Reforming revenues

Options for the future financing of local government

Report

Foreword

Between 2010 and 2019 local government faced cuts to funding from central government of £15 billion. From 2016 to 2019 increases in Core Spending Power, the Government's assessment of the revenue resources available to local government through the annual Local Government Finance Settlement, were due to increases in council tax rather than funding from central government. Local sources of income, including council tax, business rates and sales, fees and charges have become increasingly important as a source of income to local government forming an increasing proportion of their budget.

The COVID-19 pandemic has had a significant impact on these local sources of income, with losses of around £9.7 billion. Although central government provided some compensation for those losses in 2020/21, many local councils are still reporting gaps between losses and compensation. Furthermore, income will take a while to recover, so there is likely to still be a gap going forward. This has affected all councils although how badly individual councils have been affected will depend upon the importance of each of these sources of income to their overall funding position.

The 2021 Autumn Budget and Spending Review provided welcome new government funding for councils over the next three years to support vital local services. This will help meet some – but not all – of the extra cost and demand pressures just to provide services at today's levels. This has been confirmed for the forthcoming financial year in the Local Government Finance Settlement for the financial year 2022/23 which provides a potential increase of 6.9 per cent in council core spending power in cash terms, including new government grants. While the additional funding for adult and children's social care is good, it will not go far enough in addressing the very real existing pressures these vital services face and, despite additional resources in the Spending Review, initial LGA analysis suggests that there will be a shortfall of more than £1 billion in the last year of the Spending Review period.

As part of the 2022/23 settlement, the Government announced a commitment to work with local government on an up-to-date assessment of needs and resources during the forthcoming year. By that they mean the way in which the funding is distributed between councils.

Whilst the LGA is supportive of the Government proceeding with the Review of Relative Needs and Resources (also known as the Fair Funding Review), and ensuring that no council sees it funding reduce as a result of the changes, we think that now is the time for a more fundamental look at how councils are funded to ensure they are financially sustainable in the longer term.

Business rates have been criticised as it is a ‘bricks and mortar’ tax at a time when online trading has been growing. This has become more pronounced during the COVID-19 pandemic as a large number of business premises closed temporarily due to lockdown restrictions and a number did not reopen. The Treasury has now published its final report of the business rates review and outlined some minor reforms and a further technical consultation has been published. We look forward to continuing discussions and to responding to that and to future consultations including on an online sales tax.

It has been argued that council tax is regressive as people on a lower income pay more of their total income in council tax than people who are better off. Domestic properties have not been revalued since 1991. Most discounts and the band structure are fixed nationally and increases in council tax are constrained by referendum limits. The public may have an expectation of more and better services when it has to pay more in council tax. But due to the reduction of £15 billion in council funding in the period from 2010 to 2019 councils have not been in a position to meet these expectations.

Council tax and business rates are not the solution to paying for the growing costs of services and particularly social care. Council tax raises different amounts in different areas unrelated to need, and the changing nature of business alongside the nature of demand pressures on councils means that we cannot look to business rates to form such a substantial part of local government funding in the future. The LGA called on the Government to make the case for increases in income tax and/or national insurance and/or a social care premium to help pay for adult social care. However, funding from the Government’s new health and social care levy, being made available over the next three years, is not sufficient to meet the pressures on adult social care and may not even be sufficient to fund the reforms.

It is in this context that the LGA commissioned WPI Economics to carry out an objective review of the current and alternative sources of revenue finance and an assessment of their strengths and weaknesses assessed against the principles set out by the LGA in its submission to Tranche One of the Business Rates Fundamental Review: sufficiency, buoyancy, fairness, efficiency of collection, predictability and transparency and incentive. The LGA does not necessarily endorse any of the suggested options. Whilst the focus of this report is revenue funding, capital funding is also very important and there are clear links between the two.

It is clear that sources of funding, individually or together, would have to provide income for authorities in all tiers, regardless of their ability to generate this income, otherwise services that support residents would be under threat in many areas. Therefore, with any new income sources, or a combination of sources, there will need to be some redistribution between authorities.

Councils have ambitions for their communities; economically, socially and environmentally. Any sustainable finance system and sources of funding should work to support local government achieve these aims. While the commitment to funding reforms made in the 2022/23 provisional Local Government Finance Settlement make it difficult for a government to set out a multi-year settlement for local government, a series of one-year financial settlements continue to hamper financial planning and their financial sustainability. Only with adequate long-term resources, certainty and freedoms, can councils deliver world-class local services for our communities, tackle the climate emergency, and level up all parts of the country.

Councillor Shaun Davies
Chair, LGA Resources Board

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Executive summary

The Budget and Spending Review in October 2021 outlined significant changes to local government revenue financing, including an increase in grant funding for councils and reform of the business rates system.

Despite these announcements, four significant issues with local government revenue financing remain unresolved:

1. Adequately funding councils to deliver services of an acceptable standard.
2. Making the UK taxation system fairer for those who pay taxes.
3. Giving councils more tools to encourage local growth.
4. Enabling councils to deliver policies that have a wider societal benefit (such as reaching Net Zero).

While all of these issues are interlinked to some degree, the first is arguably the most pressing. Councils are going to be on the front line in delivering wide-ranging social care reforms and credible analysis suggests that current funding plans may not allow the reforms to succeed.

Within this context, this report looks at the options for local government revenue reform, judging the options for reform against common criteria.

The current system

Councils have access to four main sources of revenue: council tax, the Settlement Funding Assessment (which includes locally retained business rates and the centrally determined Revenue Support Grant), other central government grants and incentives (such as the Better Care Fund and the New Homes Bonus) and sales, fees and charges (such as income from parking and cultural attractions).

The Government places various constraints on how councils receive revenue. For example, the government requires a council to hold a referendum if it intends to raise council tax by more than certain percentage.

Deciding how local government revenue financing should work in the future is an ongoing process, with tweaks and significant changes occurring on a regular basis.

The Local Government Association (LGA) holds numerous policy positions that it argues should be part of local government revenue financing reform. They broadly fit into five categories:

1. **Increased funding for councils**. LGA initial analysis at the time of the 2021 Spending Review suggested that councils will face at least a £1 billion shortfall in their ability to keep services at their 2019/20 levels in terms of quality and access in 2024/25 (and it does not deal with pre-existing pressures such as the adult social care provider market and funding children's social care).
2. **Certainty of funding for councils.** Councils could make longer term decisions that provide better value for money for the taxpayer if longer term certainty over funding was provided (the provisional Local Government Finance Settlement for 2022/23, published in December 2021, was the fourth one-year funding settlement in a row for councils).
3. **Reforms to council tax.** For instance, the LGA has called for the council tax referendum limit to be abolished and for councils to have the powers to vary council tax discounts (although, they are clear that council tax is not the solution to filling the identified gap in council revenue financing).
4. **Reforms to business rates.** For instance, the LGA has called for business rate reliefs to be set locally, rather than centrally to allow councils to better tailor reliefs to the needs of the local economy, for a crackdown on avoidance and for a time-limited appeals process.
5. **Widening the sources of income for councils.** At present, councils rely heavily on council tax and business rates for their income. The LGA has committed to working with central and local government to identify a wider range of suitable and sustainable funding sources for council services in the future.

Interviews with councillors for this report highlighted three areas that should also be recognised in discussing the aforementioned reforms:

- **It can be politically difficult to change the tax system.** The politics can sometimes not be easy even if there is a strong theoretical economic / social case for doing so (and the politics my be borne out of genuine affordability issues for residents).
- **Invest to save / invest to grow should be a feature of funding.** Sufficient revenue does not just mean covering day-to-day spending needs, but should fund invest-to-save interventions that could ultimately save money in future or that could grow the local economy.
- **The local link between tax and spend is important.** The link between what residents pay in local taxation and what they get back in local services needs to be strengthened, as this is a key plank of local democracy.

The principles of local government revenue reform

The LGA's principles for local government revenue reform are listed in table one, below. The table also describes the tests used to assess whether a revenue source would meet the principle.

It should be noted that the tests to assess whether a principle for reform has been met will not always result in a straight 'yes' or 'no' answer and some of these principles may be regarded as more important than others.

With this in mind, the principles and their tests should be regarded as a framework through which options for reform can be assessed against each other consistently and objectively, and to inform analysis of the pros and cons of reform. They can never capture every economic and political nuance of reform. Meeting the principles, therefore, should not be seen as the final answer for how local government revenues should be reformed.

Table one: Description of the principles to underpin local government revenue reform and of tests to meet principles

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Sufficiency 'financing for local government services must be sufficient'	**Can the revenue source contribute to financing spending in every council area?** Because council revenues currently come from multiple sources, the assumption is that sufficiency will be achieved with revenues from multiple sources following reform too, ie local government should not be funded from one revenue source. In this sense, all revenue reforms would contribute to sufficiency in some way.
Buoyancy 'rises along with economic activity with protection for local government from losses in income given the need to support local government services'	**Do revenues automatically increase as economic activity increases?** For example, corporation tax, VAT and income tax are thought to be buoyant taxes, as yields from them tend to rise automatically with inflation and economic growth. Where yields decline alongside inflation and economic growth, other forms of revenue financing would fill the gap, such as grant funding.

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Fairness 'the taxpayer makes a fair contribution and the taxbase is not too narrow'	**Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that should be discouraged?** Fairness in tax is a subjective concept – what seems fair to one person may seem decidedly unfair to another. However, there would seem to be a consensus that those who are have a greater ability to pay tax should pay more in tax. There is also some evidence of a consensus that is it is fair to tax those undertaking activities that are harmful to health and the environment, regardless of the ability to pay. One additional point to consider is fairness across areas. For instance, whether different places have much bigger tax bases relative to others. This is not considered under this principle, as the system of local government finance can always use redistribution mechanisms to account for these different sized tax bases.
Efficiency 'any tax should be efficient to collect; if the costs of administration and collection of a tax are high then the net yield will be lower than it would be for a more efficient tax'	**Would the costs of collection be too high?** The majority of taxes discussed in this analysis are deemed efficient enough to collect at present. With this in mind, this principle looks at whether reform will reduce efficiency. Or if it is a new tax, whether efficiency in collection may be lower than the current system.
Predictability 'income from a tax / revenue should be predictable'	**Is the revenue source, and how it might change, well understood?** For example, property taxation lends itself to being predictable because the number of properties liable to pay the tax are known, and the tax is likely to be difficult to avoid. Revenue from a tourist levy may be regarded as unpredictable – there is some data that allows estimates of potential yield, but estimates would come with uncertainty attached. It should also be noted that revenues from grant funding are not predictable when only short-term funding settlements are granted.

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Transparency 'it should also be relatively straightforward to work out how the tax has been derived'	**Can the tax be understood by those who are liable to pay it? Or by those responsible for deciding rates and administering it?** An example of where a tax may not be transparent is that of business rates, where the valuation process of properties is often seen as lacking transparency (something the Government has set out plans to address in its recent review of business rates).
Incentivising 'incentives should be provided to both business and local government'	**Does the revenue incentivise councils to pursue growth policies?** **Does the revenue disincentivise business growth?** **Does it incentivise broader policy goals?** It is important to note that some revenue sources can create undesirable incentives, regardless of whether they are national or local. For instance, stamp duty land tax (SDLT) would disincentivise trading up or trading down as a national revenue or as an assigned revenue source.

Comparing options for local government revenue reform

A traffic light system is used to indicate the extent to which the principles of local government revenue reform are met. Red means the principle is not met, amber means the principle is partially met and green means the principle is fully met. There are three tables, looking at current local government revenue sources (table two), making national taxes local (table three) and implementing new local taxes (table four).

