interaction with the tax system.' Reporting income could very well be perceived as burdensome or intrusive. The Single Financial Statement is offered as a possible tool to assess income. However, it does not provide for the extensive assessment of income that would be required under an LIT, although we recognise it may offer a useful starting point.

Overall, we note that local assessment and collection of an LIT will only be viable if the costs do not outweigh the benefits in terms of revenue yield and overall fairness to taxpayers. Although a move to a more radical form of local taxation in Wales would not be achieved overnight, or even in the short term. Much more preparatory work would precede any option that was eventually progressed.

Local Discretion

The research finds that theoretical literature supports councils having discretion over tax rates, as this can promote responsibility and encourage councils to improve the prospects of residents. Many interview participants also saw local discretion as a key potential benefit of a local LIT, both practically and symbolically. Some suggested that variation should be limited to a small range to avoid large inequalities across Wales.

We agree with the finding that there would need to be careful consideration in designing a system so that it does not introduce new inequalities or become vulnerable to exploitation. The research reminds us that local discretion over rates was not popular with the public when the Scottish Government conducted a consultation on LIT in 2008. Equalisation of overall funding would therefore need to be carefully designed so as not to remove the incentive effects for councils to develop their revenue potential, whilst avoiding any intended consequences surrounding the setting of local, and therefore varied, tax rates across Wales. Overall, however, we maintain that local autonomy is one of the key considerations for local taxes in Wales, and should be a particular focus in the context of any move towards a local LIT in the future.

Transitional arrangements

In terms of transitional arrangements from one form of tax to another, the research suggests taxpayers should be involved in all three stages of design, implementation and evaluation, to encourage public understanding, greater support and buy-in. The transition from council tax to a local LIT would indeed need to be carefully planned, with consideration given to reliefs and other schemes to ease the impact of increases in bills for some people. If the system were more progressive, many taxpayers would see reductions in their bills.

The prospect of councils deferring the implementation of a local LIT to give taxpayers plenty of notice of a move towards a new form of local tax is also explored in the research, as well as payment deferral schemes for those without the necessary funds to make payments as normal. The report notes transitional reliefs over a defined period have been successfully used in Wales and Northern Ireland previously, though these have come with significant costs. Again, the notion of transitional relief schemes are not unique to an LIT, and would need to be a key consideration where major local tax reform in Wales is concerned.

Behavioural change

The Welsh Government concludes the design of a local LIT would need to be based around a fixed address of primary residence, regardless of place of employment, otherwise it could not function as a local tax. The research finds that a local LIT as a replacement for council tax would nevertheless still display a higher degree of mobility. The [Holtham Commission](#) found in 2010, that 50% of the Welsh population lived within 25 miles of the border with England, compared to only 3.5% of the Scottish population living within 25 miles of its border with England. This also raises questions about mobility within Wales, if it were so designed that an LIT would need to encompass 22 council borders with different tax rates charged. Whilst an LIT has the potential to be more progressive than other approaches by relating more directly to disposable household income, it is likely that very high earners would also be highly mobile if the difference in local tax rates were too great. This risk may mean that revenue stability is favoured over its progressive advantages.

The research reiterates **the length of the border and concentrations of taxpayers in border councils such as Flintshire, Wrexham and Monmouth, increases the potential scope for fiscal flight from Wales to England**, particularly for those who find that an LIT is more expensive than the current council tax. It also suggests particular care should be taken when designing the system for students to protect the future workforce and tax-base. Whilst fiscal flight is likely to be concentrated on high earners with the means to move, even losing a small number of high earners could have a significant impact on the tax-base in Wales. The research also highlights that where councils have discretion to set their own rates, fiscal flight at a local level could manipulate the tax distribution across Wales, creating a risk of a 'race to the bottom' to attract higher earners to local areas.

Finally, the extent to which taxpayers are incentivised to work or make savings will depend heavily on how ability to pay is defined. This will also dictate how many opportunities taxpayers have to manipulate their finances to reduce their exposure to local tax. Interview participants disagreed about how many people might be influenced in their decisions about work, and whether problems of this kind are already present under council tax. Perhaps the key point to note is that if a local tax based on income did have a general deflationary impact on willingness to work, this could significantly reduce the tax-base and the tax-raising abilities of councils.

Conclusion

The report's findings illustrate that a locally administered income tax for Wales would be a unique system when considering international examples of local taxation. It also explores a number of challenges, including how to define ability to pay. Importantly, the research finds many aspects of the implementation of a local LIT could require significant expansion of current provision and existing skills in councils, although one of the key benefits may be the ability to design in from the outset a minimum income floor, in order to achieve our objective of fairer and more progressive local taxes.

The research also highlights where gaps in the evidence remain. To support further exploration of the feasibility of a local LIT in Wales, along with its possible design, a number of areas for further research are identified. These are summarised as:

1. Model the economic realities of a local LIT. The primary aim of modelling should be to predict the revenue raising potential and increase understanding of how the burden of local taxation may change for different demographics, including assessing any equality implications.
2. Investigate the extent to which citizens of pension age struggle to pay council tax, using these findings to inform the definition of ability to pay for LIT and to decide whether alternative provision would be required for this demographic.
3. Investigate in greater detail the feasibility of data-sharing in relation to assessing ability to pay, involving key stakeholders such as HMRC and the DWP.
4. Investigate further the kinds of employment which contribute most to the tax-base in Wales, to understand the level of potential volatility during economic downturns.
5. Consult councils to understand their views on the feasibility of an LIT, once a clear set of options for its administration has been developed. The focus of this consultation should be the practical challenges which would need to be overcome for councils to successfully transition to and administer a local LIT.
6. Consult the public on the concept of a local LIT and whether councils should have discretion to vary tax rates between areas. This consultation should be part of wider communications which clearly explain the rationale behind reform.
7. Conduct research with the public to understand what factors inform decisions about moving home. This could improve understanding of the true risk of fiscal flight to other countries, or between council areas, in response to tax reforms.

Other notable research

[Our evidence review on systems of local government finance](#) highlights that a local income tax has been considered by UK reviews and commissions dating back to the beginning of the 20th century. The Royal Commission on Local Taxation of 1901 and the Kempe Committee of 1914 both rejected the notion, whilst in 1976, the Layfield Committee concluded that it was “the only feasible major new source of income” for councils.

The Lyons Inquiry (2007)

More recently, [Lyons](#) (2007) supported the concept and considered two options based on the 2007 tax system and rates as an addition to the then 22p basic rate of income tax. Lyons advocated income taxes as fairer than property taxes, more closely reflecting ability to pay, though concluded it would impact more on those of working age than those who had accumulated wealth in property. Although two scenarios were modelled (as a full and partial replacement to council tax), both were primarily focused on local income tax collected at source through PAYE. The inquiry does however shed light on perceptions of local income tax, which remain relevant to its consideration as a locally-administered tax.

The Scottish Burt Review (2006)

In contrast, Sir Peter Burt rejected the idea of a local income tax based on concerns which included the impact on incentives to work, and also because income taxes are already a relatively large share of total UK tax revenues. The [review](#) highlights that property as a proxy for wealth *should* feature as part of the overall basket of taxes in the UK, and the yield of a local income tax would be unpredictable. In his final report, he concludes that were a local income tax to be introduced, it should be assessed and collected using arrangements already in place for UK income tax (PAYE). Importantly, it is noted that a local income tax would be fair only if it was levied on *all* income, but it would be extremely complex and expensive to do so, and particularly if responsibility for collection rested with local councils.

Scottish Commission on Local Tax Reform

In 2015 the [Scottish Commission on Local Tax Reform](#) considered a local income tax for Scotland. It mirrored the UK Government's income tax structure and added an additional flat rate to the basic, higher and additional rates of income tax as an alternative to the current council tax in Scotland. An extensive survey carried out by the Commission found a local income tax was relatively easily understood by respondents, although the final report balances this analysis with concerns that an LIT could erode local accountability, as well as around its administration. Again, it too highlights the key challenge is ensuring a local income tax applies to all forms of income.

What we learned

Working Group

Our Local Government Finance Reform Working Group previously indicated the concept of charging local taxes on the basis of income was most suitable in the domestic context, and is where our research has taken us during this term. Although the group considered there could be greater revenue risks and volatility associated with such an approach in comparison to other approaches to local taxation (for example, during periods of recession and lower employment), it was pointed out that some Scandinavian countries administer a form of LIT very effectively. Therefore, the concept as applied to Wales was worthy of further consideration.

Our research brief was clear, to assess the feasibility of a *locally administered* tax based on ability to pay. This is because a tax collected at source through pay-as-you-earn by HMRC is not a form of local taxation permissible under the current devolution settlement. Although this concept is quite different from local income taxes used elsewhere, which are predominantly collected at source and then distributed to sub-national governments, the focus of our work during this term was investigate how the current expertise in local government might be used to administer a different form of local taxation. Local administration would also avoid placing an additional administrative burden on employers.

Conclusions

We were particularly keen to translate the conceptual options into practical action to understand the key benefits and the barriers to implementation. The following outlines our conclusions.

- **Design choices:** the various studies suggest a banded design would be preferable to a discrete value system and this is a more recognised form of income tax. The opportunity to disregard a minimum income level as a tax-free allowance is attractive and would much negate the need for support schemes which form substantial parts of the current system. It also provides opportunities for policy alignment with Welsh Rates of Income Tax choices. It appears though that the unit of taxation under a local LIT would be the household rather than an individual, due to higher individual mobility, complexity and experience of the Community Charge. A household unit of taxation is uncommon in relation to international examples of LIT.
- **Pension-age and working-age:** income taxes are traditionally raised from working-age tax-bases yet council tax has never been restricted to working-age. There is no practical or theoretical reason why pension-age households could not contribute to a local LIT. Indeed an LIT should be more progressive than the current system, supporting those on lower-incomes, but this would be a matter for political consideration.
- **Data on incomes:** a major factor in the design of a local LIT is whether councils could access data from HMRC and DWP, and potentially other bodies, at some point in the future. This would vastly reduce council administration and burden on taxpayers. At this early stage we have not entered into discussions with relevant departments, but it would be an immediate element to explore if the government wished to take forward proposals for a locally administered LIT.
- **What is income:** there are countless indicators to include or exclude in a definition of income and this may need to change over time to align with changes in other taxes and benefits. Information about the indicators needs to be reliable, timely and accurate. There would be no requirement for a large-scale property valuation function. There may be benefits to providing some kind of role or responsibility to an independent agency as part of the arrangements, provided this does not weaken local accountability.
- **Impact analysis:** the study was not able to encompass quantitative analysis due to the unavailability of data on household incomes at the required precision. The only useable output for the Welsh Government currently is estimates from the ONS' Family Resources Survey, which, while available at anonymised record level, must be utilised at aggregate level due to sample sizes. Further work is required to secure other data sources.
- **Fiscal flight:** there is no conclusion as yet as to the level of risk of fiscal flight across the border compared with what is already inherent in the property tax system. There are many other factors which influence where people choose to live than local tax rates, and council tax rates already differ between countries and

between councils. However, it is likely the effects would be pronounced for very high earners. It is unclear whether a future government would be able to quantify the revenue risk with great enough certainty. Modelled scenarios would help if the required data precision could be achieved.

- **Revenue stability:** LITs tend to fluctuate in yield with economic peaks and downturns because a fixed tax-rate is applied to fluctuating incomes. However, there could be a way to design a local LIT to shield from this variability, looking to the arrangements in Scandinavian countries. Currently, councils are legally required to set out a budget before deciding the amount of council tax which is required to be raised to meet that budget. Fluctuating rates between years could be technically challenging and difficult for taxpayers to understand. Some design ideas would be more susceptible to changes in taxes and benefits elsewhere.
- **Legislative and constitutional requirements:** replacing council tax, non-domestic rates or both with a local tax based on income would likely require several Acts of the Senedd and a large body of subordinate legislation. This provides opportunities for consolidation and modernisation of the statute. The Welsh Government may need to negotiate new legal gateways to support the provision of data to Welsh councils. As a property valuation function would no longer be required in Wales, removal of the function would require UK Government consent. Given the breadth of the legislative change required there may be other constitutional obstacles and further work will be needed to examine whether the Senedd is able to legislate in this area without further powers being devolved to it.
- **Public acceptability:** awareness of taxes based on income is high and the progressiveness argument broadly accepted. However, acceptance of a move to a local income tax would depend on how much administrative burden is placed on taxpayers, for example, annual self-assessment tax returns versus a bill calculated by the council using administrative data.
- **Timeframe:** based on these considerations, it appears the development and implementation timeframe could be shorter than for a local land value tax. However, it is still likely to be more than a single five-year Senedd term due to the extent of consultation and primary and subordinate legislation required.

Overall, the highly progressive nature of a local LIT meets our primary objective of local government finance reform, but there is less known about how this would operate in Wales than perhaps other types of tax. We recognise that a key feature of the current local taxes is the direct geographical connection between the location of a property, the council area in which the tax is levied and where decisions about local service provision are taken – and that generally it is households which benefit from local services rather than individuals. Whilst the research on a local LIT raises a number of considerations and areas for further work, there remain key unanswered questions surrounding the concept we are seeking to understand. That is not whether income tax in its current form could be applied locally, but whether the current charging regime for locally administered council tax and non-domestic rates could more simply be designed around assessments of ability to pay.

Non-domestic rates

Though the research during this term has not yet studied whether a local LIT could replace non-domestic rates, it is useful to note how the broader concept could be applied in this context. Some categories of ratepayers already pay rates according to assessments of turnover and trading figures, as these are factors included in the rateable value assessed by the Valuation Office Agency for several sectors and industries. Jennie Bunt's research on international comparisons shows 11 OECD countries apply a form of LIT to 'corporate entities'.

Successive governments have grappled with the fairness debate around those who require a physical unit to do business and those that don't, but never more so than currently given the rise of online commercial activity and the impact of COVID-19. This has led to more serious consideration of ideas like online sales taxes by the UK Government in recent years. An income-based replacement for non-domestic rates could help to alleviate some of the perceived unfairness from this aspect. It is important to remember though, that non-domestic rates are not currently designed to be a tax on business - they are a local property tax contribution to the cost of services in an area (as is council tax), including large-scale services from which ratepayers benefit such as educating the future workforce. Something like an online sales tax to address the arguments could not operate as a local tax in Wales.

To remain a local tax under the devolution arrangements a replacement for non-domestic rates based on income would still need to be tied to a fixed commercial address. However, moving more towards income-based assessments of liability could begin to conflate two very distinct forms of taxable contribution to local services (property based and business based). Not all ratepayers are businesses, and many businesses do not require a property to operate. We also suggest the concept of a local LIT provides less opportunity for a single tax covering both domestic and non-domestic contexts, than the idea of a local land value tax could.

Areas for further work

The key areas for further consideration if moving forward with a local income tax would be:

- Outline data requirements and begin discussions with the relevant UK Government departments about the feasibility of future data-sharing. Undertake a detailed costings exercise for the required digital infrastructure;
- Map out the alternative assessment mechanism if data-sharing on incomes is not feasible. Discuss views, opportunities and constraints with local government;
- Understand the implications of changes in other taxes and benefits on own LIT policy. Consider alignment with policy on Welsh Rates of Income Tax;
- Conduct a statistical analysis of incomes where possible and produce options for designs, eg. on bands and tax rates. Consider whether it is possible to safeguard yield against economic downturns;
- Undertake a fuller analysis of legislative and devolution requirements.

7. Council Tax Reform

In this chapter we discuss:

- Benefits and constraints of council tax
- Institute for Fiscal Studies research
- Sheffield University research
- Other potential reforms
- Valuation methods
- Council Tax Reduction Scheme
- What we learned, including areas for further work.

So far in this document we have discussed alternative approaches which would be a radical departure from the current system of raising revenue for local services. This chapter discusses how council tax could be reformed if the government were to keep the basic system of council tax as a traditional property tax, but find ways to improve it.

Benefits and Constraints of Council Tax

There are many benefits to the existing system to highlight and potentially preserve in future arrangements. Council tax:

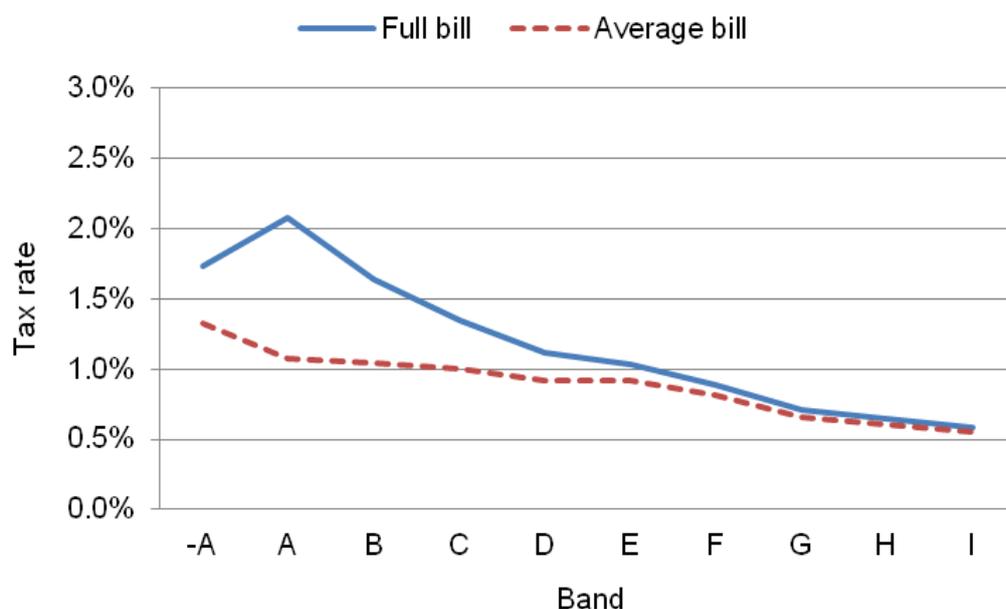
- Is a highly efficient local tax which consistently achieves over 97% collection rates in Wales year on year, with low administrative costs (less than 1% of yield);
- Is relatively well-understood by taxpayers due to its structure and longevity, and is harder to avoid than other taxes;
- Is a naturally buoyant revenue stream due to annual tax-base growth resulting from population growth and house-building;
- Provides a large degree of flexibility to councils in setting budget priorities, enabling direct democratic accountability and engagement with citizens about the use of public money;
- Is a key administrative function of councils, providing essential information about socioeconomic circumstances, and provides high quality public sector jobs dispersed across the country; and
- Protects low-income households and provides significant support to those less able to meet their liability obligations.

Taking Wales Forward 2016-2021 committed to reviewing council tax to make it fairer and more progressive. Much has been achieved towards that aim during this Senedd term, as outlined in Chapter 2, as we explored longer term options.

Could council tax be more progressive?

It is difficult to quantify how progressive council tax in Wales is since there are significant and longstanding mitigations built into the system, such as the Council Tax Reduction Scheme. Our investigations in 2017 showed that only 55% of liable households are required to pay a full council tax bill and that when looking at the distribution of liability (net of discounts and support) council tax is much less regressive in relation to property value. Figure three shows the tax rates in relation to property value for each band (for illustrative purposes we have used the upper value threshold of each band and £500k for band I).

Figure three: Illustrative tax rates based on upper value threshold



Source: Welsh Government calculations.

There are also questions about whether the right measure of 'progressive' should relate to property values or actual disposable incomes or some other measure. We agree however that the basic banded structure is a regressive design and could be designed differently. We are constrained in our ability to make changes without undertaking a revaluation exercise. Such changes could help to make the system fairer: for example, it might be possible to add bands to increase progressiveness or modernise the thresholds to fit better to present market conditions.

