The Institute of Revenues, Rating and Valuation (IRRV) is pleased to provide this response to the Housing, Communities and Local Government Committee Inquiry into Local Government Finance and the 2019 Spending Review.

The IRRV is the professional body concerned with all aspects of local taxation and local benefits administration across the United Kingdom. Institute members, in both the public and private sectors, are engaged in local tax administration, valuation of property for taxation and other purposes, local authority benefits administration, the appeals processes and financial management in local government.

**Executive summary**

1. The focus of our response has been the second of the Inquiry’s terms of reference: *The efficiency, fitness for purpose and sustainability of the current system for funding local government (central government funding, council tax, business rates retention and other income); how it could be improved, including options for widening the available sources of funding; and what lessons can be learned from other jurisdictions.*

2. The business rates and council tax systems are both administratively efficient systems. There are, however, issues with both council tax and business rates, which if addressed, would make them ‘more fit for purpose’; and provide greater sustainability in both the systems.

3. The Institute’s view is that an objective of any system change should be to significantly reduce the non-domestic rates multiplier, by as much as half, and for that to take effect within the life of the 2021 valuation list in England. We suggest mechanisms for achieving that, whilst at the same time maintaining adequate funding levels for local government, including:
   - adjusting the balance of funding between non-domestic rates and council tax and making the council tax system more progressive; and
   - augmenting local government property-based business taxes with additional revenue streams, such as a digital services tax (or internet transaction charge).

The efficiency, fitness for purpose and sustainability of the current system for funding local government (central government funding, council tax, business rates retention and other income); how it could be improved, including options for widening the available sources of funding; and what lessons can be learned from other jurisdictions

**Efficiency of the Business Rates and Council Tax Systems**

4. The business rates and council tax systems are both administratively efficient systems. They have both provided high levels of certainty regarding yield e.g. in-year collection rates in 2017-18 were 98.4% for business rates; and 97.11% for council tax. The costs of maintaining the tax
bases and costs of collection are very low relative to the yield; and accuracy of the tax bases is high.

5. There are, however, issues with both council tax and business rates, which if addressed, would make them ‘more fit for purpose’; and provide greater sustainability in both the systems.

6. The size of the non-domestic rate multiplier is a significant factor in the affordability of business rates. The Institute’s view is that an objective of system change should be to significantly reduce the multiplier, by as much as half, and for that to take effect within the life of the 2021 valuation list in England. Mechanisms for achieving that, whilst maintaining adequate funding levels for local government, include:
   • adjusting the balance of funding between non-domestic rates and council tax and making the council tax system more progressive; and
   • augmenting local government property-based business taxes with additional revenue streams, such as a digital services tax (or internet transaction charge).

A case for adjusting the balance of funding between non domestic rates and council tax and making the council tax system more progressive

7. Whilst there may be political reluctance to review the council tax, there are several justifications for doing so:
   • Property value changes have not been adequately captured and reflected in changed assessments over the years (houses with extensions, granny annexes etc.), meaning the lists are out of date in all local authority areas
   • The value of some properties has grown at different rates compared to others so inequities have emerged between individual properties and between regions that have experienced different house price trends.
   • The tax is high regressive, due to
     ▪ the operation of the wide-value bands
     ▪ the ratios of rates applied to each band
     ▪ the Single Person Discount not correlating to ability to pay.
8. We advocate a reform of council tax, to include:
   - revaluation of all domestic properties to establish up-to-date relativities in value
   - committing to regular and frequent revaluations
   - Considering use of council taxpayer-assisted valuations
   - Removing the Single Person Discount and supporting those who require financial assistance through other means
   - Making the system more progressive by valuing all domestic property on a capital valuation basis and applying a proportional tax on a percentage of the value. Research by the Resolution Foundation\(^1\) indicates that for 2015-16 a proportional tax of 0.5 per cent of capital value would have boosted annual revenues in Great Britain by £1.6 billion compared to council tax. A slightly higher proportional tax of 0.7 per cent would have boosted revenues by £12.7 billion. A one per cent tax rate with a £100,000 tax-free allowance per property would have meant no tax for the bottom 14 per cent of properties in 2015-16. A higher rate of 2 per cent on marginal property values above £500,000 would have raised £8.4 billion in the same year.

Augmentation of local government property-based business tax revenues with additional revenue streams

General principles

9. Business ratepayers and council tax payers benefit in different ways from local authority services, and to differing degrees. The decision as to how the tax burden for paying for those services should be allocated between different types of taxpayer is essentially a political one. One reason for this is the inherent difficulty in estimating the benefits to a given group of users of the local authority service that they consume.

10. Various studies have examined the extent to which businesses could be charged for services received, and concluded that businesses already pay charges for services which can be clearly costed, such as energy use; and that a much-expanded system of charges for other local government services is neither technically feasible nor politically desirable. With the advent of modern revenue administration techniques and the desire to find new sources of revenue, this view now seems a little dated in the context of the post-balance of funding debate.