Table two: Current local government revenue sources judged against the principles of revenue reform

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Council tax in its current form.	**Sufficiency**. Contributes to a significant amount of council revenue. **Efficiency**. Has an established collection system. **Predictability**. The number of properties in a council tax area, their council tax bandings are known.	**Fairness**. Areas with high house prices pay relatively less than areas with low house prices. But Council Tax Support can reduce the burden for residents. **Transparency**. The higher the value of the property within a council area, the higher the tax. But it is based on 1991 property values.	**Buoyancy**. Council tax levels are political decisions for councillors (within central government constraints). **Incentivising**. Does not strongly incentivise council or business behaviour.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Reformed council tax. Council tax bands based upon up-to-date property values. Additional bands above / below current bandings. Ending of the single-person discount and increased funding for council tax support schemes. Developers charged full council tax for every unbuilt development from the point original planning permission expires. Change referendum limit to £s rather than percentages.	**Sufficiency**. Depending on reform, yields could increase / decrease / be maintained. Would still be significant. **Fairness**. Revaluation and additional bands would mean council tax reflects the current value of a property. If the asset rich and cash poor experience a rise, they could see tax rises deferred. **Efficiency**. Council tax already has an established system of collection. **Predictability**. The number of properties in a council tax area, their council tax bandings would still be known. **Transparency**. If council tax bills were based on up-to-date values, it would be easier to understand.	No principles fell into this category.	**Buoyancy**. Council tax levels are political decisions for councillors (within central government constraints). **Incentivising**. Does not strongly incentivise desirable activity in either councils or business.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Business rates. NB: Analysis does not reflect the reforms that are being introduced following the 2021 Budget and Spending Review, which are captured below.	**Sufficiency**. Business rates contribute significantly to current local government revenues. **Efficiency**. Low risks from avoidance and evasion. **Predictability**. Councils know the number of properties within their area that are subject to business rates and the business rates liability of those properties.	**Buoyancy**. Business rates bills are determined by market rental values of properties and the attached multipliers. When revaluations occur they are revenue neutral, meaning that overall business rates revenues do not rise in line with economic activity. **Transparency**. For instance, the valuation process lacks transparency for those paying the tax, leading to more challenges and appeals. **Incentivising**. A disincentive for businesses to invest in the property they occupy. An incentive for councils to grow local economies if they retain business rates revenues.	**Fairness**. Business rates do not necessarily reflect real market rents (due to the time taken between revaluations), the activity of the business, or the ability to pay. Some argue that exemptions for student accommodation, agricultural land and charities should not exist.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Reformed business rates. Including valuation reform – publication of methodologies, defining liability on the basis of statute rather than case law, and a time limit on appeals. Giving councils the power to vary multipliers by property type and more discretion over reliefs. Tightening up action against the abuse of reliefs.	**Sufficiency**. Reforms as described would still mean significant revenue. **Efficiency**. Nothing to suggest that efficiency would decrease after reform. **Predictability**. The number of properties subject to business rates in a council area would remain known, as well as their liability. **Transparency**. Some reforms are directly targeted at greater transparency through valuation reform. **Incentivising**. Possible incentives for business to remain open / grow could be achieved if local areas could tailor multipliers and reliefs to local conditions. Greater local retention of business rates would encourage councils to support business growth. Note that Government's recent reforms are targeted at incentivising behaviour – temporary reliefs for retail, hospitality and leisure businesses, as well as for investment in net zero and productivity enhancing adjustments.	**Buoyancy**. There may be more buoyancy from more regular revaluations if rates better reflected up-to-date open market rents. **Fairness**: Some more fairness may be gained from local multipliers and local reliefs, with different business activities being taken into account. However, it is impossible to know what each council area would do with new powers.	No principles fell into this category.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Road charging (including congestion charging and clean air zones).	**Sufficiency**. Every council has roads that charges can apply to and gain revenue from. **Efficiency**. Electronic systems seem to be an efficient form of collection. **Transparency**. As long as where the charge applies and at what rate are clear, then it is transparent. **Incentivising**. These schemes exist to incentivise behaviour change.	**Fairness**. Those who use road infrastructure and those who pollute, pay for it. But it is not linked to the ability to pay.	**Buoyancy**. The idea behind these schemes is to disincentivise activity, and so are not linked to inflation or economic activity. **Predictability**. Unknowns include the rate at which electric vehicles will be adopted and how many journeys will be disincentivised.
Workplace parking levy.	**Sufficiency**. Would vary by council area, but could be applied everywhere. Revenues unlikely to be large, however. **Efficiency**. Successful precedents suggest the cost of collection is not too high. **Predictability**. It is known how many car parking spaces there are. **Transparency**. Straightforward to understand what is being taxed. **Incentivising**. These schemes are designed to change behaviour.	**Fairness**. Not linked to the ability to pay, but are based upon stopping carbon emissions.	**Buoyancy**. Revenues are linked to car parking spaces of employers, not economic activity or inflation.

Table three: Current national revenue sources judged against the principles of revenue reform

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Health and social care levy. A 1.25% Health and social care levy based on how national insurance contributions (NICs) are collected. The revenues will be ringfenced to fund increased health and social care spending.	**Sufficiency**. With revenues in the billions of pounds, could contribute significantly to sufficiency. **Buoyancy**. Receipts rise in line with economic growth. **Efficiency**. Based on NICs, it has established collection mechanisms. **Predictability**. Revenues are relatively predictable, although do move with the economic cycle. **Transparency**. It is clear how much tax people and businesses pay.	**Fairness**. The greater a person's income, the more they and businesses tend to pay in tax. But does not reflect the ability of the business to pay.	**Incentivising**. There may be some disincentive for businesses to hire or an incentive to restrict wage increases.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Stamp duty land tax. SDLT is paid upon the purchase of a property. Different rates of SDLT are paid on different portions of the purchase price.	**Sufficiency**. Could potentially provide significant revenues. **Buoyancy**. Proportional to property values that can move in line with economic growth. **Fairness**. Tax is proportional to the value of property bought. **Efficiency**. Established collection mechanisms. **Transparency**. It is clear how much stamp duty is due on a property before purchase at a particular price.	**Predictability**. The number of housing transactions in an area could be relatively predictable, but house prices can fluctuate differently in different areas.	**Incentivising**. Means that people are less likely to trade up or trade down in property. A barrier to moving to take advantage of job opportunities.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Income tax. Income tax is paid at different rates within different bands of income.	**Sufficiency**. A large generator of revenue nationally and could generate a lot locally. **Buoyancy**. Receipts rise with economic growth. **Fairness**. The more income a person has, the greater the tax they tend to pay. **Efficiency**. Established collection mechanisms. **Predictability**. Revenues are relatively predictable, although do move with the economic cycle. **Transparency**. It is clear how much tax is paid. **Incentivising**. Clear invectives for councils to increase employment in their local areas.	No principles fell into this category.	No principles fell into this category.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Vehicle excise duty (VED). Rates vary according to how polluting a car is and when it is registered.	**Sufficiency**. Will contribute to sufficiency, although not as significant as some areas. **Predictability**. The details of vehicle ownership are known, meaning that tax revenues can be straightforwardly modelled. **Transparency.** There is readily accessible information on how vehicles are taxed and why.	**Fairness**. Not linked to the ability to pay. But those with more polluting vehicles pay more. **Efficiency**. The tax has established collection mechanisms but has seen increased evasion. **Incentivising**. No incentives for councils to promote growth, although some incentives to reduce environmental harm.	**Buoyancy**. Revenues are not linked to economic growth and depend upon central government decision-making about the rates that apply.
Inheritance tax (IHT). IHT is a tax on the estate (the property, money and possessions) of someone who has died.	**Sufficiency**. Will contribute to sufficiency. **Predictability**. Established tax with little variation in revenues. **Transparency**. It is clear what has to be paid and when.	**Fairness**. The public tend to think it is unfair, but economists tend to think it is fair. **Efficiency**. Can be subject to avoidance.	**Buoyancy**. Revenues are not linked to economic growth. **Incentivising**. Possibly creates negative incentives to avoid tax.

Table four: New local government revenue sources judged against the principles of revenue reform

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
A proportional tax on domestic property. A tax rate to be nationally set at a fixed percentage of a property's value. The greater the value of the property, the greater the amount of tax will be due.	**Sufficiency**. Could in theory contribute significant sums to sufficiency (although is often discussed as a replacement to council tax). **Buoyancy**. The values of houses are linked to the strength of the economy. **Fairness**. Because it is proportional to the value of the property it is linked to the ability to pay. **Efficiency**. Households currently get charged on the value of their property via council tax and there is no reason to think a proportional tax would be more difficult to collect.	**Predictability**. The number of houses in a local area is known. On the other hand, house prices fluctuate and can fluctuate differently across local areas. **Transparency**. While a tax rate as a proportion of the value of the property is something straightforward to comprehend, it is easy to see how valuations of the property may come under scrutiny.	**Incentivising**. Some incentive to build houses, but likely to be small.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
A land value tax (LVT). An LVT is an annual levy on the ownership of land (whatever its use, ie for domestic or business use). The levy would be on the 'rental value' of land, and not factor in buildings and other developments.	**Sufficiency**. Would contribute to sufficiency, although the potential revenues are unclear. **Buoyancy**. As local economies grow so too will the value of land (although not in every case). **Fairness**. Captures unearned gains from increases in the value of land. **Incentivising**. Incentivises for councils to increase the value of land.	**Efficiency**. Difficult to understand how it will work in practice. **Predictability**. Once established, it may be that revenues are predictable if values are either uprated or regularly revalued. **Transparency**. Possibly a lack of understanding about how valuations occur.	No principles fell into this category.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
A payroll tax. Taxes that are paid by employers, employees or the self-employed, either as a proportion of wage or as a fixed amount per person.	**Sufficiency**. Potentially significant contributions. Buoyancy. As incomes rise along with the economic growth, so too will revenues from a payroll tax. **Fairness**. Revenues would be proportional to income, meaning those who earn more then pay more. **Efficiency**. There are collection systems already in place for payroll taxes. **Predictability**. Known numbers of people employed within a certain area and their salaries, would make modelling these revenues relatively straightforward. **Transparency**. It is easy to understand that the tax is paid on earnings and the more that is earned the more that is paid.	**Incentivising**. There is an incentive to grow employment if the payroll tax is paid employees; a disincentive for businesses to hire if they pay the payroll tax.	No principles fell into this category.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
A sales levy (which could be a specific e-commerce levy). This would be a tax on consumption, similar to how VAT is charged now, with the levy being a percentage of the value of a transaction, eg 1%. The tax could apply to specific types of transaction, such as those related to e-commerce.	**Sufficiency**. Potentially significant, but it depends which sales are being taxed. **Buoyancy**. As sales rise with economic activity then it would be relatively buoyant. **Predictability**. VAT revenues are relatively predictable, and this should apply to other sales taxes too. **Transparency**. Sales taxes are easy to understand. **Incentivising**. A sales tax would incentivise councils to try and grow the local economy and generate more revenue.	**Fairness**. If it is a flat rate then it could be considered regressive. However, the extent of being regressive would be dictated by the goods and services to which the tax applied. **Efficiency**. A sales tax may be efficient to collect because the VAT system does something similar in terms of collection. An e-commerce levy may be something that is harder to efficiently collect.	No principles fell into this category.