What is a council tax revaluation?

There are over 1.4 million chargeable dwellings in Wales liable for council tax. Each property is placed in one of nine bands on the basis of property values and housing market conditions on 1 April 2003, the last time the council tax base was updated and revalued. Wales is the only part of the UK to have ever updated its tax-base since its inception, meaning council tax bills in England and Scotland are based on 1991 valuations (Northern Ireland operates a different system of domestic rates). Wales also added an additional upper value band as part of the revaluation exercise. The Valuation Office Agency (VOA) is the independent body tasked with maintaining the

valuation list and places each property into a band. Each of the nine bands attracts a tax rate relative to the other bands determined by ratios set by the Welsh Government, though the actual council tax charges are set by local councils.

Table one: Council Tax Bands in Wales

Band	Tax rate relative to Band D	Valuation as at 1 April 2003
A	6/9	Up to £44,000
B	7/9	£44,001 to £65,000
C	8/9	£65,001 to £91,000
D	1	£91,001 to £123,000
E	11/9	£123,001 to £162,000
F	13/9	£162,001 to £223,000
G	15/9	£223,001 to £324,000
H	2	£324,001 to £424,000
I	21/9	Above £424,000

The tax rates for each of the nine bands could be changed so that higher value properties pay proportionately more tax than lower value properties. However, tax bills would still be based on 2003 property values, which are now 18 years out of date, potentially creating inaccuracy and unfairness by not reflecting present market conditions. Physical improvements to properties since 2003 also remain uncaptured unless the property has been sold, so a home could have undergone a significant extension and uplift in price value yet the tax rate remains unchanged. Commentators would therefore argue that making council tax more progressive should go hand in hand with a property revaluation exercise.

The valuation list maintained by the VOA places properties into bands and does not record a numerical price value for each property, as it does for non-domestic rates. This means we are unable to adjust the banding structure to create new bands without revaluing the tax-base. Welsh Ministers have powers to instruct the VOA to revalue, and this would be carried out by the VOA in accordance with the assumptions and principles set by Ministers. The exercise in 2003-2005 cost the equivalent of £26 million in today's money, required several pieces of legislation and a complex regime to ease the transition for certain taxpayers.

We know from the previous revaluation in Wales that such an exercise cannot be undertaken lightly. Nevertheless, it would open up a range of opportunities to reform council tax and to help us achieve our objectives. We commissioned a range of external work to help us better understand the house price changes across Wales, the impacts on households and on councils.

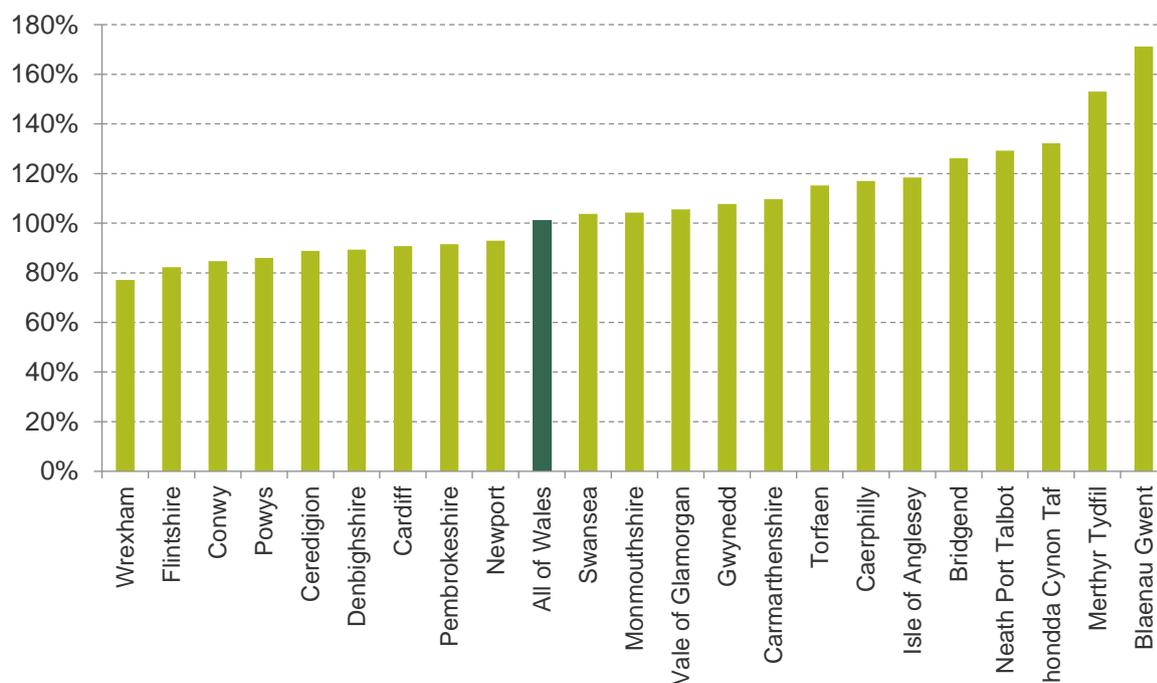
Institute for Fiscal Studies research

The Institute for Fiscal Studies (IFS) has conducted a simulated council tax revaluation for Wales, using the complete valuation list and combining this with updated area characteristics and transactional price data from HM Land Registry. The IFS studied the options for reform and how these would affect the tax-bases, tax bills, and finances of different councils; and the tax bills and after-tax incomes of different household groups. The detailed report was published in April 2020 and can be accessed [here](#).

House price changes

The IFS found that house prices increased in Wales between 2003 and 2019 though this varied significantly by council area. The average percentage increase overall was 101%, ranging from an increase of 77% in Wrexham to 171% in Blaenau Gwent.

Figure four: Percentage growth in average property price 2003–2019, by council



Source: IFS report. ONS, UK House Price Index, March 2020 release.

Reform options

Using its estimated valuations, the researchers modelled a number of possible options for improving the progressiveness of council tax.

1. **Pure revaluation** – a simple revaluation assigning properties to council tax bands of equivalent widths to the current system.

2. **Proportional bands** – as Option (1) but also changing the tax rates to be proportional to the mid-point of each band.
3. **Extra and proportional bands** – as Option (2) but adding additional bands at the bottom and top of the distribution.
4. **Extra bands and reduced regressiveness** – as Option (1), adding additional bands at the bottom and top of the distribution and making the tax rates less regressive, though not fully proportional.
5. **Continuous and proportional system v1** – remove the banding structure and apply a fixed tax rate as a percentage of property values, but retain existing discounts, premiums and exemptions.
6. **Continuous and proportional system v2** – as Option (5) but abolishing the single-adult discount.

The report summarises the impacts of all options at a high level and then focuses in more detail on Option 1, a pure revaluation and Option 5, which removes the banded structure and applies a proportional tax rate.

Pure revaluation

The report estimates that mirroring the current approach to the nine bands, around half of properties would shift bands, with 26% moving up and 26% moving down.

Individual council areas would see variations in the numbers of properties moving up and down bands. As a result, councils would see changes in their local tax-bases and therefore changes in revenue which could potentially be raised in each area. Table two is ordered by highest to lowest percentage change in properties moving up bands.

Table two: Estimated percentage of properties moving bands under a pure revaluation

Council	Down	Same	Up
Isle of Anglesey	15%	45%	40%
Monmouthshire	16%	44%	40%
Gwynedd	17%	47%	36%
Blaenau Gwent	7%	58%	35%
Newport	20%	48%	32%
Caerphilly	17%	52%	31%
Vale of Glamorgan	22%	46%	31%
Cardiff	25%	45%	30%
Torfaen	19%	52%	29%
Powys	27%	46%	27%
Conwy	29%	46%	25%
Bridgend	26%	51%	24%
Ceredigion	33%	44%	23%
Merthyr Tydfil	16%	61%	23%
Rhondda Cynon Taf	16%	61%	23%
Swansea	27%	50%	23%
Carmarthenshire	33%	47%	20%

Council	Down	Same	Up
Pembrokeshire	34%	46%	20%
Denbighshire	33%	47%	19%
Neath Port Talbot	28%	54%	18%
Flintshire	43%	43%	13%
Wrexham	47%	42%	11%
Wales average	26%	49%	26%

Source: IFS report.

Impact on councils

Revaluing the tax-base changes its 'worth' in each local area and therefore changes the tax raising ability of councils. The map in figure five shows the change in the value of the tax-bases following a pure revaluation (Option 1), and the map in figure six shows the change in tax-bases from implementing a proportional system (Option 5). Green shows increases in tax-base, red shows decreases in tax-base.

Figure five: Changes in tax-base by council area as a result of pure revaluation

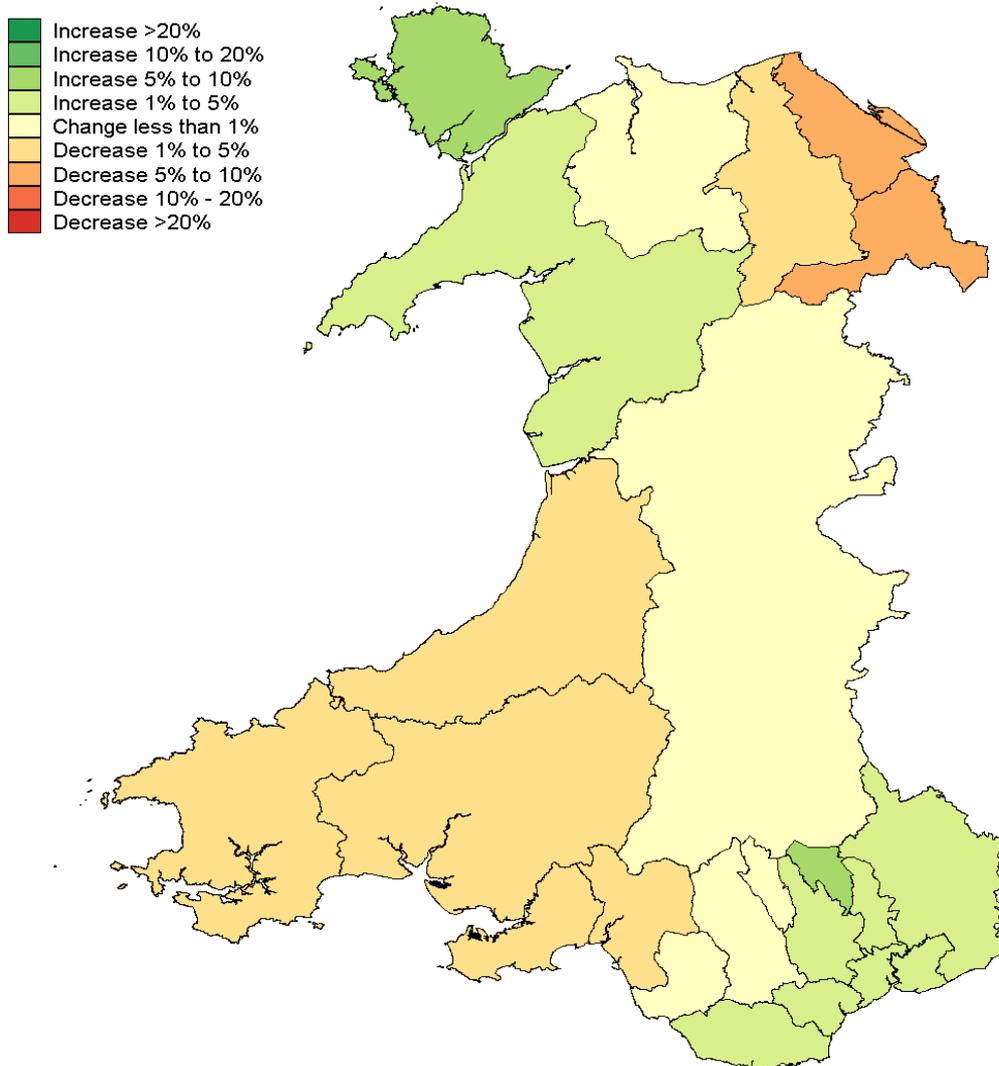
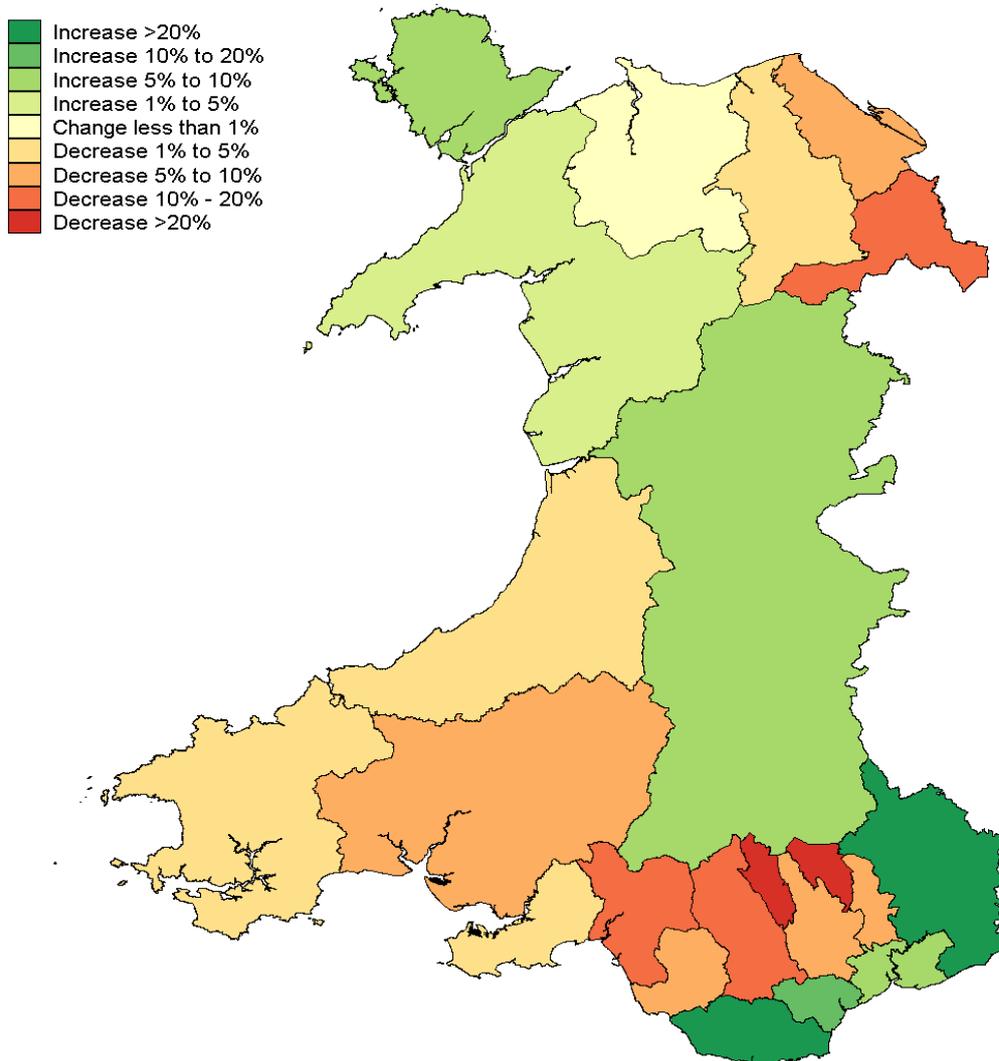


Figure six: Changes in tax-base by council area as a result of a continuous and proportional council tax



Under Option 1 a pure revaluation, tax-bases would rise in areas where relative prices have risen and vice versa, though the IFS describes the changes as relatively modest. With the exception of Anglesey (up 5%), Blaenau Gwent (up 5%), Wrexham (down 7%) and Flintshire (down 6%), tax-bases would change by less than 5% in either direction. There is a clear regional pattern, with tax-bases estimated to increase in most of South East and North West Wales, and fall in South West and North East Wales.

Under Option 5 a continuous and proportional system, changes in tax-bases would be substantially larger than a pure revaluation, falling significantly in most of the Valleys areas, with the largest falls in Neath Port Talbot (20%) and Merthyr Tydfil (24%). Whilst prices have increased in Blaenau Gwent relatively more than the rest of the country, property prices are still the lowest in Wales and so under a proportional system, the tax-base would fall 23%. In Cardiff, the Vale of Glamorgan and Monmouthshire, tax-bases would rise between 18%, 25% and 34%, reflecting the much higher property prices than the rest of the country.

Changes in revenue-raising ability of councils can be offset by counter changes in the distribution of government grant. The report notes it would be for the Welsh Government to consider how the new tax-bases would be taken into account when allocating the annual £3.5 billion Revenue Support Grant (RSG). Under the current arrangements, the funding formula for allocating the Revenue Support Grant would distribute funding between councils based on local ability to raise revenue from council tax. Areas which see an increase in tax-base would attract less RSG, and areas which see a decrease in tax-base would attract more RSG. Table three, from the IFS report, estimates the effects of grant redistribution under Option 1 compared with Option 5.

Table three: Changes in grant funding to fully offset changes in tax-bases, by council area

Council Area	Pure Revaluation		Continuous and Proportional System	
	<i>Per capita</i>	<i>Total</i>	<i>Per capita</i>	<i>Total</i>
Blaenau Gwent	-£15	-£1.1m	£64	£4.5m
Bridgend	£3	£0.4m	£27	£3.9m
Caerphilly	-£9	-£1.7m	£33	£5.9m
Cardiff	-£7	-£2.6m	-£74	-£26.9m
Carmarthenshire	£9	£1.7m	£32	£6.1m
Ceredigion	£11	£0.8m	£13	£1.0m
Conwy	£4	£0.4m	£2	£0.2m
Denbighshire	£11	£1.0m	£18	£1.7m
Flintshire	£29	£4.5m	£43	£6.7m
Gwynedd	-£18	-£2.2m	-£8	-£1.0m
Isle of Anglesey	-£25	-£1.7m	-£39	-£2.7m
Merthyr Tydfil	-£3	-£0.2m	£76	£4.6m
Monmouthshire	-£27	-£2.5m	-£189	-£17.8m
Neath Port Talbot	£5	£0.8m	£68	£9.7m
Newport	-£10	-£1.5m	-£25	-£3.9m
Pembrokeshire	£13	£1.6m	£20	£2.5m
Powys	£2	£0.2m	-£31	-£4.1m
Rhondda Cynon Taf	-£3	-£0.7m	£59	£14.2m
Swansea	£3	£0.9m	£11	£2.7m
Torfaen	-£6	-£0.6m	£25	£2.3m
Vale of Glamorgan	-£12	-£1.5m	-£124	-£16.4m
Wrexham	£30	£4.0m	£52	£7.0m

Source: IFS report.

Under a pure revaluation, the changes in RSG would be relatively modest – in only one case exceeding 2% of existing grant funding levels. Cardiff would see the biggest RSG reduction in aggregate terms (£2.6m) and Monmouthshire would see the biggest reduction in per person terms (£27). Overall, RSG would be reduced slightly for

councils in the South East and the North West. Wrexham and Flintshire would see the biggest increases in RSG.

If a proportional system were introduced, the magnitude of the changes in RSG would be larger. Monmouthshire’s grant would be reduced by £17.8 million to offset its higher tax-base, Cardiff by £26.9m and Vale of Glamorgan by £16.4m. Valleys councils would receive additional RSG. Rhondda Cynon Taf which is estimated to see a reduction in grant of £0.7 million under the pure revaluation scenario, would receive £14.2 million in additional RSG under a proportional system. Valleys councils would however become more grant dependent as they would expect to raise less from residents through council tax.

Impact on households

The study measures the impact of a revaluation on household income by comparing council tax bills before and after the various modelled reforms. The report explores the impact on pension-age and working-age households, families with and without children, homeowners, private and social renters, single persons and other household types.

