



Llywodraeth Cymru  
Welsh Government

RESEARCH

# An assessment of the feasibility of a local income tax to replace council tax in Wales: summary

Reviews international literature and presents qualitative interviews to assess the practicalities of local income tax as a replacement for council tax in Wales.

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## 1. Research aims and methodology

The main purpose of this research was to explore the feasibility of a local tax based on incomes in Wales to replace council tax, and to identify any further work required if the Welsh Government were to take forward such a concept in the future. It sought to appraise the options for shifting the design of local taxation in Wales from property value to assessments of income, and translate these conceptual options into practical action. This included consideration of the key barriers to the implementation of this kind of reform, and the potential impact it may have on taxpayers.

The first stage of the research was to review the literature on the use of local income taxes in other countries, seeking to understand where and how it is used and any issues it presents as a form of local taxation. Themes were developed by coding the literature into key aspects of the design, implementation and impact of a local income tax. The second stage of the research used these themes as the basis of interviews with 18 key stakeholders with expertise or experience of local taxation, socioeconomics and household finance. Findings from the literature review and interviews were compiled to define the key considerations in developing a local income tax for Wales.

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## 2. Key findings

### International uses of local income tax

Eighteen out of 37 Organisation for Economic Co-operation and Development (OECD) countries use some form of local income tax. Evidence suggests that in all of these countries the tax is collected at source through the equivalents of pay-as-you-earn and HMRC, however, the concept being considered for Wales due to the devolved context is one which would be locally assessed and collected. Local income tax makes up a small proportion of local revenues (less than 20% in some countries, such as the US, Spain and Korea), whereas it represents more than 90% of local revenues in Finland and Sweden. At least six of the eighteen countries identified require universal self-assessment tax returns for all taxpayers. Local discretion over tax rates is common, but varies in terms of the range of tax rates. There are some useful lessons to be learnt about equalisation from Denmark and Sweden. There are no current international examples of a local income tax which is assessed and collected at the local level, as is being considered for Wales.

### Designing indicators of ability to pay

The design of a local income tax requires careful consideration of what should be indicators of ability to pay. These indicators need to be reliable and accurate. There are many types of income and wealth which could influence someone's ability to pay, and deciding which to include may be the most challenging aspect of designing a local income tax.

Income from employment will be the major indicator of ability to pay, but variable working makes this more complicated to assess. Self-employed income should be treated the same as income from employment, though the different chronology of taxation of self-employed income presents challenges. Savings and investments could be considered a factor in ability to pay. The inclusion of income from Universal Credit or other benefits prompts consideration of a minimum income threshold for local income tax. Taxation of pensioners may be crucial in the perception of local income tax, given criticisms of council tax being

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unfair for those with reduced income later in life, though the extent of this requires further analysis as pension-age households are currently liable for council tax. If pension income was not included in the scope of an assessment of ability to pay, this will inevitably shift the burden of taxation onto the working-age population.

The literature and interviewees put forward many reasons for bills to remain at the household level, rather than switching to an individual basis, but this is at odds with the international approach. Ability to pay could be based on more than income alone, though it may be difficult to accommodate all potential circumstances. Some interviewees felt that it was not the role of a tax to be sensitive to household circumstances. A key benefit of a local income tax may be the ability to design in from the outset things which are normally dealt with through discounts and exemptions, such as low incomes or student status. This relates to the idea of a minimum income level, which would cause many who currently receive discounts and exemptions to fall out of the system automatically.

## How to assess ability to pay

Interview discussion focused on two main options: data-sharing between agencies such as HMRC or DWP and local authorities, or purely local assessment and collection. Data-sharing was seen as an obvious initial option, but one which would present challenges. It may be difficult to reach agreement for such arrangements and to make them reciprocal. In terms of purely local assessment and collection, positive views were expressed about the existing abilities of local authorities to assess finances, but there were reservations over the potential increase in the scale of the work and the different types of income which would need to be assessed to get a full picture.

The time period over which to assess income would be important as this influences the chronology of collections and the predictability of revenue. If income is self-reported this introduces a risk of inaccurate reporting and will require some form of auditing process. There is a need to be realistic about how large a change a local income tax would be in terms of requiring reporting of income, given that most people in Wales currently have very little direct

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interaction with the tax system. Reporting could be perceived as burdensome or intrusive, so care would need to be taken in communications to the public which accompanied this kind of change.

Existing tools such as the Standard Financial Statement (SFS) are used to assess household finances, but the SFS is limited in terms of its universal applicability and the assumptions it makes about living costs may be inconsistent with the wider social security system. Overall, local assessment and collection will only be viable if the costs do not outweigh the benefits in terms of revenue yield and overall fairness to taxpayers.

## Local discretion

The theoretical literature supports local authorities having discretion over their own tax rate to promote responsibility and encourage them to improve the prospects of their residents. Many interview participants also saw this as a key potential benefit of local income tax, both practically and symbolically. Some suggested that variation should be limited to a small range to avoid large inequalities, and highlighted that the actual rates charged may converge over time to a point where there is little actual variation across Wales. Local discretion over rates was not popular with the public when the Scottish Government conducted a consultation on local income tax in 2008. Equalisation of overall funding will need to be carefully designed so as not to remove the incentive effects for local authorities to develop their revenue potential.