REVENUE SOURCE	PRINCIPLES MET	PRINCIPLES PARTIALLY MET	PRINCIPLES NOT MET
Tourist levy. There are several options for how a tourist levy could be designed. For example, hotel occupancy could be charged, but the charge itself could be a flat fee, a percentage fee, per person, per room, or several other variations.	**Sufficiency**. Will likely only be small contributions. **Fairness**. Tourist levies could be perceived as fair as tourism imposes a cost on local infrastructure, usually picked up by residents. **Efficiency**. Tourist levies successfully operate around the world **Transparency**. Tourist taxes are easy to understand by those paying (and those who have travelled overseas before will likely have encountered them previously).	**Predictability**. So long as tourist numbers are predictable, then so revenues will be. But there will be initial uncertainty. **Incentivising**. Incentives to grow the visitor economy. Although potentially a disincentive for tourists to come.	**Buoyancy**. While a tourist levy could be designed to be buoyant, they are generally flat rate.
A single property tax (replacing council tax and business rates). Every "real property", regardless of size, is assessed. Real property is defined as land and any permanent structures attached to it. Examples of real property are houses, office buildings, vacant land, farms, apartments, factories, restaurants, and mobile homes.	**Sufficiency**. Potentially significant, but unclear how it would fit with other taxes. **Buoyancy**. The value of property is linked to the strength of the economy. **Fairness**. Linked to the ability to pay. **Efficiency**. Precedents from elsewhere. **Incentivising**. An incentive to build more property of all types.	**Predictable**. Known number of properties, but unpredictability in pricing. **Transparency**. Valuations could come under scrutiny, but tax rates should be transparent.	No principles fell into this category.

Conclusion

Table five outlines how local government revenue financing could be reformed to address the four issues identified with local government revenue financing.

Table five: Issues with local government revenue financing and what reform could look like

IDENTIFIED ISSUE	WHAT REFORM COULD LOOK LIKE
It does not provide sufficient revenue to fund quality services. All types of revenue reform could increase revenue for councils in theory, thereby meeting the **sufficiency** principle. Having revenues that are **buoyant** and **predictable** would also be desirable.	**For current local government revenue sources**, reformed council tax and reformed business rates would be the clearest options to meet the sufficiency, buoyancy and predictable principles. While our analysis suggests that these revenues do not meet the principle of buoyancy, they both meet the sufficiency and predictability principle (and have other features that make them more desirable than the current system). **For assigning or devolving national taxes**, assigning or devolving income tax meets all principles. The health and social care levy and SDLT would be joint second on the list. **For new local taxes**, a payroll tax and a sales levy meet the principles according to our analysis.
It is unfair, ie not linked to the ability to pay. Solutions to this problem would focus on those taxes meeting the fairness principle.	**For current local government revenue sources**, reformed council tax is the only revenue source that fully meets the fairness principle. All other options only partially meet it (and the current business rates system does not meet it at all). **For assigning or devolving national taxes**, income tax and SDLT meet the fairness test, although SDLT would be regarded as inferior to income tax because it is less predictable and less incentivising. **For new local taxes**, all options but a sales levy meet the fairness principle (although it depends how a sales levy is designed). But of all the options a payroll tax meets most other principles.

IDENTIFIED ISSUE	WHAT REFORM COULD LOOK LIKE
It does little to support local economic development. Solutions to this problem mostly relate to the incentivising principle.	**For current local government revenue sources**, a reformed business rates system could be used to better encourage business growth in the local area. For assigning or devolving national taxes, only income tax comes out as strongly incentivising local economic development in that is would encourage employment growth. For new local taxes, a land value tax would incentivise councils to increase the value of land, a sales tax would incentivise more economic activity and a single property tax would incentivise local growth.
It does not incentivise better societal outcomes. Solutions to this problem mostly relate to the incentivising principle	**For current local government revenue sources**, road charging and workplace parking levies can have an impact on local carbon emissions. **For assigning or devolving national taxes**, there are very few options that could be said to incentivise better societal outcomes. **For new local taxes**, there are very few options that could be said to incentivise better societal outcomes.

There are three conclusions that can be drawn from the above:

- **Reform of the current system will go some way to addressing the problems with local government revenues.** A reformed council tax and business rates system will help to address issues of sufficiency, unfairness and supporting local economies. Looking to assigned and devolved national taxes, income tax is the revenue source that meets most of the principles.
- **Being clear on what local government is 'for' will guide which reforms are most necessary**. If councils are just to be delivery arms of central government then issues around sufficiency and fairness are more important than incentivising local economic growth or enabling better societal outcomes. If councils are to be free to have significant autonomy in local areas then the incentivising principle becomes more important.
- **There are some options for local revenue reform that should be discarded**. They don't meet enough of the principles for good revenue reform and they do not address any of the problems with revenue financing. Localising IHT and VED fit into this category. There are others that would only be pursued if an overhaul of the system were to be considered. There are many merits, for instance, in replacing council tax with a proportional property tax or single property tax, but large transition costs to implementing them.

Introduction

What does this report do?

This report analyses the options for reforming local government revenue financing. These options sit under three headings:

1. **The current system and reforming the current system.** Looking at council tax, business rates and smaller revenue sources (sales, fees and charges, road user charges and workplace parking levies).
2. **Making national taxes local.** Looking at how some, or all, revenue from existing national taxes – such as Income tax or national insurance – could be assigned to council areas. Or how the control of revenues from existing national taxes could be devolved to council areas, in full or in part.
3. **Introducing new local taxes.** Looking at how entirely new revenue sources could be implemented by councils, such as a tourist levy or a proportional property tax.

Options for reform under each of the above headings are assessed against a set of principles that the LGA argue should guide the design of local government revenue financing. The reason for assessing reform in this way is to produce, as far as is possible, an objective comparison of the options.

The overarching purpose of the report is to contribute to the debate on a sustainable local government finance system, particularly following the funding announcements and local government finance reforms announced in the 2021 Budget and Spending Review.

What is the context?

The Chancellor delivered a Budget and Spending Review in October 2021 containing significant announcements on local government revenue financing. These announcements included £4.8 billion in grant funding for local government over the next three years, which will help to pay for some of the increasing service demand pressures that councils face. Reforms to the business rates system were set out, including measures designed to support high streets and incentivise net zero investment. It was stated that the pros and cons of further reform will be looked at, in particular the possibility of an online sales tax that could be used to fund further reductions in business rates.

Despite these announcements and reforms, significant issues remain over the future of local government revenue financing. LGA analysis has suggested that even after taking the increased grant funding into account, councils will face at least a £1 billion shortfall in their ability to keep services at their 2019/20 levels in terms of quality and access in 2024/25.[1]

This future funding gap is set against the background of council revenues have been significantly squeezed in recent years. The post-financial crisis period of austerity saw total local government spending fall by 19 per cent in real terms from 2009 to 2018.[2] More recently, the National Audit Office (NAO) has estimated that councils lost income of £9.7 billion in 2020/21 because of the COVID-19 pandemic.[3] Analysis from the Spending Review found that, despite substantial increases in public spending being announced, local government spending will be substantially less in 2024-25 than it was in 2010.[4]

One particular area of concern is the ability of councils to deliver social care services. The Government has announced £5.4 billion of funding over the next three years to introduce social care reforms (of which only £3.6 billion will go directly to local authorities), but the Institute for Fiscal Studies (IFS) has said that this is unlikely to be sufficient to deliver its social care ambitions in full. The think tank estimates that by the second half of the 2020s, the reforms could require up to an additional £5 billion every year.[5]

In addition to the overall quantum of revenues, question marks have been raised by experts and commentators over the quality of the economic, social and environmental outcomes arising from how local revenues are raised. For instance, some argue that the current system has contributed to the decline of the high street and others say that it is increasingly unfair.

There has been some reform of local government revenue financing in recent years. For instance, council tax referendum limits, greater retention of business rates and the Social Care Precept have all been introduced in the last decade. There have also been detailed reviews of how councils are funded (some of which are ongoing). While this has not been insignificant change, it has also not been a fundamental reform of the system.

Why does it matter?

There are four main reasons why reforming local government revenue financing should be considered by policymakers:

- **It could support councils delivering services to a higher standard.** Transport policy, the planning system, household waste and recycling, and homelessness are just some of the areas where councils have significant influence (and has a statutory responsibility to do so). Councils are also responsible for social care provision and will be front and centre of delivering the social care reforms recently announced by the government. Funding cuts have damaged the ability of councils to adequately deliver services, which in turn damages our economy and society. Indeed, the LGA argues that councils can only provide services at pre-pandemic levels in 2022/23 if council tax is raised by the maximum amount permitted, meaning councils face the choice of bringing in funding or placing a significant burden on households during a time when the cost of living is rising.
- **It could mean the UK taxation system is fairer.** For instance, by ensuring that the tax liability is proportional to the ability to pay.
- **It could give councils more tools to encourage local growth.** Councils have few levers to tailor local revenue-raising to suit local economic conditions. More flexibility in local government revenue financing would allow economic resources to be used more efficiently, with decisions on how these resources taken as close to citizens as is possible.[6] For example, flexibility could mean altering the business rates system to encourage thriving high streets that face stiff competition from online retail. This could in turn help to support the government's levelling-up agenda.
- **It could enable councils to deliver policies that have a wider societal benefit.** A good example would be the Government's ambition to reach net zero greenhouse gas emissions by 2050. Local taxation – such as congestion charging and levies on waste – can change behaviour and contribute to better environmental outcomes.

There are degrees to which the above bullet points matter, depending on what the government thinks the purpose of local government is. For instance, if the purpose of councils is just to be a delivery arm of central government then revenue financing would probably need to look very different than if the purpose of councils is to be powerful local institutions that are free to influence economic and social outcomes in their local areas.[7]

How is the report structured?

The rest of this report is set out as follows:

1. An overview of the current system of local government finance.
2. A comparison of options for local government revenue reform – setting out the principles to underpin reform, and assessing how current local taxes, reformed current local taxes, national taxes made local and entirely new local taxes perform against these principles.
3. A conclusion.