Figure seven shows that under a pure revaluation:

- 55% of households see a change in tax bill of less than £50;
- 8% of households lose between £50-£200;
- 12% lose more than £200;
- 12% gain between £50-£200; and
- 13% gain more than £200.

Under a proportional system:

- 30% of households see a change in tax bill of less than £50;
- 7% of households lose between £50-£200;
- 16% lose more than £200;
- 14% gain between £50-£200; and
- 34% gain more than £200.

Figure seven: Distribution of cash changes in net council tax bill (per year)

■ Gain >£200 ■ Gain £50–£200 ■ Change within £50 ■ Lose £50–£200 ■ Lose >£200

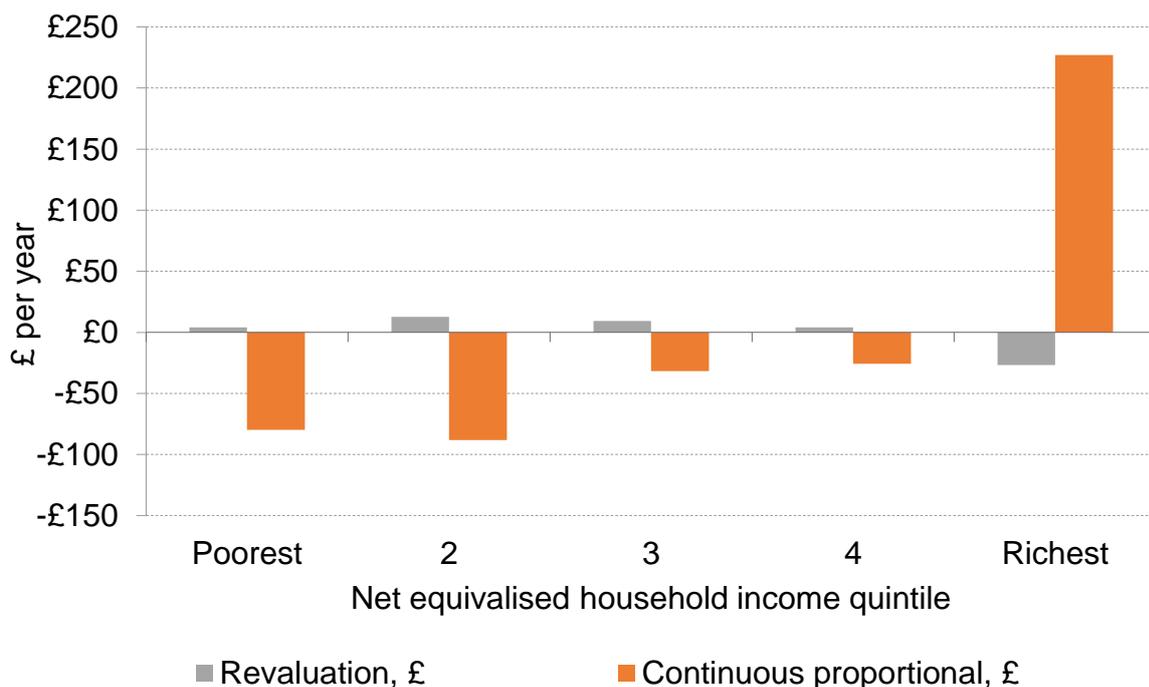


Source: IFS calculations.

The figures reflect the position net of council tax reductions, however, the IFS model assumes full take-up of the Council Tax Reduction Scheme whereas in reality this is currently not the case. It is difficult for tax and benefit models to make assumptions about take-up due to the self-reported nature of survey data and the risk of in-built underestimates of entitlement and the nuanced differences in take-up patterns of different household groups.

More households see smaller changes in bills under a pure revaluation option, whilst there are more winners and losers under a proportional system. Households with higher incomes pay more in council tax on average. Interestingly the report also analyses council tax bills across the household income distribution shown in quintiles from the poorest 20% of households to the richest. Figure eight shows that a pure revaluation has essentially no effect on average bills across the income distribution. A proportional system is generally progressive in relation to incomes. This reduces bills by £80-£90 in the bottom quintiles and increases bills by up to £230 in the top quintile. Again however, these figures assume full take-up of the Council Tax Reduction Scheme.

Figure eight: Average change in net council tax bill by household income quintile



Source: Figures from IFS online appendix.

In relation to household composition, the study suggests the average effects of a pure revaluation are minimal across all household types. Moving to a proportional system would benefit single-adult households and couples with children (which tend to live in less valuable properties) and would disadvantage pensioner couples and multi-family households (which tend to live in more valuable properties).

The research also provides further estimates of the effects on demographic groups. The effects of a proportional system are greater than a pure revaluation, and are

beneficial for those who tend to live in lower value properties, eg. younger households, renters, those receiving disability benefits and ethnic minority groups.

There is also lots of detailed information in the report about the effects of other reform options. In general, the results of 'intermediate' reform options are very similar to results under a proportional system. This is true of effects on all income levels and demographic groups.

Other considerations

The IFS study considers in some detail that an ideal future property tax would include removing the single-adult discount as it encourages what is described as inefficient use of housing stock. Removing the single-adult discount would substantially reduce the gains seen by single-adult households when moving to a proportional system – these include single working-age households, lone parents and single pensioner households.

The report emphasises that revaluation and reform will come with political and practical challenges. If undertaken on a revenue-neutral basis, by definition this will result in winners and losers and it is not clear how aware of or accepting people would be about the changes. Some households could see significant impacts if the relative value of their home has increased significantly, or their property is currently 'undertaxed', perhaps due to physical improvements. There may be a particular concern about low-income losers, including pensioners who own properties that have appreciated significantly in value, but who have low current incomes, as well as low-income people renting from private or social landlords in expensive parts of the country. The Council Tax Reduction Scheme would insulate many low-income households from both losses and gains as a result of moves to a proportional system, but this depends on take-up of the scheme.

The report discusses a number of potential policies which could ameliorate impacts, such as:

- Transitional arrangements – phasing-in changes in bands or tax bills, or focussing specifically on helping those seeing large increases, though this would probably require additional funding;
- Deferred implementation – allowing households to adjust (eg. save, move) before becoming liable to pay the new tax bill;
- Deferred payment – councils to loan households money to cover part of the bill they are unable to pay immediately; and
- More generous council tax support schemes.

Chapter 6 of the IFS report discusses the economic evidence relating to tax incidence and the possible impact of council tax reform on future rents and property values. It is suggested that properties which see a fall in council tax bills would be expected to rise in value, whilst those which see a rise in bills would be expected to fall in value, in a process called capitalisation. The IFS study concludes a pure revaluation would have little effect on property values, but a proportional system would narrow the distribution of property values and therefore wealth inequalities.

The cheapest 10% of properties in Wales could rise in value by around 18%, on average. The most expensive 10% of properties could fall in value by around 12% as a result of the reform, but these findings are highly sensitive to the analytical assumptions made. When looking at these effects geographically, the IFS estimates average property values in Blaenau Gwent, Neath Port Talbot and Merthyr Tydfil would increase by between £8,200 and £9,900. Conversely, average property values in Monmouthshire and the Vale of Glamorgan would fall by around £25,300 and £16,600, respectively. These falls however are relatively small in the context of price rises in recent years.

Conclusions

The IFS study reached the following conclusions.

- **Council tax is out of date, regressive and distortionary. It needs to be revalued and reformed.** Property values in parts of Wales have changed very differently since the last revaluation. This means properties are in increasingly arbitrary tax bands that may bear little relation to current reality. 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.
- **Whether grant funding from the Welsh Government were adjusted alongside reforms to council tax would have a crucial effect on the reforms' impact across councils.** If it were not, each council 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, 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. The IFS assumes funding is fully adjusted.
- **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.
- **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.

- **Revaluation and reform of council tax could help narrow household and geographical wealth inequalities via effects on property prices.** 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 distribution of funding from the Welsh Government, between areas with low and high property values. The scale of these impacts is highly uncertain, though.

Overall, the IFS research concludes a pure revaluation in Wales would have a modest effect on reducing regressiveness and advocates more radical options, such as the continuous and proportional system and abolishing the single-adult discount. A key conclusion from the research is that it is very difficult to find a reformed structure which is truly progressive – where the tax rate for higher value properties is greater than the tax rate for lower value properties. Instead, the IFS has presented options which are less regressive than the current position, or are ‘proportional’ eg. an equal tax rate across all property values.

There are other proponents of a proportional council tax, including the Wales Governance Centre and Fairer Share. Studies propose varying ways in which to achieve this, either through a banded system or a discrete-value design. Most studies do not outline the vastly different legislative, valuation and operational requirements of each of the variations. Some reports also advocate a shift in the tax burden towards council tax and away from other types of tax in Wales, such as those based on transactions or incomes. It is difficult for these ideas to meet the Welsh Government’s primary objective of progressive council tax (unless it were reformed) or to recognise and safeguard local democratic accountability.

Sheffield University research

Professor Leishman and Dr Hincks (the UK Collaborative Centre for Housing Evidence / the University of Sheffield) carried out a complementary [study](#) to examine possible effects of and statistical approaches to revaluation. Professor Leishman undertook similar work for the Scottish Commission on Local Tax Reform in 2015 constructing a multilevel hedonic pricing model which could be used to produce revaluation estimates. The model uses a long time series of transaction data, various geospatial elements and also looks at the environmental variables which make up a property's price value (eg. distance to green space, flood risk). This work therefore has a different focus to the IFS study, and is particularly useful for considering whether a more statistical or automated method of revaluation could be feasible in the future. The research does not seek to estimate the impact of revaluation on households.

House price changes

The research finds a pronounced increase in house prices in Wales during the period 2003 to 2007, followed by a short downturn around the global financial crisis (2008 to 2009), and then a long period of stable growth to 2019. There were also spatial variations between council areas in house price movements since the last revaluation in 2003, and varied responses to the global financial crisis. Table four shows considerable variation between council areas when comparing 2003 and 2019 values.

Table four: Median prices, and medians relative to 2003 for council areas

Council	2003	2019	Ratio
Blaenau Gwent	40,000	82,000	2.05
Bridgend	83,000	140,000	1.69
Caerphilly	69,950	128,000	1.83
Cardiff	132,000	219,000	1.66
Carmarthenshire	70,000	122,500	1.75
Ceredigion	127,000	177,000	1.39
Conwy	111,500	161,000	1.44
Denbighshire	86,250	138,250	1.60
Flintshire	95,000	153,250	1.61
Gwynedd	84,000	151,500	1.80
Isle of Anglesey	85,000	160,000	1.88
Merthyr Tydfil	41,500	85,000	2.05
Monmouthshire	145,000	240,000	1.66
Neath Port Talbot	55,000	108,250	1.97
Newport	94,000	163,250	1.74
Pembrokeshire	98,500	150,000	1.52
Powys	110,000	174,000	1.58
Rhondda Cynon Taf	48,000	91,500	1.91
Swansea	82,000	140,000	1.71
Torfaen	79,500	133,000	1.67
Vale of Glamorgan	115,000	197,750	1.72
Wrexham	89,000	148,000	1.66

Source: Sheffield report.

The report provides further detail of the trends by dwelling type and council tax band. The most notable pattern appears to be one of **stronger growth in prices at the lower end of the property market, than the upper end of the market, since 2003**. For example, the median price for Band A dwellings increased from £34,000 to £69,000 (a ratio of 2.03), compared to an increase for Band I from £485,000 to £720,000 (a ratio of 1.48). This suggests a repositioning of the lower band limits may result from a future revaluation.

The report shows that with the possible exceptions of bands A and B, the updated band limits proposed under a ‘pure revaluation’ (ie. keeping the same proportion of properties in each council tax band as now) are close to the values suggested by the IFS study.

Price indicators

Professor Leishman’s model finds the following factors to have the most influence on property prices across Wales.

Table five: Factors influencing property prices in Wales

Variable	Influence (plus or minus %)
Property type	-12.0 to +31.2
Property age	-12.2 to +17.6
Parking	-1.4 to +11.4
Neighbourhood	85.0
Bathrooms	15.7
Rooms	3.0
Conservation area within 250m	2.5
Bedrooms	2.1
Flood zone high risk	-1.4
Floor area	0.6
Walk time to secondary school	0.5

Source: Sheffield report.

The model finds the following to be lower determinants of price (less than 0.5%) though still statistically significant:

- Proximity to green space, woodland, blue space and coast;
- Proximity to main roads, stations and supermarkets.

Distance to a hospital, levels of air pollution, broadband speed and orientation towards the sun either had no influence on price or were too unstable to measure. Perhaps surprisingly, distance to primary schools was also not found to influence prices but this could mean the relationship was too complex to measure.

Complexities arise when the factors show different levels of ‘worth’ between areas and also between time periods. This type of model is thought to be versatile and able to capture these effects. However, it suggests choices about the timing of a revaluation,

and what data to include (length of time series, which factors) are decisions which would affect the outcome.

Band structures

The research examines alternative approaches to setting new council tax band thresholds. As well as a 'pure revaluation' option, band thresholds were designed:

- To deliver the same property distribution as the 1993 list;
- As they were in 2005 (ie. bands based on the 2005 revaluation method);
- To result in an equal proportion of dwellings in each of the nine bands; and
- Using a cluster analysis to determine natural breaks or clustering within the data.

These options yield varying results in tax-base change for each council area, with the natural cluster analysis leading to the greatest increases in tax-base for higher price areas, such as Monmouthshire and the Vale of Glamorgan.

Table six: Change in tax-base arising from different banding approaches

Council	To replicate 1993 list	To replicate 2005 list	2005 revaluation method	Equal % in each band	Cluster analysis
Blaenau Gwent	-5.9%	-4.0%	-2.5%	2.1%	4.2%
Bridgend	-4.0%	0.7%	1.5%	34.9%	14.2%
Caerphilly	-5.9%	-2.0%	-0.5%	22.2%	9.0%
Cardiff	-3.0%	3.5%	3.7%	50.1%	19.6%
Carmarthenshire	-6.5%	-1.8%	-1.0%	30.5%	11.3%
Ceredigion	-4.0%	1.9%	2.2%	47.5%	17.3%
Conwy	-2.8%	3.1%	3.5%	46.0%	17.7%
Denbighshire	-5.4%	-0.1%	0.7%	37.8%	13.5%
Flintshire	-9.2%	-4.3%	-3.7%	32.7%	9.0%
Gwynedd	-0.9%	4.4%	5.2%	42.9%	18.9%
Isle of Anglesey	0.9%	6.9%	7.2%	51.3%	22.7%
Merthyr Tydfil	-8.5%	-6.3%	-4.7%	3.1%	3.1%
Monmouthshire	1.5%	9.4%	9.3%	60.6%	28.2%
Neath Port Talbot	-7.7%	-4.4%	-3.1%	14.4%	6.0%
Newport	-4.9%	0.1%	1.0%	35.4%	13.9%
Pembrokeshire	-4.8%	0.9%	1.3%	40.3%	15.4%
Powys	-4.3%	1.9%	2.2%	44.1%	17.2%
Rhondda Cynon Taf	-5.5%	-2.5%	-1.4%	16.6%	7.4%
Swansea	-6.1%	-1.3%	-0.3%	29.4%	11.9%
Torfaen	-6.8%	-2.7%	-1.3%	23.6%	9.0%
Vale of Glamorgan	-0.8%	6.4%	7.0%	50.5%	23.0%
Wrexham	-9.2%	-4.5%	-3.8%	27.9%	8.2%

Source: Sheffield report.

Under some reform options, councils with already lower tax-bases would see further reductions in capacity to raise revenue, and would attract more Revenue Support Grant from the Welsh Government through the annual funding formula.

Conclusions

The Sheffield University report concludes that a revaluation would go some way towards addressing the regressive band structure of council tax if an alternative approach were taken to the design of band thresholds. The market trends since the last revaluation in 2005, and since the global financial crisis, show that **the timing of a revaluation and the choice of base year are important and should be selected to avoid short-term distortions**. The report notes it seems likely that a period of significant housing market adjustment could occur as a result of the COVID-19 pandemic, and it would be prudent to consider the implications on the timing and choice of revaluation year should the Welsh Government decide to move towards a revaluation of the council tax-base in the future.

In terms of reform options, the cluster analysis revealed nine natural groupings of dwellings, and this more closely reflects the differential movement of prices within Wales since the last revaluation. Future research could explore the impact of such a banding approach on households.

The researchers suggest the updated band A and B thresholds differ from the IFS study potentially because the Sheffield model used a longer time series of transactions (1995 to 2019), compared to the IFS study which used 2010 to 2018. The Sheffield model also tests a more complex interaction between spatial and temporal effects, ie. the factors differ between geographical areas but these differences can also change over time.

The researchers conclude that **statistical methods are an effective approach to market value estimation**, with a high degree of predictive accuracy, which could be used to allow more frequent and systematic monitoring of property values in the future. More manual, traditional, approaches may always be needed for atypical dwelling types, sizes or locations.

Other potential reforms

Review discounts and exemptions

Some proponents of council tax reform suggest the need to review the suite of discounts, exemptions and disregards etc which form a key part of the system, either alongside larger scale changes or as required reforms in their own right. The arrangements are complex and have grown incrementally since the inception of the council tax in 1993. The system comprises:

- **24** categories of **exemptions** from council tax liability completely, covering 60,650 dwellings (or 4% of dwellings), the largest being empty / unfurnished properties and student dwellings. Some are time-limited to six months;

- **16 categories of disregarded persons** for certain individuals when calculating the number of people living in a property for the purposes of determining the amount of council tax payable, eg. students and carers;
- **Discounts** of 25% or 50% applied to the amount of council tax payable, including two statutory categories (single liable adult, empty property) and three classes of empty property where local discretion is permitted. 37% of dwellings are subject to one or more discounts;
- **Premiums** applied to the amount of council tax payable on long-term empty and second homes at local discretion; and
- a general **discretionary power** for councils to reduce bills in cases of hardship.

There are unique reasons for each of these, though many have existed for decades and some may be considered less relevant. For example, a key feature of the current system is that it is partly (50%) based on property value and partly based on household characteristics. A review could identify changes aligned to our fairness and progressive objective. Council tax liability could be increased for certain households who are deemed to be able to afford to pay more, or reduced further for those with less means. The [Independent Commission on Local Government Finance in Wales](#) in 2016 recommended these be reviewed with a view to further localising decisions to local government. Other suggestions over the years have included:

- making the single-adult discount (25%) and the empty property discount (50%) more or less generous in percentage terms;
- abolishing the single-adult discount, making it means-tested, or relying on the Council Tax Reduction Scheme for those who may require it;
- removing the exemption for student dwellings, making student occupiers pay (with possible collection difficulties) or transferring the liability to landlords (though costs could be passed on to students as higher rents);
- not allowing higher value properties to be eligible for any reductions;
- further increasing the maximum amount by which local councils can charge a premium on empty and second homes (eg. to an additional 200% rather than 100%);
- removing some of the empty property exemptions, removing the exemption for repossessions making financial institutions pay until the property is sold, or conversely making time-limited exemptions more generous;
- localising the policies for exemptions, disregards and discounts to councils (premiums and certain discounts are already localised).

Most of these changes would require a primary legislative change through an Act of the Senedd. The legislation does not currently allow us to remove discounts completely and there are other legislative requirements, such as the empty property discount must be set at twice the amount as the single-adult discount.

Some of the changes described would add further to the complexity rather than reduce it. Changes in one area may require alterations to other discounts and disregards. When making changes, the interconnections between the different criteria need to be

carefully thought out so as not to introduce loopholes in the system that would allow for fraud and avoidance. There are complex relationships between council tax and non-domestic rates which would also need to be considered. In relation to public acceptance, it is more difficult to remove arrangements from recipients accustomed to the current arrangements, even where the rationale for previous decisions may have been superseded.