11. Local taxes should be a mix of stable and predictable sources, such as the property tax and a range of alternative buoyant sources of revenue, to reduce the gearing effect. They should be economically efficient in that local taxes must try to avoid perverse distortions of taxpayer behaviour. The economic efficiency argument is often cited in the context of local sales taxes and cross-border shopping. There is an upside to creating economic distortions though; society may want to affect individuals’, households’ or firms’ behaviour when markets are working badly.

12. Local authorities should be accountable, i.e. locally determined expenditure should be funded by locally determined taxation. The property tax has one particular advantage over other taxes in that it provides a reasonably clear and effective system of accountability to the electorate. The tax base varies only marginally annually and, therefore, increased expenditure by regional

governments or local authorities often results in high taxpayer awareness of the levels of tax; this, however, this can be obscured by the gearing effect. Recent developments in rate retention are a step in the right direction; however, the necessary equalisation tools such as “tariffs and top-ups” distort this argument.

13. The base of an ad valorem property tax is more dynamic and more likely to grow in relation with the GDP growth, because it is linked to market value. Also, an ad valorem property tax necessitates the implementation of tighter management and of a more comprehensive registration and data gathering system. Thus, an ad valorem property tax will provide a larger as well as a much more dynamic base.

**Alternatives to property-based business taxes, such as the proposed digital services tax**

14. The Institute regards the word ‘alternatives’ in this heading as being inappropriate: business rates should be augmented by a complementary basket of revenue sources that will ensure that local taxation of businesses reflects current economic trends. The ideal scenario would be to enable a reduction in the total business rates yield and maintaining the overall yield by the addition of complementary taxation or revenues mechanism.

15. In investigating the alternative sources of local revenue, the Institute has considered those sources of revenue that:

- Are in existence and which could be hypothecated to local government.
- Are supportive of environmental objectives and which were seen as appropriate sources of local income.
- Provided a reasonable level of buoyancy.
- Assisted the balance of funding by directly contributing to local budgets.
- Are administratively efficient in terms of collection.

16. They fall in to several categories and wherever possible should relate to the implementation of policies that directly improve the environment; and support economic challenges.

**Policy-related environmental charges**

17. United Kingdom local governments appear to perform much worse than their counterparts in North America in raising income from fees and charges. In the United States local governments’ total revenue from user fees represents up to 28% of all local government revenue, whilst in the UK, income from sales, fees and charge’ is less than 15% of local government income.
18. The Institute believes the government should set a target for the amount of local income that should be raised through sales, fees and charges. These targets should be demanding, with a level of 20% being achieved within five years and 30% within ten years.

19. The effort local government is putting in to maximise fees and charges seems low and was raised in the former Audit Commission publication “The Price is Right”. When maximising the income locally, administrations should have regard to social need and ensure differential charging policies protect those in need.

20. The Institute has considered the viability of developing a series of discretionary, policy-linked taxes and charges that could be collected and retained at a local level.

21. These charges consist of specific levies for a series of issues that could be regarded as matters driven by local policy decisions. They, therefore, fulfil two objectives:-
   - To meet a specific policy, and
   - Raise local revenue.

22. Taxes and charges within this category include:-
   - Traffic Management Revenue such as Congestion Charging, emission charges, business parking, tolls and road pricing, car occupancy and Speed Control, and Safety Measures. There are many examples of successful operation of these schemes. With the continuing impact of global warming and the diminution of fossil fuels there is a certainty that these taxes will become more and more prominent. It is logical that local government should benefit from these revenues.
   - Betting and Gaming Levies such as licence fees and local turnover taxes. Government policy in this area is developing rapidly. Revenue generation could be considerable.
   - Accommodation Levies such as a charge for the use of a hotel room. This could incorporate a model where the tax is raised as a levy at the point of exit from the country. Such an approach would protect the domestic holiday maker and would be relatively easy to administer as a levy on foreign holiday makers.

Revenue sources directly related to the enhancement of local economic challenges

Digital Services Tax or Internet Transaction Charge

23. Arguments for a Digital Services Tax (DST) to date have given little consideration of how it would work in practice. The Institute is shortly to begin work on examination of the delivery mechanisms that DST would require; and will be pleased to share the findings of the resulting report.

24. An Internet transaction tax or a delivery tax is worthy of detailed consideration. Bricks and mortar businesses, particularly in the retail sector have been struggling to cope with the increase in alternative internet-based retail businesses; they have to compete on price with those internet-based businesses, even though those on-line businesses generally face significantly lower fixed costs.

25. Over the last three years, Governments in many countries have become more concerned about the impact of internet retail on the bricks and mortar retailer.