An overview of the current system

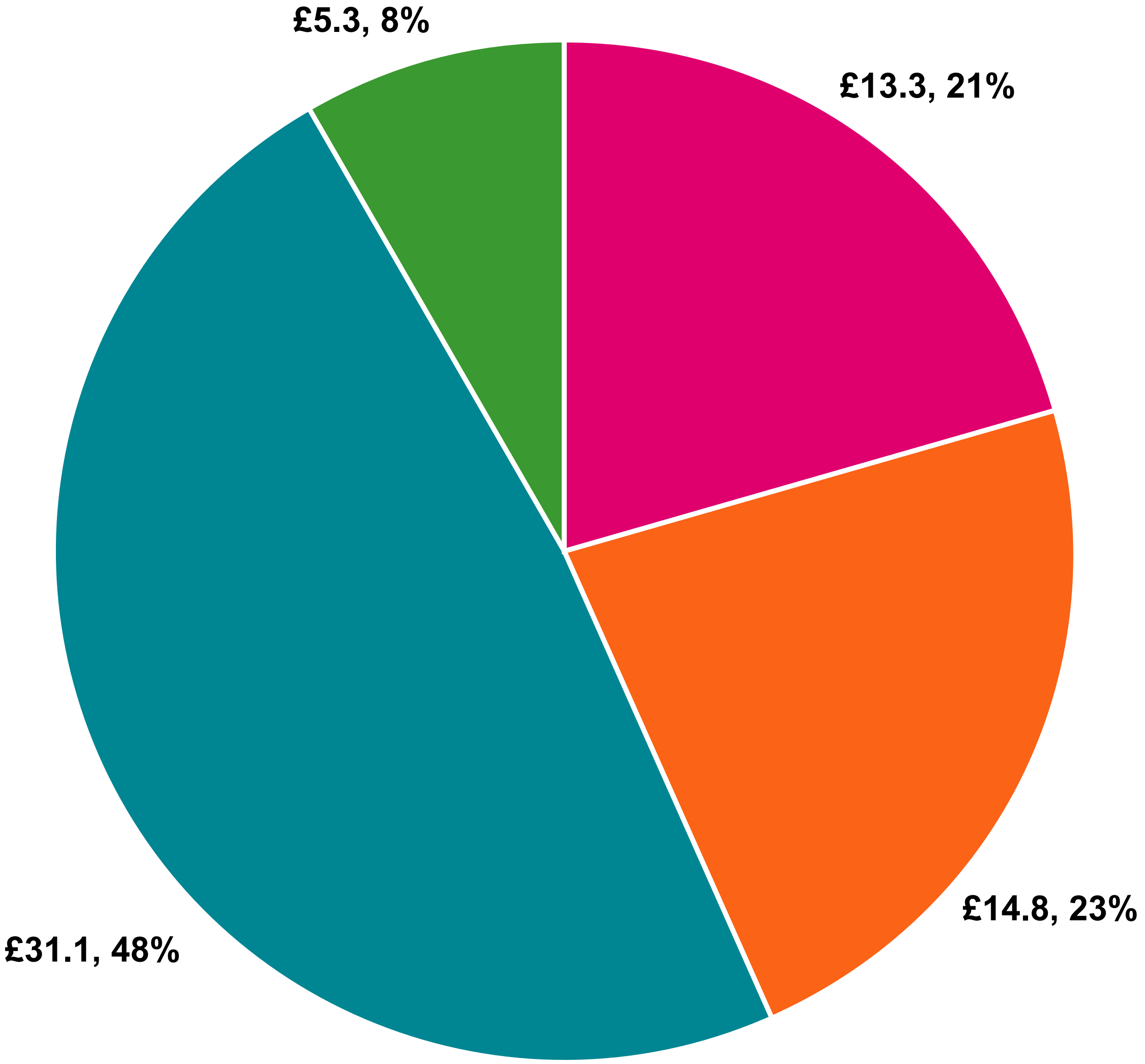
What are the sources of local government revenue financing?

Councils have access to four main sources of revenue:

1. **Council tax**. A tax paid by the occupiers of residential properties.
2. **The Settlement Funding Assessment**. Which includes locally retained business rates (a tax on commercial properties, with tax liability for individual properties based upon open market rental values) and the central government determined Revenue Support Grant.
3. **Other central government grants and incentives**. These include the Better Care Fund and the New Homes Bonus. Ring-fenced grants that are simply passed on via councils, such as education budgets, are not included.
4. **Sales, fees and charges**. There are many and varied examples of where councils generate revenue from sales, fees and charges. They include parking, cultural attractions (such as museums), planning applications, leisure centres and registrar services.[8] These types of revenue were significantly affected by the pandemic, with councils forecasting £2.1 billion in lost sales, fees and charges income in 2020/21.[9]

The contribution of each of these sources of council revenue can be seen in chart one, below.

Chart one: Local government core spending power, England, 2021/22 (£billion, % of total)



	£13.3, 21%	Sales, fees and charges
	£14.8, 23%	Settlement Funding Assessment (business rates and Revenue Support Grant)
	£31.1, 48%	Council Tax
	£5.3, 8%	Government Grants and Incentives (excluding Revenue Support Grant, including New Home Bonus and Better Care Fund etc.)

Source: MHCLG, Core Spending Power[10]

How are these revenue sources managed?

Councils must manage various competing priorities, whilst being accountable to their electorate. For instance, rural councils face different types of spending pressures from urban councils. In some areas, there are two tiers of councils (counties and shire districts), with each tier having responsibility for different services.

London boroughs and metropolitan boroughs, shire districts and unitary councils (known as 'billing authorities') collect council tax and business rates. Billing authorities also have responsibility for collecting revenues for parts of police and fire services through precepts as a component of council tax.

The Government places various constraints on how councils are funded. For example, the government requires a council to hold a referendum if it intends to raise council tax by more than certain percentage (the percentage increase allowed has changed since the requirement was introduced in 2012/13).

There are also mechanisms to close the gaps between those councils that have greater financial resources than spending need and those councils that have greater spending need than financial resources.[1]

What is the future direction for local government revenue?

There are big questions around the main components of local government revenue financing:

- **Business rates**. HM Treasury has undertaken a fundamental review of business rates. The review looked at: reducing the overall burden on business; improving the current business rates system; and considering more fundamental changes in the medium-to-long term. There are also debates to be had about whether the amount of business rates revenue councils can retain should change. And, as noted above, HM Treasury will look further at how an online sales levy would work, which may interact with the business rates system.
- **Council tax.** At present, councils with responsibility for social care can increase council tax levels above the threshold required for holding a referendum to help fund social care services.
- **Grants**. Previous LGA research has found that in any given year, councils received around 250 grants and more than a third were discontinued from one year to the next. Moreover, some grants are ringfenced and simply get passed on by councils to their final destination, such as schools.[11] The last 10 years have seen the contribution of grants to overall local government revenue falling. That said, the support measures provided by the government to offset the impact of the pandemic since

1 These mechanisms include: funding formulas that calculate the spending needs faced by councils (although, new formulas are still being debated though the process that is called the Fair Funding Review); and business rates 'tariffs' and 'top-ups' where business rates revenues retained locally are adjusted up or down based upon the ability of individual councils to generate income.

2019/20 has resulted in a temporary boost to grant funding.

- **Sales, fees and charges**. There are central government restrictions on the implementation of sales, fees and charges, which it has been argued could be removed to allow more flexibilities for local government spending.[12] There is also a debate about fairness in applying charges, and whether some should be funded more generally out of council tax.

What are the relevant LGA positions on local government finance?

The LGA has a range of policy positions that are relevant to local government finance reform. These policy positions broadly fit into five categories:

1. **Increased funding for councils**. The LGA's initial analysis at the time of the 2021 Spending Review suggested that councils will face at least a £1 billion shortfall in their ability to keep services at their 2019/20 levels in terms of quality and access in 2024/25 (and it does not deal with pre-existing pressures such as the adult social care provider market and funding children's social care).[13]

2. **Certainty of funding for councils.** Councils have received one-year funding envelopes for four years in a row now (the latest being published in December 2021 for 2022/23), creating an obstacle to councils making innovative financial planning decisions. In addition, the LGA argues that without certainty councils may plan on the assumption that they will have less funding available than actually comes to pass, causing them to needlessly scale back non-statutory services and to make redundancies.[14]

3. **Reforms to council tax.** The LGA has called for the council tax referendum limit to be abolished for all local authority types, for councils to have the powers to vary council tax discounts and for councils to be able to charge developers full council tax for every unbuilt development from the point that the original planning permission expires. The LGA is also clear that clear that council tax is not the solution to filling the identified gap in council revenue financing.

4. **Reforms to business rates.** The LGA has called for business rate reliefs to be set locally, rather than centrally to allow councils to better tailor reliefs to the needs of the local economy and to incentivise other behaviour, such as new green investments. The LGA has also called for:

    - local government to be able to set its own business rates multiplier and would like to see flexibility to set a multiplier (p in the £) above or below the nationally set multiplier

    - a review of exemptions and tightening up on the abuse of reliefs (highlighting that charity exemptions are particularly open to abuse)

- confirmation of whether and when each of the planned business rates reforms will be implemented, including business rates retention and the business rates reset. Like the argument for longer-term finance settlements, certainty would aid council financial planning and better public services.

The LGA has welcomed that the Government is consulting on proposals for an online levy as part of its business rates review, however, argue that the proceeds of such a levy should be retained by local government as a way to diversify the local taxbase and protect against further shifts in the balance between traditional and online retail.

5. **Widen the sources of income for councils.** At present, councils rely heavily on council tax and business rates for their income. Although have not specified additional sources of funding or number of sources.

There are other organisations that have asks to reform the local government revenues too. For instance, a recent commission by the APSE local government commission neatly summarise some of these asks:[15]

"First, support for place-based budgeting. Second, support for additional sources of revenue. Third, improved relationships with central governments around grant funding, and the need for continued redistribution. Fourth, greater flexibility: opposition to 'bid and pilot' culture, and broader powers to borrow and invest".

What else needs to be considered?

Stakeholder interviews that contributed to this report highlighted three other areas that should be considered in terms of reform of local government finance:

1. **The politics of change.** It is not easy to change the tax system, even if there is a strong economic / social case for doing so. For instance, even if councils could increase council tax rates above the referendum threshold, the political unpopularity of the move may make it impossible to enact. Moreover, the reason that it is politically unpopular may be that households are already struggling to make ends meet due to the rising cost of living.

2. **Invest to save / invest to grow.** Councils were keen to highlight that sufficient revenue does not just mean covering day-to-day spending needs but highlighted that they wanted funding to invest in interventions that could ultimately save money further down the line (such as homelessness prevention), or that could grow the local economy.

3. **Making the local link.** Several council representatives felt that the link between what residents pay in local taxation and what they get back in local services needs to be strengthened, as this is a key plank of local democracy.

Comparing options for local government revenue reform

This chapter sets out the principles that the LGA state should underpin local government revenue reform (see the LGA's response to the business rates review). It then assesses whether different current and reformed revenue sources meet those principles. A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

The principles for local government revenue reform

Table six below lists the LGA's principles for local government revenue reform, and describes the tests used to assess whether a revenue source would meet the principle.

It should be noted that the tests to assess whether a principle for reform has been met will not always result in a straight 'yes' or 'no' answer. For instance, the test for meeting the principle of buoyancy is whether revenues increase as economic activity increases – some revenues may have a stronger relationship with economic activity than others.

It should also be noted that some of these principles may be regarded as more important than others. For instance, if a revenue source met the principle of fairly funding local government services then meeting the buoyancy principle may be regarded as less important. Some of these trade-offs are discussed in the conclusion of the report.

With the above in mind, the principles and their tests should be regarded as an analytical framework through which options for reform can be assessed against each other consistently and objectively, and not as the final answer for how local government revenues should be reformed.

Table six: Description of the principles to underpin local government revenue reform and of tests to meet principles

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Sufficiency 'financing for local government services must be sufficient'	**Can the revenue source contribute to financing spending in every council area?** At present, councils receive revenue from a variety of sources. Some of these revenues are collected directly, such as council tax and business rates. Some of these revenues come indirectly from central government grants, which are funded by national taxes and borrowing. Because council revenues currently come from multiple sources, the assumption in this analysis is that sufficiency will be achieved with revenues from multiple sources following reform too, ie local government should not be funded by one revenue source. In this sense, all revenue reforms that increase local government revenues would contribute to sufficiency. Even a relatively small amount – for example from a tourist levy – would contribute to council revenues being sufficient. Hence, we assume that the sufficiency principle is always met. Although, more generally, larger sources of revenue would be go much further to making the system as a whole receive sufficient revenue (for example if the health and social care levy were devoted to meeting existing pressures). However, there are factors that could change by how much a reform contributes to sufficiency, ie economic changes. These factors are discussed where they arise.
Buoyancy 'rises along with economic activity with protection for local government from losses in income given the need to support local government services'	**Do revenues automatically increase as economic activity increases?** For example, corporation tax, VAT and income tax are thought to be buoyant taxes, as the yield from them tends to rise automatically with inflation and economic growth.[16] Where yields decline in line with inflation and economic growth, other forms of revenue financing would fill the revenue gap for councils, such as grant funding.