Changes to tax rates

Despite the lengthy consideration about revaluation in this document, changes can be made to tax rates without a revaluation of properties. Indeed this was a change implemented in Scotland in 2017. Council tax charges would still be set annually by local councils, but the Welsh Government could change the set of tax ‘ratios’ for the nine bands – the relativities between the amount charged for each band shown in table seven.

Table seven: Council tax ratios

Band	Tax ratios
A	6/9
B	7/9
C	8/9
D	1
E	11/9
F	13/9
G	15/9
H	2
I	21/9

Altering the ratios could nudge the system in the direction of progressiveness, so that higher value properties pay proportionately more tax than lower value properties. The advantages of this option are that it would be quicker to implement than other more substantial reforms and it can be achieved through passing subordinate legislation. It is largely an administrative exercise not affecting the current valuation lists or the work of the Valuation Office Agency. The financial impact can be analysed in more detail as the property valuations are fixed. Changes in bills can be anticipated to a greater degree than for other reforms, subject to individual council level plans for annual tax setting. Some technical changes would be required to local billing systems, but these would be lower cost than other reforms.

The Scottish Government’s changes had a very specific aim, to raise an additional £100 million revenue for schools. However, when the Scottish Government made the change in 2017 it received some criticism for not incorporating a revaluation exercise into the reforms. If this approach were followed in Wales, tax bills would still be based on 2003 property values, meaning the new structure would not accurately represent the property wealth of taxpayers who reside in areas of higher growth. Significant property improvements would also remain uncaptured if a property has not been sold since 2003.

While there is good information available to us about the existing tax-base, modelling the impacts in relation to actual household incomes is much more difficult and would not be possible at a household level or even by small geographical area. Preliminary analysis shows that if we seek to maintain revenue at current levels, to meaningfully reduce the tax burden on lower banded properties would require more of it to be shifted onto the middle bands due to the small numbers of properties at the top of the scale. Therefore, despite this being a relatively simpler option for reform, it would still represent a significant upheaval for many taxpayers.

Mansion tax

An idea allied to changes in tax rates is often termed proposals for a 'mansion tax'. Essentially this involves charging much higher council tax rates on properties of very high value. Sometimes the idea relates to the ninth band (Band I), or sometimes over a price threshold such as £1 million or £ 2 million. Wales has around 5,400 properties in Band I, with 4,000 of these not currently subject to any discounts or reductions. It is not known how many properties in Wales are currently worth over £1 million in today's prices. An analytical release by the ONS in 2016 suggested there were 567 transactions worth over £1 million between 1996 and end of 2015.

Such a proposal could only be applied to a whole tax band if the government wished to bring in the change relatively quickly and via subordinate legislation. To increase the tax rate on properties above a certain price threshold would require a revaluation of all 1.4 million properties, as the point of the banded system is so that precise valuations for each property are not required. A mansion tax in Wales would raise small additional revenues due to the number of high value properties, so revenue-raising would not be a primary aim of this idea. The aim would need to be grounded more in arguments of fairness, ensuring those living in very expensive properties contribute more to the cost of local services.

Valuation Methods for Domestic Dwellings

Earlier in this term we explored some ideas for different valuation methods than the traditional, largely manual, method of valuation which was undertaken for council tax in 1991 and 2003. Reasons for considering other ways of valuing property for the purposes of tax may be to try to avoid lengthy, costly, infrequent and 'big-bang' exercises to update the tax-base.

Ideas

Possible methods we have come across include:

- **Statistical modelling:** better use of administrative data to estimate valuations based on property features and economic information. As well as utilising transaction data, this method requires securing better access to GIS technologies, environmental databases and an array of property market information;

- **Indexing:** using house price indices to uprate property values from 2003 to the present day and possibly regularly thereafter. This would account for price inflation over time but not individual property features or alterations;
- **Self-assessment by households:** where council tax payers provide information about their property and circumstances on a regular basis, perhaps annually, which is then used to populate a formula capable of assessing liability;
- **Rolling revaluations:** updating sections of the tax-base over time on a rolling basis, thus becoming a more integrated and constant programme of work for the valuation body;
- **Localising:** the most radical change to the traditional approach in which local government is given the responsibility to assess and decide whether a revaluation is in the interests of its local area, and to work with the valuation body to produce updated values, perhaps within parameters set by the Welsh Government.

Feasibility

Statistical methods of property valuation are increasing with advancements in digital systems and availability of linkable data. The Valuation Office Agency has developed its modelling capability since the 2003 revaluation in Wales. Companies like Zoopla operate algorithms that work at local levels and produces estimates of statistical error. The research by Sheffield University and the Institute for Fiscal Studies described earlier in this chapter provides further ideas and suggests it might be practically feasible to construct a model for the purposes of valuation with a high degree of predictability. The studies also highlight the limitations of the models, such as the current quality of data, loss of precision through matching and the variance in estimates depending on the chosen input data and parameters. Success depends heavily on securing access to the required data at adequate precision. It is likely there will always be a need for professional valuation of a subset of dwellings plus a quality assurance role. Due to the digital presence of Zoopla and Rightmove, public awareness of house price models is likely to be higher than at the time of the last revaluation. Such an assumption could be tested through dedicated social research.

An **indexing** approach is used for property valuation in some parts of the world and has been proposed in the UK by a number of economists. The ONS' House Price Index (HPI) is itself a hedonic regression model based on sales data, the VOA's valuation list, mortgage completions and consumer classifications. As the VOA does not record a precise value for each domestic property, the indexing method is not possible unless a fresh revaluation of all properties were to be carried out first and a precise value recorded. More regular indexing between revaluations could be a feasible option though. Indexing at council level would assume all properties in the same council area have been uniformly affected by rising prices. It has been suggested that band thresholds could be indexed instead of individual properties and localised indices applied. In this instance, whole bands in council areas would move up or down in relation to the national average. It might be possible to create small-area HPIs, however, these would be based on a very small number of cases in some parts of Wales and are unlikely to be statistically robust.

Self-assessment is successfully operated for elements of income tax, inheritance tax and capital gains tax. For council tax this approach could range from taxpayers producing their own valuation, to answering a common set of questions about their property and circumstances, with a model sitting behind this producing the valuation (akin to obtaining a home insurance quote, for example). Self-assessment could deliver a more responsive system by allowing for more frequent updates and at individual property level. The role of the valuation body would focus on quality assurance and compliance. Public acceptance of this option could vary considerably. It could empower taxpayers through increased awareness and ownership of their council tax bills, but specific social research and investment in a customer interface would be required. The potential for growth of an advice industry focussed on reducing valuations for households would be high, potentially negating the administrative benefits of the approach.

A **rolling revaluations** approach would update portions of the tax-base at a time to avoid a large scale exercise. This could be achieved geographically, by council tax band, or by some other attribute (for example when a property is sold or altered). It may include elements of other methods but the basic premise is to spread the cost and implementation over a longer period of time. It could also deliver more frequent valuations if the work was continuous. However, this approach would result in a far more complex system which would need to accommodate valuations at different base years. It diverges from a fundamental principle that all valuations relate to a common date and we anticipate perceived unfairness amongst taxpayers to be higher for this approach.

Localising valuation decisions to councils would place the onus on local government to determine how it might proceed. Due to variances in tax-base and economic conditions between areas, the National Policy Institute and the Independent Commission on Local Government Finance in Wales argued for greater localism in the decision to revalue. The Welsh Government's role may be to set a framework within which decisions could be made, such as prescribing criteria about bands (eg. width, progressive tax rates). The more choice permitted, the more localised the approach and the appetite for this would need to be tested with local government. If valuation were localised it is likely the Council Tax Reduction Scheme would also need to be localised, though local government supports the consistency of our national scheme. With regards to this option, questions around the methodology remain.

Conclusions

It is clear there are alternative and more modern ways to value domestic properties for a future local tax system given advancements in data and technology. Not all ideas would achieve more frequent revaluations or allow for a progressive council tax though. In relation to greater frequency, it appears statistically based methods could be promising, if the appropriate level of robustness and precision could be achieved. The lead-in time to develop these as well as upfront costs could be relatively high, but could lead to savings on more expensive valuation methods in the future. In most cases, the first revaluation using a different method is likely to be an impactful and politicised exercise, realising more of the benefits thereafter. Public acceptance of the method will be key to ensuring confidence in the arrangements and compliance. A suitable next step would be to explore with the VOA the ways in which conducting a

traditional revaluation might have changed since 2003, in the context of advances in technical capability. Chapter 9 considers broader questions about the future form of valuation functions for both council tax and non-domestic rates in Wales and compares with other nations.

Council Tax Reduction Scheme

In any reformed version of council tax, it is likely there will need to be some form of support for low-income and other households. It would seem logical to assume that the more progressive the future system, the smaller the possible intervention might need to be. During this term we have delivered improvements to the Council Tax Reduction Scheme while exploring its future form and purpose. The policy changes and our research have emerged through necessity, as the UK Government rolled out its Universal Credit to replace a number of legacy benefits.

The Council Tax Reduction Scheme (CTRS) is a [national scheme](#) in Wales which provides direct financial support to around 275,000 low-income households by reducing their council tax bills. Since the introduction of our scheme in 2013-14, we have continued to protect vulnerable and low-income households by maintaining full entitlements to support despite decisions to cut support elsewhere. This means that in 2019-20, approximately 220,000 households continued to pay no council tax at all. The scheme makes a significant contribution to tackling poverty and helps to safeguard vulnerable people from getting into financial difficulty, often as a result of UK Government reforms to the welfare system.

In addition to creating a single national scheme for Wales, the Welsh Government made up the 10% funding cut which accompanied the UK Government's decision to end Council Tax Benefit in 2013. We know this fairer approach has helped to prevent both council tax and rent arrears from increasing in Wales during periods of austerity. In England, councils were given powers to design their own reduction schemes. As a result, council tax support varies by council area and research has shown that over three million low-income households are having to pay more of their council tax bill ([Institute for Fiscal Studies, 2019](#)).

Approximately **275,000 households** in Wales received a council tax reduction (CTR) in 2019-20.

The total recorded value of reductions provided through CTRS in Wales for 2019-20 was approximately **£272m**.

In March 2020:

- **111,000 pensioner** households received a CTR.
- **166,000 working-age** households received a CTR.
- **217,000** households **paid no council tax** at all.
- **22%** of households receiving CTR were **Universal Credit** recipients.
- **85%** of households receiving CTR were living in properties in **Bands A – C**.

The UK Government's Universal Credit (UC) is replacing most income-related social security benefits and tax credits for people of working age and continues to be rolled out across the UK. There is clear evidence that these reforms are having a detrimental impact on households in a number of ways, including on devolved areas of policy such as council tax support, social housing and household debt ([National Audit Office, 2018](#)). While one of the objectives of welfare reform to increase work incentives is positive, it cannot be right that decisions taken in the UK context about welfare have an impact on local tax decisions and other devolved policy areas in Wales.

The CTRS has been a priority for this government, both in terms of ensuring it supports vulnerable and low-income households in the fairest way possible, and in terms of extending its reach. This is one reason why we commissioned detailed research by Policy in Practice in January 2019 to shed light on the impact of UC on our national council tax support scheme, council tax debt and rent arrears in Wales. The in-depth and longitudinal research tracks the circumstances of households in Wales over time using data from all areas of Wales. It is supplemented by qualitative research into the experiences of UC claimants, advice services, councils, housing associations and private landlords. The research is wide-ranging and we are particularly thankful that all 22 Welsh councils, 15 housing associations and several private-rented sector representatives participated.

An interim report published in January 2020 considered specifically the impact of UC on the CTRS. This was followed by a final report in July which was wider in scope.

Policy in Practice Research

The final report by Policy in Practice, *Understanding the Impact of Universal Credit on the Council Tax Reduction Scheme and Rent Arrears in Wales*, was published on 29 July 2020. It can be accessed [here](#).

It presents an analysis of the current provision of council tax reduction across Wales, the current CTRS scheme as estimated in 2021-22 when more of the population in Wales will have moved onto UC, as well as the impact of making two minor adjustments to the current scheme for **working-age households**. The report goes on to explore the impact of UC on council tax arrears and rent arrears, as well as the experiences of UC from the perspectives of claimants and stakeholders.

Council Tax Reductions in 2019-20 and 2021-22

The report shows that in 2019-20, approximately 275,000 households received support under the scheme and the total value of council tax reductions was an estimated £269 million. The average reduction per household was around £19.00 per week, although this varied by household circumstances. This shows that our national scheme provides almost 20% of council tax payers in Wales with an average council tax reduction of £1,000 annually. Households in receipt of UC received a lower average weekly award: £16.70 per week compared to their counterparts receiving legacy benefits who received £19.10 per week.

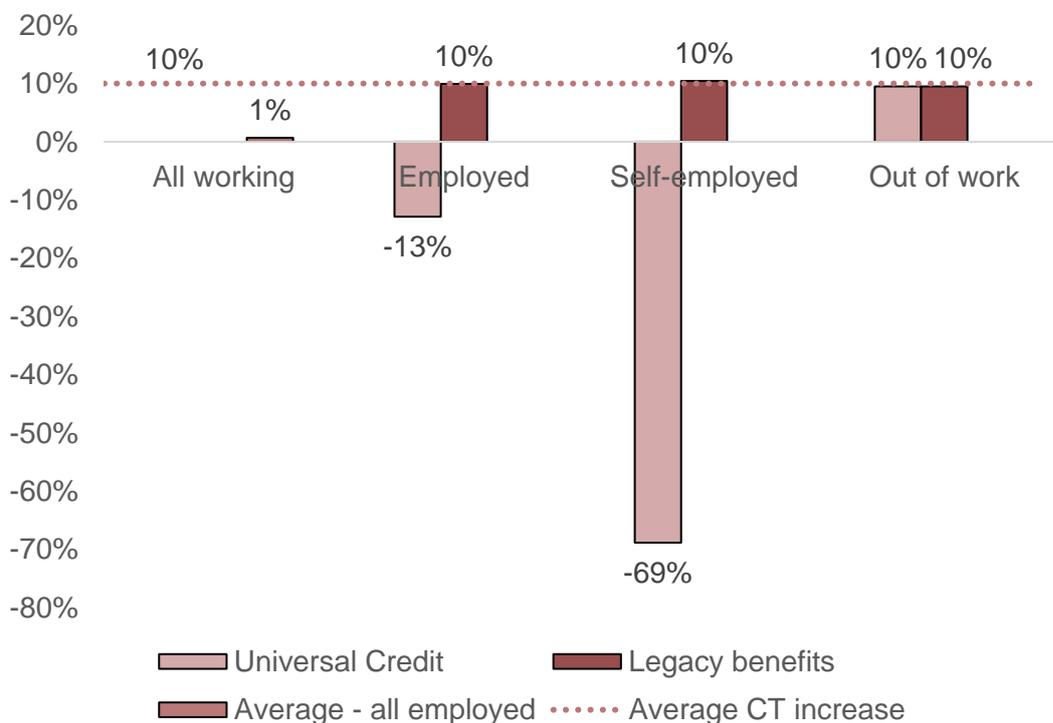
Should the current scheme be retained into 2021-22, Policy in Practice estimated the total value of reductions could increase to approximately £294 million. This is an

increase of 9% from 2019-20, slightly below the average increase in council tax liability, which is estimated to be 10%. This projected increase is primarily the result of modelling assumptions for council tax rises in Wales over the two-year period.

An important finding from the report is that while most groups see an increase in support in line with council tax rises over the period, working households in receipt of UC are more likely to see reductions in their awards. This is because the assessment for council tax reduction for people in receipt of UC is now different from those who remain on legacy benefits.

The research goes on to highlight that people currently receiving a 100% council tax reduction because they have no income continue to do so. However, for others, **the move to Universal Credit from legacy benefits triggers an adverse impact on council tax reduction awards**. Figure nine shows that average support for employed and self-employed households in receipt of UC reduces by 13% and 69% respectively. A similar observation is likely to be seen for working households in receipt of Disability Living Allowance or Personal Independent Payment who migrate to UC. For this group, average support reduces by 22%. Overall, the research gives a valuable insight into who is negatively impacted by the rollout of UC in the context of council tax reduction awards in Wales.

Figure nine: Percentage Change in Council Tax Reduction Awards from Current to 2021-22, by Economic Status for Working-Age Households



Source: Policy In Practice report.

The report reminds us that due to retention of earnings under UC, **not all of these households will necessarily be worse off financially overall**. This higher retention of earnings works to reduce the amount of council tax reduction these households become eligible for. It is important to understand to what extent households lose out by moving across to UC, whilst recognising the move *can* mean some households retain more income. A key question being considered by the Welsh Government and other devolved administrations, is whether retained earnings from UC should be seen as replacement for council tax reduction lost. Understanding impact by specific group, as well as financial impact on affected households, will now help to progress policy decisions in this area.

Making Adjustments to the CTRS

Policy in Practice modelled numerous possible adjustments to the CTRS, which could increase parity between working-age legacy and working-age UC households. The final report focusses in greater detail on one of the available options which would be to amend the CTRS 'taper'. The taper is the rate at which support is gradually withdrawn when a household has earned income above a certain threshold. It is currently set at 20%, meaning for every £1 of additional income earned, support reduces by 20p.

Reducing the taper rate offers an opportunity to make the CTRS more progressive. The lower the percentage rate, the more generous the scheme. Reducing the taper rate from 20% to 10% for all working-age households to increase the generosity of the scheme is estimated to benefit approximately 27,000 households in 2021-22. These households see an average increase of around £6 per week. Importantly, Policy in Practice's research shows households gaining most from this measure are self-employed and employed households in receipt of UC; or households that are more likely to be negatively impacted by UC. The total value of reductions would increase by £8 million in 2021-22, although this amount could change, as reducing the taper also has the capacity to bring more people on to the scheme¹. If it was felt this option was viable, it could be extended to include pension-age households, or it could be restricted to benefit only those on UC given the reductions these households face.

The report also provides insight into one option for improving the administration of CTRS. There is anecdotal evidence that UC increases CTRS administration costs due to a need for more frequent reassessments in response to the monthly assessments of UC. This increased frequency of reassessment can result in households receiving a series of award notices and revised council tax bills. The report suggests the CTRS could incorporate measures to reduce this need for reassessment by adopting a 'de minimis' threshold for change. Changes in income below the threshold would be ignored for reassessment purposes. Analysis indicates this would likely be a cost-neutral measure as underpayments and overpayments are offset against each other,

¹ Modelling can only take account of households currently represented in the datasets used. It therefore cannot anticipate behavioural change in response to scheme adjustment. Specific measures that result in wider eligibility cannot model increases in caseload or the resulting increase in the total value of council tax reductions. Where this occurs, modelling may result in an underestimation of cost. However, where an adjustment may result in increased caseload this is highlighted in the final report. Further information on data sources, data processing, modelling assumptions, and analytical process is supplied in Appendix C of the final report.

but further work would be required, for example to determine the optimum 'de minimis' threshold. Nevertheless, we recognise the matter of CTRS reassessments under UC remains a pertinent consideration for improving the scheme in the future.

The interim report by Policy in Practice published in January 2020 offers other modelling options for reducing some of the negative impacts of UC on council tax reduction awards in Wales. It can be accessed [here](#).

The final report updates the analysis on the following five adjustments to the current CTRS, some of which could restore parity between households in receipt of legacy benefits and UC. These include:

- amending non-dependent deductions;
- introducing a guaranteed minimum award;
- lowering the notional Minimum Income Floor used in the calculations for self-employed claimants on UC;
- changes to the two-child limit for families; and
- introducing an income-banded scheme.

