Localising Support for Council Tax -

Taking work incentives into account

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Department for Communities and Local Government

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Chapter 1

Executive summary

Background

1.1. In 2011 the Government consulted on proposals for the localisation of support for council tax in England. This followed the announcement at Spending Review 2010 that support for council tax would be localised from 2013-14 and expenditure reduced by 10 per cent from the same date.

1.2. Localisation of council tax support is part of a wider set of reforms to the welfare system: improving the incentives to work and ensuring resources are used more effectively, so reducing worklessness and ending a culture of benefit dependency.

1.3. Local schemes of support for council tax will be implemented shortly before the introduction of Universal Credit begins in October 2013. Universal Credit will bring together different forms of income-related support and provide a simple integrated benefit for people in or out of work, simplifying the welfare system to make work pay and combat worklessness and poverty.

1.4. In its response to the outcome of consultation the Government indicated that it intended for the general principles of supporting work incentives to be set out in guidance which will help local authorities to design support for the low-waged or those returning to work from periods of unemployment. It also indicated that it would consider what technical details around work incentives could help local authorities to consider interactions with Universal Credit.

1.5. Regulations will set out the requirements in relation to applicants of state pension age that must be in all local schemes. The intention is that pensioners should not experience a reduction in support as a direct result of this reform.

What this guidance covers

Work incentives

1.6. This document sets out key considerations which we expect local authorities will want to take into account when designing their local council tax support schemes for working-age applicants, to support the wider objectives of welfare reform. It does not recommend a particular approach, but sets out the considerations of scheme design that can impact on decisions about work, which local authorities may want to consider alongside other local factors.

1.7. The main aim of welfare reform is a simple system that supports work incentives. People should get more overall income in work than out, and they should have an incentive to increase their earnings once in work. People should be confident that the support provided will be timely and correct, whether they are in or out of work.

1.8. This guidance considers the main design features of local schemes that can be used to support work incentives, including:

- How income from Universal Credit is treated (paragraphs 4.10 - 4.15)
- How other income is treated (paragraphs 4.16 - 4.21)
- The point and rate at which support is withdrawn (paragraphs 4.22 - 4.35)

1.9. It also considers other factors that can influence decisions about work, including how the scheme is administered and communicated to applicants. (paragraphs 4.36 – 4.38).

Chapter 2

Work Incentives, Working Age Benefits and Welfare Reform

2.1. The current council tax benefit system gives consideration to work incentives in a number of ways: through its series of disregards, the taper for removing support, and the *extended payments* or *run on* for those entering work from certain income-related benefits, and for those who have commenced employment as a self-employed earner, increased their earnings or increased the number of hours worked.[1]

2.2. However, the current council tax benefit system was designed to interact with the current benefits system, which is being reformed, including through the introduction of the Universal Credit. As such local authorities will want to consider the interaction of their scheme with Universal Credit and other benefits, as well as the administrative implications of their proposed scheme and the potential impact on vulnerable groups[2].

Council tax benefit and work incentives

Income disregards

2.3. People who are out of work and in financial need may be on one of three working age benefits – income-related Job Seeker's Allowance, income-related Employment and Support Allowance and Income Support. Individuals on these benefits have distinctly identifiable benefits income.

2.4. Under council tax benefit arrangements any income from these benefits and capital held by a claimant receiving them is completely disregarded. This results in them receiving up to 100 per cent of their maximum council tax benefit amount[3] and avoids the need for means-testing.

2.5. For those who are means-tested for council tax benefit, i.e. those with low levels of earnings but in financial need, there are thresholds and disregards for earned and unearned income which determine how much council tax benefit is awarded.

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[1] Relevant income-related benefits include: income support, income-related jobseeker's allowance and income-related employment and support allowance – for full extended payment details see SI 2006/216, regulation 60.
[2] Details on duties towards vulnerable groups are set out in the accompanying note, available from www.communities.gov.uk.
[3] Minus non-dependant deductions. See Annex A on council tax benefit for more detail.

Run-ons

2.6. Once claimants return to work, they are treated as if they continue to receive these benefits for four weeks. This is known as an *extended payment period* or *run on*.

2.7. This mechanism means that their 100 per cent council tax reduction does not suddenly disappear – ensuring that they feel some financial benefit from entering work and providing certainty if the work proves to be short-term.

2.8. For means-tested claimants the *extended payment* or *run on* also applies, where the four week period of continuing council tax benefit when earnings have risen due to increased hours, increased earnings, or commencement of self-employment means support is withdrawn less abruptly from claimants as they enter work.

Tapers

2.9. Finally, once claimants do start to earn more money, the council tax benefit system will re-assess them using a *taper* of 20 per cent, so that as their income rises above the amount the system decides they need to live on, support is gradually reduced.

2.10. Full details on the current system are set out in the Department for Work and Pensions guidance on Housing Benefit and council tax benefit[4].

