

## Moving to a Proportional Property Tax

Addressing the impacts on council revenues, resources and residents

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## Summary

The Fairer Share campaign calls for a new tax – the Proportional Property Tax (PPT) – to replace Council Tax and Stamp Duty. The campaign argues that England’s current property tax regime is unfair, placing a disproportionate financial burden on those living in lower value homes and discouraging property transactions from taking place.

The design of PPT proposed by Fairer Share is summarised as follows:

- A flat rate of 0.48% on the value of residential property. Liability for payment moves from occupier to owner.
- A higher 0.96% rate would apply to empty and second homes, and those owned by UK non-residents.
- The 0.48% makes PPT revenue-neutral upon introduction. Revenue from PPT (£36.7 billion) recoups lost revenue from the removal of Council Tax (£31.9bn), abolition of SDLT (£4.2 billion) and miscellaneous adjustments (£0.6 billion).
- Flexibility to increase or decrease the tax take in future by adjustment of the 0.48% rate.
- Transitional protection and deferral mechanisms to ensure that any increases in liabilities are affordable.

The purpose of this report is not to explain why PPT should be implemented, which is covered by other material produced by the Fairer Share campaign. Instead, the purpose of this report is to set out how PPT can be implemented in both theory and in practice, taking account of both technical and political issues.

To do this, WPI Economics undertook desk research, had discussions with local government experts and undertook quantitative analysis. The implementation issues identified from this process – and the potential solutions to them – are summarised in the table on the next page, grouped under three headings:

- Managing PPT revenue flows.
- Managing the impact of PPT on council resources.
- Managing the impact of PPT on council residents.

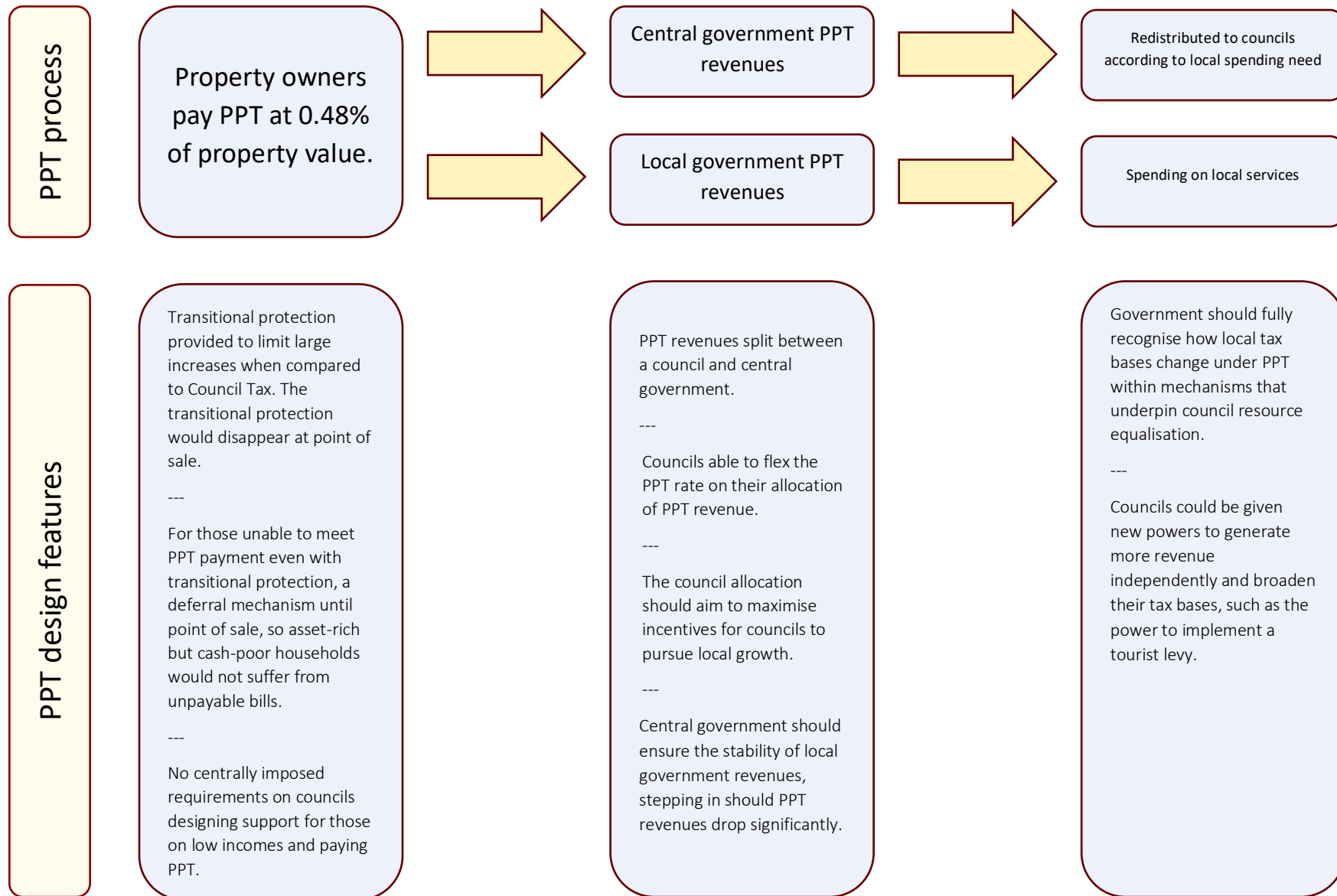
A graphic (Figure One, after the table) shows the PPT process and PPT design features in a simplified way.

