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My ref:

Your ref:

Paul Gray Esq
Private Secretary to
The Prime Minister
10 Downing Street
LONDON
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14 April 1988

Dear Paul,

LOCAL GOVERNMENT FINANCE BILL: COMMUNITY CHARGE REBATES

Following this morning's discussion at Cabinet, I enclose:-

- a briefing on the amendment tabled by Michael Mates MP;
- b a copy of my Secretary of State's statement this evening announcing the Government's intention to modify the system of community charge rebates.

Copies of this letter and the attachments go to private secretaries to other members of Cabinet and to Trevor Woolley (Cabinet Office).

Yours

A D RING
Private Secretary



2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref:

Your ref:

Michael Mates Esq MP
House of Commons
LONDON
SW1A 0AA

29 March 1988

Dear Michael

NEW CLAUSE 1 OF LOCAL GOVERNMENT FINANCE BILL

I thought I would write to you to set out the main reasons why your proposed new clause to the Local Government Finance Bill is not acceptable to the Government. We have given the matter careful consideration since we discussed it in December and January.

We regard the New Clause 1 proposal for a three banded charge as a very crude step towards a local income tax. It may sound fair. But it is not. Let us take one aspect only. A simple 50% community charge for non-taxpayers would leave the vast majority of non-taxpayers worse off than under our proposals. This is because we already propose reduced charges of up to 80% for those on low incomes, and increased income support for those paying the minimum 20% charge. So your proposal can only protect those on lower incomes by grafting our rebate proposals onto the 50% charge. The end result is much the same, but it would be much more complicated and costly to get there.

For the minority of non-taxpayers who would pay more than a 50% charge under our scheme the new proposal has a nasty sting. Instead of our taper of charges from 50% to 100%, a sudden and painful earnings trap appears. A single pound of taxable earnings would cost the average person (and their spouse) £100 extra in community charge each. In the higher spending areas the step would be much greater.

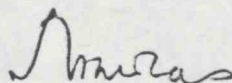
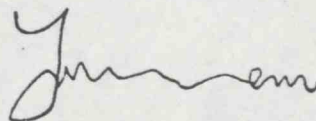
Those paying higher rates of tax will have to pay more, but not I suspect enough to satisfy those who believe that the community charge should be wholly based on levels of income. Only a full-blown Local Income Tax will do that. In fact, as you know, taking account of contributions to Central Government grant, the top 10% of households by income will pay about 15 times as much towards the cost of local government as the bottom 10%. Making non-earning and low-earning wives liable to the same charge as their husbands would be a tax on marriage which would be widely resented as unfair.

The basic charge under your proposals would fall by only about 10p per week and that takes no account of the extra costs of administering its collection which could be very substantial and would have to be paid for somehow.



Your scheme would also involve requiring all households to provide their local authorities with information about their incomes. I suspect that would be extremely unpopular with many taxpayers.

I will be sending copies of this letter to those colleagues who have expressed an interest in your scheme.



NICHOLAS RIDLEY

Conservative Research Department Brief

A THREE TIERED COMMUNITY CHARGE

Prepared For:

Consideration of the Local Government Finance Bill
- new clause one

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Introduction

A proposal for a three tiered Community Charge has been put forward. Under this :

- * those below the income tax threshold would pay only 50 per cent of the Charge;
- * those paying income tax at the basic rate would pay 100 per cent of the Charge;
- * those paying income tax at the higher rate would pay 150 per cent of the Charge.

Key Disadvantages

The key disadvantages of the scheme are :

- creation of an earnings trap for those on the threshold of beginning to pay income tax and those at the threshold between the basic and higher rates - at these points an extra £1 of income could produce major increases in Community Charge, of up to an extra £800 for those on the higher rates;
- enormous complexity in implementation - since the self-assessment system (included in the scheme) is a bizarre innovation to introduce into Britain's taxation system for the first time as a side effect of the local government finance system;
- it would undermine the separate taxation of married women only just achieved in the Budget, since the Community Charge liability of one spouse would be dependent on the income of the other;
- ineffectiveness in aiding the less well-off since under the existing Government's scheme those on low incomes would receive rebates of up to 80 per cent not the 50 per cent reduction proposed in the scheme;
- major penalties for higher rate taxpayers - of up to £400 for a single person or £800 for a married couple - for little gain to others since the 150 per cent surcharge on these people would reduce the Community Charge paid by basic rate taxpayers by only about £5.