Improving take-up

Survey analysis by Policy in Practice highlights there is confusion about the relationship between UC and council tax reduction; **25% of survey respondents believed that an application for council tax reduction was included as part of UC**. This is not the case. Eligible households now need to apply separately for a council tax reduction. UC is directly reducing the number of automatically-passported cases, making the application process more complicated for eligible households and making it more difficult for councils to proactively contact households. There is also a loss of information held by councils as, unlike Housing Benefit, the housing element of UC is not administered by them.

Our internal research in 2017 suggested the take-up of CTRS in Wales could be as low as 55% to 65% of eligible households, though this is comparable with most UK benefits. Prior to COVID-19 the Welsh Government had been responding to historical evidence of potentially low take-up rates by launching awareness campaigns. In 2018, we launched a national campaign to raise public awareness of the scheme and the other forms of council tax support (discounts and exemptions) available. The online publicity campaign is supported by a website and printed material explaining the help which is available and how to access it. We relaunched this campaign in April 2019 and have undertaken a further awareness drive focusing on households who are receiving or may be eligible for UC. Overall, our campaign has now reached over 80,000 people through general and targeted information.

Ensuring all eligible households, including UC households, receive the council tax support they are entitled to has been a priority aim for this government, a drive made all the more relevant given Policy in Practice found **council tax arrears were more common, and more severe, for those receiving UC compared to legacy benefits**. This outcome appeared to be relatively consistent across different demographics and vulnerable groups. The analysis also indicates both the move to UC and ongoing receipt of UC can lead to council tax arrears for some households, particularly those with arrears to start with. It is likely that elements of the transition (such as the five-

week wait) and ongoing factors (eg. monthly budgeting, award levels) are contributing to council tax arrears, and similar patterns were described in the context of the impact of UC on rent arrears. This worrying trajectory is one we have taken a cross-government approach on as part of tackling poverty in Wales, and mitigating the impact of regressive welfare reforms.

Impact of COVID-19 on the CTRS

It is worth highlighting the research findings do not take into account any emerging economic or societal effects of the coronavirus pandemic². We know there has been an impact on the CTRS, council tax more generally, and on household circumstances as a result of COVID-19. In response to this, we commissioned further work on the impact of COVID-19 on the CTRS from Policy in Practice. Initial findings were published in February 2021 and can be accessed [here](#).

While the impact of the coronavirus on take-up of financial support, including the CTRS, is being actively considered, the initial findings confirm **council tax reductions have increased since the beginning of the pandemic**. Policy in Practice found CTRS caseload increased by around 5% across Wales between November 2019 and September 2020, at a value of around £17 million³. This translates to approximately 10,000 additional working-age cases, although changes in caseload differ between council areas. There has also been a notable move from legacy benefits to UC claims within the CTRS caseload. The number of households receiving UC increased by 52% whilst households in receipt of legacy benefits fell by 14%. This is symptomatic of the pace at which UC is being rolled out across the country, as well as new claims leading to an application for CTRS as a likely consequence of COVID-19. Policy in Practice also predict council tax arrears are likely to increase.

We have provided additional financial support to councils as a contribution towards the increase in CTRS cases. Since the beginning of the pandemic, we have provided an additional £10.9m to support those who have sought assistance as a result of the financial impact on household incomes. We will continue to monitor take-up of CTRS as a result of the pandemic and are committed to responding where appropriate.

Conclusions

As far as we are aware, the research by Policy in Practice is the most detailed study to date into the impact of UC in Wales, utilising data on individual households which the Welsh Government does not have access to. It advances our knowledge in this area significantly, and will now inform future development of the CTRS. It provides crucial information to allow us to amend our CTRS, if needed, to mitigate negative impacts on certain groups of people.

² In addition, any modelling of future years does not take account of macro-economic conditions or changes in policy resulting from a change of UK Government. In particular, the modelling does not take into account any economic impacts of exiting the European Union, or any policy changes that may result from a change of Government between 2019 and 2022.

³ Part of the increase in value of awards will relate to council tax rises in Wales from April 2020 and not necessarily the pandemic.

Any changes made to the CTRS need to be commensurate, avoid unintended consequences and considered within the wider context of the administration of the scheme, as well as future options for longer-term reform. We will need to reflect carefully as to whether a more fundamental rethink of the scheme is required to mitigate the impact of welfare reform and to make council tax fairer and more progressive. Amending the ‘taper’ and introducing a de minimis threshold for changes in income to reduce rebilling are attractive options for improving the CTRS and reducing administration costs. However, these amendments will only go so far.

We recognise the arguments for being bolder in our redesign of the scheme in the future. We understand the Scottish Government is in the process of preparing revisions to its Council Tax Reduction scheme, with the intention of ensuring that those on Universal Credit get the level of CTR they would have received if they were on legacy benefits, as far as practicable. As part of our longer term explorations, we will need to consider whether a new approach to local taxation in the future requires a separate support scheme or whether support could be more directly integrated into the design of any new tax.

Elsewhere, insights into the wider impacts of UC on council tax and rent arrears help to provide a valuable evidence base to inform further discussions about the implementation of UC, its payment processing, and the managed migration of claimants from legacy benefits to UC who have housing costs. [The Bevan Foundation](#) suggests CTRS should be broadened to encompass all UC recipients as automatically-passported cases. However, the Welsh Government would not have any control over which benefits, tax credits or types of households might be rolled into UC in the future. The Welsh Government will continue to take a cross-government approach to tackling poverty and mitigating the impact of regressive welfare reforms.

We will also publish further work on the impact of COVID-19 on the CTRS and are committed to monitoring the impact. Economic downturns and unprecedented shocks like coronavirus put additional pressure on support systems but without them, the consequences for households in Wales would be far worse. These important safety nets are a priority for the Welsh Government but will continue to present challenges as circumstances and needs change. Future systems would ideally be designed to be less complex and less administratively burdensome. However, we have found little evidence that a future system could or should be entirely diverged from the UK welfare system and the reality is that targeted support relies on detailed assessments of household finances. Our work during this term raises promising options for smaller-scale improvements which could go some way towards these aims. While we believe any future local tax system is likely to still require a safety net for some households, more progressive systems overall would require a narrower set of interventions.

What we learned

This chapter outlines a wide spectrum of options for the future of council tax if the Welsh Government decided to keep a broadly similar kind of local property tax system, rather than propose a fundamentally different form of local tax, such as land value tax or local income tax. Many of the ideas are as significant in terms of the required resource, lead time, legislation, practical implementation and magnitude of change for households and councils. These are the key points which resonated with us.

Meeting objectives: both the Institute for Fiscal Studies and Sheffield University research make unique and significant contributions to the debate about the options for council tax reform in Wales, using data which has not previously been available to researchers. The work is of high quality and demonstrates there are possibilities to meet our objective of making council tax more progressive. The array of options however is currently so vast that these will need to at least be narrowed down to move forward with policy development. A revaluation opens the door to more options than adjusting the system based on 2003 values.

Impact on councils: making council tax more progressive requires a redistribution of the tax burden from less affluent to more affluent areas of Wales, meaning councils with higher levels of deprivation would raise less tax and become more dependent on government grant funding. A choice for the Welsh Government in any future reform therefore often becomes a trade-off between fairness for households and ability to raise local revenues.

Impact on households: the range of impacts on households is currently too extensive and varied to consolidate into a set of conclusions, though there is clearly potential to redistribute liability in a more progressive way. Seeking greater precision of data is paramount. The limitations may prevent us from measuring the precise impact on each household and how this relates to true ability to pay, for example, there is little information available to the Welsh Government about household incomes at a sub-national level. Some of the options would benefit some higher-income households, as property value is only partly indicative of income.

Support for those who need it: we conclude any future choice of council tax system will still require some form of support as a safety net for low-income households and other households. However, we have not been able to ascertain to what extent the arrangements could be decoupled from the UK welfare system. We learned through our own analysis and from the Institute for Fiscal Studies and Policy in Practice reports, that understanding the take-up rate of the Council Tax Reduction Scheme is incredibly difficult. Due to this, the IFS report could only analyse the options assuming either no take-up or full take-up of CTRS, when the reality will be somewhere in between.

Local accountability: council tax should remain a local tax and therefore if reforms are to strengthen local autonomy and flexibility, the Welsh Government will need to better understand what elements of the system require national consistency to be able to meet objectives and where there can be greater levels of local discretion.

Banded designs: if we are seeking to preserve a banded design, there are seemingly endless choices about where to position new bands and future tax rates. This has the advantage of providing the government with lots of flexibility to design a system according to objectives. We are mindful that a revaluation represents a snapshot of circumstances at a point in time, and the lead time between consultation, valuations and implementation is not short. The evidence shows the timing of a revaluation is very important.

Discrete value designs: one option at the more radical end of the spectrum would be to remove the bands and return in part to the former domestic rates system. This type of system preceded council tax and still operates in Northern Ireland and so further work could seek to identify the benefits and drawbacks from previous and current experience. It is worth noting that greater volumes of appeals may be made by taxpayers. There are lessons to learn from the speculative appeals culture which exists around non-domestic properties for a far smaller tax-base.

Valuation: whether the choice of future system requires a revaluation exercise or not, there are choices about the future valuation method. The similar results between the Institute for Fiscal Studies and Sheffield University studies, other than some differences at the lower end of the property market, suggest a degree of reliability and may indicate approaches to revaluation could be based more on statistical methods in the future, potentially avoiding some of the need to conduct labour intensive manual revaluations, as was the case in 2005.

No revaluation: the changes in recent years in Scotland show that relatively minor adjustments could be made to the existing tax rates without a revaluation, though this may preserve inaccuracy and unfairness in the system's foundations. Our analysis suggests that to meaningfully reduce the liability on lower banded properties, more of the tax burden would need to be shifted onto the middle bands due to the small numbers of properties at the top end of the property market in Wales. This could result in a middle-income 'squeeze'.

Big-bang versus gradual change: if revaluation is preferred, but large scale immediate change is not, there may be other reforms which could achieve more gradual improvement, for example, phasing, deferring, annual indexing, or piecemeal valuations. Previous experience indicates gradual implementations of policy changes add complexity and may be the least understood by citizens and stakeholders. The next step would be to discuss the possibilities with the Valuation Office Agency.

Public engagement / acceptability: again, the choice of options is too great to be able to reach conclusions about public acceptance of a future council tax system. The research is clear though that all options require improvements in the way tax is communicated, understood and interacted with.

Legislative and constitutional requirements: all options from smaller to larger scale reform require some degree of legislative change. This creates opportunities to modernise and consolidate the statute. The need for UK Government consent arises for options which involve modifying the valuation function, including a discrete value system or a different valuation methodology. Depending on the breadth of the legislative change required there may be other constitutional obstacles.

Timeframes: the timeframe to develop and implement changes varies considerably depending on the magnitude of change. At the more substantial end of the spectrum, ie. an unbanded continuous system, this would require a timeframe of more than one five-year term. A more straight forward revaluation and rebanding exercise could be achieved towards the end of the next term though the transition for households and councils would likely run into a second term. Smaller scale changes such as a review of support schemes could be undertaken in around three years due to legislative requirements. All options are highly dependent on what changes are required to the valuation function and the capability of the Valuation Office Agency to deliver.

Working Group

The Local Government Finance Reform Working Group discussed a range of council tax reforms in detail during 2016-2018. A key focus of the discussion was the need to be clear about the intended purpose of council tax in the future, whether it should be designed and perceived as a charge for the consumption of services, a wealth tax, or a hybrid of both. The group also discussed at length the meaning of progressiveness with respect to properties, incomes and other aspects of affordability. The group also considered the interplay between the domestic and non-domestic rating systems, and that it is important for the two taxes to work together.

Members agreed that whatever changes are considered, simplifying rather than complicating the system should be one of the primary aims. The group felt the suite of discounts and exemptions should be reviewed, noting the benefits and drawbacks of the single adult and student discounts in relation to fairness and ease of administration. The importance of retaining some local flexibility with regards to discounts and exemptions was noted. Finally, members highlighted the importance of communicating policy changes in a clear and transparent way, learning lessons from previous changes such as the 2005 revaluation.

Areas for further work

The key areas for further consideration if retaining council tax would be:

- Discuss in more depth with local government and others and agree a set of principles which would help to rule out some reform options;
- Discuss the existing and potential future valuation methods for domestic property valuation with the Valuation Office Agency, including understanding the extent to which revaluations could be carried out using hedonic pricing models;
- Investigate the potential for better and more precise data on households and incomes which will help us understand the impacts in more granular detail;
- Monitor the impact of COVID-19 and EU Exit on local tax-bases and taxpayers;
- Understand the implications of changes in other taxes and benefits on the Council Tax Reduction Scheme;
- Undertake a fuller analysis of legislative and devolution requirements.

8. Non-Domestic Rates Reform

In this chapter we discuss:

- Benefits and constraints of non-domestic rates
- Valuation and appeals
- Tax rates and localisation
- Relief schemes
- Other potential reforms
- What we learned, including areas for further work.

So far in this document we have discussed alternative approaches which would be a radical departure from the current system of raising revenue for local services. This chapter discusses how non-domestic rates could be improved if future governments wished to keep the basic system as a property tax, rather than move towards one of the alternative approaches discussed in this document.

Benefits and constraints of Non-Domestic Rates

There are many benefits to the existing system to highlight and potentially preserve in future arrangements. The non-domestic rates system:

- Has a proportional tax rate and is (largely) a naturally buoyant and reliable revenue stream for local services;
- Operates as a national pool which distributes the yield amongst councils to allow for the high variance in tax-raising ability, ensuring broad equity;
- Is able to flex to provide significant support for those less able to meet their liability obligations, such as occupiers of smaller properties and certain sectors during difficult economic periods; and
- Strengthens local relationships between councils and business communities, maintaining local knowledge of the business landscape and enabling linkages to the wider economic policies of councils.

In common with council tax, it is also:

- A highly efficient local tax which consistently achieves over 97% collection rates year-on-year, with low administrative costs (less than 1% of yield);
- Has demonstrated longevity and is harder to avoid than other types of tax; and
- Is a key administrative function of councils, providing high quality public sector jobs dispersed across the country.

Taking Wales Forward 2016-2021 committed to reducing non-domestic rates for 70,000 ratepayers, including reducing bills to zero for half of all eligible ratepayers. We achieved that aim by providing Small Business Rates Relief at the beginning of this Senedd term and establishing it as a permanent scheme from 1 April 2018, alongside other achievements outlined in Chapter 2.



Is non-domestic rates a property tax or a business tax?

The current local tax system operates on the basis of hereditaments being defined as domestic or non-domestic. Rates are levied on owners or occupiers of non-domestic *hereditaments*, a term which has a meaning far broader than a traditional bricks and mortar building. The rating list includes hereditaments such as major transport and utilities infrastructure, eg. airports, telecommunications networks, infrastructure for gas, electricity and water supply. Not all ratepayers are businesses, and certainly not all businesses require a commercial property from which to operate.

This begs the question as to whether non-domestic rates are designed to be a local property tax, or a business tax and lever for economic growth. The existing system has elements of both. Rates are first and foremost a local tax on non-domestic properties to fund local services – a contribution within local areas in the same way as council tax is for domestic properties: the two taxes were designed as complementary replacements for the general rates. However, it cannot be ignored that rates bills represent a key cost for many businesses and other ratepayers alongside the cost of rent, utilities, equipment, staff remuneration and stock / raw materials and so forth (as council tax is a key cost for households). Sustainable business communities safeguard prosperity for all. Trying to conform to both concepts within non-domestic rates can create complexity and confusion about its purpose.

Why is the non-domestic rates system complex?

The combination of the valuation methodology and extensive relief and exemption arrangements makes the system complex. The nature of the non-domestic tax-base - property values and uses - is far more heterogeneous than it is for domestic properties. Non-domestic rates is also a discrete-value system as opposed to a banded system like council tax, and it is based on rental values rather than capital values. The core concepts of rating existed well before the inception of the current version of non-domestic rates in 1990, dating back to general rates in the 1960s and beyond. Valuation has grown in precision (and therefore complexity) over time, as rating professionals strive to account for the intricacies of relative market conditions and adapt to changes. There have been five revaluation exercises since the original rating list was compiled in 1990. Updated lists were implemented in 1995, 2000, 2005, 2010 and 2017.

Rating includes some assessment of non-property aspects, such as assessments of receipts and expenditure or units of output, to make up the overall rateable value and this varies by sector. The value of certain assets is also taken into account, termed plant and machinery, eg. fittings and fixtures. There are also numerous methods of measurement, such as zoning for retail, formula-based and survey-based. Other methods are required where there is little rental evidence for properties which are seldom let. There are hundreds of sectoral categories and the rating approach for these involves engagement with industry experts. Rating methods and concepts are more frequently challenged in the courts than is the case for domestic dwellings, leading to a large amount of litigation and legal precedent in the rating system.

This complexity can be viewed as both a benefit and a constraint of the existing system. On the one hand, the degree of granularity ensures a fair and equitable distribution of liability which reflects market conditions (so long as regular revaluations are undertaken). The valuation profession is technically highly skilled and a benefit to wider society. On the other hand, this precision drives complexity which is impenetrable to the layperson, resulting in disproportionate appeals and litigation cultures.

In this chapter, we take a look at some of the ideas for reforms to non-domestic rates we have come across. These are drawn from Scotland's [Barclay Review of Business Rates](#) (2017), the Welsh Government's Business Rates Panel (2015), the [Lyons Inquiry](#) (2007) and various UK Government led reviews, [Business rates: delivering more frequent revaluations](#) and [Fundamental review of business rates](#). There is little recent evidence for us to draw upon that is specific to Wales on the advantages and disadvantages, therefore some of these ideas will require further research in the near future.

Revaluation and Appeals

Higher frequency

The fairness and accuracy of non-domestic rates is maintained through periodic revaluations which redistribute the tax burden based on relative changes in market conditions, thereby ensuring those sectors and areas which have grown relatively more contribute more. Revaluations currently happen every five years, with some postponements in recent years for various reasons⁴. New rating lists come into effect two years after the chosen date that valuations relate to – the 'antecedent valuation date'. The next revaluation in Wales will be implemented in April 2023 based on an antecedent valuation date of 1 April 2021.

There have been numerous calls for more frequent revaluations and a shorter gap between the antecedent valuation date and the new rating list coming into effect. Proponents of this idea suggest it would make the system more responsive to market conditions and reduce volatility of bills, making non-domestic rates fairer and more acceptable to ratepayers. The UK Government published a consultation in 2016

⁴ The rating list planned for implementation on 1 April 2015 was postponed until 1 April 2017. The next list originally planned for 2021 will now come into effect in 2023 due to the coronavirus pandemic.

outlining a preference to move towards three-yearly revaluations in England. This consideration now forms part of HM Treasury's ongoing Fundamental Review of Business Rates set to conclude in autumn 2021. The Non-Domestic Rates (Scotland) Act 2020 provides for three-yearly revaluations in Scotland following a Barclay Review recommendation. It is currently planned that revaluations will move to three-yearly from 2023.

On the basis that some countries achieve annual valuations for property taxes, the Lyons Inquiry looked at increasing the frequency of non-domestic revaluations to annually, suggesting this would have economic advantages by reducing the burden of taxation on some businesses during downturns. Lyons suggested it could also be possible to scale back or remove transitional relief, reducing complexity. The [Institute for Fiscal Studies](#) in 2017 also concluded more frequent revaluations could provide a better way of smoothing overnight changes than complex transitional relief schemes. However, Lyons also outlined the drawbacks such as higher costs and less stability for businesses as the current system enables ratepayers to estimate their bills over a five-year period. Sectors which are not valued on the basis of rental value methods could be disadvantaged. Lyons suggested technological advances should allow for annual valuations, and if not, there could be a system of rolling manual revaluations for parts of the tax-base each year while others were updated using statistical analyses of market price changes.