Our headline conclusion is that there are no insurmountable technical issues to implementing PPT as proposed by the Fairer Share campaign. There are numerous design features – many with successful precedents – that can be applied to PPT to overcome political issues that may arise.

	Potential issues arising from the introduction of PPT	Potential solutions to the issues arising from the introduction of PPT
<b>Managing PPT revenue flows</b>	<p>PPT would merge local government and central government revenue streams.</p> <p>The reasons for councils wanting direct access to PPT revenue (as opposed to PPT revenue flowing to central government to be redistributed to councils via grants) are:</p> <ul style="list-style-type: none"> <li>• Local taxation is the foundation of local democracy.</li> <li>• Local government wants less centralisation of fiscal and legislative power (as does central government, according to the Conservative Party manifesto).</li> <li>• The ability to raise and retain local tax revenues can create positive incentives for councils to boost local economic growth.</li> </ul> <p>The simple reason for central government wanting direct access to PPT revenue is that it would want to replace the significant revenues that it derives from SDLT.</p> <p>Within this context, stability in tax revenue streams is desirable both locally and nationally. There is a question over how to manage any instability in PPT revenues that may arise.</p>	<p>The following are PPT design features and design principles that could address the identified issues related to the management of PPT revenue flows:</p> <ul style="list-style-type: none"> <li>• PPT revenues generated in a local authority area would be split between a council allocation and a central government allocation.</li> <li>• Councils should be able to flex the PPT rate that gives them their allocation of PPT revenue. For example, councils may initially receive revenue equivalent to 0.24 percentage points of the 0.48% rate of PPT, which they could increase or decrease, i.e., to 0.26 percentage points or 0.22 percentage points.</li> <li>• The size of the council allocation does not have to be decided yet but should aim to maximise incentives for local authorities to pursue local growth initiatives.</li> <li>• Central government should ensure the stability of all revenues within the system of local government finance, stepping in should there be times when revenues from PPT drop significantly. Another way of guaranteeing more stable revenues is to look at the mechanics of property taxes applied overseas that are similar to PPT. Some – such as those in Australia – take averages of values over a recent time period to calculate tax liability.</li> </ul>
<b>Managing the impact of PPT on council resources</b>	<p>A key feature of local government finance in England is the mechanisms that try and ensure consistent access to funding resources across councils in different parts of the country (technically referred to as “equalisation”).</p> <p>If local tax bases change in size when reforming property taxation – which under PPT they would do to quite a large extent – and resource equalisation is still a desirable aim of policy, then it would require funding mechanisms to adjust.</p> <p>It is important to note that those areas that see the biggest reduction in the size of their tax bases under PPT are also the areas where the greatest proportion of residents will make gains or experience no change in their tax liability as a result of PPT.</p>	<p>This is a complex area of policy, and the detail of how PPT sits within it will depend upon other local government policy context at the time of implementation, such as how business rate revenues are being retained. Yet there are principles of equalisation that can be committed to regardless of this policy context, which are:</p> <ul style="list-style-type: none"> <li>• Government should fully recognise how local tax bases change under PPT within mechanisms that underpin council resource equalisation.</li> <li>• Councils could be given new powers to generate more revenue independently and broaden their tax bases, such as the power to implement a tourist levy.</li> </ul>

<p><b>Managing the impact of PPT on council residents</b></p>	<p>Overall, there would be far more winners than there are losers. WPI Economics analysis has found that PPT would benefit 76% of England’s households.</p> <p>But due consideration needs to be given to those residents that may not benefit from PPT. Some of these residents would be homeowners – predominately in London and the South East – who would pay more in PPT than they currently do in Council Tax. Many will be able to soak up increased property taxes, as those owning more valuable houses will tend to have higher levels of household income. But there are some homeowners who may have lived in the same house for many years, experienced large increases in the value of their house, and whose incomes are relatively low.</p> <p>Other residents who may not benefit are those currently receiving some help to pay Council Tax. They may be exempt from paying Council Tax or receiving some form of Council Tax reduction. For example, students who live with other students are exempt from paying Council Tax; a single person is entitled to a reduction of 25% from the full Council Tax payable (the “Single-Person Discount”).</p> <p>How these residents who receive help in paying Council Tax are affected by PPT will depend upon how much help they have been receiving, if they are homeowners or renters, and to what extent PPT passes through to their rent payments if they are in the latter category. The impact on renters more generally will depend upon whether they are in the private rented sector or the social rented sector.</p> <p>To summarise the above, some residents in specific circumstances – those who are asset rich/cash poor and those who are eligible for Council Tax discounts or support – may lose out from PPT if no mitigating action is taken anyway.</p>	<p>Fairer Share has already outlined some plans for mitigating action in the design of PPT:</p> <ul style="list-style-type: none"> <li>• No household would pay over £100 a month more on their primary residence than they are currently paying in Council Tax at the point of transition to PPT.</li> <li>• The transitional protection would disappear at point of sale, meaning that when homeowners buying expensive properties enjoy the significant gains from the removal of SDLT, they would not have transitional protection for PPT.</li> <li>• For those unable to meet the £100 a month increase under transitional protection, or in the longer-term, the full costs of PPT, there is a deferral mechanism until point of sale, so asset-rich but cash-poor households would not suffer from unpayable bills.</li> </ul> <p>These mitigating actions are purely financial, but there are other options to consider when taking account of those residents who may not benefit from PPT. These actions include:</p> <ul style="list-style-type: none"> <li>• Giving councils the power to design their own systems of supporting low-income residents through PPT, i.e., not having centrally imposed restrictions.</li> <li>• Central government could offer councils financial resource for those negatively affected by PPT by increasing funding for Discretionary Housing Payments.</li> <li>• The Government could offer generous PPT discounts for socially rented homes that meet the highest level of energy efficiency.</li> </ul>
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Figure One: Simplified explanation of PPT process and PPT design features