Proposed changes to the welfare system

2.11. The Government is reforming the welfare system to make it fairer, more affordable and better able to tackle poverty, worklessness and welfare dependency. Universal Credit, to be introduced in 2013, will be an integrated working-age benefit to provide support for living costs with additional elements for children, disability, housing and care.[5]

2.12. A key objective of Universal Credit is to improve financial work incentives by ensuring that support is reduced at a consistent and managed rate as people return to work and increase their working hours and earnings. People will generally keep more of their earnings for themselves and their families than is currently the case. Universal Credit will also remove the distortions in the current system that tend to reward people for working a specific number of hours that may not suit them or their employers. Universal Credit will ensure that all amounts of work will be more financially rewarding than inactivity and remove the current barriers to undertaking small amounts of work.

2.13. Universal Credit is due to be introduced nationally in October 2013. New claimants would start receiving it straight away, and existing benefits claimants would be gradually moved across from April 2014, with transitional protection ensuring that they are no worse off where their circumstances

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[4] http://www.dwp.gov.uk/local-authority-staff/housing-benefit/claims-processing/operational-manuals/housing-benefit-guidance/

[5] Universal Credit will be paid monthly in arrears, to resemble a typical wage packet and help people manage the move into work

remain the same. The precise levels of Universal Credit will be published in due course.

Earnings or income disregards

2.14. In Universal Credit some money can be earned by members of the household before it has any impact on the amount of Universal Credit received – this amount is called the earnings disregard. Different amounts will be disregarded from earnings in order to reflect the needs of different types of household and to support the aim that work pays.

2.15. Since Government announced it would localise council tax support, the proposed Universal Credit earnings disregards have been adjusted upwards[6]. The box below sets out the detail of these changes. These higher disregards mean that there is now a reduced risk of dual tapering (council tax support and Universal Credit being withdrawn simultaneously). This risk and possible ways of mitigating it are explored in section 4.

Box 1: Universal Credit Income Disregards

In October 2011 the Department for Work and Pensions published its revised Impact Assessment for Universal Credit. This set out some changes to the Universal Credit parameters that had been presented in the White Paper, specifically setting out higher earnings disregards for certain groups, meaning that Universal Credit would start to be withdrawn at higher earnings levels than had originally been proposed.

These changes will help to reduce the risk of 'dual tapering', where council tax support and Universal Credit are withdrawn simultaneously, leading to higher marginal deduction rates (the rate at which the gains from increased earnings through work are reduced by the withdrawal of benefits and increased tax), and will help ensure that the incentives to enter work (measured by the participation tax rate) remain strong.

To achieve this, additions to the original annual earnings disregards in Universal Credit have been proposed, including:

• An additional earnings disregard to couples with children of £250;

• Increasing the child element in the earnings disregard from £2,700 to £4,000, and;

• An increase in the minimum disregard per adult of £700, including for single claimants.

[6] For details on proposed Universal Credit scheme design, see http://www.dwp.gov.uk/policy/welfare-reform/legislation-and-key-documents/welfare-reform-bill-2011/universal-credit-briefing/
and
http://www.dwp.gov.uk/docs/universal-credit-wr2011-ia.pdf

Transition

2.16. Universal Credit is due to be introduced nationally in October 2013, six months after the introduction of localised council tax support. However, existing *working age* benefits abolished as a result of the introduction of Universal Credit will continue during transition to the new benefit. New claimants will start receiving Universal Credit in 2013 and existing benefits claimants will be gradually moved across, ensuring that they are not worse off during the transition. The precise levels of Universal Credit income thresholds and tapers will be published in due course.

Chapter 3

Key principles of work incentives

3.1. The key principles for incentivising people to work that underpin the Government's welfare reform programme are:

- People should get more overall income in work than out of work.
- People should get more overall income from working more and earning more.
- People should be confident that support will be provided whether they are in or out of work that it will be timely and correct, and that claiming will not be a complicated and frustrating experience.

3.2. These principles have implications for how local authorities may wish to design schemes:

- Rules on eligibility and award levels for council tax support should be predictable and transparent.
- Applicants should be able to see the financial implications of entering work, or increasing their income.
- The scheme design should not provide a deterrent to working and applicants should be able to see that it is in their interests to take up work opportunities, including short-term ones.

3.3. A key way in which local authorities can support positive work incentives is by avoiding *high participation tax rates*, which remove the incentives to enter work. The participation tax rate is the proportion of earnings that are taken away by taxes and withdrawn benefits or discounts when someone moves into work. A very high participation tax rate might leave someone feeling they are *better off* not working. This can happen when several benefits or discounts are withdrawn at once and/or when a certain earnings or hours level is reached.[7]

3.4. The Government is also keen that people have an incentive to increase their earnings once in work, through more hours or higher wages. To support work incentives in this way, high *marginal deduction rates*, also known as *effective marginal tax rates*, should be avoided. The marginal deduction rate shows

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[7] For more analysis on participation tax rates, see the Local Government Finance Bill: Localising Support for Council Tax Impact Assessment
http://www.communities.gov.uk/publications/localgovernment/lgfblocalisingcounciltax

how much of each additional pound of gross earnings is lost through higher taxes and withdrawn benefits, discounts or tax credits[8] as earnings increase.