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Fairness 'the taxpayer makes a fair contribution and the taxbase is not too narrow'	**Do revenues relate to the ability to pay?** **and / or** **Does liability relate directly to an activity that it is desirable to discourage?** Fairness in tax can be a subjective concept – what seems fair to one person may seem decidedly unfair to another. For example, public polling asking respondents whether they thought stamp duty was fair reported 22% of respondents agreeing that it was fair, 30% stating that it was unfair, 24% said neither and 23% said they were not sure.[17] However, there would seem to be a consensus that those who are have a greater ability to pay tax should pay more in tax. There is also some evidence of a consensus that is it is fair to tax activities that are harmful to health and the environment, regardless of the ability to pay.[18] **One additional point to consider is fairness across areas**. For instance, whether different places have much bigger tax bases relative to others. This is not considered under this principle, as the system of local government finance can always use redistribution mechanisms to account for these different sized tax bases.
Efficiency 'any tax should be efficient to collect; if the costs of administration and collection of a tax are high then the net yield will be lower than it would be for a more efficient tax'	**Would the costs of collection be too high?** The majority of taxes discussed in this analysis are already collected, meaning that they are deemed efficient enough to collect at present. With this in mind, this principle looks at whether reform will reduce efficiency. Or if it is a new tax, whether efficiency in collection may be worse than the current system.

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Predictability 'income from a tax / revenue should be predictable'	**Is the revenue source, and how it might change, well understood?** For example, property taxation lends itself to being predictable because the number of properties liable to pay the tax are known, and the tax is likely to be difficult to avoid. Revenue from a tourist levy may be regarded as unpredictable – there is some data that allows estimates of potential yield, but it comes with large amounts of uncertainty attached. It should be noted that there will always be some element of unpredictability, given the ups and downs of the economy and how that tends to affect revenues. The analysis looks for evidence of unpredictability outside of the economic cycle. It should also be noted that revenues from grant funding are not predictable when there are short-term funding settlements.
Transparency 'it should also be relatively straightforward to work out how the tax has been derived'	**Can the tax be understood by those who are liable to pay it? Or by those responsible for deciding rates and administering it?** An example of where a tax may not be transparent is that of business rates, where the valuation process of properties is often seen as lacking transparency.

PRINCIPLE	TEST TO MEET THE PRINCIPLE
Incentivising 'incentives should be provided to both business and local government'	**Does the revenue incentivise councils to pursue growth policies?** This broadly means councils being able to keep the revenues from growing their local tax bases. For instance, one of the rationales for the move to councils being able to retain more business rates revenues was for it to encourage greater business growth. **Does the revenue disincentivise business growth?** The disincentivising effect could be levelled at any tax that places a new burden on business. However, this applies to different extents. **Does it incentivise broader policy goals?** For example, a revenue source may be implemented that does not support local economic growth or business growth but would contribute to reducing harmful greenhouse gas emissions. It is important to note that some revenue sources can create undesirable incentives, regardless of whether they are national or local. For instance, SDLT would disincentivise trading up or trading down as a national revenue or as an assigned revenue source.

The current system and a reformed current system

This section looks at council tax and business rates separately in the first instance. A table sets out how each revenue source is implemented and its yield. This is followed by a table assessing if the revenue source meets each principle of reform, and a further table looking at how reform of the revenue source alters whether each principle is met (using the traffic light system described above).

Following this, the section looks at smaller revenue sources – sales, fees and charges (charged across the country), as well as congestion charging and workplace charging levies, which have been implemented in a handful of places.

Council tax

Council tax is a significant source of revenue for councils. And its significance has been growing in recent years as government grants have reduced. Revenues from council tax are fully retained by local government. Table seven outlines how council tax is designed and the revenues that are derived from it.

Table seven: Information on implementation and yield associated with council tax

REVENUE SOURCE	IMPLEMENTATION	YIELD
Council tax	Council tax is paid by adults who own or rent a home. Not every adult pays in full. There are some discounts for households with only one council tax paying adult, students, the disabled and on second or empty homes.[19] A house or flat is assigned a council tax band by the Valuation Office Agency, based upon the property's value in 1991. There are eight bands, assigned a letter from A to H. The later the letter in the alphabet, the more council tax the property occupier has to pay. Councils cannot raise council tax by any amount, having to hold a referendum to raise it above a certain percentage (the percentage is set by the Secretary of State). Since 2016/17 social care authorities have been able to increase council tax under the social care precept (in 2021/22 this is 3% above the referendum limit). Of 152 authorities with adult social care responsibilities, 148 utilised some, or all, of the precept in 2021/22.[20]	English councils expected to raise £33.8bn in council tax in 2021/22.[21] This has risen from £27.2bn in 2017/18.[22] The average Band D council tax set by English councils for 2021/22 is £1,898, an increase of £81 or 4.4% on the 2020/21 figure of £1,818.[23]

The principles of revenue reform not met by the current design of council tax are buoyancy, fairness, transparency and incentivising (see table eight, below). Of these, the issue around fairness is the most prominent among critics of the current council tax system. As the IFS states, 'two households living in equally valuable properties in the same local authority can find themselves paying tax bills hundreds of pounds apart just because their properties used to be worth different amounts in 1991.' [24] The principles of sufficiency, efficiency and predictability are met.

Table eight: Council tax assessed against principles of local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISING
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the revenue source, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or disincentivise business growth?
Council tax	Green (the principle is fully met) Council tax already contributes a significant amount to local government revenue sources in every part of the country.	Red (the principle is not met) Increases in council tax are political decisions for councillors (albeit with decisions influenced by central government parameters). One caveat is that as economic activity rises, the taxbase could increase (more houses get built and pay council tax and more people are in employment and are able to pay). However, these increases are not automatic. Historic levels of council tax are the base from which increases are capped. Historic council tax levels reflect previous local political decisions, but also historic grant distribution and ability to raise other income.	Amber (the principle is partially met) Places with high house prices pay relatively less than places with low house prices. Equally, those living in higher value houses will not necessarily have a higher income, ie they are asset rich and cash poor. Council Tax Support (CTS) does mean that councils can reduce the burden for working age residents on low incomes. Reductions for pensioners are also available but are determined by central government. The IFS has found that even after applying CTS, those on lower incomes tend to pay more in council tax as a proportion of household income than those on higher incomes.[25] There is a mandatory single person discount. This may seem fair as single people use fewer services, but more wealthy single adults getting the discount may seem unfair.	Green (the principle is fully met) Council tax collection is an established system, with no suggestion that collection is inefficient. Collection rates were above 97% before the pandemic (and up around 98% in shire districts).[26]	Green (the principle is fully met) Councils know the council tax bandings of the properties within their areas and how many properties there are within their areas. Councils also know what the levels of council tax are and the maximum they can increase is by.	Amber (the principle is partially met) Council tax is transparent as the higher the value of a property (in 1991), the higher council tax will be. Council tax is not transparent as the banding system is based upon 1991 property values, with the relative size of the council tax liability possibly complex to understand for those that pay it. It could also be argued that council tax discounts are hard to understand. However, no data is collected on council tax discount take-up.[27]	Red (the principle is not met) Council tax on its own does not incentivise desirable activity in either councils or business. Instead, the New Homes Bonus (NHB) rewards councils for additional homes added to the Council Tax Base, thereby seeking to incentivise councils to build more houses, convert more houses or bring new houses into use. Although the scheme has become less generous, revenues from the NHB have been significant for some councils (mainly shire districts). Half of all districts have received payments of 8.7% or more of their revenues in the nine years to 2019/20.[28] Responses to a consultation on the future of the NHB is currently being considered by the Government.[29]

One of the key issues related to council tax is the unequal treatment of similar properties described above, which underpins calls for revaluation and additional council tax bands. Another key issue is how exemptions and discounts are managed, with restrictions on how councils can help vulnerable residents and limits on the funding available to help them. Reforming council tax to address these issues would mean a big shift in how much households pay in council tax (see table nine, below).

Table nine: Information on implementation and yield associated with reformed council tax

REVENUE SOURCE	IMPLEMENTATION	YIELD
Reformed council tax	Reforms could be implemented in the following ways: • **Revaluation**. This would mean assigning properties to council tax bands based upon up-to-date values. The IFS has suggested 'proportional revaluation', where council tax payments are made proportional to the median price with bands. • **Additional bands**. These bands could be added above the current highest bands and / or below the current lowest bands (it is worth noting that the Scottish Government made council tax slightly less regressive by increasing the tax rate on bands above Band D, and the Welsh government introduced an additional band, Band I, in 2005).[30] • **Changes to exemptions and discounts**. There are various ways that this could be done. One of the most called-for is ending the mandatory single-person discount and increasing the funding for local council tax support schemes, allowing councils to implement their own support schemes for vulnerable adults. • **Charge developers full council tax for every unbuilt development from the point that the original planning permission expires**. LGA analysis found that more than one million homes granted planning permission since 2010 have not been built.[31] • **Change referendum limit to £s rather than percentages**. This would be an alternative way of allowing overall increases in council tax.	Because of the different reforms described here – and the different ways of implementing them – assessing yield impact is not straightforward. For instance, revaluation and additional bands could be implemented so that overall yield remains the same, even if the distribution of that yield changed. The same can be said of reforms to exemptions and discounts.

Implementing the reforms set out in table nine would mean more principles of revenue reform would be met (see table ten, below). Meeting the principle of fairness would be the most significant change, as revaluation and additional bands would ensure that people living in more valuable properties would pay a tax that better reflects that higher value. A knock-on effect of revaluation is that banding, and therefore liability, would be easier to understand than currently, ie it would not based on valuations in 1991.

Table ten: A reformed council tax assessed against the principles of local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISING
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the tax base, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or disincentivise business growth?
Reformed council tax	Green (the principle is fully met A reformed council tax could increase / decrease / maintain yield (depending on the approach take to reform). Although, it would still likely contribute significantly to overall local government revenues.	Red (the principle is not met) Reforming council tax would not strengthen the link to economic activity, compared to the current system. This would only happen if revaluation were consistently and repeatedly applied, or an automatic inflation-linked increase were put in place.	Green (the principle is fully met Revaluation and additional bands would mean more households owing council tax better reflecting the relative value of their property. The asset rich and cash poor could see their tax rises deferred if necessary.	Green (the principle is fully met There is nothing to suggest that reform would make collection any less efficient than the current system.	Green (the principle is fully met There is nothing to suggest that reform would make revenues less predictable than the current system.	Green (the principle is fully met It is reasonable to assume that if council tax were based on up-to-date values, it would be easier to understand, ie residents would know that there bill was based on current values, rather than 1991 values.	Red (the principle is not met) A reformed council tax may mean councils are incentivised to allow more house building, but it is unlikely to be a major factor in decisions. The future of the NHB could change this, depending on approach following consultation.

Business rates

The business rates system is a significant source of revenue for councils, which has gone through major reform over the last decade. And there may be more reform to come, with the Government's fundamental review of business rates taking place. Some business rates revenues – but not all – are retained by councils (see table eleven, below).