## Introduction – Implementing PPT in theory and in practice

The Fairer Share campaign calls for a new tax – the Proportional Property Tax (PPT) – to replace Council Tax and Stamp Duty.

Fairer Share argues that PPT would address two types of unfairness created by England’s current system of property taxes.

The first is that Council Tax is only weakly linked to property values. A person living in a property worth £100,000 pays around five times more in tax as a share of the property’s value than someone living in a property worth £1m. This means that younger adults and low earners – who are more likely to live in low value properties – pay higher effective tax rates than wealthier, older households.

The second is that Stamp Duty creates inefficiencies in the housing market – it discourages property transactions. This might mean an older family does not downsize or that a growing family might not upsize.<sup>1</sup>

The outline design of PPT proposed by Fairer Share is as follows:

- Removal of Council Tax and Stamp Duty Land Tax (SDLT).
- Replaced with PPT, a flat rate of 0.48% on the value of residential property.
- Liability for payment is on the owner (rather than the occupier).
- A higher 0.96% rate applies to empty and second homes, and those owned by UK non-residents.
- Revenue-neutral upon introduction.
- Revenue from PPT (£36.7 billion) recoups lost revenue from the removal of Council Tax (£31.9bn), abolition of SDLT (£4.2 billion) and miscellaneous adjustments (£0.6 billion).<sup>1</sup>
- Flexibility to increase or decrease the tax take in future years by adjusting the 0.48% rate.
- Transitional protection and deferral mechanisms to ensure that any increases in liabilities are affordable. No household would pay over £100 a month more on their primary residence than they pay in Council Tax at the point of transition to PPT.

Fairer Share has commissioned WPI Economics to identify the technical issues that policymakers need to consider if PPT is to successfully integrate into England’s system of local government finance. Some of these technical issues have associated political issues, which are also identified where they arise.

Workable suggestions are made on how PPT can be designed and implemented to address the technical and political issues that are identified.

In short, the purpose of this report is to set out how PPT can be implemented in both theory and in practice. It is not about why PPT should be implemented, which has been explained by Fairer Share in other documents and on its website.

The report’s intended audiences are national and local politicians, HM Treasury (HMT), the Ministry of Housing, Communities and Local Government (MHCLG), councils and any other organisation or person that has an interest in local government finance or property taxes.

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<sup>1</sup> These miscellaneous adjustments are: scrapping the under-occupancy penalty (the Bedroom Tax), the Empty Homes Premium and the Annual Tax on Enveloped Dwellings.

Despite PPT's selling points – its economic logic and its support for people on low incomes – implementing a policy of this scale is never going to be easy. A positive design feature of PPT for one stakeholder may be a negative for another.

Nevertheless, the headline conclusion of this report is that there are no insurmountable technical issues to implementing PPT as proposed by the Fairer Share campaign. In addition, there are several approaches – many with successful precedents – that can be included in the design of PPT to address political issues.

In reaching this conclusion, the starting point for our analysis was to identify the technical and political issues that may affect the implementation of a PPT. This was a three-phase process:

- i. **Desk research.** Identifying those issues that are relevant to PPT from the recent evolution of England's system of local government finance. For example, the debates around the design of funding formulas in the Fair Funding Review.
- ii. **Discussions with experts on local government / local government finance.** To understand more about how councils would view technical aspects of PPT. For example, what their attitudes would be to changing the size of local tax bases across local authorities.
- iii. **A quantitative analysis.** To understand the extent to which revenues in the local government finance system would change.

This process adds to the knowledge that WPI Economics already has about local government and local government finance. The findings from this exercise suggested technical and political issues with PPT implementation fit into three headline categories:

- **Revenue impacts.** Because concerns were raised over what PPT means for the relationship between local and central government, specifically the positive incentives created by councils being able to tax and spend at a local level.
- **Resource impacts.** Because questions were raised about what PPT means for managing the differences in resources and spending needs across better-off and worse-off councils.
- **Resident impacts.** Because concerns were raised about how residents may be negatively affected by the introduction of PPT.

These issues are discussed across the next three chapters, followed by a conclusion.

Other pieces of analysis commissioned by Fairer Share that complement this report are:

- The International Property Tax Institute, "Consideration of Valuation Issues"
- WPI Economics analysis of distributional impacts of PPT across Parliamentary constituencies.



## The management of PPT revenue

### What are the issues?

PPT would replace council revenue streams (Council Tax and the Empty Homes Premium) and central government revenue streams (SDLT, under-occupancy charge, Annual Tax on Enveloped Dwellings).

Given that overall tax revenue would remain the same under PPT, a simple way of managing the revenue may appear to be central government collecting it all, then redistributing to councils. This could come with guarantees that no council would be left financially worse-off by the new arrangement.