3.5. The previous section looked at how the existing council tax benefit system seeks to incentivise work for those who are workless and returning to work. People who have had to pay no council tax because of their receipt of three specific working age benefits (income-based Jobseeker's Allowance, income-related Employment and Support Allowance, and Income Support) are treated as if they continue to receive these benefits for four weeks once they have gone back out to work.

3.6. This mechanism means that their 100 per cent council tax reduction does not suddenly disappear. Also, once they do start to earn more money, the council tax benefit system will re-assess them using a *taper* of 20 per cent, so that as their income rises above the amount the system decides they need to live on, support is gradually (and not suddenly) reduced.

3.7. Together, these mechanisms delay any sudden increase in the *participation tax rate* allowing the person to earn some wages first before they start to lose benefit, and help to smooth the *marginal deduction rate*, by only reducing support by a certain percentage (20 per cent) of their surplus income.

3.8. Universal Credit has been designed with these two types of work incentives in mind. It seeks to achieve this through a single withdrawal rate or *taper*, which ensure that it is withdrawn at a steady, predictable rate, as earnings increase. However there is of course a risk that if council tax support is withdrawn at the same point as Universal Credit is withdrawn, or is withdrawn at a high rate, or if some types of income are overly penalised, there could still be an impact on the incentives to work.[9]

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[8] For instance, a marginal deduction rate of 70 per cent means that, for every one pound of additional gross income, 70 pence of that additional pound is taken away, either by taxes or a reduction in benefits

[9] By itself, Universal Credit is proposed to have a maximum marginal discount rate of 65 per cent for those not paying income tax and national insurance, and 76 per cent for those paying them

Chapter 4

Design features to support work incentives

4.1. Local authorities will want to consider the impact on work incentives from the following aspects of scheme design:

- **Operation**
  - o how income and living allowances are treated in the scheme
  - o the point at which support starts to be withdrawn
  - o the rate at which support is withdrawn

- **Communications**
  how applicants will know what support they are entitled to and how changes in circumstances affect this

4.2. In doing this they will want to bear in mind the interaction of their scheme with other benefits, including Universal Credit. Section 5 sets out some illustrative scenarios, showing how different types of scheme could interact with Universal Credit. A key factor affecting work incentives is whether all council tax support is withdrawn before Universal Credit starts to be withdrawn.

4.3. The components of the current council tax benefit calculation are set out in **Annex A**, and more detail on Universal Credit in **Annex B**. Local authorities may choose to retain some or all of the current council tax benefit components in their local schemes, adjusting the value of these components to change the final award.[10]

4.4. The considerations below use current arrangements and the terminology of council tax benefit to highlight principles that may be applied to local schemes, including those of simpler design. Different design features may be combined to different effect.

[10] The treatment of capital – for example savings or assets like owned housing – is not covered here as it relates more to incentives to save. However, eligibility rules for council tax based on capital are something that local authorities might want to look at when designing their schemes. Detail of the current treatment of capital is available from the Department for Work and Pensions guidance manual on housing benefit and council tax benefit.

Operation: How income and living allowances are treated in the scheme

4.5. Under local schemes, local authorities will be able to decide for working-age applicants what income is brought to account (i.e. taken into consideration in establishing eligibility and award), what income should be disregarded, and whether wholly or in part, and what people need to live on when calculating the council tax reduction.

4.6. Currently, the council tax benefit award is calculated by comparing the claimant's income with their *applicable amount* – the amount the Government considers the claimant and their household need to live on each week. Income disregards reduce the amount of income that is considered in the calculation. Premiums and personal allowances increase the applicable amount – what the person needs to live on.

4.7. In designing their local scheme to take into account some form of means-test, local authorities may consider adjusting such elements - for example, both the number and the value of disregards and the type or number of *premiums* or living expense considerations offered. Local authorities should consider how measurement of *income* and calculation of disregards and premiums may affect work incentives for those who are out of work, moving from worklessness to work, and on low wages or hours but seeking to increase these, bearing in mind how Universal Credit will operate.

4.8. Local authorities need to decide how to treat income in the calculation, in particular:

- how to treat earnings,
- how to treat Universal Credit income,
- how to treat the various types of *other* unearned income.

Earnings

4.9. Earned income is generally treated as income and fully brought to account (not disregarded), and so subject to whatever tapers or equivalents apply. Local authorities would have the option, subject to considerations of affordability, of creating additional premiums to disregard additional earned income and increase the financial benefit of additional work. Earnings are considered in more detail in paragraphs 4.22 – 4.28, in relation to determining the point where support starts to be withdrawn.

