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PRIME MINISTER P 03664

THE COMMUNITY CHARGE

Minutes from the Secretary of State for the Environment (23 April) and the Chancellor of the Exchequer (24 April)

DECISIONS

1. The central issue is still what improvements should be made to the community charge in order to secure better control over local authority expenditure; and second, what should be done to meet concerns about unfairness. You will wish to work through the issues, and in conclusion commission further work on key areas which may include:

   i. the extended use of community charge capping;

   ii. an additional charge on people with high incomes;

   iii. improvements to the transitional relief grant scheme;

   iv. the powers of local authorities with particular reference to additional duties contained in legislation this or next session;

   v. the timing of legislation.

In each case you will want to make it clear who is to take the lead in this further work.

HANDLING

2. You may find it helpful to take the issues in the order in which they appear in paragraphs 52 and 53 of Mr Patten's paper, bringing in the Chancellor's paper at relevant points, as follows:

   i. grant. Mr Patten wants substantial extra provision for

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Aggregate External Finance (AEF). You may wish to defer discussion of grant until a way has been found of ensuring that it does not simply push up local authority spending.

ii. the control of local authority expenditure. Mr Patten proposes enhanced powers to cap about 50 high-spending authorities. He rejects the further proposal from the last meeting to set targets for all authorities, with grant incentives for those which meet them. You will want to consider whether this is acceptable, or whether it is essential to take further steps to control spending (for instance, through extended capping of all local authorities which are large spenders).

iii. new "safety valve" taxes to take some of the burden off the community charge. The Chancellor's minute considers possible surcharges on VAT or excise duty on fuel and on Vehicle Excise Duty (VED). His firm view is that all are subject to serious problems and should be ruled out. You will want to consider whether to endorse his conclusion. It leaves only the option of spending out of capital receipts as a safety valve, on which Mr Patten has an outstanding remit.

iv. fairness: a special levy on the better off. The Chancellor says that various options are feasible for a surcharge on incomes over about £50,000, but he is not convinced at this stage that the advantages outweigh the disadvantages. Mr Patten favours a more comprehensive scheme, with a banded levy on all higher rate taxpayers: the proceeds would be used to pay for his other proposals at v and vi below. You will wish to decide what further work should be done.

v. an enhanced transitional relief scheme. Mr Patten suggests that the proposed withdrawal of relief over the next two years should be cancelled; that the scheme should

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be extended for a further 3 years after that; and that it should be enhanced to cover the effects of withdrawing the area safety net and low rateable value (RV) grant in 1991/92 and subsequent years. Annex A to his paper sets out further possibilities such as the possibility of relaunching the scheme. You will wish to decide what further work should be done.

vi. enhanced community charge benefits. Mr Patten proposes doubling the earnings disregards for benefits (with a differential reduction in the taper at the top end as a second best option). He also proposes an increase in the lower capital limit and/or a cut in the tariff applied to savings. You will wish to consider whether these possibilities should be taken forward.

vii. powers and duties. An exercise is needed on the powers and duties of local authorities where the main immediate issue is the extent to which the legislative programmes for this and next Session include additional functions for local authorities which could influence the level of community charges in 1991-92 (eg. community care, food safety, litter on roads). You will wish this work to be set in hand.

3. Finally, you will wish to ask the Lord President about the scope for fitting a Bill into the legislative programme this or next Session. To some extent this may depend on the complexity of the provisions to be taken and the date by which Mr Patten needs to have the new powers. Further work, in consultation with the Law Officers and business managers, may be needed.

ISSUES

Grant

4. Mr Patten says that the Government will need to make substantial extra provision for Aggregate External Finance (AEF) in 1991/92 to achieve an acceptable level of community charges (paragraph 52). But you agreed at your last meeting that you

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could not consider the level of AEF until you had identified ways to control spending and prevent extra grant leaking into yet higher spending. You will probably want to repeat the point.

Capping

5. Mr Patten proposes to take enhanced powers to cap about 50 high-spending authorities. These would allow authorities to be capped down to about 5% above their standard spending assessments (SSAs); to be capped either before or during the financial year; and to be capped for a run of years ("multi-year capping"). You will want to decide whether enhanced capping on this basis is a sufficient response to the need to control local authority expenditure and keep down community charges.