Table eleven: Information on implementation and yield associated with business rates

REVENUE SOURCE	IMPLEMENTATION	YIELD
Business rates	Business rates are a property tax paid by the occupants of non-domestic properties. There is a long list of reliefs available from full business rates liability, including for small businesses, charities, empty properties, for some rural businesses and within Enterprise Zones.[32] The basic business rates bill is determined by multiplying the rateable value (set by the VOA) of a property by the relevant 'multiplier'.[33] District and unitary councils collect business rates. In England, the revenue is 50% pooled at central government level and redistributed, and 50% retained locally (a 'tariff' or 'top-up' is applied to this 50% local share to balance need and resources at the point of implementation).[34] The tariffs and top-up system can be adjusted using periodic resets. Councils also retain up to 50% of additional business rate revenue that they raise in the period 2013-22. 'Additional revenue' is revenue above a baseline, based on the authority's average business rate revenue in 2011/12 and 2012/13. Pilots have been run whereby councils can retain a greater share of additional business rate revenues.[35] HM Treasury has recently completed a review of business rates. The outcome of it is a suite of reforms, including new reliefs and efforts to improve transparency. These are discussed in the section that looks at a reformed system.	Councils estimate the non-domestic rate income for 2021/22 will be £25.1 billion (this is after taking into account all reliefs).[36] Councils estimate that they will grant a total of £4.7 billion of standard reliefs from business rates in 2021/22.[37] Budget 2021 announced £6bn of further of business rates reliefs have been added in response to the COVID-19 pandemic. These reliefs were primarily for retail, hospitality and leisure businesses in England.[38]

The principles of revenue reform that are not met by the current design of business rates are buoyancy, fairness, transparency and incentivising (see table twelve, below). Of these (and like council tax) the issue of fairness is probably the most prominent among critics of the current system.

Table twelve: Business rates assessed against the principles for local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISNG
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the tax base, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or Does the revenue disincentivise business growth?
Business rates	Green (the principle is fully met) Business rates currently contribute to a large proportion of current local government revenues. The size of this contribution could change if, for example, there is successful lobbying to reduce the business rates burden.	Amber (the principle is partially met) Bills are determined by the market rental value of properties and the 'multipliers' set by the Government. Rental values will rise alongside economic activity, but when revaluations occur they are revenue neutral, meaning that overall business rates revenues do not rise in line with economic activity. Some buoyancy is achieved, however, through the annual uprating of multipliers by CPI inflation (although, the Government is freezing the multiplier in 2022/23).	Red (the principle is not met) The business rates system does not necessarily reflect real market rents (due to the time taken to revalue), the activity of the business, or the ability to pay.[39] Some exemptions could be regarded as unfair. For example, it has been argued that business rates should fully payable on student accommodation, agricultural land and by charities (which get an 80% discount).	Green (the principle is fully met) HM Treasury's recent review of the business rates system argued that one of its main strengths is its efficiency, with low risks from avoidance and evasion.[40]	Green (the principle is fully met) Councils have good sources of information on the properties within their areas and the business rates liability of those properties.	Amber (the principle is partially met) HM Treasury's review of business rates raised concerns that the valuation process lacks transparency for those paying the tax, leading to more challenges and appeals.[41] Anecdotal evidence suggested that ratepayers may not know the split of responsibilities between councils and the Valuation Office Agency. Nevertheless, it is not known how widespread these issues are. The Government has announced action to increase transparency, which are included in the analysis of a reformed system, below.	Amber (the principle is partially met) Numerous organisations have made the argument that business rates are a disincentive for businesses to invest in new property and to upgrade existing properties.[42] Reforms announced by the Government will implement new reliefs for net zero and productivity-enhancing investments (again, discussed alongside a reformed system, set out below). Another point is that where councils can retain the growth in business rates revenues, it is believed to be an incentive to grow the local economy.[43]

Table thirteen, below, describes some of the reforms that could be applied to business rates and offers some commentary on the yield that could be derived from them.

Table thirteen: Information on implementation and yield associated with reformed business rates

REVENUE SOURCE	IMPLEMENTATION	YIELD
Reformed business rates	The following reforms have all been advocated for by the LGA: • **Valuation reform**. Publication of new guidance on valuation methodologies and analysis of rental evidence for each specific property. Defining liability on the basis of statue, rather than case law (which has led to some large vacant sites not paying business rates). A time limit on appeals, and a requirement for ratepayers to provide more data so that valuations take less time, might make more frequent valuations viable. To note, the Government has subsequently announced that it will take action to improve the frequency and transparency of valuations, as well as streamlining the appeals process and introducing time limits from the 2026 list (which the LGA has broadly welcomed). • **Changes to multipliers**. Give councils the power to vary multipliers by property value or property type. This could mean charging a higher multiplier to businesses such as online warehouses in order to support reliefs for other businesses. • **Changes to reliefs**. Giving councils more discretion over reliefs that are centrally determined would enable targeting to suit local economic need. • **Avoidance**. There is evidence of specific avoidance, such as misuse of charitable occupation rules and misuse of insolvency exemptions. There could be a tightening up of the abuse of reliefs. To note, the Government has subsequently announced that it will consult on avoidance (which the LGA has welcomed).	The impact on yield would vary according to the measure implemented. For example, valuation reform as stated may not have any impact. Changes to the multipliers could, as could changes to reliefs. In the case of the latter – and with changes to reliefs – the impact on yield would depend on the individual decisions of councils, whereas the issue of avoidance would depend how successful anti-avoidance measures were.

The reforms set out in table thirteen would mean more principles of revenue reform would be met (see table fourteen, below). The principles of fairness, transparency and incentivising would all be met more fully. The general message is that local discretion over how business rates are charged could (in theory) counter the issues described with the current business rates system. The big unknown would be how councils would use greater discretion – it could be argued that these powers would result in less fairness, transparency and incentivising.

Table fourteen: Reformed business rates assessed against the principles for local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISING
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the tax base, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or disincentivise business growth?
Reformed business rates	Green (the principle is fully met) Reform as described would still mean that significant revenue could be derived from business rates.	Amber (the principle is partially met) The described reforms would not make much difference to buoyancy.	Amber (the principle is partially met) Greater fairness may be gained from local multipliers and reliefs, allowing differentiation between different business activities. For example, high street premises may be given reliefs and out of town warehouses may be asked to pay more. However, how councils would use their new powers is an unknown (and how they use them to try and achieve greater fairness may be subjective).	Green (the principle is fully met) There is nothing to suggest that efficiency would decrease following reform.	Green (the principle is fully met) Revenues would remain predictable after reform. This is because the number of properties in a council area subject to business rates would still be known, as would how they would be taxed.	Green (the principle is fully met) Some of the valuation reforms described would be targeted at greater transparency.	Green (the principle is fully met) Better incentives for business to remain open / grow could be achieved if local areas could tailor multipliers and reliefs to local conditions. Greater local retention of business rates would also incentivise councils to encourage business growth. Some of the Government's recent reforms are targeted at incentivising behaviour – temporary reliefs for retail, hospitality and leisure businesses, as well as for investment in net zero and productivity enhancing adjustments.

Other existing revenue sources

The revenue sources described in table fifteen do not generate anywhere near as much revenue as council tax and business rates. And in the case of congestion charging/clean air zones and the workplace parking levy are only implemented in a handful of places. Yet they are important to consider as the aggregate of smaller revenue sources can contribute a substantial amount to local government coffers, broaden the tax base and be implemented to achieve specific policy aims.

Table fifteen: Information on implementation and yield associated with smaller revenue sources

REVENUE SOURCE	IMPLEMENTATION	YIELD
Sales, fees and charges	Councils can attach fees and charges to many different types of service. But there are rules that restrict how the fees and charges can be applied. For instance, they cannot be applied to services that councils have a legal duty to provide and the income from them must be spent within that service area (parking charges must be used for parking, for example).[44] Income from fees and charges cannot exceed the cost of provision of the service.	Sales, fees and charges raised £13.3bn in 2019/20.
Road charging (including congestion charging and clean air zones)	Councils across the UK can implement road charging schemes (NB: other entities in addition to councils can implement road charging, such as transport bodies). The rationale for implementation tends to be to reduce congestion or to generate environmental benefits (or both). The most obvious example can be found in London, which has three different types of charges for vehicles covering different geographies within the capital.[45] There is a smaller congestion charge scheme in Durham, and numerous toll road charges too. Birmingham and Bath have implemented Clean Air Zones in 2021, with more cities to follow.	Money raised from these schemes typically have to be reinvested into transport related projects. Yields vary according to charging structure, and will in some cases be affected by the success of the policy, ie if congestion is reduced then yields will reduce also.
Workplace parking levy	The workplace parking levy (WPL) is collected by Nottingham City Council – a charge on employers who provide car parking spaces – was enabled by the Transport Act 2000 and implemented in 2012 in Nottingham.[46] All funds raised from the WPL are ring-fenced for investing to meet the objectives of the Local Transport Plan. The WPL has paid for extending the tram network, redeveloping Nottingham Railway Station and improving and maintaining the city's bus service. Other areas can implement a WPL and have considered it, but so far none have followed Nottingham.	Yield in the first few years of operation in Nottingham was around £25m in total.[47]

The smaller revenue sources of road charging and workplace parking levy meet various principles of what good looks like when it comes to raising local revenue, as shown in table sixteen, below. Sales, fees and charges were not considered here because there are so many different varieties of them.

Table sixteen: Smaller revenue sources assessed against the principles for local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISING
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the tax base, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or disincentivise business growth?
Road charging (including	Green (the principle is fully met) Every council area has roads that it can apply a charge to, albeit the revenue raising potential in each area will vary a lot.	Red (the principle is not met) While there may be more journeys when economic activity is higher, the idea behind many of these charges is to disincentivise behaviour, and therefore activity.	Amber (the principle is partially met) In one sense it is regarded as fair that those who use road infrastructure and those who pollute pay for the costs they impose. However, the charges are not linked to the ability to pay.	Green (the principle is fully met) Electronic systems seem to be an efficient form of collection for these types of schemes.	Red (the principle is not met) It is difficult to predict revenues from these sources as there are unknown behaviours, such as the rate at which electric vehicles will be adopted and how many journeys will be disincentivised.	Green (the principle is fully met) As long as where the charge applies and the rate at which it applies are clear then it can be regarded as transparent.	Green (the principle is fully met) The reason to implement these schemes is to incentivise a change in behaviour.
Workplace parking levy	Green (the principle is fully met) There are workplaces in every council area, so theoretically this could apply to the sufficiency of local government spend in every area. Although, potential revenues would vary significantly by area.	Red (the principle is not met) Revenues are linked to car parking spaces of employers, not economic activity or inflation.	Amber (the principle is partially met) The charges are not linked to the ability to pay (especially if they get passed through to employees).	Green (the principle is fully met) The system seems to be efficient in Nottingham.	Green (the principle is fully met) It is known (or straightforwardly found out) how many employers have car parking spaces and so what revenues should be predictable.	Green (the principle is fully met) It is straightforward to understand what is being taxed, why it is being taxed and how it is being taxed.	Green (the principle is fully met) The reason to implement these schemes is to incentivise a change in behaviour, ie stop driving to work and take public transport.

Making national taxes local

There are two ways to make national taxes local:

1. **Assignment of national tax revenues to the council areas where they originated**. For instance, assigning stamp duty to the local area where a property transaction takes place.
2. **Giving local areas the freedom to collect revenues and set rates on all or a portion of current national taxes**. For example, this might be giving council areas control over two percentage points of the income tax rate.

Table seventeen, below, sets out some of the options for making current taxes local, how these taxes are currently implemented, the rationale for localisation and the revenues that the taxes yield.