Yet there are good arguments for why councils would want PPT revenue raised in their areas to flow directly to them, without central government involvement. These arguments are:

#### I. Local taxation is the foundation of local democracy.

Councillors make choices about how to tax their residents and how to spend the proceeds of that taxation. Residents can use their vote at the ballot box to support or oppose the tax and spend choices that are on offer (or those that have happened since the last local election). Choosing the level of Council Tax is the most important tax lever that councillors have, albeit one that typically has been subject to constraints by central government. These constraints tend to allow for only small year-on-year variations in what residents pay, such as the requirement to hold a local referendum if a council proposes raising Council Tax above a certain limit.

#### II. Councils want less centralisation of power in Whitehall.

It has long been argued that the UK is highly centralised in comparison to other developed nations, and especially when it comes to revenue raising powers.<sup>ii</sup>

Local government has made it abundantly clear that they want this to change. Councils have argued that the ability of local government to make important choices, *"...is being hampered by the centralisation of powers in Whitehall"*.<sup>iii</sup>

This is not necessarily at odds with the Government's thinking. The Conservative Party's election manifesto stated that as a governing party it will, *"...remain committed to devolving power to people and places across the UK...so that every part of the country can shape its own destiny"*.<sup>iv</sup>

If PPT revenues were centralised and then recycled to councils using grants, those grants could always be subject to cuts determined by national politicians at some point in the future. For instance, there was a 49.1% real-terms reduction in central government funding for local authorities between 2010-11 and 2017-18.<sup>v</sup>

#### III. The ability to raise and retain local tax revenues can create positive incentives to boost local economic growth.

Locally generated revenues that are retained by councils incentivise the pursuit of economic development initiatives to improve local economic outcomes.<sup>vi</sup>

The greater the financial returns that can be gained from these policies, the greater the incentive. Put another way, *"...councils need confidence that the gains they make for their place can be retained in order to afford the investments that create the benefits"*.<sup>vii</sup> This is the

underlying principle of numerous agreements between central and local government in recent years, such as City Deals and Growth Deals.<sup>viii</sup>

Locally retained revenues may also create the incentive for councils to maximise their administrative efficiency, providing more resource to spend on local economic development (or services).<sup>ix</sup>

The reason for central government wanting direct access to PPT revenue is much more straightforward. HMT gains a significant source of revenue from SDLT (over £4bn a year from primary dwellings) which it would want to directly replace from PPT.

In addition to all of the above, there is a more general point to make about the management of PPT revenue. Stability in tax revenue streams is desirable at both a local and national level. There is a question over how to manage any instability in PPT revenues that may arise.

## What are the solutions?

The following describe the features that could be incorporated into PPT design to address the issues set out above:

- **PPT revenue would be split between a council allocation and a central government allocation.**

The council allocation would mean that some PPT revenue raised in a local authority area is retained to spend on services.

The central government allocation of PPT revenue would mean that HMT has a replacement for SDLT revenue.

This approach would effectively mean that part of the 0.48% PPT rate is allocated to councils, with the other part allocated to central government. For example, if revenues from the 0.48% PPT rate were split equally between councils and central government it would mean councils raising revenue equivalent to 0.24 percentage points of the overall PPT rate and central government raising revenue equivalent to the other 0.24 percentage points of the overall PPT rate.

This approach would mean that there is a direct link between local taxation and local politicians' spending decisions, that current local revenue streams replaced by PPT would not all be centralised, and that positive local growth incentives would be maintained.

There is a good argument for councils to have discretion to increase, decrease or maintain their part of the 0.48% rate (discussed under the next bullet point, below).

The size of the respective PPT allocations does not have to be committed to now. However, our analysis – see Table One, below – sets out how different council / central government PPT allocations affect council revenues and central government revenues. It looks at a 50:50 allocation of PPT revenue between councils and central government and a split of PPT revenue so that the central government allocation covers only its lost SDLT revenue and councils keep the rest. As discussed above, a system whereby 100% PPT revenue either goes to councils or to central government is undesirable, but both have been included in the analysis for comparison.

As Table One shows, some councils would receive more revenue from PPT than they do currently from Council Tax, and some would receive less revenue from PPT than they do currently from Council Tax. This is inevitable because PPT changes the size of tax bases across

council areas. This has implications for how it can be ensured that all councils can meet their spending needs, regardless of how much revenue they can raise from their tax base (discussed more fully in the next chapter).

It is worth noting that one stakeholder we spoke to suggested that PPT revenue could even be split into three allocations – a council allocation, a central government allocation to be redistributed among councils and a general revenue stream for central government. This would add complexity to the system, but it is another option to consider.

It is also worth noting that in two-tier council areas PPT could work as Council Tax does now. A set amount of a lower-tier council’s PPT revenue would be allocated to the upper-tier council to fund the services it pays for. Although, this may not be an issue in the future. There have been suggestions that two-tier local government will be replaced by unitary structures in the future, which would mean that it would no longer be a consideration.<sup>x</sup>

**Table One: Scenarios of PPT Split**

PPT revenue split scenario (based on a PPT rate of 0.48%)	Number of councils that receive less revenue than under Council Tax	Number of councils that receive more revenue than under Council Tax	Proportion of councils that gain in revenue terms from PPT	Average % revenue loss from across all councils that lose revenue under PPT	Average % revenue gain across all councils that gain revenue under PPT
Central government keeps all PPT revenue	316	0	0.00%	-100.00%	0.00%
50:50 split of PPT revenue between councils and central Government	294	22	6.96%	-43.73%	39.12%
Central government receives PPT revenue to cover lost SDLT revenue	160	156	49.37%	-20.49%	42.14%
Councils keep all PPT revenue	116	200	63.29%	-17.28%	48.06%

- **Councils should be able to increase or decrease the PPT rate that provides them with their allocation of PPT revenue.**

At present – and as noted above – councils have some discretion over the level of Council Tax that they set.<sup>xi</sup> Councils are more likely to find the move to PPT unpalatable if this discretion is removed under the new system.