Universal credit income

4.10. The introduction of Universal Credit changes the environment in which council tax support operates, because of the implications for disregards and allowances. Simply carrying on with the current council tax benefit system would lead to differences in how applicants are treated, depending on whether they are on Universal Credit or not, and could lead to less effective targeting of support.

4.11. Under Universal Credit the default treatment of income, other than earnings, will be to take it into account in full, so that the Universal Credit award is reduced pound for pound. However, where claimants' living costs are increased by their personal circumstances, or there is a disproportionate administrative cost in taking a particular type of income into account, such income may be fully disregarded. In addition, a few income types will be treated as equivalent to earnings.

4.12. Local authorities will not necessarily have to adopt the same approach to the various income streams as Universal Credit takes, including in their treatment of earnings, but may wish to familiarise themselves with the approach Universal Credit takes, as this is confirmed.

4.13. Universal Credit will be based on a number of elements including personal allowances, a housing element and a disability element (the last two where relevant). Local authorities may wish to consider which of these elements to count as income or to disregard.

4.14. These elements will together make up the Universal Credit maximum amount. Local authorities may wish to use this information to design disregards as they see fit. These could be either an allowance, or the full amount of a particular type of income.

4.15. The Government is working towards a data sharing solution where local authorities are informed of Universal Credit claimants' circumstances, provided the information was relevant to the Universal Credit award. This means that local authorities will be able to see which individual elements of Universal Credit make up the maximum amount for each claimant, and this can inform their choices around scheme design.

'Other' types of income

4.16. Income is all the money an individual has coming in from earnings, social security benefits, maintenance payments and other sources. In this document, *other income* is used to refer to all unearned income. The way *other income* is treated in Universal Credit has implications for how local authorities may choose to treat it in their local council tax support scheme.

4.17. Taking the same income into account in both systems results in that income effectively being *taxed* twice (because the same income could be taken into account in calculating lower Universal Credit and council tax support awards). This is already the case in parts of the benefit system, so it is not that it must be avoided – just that local authorities should be aware of the implications of income treatment in scheme design.

4.18. Local schemes can be designed with some (or all) types of income being fully brought to account, fully disregarded, or given a partial disregard. The current treatment of *other income* in council tax benefit, and its proposed treatment for calculation of Universal Credit entitlement, is summarised below[11].

'Other' income disregards

4.19. Certain types of income qualify for 100 per cent disregard under current council tax benefit rules, for example income-replacement benefits, child maintenance and child benefit. Similarly, Universal Credit also disregards in full some circumstance-specific additional living costs, such as child benefit and Constant Attendance Allowance.

4.20. Where income is being fully taken into account (i.e. not disregarded at all) it is effectively being taxed, because counting this income in the calculation leads to a lower final award being made[12]. For example, spousal maintenance is wholly brought to account in Universal Credit.

4.21. Local authorities will have choices about what types of income to disregard and to what extent. Disregarding income might be administratively simple and avoid counting the same income twice. However, it could also have undesirable distributional and financial consequences particularly between those on Universal Credit and those who are not.

Operation: The point at which support starts to be withdrawn

4.22. Where local authorities make income a consideration in calculating support, they will need to decide at what level of income support begins to be withdrawn. Schemes could start to withdraw support for council tax as soon as an applicant starts earning any amount of money. Alternatively they could allow applicants to earn some income, without this affecting their award. This could be achieved by disregarding an amount of earned income in calculating eligibility, or introducing a *work premium*. This helps the applicant feel a financial benefit from work.

4.23. In the past some benefits or tax credits have had thresholds set in terms of number of hours worked, but Universal Credit has taken the approach of focusing on earnings, not hours worked.

4.24. Extended payments or *run-ons* are where the benefit continues to be paid even when circumstances have changed, for a set period[13]. Currently council tax benefit is paid for a month after the claimant starts earning above the threshold. This has two potential benefits:

- it helps to avoid the sudden *cliff edge* of paid work immediately and visibly stopping a benefit;

[11] More detail on the proposed structure of Universal Credit, including treatment of income, is available from the Universal Credit briefing notes: http://www.dwp.gov.uk/policy/welfare-reform/legislation-and-key-documents/welfare-reform-bill-2011/universal-credit-briefing/ More detail on current treatment of income in council tax benefit is available from the housing benefit and council tax benefit guidance manual, referenced in Annex A

[12] Unless a compensating allowance is made of the same amount.

[13] There is the option to taper this extended payment off over time.

- it makes it easier for claimants to enter uncertain or short-term unemployment, knowing that if that if that employment does not last long, they will not need to reapply for support.

4.25. When deciding on the point at which support starts to be withdrawn, local authorities should take account of how and when other benefits are withdrawn, including Universal Credit and passported benefits. This is to avoid multiple benefits or entitlements stopping or tapering off at the same time.

4.26. Simultaneous withdrawal worsens work incentives as it means it may no longer be financially worthwhile to increase hours worked and earnings, because of the accompanying losses in benefit income and tax. This loss of income through withdrawn benefit and tax is known as the marginal deduction rate[14]. High marginal deductions rates act as a disincentive to increasing hours or earnings.

