Local Government Finance (Wales) Bill

Submission to Senedd Local Government and Housing Committee

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Preamble

1. Stuart Adam is a Senior Economist at the Institute for Fiscal Studies (IFS), working in the tax sector. David Phillips is an Associate Director at the IFS, leading its work on devolved and local government finance. All views stated in this submission are those of the authors; the IFS has no corporate views on these or other issues.

2. This response focuses on a subset of the questions the Committee has sought views on. It is accompanied by the Executive Summary of the IFS's recent report examining the potential impacts of revaluing and reforming council tax in Wales, focusing on the approaches set out in the Welsh Government's consultation. The full report and accompanying spreadsheets are available for download here: https://ifs.org.uk/publications/assessing-welsh-governments-consultation-reforms-council-tax.

General comments

3. One of the key aspects of the bill is to grant Ministers regulation-making powers on a wide range of issues: the provision and generosity of non-domestic rates reliefs and exemptions; the timing of non-domestic rates revaluations; the multipliers applied to different types of non-domestic properties; and the provision and generosity of council tax discounts and disregards. The explanatory memorandum also states that Ministers would have the power to vary the timing and/or cycle length of council tax revaluations, although it is not clear whether this would be via regulations laid before the Senedd.

4. The justification for these regulation making powers is to enable Ministers to respond flexibly and promptly to changing circumstances and policy priorities. The Welsh Government also highlights the potential to rationalise the legislative treatment of non-domestic rates reliefs, where some are defined under primary legislation and others via local authorities' general discretionary powers conferred under primary legislation. These need to be traded off against: (a) the reduced opportunities for scrutiny and debate for changes made via regulation as opposed to primary legislation, and (b) the potential benefits of limiting Ministers' discretion to tinker with policy, whether that be by frequently changing reliefs and exemptions (which causes instability and uncertainty) or repeatedly postponing important but sometimes politically difficult revaluations of properties.

5. We are not best placed to say how these factors should be traded off. However, we note that the regulation-making powers granted in the Welsh Tax Acts (Power to Modify) Act are to be used only in particular circumstances: (a) to comply with international obligations; (b) to protect against tax avoidance; (c) to respond to changes made by the UK government; and (d) to respond to courts and tribunals. It may be possible to set out similarly a set of circumstances when the regulation-making powers and other discretionary powers granted under the Local Government Finance Bill could be utilised to reduce the risk they are used in ways that the Senedd deems inappropriate.

Revaluation

6. The bill proposes to increase the frequency of revaluation of non-domestic properties to a 3-yearly cycle, by default, and introduce 5-yearly cycles of revaluations for domestic property (i.e. council tax). Both in would represent improvements on the current system from a policy perspective, but would entail some additional administration costs.

    a. Moving from 5-yearly to 3-yearly cycles for business rates would mean that tax bills can, in principle, respond more quickly to changes in economic circumstances and the resulting changes in rental values – although responsiveness in practice will still depend on the design of transitional relief schemes. Aligning with revaluations being undertaken in England may also have some benefits in terms of minimising costs. However, as the explanatory note explains, more frequent revaluations would entail some additional valuation and administration costs. More frequent revaluations would also see bills change more often in ways that businesses might find hard to predict, but the changes should generally be smaller than at less frequent revaluations and so easier to respond to. Determining the appropriate revaluation cycle therefore involves trade-offs. We are not well placed to fully judge that trade-off, though we note that the cost of more frequent revaluations should be lower now given the increasing use of computer-based statistical modelling.

    b. Introducing a regular revaluation cycle for council tax would help avoid the current situation whereby council tax is based on the relative value of properties more than 20 years ago – a period of time which means that over 40% of properties are now effectively in the wrong band. Undertaking revaluations on a predictable cycle rather than an ad hoc basis would have several important benefits. It would help households to plan – including when buying and selling properties. It would also help the Valuation Office Agency and local authorities to plan. And it would hopefully increase the likelihood of revaluations actually taking place.

    c. Revaluing properties more frequently than the suggested 5 years would more closely align council tax bills with contemporaneous property values (the underlying tax base). However, as with non-domestic rates, more frequent revaluations would entail additional valuation and administration costs. More frequent revaluations would also see bills change more often in ways that households might find hard to predict, but the changes should generally be smaller than at less frequent revaluations and so easier to respond to. Determining the appropriate revaluation cycle therefore involves trade-offs. We are not well placed to fully judge that trade-off, though we note that the cost of more frequent revaluations should be lower now that valuations are mostly based on computer modelling rather than manual assessments.

    d. Under the current 5-year Senedd terms, a 5-yearly cycle could be aligned so that revaluations took place at a point in a term where there would be least political pressure to cancel or postpone it, which may help ensure it actually takes place. This may suggest that from a political perspective, a 4-yearly cycle could be better than a 5-yearly cycle if the Senedd moves to 4-yearly elections as planned.

7. The explanatory note to the bill says that Ministers will have the power vary the timing and/or cycle length of council tax revaluations. Given experience across the UK of how politically difficult it is to keep council tax up-to-date, there is a risk that if this power is unconstrained, revaluations will be repeatedly postponed.

Non-domestic rate multipliers

8. The bill allows for different multipliers to be set for different properties (based on value, type/usage and location, for example). The stated aim is to allow Ministers to support or disincentivise particular sizes and types of businesses and particular locations. We would note that:

    a. Reliefs can be used to give effect to lower tax rates already, and can vary by size, type/use and location of property. There is currently no mechanism to charge higher-than-standard tax rates, so this would be a new power under the proposals. The Committee may wish to consider whether transparency and scrutiny would be served better by having varying multipliers (tax rates), or through having reliefs and premiums applied to the standard multiplier. Both of these approaches can be used for the same practical effect but may be interpreted differently by taxpayers and other stakeholders.

    b. It is unclear whether applying different non-domestic rates multipliers to particular properties would achieve the types of objectives the Welsh Government envisions. While temporary and/or sectorally targeted reductions in rates are likely to benefit the occupiers of properties, long-standing and broad reductions in rates are likely to largely benefit landlords as rents are bid up, as the lower cost of rates increases the demand for properties. On the other hand, a revolving series of multiple temporary and highly targeted reliefs would increase the complexity of the business rates system, and distort the commercial property market. In general, the aim should be to simplify the non-domestic rates system rather than complicate it further.

Council tax reference band

9. Current legislation requires that Band D be the reference band for council tax. In principle this need not constrain the design of banded tax systems – as with the approaches set out in the Welsh Government's consultation, one can add new bands below D and label them, for example, "A1", "A2", etc. However, the flexibility to use a different naming convention may make it easier to communicate more radical reforms of the council tax system.

10. Ultimately, more important than the reference band and naming conventions is the design of the council tax rate structure. From a policy perspective, systems with many more bands or based on continuous (point) values rather than bands would be better than the current system. Such systems would allow tax bills to be aligned more closely with property values, avoiding the situation under the current system whereby properties with very similar values can see tax bills that are hundreds of pounds different if they either side of a band threshold. Systems with many more bands or point values would also make it easier to make council tax less regressive: currently, making it less regressive overall increases the size of the jumps in bills at the small number of tax band thresholds that exist. In other words, there is currently a trade-off between vertical equity (making the tax less regressive) and horizontal equity (avoiding big differences in bills just either side of band thresholds), which could be ameliorated with systems with many bands or avoided completely with point values.

Final Point

11. While this Inquiry is focused on the Local Government Finance Bill rather than the ongoing consultation on council tax reform, we have attached the summary of our analysis of the approaches to reform set out in that consultation.