LOCAL GOVERNMENT FINANCE BILL - REPORT STAGE

Briefing on New Clause 1 tabled by Michael Mates MP and others

The proposed variant of a community charge set out in New Clause 1 is - it is assumed - based on proposals set out by Michael Mates MP in an article in The Sunday Times in January. Mr Mates was told by Mr Nicholas Ridley why he found the idea unacceptable and this brief contains the information set out in a briefing note sent to Mr Mates, updated to take account of income tax changes announced in the Chancellor's Budget. The main points are

a) The proposal achieves very little in practice. It is ostensibly designed to make the community charge "fairer" but in fact:

- It does not offer significant new help for those on low incomes. All those on income support will receive the maximum rebate of 80% of the community charge and will receive help with the remaining remaining 20%. The vast majority of people on rate rebates will receive rebates above 50% - so very few would be better off as a result of the proposal for a half charge for non-taxpayers.

- For those above rebate level it would reduce the standard community charge by only about £5 per annum. But that takes no account of the need to pay for the extra administrative costs.

- The higher 1½ unit rate for higher rate taxpayers would do little to satisfy those who want a graduated system to hit the rich. It would create an enterprise trap for those crossing the threshold to the higher rate. In the highest spending areas, for example, the total bill could be £1,200 for a single person or £2,400 for a couple. It would give rise to anomalies especially in the treatment of married couples. Hitting the better off for no practical gain is hardly in line with the Government's general taxation policies.

Nor is it in line with the policies set out in the Chancellor's Budget to have a tax on marriage.

b) It would be far more costly and complex to administer, combining as it does a community charge with a tax based on assessed income. Establishing an individuals liability to pay a particular rate could be a process that dragged on after the end of the year in which the tax was levied. Mr Mates' scheme suggested that liability should be established by self-assessment. This would be an entirely new concept to UK personal taxation. It would seem odd to introduce this change into tax law merely as a side effect of a change to the local government finance system - especially one which achieves so little in practice. Self-assessment could not avoid the need for local authorities to be able to verify information with the Inland Revenue.

Finally the scheme destroys the principle that a local tax should be a flat-rate payment for services. While it does that, because it achieves so little, it is unlikely to satisfy those who wish to see the principle of progressive taxation implemented with a local income tax. It should be remembered that the community charge raises about one $\frac{1}{4}$ of total local authority spending. About $\frac{1}{2}$ will come from the national taxpayer - progressively taxed. This is the way in which higher rate taxpayers properly contribute more than those who are less well off.

Detailed comments on New Clause 1 scheme

1. The proposal envisages three levels of community charge:
 - (i) the full charge payable by all those liable for income tax at the basic rate;
 - (ii) a higher charge, of $1\frac{1}{2}$ times the full charge, for taxpayers paying income tax at above the basic rate;
 - (iii) a lower charge, of $\frac{1}{2}$ the full charge, for non-taxpayers.

It is assumed that the details of the scheme follow those set out
Michael Mates MP in an article in The Sunday Times in January.

Operation of the system

2. The system would build on the provisions of the Local Government Finance Bill, under which the "responsible individual" at each address will supply the names of all the adults living there, and the local authority will then notify each person that his or her name has been put on the community charges register.

3. On receiving that notification, this scheme would require each adult to say whether they were

- a) a higher rate taxpayer;
- b) a basic rate taxpayer; or
- c) a non-taxpayer.

4. Where a "responsible individual" fails to respond to a canvass there are already provisions for chasing non-respondents, imposing financial penalties and providing grounds for appeal. These would be extended, under the scheme, to provide redress against individuals who refused to divulge which of the groups at paragraph 3 above they fell into; or who were found not to be telling the truth. There would also need to be a new power to check cases with the Inland Revenue.

