

What Would I Pay in Local Income Tax?

Council Tax is unfair. It is based on purely notional property values. But the value of your house does not pay your Council Tax. You cannot sell off a few more bricks from your house every month to pay your Council Tax. In practice most of us have to pay our Council Tax from our incomes. And our incomes may bear no relation whatsoever to the value of our homes.

Take the following examples (figures refer to 2011-2012 tax and pension rates):

Jean Black is a 74-year old widow. Her only income is her state pension and pension credit of £137.35 per week (£7,142 per year). She has modest savings that make her ineligible for Council Tax Benefit. (The interest on her savings struggles to keep pace with inflation, so it is not real income.) She lives in her married home, a Band D house in Glasgow. Even with the single person's discount of 25%, she pays £910 in Council Tax, excluding water charges -12.74% of her income. If, like many pensioners – see below – Jean does not claim the Pension Credit to which she is entitled, her Council Tax will represent 17.13% of her basic state pension of £102.15 per week (£5,312 per year).

John and Jessie Green also live in a Band D house. John is the only wage earner. Jessie stays at home to look after their two young children. Their total income, including benefits, is £25,000. Their Council Tax, £1213, represents 4.9% of their gross income.

Paul and Moll Brown also live in a Band D house with their two grown-up sons, Henry and Joseph. All have jobs, and the total gross family income is £90,000. They pay exactly the same Council Tax as John and Jessie Green – but this is only 1.3% of their total gross family income.

Jeremy and Margot Gray live in a two million pound mansion (Band H). Both are company directors, and their joint incomes are £200,000. Their Council Tax, £2,426, represents 1.2% of their gross income.

It is true that people on very low incomes, and with little or no savings, are eligible for Council Tax Benefit, Income Support, Pension Credit and other benefits. But there is overwhelming evidence that means-tested benefits do not work fairly, and cannot be made to work fairly. Many people do not claim the Pension Credit, Council Tax Benefit and other benefits to which they are entitled. For example, in a report published on 25th June 2009, the Department for Work and Pensions estimated that, UK-wide, the number of people who did not claim Council Tax Benefit in 2007-2008, although they were entitled to claim it, was between 2.33 million and 3.06 million. And even modest savings make people ineligible for Council Tax Benefit. Needless to say, an income-based tax would do away with the need for a separate Council Tax Benefit.

What if Council Tax were replaced by a flat-rate income-based tax ring-fenced for local government expenditure (Local Income Tax, or LIT)? There are two points to remember:

- (1) Income-based taxes are calculated on TAXABLE income, not GROSS income. Nearly everyone (the exceptions being those with incomes above £115,000) has a tax-free personal allowance. For 2011-12, the personal allowance – subject to certain limitations of income – is £7,475 for those aged under 65, £9,940 for those aged 65-74, and £10,090 for those aged 75 and over. There are also other tax-free allowances including most contributions to (non-state) pensions, donations to charities through Gift Aid or Payroll Giving, and trading losses.

Your taxable income is your gross income **less** your personal allowance and any other tax-free allowances.

- (2) Under a flat-rate income-based tax, everyone pays exactly the same **percentage** of their taxable income.

So how would Local Income Tax affect the people in our example? Assuming that their personal allowance is their only tax-free allowance, their TAXABLE incomes in 2011-2012 would be as follows. (If, of course, they had other tax-free allowances, their taxable incomes would be even lower.)

Jean Black: No taxable income. Her pension is less than her tax-free allowance of £9,940

John and Jessie Green: £17,525 (25,000 less £7,475)

Paul and Moll Brown's family: £60,100 (£90,000 less £29,900 [$£7,475 \times 4$])

Jeremy and Margot Gray: £185,050 (£200,000 less £14,950 [$£7,475 \times 2$])

Depending on the proportion of Council expenditure met from central government grants, most political parties have estimated that the amount of Local Income Tax would be between 3% and 5%.

If LIT were set at 3%:

Jean Black would pay nothing (compared with £910 Council Tax), as her income is below the tax-free allowance.

John and Jessie Green would pay £526 (3% of £17,525) compared with £1213 Council Tax.

Paul and Moll Brown's family would pay £1803 (3% of £60,100) compared with £1213 Council Tax.

Jeremy and Margot Gray would pay £5,552 (3% of £185,050) compared with £2,426 Council Tax.

If LIT were set at 5%:

Jean Black would pay nothing (compared with £910 Council Tax), as her income is below the tax-free allowance.

John and Jessie Green would pay £876 (5% of £17,525) compared with £1213 Council Tax.

Paul and Moll Brown's family would pay £3,005 (5% of £60,100) compared with £1213 Council Tax.

Jeremy and Margot Gray would pay £9,252 (5% of £185,050) compared with £2,426 Council Tax.

So clearly those on lower incomes would benefit compared with those able to pay their fair share.

Most of us can easily work out what we would pay under a Local Income Tax, whatever the tax rate.

- (1) **Take your GROSS ANNUAL INCOME.** [You will find your gross annual income on your P60 Form. Or you will find it on your pay slips, pension advice, etc: multiply by 12 if paid monthly or by 52 if paid weekly].
- (2) **Take your total TAX FREE ALLOWANCES.** [The simplest way to find your tax-free allowances is to look at your tax code. You will find your tax code on the annual tax coding notice issued annually by Her Majesty's Revenue and Customs (HMRC), or you will find it on your P60 Form, pay slips, pension advice, etc. Your tax code consists of a number and a letter. If the letter is replaced by a '9', then this represents the tax-free allowance allocated by HMRC. For example, if your tax code is 747L, this would mean you had a tax free allowance of £7479 . Most of us can easily work out our tax free allowances for ourselves by adding together our personal allowance, non-state pension contributions, etc.]
- (3) **Subtract your total TAX FREE ALLOWANCES from your GROSS ANNUAL INCOME to give your TAXABLE INCOME.**
- (4) **Then multiply your TAXABLE INCOME by 3%, 5% or whatever LIT rate is proposed. This will show the amount of Local Income Tax that you would pay. Then compare this with what you pay in Council Tax!**

Examples:

Gross Annual Income = £24,000

Total Tax Free Allowances = £7,475

Therefore Taxable Income = £16,525 (£24,000 minus £7,475)

Therefore Local Income Tax at 3% = £496; Local Income Tax at 5% = £826

Gross Annual Income = £40,000

Total Tax Free Allowances = £7,475

Therefore Taxable Income = £32,525 (£40,000 minus £7,475)

Therefore Local Income Tax at 3% = £976; Local Income Tax at 5% = £1,626