4.27. In addition to the possible interaction with Universal Credit and the benefits which will be replaced by it, local authorities will want to consider the interaction with other benefits and benefits in kind, such as Free School Meals, free prescriptions, Sure Start Maternity Grant, Disabled Facilities Grant and any others that are relevant to those of working-age needing council tax support. Local authorities will want to consider how to avoid the same withdrawal thresholds and so minimise the *cliff edge* effects. The Government is considering whether to revise eligibility for these benefits/ benefits in kind and will publish further details in due course.

4.28. The approach taken by Universal Credit (outlined earlier in Box 1) means it is possible to withdraw council tax support at lower levels of earnings. This means that, depending how local schemes are designed, they could avoid any interaction with Universal Credit, as council tax support would be fully withdrawn before the Universal Credit taper begins.

Operation: The rate at which support is withdrawn

4.29. Schemes can withdraw support suddenly or gradually, at a set rate or in a more tailored and complex way. Stepped reductions are simple but can discourage work at certain thresholds, whereas graduated tapers help lessen the impact of withdrawing benefit entitlement as earnings (or hours) rise.

4.30. Currently, under council tax benefit, where a claimant's income exceeds their applicable amount, their full council tax benefit award is reduced by 20 per cent of the difference between their income and their applicable amount. This is called the taper, as support is withdrawn gradually.

4.31. Options for removing support include:

- a percentage taper resulting in a *smooth* withdrawal rate

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[14] This is a key recommendation of the Social Security Advisory Committee (SSAC) report into passporting benefits, available at http://ssac.independent.gov.uk/press/27-03-12.shtml

- reducing support in *steps* at particular thresholds.

4.32. **Percentage tapers**, like the proposed flat taper rate of 65 per cent for Universal Credit or the current 20 per cent taper for council tax benefit, give a smoother withdrawal of benefits. This gradual reduction in benefits aims to keep applicants seeing work as being more attractive financially, for all levels of earnings, as applicants get to keep a portion of their increased earnings.

4.33. **Stepped reductions** mean withdrawing all or part of the benefit once a threshold(s) is reached. This could be through a series of steps or thresholds: giving the full amount of council tax support to those earning below one threshold; a reduced level of support for those earning below a higher threshold and no support at all for those earning above this second threshold.

4.34. However this approach creates new *cliff edges* where the marginal deduction rate rises sharply at those thresholds. This can lead to situations where the applicant could be worse off by earning slightly more, i.e. a marginal deduction rate of over 100 per cent. This disincentive to work should be kept in mind by local authorities considering such a scheme design.

4.35. Either approach – gradual taper or stepped reduction – can alternatively be done in a time-defined way. Schemes could be designed to offer a defined level of support for defined a period(s) of time. Instead of basing the taper or stepped reduction on earnings thresholds, it could be based on time periods. For example, support might be reduced after six months, then fall to zero after another six months. This might be more appropriate for some types of applicants than others.

Communications with applicants

4.36. How and when information is communicated with applicants can help decisions about work. Applicants need up-front clarity on their eligibility, and what happens when they enter work. If work incentives have been taken into account in the scheme design, applicants should be able to see that taking on work will make them better off.

4.37. Local authorities will want to consider, for example, whether it would be helpful to provide applicants with the information to be able to demonstrate the financial impact of working.

4.38. Applicants may also need reassurance that they will not lose all their support if they take on work that may only be short-term or temporary. Making clear information available about a system where it is easy to re-establish eligibility if no longer in work, so that applicants are not put off work that may only be temporary could help with this. Earlier in this section we outlined the role of *run-ons* in providing this certainty. Another approach could be for the local authority to keep *information stubs* for a certain period of time after council tax support ends. This means that if the applicant needs support again they know it will be a quicker, more streamlined process, where only changes in circumstances need updating.

Using data from Universal Credit to support positive work incentives

4.39. The Departments for Communities and Local Government and Work and Pensions are working together to ensure where possible that local authorities continue to have access to the same data on claimants of existing benefits, and will be provided with a breakdown of the full Universal Credit award, before the application of any taper or sanctions, together with the final amount that the claimant receives. Further information on this will be published as it becomes available on the Department for Communities and Local Government website[15].

[15] http://www.communities.gov.uk/

Chapter 5

Interactions of design features – implications for work incentives

Maximum participation tax rates and marginal deduction rates

5.1. The Government considers that it is particularly important that local authorities seek to avoid high participation tax rates, which remove the incentives to enter work[16]. Marginal deduction rates (also known as effective marginal tax rates) can also impact on decisions to work more. A marginal deduction rate of over 100 per cent means there is a disincentive to increase earnings at that point.

5.2. Even if an effective tax rate is less than 100 per cent, high effective tax rates are still a disincentive to work. This is why Universal Credit is seeking to keep its maximum deduction rate at 65 per cent of net income (or 76 per cent for those paying income tax and National Insurance) by using a simple taper.