5. The process of requiring individuals to say which income tax category they were in would then be carried out annually for all those on the community charges register. In each case, the question would need to relate to a previous financial year. This would cause difficulties when earnings changed considerably.

- It would be up to 2 years before a move into a higher tax bracket was reflected in liability to pay the higher community charge.

- In the same way, a person whose earnings fell might be required to pay the higher charge for 2 years after his circumstances altered.

The latter makes it appear inevitable that there would have to be a special provision for later information to be used in determining liability in some cases.

6. Self-assessment would be a new concept in personal taxation in this country. It must be questionable whether it would be sensible or practical to introduce it for the community charge in isolation. And, even if such an approach were adopted, there would still need to be contact with the Revenue for verification.

7. A question directed to individuals based on liability to income tax would not necessarily be a straightforward one for people to answer. Those with incomes fairly close to the levels at which higher rate taxation begins are not automatically told by the Revenue whether they paid some tax at the higher rate: to work it out they would either have to do a complicated sum themselves, taking account of their allowances, or the Revenue would need to institute a system of automatic notification of higher-rate taxpayers.

8. All this suggests that it would be more straightforward to implement a scheme where the Revenue provided the information. Even this would not solve all the problems, however. In particular, it may take some years for an agreement to be reached between individual taxpayers and the Revenue about amounts to be allowed against tax. While such disputes are being resolved, even the Revenue will not be able to say conclusively in all cases whether an individual is liable for higher-rate tax. There might also be difficulty in ensuring that the Revenue and the local authority knew they were talking about the same person: the address that a taxpayer gives the Revenue for the purposes of correspondence about income tax will not necessarily be the address at which he or she is registered for the community charge.

9. There is also an inherent disadvantage in linking the basis of liability for the community charge with the rules governing another tax system. Income tax thresholds and allowances are normally changed each year. These changes would produce unpredictable and unintended effects on liability for the

community charge. Periodically, more fundamental changes are made the income tax system, which could have an even more dramatic effect (see paragraph 11 (iii) below, for example).

Treatment of married and unmarried couples

10. The proposal envisage that non-earning spouses would pay the same level of community charge as their partners. This is to avoid a situation where a non-earning wife whose husband had a very large income would be required to pay only the reduced level of community charge.

11. There are however several problems with this approach.

(i) Changes in income tax arrangements. The Chancellor announced in his 1988 Budget a system of independent taxation of husbands and wives, beginning in 1990. This scheme, in contrast, means that the community charge liability of one spouse is dependant on the income of the other. It involves, for example, treating a wife, who is a basic rate taxpayer and who automatically will be separately assessed for income tax, at the same community charge level as her husband if he is a higher rate taxpayer. This is technically possible, but presentationally difficult given the acceptance in the income tax system of the case for independent taxation of married women.

(ii) Unmarried couples. The income tax system treats married couples differently from unmarried couples. This scheme follows that precedent. In the case of couples with one earner, however, the result would be to give a financial advantage to unmarried couples. A non-earning married spouse would be liable for the full community charge if the partner were a taxpayer; but if the couple were not married, only $\frac{1}{2}$ a unit of community charge would be payable. If the partner was a higher-rate taxpayer, the difference would be $1\frac{1}{2}$ units of community charge to $\frac{1}{2}$. This means that there would be a financial benefit from choosing cohabitation rather than

marriage. The amounts at stake could be significant for couples with one, low-paid earner.

(iii) Anomalies. Even if married and unmarried couples were treated equally, there would still be cases where couples with two incomes would pay less in community charges than couples with one earner and a lower income. For example, a couple where one spouse earned £30,000 and the other did not work would pay 3 units of community charge. If both partners earned £20,000, the combined liability of the couple would be only 2 units of charge, despite the fact that their combined earnings were £40,000.

Reduction for non-taxpayers

12. The New Clause 1 scheme envisages according to Mr Mates that the proposal for an automatic reduction in the community charge payable by non-taxpayers would exist alongside the rebate system.

13. The system envisaged in the Bill means that local authorities would consider for rebates those on low incomes - either passported, as a result of notification from DHSS that the individuals concerned were receiving income support, or as a result of separate application for rebates made direct to the local authority by individuals with incomes above the income support level. The scheme would mean that non-taxpayers would also be assessed, through a separate route (either on the basis of their own returns or information from the Revenue) to the 50% band.

