



Ministry of Housing,  
Communities &  
Local Government

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Title: **Needs & Redistribution Technical Working Group**

Paper: NR TWG 19-03: Notional council tax level in the review of relative needs and resources

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Venue: Local Government Association, 18 Smith Square, London

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## Summary

1. A local authority's final funding position is determined by its relative need allocation, its relative resource adjustment, its actual resources income, and any potential transitional arrangements:

$$\begin{array}{|c|} \hline \text{Final} \\ \text{funding} \\ \text{position} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Relative} \\ \text{need} \\ \text{allocation} \\ \hline \end{array} - \begin{array}{|c|} \hline \text{Relative} \\ \text{resource} \\ \text{adjustment} \\ \hline \end{array} + \begin{array}{|c|} \hline \text{Actual} \\ \text{resources} \\ \text{incomes} \\ \hline \end{array} +/- \begin{array}{|c|} \hline \text{Transitional} \\ \text{arrangements} \\ \hline \end{array}$$

2. This note:
  - a. **is** about the impact on the funding position of individual authorities of using a higher or lower notional council tax level;
  - b. **is not** about 'winners' and 'losers' from the review, since this comparison depends, for example, on the funding position of each authority in the year preceding implementation;
  - c. takes no account of potential **transitional arrangements**.
3. In summary:
  - a. if an authority's actual council tax level is *below* the notional council tax level, then setting a lower notional (to move towards their actual) will not improve their funding position if their share of needs exceeds their share of tax base;
  - b. conversely, if another authority's actual council tax level is *above* the notional council tax level, setting a higher notional (to move towards their actual) will not improve the funding position if their share of the tax base exceeds their needs share;
  - c. in all cases, because **actual council tax receipts remain with the local authority**, all authorities benefit from a higher actual council tax level.

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4. **Final decisions** on the notional council tax level will be subject to the outcome of the Spending Review, business rates retention reform and the December 2018 consultation, and the Government is keen to hear wider views before proceeding.

### Notional council tax level

5. The Government is minded to use a notional council tax level in determining the resources adjustment in the review of relative needs and resources. Using a **notional council tax level** strips out the effect of local choice on baseline funding levels: in general, baseline funding levels are higher for authorities with higher relative need, and lower for authorities with larger taxbases. The **actual council tax level of an authority has no impact** on the calculation of their baseline funding level. However, if two authorities had an equal share of relative needs and taxbase, the authority with a higher actual council tax level would have a higher final funding position.
6. In determining where to set the notional council tax level, there are key questions to consider, such as:
  - a. What proportion of available resources should be allocated according to relative needs? Or, in other words, to what extent should the incidence of council tax be 'equalised' in the relative resources adjustment, as part of national notional spending power?<sup>1</sup> (This would tend to argue for a notional council tax level around the average Band D level.)
  - b. All other things being equal, should authorities whose taxpayers pay more in council tax retain more business rates in the redistribution process (through incomplete equalisation), with the opportunity for higher levels of services? (This would tend to argue for a notional council tax level below the average Band D level.)
7. There are also wider implications to consider, such as the likelihood of authorities retaining low or zero business rates<sup>2</sup>.

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<sup>1</sup> For reference, the current system does not result in 'full' equalisation. 'Full' equalisation could only be achieved by using actual council tax levels; however, setting the notional council tax level at the average Band D level would achieve the most similar outcome at a sector level.

<sup>2</sup> A consequence of the relationship between the measures of tax base, notional tax level and relative needs share is that a higher notional council tax level increases the likelihood of a number of authorities that will be assessed as being able to meet their needs entirely through their actual council tax income (depending on the level of funding available to local government, as determined at Spending Review 2019). This is because, in calculating a council's baseline funding level, if the relative resources adjustment exceeds their relative needs share they would be subject to a 100%

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### Illustrative examples

8. To illustrate these effects, we use four example local authorities with different relative needs and resources:

Authority	Relative need	Taxbase	Council tax level	Council tax receipts
A	20% (low)	3 (high)	£200 (high)	£600
B	20% (low)	3 (high)	£100 (low)	£300
C	30% (high)	2 (low)	£100 (low)	£200
D	30% (high)	2 (low)	£200 (high)	£400
Total	100%	10		£1,500
Average			£150	

9. In this example, authorities A and B have low(er) relative need and a high(er) taxbase, and one of them has an above-average council tax level; authorities C and D have high need and a low taxbase.
10. In addition to the £1,500 local authorities raise in council tax, we assume there are £3,500 of retained business rates to be distributed.