6. Mr Patten estimates that his proposals would bite on rather less than half of local authority spending, and secure reductions of no more than £1 billion. This compares with an overspend of £3.2 billion in this year's budgets. It seems unlikely therefore that such a scheme would go more than part way to ensure that Government spending plans were adhered to. You will want to consider the options for further action. There are a number of possibilities:

> i. indicative targets on their own. Annex D to Mr Patten's paper shows that it is feasible to devise expenditure targets for all authorities on a formula basis. Indeed this was done between 1981/82 and 1985/86. The simplest option would be to publish such targets as indicative spending levels. This might have some effect at least on responsible authorities. On the other hand the overall benefit of indicative targets on their own would probably be fairly limited.
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> ii. indicative targets plus extended capping. There are a variety of ways in which indicative targets could be coupled with capping. For instance, capping could be applied to all authorities; or it might be applied only to those above their SSA. It might also operate on a more mechanical basis

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than existing, discretionary capping, for example using formula-based targets as discussed in annex D to Mr Patten's paper. One particular possibility might be to have capping linked to formula-based targets for those authorities which are the largest spenders (eg. the 107 shire counties, metropolitan districts and London boroughs, or alternatively all authorities with budgets over £15 million) which between them account for a high proportion of all local authority expenditure.

iii. <u>targets backed by grant incentives</u>. This too is worked up in Annex D. It has the advantages that authorities would have a financial incentive to meet their targets, and that the extra grant (if paid) would all feed into lower community charges. On the other hand the paper says that it could have perverse effects. Extra grant could go to some of the highest spenders at the expense (as they would see it) of more responsible authorities. And it could increase the gearing effect of the community charge (for example, the scheme outlined in Annex D would double the gearing for any authority in the critical region just above target, eg from 4:1 to 8:1).

7. Mr Patten says that he has no doubt that his department could make a system of targets backed up by extended capping work in technical and administrative terms (paragraph 47 of his minute). Such an approach would meet the immediate need to control local authority expenditure and protect the community charge payer, particularly in the early years of the new system. It could also be a sensible half-way house towards radical limitation of the powers of local authorities to tax, which Mr Patten suggests might be the Government's long-term aim (paragraph 9 of his minute). <u>You will wish to weigh up these arguments for such a system against the difficulties which Mr Patten identifies</u>. In particular:

i. <u>complexity</u>. He says that the system would be extremely complicated. But this complexity would primarily affect local authorities who are used to complex financial arrangements rather than the charge payer.

ii. accountability. The Government would appear to be giving up on the accountability of the community charge. But the new scheme could be presented as part of the transition and evolution of the new system.

iii. criticism. He refers particularly to the Government's own supporters and the criticism that the Government was reinventing the unpopular regimes of the 1980s. But the measures could be presented as transitional, or else as a first step to a scheme which limited the power of local authorities to raise tax.

Manpower controls

8. Annex E to Mr Patten's minute also fulfils the remit from the last meeting to consider manpower controls further but he argues against it on the grounds that it would require new data from authorities, would have substantial resource implications for DOE and be uncertain in its effect on spending. You will wish to decide whether this approach should be pursued.

"Safety valve" taxes

9. The paper attached to the Chancellor's minute identifies serious disadvantages with each of the possible new local taxes identified at the last meeting:

i. a surcharge on VAT or excise duty on petrol would lead to cross-border shopping and the yield in different authorities would vary substantially. Accountability would therefore be poor. Administration and compliance costs would be high, for both the public and private sectors. Both options would require petrol sales to be allocated by location in cases where this is not done at present. The problem would be most acute in the case of excise duty which is currently collected at the refinery gate (30 locations only).

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ii. a surcharge on VED could also be subject to evasion, through increased non-payment and the registration of vehicles in low-VED areas. It would also be a flat rate charge on all car owners, which, at the £45 per annum suggested in the paper, could be controversial in its own right, particularly perhaps in rural areas.

10. You will want to consider whether, despite these difficulties, one or more of these options should be pursued further. If not, there is still the possibility of allowing the use of a proportion of capital receipts (perhaps from specific sources such as council house or derelict land sales) to fund revenue spending. Mr Patten has a remit from the last meeting to look at this. You might ask him to bring forward his paper urgently.

A "community levy" on the better off

11. The Chancellor says that a community levy, collected through the income tax system, would be feasible. There are two main proposals on the table:

i. the Treasury paper discusses a flat rate levy of one average community charge on incomes over £50,000 (yield about £100m), with the possibility of a double levy on incomes over £100,000 (yielding a further £20m). This would restrict the levy to people earning several times average earnings, but the yield would be relatively low.

ii. Mr Patten proposes a levy of half an average charge on higher rate taxpayers with incomes below £50,000, in addition to the two higher bands proposed by the Treasury. The total yield would be higher at about £400m, which he suggested could be used to finance his other proposals on transitional relief and community charge benefits. This scheme would however bite on many more taxpayers, and would look more like the sort of banded community charge which has been rejected in the past.