14. A dual scheme of this kind would inevitably increase administrative costs. But, on the basis of the 1988/89 rebate arrangements, it would benefit only a relatively small number of adults, most of whom would already have been receiving rebates, but of less than 50%.

15. Under the Government's proposals the majority of non-taxpayers would receive a rebate in excess of 50%. This is because, for most people, the income support level is close to the income tax threshold; those entitled to less than a 50% rebate

will therefore be paying income tax and would not benefit from the scheme.

16. Non-taxpayers likely, on the basis of the 1988/89 rebate system, to receive rebates of less than 50% would be better off under the New Clause 1 scheme than under the scheme envisaged in the Bill. These fall largely into two groups. The first is those who have high tax allowances, taking their incomes above the income support level. This will include pensioners with a small occupational pension. The second group is those who receive benefits which are classified as net income, and hence reduce housing benefit entitlements, but which are not taxable. This includes such groups as unemployed people receiving a disability pension or families in receipt of family credit.

17. Where people were liable to pay the 50% rate, but were not eligible for a rebate, there would be a 'step' effect if they moved into income tax. An increase in income of a few pounds could increase their community charge liability by £200 for a couple, or significantly more in some areas.

Surcharge for higher rate taxpayers

18. The proposal is for a 50% surcharge on higher-rate taxpayers - ie single people with minimum gross incomes in 1987/88 of £20,325 and married couples (with one earner) with minimum gross incomes of £21,695. There are only about 1.2 million tax units paying higher rate taxes - perhaps 2 million individuals paying the increased community charge if it were levied on spouses as well as higher rate taxpayers themselves.

19. On this basis, a surcharge might raise an extra £200 million in income each year, producing a saving of around £5 in the community charges paid by basic rate taxpayers. (This assumes that the 50% band has no cost. Any cost that did feed through would mean a smaller reduction for basic rate taxpayers.)

20. A 50% surcharge would mean higher-rate taxpayers, on average, paying around £330 in community charges, compared with £220 for basic rate taxpayers. Such a step would penalise those whose incomes brought them just within higher rate taxes. The size of

the step would be larger in higher spending areas - approaching £400 in Camden on existing spending levels - and for married couples, where it would be doubled in size. This means that an increased income of £1, taking the taxpayer into the higher rate, could lead to an increased community charge payment of up to £800.

21. A flat-rate supplement of this size does not raise sufficient revenue to make a significant impact on the charges paid by others. It would, of course, be possible to increase the surcharge. But that would make the "step" worse and would mean that the higher level of charge bore much more harshly on those with incomes just above the level at which higher rates of taxes become payable than on the very rich. Devising a scheme that distinguished someone earning £25,000 from someone earning £250,000 would involve introducing further bands, and begin to make the scheme much more like a Local Income Tax.

Equalisation

22. The Inland Revenue does not have accurate information, down to district council level, of the numbers of higher rate taxpayers, basic rate taxpayers and non-taxpayers. Information at regional level, however, suggests that there will be considerable variations between local authorities. An area with a much larger than average proportion of higher rate taxpayers would gain a financial advantage from the scheme unless the Government were to equalise for variations in taxable capacity by means of a new grant, not envisaged under the community charge at present.

Amendments to the Local Government Finance Bill

23. The Local Government Finance Bill would need substantial amendment to take the proposal on board. There would need to be provisions for each of the following

- (i) the supply of information about income, including rules about the community charge treatment of couples;

(ii) additional powers for financial penalties and appeals against individuals failing to declare their income band, and provision for checking a sample of responses with the Revenue;

(iii) provisions allowing the higher amount of community charge to be waived if an individual's circumstances changed significantly;

(iv) provisions setting out the relationship between the 50% band and eligibility for rebates;

(v) the rules for determining the size of the community charge in each area would have to be altered - it would no longer be a uniform amount across each local authority; the Government would need to set the relationship between the bands.