The ability to change the PPT rate on the council allocation of PPT revenue does not have to be introduced straightaway – there may be benefits to the system bedding in for a couple of years (Fairer Share has stated that this would not be introduced immediately). If this were the case, the Government should guarantee that the revenues in the system increase as they would have under the Council Tax regime and that no council will be left worse off (this has implications for the system of redistributing revenues across councils, discussed in the next chapter).

To note, allowing councils to increase or decrease their PPT rate would mean that PPT could no longer be described as a flat rate tax. Instead, PPT would be made up of a national fixed rate

(which could be changed, but that would be uniform across England) and a local flexible rate (which would vary across England according to decisions that taken by individual councils).

Table Two, below, shows what this might look like if PPT revenues were split 50:50 between councils and central government.

**Table Two: Example of national and local split**

	Example of PPT rate split upon introduction within a single council area	Example of PPT rate split after following a decision to change the local rate within a council area
Effective council PPT rate	0.24%	0.26%
Effective central government PPT rate	0.24%	0.24%
Overall PPT rate	0.48%	0.50%

Conditions on the extent to which councils could increase or decrease the local rate of PPT would likely be required by central government to guard against unjustifiably large increases (as they are now). This could include local referenda on councils raising their PPT rate above a certain level (as exists now). There would also be a case for some councils to raise their PPT rate above certain levels for a specific purpose, i.e., such as the current precepting arrangements for councils that deliver social care.<sup>xii</sup>

- **The council allocation of PPT revenue should maximise incentives to pursue local growth initiatives.**

While council and central government PPT revenue allocations do not have to be committed to now, a guiding principle for deciding allocations would be to allow local councils to keep as much PPT revenue as possible to make the system workable.

In this context, ‘workable’ means ensuring that central government would not lose revenue by moving to PPT and that all councils can ultimately meet their spending needs.

This points towards the third scenario in Table One – central government would keep enough PPT revenue to cover its SDLT losses, and the rest would stay with councils. Indeed, there seems no reason for this not to be the starting point when considering the split of PPT revenues in PPT design.

- **Central government should ensure the stability of all revenues within the system of local government finance.**

As noted, stability of any tax revenue is desirable for local and national policymakers.

Given that house prices go up and down, PPT revenue would go up and down as well. Fairer Share has argued that this is an ‘automatic stabiliser’, where in good times the system generates excess revenues and in bad times there are lower receipts but the community benefits from a tax cut for residents.

Should there be times when revenues from PPT drop significantly, central government could step-in and fill the gap with grants, or let councils try and raise more revenue themselves. Some councils may decide to adjust their PPT rate so that residents experience consistency in the

amounts that they are billed, rather than having bills that vary from year to year. If this were the case, PPT would not be an automatic stabiliser, but councils would have greater say over how to manage their local financial position.

Although on this latter point, some councils with generally less well-off residents and economies may be unable to levy more from them in tough economic circumstances.

It is worth pointing out that Council Tax and SDLT revenues are affected by fluctuations in the economy anyway. A good example of this is the Covid-19 pandemic. Councils have suggested that they expect to collect £1.4bn less in Council Tax in 2020–21 than they had budgeted at the start of the year. The main reasons for this are a failure for some people to pay their Council Tax, and an increase in Council Tax Support (CTS) being offered to those who have been hit financially by the pandemic. This includes over £800m of payment failures and a £475 increase in CTS.<sup>xiii</sup>

Another way of guaranteeing more stable revenues is to look at the mechanics of property taxes applied overseas that are similar to PPT. Some – such as those in Australia – take averages of values over a recent time period to calculate tax liability, i.e., an average of the last three valuations. This type of approach would smooth tax liabilities for households and revenues for councils alike.<sup>xiv</sup>

## The impact of PPT on council resources

### What are the issues?

Financial needs vary across councils. For example, the larger a local authority's population, the larger the demands on its services, and hence the larger its spending needs. Bury Council with its population of 191,000 will likely have lower spending needs than Wigan Council with its population of 329,000.<sup>xv</sup> But there are other factors – such as the characteristics of local populations – that have an influence on the demand for council services. For instance, older and more deprived populations will create more spending requirements than younger, less-deprived ones. Because of this, the Government has proposed that, in addition to considering population size, it will consider other metrics, such as local social services demand and local public health indicators, to assess the financial need of individual councils.<sup>xvi</sup>

Financial resources also vary across councils. In other words, ability to raise revenue – the tax base – varies across councils. Blackburn and Darwen Council has 35,160 “Band D equivalent chargeable dwellings” (the technical measure of local authority's tax base in terms of Council Tax); Richmond Upon Thames council has 89,610 Band D equivalent chargeable dwellings.<sup>xvii</sup> The tax base of local councils is largely made up of the properties that are required to pay Council Tax and Business Rates.