5.3. For illustration of how take-home income and effective tax rates might look, we provide diagrams below showing simple scenarios where local council tax support and Universal Credit do and do not overlap, showing the implications of a smooth taper versus stepped withdrawal for each. These highlight some of the interactions and possible outcomes of the local authority's scheme design. These are illustrations only, to guide thinking.

[16] The consultation document *Localising Support for Council Tax in England* suggested a 20 per cent maximum net participation tax rate for council tax support.

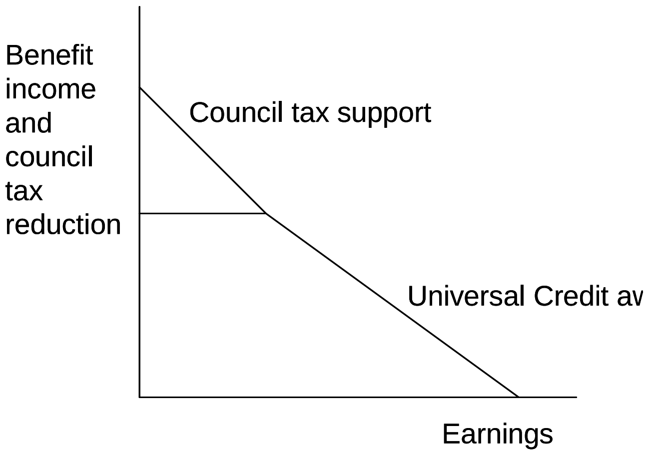
Scenario where council tax support and Universal Credit do not overlap

5.4. In a scenario where council tax support withdrawal and Universal Credit withdrawal **do not overlap**, this avoids the *dual taper* effect that leads to a high marginal deduction rate. This means that, at whatever rate council tax support is withdrawn, it does not happen at the same time as (for example) Universal Credit is being withdrawn. As a result, the marginal deduction rate is the same as the taper rate of the benefit being withdrawn. This is good for work incentives.

5.5. **Diagram 1** below illustrates a smooth withdrawal of council tax support, such as a fixed percentage taper, where council tax support is fully withdrawn at the point where Universal Credit starts to be withdrawn. This could be achieved, for example, by removing eligibility for council tax support by that point).

5.6. In this illustration, council tax support starts tapering off as soon as earnings increase above zero. This need not be the case if an earnings disregard is included. Including an earnings disregard would give a zero per cent marginal deduction rate at the levels of earnings below the threshold, i.e. very strong incentives to work at low hours and a low participation tax rate.

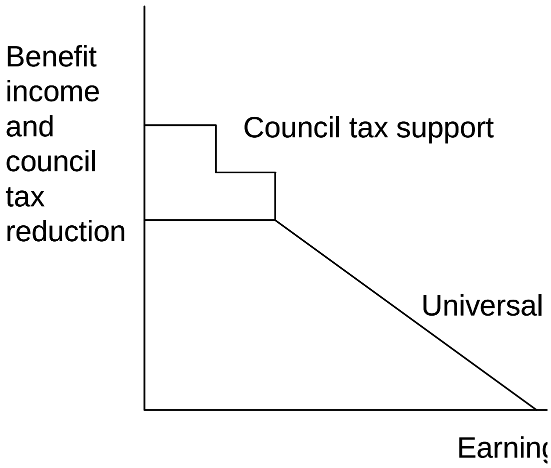
Diagram 1: smooth taper, no overlap with Universal Credit



5.7. **Diagram 2** below illustrates a stepped withdrawal of council tax support, where council tax support is fully withdrawn before Universal Credit starts to be withdrawn. This scenario might arise if the calculation of the reduction was linked to a series of income thresholds (earning of, for example, £0 - £50 per week lead to a 100 per cent reduction; earnings of £51 - £100 per week lead to a 50 per cent reduction etc.). This type of approach could reduce administrative cost and complexity, and provide for fairly generous income *run-ons*.

5.8. The impact of having a stepped reduction in support, rather than gradual taper, is that at certain levels of earnings there are *cliff edges*. Work is strongly incentivised initially, as all additional earnings are entirely kept and council tax support is not reduced. However, as earnings rise, there is a sudden reduction in council tax support. Put another way, the marginal tax rate leaps up at the thresholds, reducing the incentive for someone to increase their earnings above it, unless they increase it by a substantial amount.

Diagram 2: stepped taper, no overlap with Universal Credit



5.9. However, it might be difficult to ensure that the council tax support is withdrawn for all applicants in all circumstances before the Universal Credit taper starts. If this cannot be (or is not) done, it gives rise to the following illustrative scenarios.

Scenario where withdrawal of council tax support and Universal Credit overlap

5.10. The diagrams below show illustrative scenarios where council tax support is still being withdrawn when Universal Credit starts to be withdrawn[17]. This leads to a *dual taper* effect, with both participation tax rates and marginal deduction rates.