### Example 1: Setting baseline funding levels using a notional council tax level of £100

11. An authority's baseline funding level is its relative need allocation minus its relative resource adjustment.
- a. With a notional council tax level of £100, the relative need allocation is an authority's relative need share of retained business rates plus the national total of notional council tax receipts: that is, the sum of all council tax receipts if all authorities were to set a council tax level of £100.
    - i. For authority A, this is 20% of £3,500 of retained business rates and £1,000 of notional council tax receipts = £900.

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tariff on their retained business rates. Since the Government is committed to no redistribution of council tax, the tariff would be capped at a maximum of 100%. In effect this would mean that the council would not retain any business rates locally because their relative need was assessed as met through other local resources; however, the authority would continue to retain a proportion of business rates growth as determined by the national business rates retention scheme.

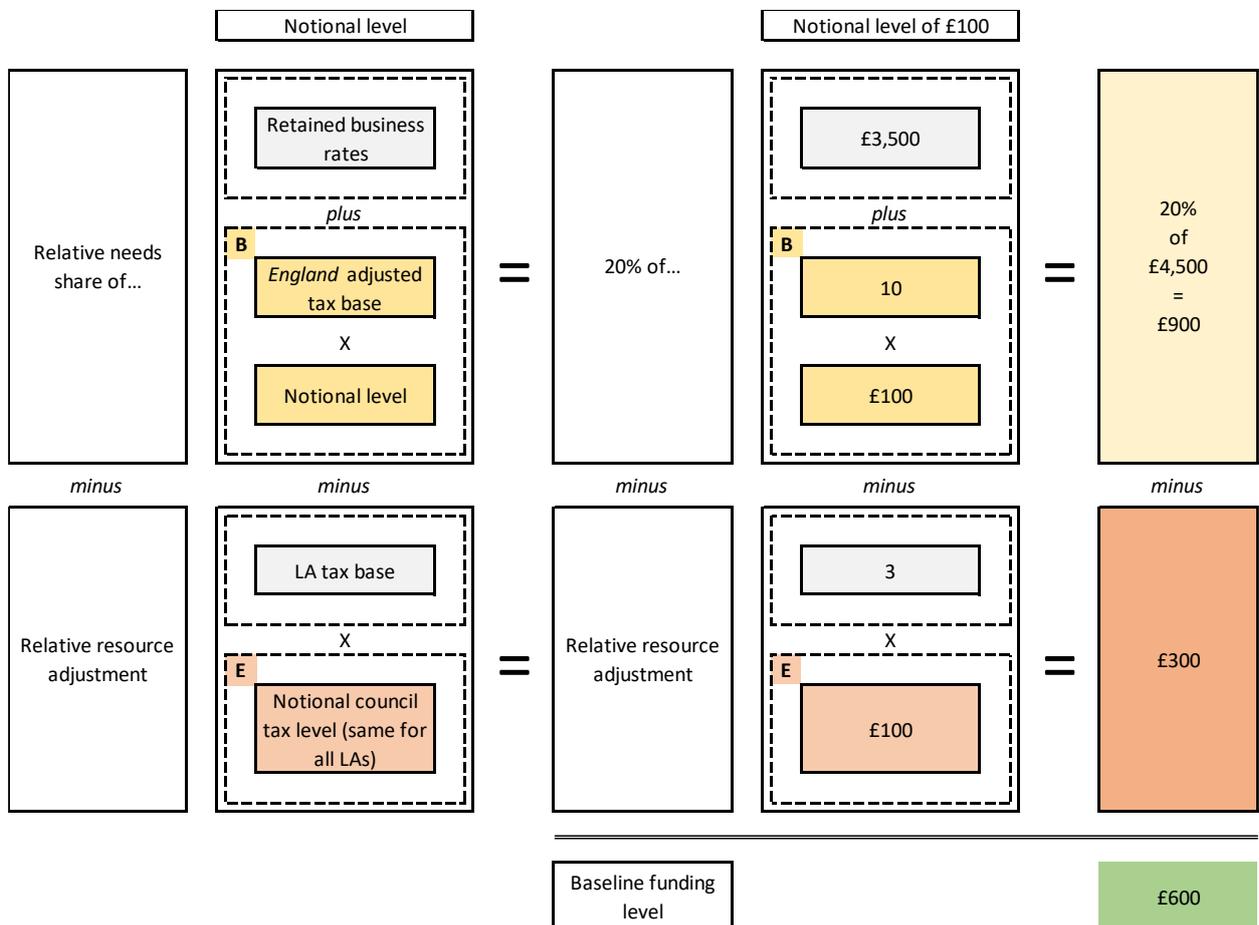
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b. With a notional council tax level of £100, the relative resource adjustment is an authority's notional council tax receipts: that is, their council tax receipts if they were to set a council tax level of £100.