A key feature of local government finance in England is mechanisms to close the gaps between these needs and resources. Funds are taken from councils where financial resources exceed financial need and are directed to councils where financial need exceeds financial resources. Central government grants – sometimes for strictly defined spending purposes – are added into the mix and distributed based upon formulas to assess how much each council should receive.

This process is referred to as “equalisation” and is an attempt to ensure consistency of funding provision and service provision across councils in different parts of the country.

The introduction of PPT would change council resources (because local tax bases will change in size) and has consequences for equalisation.

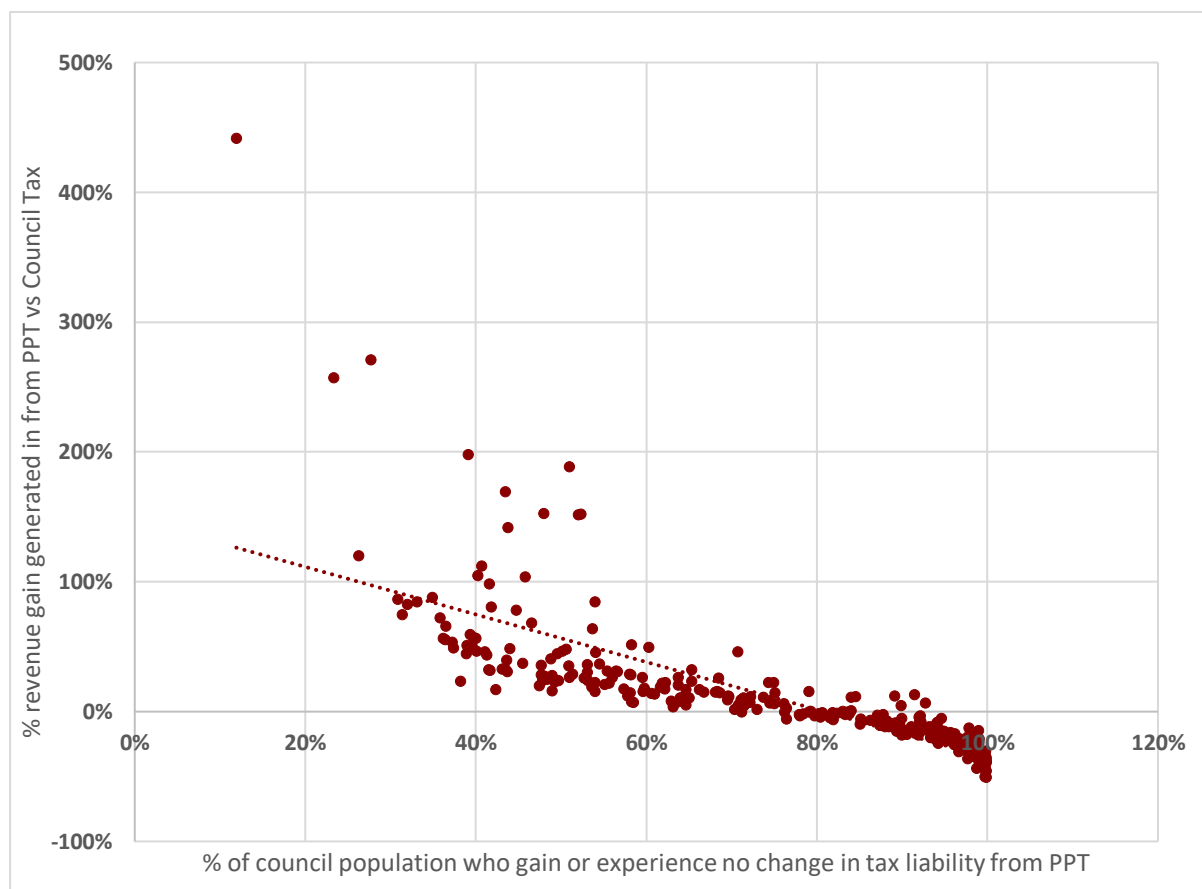
As the Institute for Fiscal Studies (IFS) note, if local tax bases change in size when reforming local taxation and resource equalisation is still a desirable aim of policy then it would require funding levels to adjust, “...increasing them for those [local authorities] whose tax base falls, and reducing them for those whose tax base rises.”<sup>xviii</sup>

If this adjustment did not happen, councils with a smaller tax base under PPT would have to find revenues from elsewhere to maintain pre-PPT spending levels.

It is important to note that a large number of councils would have a gap between their current Council Tax revenues and PPT revenues, regardless of how those revenues are allocated between councils and central government (refer back to Table One for the specific numbers). This happens because of how much PPT changes local tax bases, growing (shrinking) those with relatively high (low) property prices and relatively more (fewer) houses.

PPT changes local tax bases to such a degree because of how poorly the current Council Tax system relates to the value of residential property upon which it is levied. The quid pro quo for council areas that experience a reduced tax base under PPT is that they are also the council areas that tend to see the greatest proportion of residents gaining or experiencing no change in their tax liability. This is shown in Chart One, below.