12. The Treasury paper also discusses two other options:

iii. a percentage surcharge on higher incomes. For example, there could be a 5% surcharge on taxable incomes over £40,000 (yield about £750m per annum) or a 1 or 2% surcharge on all incomes liable for higher rate tax (yield around £300m per annum for each percentage point). However these options would be indistinguishable from an increase in higher rate taxation, reversing the Government's tax reforms. You may feel they should be ruled out for that reason.

iv. a surcharge on the occupiers of high rateable value homes. Such a system would operate on the old rating list, and could be uprated by local authorities. On the other hand it would become increasingly subject to anomalies, eg as new houses were built with no entries in the list. It would also appear to reintroduce a restricted form of rates. You may therefore conclude that it should be ruled out.

13. You may therefore conclude that the best option would be some form of flat-rate levy on high earners. If so, you will want to decide between options (i) and (ii) above, or some other variant.

An enhanced transitional relief scheme

14. Mr Patten says that the present plan to phase out relief by £13 per adult in each of the next 2 years will mean that 2 million people will lose relief altogether in 1991/92 and a further 1 million in 1992/93. The remaining 4 million beneficiaries will lose all relief in 1993/94, when some will face very steep losses (eg £300 a year). In addition many of these chargepayers will lose from the phasing out of the area safety net, the low RV grant and the ILEA transitional grant.

15. To tackle these problems, he proposes two main changes in

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the scheme:

i. to cancel the planned withdrawal of relief over the next two years, and extend the scheme for a further three years (during which relief would be phased out at £13 per adult each year);

ii. to extend the scheme to cover the effects of phasing out the area safety net and the low RV grant (and perhaps also the ILEA transitional grant, although this does not appear to have been costed).

The estimated costs of these and Mr Patten's other proposals are summarised in Table 1 attached to this brief.

16. These proposals would shield eligible chargepayers from some further losses which they are currently due to suffer in 1991/92 and subsequent years. This might prevent additional hardship and controversy. But it would do nothing in itself to ease the position of chargepayers who are already facing unacceptable bills in 1990/91; for example among those just above benefit levels about whom you were concerned at the last meeting.

17. You may feel that you want to consider further options to help this group, either in addition or as an alternative to what Mr Patten proposes. For instance, Annex A to his paper suggests the possibility of relaunching the scheme with a commitment that community charge bills in 1991-92 would be no more than (say) £5 above rates in 1989-90 provided local authorities spent at or below their targets (paragraph 32 of the annex). There might be other variants on this approach: for instance, changing the base of the scheme so that it was focused on increases in charges between 1990-91 and 1991-92. You will want to consider whether to commission further work on other possible improvements to the transitional relief grant scheme. You may think this is a higher priority than proposals for enhanced community charge benefits (see below).

Enhanced community charge benefits

18. Mr Patten proposes two changes to make benefits more generous for those with modest incomes or savings:

i. doubling the earnings disregards, to £10 per week for single people and £20 for couples. This would benefit all benefit recipients earning at least these amounts by a flat rate of 75p per week (singles) or £1.50 (couples). Mr Patten favours restricting the change to community charge rebates only (cost £80m - extension to all housing benefits would we believe cost about £250m in total). If this proves impractical, Mr Patten suggests a cut in the taper at the top end only as a second best option;

ii. increasing the lower capital limit (currently £3,000) and/or reducing the tariff rate applied to savings above this level. This would benefit people with savings between £3,000 and the new upper limit of £16,000 set in the Budget. The option costed in the paper is a cut in the tariff from £1 per week for each £250 of savings to £1 for each £400 (cost £40m, or £70m if extended to other benefits).

Again, the costs are summarised in Table 1 attached.

19. The new community charge rebate scheme is already much more generous than for rates: around 1 in 4 chargepayers (9 million) are expected to get benefit, with 5 million on the maximum 80% rate. The capital rules were eased, at substantial cost, in the Budget. Against this background, you will want to consider whether the further changes proposed by Mr Patten would be justified.

RW.

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Cabinet Office
25 April 1990

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TABLE 1

PROPOSALS ON FAIRNESS: ESTIMATED COSTS

	1991/92	1993/94
Transitional relief scheme		
- enhancement for existing recipients	120	300
- extension to new recipients	20	50
Community charge benefits:		
- doubling earnings disregards*	80	80
- cut in capital tariff	40	40
GROSS COST	260	470
Differential levy on better off (saving)	(400)	(400)
NET COST (SAVING)	(140)	70

*Alternative: differential cut in taper at top end	30-50	30-50