5.11. This means that, for a certain range of earnings, applicants lose a high proportion of their additional earned income due to the sharp withdrawal of benefit income. This can be a strong disincentive to work in this earnings range.

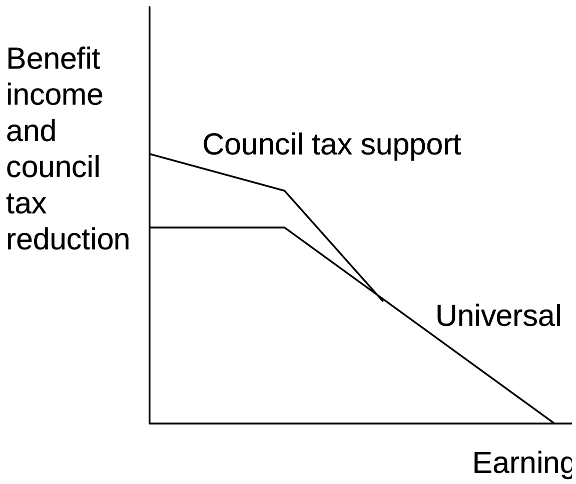
5.12. For example, where the current council tax benefit taper of 20 per cent was applied at the same time as the Universal Credit taper of 65 per cent, even if the 20 per cent reduction was applied to extra earnings net of the Universal Credit taper, there is still a marginal deduction rate of around 80 per cent. If the scheme design meant that Universal Credit income (and tapering) was ignored, this marginal deduction rate would be almost 90 per cent. Either of these scenarios would mean that claimants could see little benefit in earning the extra amount, especially if the council tax support scheme was not communicated clearly enough to help claimants to understand how much they would need to earn to feel a real financial benefit.

[17] An alternative might be to withdraw council tax support after Universal Credit has started to be withdrawn.

5.13. **Diagram 3** shows a smooth taper, where council tax support is designed to taper on top of Universal Credit, taking Universal Credit income into account[18]. In this example there are no earnings disregards, meaning the amount of council tax support begins to fall as soon as earnings rise above zero, but it is possible to design the scheme to include an earnings disregard, which would have a positive effect on the participation tax rate.

5.14. In this situation, the marginal deduction rate is below 100 per cent at all points, i.e. there are no clear disincentives to work. However, work incentives are strongest for low levels of earnings and weakest at low-to-middle levels of earnings (where the line is steepest). At the point where the Universal Credit taper started, the marginal deduction rate is 86 per cent which, while below 100, is still a high deduction rate until the rest of council tax support has tapered away. After that, the standard Universal Credit marginal deduction rates apply.

Diagram 3: smooth taper, overlap with Universal Credit



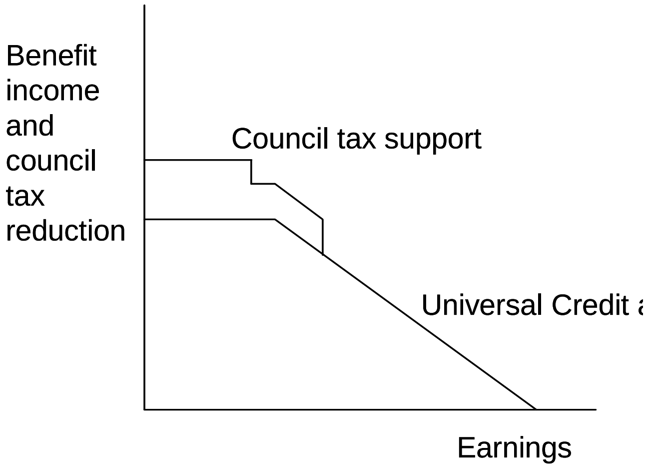
5.15. **Diagram 4** below looks at the same scenario, where the withdrawal rates overlap, but showing a stepped withdrawal of council tax support rather than a smooth taper.

5.16. In this example the gross award is the full council tax liability (i.e. a 100 per cent reduction) for those earning less than the first threshold, and a 50 per cent for those earning between the first and second thresholds. The award is zero for those earning over this second threshold.

5.17. At very low levels of earnings the marginal deduction rate is zero (i.e. strong incentives to increase earnings) while both sets of benefits are being received in full. At the thresholds, there is a sudden disincentive to increase earnings as the marginal deduction rate rises to 100 per cent. In terms of earnings between the thresholds, the marginal deduction rate is just the Universal Credit taper, except for immediately following the first reduction in council tax support. This presents a more complicated picture for claimants to understand.

[18] In this instance the scheme could have a disregard set equal to the Universal Credit award.

Diagram 4: stepped taper, overlap with Universal Credit



Annex A

Council tax benefit terms

Council Tax Liability

The council tax liability is based on the valuation band of the property, net of any council tax discounts (for example, single person allowance).