Table seventeen: Description of making national taxes local implementation, rationale for localisation and revenues

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR LOCALISATION	YIELD
Health and social care levy	The Government has announced plans to introduce a 1.25% health and social care levy based on how national insurance contributions (NICs) are collected. The revenues will be ringfenced to fund increased health and social care spending.[48]	The Government's plan for social care states that:[49] "Specific funding allocations for each Local Authority will be communicated by MHCLG in the usual way through the Local Government Finance Settlement process." As every council area needs revenue to fund social care, it could be argued that all or some revenues from the health and social care levy could be devolved to the places they were raised. Although, there would need to be some element of redistribution as where revenues are raised would not be where they are most needed.	The levy is expected to raise £12bn for health and social care, for the next three years.[50]

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR LOCALISATION	YIELD
Stamp duty land tax (SDLT)	SDLT is paid upon the purchase of a property. Different rates of SDLT are paid on different portions of the purchase price. From October 2021, SDLT rates will be:[51] • zero on properties up to £125,000 • 2% on properties of £125,000 to £250,000 • 5% on properties of £250,001 to £925,000. • 10% on properties of £925,001 to £1.5 million. • 12% on properties above £1.5 million.	In terms of assignment, the rationale is that a property being bought is fixed in a particular area. Hence it is straightforward to understand where tax revenues originate and should be assigned. In terms of freedom to collect revenues and set rates, the rationale for devolution is less clear. As the IFS has pointed out, the tax base is unequally distributed across the country (although revenues could be redistributed) and vary significantly across areas.[52]	Revenue from SDLT in 2020/21 was £8.7bn. However, this figure was affected by the stamp duty holiday implemented during the pandemic. Figures for the previous two years were £11.6bn and £11.9bn respectively.[53] For illustrative purposes, if the 5% rate on properties between £250,001 and £925,000 were increased by one percentage point then it would mean increased revenues of around £600m.[54]
Income tax	Income tax is paid at different rates within different bands of income. Every earner gets paid a personal allowance of £12,750 where 0% is paid in tax. After this figure the rates and bandings are:[55] • 20% on income between £12,571 to £50,270 • 40% on income between £50,271 to £150,000 • 45% additional rate over £150,000.	In terms of both assignment and the freedom to collect revenues and set rates, the localisation of income tax would provide incentives to grow the local tax base. It is also relatively straightforward to understand where income tax liability has arisen (although there may be some decision making on whether to assign revenues based on a person's home or place of work).[56]	Income tax is expected to raise £198 billion in 2021-22.[57] For illustrative purposes, increasing the basic rate of Income tax by 1p in the pound would raise an additional £5.8bn.[58]

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR LOCALISATION	YIELD
Vehicle excise duties (VED)	Vehicle tax rates for the first year of registration vary according to how polluting the vehicle is. For instance, vehicles that produce 101-110 grams of emissions per km pay £160 in the first year of registration; a vehicle that produces 51-75 grams of emissions per km pay £25. Rates for the second year are £155. The rates for electric vehicles are zero.[59]	There are examples of vehicle taxes being either devolved or assigned in other countries.[60] Vehicle tend to be used locally and therefore cause wear and tear on local infrastructure.	VED is expected to raise £6.9bn in 2020-21.[61] Increasing rates by £1 for motorbikes and £5 for all other vehicles would yield around £200m a year.[62]
Inheritance tax (IHT)	IHT is a tax on the estate (the property, money and possessions) of someone who has died. It is not necessary to pay IHT to pay if either: • the value of a person's estate is below the £325,000 threshold • a person leaves everything above the £325,000 threshold to your spouse, civil partner, a charity or a community amateur sports club. The standard IHT rate is 40%.[63]	The Scottish National Party has previously argued that IHT should be devolved to Scotland so as to stop loopholes being exploited, and to implement anti-avoidance measures.[64]	In 2019-20 IHT raised £5.1 billion.[65]

As can be seen from table eighteen, below, SDLT and VED raise concerns from a localisation point of view. The former chiefly because of predictability and the latter chiefly because of efficiency. A localised income tax, however, comes out strongly in terms of meeting the principles for revenue reform.

Table eighteen: Making national taxes local assessed against the principles for local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICTABILITY	TRANSPARENCY	INCENTIVISING
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the tax base, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or disincentivise business growth?
Health and social care levy	Green (the principle is fully met) With revenues in the billions of pounds, the health and social care levy could contribute significantly to local government finance sufficiency. However, it is not known how much will be split between local government and the NHS in the first three years.	Green (the principle is fully met) NICs receipts rise in line with economic growth.	Amber (the principle is partially met) The greater a person's income, the more they and businesses tend to pay in tax. However, this is categorised as amber because the levy does not reflect the ability of the business to pay.	Green (the principle is fully met) Being based upon NICs, the levy has established collection mechanisms.	Green (the principle is fully met) Revenues are relatively predictable, although do move with the economic cycle.	Green (the principle is fully met) It is clear how much tax people and businesses pay.	Red (the principle is not met) There may be some disincentive for businesses to hire, or to increase wages.
SDLT	Green (the principle is fully met) There are potentially significant revenues from SDLT to contribute to sufficiency.	Green (the principle is fully met) As stamp duty is proportional to the value of properties, and property values move in line with economic growth, the tax can be said to be buoyant.	Green (the principle is fully met) Given that the tax is proportional to the value of home bought then it can be viewed as fair – the more expensive a property somebody can buy the more funds or ability to access finance they will have.	Green (the principle is fully met) The tax has established collection mechanisms and is difficult to avoid.	Amber (the principle is partially met) On the one hand, revenues are straightforward to understand because it is known how many houses there are in a local area. On the other hand, house prices fluctuate and can fluctuate differently across local areas. If tax rates can adjust to offset fluctuations in price then revenues would be more predictable.	Green (the principle is fully met) It is levied as a proportion of the sale of property which is an observable value, and these proportions are known before sale.	Red (the principle is not met) There may be some weak incentives for councils to pursue growth polices to encourage property transactions, but it does not seem like a major incentive. There are no disincentives to business growth. Regardless of whether the tax is devolved or not, the IFS suggest that stamp duty means that people are less likely to trade up or trade down in property and so end up in less suitable houses. They are also less likely to move to take advantage of job opportunities.[66]

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICTABILITY	TRANSPARENCY	INCENTIVISING
Income tax	Green (the principle is fully met) Income tax is a big generator of revenue nationally and could contribute a lot to local government revenue sufficiency.	Green (the principle is fully met) Income tax receipts rise in line with economic growth.	Green (the principle is fully met) The greater a person's income, the more they tend to pay in tax.	Green (the principle is fully met) The tax has established collection mechanisms.	Green (the principle is fully met) Revenues are relatively predictable, although do move with the economic cycle.	Green (the principle is fully met) It is clear how much tax people pay on income.	Green (the principle is fully met) Clear incentives for councils to increase employment in their local areas.
Vehicle excise duties	Green (the principle is fully met) Will contribute to sufficiency, albeit differently in different areas.	Red (the principle is not met) Revenues are not linked to economic growth and depend upon central government decision-making about the rates that apply.	Amber (the principle is partially met) It is not linked to the ability to pay. Two people who have the same make and model of car, but vastly different incomes, would pay the same amount in VED. However, those who own more polluting vehicles pay more because of the worse environmental impact that their car has.	Amber (the principle is partially met) The tax has established collection mechanisms. However, there has been increased incidence of evasion in recent years.[67]	Green (the principle is fully met) The details of vehicle ownership and type of vehicle ownership are known, meaning that tax revenues can be straightforwardly modelled.	Green (the principle is fully met) There is readily accessible information on how vehicles are taxed and why.	Amber (the principle is partially met) There are no incentives for councils to promote growth or disincentives for businesses to grow. Some incentives could be provided for residents to take up electric vehicles, such as zero or reduced rates.
IHT	Green (the principle is fully met) Will contribute to sufficiency, albeit differently in different areas (because there is an imbalance of assets in the country).	Red (the principle is not met) Revenues are not linked to economic growth or inflation.	Amber (the principle is partially met) The public tend to think it is unfair, but economists tend to think it is fair.	Amber (the principle is partially met) Can be subject to avoidance.	Green (the principle is fully met) Difficult to say with certainty, but it is an established tax with little variation in revenues.	Green (the principle is fully met) It is clear what has to be paid and on what.	Red (the principle is not met) Possibly creates negative incentives to avoid tax.

New local taxes

New local taxes are often suggested in response to the perceived needs of local government finance reform. In this chapter, six new sources of revenue are discussed (see table nineteen, below).

Table nineteen: Description of new local taxes implementation, rationale for introduction and potential yields

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR INTRODUCTION	YIELD
A proportional tax on domestic property	The idea is for the tax rate to be nationally set at a fixed percentage of a property's value. The greater the value of the property, the greater the amount of tax will be due. Exemptions and discounts could still apply. There are various aspects of design that could change how a proportional tax on property works in practice. For example, the liability to pay the tax could fall on the occupier of the property or on the owner of the property.	This type of tax is often discussed as an alternative to the current council tax system, with the rationale for reform being the problems associated with council tax set out earlier in this report. A key feature of a proportional tax on property would be that the distribution of revenues change quite significantly. Those who live in or own properties that are relatively low value will tend to pay less and those who live in or own properties that are relatively high value will tend to pay more. On a geographic basis, this means that council residents in the north will see more winners from such a reform, whereas council residents in the south will see more losers form such a reform.[68]	Revenues will depend upon the tax rate that is set. Fairer Share – an organisation campaigning for the introduction of a Proportional Property Tax – has undertaken modelling that suggests 0.48% rate will cover the revenues raised by council tax today.[69]

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR INTRODUCTION	YIELD
A land value tax (LVT)	An LVT is an annual levy on the ownership of land (of all types, domestic or business). The levy would be on the 'rental value' of land, and not factor in buildings and other developments.[70]	There is a clear economic argument for introducing a land value tax. Landowners benefit from an uplift in value from investment in surrounding infrastructure. Hence, some of that unearned value should be captured by the tax system. Economists also argue that the incentive to buy, develop, or use land would not change.[71]	Revenues will depend on the tax rate that is set. The New Economics Foundation has estimated revenues across various packages of reform, finding that the revenues that could be raised would be between £4.4 and £5.5bn annually.[72]
A payroll tax	Taxes that are paid by employers, employees or the self-employed, either as a proportion of wage or as a fixed amount per person. National insurance in the UK is an example of a payroll tax.[73]	There are not many calls for a new payroll tax, but there are local examples of it around the world. For instance, the authorities that organise transport at an urban level in France have the option to establish a dedicated transport tax, known as Versement Transport (VT). In the urban areas where VT is imposed, it applies to all employers that have more than 11 employees. The rate of the VT is capped by law.[74]	Revenues will depend on the tax rate is set. An illustrative example can be taken from national insurance, which if raised by one percentage point would raise revenue by around £4.3bn per annum.[75]

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR INTRODUCTION	YIELD
A sales levy (which could be a specific e-commerce levy)	This would be a tax on consumption, similar to how VAT is charged now, with the levy being a percentage of the value of a transaction, eg 1%. The tax could apply to specific types of transaction, such as those related to e-commerce (which some have advocated for using the justification the online retail businesses have an unfair advantage of bricks and mortar stores). The Government has said that it will consult further on an online sales tax. Revenues could be collected nationally and returned to the area where they originated (or redistributed according to funding formulas). The Department for Transport's Advisory Council has referenced an idea to introduce a mandatory charge, similar to that on plastic bag use, applied to all consumer deliveries and returns to encourage consumers to recognise their business, societal and environmental cost.[76]	The rationale for introduction is often that there are examples of local sales levies across the world. The specific case for an e-commerce levy relates to the changing nature of how retail is conducted and the impact that this is having on the high street.	To give an example of the revenues that could be raised, if the standard rate of VAT were increased by 1 percentage point then it would raise an additional £6.9bn in 2022/23.[77] Previous modelling undertaken by WPI Economics suggested that a 1.5% levy on e-commerce transactions would raise around £2.9bn in 2022/23.[78]

REVENUE SOURCE	IMPLEMENTATION	RATIONALE FOR INTRODUCTION	YIELD
Tourist levy	There are several options for how a tourist levy could be designed. For example, hotel occupancy could be charged, but the charge itself could be a flat fee, a percentage fee, per person, per room, or several other variations.	Many other cities around the world have implemented tourist levies of some kind. Many of the revenues from these levies are hypothecated to be spent on the costs arising from being a tourist destination, such as street cleaning or transport infrastructure.	Previous WPI Economics modelling calculated that £135m could be raised from a tourist levy in England.
A single property tax (replacing council tax and business rates)	For example, found in New York. Every 'real property', regardless of size, is assessed. Real property is defined as land and any permanent structures attached to it. Examples of real property are houses, office buildings, vacant land, farms, apartments, factories, restaurants, and mobile homes.[79] The property tax bill is calculated as the property's taxable assessment and local tax rates.	In addition to New York, there are other examples of this type of tax operating around the world. It would potentially be a simpler method of property taxes than is currently in existence.	Yield is difficult to establish without a detailed modelling exercise, and revenues would depend on the rate imposed. However, revenues would potentially be significant given current property tax rates.