There have also been calls from stakeholders to reduce the length of time between the antecedent valuation date and the rating list coming into effect. This was a recommendation of Scotland's Barclay Review and it is intended that a one-year antecedent date will be implemented there from 2023. It is assumed this is feasible due to the size of Scotland's tax-base. The Valuation Office Agency considers that a one-year antecedent date for England and Wales significantly risks accuracy as the combined size of the tax-bases takes longer to value and it is currently unable to maintain separate rating lists for each nation. A shorter timeframe to gather evidence would exclude key rental evidence such as lease renewals and rent reviews, meaning valuations would be based on a greater number of assumptions relying on other market intelligence.

Alternative methods

In order to effect more frequent revaluations the UK Government's 2016 consultation sought views on alternative methods, including a self-assessment option and a formula option. On self-assessment, respondents felt this was not as feasible for rates valuations as it is for other UK taxes, and would lead to increased costs for ratepayers, disproportionately affecting small and medium-sized businesses. Self-assessment would shift the role of valuation onto ratepayers and the VOA would become a compliance body. There was little support for the formula option from rating agents, with views expressed that it would need to be just as complex as traditional valuations and therefore impenetrable for ratepayers. However, local government's views differed, favouring potential simplicity and stability. Overall there was a view that alternative methods such as these could be feasible for valuing some parts of the tax-base, for example, smaller properties which are likely to be relieved from paying a bill anyway. The UK Government decided not to pursue alternative methods further.

The rating of plant and machinery is an important element of valuation. Most plant and machinery used to run a business is not included in rateable values, with the broad principle being that “tools of the trade” should not be rateable. Where a business invests in process machinery to manufacture products, they will not pay rates on that machinery. There are however some circumstances in which plant and machinery may be rated, such as where:

- it is providing power or services to the hereditament;
- it is infrastructure, eg. pipes, wires, cables and fibre; or
- it is so large that it is in the nature of a building or structure, eg. large tanks.

The valuation of plant and machinery is incredibly complex and a key component of the current valuation methodology. There have been calls from certain sectors, for example renewable energy, for reviews of the way plant and machinery is included in rateable values. Legal challenges in recent years have had a fundamental impact on valuation in Wales and England. A review of plant and machinery rating would be a substantial and technical task having wider implications for the entire tax-base.

Appeals reform

Ratepayers have the right to appeal a valuation if they believe it to be incorrect and this is an integral part of the non-domestic rates system. It is important ratepayers are paying the right amount of rates and, if this is not the case, that corrections are made as quickly as possible. Every ratepayer should act responsibly in using the appeals system, as speculative appeals slow down the process for genuine appeals and add to the costs of administering the system, taking resources away from other services.

Volumes of appeals are variable over the life of a rating list and are often concentrated towards its end. Policy changes also prompt pre-emptive spikes. The COVID-19 pandemic has seen large increases in challenges to the rating list. The VOA has received 27,000 challenges from Welsh ratepayers to the 2017 rating list, representing 22% of the tax-base. Of those resolved so far, around 45% have resulted in list alterations. Ratepayers can also dispute the VOA's decision with the Valuation Tribunal for Wales (VTW). Non-domestic rates appeals account for the majority of the VTW's workload, with the large majority being settled via negotiation between ratepayers and the VOA ahead of a formal tribunal determination. This is an ineffective and resource intensive procedure for a large number of challenges.

Regardless of future changes in the frequency or method of valuation, the Welsh Government has been working with the VOA in recent years to explore improvements to the appeals system. [We consulted](#) in 2017 seeking views on registration and fees, provision of information, timeframes and backdating. Overall, it was recognised that the appeals system works reasonably well in Wales with some areas identified for improvement. At the time though, many respondents felt the Check, Challenge, Appeal (CCA) system being introduced in England was not fit for purpose and should not be implemented in Wales. Our subsequent decision to postpone the next revaluation to 2023 means we have an opportunity to take a fresh look at appeals requirements.

Issues remain in the system. Ratepayers often feel the information provided about valuations by the VOA is too limited, which drives challenges. Ratepayers and agents

do not submit enough evidence to the VOA in the initial stages of a challenge to enable challenges to progress. Negotiations between the VOA and ratepayers or their agents therefore often only begin in earnest once an appeal has been listed with the tribunal for hearing.

Check, Challenge, Appeal attracted widespread criticism in its initial phase due to implementation issues and views relating to new timescales, fees, permissible evidence and narrowing of the role of tribunals at the final stage. There were also concerns about inadequate support and guidance for unrepresented ratepayers finding it difficult to navigate and meet the evidence requirements, driving ratepayers to utilise agents more. However, there are advantageous elements of CCA and there is an opportunity consider reforms which are tailored to the needs of Wales alongside this wider programme of reform. CCA is designed to reduce speculative appeals by requiring fuller information and evidence at earlier stages. There are also new digital platforms enabling ratepayers to register and interrogate their property's information. These improvements could be made to the Welsh appeals system in the next Senedd term.

A move to more frequent valuations would necessitate some appeals reforms and this requires careful consideration. Some stakeholders believe the volume of appeals submitted annually would not reduce with more frequent revaluations, and there would be less time within each revaluation window to manage the same number of appeals. The Valuation Tribunal for Wales' workload could also be affected.

Tax Rates and Localisation

The multiplier

In Wales, non-domestic rates are set by the Welsh Government via a single national multiplier which is uprated annually according to the Consumer Prices Index. The yield makes up around 13% of local government's gross expenditure and has remained static over the last 15 years (in contrast to council tax which has grown as a percentage of spend). From a ratepayer perspective though, in the early 1990s rates bills were equivalent to about a third of rents and rates now represent just over a half. The revenue raised is vital for the sustainability of local services, though ratepayers argue the burden of rates among the basket of bills paid by a business is too high. This sparks debate about other approaches to the setting of tax rates and there are very different approaches across the UK nations.

Table eight sets out the differences in rate setting policy. Non-domestic rates in Northern Ireland are set in two parts; by the NI Executive and by the 11 district councils. The overall rate is lower than for other nations because district councils in Northern Ireland do not have the same responsibilities to deliver services. Most notably, they do not deliver education and housing services which are major areas of public expenditure delivered by the NI Executive. Scotland has a tiered system of three separate rates, and England has separate small and large business multipliers.

Table eight: Non-domestic rates multipliers (or ‘poundages’) in 2020-21

	Policy	Poundages 2020-21	Set by
Wales	Uniform national rate	53.5p	Welsh Government
Northern Ireland	Regional rate	27.9p	NI Executive
	District rates	Range from 21.8p to 30.9p	District Councils
Scotland	Basic rate (rateable value <£51,000)	49.8p	Scottish Government
	Intermediate rate (rateable value £51,000 - £95,000)	50.3p	
	Higher rate (rateable value >£95,000)	51.6p	
England	Small businesses (rateable value <£51,000)	49.9p	UK Government
	All other businesses	51.2p	

We have delivered numerous policy changes over this Senedd term to reduce the costs to Welsh ratepayers. The multiplier was for many years increased in line with the Retail Prices Index measure of inflation. Since 2018-19, the Welsh Government has increased the multiplier in line with the Consumer Prices Index which is a lower measure. We also announced in December 2020 that the multiplier for 2021-22 will be frozen, meaning there will be no inflationary increase for ratepayers in the next financial year to support the economic recovery from COVID-19. Changing the inflationary measure to CPI and a freeze in 2021-22 will result in Welsh ratepayers saving over £90 million on their rates bills since 2018-19. These policy decisions inevitably come with significant additional costs to the public purse and therefore tend to be shorter term decisions based on budget flexibilities in any given year. It is worth considering options for setting tax rates alongside other reforms to non-domestic rates. Options include:

- Tiered multipliers for different property sizes (small and large; or small, medium and large);
- A part-national rate with powers for local government to set additional local or regional supplements;
- Localising the setting of tax rates to principal councils or regional local government structures, eg. corporate joint committees.

Adding tiered multipliers adds complexity to the system and may be less understandable for ratepayers. However, it also provides the Welsh Government with flexibility to tailor non-domestic rates policy to Wales’ needs. Tiered rates could nudge the system in the direction of progressiveness rather than proportionality. Some or all

of the revenue raised could be used to offset the cost of support to smaller businesses or particular sectors. The tax-base in Wales is often compared to England and there are fewer properties (proportionally) with large rateable values in Wales, meaning large businesses are likely to face a disproportionate tax liability. The additional revenue raised would need to justify the added administration.

The non-domestic rates system established in 1990 created the uniform national rate whereas under its predecessor, general rates, these had been set locally. There are further precedents for local or regional tax setting in Wales given councils and Police and Crime Commissioner responsibilities to set council tax rates each year. Lyons (2007) rejected a full return to local control and instead proposed giving councils the power to levy a local supplement, in consultation with businesses. Partially or fully localised rate setting could strengthen local relationships with business communities and make the Welsh system more unique, lessening the comparisons with neighbouring nations with significantly different tax-bases. Future governments could consider with local government whether there is an appetite for more autonomy in the system, and whether such a policy could work alone or would need to be encompassed within greater decentralisation, such as more discretion on relief schemes and local retention of revenues. It is important to note that local rate setting is not the same as the local retention of revenues.

Pooling versus local retention

Due to the variation in revenue-raising ability between the 22 councils in Wales, non-domestic rates yields are pooled and distributed on a population basis, as part of the annual local government settlements. In contrast, council tax yields are set and kept locally and these are factored into the distribution of the Revenue Support Grant⁵. Local retention of revenues refers to abolishing the pooling arrangements and allowing local councils to retain the yields collected in their area. Various reviews have called for local retention to strengthen local accountability and to provide an incentive for councils to grow their revenues and tax-bases.

As collection rates are already in the region of 97-98%, there are marginal gains from maximising revenue collection from the existing tax-base, though councils may be incentivised to maintain local rating lists more actively, for example by ensuring new or expanded properties are accurately rated, and to invest more time in investigating fraud and error. The key goal however is to grow the size of future tax-bases through economic stimulation which then results in increased funding for local services. It could be argued that there are already enough incentives for local government to do so, including improving local prosperity, place-shaping through land and property strategies, serving vibrant communities and growing existing tax revenues. National and UK policies, as well as global trends also impact on local councils' ability to stimulate the economy. Nevertheless, if more direct autonomy and incentives for non-domestic rates are thought to be of benefit, there are several policy choices, including:

- Allow revenues to be retained locally but adjust the Revenue Support Grant accordingly to ensure equity is maintained;

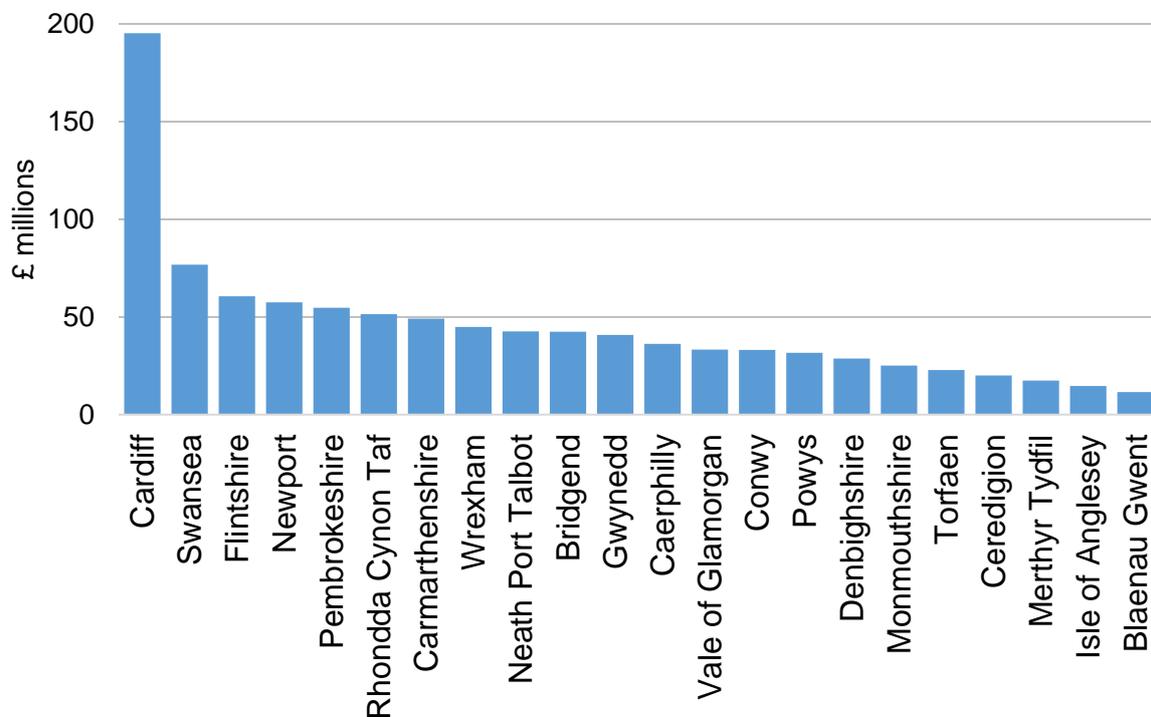
⁵The Revenue Support Grant factors in a notional council tax yield for each area based on the latest tax-base data and an averaged tax rate.

- Allow local revenues to be fully retained and do not adjust the Revenue Support Grant, meaning large changes in public expenditure between areas;
- Allow revenues to be partly retained through a system of marginal incentives.

These choices could be made on the basis of council or regional geographies. Local retention with an RSG adjustment is largely an administrative change providing some level of new local autonomy over non-domestic rates, but the direct incentives for growth would be lessened with this option. Incentive effects would be greater under the other two options, with more significant impact on equity. Some areas of Wales may be less able to attract new business activity due to geographical and socioeconomic factors, regardless of the level of incentive built into the system. All ideas would require significant new legislation.

Full rates retention was not a policy ambition for this Senedd term due to wider proposals to reform local government and the substantial impacts this would have on some Welsh councils. Retention brings increased financial risk to local areas from closures of large businesses and appeals. Currently, these risks are pooled and borne at a national level. Most Welsh councils are too small to manage such risk, particularly those where a large amount of rateable value is concentrated in a very small number of properties. Figure ten shows the variation in contributions paid into the pool from each council in 2019-20, with Cardiff being by far the largest. Currently, only four of the 22 council areas would benefit from full rates retention. Even for these four, success would depend on them being able to increase their growth year on year.

Figure ten: NDR contributions to the national pool by each council, 2019-20



There have been various moves towards retention elsewhere in the UK. The UK Government began implementing local retention of rates in England in 2013-14, starting with 50% retention gradually aiming for 100% retention by 2020. This timetable has since been extended, with councils participating in pilots for 75% retention. The approach formed part of broader changes to local government finance which included reducing RSG to near zero. The system in England still features a degree of redistribution to smooth the stark variations in revenue-raising ability. This is achieved through a complicated system of tariffs, top-ups and safety nets which has added complexity and reduces transparency. To counteract the localised risks of volatility, councils are able to group together to pool their rates revenue.

Scotland has operated a smaller-scale Business Rates Incentivisation Scheme since 2012 as part of its annual local government funding settlement. It is designed to incentivise councils to maximise collection and grow tax-bases. Originally the scheme was based on national targets, where councils exceeding these targets were able to retain 50% of the additional rates revenue, with the other 50% paid into the national pool. However, the setting of targets was impacted by late appeals and 'significant event' shocks to the tax-base. The scheme was suspended for a short period while a review took place. In 2014, a revised scheme was implemented with individualised council targets based more closely on their ability to influence growth, rather than factors outside local control. The Scottish Government retains the risk of councils failing to achieve estimates of income, by guaranteeing a minimum 'distributable amount' and topping this up with additional general grant if required. On average, just over a quarter of councils exceed targeted growth and retain some rates. The most a single council has retained in one year is £3.4 million, for Aberdeen City in 2015-16.

The [Independent Commission on Local Government Finance Wales](#) recommended non-domestic rates be retained in full by councils, and in the year of implementation, pooling or RSG adjustment should be put in place to ensure no council is better or worse off financially than in the previous year. It also recommended regions be allowed to pool revenues to smooth out local fluctuations and be given a power to add a supplementary rate to assist in paying for large capital projects. Any council found with rapidly-declining resources at any given time should be supported through temporary Welsh Government grants outside this system. This set of recommendations was presented as increasing local control over revenues. However, it appears the risk mitigations required are more significant and more complex than the pooling arrangement which is already in place.

Local retention was also considered by [Wales Public Services 2025](#) in 2018, in the context of emerging regional growth partnerships. It explored a regional shared-gain incentivisation model, but recognises the trade-off against redistribution and whether inequity between regions can be justified. It outlined a number of practical models for regional retention, though agreed there was yet limited evidence of growth in other nations as a result of retention models.

The Welsh Government has committed to exploring some form of partial rates retention at a regional level in connection with City and Growth Deal developments, where it can be demonstrated that the actions of the regions have resulted in additional growth in the non-domestic rates tax-base. We have invited regions to come forward with proposals.

Relief schemes



A significant element of any tax system is an ability for central or local governments to support certain taxpayers with their liability for various reasons, either temporarily or permanently. These decisions must be carefully balanced between being responsive to certain circumstances and maintaining vital funding for public services. Table nine details the numerous relief schemes currently in operation for non-domestic rates. All the statutory schemes are fully funded by the Welsh Government.

Table nine: current relief schemes for non-domestic rates in Wales, 2020-21

Scheme	Features	Number of properties	Value in 2020-21
Small Business Rates Relief	<p>Properties with a rateable value up to £6,000 receive 100% relief.</p> <p>Tapered relief for rateable values between £6,001 and £12,000.</p> <p>Currently more generous relief for childcare providers and post offices.</p>	65,000	£129m
Retail, Leisure and Hospitality Rates Relief	<p>Extended COVID support in 2020-21: all properties in the retail, leisure and hospitality sectors with a rateable value of up to £500,000 receive 100% relief.</p>	25,000	Extended COVID support in 2020-21 to £350m

Scheme	Features	Number of properties	Value in 2020-21
	Previous scheme in 2019-20: provided up to £2,500 off rates bills for all retailers with a rateable value of up to £50,000.	15,000	Previously £23.6m in 2019-20.
Local discretionary relief	Councils can also provide up to 100% relief to ratepayers at their discretion for the following reasons: <ul style="list-style-type: none"> • Hardship • Partly occupied properties • Non-profit making bodies (other than registered charities and community amateur sports clubs). 	600	£8m
Charitable Relief	Registered charities and community amateur sports clubs are eligible for 80% mandatory relief. A further 20% relief can be granted at the discretion of councils. Other non-profit making bodies may also qualify for relief up to 100% at the discretion of the council.	6,000	£68m
Empty Property Rates Relief	100% relief for a 3 month or 6 month (for industrial premises) period when a property becomes unoccupied.	Unknown	£30m
Hydropower Grant Scheme	Hydropower projects with a rateable value up to £50,000 can apply for support towards their rates liability.	59	£403,000

While reliefs are valuable to ratepayers and sometimes vital for survival during challenging periods, the arrangements add significant complexity, administration and cost, and makes the system less understandable to ratepayers. It also removes significant revenue-raising ability for future, more economically favourable times. Providing 100% relief also distances businesses and other ratepayers from the local tax system completely. The ability to target relief towards the desired recipients is highly dependent on the information held about ratepayers and properties by councils and the Valuation Office Agency. This means schemes often have to be applied as blanket approaches and blunter instruments than we would otherwise wish to design. In this section we consider whether the system could be improved by taking a different approach to reliefs.