BRIEFING FOR PRIME MINISTER'S QUESTIONS
THE COMMUNITY CHARGE - MICHAEL MATES MP'S AMENDMENT

Line to Take

I do not think the amendment put forward by my Hon Friend is necessary. And it would have some highly undesirable effects. For example:

- A married man whose income increased by a few pounds a year, bringing him into higher rate income tax, would find a £250 - or more - increase in his community charge in many areas.

- Reductions in personal allowances - for example a cut in mortgage interest rates - would have the same effect. A cut of only $\frac{1}{8}\%$ in the mortgage interest rate could lead to some couples having to pay several hundreds of pounds more in community charge.

- And for those few people who benefited from my Hon Friend's proposed 50% band, there would be a similar increase in community charge payable if their income increased by only a few pounds but brought them into income tax.

BRIEFING FOR PRIME MINISTER'S QUESTIONS

THE COMMUNITY CHARGE - MICHAEL MATES MP'S AMENDMENT

Background Note

Mr Mates has tabled a New Clause to the Local Government Finance Bill. It seeks to band the community charge according to people's income. Non-taxpayers would pay 50%; taxpayers (and their partners) would pay 100%; higher-rate taxpayers (and their partners) would pay 150%.

This proposal has many defects:

For most non-taxpayers the rebate scheme will be more generous than the 50% band; so the 50% band would have to be grafted on to the rebate scheme at considerable cost, but with little significant benefit.

There are two nasty steps between the bands. A £1 increase in a person's earnings (or a £1 decrease in his or her tax allowances) could cost that person several hundred pounds a year.

The top band would raise little extra money; only enough to reduce the basic charge by about £5. The well-off already pay far more towards the cost of local services than the less well-off, through national income tax.

The proposal would involve requiring all households to provide their local authorities with information about their incomes - likely to be unpopular with many taxpayers.

ENVIRONMENT

NEWS RELEASE

214

14 April 1988

MORE HELP FOR PEOPLE ON LOW INCOMES
TO PAY THE COMMUNITY CHARGE

One million more people on low incomes are to get help towards paying their community charge, Environment Secretary Nicholas Ridley told the House of Commons today.

This brings to nine million the total number of people who would pay reduced charges through a system of rebates.

About four million people, already eligible for rebates, who would have paid a reduced charge, would now pay even less.

Pursuant to an Answer to a written Question from Eric Forth MP (Mid-Worcestershire), Mr Ridley said:

"The Government has now decided on the taper to be used in calculating entitlement to community charge rebates under the new system.

"Under the Government's existing proposals, all those receiving income support - the successor to supplementary benefit - will have their rates or in future their community charge bills reduced by 80 per cent. So they will pay only 20 per cent of the community charge for the area in which they live. In addition, their income support will include an amount to help meet the 20 per cent charges that they do have to pay.

"Those with incomes above the income support level will also be eligible for rebates of up to 80 per cent according to their circumstances. In 1988/89, with domestic rates, the amount of their rebate is reduced by 20 pence for each £1 increase in their income.

"The Government has now decided that, when the community charge is introduced, rebates should be calculated on the basis of a lower 'taper', of 15 pence for every additional £1 of income. This means that the community charges of those on low incomes will rise more slowly as their incomes increase. Their rebate will be reduced by only 15 pence for every £1 rise in their net earnings above the income support level.

"This reduced taper will come into effect when the community charge is introduced - in Scotland in 1989 and in England and Wales in 1990.

"Four million people will receive the maximum 80 per cent reduction. If a 20 per cent taper had been used for the community charge, about a further four million people would have received reductions of up to 80 per cent. With a 15 pence taper, rebates will extend further up the income scale. One million additional adults will have their community charge bill reduced. About nine million people will pay reduced charges and about five million people with incomes above the income support level will have larger reductions in community charge than they would have had with the 20 pence taper.

"Of these five million, about three quarters are people who do not pay income tax.

"This improvement in the rebate proposals achieves a better targeted result than the New Clause I proposal for a 50 per cent community charge for those who do not pay income tax. But it does so by a simpler and much less bureaucratic route, with no anomalies, and one that avoids the earnings trap which New Clause I would produce. It does not require an amendment to the Local Government Finance Bill."

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