**Chart One: % revenue gain generated from PPT vs Council Tax by local authority, compared to % residents who gain or experience no change in tax liability from PPT by local authority**



### What are the solutions?

The following describe the features that could be incorporated into PPT design to address the issues set out above:

- **Government should fully recognise the change in local authority tax bases arising from PPT in its approach to resource equalisation.**

In line with the conclusions of the Fair Funding Review, Government would take account of the relative size of a council’s PPT tax base, and not the revenue that a council intends to generate from that PPT tax base. What this should mean in practice is that two local authorities with similar tax bases and a similar assessment of relative need would receive broadly similar baseline funding levels, irrespective of their local PPT rates. This way, councils that want to increase or decrease the local rate of PPT will not just see those increases or decreases offset by equalisation formulas. In short, local decisions on local PPT rates would not be causally linked to funding methodology (which would create obvious perverse incentives).<sup>xix</sup>

With regard to this, there are some transitional arrangements that may be needed if PPT were to be initially introduced without the ability for councils to flex their PPT rate (with this flex being introduced after a few years). There would have to be some kind of mechanism in transition that meant individual councils were not forced into a situation where they were having to spend less on services than they were pre-PPT purely because they could not yet take a decision to increase their local PPT rate. This may occur, for example, if a council had

historically charged above average Council Tax relative to its tax base, with only a pure comparison of tax bases recognised in PPT (meaning that historically above average Council Tax levies are not considered). In deciding upon mechanisms like this, it may be useful to apply the principles for transition set out in the Fair Funding Review – that transition should be stable, transparent, time-limited and flexible.<sup>xx</sup>

There is also the possibility that some councils would have a tax base so big under PPT that they may be able to cover all of their funding needs and more. Under this scenario, those councils would not get any central government funding or retain any business rate revenue. Central government taking a slice of the PPT revenue in these areas to redistribute may be an option, but historically central government has not taken Council Tax in this way, and it would be easy to see why councils may feel that an uncomfortable precedent is being set, i.e., it opens the door for Government to take an increasing share of revenue over time.

This may particularly be an issue in London (See Box One, below).

For some councils, this may not be an issue immediately but could be in the future if house prices rise rapidly in some areas, growing the resources they derive from PPT revenue to more than cover their spending need. Given this potential, the possibility of some type of “Gain Share” arrangements could be built into the system – local and central government sharing some or all of the additional tax revenue generated from growth.

- **Councils could be given new powers to generate more revenue.**

Councils have been advocating for greater fiscal devolution for years, with proponents of it often pointing towards the experience of other countries. As the Local Government Association notes:<sup>xxi</sup>

*“Local authorities in Germany, Switzerland and Holland can access a wide-range of revenue sources. They are also able to adjust and introduce local levies in consultation with their residents and businesses innovating and diversifying their tax base in response to new public priorities, such as responding to climate change, and new forms of economic activity”.*

If it were deemed concerning that some councils were losing the ability to generate their own resources because under PPT their tax bases have shrunk, more powers could be granted to raise local revenue and broaden their tax bases. Councils already have the power to introduce congestion charging and workplace parking levies, but there are other potential sources that they do not have the power to introduce, such as local tourist levies.

It is also the case that in some council areas a large number of residents would face lower tax bills under PPT than they otherwise would do under Council Tax. Therefore, councils may take the decision to broaden their revenues streams through other routes, such as increasing or introducing fees and charges (such as parking fees or transport levies).

There are other options that could be considered in this context too. For example, a relaxation of planning laws could allow more houses to be built, meaning more PPT revenue.



**Box One – The issue of high PPT revenues in London boroughs**

London boroughs dominate the list of biggest gainers in terms of revenue by moving to a system of PPT.

Of the Top 20 local authority areas that would gain the most out of PPT, 19 are in London. Brighton & Hove is the one exception, sitting in 20<sup>th</sup> place in the Top 20.

This demonstrates that under PPT revenue, overall local government revenues would be rebalanced towards London.

As noted in this section, adjustments to the distribution of funds through equalisation mechanisms will address this in part, but the revenue gain may be so large so as to need further action.

There are good arguments for action to be taken. In particular, the rest of the country contributes to London's success, providing justification in taking some PPT revenues generated in London boroughs and redistributing them across England (this also supports the levelling-up agenda).

The other consideration is if property values rise as steeply in the capital as they have in the past. In this scenario there may be some merit in applying 'Gain Share' arrangements, whereby HM Treasury gets some return on the policies that contribute to such significant house price growth.

## The impact of PPT on residents

### What are the issues?

The introduction of PPT would change what council residents pay in property taxes.

Overall, there would be far more winners than there would be losers. WPI Economics analysis has found that PPT would benefit 76% of England's households. The average annual saving of a benefitting household would be £750. Moreover, 98% of households in the most deprived decile of Parliamentary constituencies would benefit.<sup>xxii</sup>

But due consideration needs to be given to those residents that may not benefit from PPT.

Some of these residents would be homeowners – predominately in London and the South East – who would pay more in PPT than they currently do in Council Tax. Many will be able to soak up increased property taxes, as those owning more valuable houses will tend to have higher levels of household income. But there are some homeowners who may have lived in the same house for many years, experienced large increases in the value of their house, and whose incomes are relatively low (and who would undoubtedly be the focus of heated political debate about the merits of introducing PPT).

Other residents who may not benefit are those currently receiving some help to pay Council Tax. They may be exempt from paying Council Tax or receiving some form of Council Tax reduction. For example, students who live with other students are exempt from paying Council Tax; a single person is entitled to a reduction of 25% from the full Council Tax payable (the "Single-Person Discount").

How these residents who receive help in paying Council Tax are affected by PPT will depend upon how much help they have been receiving, if they are homeowners or renters, and to what extent PPT passes through to their rent payments if they are in the latter category.