How has COVID-19 impacted non-domestic rates?

The pandemic continues to have a negative impact on many businesses and ratepayers across Wales. By December 2020, the non-domestic rates collection rate was an estimated 7% lower than at the equivalent point of the year for previous financial years. This is due to a combination of agreed payment deferrals, some non-payment and some businesses which have unfortunately ceased trading. The overall loss will depend on collection activity in the final few months of the financial year and recovery action continuing into the future. In the first three months of the pandemic the VOA saw a large number of new appeals to the rating list as ratepayers sought to challenge the impact of the first lockdown restrictions on rateable values. Any successful appeals will result in a permanent loss in revenue.

The medium to longer term effects of COVID-19 are likely to result in further business closures and property vacancies. The Welsh Government has mitigated this as much as possible by implementing the most generous package of business support in the UK. Aside from new rates relief, we created business grant schemes which are not part of the non-domestic rates system but are linked to rateable values and administered by local councils with the knowledge of local tax-bases. Due to the local expertise dispersed across Wales in every council, we were able to administer this emergency support quickly and efficiently. To date, 153,000 grants totalling £1.2 billion in value have been issued to businesses.

Wales Business Omnibus Survey Research

Earlier this year, we published findings from survey questions commissioned by the Welsh Government through Beaufort Research's Wales Business Omnibus Survey of SMEs. The research can be accessed [here](#). It explored awareness and perceptions of rates relief schemes and the different characteristics of businesses receiving relief. The study found that awareness of relief schemes was low among SMEs. Over a third of businesses surveyed (36%) had not heard of any of the schemes available in Wales. The most well-known scheme was the Small Business Rates Relief Scheme (58% aware), followed by the High Street Rates Relief Scheme (26%) and Transitional Rates Relief Scheme (9%). The proportion receiving relief was higher among businesses with fewer than 10 employees, those who rented their property and those which had a smaller turnover. Small Business Rates Relief was perceived as important and impactful across a variety of aspects of trading across various business activities.

Sectors with the highest proportion of respondents receiving Small Business Rates Relief were 'wholesale or retail', and 'hotel or other services'.

The perceptions revealed that the majority of businesses surveyed were in favour of the rates relief schemes, particularly for ensuring businesses in deprived and rural communities survive. While these findings are preliminary due to sample sizes and the nature of the methodology, they have helped us assess the effectiveness of rates relief and have offered some areas for further in-depth research.

Small Business Rates Relief

Small Business Rates Relief is a long-standing scheme currently supporting around 65,000 occupiers of smaller sized non-domestic properties, or 53% of the entire tax-base. It is a substantial investment of public funds to support small businesses to thrive in local economies. We consulted on and delivered an improved permanent scheme in 2018, adding features to improve fairness. One of the beneficial features added was to limit the number of properties eligible for relief to two per business in each council area, preventing larger businesses and national chains from benefitting from a scheme which is designed to support small businesses. This unlocked revenue which enabled these further enhancements:

- Enhanced relief for childcare premises to support our flagship commitment to offer 30 hours of free childcare for working-age parents of three and four year-olds;
- Targeted support for community energy projects;
- An extension to the high street rates relief scheme; and
- Extra funding for councils to provide discretionary relief to local businesses and other ratepayers, which would benefit from locally-determined assistance.

As we evaluate the success of the enhanced scheme, we are continuing to explore ideas which require a longer lead time to develop. These include better targeting our investment in relief to support priorities which are aligned with wider Welsh Government objectives. Our future ability to target rates relief to wider priorities depends on the information about businesses held by councils as administrators and by the Welsh Government as policy-maker. We must also consider the possible future enhancements against creating additional complexity for ratepayers, and for councils administering relief.

High streets, retail and leisure

It is well documented that the retail sector faced challenges from a range of factors even before the pandemic: shifts in consumer trends to online shopping, squeezed disposable incomes, rising costs, increased diversity and competition. Though many of these are global economic trends, we are committed to doing all we can in Wales to help local communities sustain their identities and the facilities people want. This drives prosperity, tackles poverty and reduces inequality.

Some commentators argue non-domestic rates has not adapted to the changing use of non-domestic property as a result of consumer trends towards online retail and services. Reducing demand for bricks and mortar for traditional high street purposes

has led to numerous calls to tax online activity. This is a challenging issue for the Welsh Government to address alone within our tax system and particularly within non-domestic rates. It is not currently possible to introduce an online sales tax due to constitutional constraints. It may be possible to review valuation methodology to include a greater degree of 'non-property' indicators in rateable values, but this would be a fundamental change affecting all sectors. It should be noted however, that the physical local basis for taxation is a deliberate feature of the non-domestic rates system (and of council tax). Other taxes, which serve different purposes, are charged on business incomes and profits.

The current level of support we are providing in rates relief for retail and other sectors in Wales is significantly greater than in pre-COVID times, due to additional expenditure on a UK-wide basis and the additional flexibility this affords us within our own budget. We have gone further by widening eligibility and providing the most generous financial support package anywhere in the UK. Our Retail, Leisure and Hospitality Rates Relief Scheme provides £350 million to 25,000 ratepayers in those sectors. Prior to the pandemic, the High Street and Retail Rates Relief scheme provided £24 million support to 15,000 ratepayers. There is a challenging choice about the future levels of support for these sectors and in what form. This is dependent on budget provision and will need to be guided by broader strategic aims, such as COVID-19 recovery and improving town centres. Our Transforming Towns initiative recognises that high streets and town centres are evolving to meet different needs, with the need for transformation exacerbated by the pandemic. There are other policy and financial levers through which the Welsh Government and local government can sustain vibrancy, in recognition of high streets as sources of identity and wellbeing. The importance of place-shaping coined by Lyons in 2007 comes into sharper focus.

Charitable relief

Charities, non-profit organisations and community amateur sports clubs are eligible for 80% mandatory rates relief and a further 20% relief at the local discretion of councils (part of which is also funded by the Welsh Government). The property must be wholly or mainly used for a charitable purpose. Financial support for the charity sector in Wales continues to be important, though there is increased diversity in the goods and services provided by the sector, with some larger organisations occupying a sizeable proportion of retail space. There are also issues with fraud and avoidance discussed later in this document. We have consulted on the effectiveness of this relief in 2013 and 2018. The Welsh Government has not made changes to charitable rates relief during this Senedd term, but it is an element of any future reformed system. Ideas for future changes include:

- Increasing or reducing the amount of mandatory and discretionary relief;
- Making relief wholly mandatory or wholly discretionary;
- Linking eligibility more directly to registered charitable status. However, registration is not a devolved function and some rates practitioners are of the view it is relatively easy to gain charitable status. Registered charitable status does not necessarily mean the property is being used for charitable purposes;
- Requiring some form of evidence from ratepayers that the use of the property aligns with the charitable purpose of the organisation.

Scotland's Barclay Review considered whether it is right for public and private sector providers of similar services, such as schools and hospitals, to be treated differently in relation to rates relief. In 2019 [we consulted](#) on this issue to ascertain whether there was potential for unfair competition, and whether private sector providers that are charities should be liable for rates, bringing them into line with most state-funded schools and NHS hospitals that pay rates. This is a potential area for future consideration.

Empty properties

Some form of rates relief for owners of empty property has been a feature of non-domestic rates since its inception in 1990. Governments have taken various approaches to relief over the years, sometimes using it as a lever to influence behaviour and encourage empty properties back into use. The Empty Property Rates Relief scheme provides 3 or 6 months relief when a property is vacated, to support the owner while a new tenant can be found. Full rates are liable thereafter, though there are some exceptions, for example, properties under £2,600 rateable value and listed buildings. The scheme was last amended significantly in 2008 to increase the rates due on empty properties from 50% of liability to 100%, following recommendations by the Lyons Inquiry in 2007.

There is emerging evidence of upheaval in the property market due to COVID-19 and there is currently a higher likelihood of legitimate reasons for properties to be vacant for longer periods than usual. The current scale of financial support for businesses may be masking the medium to longer term effects of the pandemic in the numbers of empty properties. The Welsh Government will continue to monitor the position and rates relief arrangements. Some changes proposed to this scheme from April 2022 relate to fraud and avoidance and are discussed later. The treatment of empty properties remains an important element of any reformed non-domestic rates system.

Other potential reforms

More radical reforms

There are some ideas which would be a departure from the existing system design yet are still within the broad concept of a local property tax. These include making non-domestic rates a banded system like council tax, which could reduce complexity, allow for progressive tax rates and enable some absorption of market changes between revaluations. The challenge is deciding the required number of bands and the value thresholds, as non-domestic property is far more varied than domestic. Consideration would be required as to whether it is feasible to simplify valuation given rating history and whether a banded system would actually achieve any benefits. Given the longevity of rates as a discrete-value system, such a reform may not be acceptable to the business community.

Various reviews have considered whether rateable values should be based on capital values rather than rental values. HM Treasury's most recent [call for evidence](#) explained that some countries and jurisdictions base non-domestic property taxes on

capital values. Council tax is also based in part on capital values. This may alleviate some criticisms that the standardised annual rents approach does not reflect the actual rents paid. The availability of regular evidence on capital values for some sectors would require detailed thought. The HM Treasury review notes concerns about changing the liability to fall on the owner rather than the occupier as part of this change, however, this does not need to take place as demonstrated in council tax which is both capital value and occupier based.

Incentivising investment

A common criticism of non-domestic rates is that it disincentivises business expansion and investment. In connection with this, the Business Rates Panel (2015) discussed the incidence of the tax and whether this falls on the owner, or the occupier in the form of higher or lower rents. The panel suggested that temporary rates reductions for the purposes of growth incentivisation are likely to benefit occupiers (because rents are often fixed for several years at a time), whereas permanent measures are likely to benefit owners and landlords in higher capital values and higher rents.

Scotland has operated a Business Growth Accelerator Relief scheme since 2018 and plans to expand it from April 2021. It provides support to newly built properties and those that have expanded or improved. Where expansions or improvements have been made to a property, the increase in rateable value will not be charged for 12 months. In its 2021-22 Budget, the Scottish Government announced that this relief would be enhanced to cover any increases resulting from a change of use for 12 months. It is also planning to extend the period of relief for unoccupied new builds to three years.

In Wales we have previously operated various schemes aimed at incentivising speculative development or reoccupation of vacant properties, eg. the Open for Business scheme and the New Developments scheme between 2013 and 2016. The schemes were closed due to low take-up concluding that rates relief schemes for such purposes are weak levers. Schemes to incentivise business growth may be a consideration for a future system. It may also be deemed simpler and more effective to achieve this aim through other policy choices, such as separate financial incentives, planning decisions and targeted investment in infrastructure.

Consistency in billing, better platforms

Payment of rates is a routine process for many ratepayers with most choosing to pay by automatic instalments or as a lump sum, making it a relatively efficient tax to collect. There have been calls for greater consistency and transparency in the billing process and our digital discovery review in 2020 highlighted some issues. There is currently no set format for rates bills generated by each council, other than certain prescribed information which must be included. Due to the complexity of the system and the number of reliefs etc, bills can be difficult to understand and are inconsistent. Each council has its own local rating list, meaning larger companies which operate across a number of areas receive separate bills for properties in each area. Some consideration could be given in future to improving the ratepayer experience alongside digital modernisation.

Reducing avoidance

Tax avoidance and evasion are lower for property taxes than for other taxes due to the visibility and immovability of the property upon which the tax is levied. Nevertheless problems within non-domestic rates do exist, particularly in relation to shell companies, charitable relief and empty property relief. The Welsh Government has had an ambition to tackle fraud and avoidance of non-domestic rates since the beginning of this Senedd term and is implementing a package of measures. The Local Government and Elections (Wales) Act 2021 provides councils with strengthened powers of investigation, including the ability to undertake property inspections and to request information from ratepayers and others. The Act also paves the way for a new legal duty on ratepayers to notify councils of a change in circumstances, as is required of most taxpayers under most tax regimes. Further regulations are planned to enact this duty from April 2022.

There is more which could be considered in relation to rates avoidance such as the creating of a General Anti Avoidance Rule. We consulted on this in 2018 with a view to developing future legislation after our other measures have been implemented. We will also be able to learn lessons from the introduction of a General Anti Avoidance Rule in Scotland in 2020. A general rule on anti-avoidance would apply to those who actively avoid paying their tax liabilities and those who promote tax avoidance schemes. A General Anti Avoidance Rule is already in place for Land Transaction Tax and Landfill Disposals Tax in Wales.

What we learned

There is much to consider if the broad system of non-domestic rates were felt to be the most appropriate future form of raising revenue for local services in Wales. Barclay (2017) concluded that "some form of property tax is still an appropriate way to fund the local services provided by councils, as the whole of society benefits from the services they provide". The Business Rates Panel (2015) set out that a future government needs to determine where it intends for non-domestic rates to sit on the spectrum of stable revenue-raising and a tool which can flex to stimulate economic growth. Lyons (2007) argued that "changes to business taxation can provide greater local flexibility for communities to invest in themselves and in the infrastructure needed to support growth, and improved incentives for the efficient use of land".

Localisation

The local government finance system would benefit from greater awareness that non-domestic rates is a contribution the business community and other organisations make towards the services they utilise in the area where they operate. This is possible due to its nature as a property-based tax. In contrast to a tax based on earnings or profits, a clearer link can be made between the means through which the tax is generated and the goods or services the revenue subsequently funds. Business communities and other employers not only benefit directly from services such as policing and transport infrastructure, but more universally from skilled workforces and attractive localities.

It is right to recognise that the strength of the local democratic link can be diluted by certain features, such as pooling and the national tax rate. Non-domestic rates can be perceived as a national tax collected 'on behalf' of the Welsh Government – despite its 30-year history as a local tax and all of the revenue being distributed to fund local services. The mix of localised and centralised features of the system could be reconsidered in future. There are many options to choose from, with the Welsh Government and local government needing to be clear about collective aims.

Reconsidering these features however creates a marked trade-off with equity between councils. If fair and progressive systems is our primary objective, some redistribution is likely to always be required in future non-domestic rates. There is mixed evidence as to whether measures such as local retention elsewhere have incentivised growth. The current view of the Welsh Government is that rates retention in its fullest concept would not appear to benefit the particular tax-base of Wales, is complex and creates disproportionate risks. We could test smaller-scale growth incentives based on defined areas where there is evidence of positive effects. We remain committed to a 'shared-gain' approach in connection with City and Growth Deals.

The [Wales Governance Centre](#) advocates for any incentives to be properly aligned with wider economic objectives of the Welsh Government. Other policies relating to the economy, skills, education and housing have a direct influence on the performance of the Welsh tax-base, eg. incentivising graduates to stay in Wales, or transport infrastructure enabling commuting to high-paid to jobs.

Valuation and appeals

There are merits to more frequent revaluations though we are not currently committed to this in the same way as other nations due to our consideration of wider local government finance reform. We find little practical evidence which compares the merits of annual versus three-yearly valuations. For both options, rateable values would track market conditions more closely which could promote acceptance and fairness, but this would not necessarily lead to a smaller magnitude of change in bills for ratepayers each time. As we have learned from the research carried out on council tax revaluation, the outcomes vary depending on the period chosen, the data which is available and length of time the exercise takes.

Annual valuations may be less affected by medium to longer term economic trends but not by shocks with a rapid onset, such as the Global Financial Crisis and the coronavirus pandemic, though revaluations could be postponed in those instances until recovery. We are unable to test whether higher frequency valuations negate the need for transitional relief schemes. There are likely to be some ratepayers significantly impacted by any revaluation however frequent.

The approaches elsewhere in the UK support us in continuing to explore tailored valuation and appeals requirements for Wales. Rights of appeal for taxpayers are essential to the integrity and fairness of local tax systems. There are incremental improvements to be made in the short to medium term though the future choices for appeals systems will need to be guided by broader reforms.

Valuation and appeals are key areas for reform if future governments wished to keep non-domestic rates a broadly similar system. This would be alongside digital transformation and our interest in alternative valuation methods for council tax outlined in Chapter 7. As Chapter 9 explains in more detail, the VOA's operational and ICT systems are not currently configured to support separate valuation frequencies or methods for Wales than England, though transformative ICT modernisation is in train. We will need to carefully balance what is practically feasible while navigating the art of the possible in tailoring to our needs.

Rates Relief

Relief is a substantial financial subsidy by the public purse and so it is right to continually review its purpose and effect. We must ensure it reaches those we intend to support and is in place only for as long as it is necessary. While our reliefs are fully funded, the provision of relief can place a higher relative burden on taxpayers who are not eligible. Non-domestic rates is a tax where currently half of all ratepayers pay no tax at all. This contrasts with roughly 16% of the council tax-base.

The range of schemes and criteria within each scheme adds complexity to policy, legislation and administration. In Wales, some reliefs operate through the national pool, others via grant funding, some are prescribed in legislation and others are application based. Due to this complexity and the longevity of the rates system, it is difficult to determine whether the arrangements currently work effectively together. A review and consolidation of the arrangements (including exemptions) is an option if a broadly similar non-domestic rates system were to remain in place.

Administration

Many recommendations of previous reviews focus on improving the ratepayer experience and administration of the system. These could be implemented alone or alongside larger-scale change, especially if other reforms necessitate digital modernisation. Coproduction with councils and ratepayers would be imperative to the success of these improvements. We will continue to implement measures to tackle rates avoidance and monitor newly emerging disingenuous behaviours.

Implementation

Implementing some of the more radical departures from the existing system will require significant new primary legislation, for example, greater localisation, a significant shift in valuation or the broad discrete-value and multiplier design. Crown Consent is required for reforms which would constitute a modification to the valuation function. The likely timeframe for such reforms would be five to ten years. Smaller-scale changes, such as administrative improvements and changes to relief schemes would be achievable within the next Senedd term.

Areas for further work

The key areas for further consideration if retaining non-domestic rates would be:

- Consider the outcome of HM Treasury's Fundamental Review of Business Rates, set to conclude in autumn 2021 and any implications for the pace of change in Wales;
- Monitor the impact of COVID-19 and EU Exit on local tax-bases and ratepayers;
- Investigate the appetite for and benefit of greater localisation, undertaking specific analysis on the effects within Wales, particularly in light of future pandemic effects;
- Continue our feasibility work looking at what would be involved in developing customised valuations and appeals functions for Wales;
- Understand the effectiveness of relief schemes and the implications of changes on ratepayers. Consider consolidation and undertake more detailed behavioural analysis;
- Undertake a fuller analysis of legislative and devolution requirements;
- Conduct Welsh-specific social and behavioural research, exploring awareness, acceptance and attitudes to reforms.

9. Summary of Findings

“Land and property have been taxed for centuries, certainly for longer than income, and they continue to form an important part of the tax base in most advanced economies” Mirrlees, 2011.

There is a growing view that the coronavirus pandemic could lead to a step change in inequality persisting far longer than its immediate effects. Many have sustained financial losses, poorer health and poorer education outcomes. The climate change emergency and population growth rear just behind this, driving leaders of public bodies to rethink priorities and shift to prevention rather than cure. We must mitigate against disproportionate effects on those with low-incomes, women, disabled people and people from black, Asian and minority ethnic backgrounds. Local government’s role is vital in the collective response. Its finance system has a valuable contribution to make.

The collection of recurring contributions from the local population to fund services for certain groups dates back to Elizabethan Poor Law of the 1600s. The current versions of property-based local taxation have roots in the General Rating Act of 1967, which in itself consolidated over thirty statutes about local contributions to services. There have been many changes in the role of local governments since then but its core purpose remains steadfast: to represent and govern for its people; and to determine locally-based public services for those in need.