i. For authority A, this is their taxbase multiplied by the notional council tax level:  $3 \times £100 = £300$ .

12. In this example, the **baseline funding level** for authority A is the difference between their relative need allocation and their relative resource adjustment:  $£900 - £300 = £600$ . This is illustrated in the graphic below.

13. Their **final funding position** is their baseline funding level plus their actual council tax receipts:  $£600 + £600 = £1,200$ .



**Example 2: Setting baseline funding levels using a notional council tax level of £50**

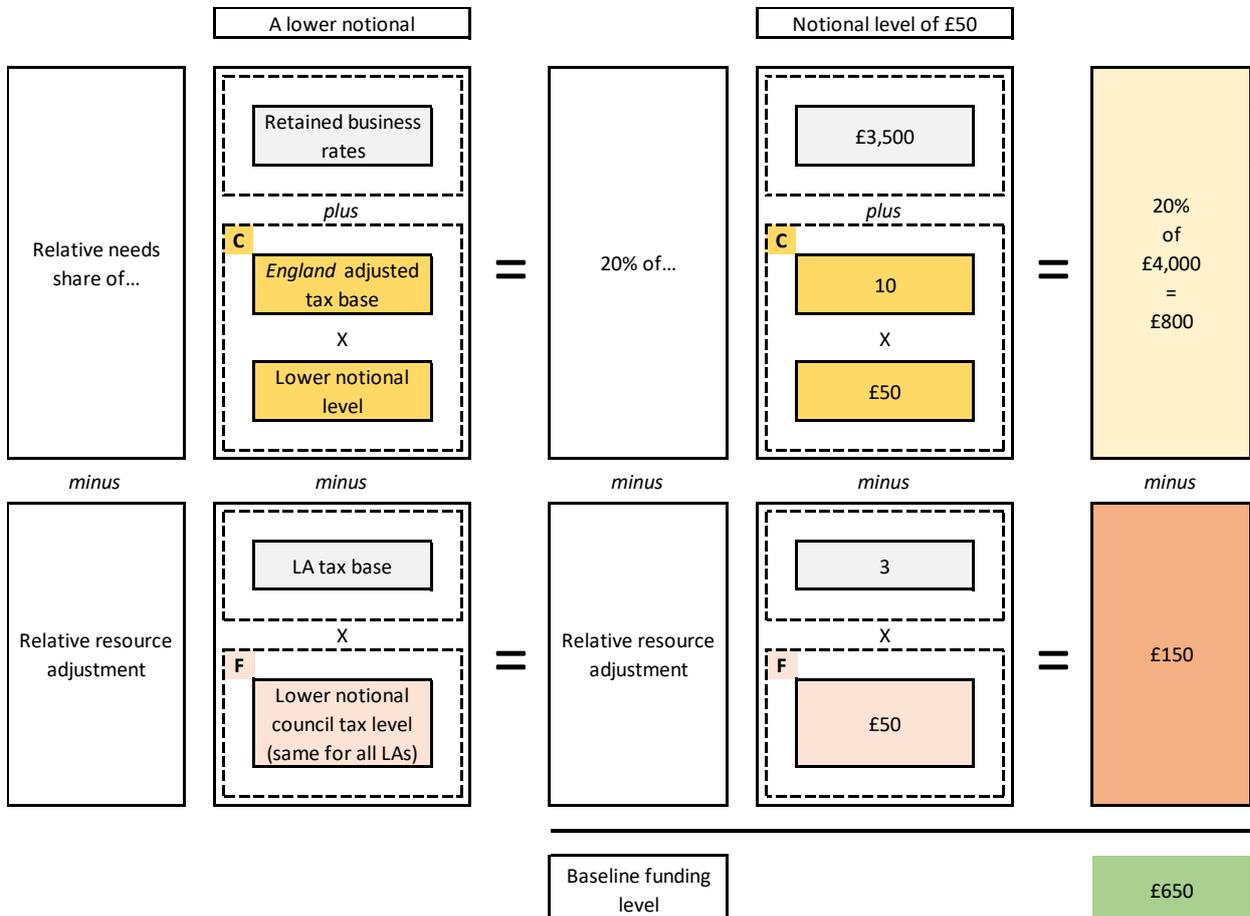
14. An authority's baseline funding level is its relative need allocation minus its relative resource adjustment.