Table twenty, below, assesses these new local taxes against the desirable principles for local government revenues. There are a mixture of strengths and weaknesses for the different options available.

Table twenty: New local taxes assessed against the principles for local government revenue reform

A traffic light system is used to indicate the extent to which a principle is met, with an explanation of why a revenue source has been categorised as red (the principle is not met), amber (the principle is partially met) or green (the principle is fully met).

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISING
	Can the revenue source contribute to financing spending in every council area?	Do revenues automatically increase as economic activity increases?	Do revenues relate to the ability to pay? and / or Does liability relate directly to an activity that is trying to be discouraged?	Would the costs of collection be too high?	Is the tax base, and how it might change, well understood?	Can the tax be understood by those who are liable to pay it?	Does the revenue incentivise councils to pursue growth policies? and / or disincentivise business growth?
A proportional tax on domestic property	Green (the principle is fully met) Could in theory contribute significant sums to sufficiency (although is often discussed as a replacement to council tax).	Green (the principle is fully met) The values of houses are linked to the strength of the economy, so a growing economy is likely to see house price growth too.[80]	Green (the principle is fully met) Because it is proportional to the value of the property it is linked to the ability to pay. It may be argued that those who are asset rich and cash poor will lose out. However, this is something that can be addressed by mechanisms such as council tax support.	Green (the principle is fully met) Households currently get charged on the value of their property via council tax and there is no reason to think a proportional tax would be more difficult to collect.	Amber (the principle is partially met) On the one hand, revenues are straightforward to understand because it is known how many houses there are in a local area. On the other hand, house prices fluctuate and can fluctuate differently across local areas. If tax rates can adjust to offset fluctuations in price then revenues would be more predictable.	Amber (the principle is partially met) While a tax rate as a proportion of the value of the property is something straightforward to comprehend, it is easy to see how valuations of the property may come under scrutiny. In urban areas where there is a lot of data on house values (because houses get sold more often), valuations will be more clear than rural.	Red (the principle is not met) There is some incentive to build houses, so long as they will be occupied by proportional property tax payers. But this incentive is like to be small. There is no disincentive for business growth.
A land value tax (LVT)	Green (the principle is fully met) Would contribute to sufficiency, although the potential revenues are unclear.	Green (the principle is fully met) As local economies grow so too will the value of land (although not in every case).	Green (the principle is fully met) As noted in the above table, the fairness argument comes from capturing unearned gains from increases in the value of land.	Amber (the principle is partially met) It is difficult to judge the efficiency of collecting a land value tax, as little has been written on how it may work in practice in England.	Amber (the principle is partially met) Once established, it may be that revenues are predictable if values are either uprated or regularly revalued.	Amber (the principle is partially met)	Green (the principle is fully met) It would create incentives for councils to increase the value of land.
A payroll tax	Green (the principle is fully met) Potentially significant contributions to efficiency, but it would have to be understood how it works with the NICs system	Green (the principle is fully met) As incomes rise along with the economic growth, so too will revenues from a payroll tax.	Green (the principle is fully met) Revenues would be proportional to income, meaning those who earn more then pay more.	Green (the principle is fully met) There are collection systems already in place for payroll taxes.	Green (the principle is fully met) Knowing the number of people employed within a certain area and their salaries (which is data held by HMRC), would make modelling these revenues relatively straightforward.	Green (the principle is fully met) It is easy to understand that the tax is paid on earnings and the more that is earned the more that is paid.	Amber (the principle is partially met) There is an incentive to grow employment if the payroll tax is paid employees; a disincentive for businesses to hire if they pay the payroll tax.

	SUFFICIENCY	BUOYANCY	FAIRNESS	EFFICIENCY	PREDICABILITY	TRANSPARENCY	INCENTIVISING
A sales levy (which could be a specific e-commerce levy)	Green (the principle is fully met) Potentially significant, but it depends which sales are being taxed.	Green (the principle is fully met) As sales rise with economic activity then it would be relatively buoyant.	Amber (the principle is partially met) If it is a flat rate then it could be considered regressive (as VAT is). However, the extent of being regressive would be dictated by the goods and services to which the tax applied.	Amber (the principle is partially met) A sales tax may be efficient to collect because the VAT system does something similar in terms of collection. An e-commerce levy may be something that is harder to efficiently collect, as there are question marks over the origin of the activity taking place.	Green (the principle is fully met) VAT revenues are relatively predictable, and this should apply to other sales taxes too.	Green (the principle is fully met) Sales taxes are easy to understand.	Green (the principle is fully met) A sales tax would incentivise councils to try and grow the local economy and generate more revenue.
Tourist levy	Green (the principle is fully met) This would contribute very little to sufficiency, as potential yields are low. Equally, some areas are far more suited to attracting tourists than others.	Red (the principle is not met) While more tourist levy revenue would be generated with more economic activity, tourist levies are generally flat rate fees of round numbers, ie they are not uprated every year.	Green (the principle is fully met) Tourist levies could be perceived as fair as tourism imposes a cost on local infrastructure, with the tab usually picked up by residents instead of the visitor.	Green (the principle is fully met) Tourist levies successfully operate around the world, and are deemed worthwhile to collect even if total revenues are relatively small.	Amber (the principle is partially met) So long as tourist numbers are predictable, then so revenues will be. However, initially there will be some uncertainty over how much revenue could be generated.	Green (the principle is fully met) Tourist taxes are easy to understand by those paying (and those who have travelled overseas before will likely have encountered them previously).	Amber (the principle is partially met) A tourist levy will incentivise a council to grow the local visitor market. The hospitality industry may argue that it disincentivises visitors to come to a place, but the evidence on that is inconclusive.
A single property tax	Green (the principle is fully met) Potentially significant in contributing to sufficiency, but also would have to be determined how it would fit with other property taxes that are part of the system.	Green (the principle is fully met) The value of property is linked to the strength of the economy, so a growing economy is likely to see property value growth price growth too	Green (the principle is fully met) Like the Proportional Property Tax, because rates it is proportional to the value of the property it is linked to the ability to pay. Again, mechanisms can be implemented to support those who are asset rich and cash poor.	Green (the principle is fully met) There are precedents for collection elsewhere which suggests efficiency.	Amber (the principle is partially met) For the same reasons as a proportional property tax, the number of assessed properties within a local are would be known. However, property prices could fluctuate.	Amber (the principle is partially met) The valuations could come under scrutiny, but the tax rates should be transparent.	Green (the principle is fully met) Given that the tax applies to all types of property, there is an incentive to build more property of all types (or provide planning permission to build more property of all types).

Conclusion

There are four main problems with the current system of local government revenue financing:

1. It does not provide sufficient revenue to fund services of an adequate standard.
2. It is unfair, ie not linked to the ability to pay.
3. It does little to support the local economy.
4. It does not incentivise better societal outcomes (such as to reduce carbon emissions or encourage thriving high streets).

Solving these problems would require different types of reform. For instance, introducing additional council tax bands would be of no use to reducing carbon emissions and introducing a tourist levy would not significantly boost revenues to fund higher quality services.

The following table outlines how local government revenue financing could be reformed to address the four problems set out above, based on the analysis in previous chapters.

Table twenty one: Problems with local government revenue financing and what reform could look like

IDENTIFIED PROBLEM	WHAT REFORM COULD LOOK LIKE
It does not provide sufficient revenue to fund quality services All types of revenue reform could increase revenue for councils in theory, thereby meeting the **sufficiency** principle. Having revenues that are **buoyant** and **predictable** would also be desirable.	**For current local government revenue sources**, reformed council tax and reformed business rates would be the clearest options to meet the sufficiency, buoyancy and predictable principles. While our analysis suggests that these revenues do not meet the principle of buoyancy, they both meet the sufficiency and predictability principle (and have other features that make them more desirable than the current system). **For assigning or devolving national taxes**, assigning or devolving income tax meets all principles. The health and social care levy and SDLT would be joint second on the list. **For new local taxes**, a payroll tax and a sales levy meet the principles according to our analysis.
It is unfair, ie not linked to the ability to pay Solutions to this problem would focus on those taxes meeting the **fairness** principle.	**For current local government revenue sources**, reformed council tax is the only revenue source that fully meets the fairness principle. All other options only partially meet it (and the current business rates system does not meet it at all). **For assigning or devolving national taxes**, income tax and SDLT meet the fairness test, although SDLT would be regarded as inferior to income tax because it is less predictable and less incentivising. **For new local taxes**, all options but a sales levy meet the fairness principle (and the fairness of a sales levy would depend on design). But of all the options a payroll tax meets most other principles.
It does little to support local economic development Solutions to this problem mostly relate to the **incentivising** principle.	**For current local government revenue sources**, a reformed business rates system could be used to better encourage business growth in the local area. **For assigning or devolving national taxes**, only income tax comes out as strongly incentivising local economic development in that is would encourage employment growth. **For new local taxes**, a land value tax would incentivise councils to increase the value of land, a sales tax would incentivise more economic activity and a single property tax would incentivise local growth.

IDENTIFIED PROBLEM	WHAT REFORM COULD LOOK LIKE
It does not incentivise better societal outcomes Solutions to this problem mostly relate to the **incentivising** principle	**For current local government revenue sources**, road charging and workplace parking levies can have an impact on local carbon emissions. **For assigning or devolving national taxes**, there are very few options that could be said to incentivise better societal outcomes. **For new local taxes**, there are very few options that could be said to incentivise better societal outcomes.

What does this mean?

There are three conclusions that can be drawn from the table in the preceding section:

1. **Reform of the current system will go some way to addressing the problems with local government revenues**. A reformed council tax and business rates system will help to address issues of sufficiency, unfairness and supporting local economies. Looking to assigned and devolved national taxes, income tax is the revenue source that meets most of the principles.

2. **Being clear on what local government is 'for' will guide which reforms are most necessary**. If councils are just to be delivery arms of central government then issues around sufficiency and fairness are more important than incentivising local economic growth or enabling better societal outcomes. If councils are to be free to have significant autonomy in local areas then the incentivising principle becomes more important.

3. **There are some options for local revenue reform that should be discarded**. They don't meet enough of the principles for good revenue reform and they do not address any of the problems with revenue financing. Localising IHT and VED fit into this category. There are others that would only be pursued if an overhaul of the system were to be considered. There are many merits, for instance, in replacing council tax with a proportional property tax or single property tax, but large transition costs to implementing them.

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Local Government Association
18 Smith Square
London SW1P 3HZ

Telephone 020 7664 3000
Email info@local.gov.uk
www.local.gov.uk

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