Through the Local Government and Elections (Wales) Act 2021 we are building a resilient and renewed local government for generations ahead. Layfield’s influential conclusion from 45 years ago is still pertinent today: that the design of finance systems is dependent upon the relationship between central and local government, and what the role of local government is. It promoted responsible and accountable government at all levels, aligned to responsibilities for delivering services. Layfield did not offer two polar options (central versus local) as is often misinterpreted. Rather, it demonstrated a spectrum and advocated for genuine partnership, with clarity between levels of governance and therefore also, between levels of raising finance.

The majority of this document considers local taxes as key elements of finance which attract much debate. Changes impact on the whole system: the distribution of grants, affordability of support for certain groups and the balance of funding between centrally provided or locally raised means. Wales’ fiscal position within the UK limits reform of other elements of the system, yet we have protected local government funding as much as possible over this Senedd term. There is other important work allied to this, including on devolved taxes and the future landscape for social care funding. There are other theories about economic models to consider too, such as growth which values nature as our biggest asset, where economies are redefined based on health and wellbeing outcomes. The [Dasgupta Review](#) published recently outlines how to tax the harmful effects of economic activity and subsidise the beneficial effects. Such a model requires a global shift, yet the principles could be considered in a narrower form in relation to Welsh Government’s future fiscal choices.

The reforms set out in this document offer choices which could contribute to a fairer, more equal and greener Wales. There are opportunities to further recognise local government's capability as financial guardians and tax administrators. There are also opportunities to modernise key functions and to foster a greater awareness amongst citizens. While highlighting the ability to deliver a range of policy objectives, this document also highlights the risks and the barriers to reform. Alternative approaches need to be demonstrably better than the existing arrangements, not just different.

The five aspirations

At the beginning of this document we set out five aspirations for a future local government finance system: fairer, local, sustainable, simpler and understood. Our broad reflection on the range of options in relation to these aspirations is as follows.

FAIRER

Strive for more progressive revenue raising where possible, and greater fairness in the treatment of taxpayers. Geographical equity across Wales and between socioeconomic groups should not be compromised.

The most progressive option would be to base local revenue-raising on taxpayer incomes, but its practical implementation is the least understood and it carries higher avoidance risks, particularly in relation to offshore or hidden wealth. A local land value tax appears promising compared with existing systems, if the data infrastructure requirements could be met. Revaluation and rebanding of council tax could achieve a less regressive or more proportional position with respect to property wealth rather than incomes. Smaller-scale reforms to council tax would not achieve this aspiration alone. The fairness debate around non-domestic rates tends to focus on the tax rate and on changing consumer trends. Revenue needs for local services and devolution constraints mean these matters are unlikely to be fully addressed, though a widening of the tax-base could contribute. All reforms require consideration of the 'after effects' of change, eg. true tax incidence and capitalisation of wealth. All reforms require redistribution of the Revenue Support Grant to ensure equity and we have not seen evidence to the contrary.

LOCAL

Strengthen not weaken local democracy, autonomy and flexibility. Complement the broader reform of local government, which enables service transformation and greater participation in local democracy.

All options provide flexibility to meet this aspiration, depending on the intricate choices made during policy development, eg. on setting tax rates, collection and administration. The benefits of local knowledge and expertise within the existing arrangements have proven to be clear. The government would need to consider for which elements it requires national consistency in order to ensure fairness, and this

might be in areas such as support for those less able to meet liabilities. We would aim to coproduce a reformed system as far as is practicable with local government. Implementation of the Local Government and Elections (Wales) Act 2021 stimulates further regional and collaborative service delivery, coupled with increasing City and Growth Deal activity. Regardless of future options, finance systems will need to morph over time to take account of this and new layers of decision making about spending priorities and needs.

SUSTAINABLE

Safeguard the future sustainability of services to communities through stable funding streams. Safeguard prosperity and growth in local economies.

To meet this aspiration any reforms need to be revenue-neutral at an overall Wales level for local government. They also need to build in gradual growth in the tax-base. All options carry this potential but with highly variable effects on people and on places. The pursuit of progressive systems whilst maintaining buoyant revenues could happen more slowly if desired. Gradual transitions are possible, though often costly. A system more closely affected by economic cycles such as a local income tax has more damaging effects during downturns and shocks, though it could be argued that other fiscal mechanisms could kick-in in these instances. Effects are somewhat mitigated in land and property based taxes. There is a marked trade-off between sustaining revenue for services and stimulating economic growth through tax relief. Sustaining services contributes hugely to overall prosperity through quality education provision, adequate housing, public safety, wellbeing services and community cohesion.

SIMPLER

Strive, where possible, to reduce complexity in the design of our future systems. Local tax administration should be efficient with proportionate costs.

There is a trade-off between targeted and complex systems versus those which are simpler but imprecise. Much of the current system's complexity derives from the myriad of criteria determining liability, its growing case law and the valuation arrangements. A land value tax offers an opportunity to at least aim to reset this complexity, though in reality the rationale for greater precision may still prevail (due to fairness arguments). The complexity of a local income tax would stem from its definition of taxable income and how readily available precise data is to councils. In the absence of data, local means-assessments would be far more administratively burdensome. Options based on versions of existing systems could be simplified through consolidation of the legislation and a review of discounts, exemptions and reliefs. However, a discrete-value system for council tax would be more complex in terms of valuation, administration and appeals aspects. The extent to which complexity would grow over time in any new system is unknown and may be unavoidable.

UNDERSTOOD

Improve public awareness and understanding of the arrangements. Modernise how systems are delivered and take advantage of digital transformation.

Public acceptance and understanding of reforms will be multifaceted and may not become clearer until impacts begin to be felt, ie. following implementation. Local taxes are unpopular yet well established. As all options require new legislation and therefore periods of concerted public engagement, there are opportunities to raise awareness of the purpose and effect of reforms. A completely new type of system is more likely to break longstanding misconceptions. However, we will be less able to exemplify precise effects on individuals for the land value tax and local income tax ideas. Local administration of tax and finance systems is a promising candidate for digital transformation in the near future regardless of the option chosen, but options which are broadly similar to existing systems may spark less momentum for modernisation.

It's not just about tax

Local taxes contribute around a third of revenue for local government and are inseparable from the wider finance system. The diagram at Annex 2 outlines the various elements of the system as it looked before the COVID-19 pandemic. The system's functionality is premised on the approach local government follows in setting annual budgets. Principal councils and precepting bodies are legally required to set a balanced budget each year, meaning there cannot be substantive overspends or underspends against plans (other than the prudent use of reserves). This is a core principle of local government as a guardian of public money in its own right, separately from the Welsh Government.

This document outlines throughout that the various ideas for reform will impact on the whole system. Changes in locally-raised revenues impact on spending power and on the distribution of the Revenue Support Grant. Conversely, changes in centrally provided funding impact on the requirement to raise local revenues to meet spending plans. Reforms will affect the dependency of some councils on government grant funding. There are gearing effects whereby to increase a budget by 1%, the amount needed to be raised in council tax is proportionally higher at around 3.5%. These proportions differ between council areas with higher and lower value tax-bases and are influenced by historic tax levels. The right balance of funding between locally raised and centrally provided sources is fundamentally connected to questions of wider governance and accountability.

The Distribution Sub Group, which is a technical subgroup of the Partnership Council for Wales, develops the funding methodology for the annual revenue settlement issued by the Welsh Government. Where required the group will consider, in due course, the implications of any changes described in this document on the way the settlement is constructed. The group is also considering ways to improve the funding formula over the medium to longer term, addressing issues such as complexity and the use of, and dependence on, historical data.

There are other significant elements of the finance system. Councils usually raise around £1.3bn a year via fees and charges where permitted, eg. parking, leisure facilities, but in some cases these must be charged on a cost-recovery basis. Capital expenditure is another significant element of the system which enables investment in assets, infrastructure and service improvement. During this Senedd term we made changes to increase local government's flexibility, including the use of capital receipts to fund transformation, relaxing constraints around loan capital transactions, share capital transactions and bonds. Local choices around capital financing depend on long term revenue affordability and risk.

The Local Government and Elections (Wales) Act 2021 provides a new legislative framework for regional collaboration between councils through Corporate Joint Committees. It also provides a General Power of Competence to councils, enabling them to enter into innovative financial arrangements, including commercial ventures. Different needs and spending patterns may therefore emerge over time. There are also opportunities for voluntary mergers of councils in the future which may require some further thought in relation to finance. Local government expenditure is subject to strict financial governance and audit requirements to protect the integrity of the public purse and the future sustainability of services. The framework will need to be considered in relation to any reforms taken forward in future. We will, of course, also need to monitor the impact of events such as the pandemic and the UK's exit from the EU on the system and assess whether such effects are temporary or necessitate structural changes in the longer term.

There is much more to consider in relation to the 'non-tax' elements of the system, including whether there are further financial flexibilities which could be provided to local government. These discussions will be held during the next Senedd term alongside discussions about local tax reform.

Valuation functions in Wales

One of our key ambitions for reform is for our systems to be more tailored to the needs and circumstances of Wales in the future, and greater flexibility for the government of the day to make unique policy choices. This is highly dependent on being able to specify the valuation functions. We are grateful to the Valuation Office Agency for its involvement in our reform work.

The valuation function for council tax and non-domestic rates in Wales is carried out by the Valuation Office Agency, an executive agency of HMRC, therefore it is an administrative function discharged on an England and Wales basis. The Welsh Government instructs the VOA to maintain the valuation lists for Wales, managing performance and policy changes annually through a Service Level Agreement and provision of funding. However, valuations for Wales operate within a strategic, operational and broader policy context which is England and Wales focussed.

There are advantages and disadvantages to this arrangement. The availability of professional expertise is paramount to the success of local taxation and there are administrative and financial economies of scale. Working relationships between the Agency and Welsh Government officials are well established. However, the policy choices available to the Welsh Government in relation to revaluation cycles for non-domestic rates, for example, have been significantly constrained by operational

and strategic matters. Decisions made by the UK Government about rates revaluation in England, which drives the majority of valuation work, has restricted the Agency from delivering a separate arrangement for Wales. We have been unable to achieve reforms in the current Senedd term that we may otherwise have wanted to explore in greater detail with the VOA.

It is prescribed in the Local Government Finance Act 1992 that Welsh Ministers are able to set the 'assumptions and principles' regarding how council tax valuations are carried out. There are various flexibilities relating to non-domestic rates valuation in the Local Government Finance Act 1988. Many of the reform ideas described in this paper would require significant amendment to valuation procedures, constituting a modification of HMRC functions which requires UK Government consent. Even where it could be argued that a reform idea resides within the devolved flexibilities, recent experience suggests that such ideas would not be achievable operationally.

Other types of arrangements exist in the UK. Property valuations in Scotland are carried out by the Scottish Assessors Association, which is a voluntary organisation made up of independent assessors responsible for different areas of Scotland. Each of the Scottish councils is a Valuation Authority that appoints assessors (14 assessors work jointly across 32 councils). In Northern Ireland, valuations are carried out by the Land and Property Services which is part of the government's Department of Finance. It is accountable to Ministers and the Northern Ireland Assembly.

As local tax systems have increasingly diverged between nations, it may be desirable to consider whether there are benefits to a different form or function for valuation in Wales. Reflecting on the ideas for alternative methods, valuations would not necessarily need to be carried out by a body akin to the way the VOA carries out this function at present. For example, it could sit closer to local government (as in Scotland), closer to the government of Wales (as in Northern Ireland), or within one or more existing organisations. One consideration would be whether the valuation function should continue to be independent of tax policy and tax collection functions, as is currently the case. Periodic revaluation exercises could also be separate functions to the ongoing maintenance of the lists.

It is clear the current devolution arrangement constrains the Welsh Government's flexibility and autonomy over large elements of local tax policy, despite local government and the local taxes being devolved matters. Developing ideas for different arrangements is a significant undertaking, but one which has a fundamental bearing on the success of the local government finance system in the future.

Data and digital capability

Whether the Welsh Government wishes to stay broadly within traditional property taxes or shift to more radical alternatives in the future, our work has shown there are real opportunities to improve technological capability and it is what taxpayers and stakeholders expect. Improved user interfaces, real-time data, GIS technologies and more modern administrative platforms should be core features of any reforms. We saw first-hand the capability developed in recent years in Northern Ireland and Scotland for local tax purposes. The various research outlined in this document confirms the data requirements for implementing progressive systems are not currently met.

Our exploration of council software systems suggests there will come a time in the not too distant future where councils will need to invest more heavily in alternative platforms for tax administration, to alleviate issues around automation, data-access and adherence to policy rollouts. There is already a considerable amount of digital transformation already happening within local government for various services. The recently appointed **Chief Digital Officer for Local Government** will provide new leadership for digital technology in local services. This is a dedicated resource to identify, share, promote and champion a joined-up approach to digital initiatives across local government. Through our Local Government Digital Transformation Fund we have made over a million pounds available in this financial year to support the digital transformation of local government in Wales.

The **Centre for Digital Public Services Wales** established in 2020 is currently testing a draft set of standards for the adoption of digital across public bodies. The standards will advocate that every service should be user-focussed and take a multidisciplinary approach. Whatever direction local government finance reform takes, this drive for digital has created momentum which could be incredibly useful.



KEY QUESTIONS TO BE ANSWERED BY FUTURE GOVERNMENTS

- What benefits of the existing systems would we aim to keep? What are the priority issues to address?
- What should form the basis of a set of principles or outcomes to guide policy development?
- How could the local government finance system help us deliver the seven goals contained in the Well-being of Future Generations Act, and further embed the Sustainable Development principle?
- Can the local government finance system contribute to greener and foundational economies while sustaining revenue? Could it contain levers to mitigate societal challenges, such as housing poverty and decarbonisation, without diluting purpose or adding complexity?
- How could we explore awareness and attitudes to reforms?
- Are there benefits of replacing council tax and non-domestic rates with a single local tax system?
- If we intend to keep council tax and non-domestic rates as separate local taxes, to what extent does the design of each need to be complementary? What is the rationale for greater congruence or greater divergence?

Annex 1. Public Attitudes to Local Taxes

We know and have commented previously that council tax is generally widely accepted. Collection rates for the tax are high, it is administered by councils efficiently and effectively, and the concept is broadly understood by taxpayers. The same is true for non-domestic rates in Wales. However, we also know that both taxes can be viewed as unfair and are sources of vigorous debate and negative commentary, particularly when rates are increased. We encounter many misconceptions about both systems.

This requires attention if we are to safeguard local government finances for the future and is one of the reasons why the Welsh Government has committed to making council tax fairer. Given the existing local taxes are broadly effective, any reform options not only need to be more progressive, but they also need to be demonstrably better than what is currently in place. Future systems need to be easy to understand since we would need to be able to communicate any new tax system straightforwardly to households, businesses and other taxpayers in Wales. The complex aspects of local taxation means it can be difficult to communicate messages effectively, and this in turn can lead to disengagement from those it directly impacts.

Research on public attitudes to local tax

Reflecting on previous research about public attitudes towards local tax, a common view is that while council tax is a well-established and familiar tax for Welsh taxpayers, its regressive nature and perceived unfairness can place a burden on local government finances, and damage perceptions of councils as administrators ([The Lyons Inquiry](#)). This view was put forward by the Lyons Inquiry into Local Government in March 2007.

The Lyons Inquiry also suggested that while public awareness of the current council tax system is strong, there is more limited understanding of how it works in practice. It would therefore be essential for when reforming and implementing new forms of local taxation, it is made clear to people how local taxes work in practice. This is reiterated by a further study [Public Understanding of Tax Devolution](#), part of the annual National Survey for Wales, which found that only four in every ten members of the public recognised that councils have control over setting council tax levels in Wales. Whilst public understanding of devolved taxes, and local taxes, had broadly increased according to survey data obtained between 2017 and 2020, less than half of the population had a general understanding of the taxes they pay in Wales. Future taxation reforms in Wales will need to consider the best way to communicate with taxpayers.

The same study highlights understanding of local taxes was lowest amongst young people (18 to 36 year olds) and those with no qualifications², which suggests communicating changes to local taxes needs to be thought about carefully and tailored to a range of audiences.

The Scottish Government's [Commission on Local Tax Reform](#) provides a contemporary analysis of perspectives of members of the public on local taxes, including what the priorities for a new system should be. Three quarters of respondents disagreed that everyone should pay an equal amount of tax in response to one of the questions asked by the researchers. However, responding to a different question, over half of respondents broadly agreed that the amount paid should be based on income. Half of respondents also believed local tax bills should not be based on usage of local services, the value of property or land owned.

In contrast to the Lyons Inquiry, the Scottish Commission on Local Tax Reform found over half of respondents *did* feel that the council tax system was easy to understand and two thirds of respondents felt that paying council tax was a simple process. Homeowners were more likely to agree with these statements than those who were renting, suggesting varying levels of visibility for different types of households. Overall, however, two thirds of respondents did not feel that the council tax system was fair. In particular, younger people (aged 16 – 34), people on low incomes and single people were less likely to have positive views about council tax.

Respondents who were aged under 24 and over 65, disabled, living alone, renting and/or those living in council tax bands A to C were more likely to identify a tax system based on income as a top priority. Conversely, high earners and/or those in full time work were less likely to identify such a tax system as a top priority, preferring local taxes to be based on land and/or property value. This is perhaps unsurprising given the implications of certain tax regimes on those who earn more.

Almost half of respondents said that if they could change anything about local taxes, it would be the basis for liability. The most popular response was to base liability on a hybrid of property, land, wealth and income, the reasoning being that by taking into account a range of factors, the system would be more progressive. However, it is clear from the analysis, given the diverging views depending on people's circumstances, that it would be extremely difficult to reconcile all views on local taxes and achieve a one-size-fits-all approach.

Other research reminds us that any future reform will need to carefully consider public opinion and learn from previous experience. For example, when the Community Charge (more commonly known as the Poll Tax) was introduced in 1990, it received intense public criticism and civil discontent ([Jennie Bunt, 2020](#)). The Poll Tax was viewed by many as an unfair local tax because it was a flat rate charged to every adult, regardless of means to pay. The council tax which replaced it was therefore designed to be a hybrid tax, based in part on property value and in part on the circumstances of the household, and had higher levels of public acceptance.

Non-domestic rates tends to be more susceptible to frequent policy changes due to the annual setting of the national rate, more regular revaluation exercises and decisions about relief schemes, which typically draws public debate about the system's fairness and effectiveness. The Welsh Government receives a large amount of correspondence from ratepayers and business representatives which illustrates that the tax is complex and needs to be better understood.

There is less specific research about the awareness and acceptance of non-domestic rates in comparison with council tax. This gap in evidence will require further consideration ahead of any future plans for local taxation reform. While only focusing on an element of non-domestic rates, the Small Business Rates Relief scheme, a [recent survey](#) commissioned by the Welsh Government provides a brief insight into the perceptions and awareness of a significant aspect of the system, from which general conclusions may be drawn. For example, the number of ratepayers able to identify the different types of rates relief offered by the Welsh Government was relatively small despite the fact that around three-quarters of ratepayers currently receive some form of relief. Lack of awareness or knowledge of support was one of the largest identified reasons within the survey results for ratepayers not receiving support with non-domestic rates.

Further consideration will be needed to evaluate how changes to the non-domestic rates system can be communicated in a clear and concise way. In the same way as this is needed for council tax, the aim will be to improve how taxpayers understand the purpose of local taxation to fund public services, for the benefit of everyone in wider society. Taxpayers have expressed a multitude of views on the design and operation of local taxes. These views should be reflected upon and are important in terms of developing future local taxes for Wales.

Annex 2. Current System

This diagram reflects the system as it was prior to the coronavirus pandemic.