To give an example, councils have discretion over how to design Council Tax Support (CTS) for those within their area who are of working-age (CTS used to be part of the national welfare system but was devolved, and pension-age CTS still is part of the national welfare system). For the latest data available, there are 2.56m working-age claimants of CTS across councils in England.<sup>xxiii</sup> Those in receipt of CTS could be either homeowners or renters (although, are most likely the latter category). Under PPT – unless there were mitigating action – those who had previously been in receipt of CTS could lose out if rent increases resulting from PPT are greater in value than the reduced rate of Council Tax they were paying. The same argument applies to those in receipt of the Single-Person Discount.

The impact on renters more generally will depend upon whether they are in the private rented sector (PRS) or the social rented sector (SRS). SRS rents are regulated by central government, with the regulations attempting to strike the "right balance" between the objectives of protecting tenants, protecting taxpayers (by limiting the welfare costs associated with social housing rents) and supporting the delivery of new social homes and the management and maintenance of existing properties.<sup>xxiv</sup>

At present, the Government limits annual social rent increases by CPI inflation plus one percentage point. This could dampen social rent increases resulting from social housing providers having to pay PPT. That said, if social rents were not going to rise to the central government ceiling then they might be pushed further in that direction by PPT. It is also worth noting that if the social housing provider is a local authority, it would be simply recycling some PPT payments – the council allocation of PPT revenue – back to itself anyway.

Fairer Share also looked at the idea of allowing social providers a one-off increase in rent to include the existing Council Tax paid by a tenant or average Council Tax paid by tenants. This would mean that the social provider would limit any losses.

To summarise the above, some residents in specific circumstances – those who are asset rich/cash poor and those who are eligible for Council Tax discounts or support – may lose out from PPT if no mitigating action is taken anyway.

Fairer Share has already outlined some plans for this action in the design of PPT:

- No household would pay over £100 a month more on their primary residence than they are currently paying in Council Tax at the point of transition to PPT.
- The costs of this protection are already factored into the revenue-neutral costing of the 0.48% rate, but to further protect the Exchequer, the transitional protection would disappear at point of sale, meaning that when homeowners buying expensive properties enjoy the significant gains from the removal of SDLT, they would not have transitional protection for PPT.
- For those unable to meet the £100 a month increase under transitional protection, or in the longer-term, the full costs of PPT, there is a deferral mechanism until point of sale, so asset-rich but cash-poor households would not suffer from unpayable bills.

These mitigating actions are purely financial, but there are other options to consider when taking account of those residents who may not benefit from PPT. Not least the opportunity for PPT to remove constraints on local government when it comes to designing local welfare support or to design PPT to support Government's wider objectives.

## What are the solutions?

The following describe the features that could be incorporated into PPT design to address the issues set out above:

- **Give councils the powers to design their own systems of supporting low-income residents through PPT.**

Local government has argued that councils should have the power to vary Council Tax discounts to reflect local circumstances. This argument is made with particular reference to the current single person discount, which costs £3bn a year.<sup>xxv</sup> There is a question about how this would be funded, i.e., councils who see their tax bases shrink may not have the means to support the programmes that they want. In order to address this, funding formulas could be tweaked, or a specific central government fund could be created.

- **Central government could offer councils funds for those negatively affected by PPT by increasing funding for Discretionary Housing Payments.**

Indeed, these payments are designed to help the most vulnerable meet housing costs, and it would again mean local government has choice over the system of implementation.

- **The Government could offer a generous PPT discounts for socially rented homes that meet the highest level of energy efficiency.**

Social landlords will be incentivised to carry out property improvements that will reduce carbon emissions (contributing to Net Zero ambitions) and disincentivise rent increases to offset PPT liabilities. Residents will benefit and face lower energy bills, decreasing reliance on

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the welfare system. The government would benefit from meeting its targets with having to run complex grant schemes. If successful, the policy could be rolled-out more widely to the private rented sector.

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## Conclusion – PPT is technically and politically feasible

The previous sections of this report were written to answer the most important – and potentially most controversial – questions that arose when the design of PPT was discussed with stakeholders.

There will clearly be opponents of PPT. Some will argue that it is too difficult to implement. Some councils will be resistant to the idea of having a smaller tax base (linking that to a weakening of local democracy). Others will be more concerned about those residents who may be negatively financially affected by the new system.

But there are evidence-based counter arguments to all criticisms of PPT. The design of PPT can support council independence and decentralisation through the design of revenue allocations between councils and central government. It can fit into the current system of local government finance so that the resources and needs of councils are recognised. It can protect those who are asset rich / cash poor and / or are currently exempt from Council Tax or are eligible for a discounted rate.

This is all in addition to the other arguments in favour of PPT, such as working international precedents and a coherent approach to valuation (outlined in the paper by IPTI).

There can be no pretence that the design features of PPT presented in this paper are simple to understand or to implement. But in our judgement, they are no more complicated or harder to implement than the changes made to the local government finance system in the past and that have been discussed in the last few years.

There are clearly political issues to navigate in implementing PPT. But the distribution of PPT beneficiaries (that supports the Government's levelling-up agenda) and the ways through which councils can gain more powers via the detail of PPT design, suggest that there is a path to successfully addressing these issues.

In successfully navigating this path, HMT and MHCLG would solve a longstanding problem – the huge amounts of time and resource taken up applying sticking plasters to the outdated and unfair system of property taxes in the UK.

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