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- a. With a notional council tax level of £50, the relative need allocation is an authority's relative need share of retained business rates plus the national total of notional council tax receipts: that is, the sum of all council tax receipts if all authorities were to set a council tax level of £50.
  - i. For authority A, this is 20% of £3,500 of retained business rates and £500 of notional council tax receipts = £800.
- b. With a notional council tax level of £50, the relative resource adjustment is an authority's notional council tax receipts: that is, their council tax receipts if they were to set a council tax level of £50.
  - i. For authority A, this is their taxbase multiplied by the notional council tax level: 3 x £50 = £150.

15. In this example, the **baseline funding level** for authority A is the difference between their relative need allocation and their relative resource adjustment: £800 - £150 = £650. This is illustrated in the graphic below.

16. Their **final funding position** is their baseline funding level plus their actual council tax receipts: £650 + £600 = £1,250.



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**Comparison**

17. Authority A in the examples above has a **higher final funding position when the notional council tax is lower**. This is because **authority A's share of the taxbase is larger than its share of relative need**. This is explained in more detail below.

**Impact of different notional council tax levels**

18. When the notional council tax level is higher, all authorities get their need share of a larger amount, i.e. a larger need allocation. This is because relative need shares represent a proportion of the national notional spending power, which is equal to retained business rates *plus* (notional council tax level *multiplied* by the council tax base).

19. When the notional council tax level is higher, the downward relative resource adjustment is also larger for all local authorities; however, it increases at different rates for different authorities. This is because it is a measure of their tax base *multiplied* by the notional council tax level.

20. When the notional council tax level is higher, all authorities get a larger need amount, and a larger downward resource adjustment. This means an authority does better with a higher notional if **the higher need amount increases at a faster rate to cancel out the larger downward resource adjustment**. In other words, it depends on whether their share of relative need is larger than their share of the taxbase or vice versa. This is illustrated below.

Table 1: Implications of higher or lower notional council tax level

	<i>Characteristics</i>	<i>Relative need allocation</i>	<i>Relative resource adjustment</i>	<i>Preference</i>
1	<b>Higher relative need share</b> and <b>Lower taxbase share</b>	Larger with a higher notional level, with a large effect due to their high relative need	More negative with a higher notional level, but with a small effect due to their low taxbase	Higher notional level
2	<b>Share of relative need</b> about the same as <b>Share of national taxbase</b>	Larger with a higher notional level – but about cancelled out by the change in their relative resource adjustment, which is more negative	More negative with a higher notional level – but about cancelled out by the change in their relative need allocation, which is also larger	No preference
3	<b>Lower relative need share</b>	Larger with a higher notional level, but with	More negative with a higher notional level,	Lower notional level

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and	a small effect due to their low relative need	with a large effect due to their high taxbase
<b>Higher taxbase share</b>		

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21. We can therefore conclude that:

- a. local authorities **do not systematically win or lose** from a notional council tax level which is higher or lower than their actual council tax level;
- b. in particular, whether they gain or lose from a higher or lower notional council tax level does not depend on their **actual council tax level**;
- c. the key factor which determines the impact of the notional council tax level is whether an authority's **share of relative needs is greater or less than their share of the tax base**;
- d. an authority whose **needs share is greater than its tax base share** will benefit from a higher notional level and vice versa;
- e. this is because a higher notional council tax level increases the national notional spending power and means that **more resources are therefore distributed according to need** across all authorities (this is equivalent to a higher percentage of equalisation);
- f. in all cases, because actual council tax receipts remain with the local authority, all authorities **benefit from a higher actual council tax level**.