26. Any internet retailer operating in Great Britain and Northern Ireland will have an administrative centre, which would consist of call centre facilities, administrative buildings and a distribution warehouse. Any of these facilities that satisfy the four ingredients of rateable occupation
would attract rate liability. Many of the major on-line providers use outsourced facilities and again these would attract a rate liability. However, the actual internet traffic determining the transaction itself would escape liability. There are situations where on-line retail activity is operated from a dwelling house, in these circumstances an effort would be made to place a value on the commercial part of the building and then the retailer could be charged rates in the normal way; however, the difficulty is in finding the location and then identifying a separate rating assessment. The practice on this varies across the various parts of GB and Northern Ireland.

27. It has been considered whether the signal pulses on the internet could be measured and if some form of virtual rating assessment could be created; but under the current legislation and case law in all parts of Great Britain and Northern Ireland this would be most unlikely. The problem is that this sort of traffic already attracts rate liability through the providers of telecommunications. In these circumstances major providers of cables are rated on a basis which attempts to place a value on the volume of activity. This situation means that any attempt to create an assessment based on virtual traffic would amount to double taxation. There are also difficulties with the majority of the bricks and mortar retailers, who run online services, alongside their normal retail activity. These retailers, range from major chains through to small high street retailers.

28. If there is a desire to level the playing field between the bricks and mortar retailer, and the online retailer, we believe this can only be achieved by a form of sales tax or a internet transaction charge. In Europe, it is often said that a sales tax would be in conflict with European Law because of the levy of value added tax. This only leaves the option of a transaction charge which would be relatively easy to administer and collect because it could be operated by the retailer themselves as part of the selling processes.

29. The approach of a sales tax or a transaction tax does exist in Countries around the World, but we draw specifically with current operations in the USA and Canada, where this type of activity has been subject to a sales tax for a number of years and where they are moving forward to levy an online transaction tax in addition to the existing sales tax.

30. In the US each individual state has the option to levy a sales tax in addition to conventional property taxes. This has been the practice for a number of years however in the last two years there have been significant moves to raise a levy on internet retail transactions.

31. In Canada and New Zealand there are several sales taxes which vary from province to province. There are specific rules on where the tax is raised, which address in an interesting way how “out of country” transactions are taxed.
**Green taxes**

32. The UK government has already started to introduce the concept of green taxes but the Institute believes that there is more scope for such taxes to be introduced at a local level.

33. Pure green taxes are there to change behaviour rather than raise taxes, however there is a strong argument for these taxes to be levied and collected locally; and given that local authorities will have major environmental objectives, the fact that they should retain this income seems logical.

34. Pay-as-you-throw (PAYT) is already used for commercial waste. Local authorities are considering significant investment in technology to measure domestic refuse. Whilst the Institute supports these initiatives it is concerned at the economic efficiency of this approach and would rather adopt a “reward” system rather than one based upon inefficient charges.

35. The Institute believes a range of green credits would be economically efficient. They could be used for purchase of local authority services or to reduce council tax or business rate bills. The green credits would be gathered through an intelligent point accumulator card. Credits would be earned by various measures such as re-cycling, environmentally friendly building construction, and progressive and economic uses of energy. Local partnerships could be developed with key community service providers and retailers to develop these initiatives.

36. As well as a range of green credits, the Institute would like to see the government develop local taxes related to the carbon footprint of buildings. This could be linked to a carbon abatement incentive which would contribute to the range of green credits.

37. There is likely to be a very positive role for local government in the development of green taxes and green initiatives linked to local taxes and we recommend that further research should be undertaken as to their suitability for local government.

**Gambling licences and levies**

38. The national lottery has a standard tax level of 12% based on the volume of sales. Local government was the pioneer of large-scale lotteries in the United Kingdom and it could be argued that much of the success of the national lottery has built upon the pioneering work carried out by local government.

39. It is the Institute’s view that the 12% tax element should be paid to local government. The collection process should remain as now but the tax collected should be specifically directed to the area in which the lottery sales occur.
New or enhanced land and property taxes

40. The three principle bases for the property tax tend to be capital improved value, annual rental value and land value. There are some instances where a country or jurisdiction may apply more than one basis at the same time. For example, in Northern Ireland residential property is valued on its capital improved value whilst commercial property is valued on annual rental value. There are a number of jurisdictions in the United States that value land and buildings separately for the purposes of applying different tax rates (several jurisdictions in Pennsylvania).

41. From an international perspective, given the choice of property tax basis, land value tends to be the least used. It is a conceptually sound system but with limited international application.

42. A system of land value taxation should ideally be based upon the concept of highest and best use. This creates difficulties when considering the value of historic and heritage property located on extremely valuable sites. A system of ‘value’ relief would have to be considered in order to protect such buildings. Equally, there are other instances where highest and best use should not apply, for example, agricultural land used for farming but under developmental pressures.

43. Under a land value system all land is normally included in the tax base including agricultural land. However, special consideration has to be given to land devoted to agriculture; this is normally applied through the valuation process where values are based on existing use rather than highest and best use. In the United Kingdom the problems of adopting a land tax is fraught with difficulty, especially in having evidence to support values and transparency in terms of ownership.

April 2019