## Budgeting

A key decision for a local income tax would be whether to redesign the timelines associated with local taxation to align with the availability of information, or try to fit into the current system. Different forms of income will be paid and assessed at different intervals, introducing delay into the assessment process depending on how ability to pay is defined. A holding tax could incentivise taxpayers to provide their financial information, whilst ensuring a predictable yield from those who choose not to opt in to the new system. The rate of a holding tax would be challenging to calculate.

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## Policy development and piloting

Pilot projects would allow different versions of a local income tax to be trialled to understand how they work in practice, but pilots can introduce unfairness which could be unpopular or open to legal challenge. A local income tax which involves the public in all three stages of design, implementation and evaluation may encourage greater support as opposed to a new system which is imposed in a 'top-down' style.

## Transitional arrangements

The transition from council tax to a local income tax would need to be carefully planned, with consideration given to reliefs and other schemes to ease the impact of sharp increases in bills. Local authorities could defer the implementation of the scheme to give taxpayers plenty of notice of the changes if permitted. They could consider payment deferral schemes for those without the funds to make payments as normal. Transitional reliefs over a defined period have been used successfully in Wales and Northern Ireland previously, though these come with significant costs. The timescale of reform is uncertain, but could be considerable, with previous estimates being longer than a single Senedd term. This may depend on the extent of legislative change required and the ability to achieve political consensus. Transition schemes introduce large expenses, but this is not unique to a local income tax and would be a factor in all major tax reforms.

## Behavioural changes

The length of the border and concentration of taxpayers in border local authorities increases the potential scope for fiscal flight from Wales to England for those for whom a local income tax would be more expensive than council tax. Particular care should be taken when designing the system for students to protect the future workforce and tax-base. Fiscal flight is likely to be concentrated on high earners with the means to move, but even losing a small number of high earners would have a significant impact on the tax-base. If local

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authorities have discretion to set their own rates, fiscal flight at a local level could manipulate the tax distribution across Wales, creating a risk of a 'race to the bottom' to attract higher earners to local areas. The extent to which taxpayers are incentivised to work or make savings will depend heavily on the way in which ability to pay is defined. This will also dictate how many opportunities taxpayers have to manipulate their finances to reduce their exposure to local tax. Interview participants disagreed about how many people may be influenced in their decisions about work, and whether problems of this kind are already present under council tax. If a tax based on income did have a general deflationary impact on willingness to work, this could significantly reduce the tax-base.

## **Public understanding and perception of fairness**

Public approval and understanding of local taxation are interconnected, meaning communication requirements for a local income tax must be considered at an early stage of the design. The quality of local services influences public attitudes, but only to an extent. Previous public consultations suggest that the level of the bill is often most important. Interviewees suggested that putting the rationale for reform into a moral context may increase public support, as long as it is supported by evidence. The practical interactions that taxpayers have with the local authority as the tax administrator are important, and protection of personal data would play a big part in fostering trust and support.

## **3. Conclusions and further evidence needs**

These findings illustrate that a locally administered income tax for Wales would be a unique system when considering international examples of local taxation. It presents a number of challenges, the most significant of which is likely to be how to define ability to pay. Many aspects of the implementation of a local income tax would require significant expansion of current provision and existing skills in local authorities, so it is key that they are involved in the design process. One key benefit of a local income tax may be the ability to design in from the outset an assessment of ability to pay, something which is achieved to some extent through the current discounts, exemptions and reduction schemes, but only for the lowest earners.

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This research has also highlighted where gaps in the evidence base remain if such a reform were to be taken forward. To support further exploration of the feasibility of a local income tax in Wales and its possible design, the Welsh Government should consider conducting the following research:

- Model the economic realities of a local income tax. The primary aim of modelling should be to predict the revenue raising potential of a local income tax. Modelling should also increase understanding of how the burden of local taxation may change for different demographics, and any equality implications.
- Investigate the extent to which citizens of pension age struggle to pay council tax, using these findings to inform the definition of ability to pay for local income tax and to decide whether alternative provision would be required for this demographic.
- Investigate in greater detail the feasibility of data-sharing in relation to assessing ability to pay, involving key stakeholders.
- Investigate further the kinds of employment which contribute most to the tax-base in Wales, to understand the level of potential volatility during economic downturns.
- Consult local authorities to understand their views on the feasibility of local income tax in much more detail, once a clear set of options for its administration has been developed. The focus of this consultation should be the practical challenges which would need to be overcome for local authorities to successfully transition to and administer a local income tax.
- Consult the public on the concept of a local income tax and whether local authorities should have the discretion to vary their rate. This consultation should be part of wider communications which clearly explain the rationale behind the reform.
- Conduct a research with the public to understand what factors inform decisions about moving home. This could improve understanding of the true risk of fiscal flight to other countries, or between local authority areas, in response to tax reforms.

## 4. Contact details

Jennie Bunt, Cardiff University, on ESRC internship to the Welsh Government

Full Research Report: Bunt, J. (2020). An assessment of the feasibility of a local income tax to replace council tax in Wales. Cardiff: Welsh Government, GSR report number 74/2020.

Views expressed in this report are those of the researchers and not necessarily those of the Welsh Government

For further information please contact:

Dr John Broomfield  
Local Government Strategic Finance Division  
Welsh Government  
Cathays Park  
Cardiff  
CF10 3NQ

Email: [localtaxationpolicy@gov.wales](mailto:localtaxationpolicy@gov.wales)



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