Passported Benefits

Claimants receiving Income Support, Job Seekers Allowance (income based) or Employment Support Allowance (income related) are entitled to receive full council tax benefit subject to any non-dependant deductions which may apply.

Non-dependant deductions

A non-dependant is someone who is 18 or over and who normally lives with the claimant but isn't:

Claimant’s husband/wife/partner; or
A child the claimant receives child benefit for; or
Someone jointly liable to pay council tax

There are different deductions for non-dependants, based on their earnings.

Personal Allowances

Personal Allowances are the basic amounts of money the government says a claimant needs to live on. The level of the personal allowance will depend on the claimant’s age and whether they are part of a couple. There are additional personal allowances for dependant children.

Premiums

Premiums are additional amounts added to the personal allowance because of claimant’s personal circumstances. The government recognises that it is more expensive to live with a family or if someone have a disability or caring responsibilities. Extra amounts are added to income based benefits to account for this.

Applicable Amount

The applicable amount in council tax benefit is the amount that the Government says that the claimant and their family need to live on each week. It is made up of either personal allowances only or a combination of personal allowances and premiums.

Capital

Under council tax benefit a person's capital exceeds £16,000 then they are not entitled to claim council tax benefit. They could however still claim Second Adult Rebate (see paragraphs 14 and 15) If a claimant has capital of more than £6,000, £1 per week will be added to the income that is used to work out the benefit for every £250 or part of £250 above this amount, this is called tariff income.

Income

Income from all sources is taken into account in the calculation of council tax benefit (though some is partially, or entirely *disregarded*). This includes income from employment, self employment, pensions, benefits and maintenance. If the claimant has a partner than both incomes are added together.

Disregards

There are standard earnings disregards for singles, couples and lone parents. People in certain groups, such as carers and people with disabilities are eligible for a higher disregard. In addition, people in certain special occupations are also eligible for the higher disregard e.g. coastguards and fire-fighters in recognition of the services they provide and the potential hazards they face in undertaking these duties.

Childcare charges disregard offers extra financial help to those people who are on a low income, work over 16 hours and incur childcare costs.

As part of the income calculation, some income is either disregarded in part or in full. Income from benefits that are fully disregarded include:

- Disability living allowance
- Attendance allowance
- Maintenance for children
- Child benefit

Excess Income

Excess income is the sum of income minus any disregards minus the applicable amount.

Second Adult Rebate or Alternative maximum council tax benefit

A claimant can receive Second Adult Rebate if the person they share their home with is:

- not their partner or civil partner
- aged 18 or over
- not paying the claimant rent
- not paying council tax themselves
- on a low income

The following discounts are awarded:

- 25 per cent - when the second person is in receipt of Income Support, Job Seekers Allowance (income based) or Employment Support Allowance (income related)
- 15 per cent - second adult's gross income is under £177.00 per week
- 7.5 per cent - second adult's gross income is between £177.00 and £230.99 per week

Taper

Where income (as defined in regulations) is greater than the *applicable amount* the person needs to live on, any excess income is reduced by 20p for each £1, and the resulting amount is deducted from the person's maximum council tax liability to give the net amount of council tax payable. This is known as the application of the *taper*.

More detail on council tax benefit is available from the Department for Work and Pensions guidance manual on housing benefit and council tax benefit: http://www.dwp.gov.uk/local-authority-staff/housing-benefit/claims-processing/operational-manuals/housing-benefit-guidance/

Annex B

Universal credit

1. Universal Credit will bring together different forms of income-related support and provide a simple integrated benefit for people in or out of work. It will provide a basic income covering a range of needs including those currently delivered by Housing Benefit. It will make work pay as people move into and progress in work.

2. Universal Credit will improve work incentives in three ways by:

   - Ensuring that support is reduced at a consistent and predictable rate, and that people generally keep a higher proportion of their earnings.
   - Ensuring that any work pays.
   - Reducing the complexity of the system, and removing the distinction between in-work and out-of-work support, thus making clear the potential gains to work and reducing the risks associated with moves into employment.

Single earnings taper

3. The taper is the rate at which benefit is reduced to take account of earnings. Currently there are different tapers for in-work benefits and Tax Credits which apply to either gross or net income. Housing benefit and council tax benefit together have an 85 per cent taper on net income; Tax Credits have a 41 per cent taper on gross income. Universal Credit will improve work incentives for low earners by means of a single gradual withdrawal of benefits as earned income increases. This will be by means of a single taper of around 65 per cent of net earnings.

4. A single taper will produce a marginal deduction rate (the impact on income of the combined effect of tax and benefits being withdrawn) on earned income of 76 per cent for those paying national insurance and income tax, a significantly lower withdrawal rate than the current maximum marginal deduction rate of 96 per cent that people can currently experience.

5. The gradual withdrawal of benefit through the taper is complemented by a system of earnings disregards which help to strengthen work incentives for those who have been out of work for a long time, who are looking to take their first steps into the labour market. Together the disregards and taper ensure that people should see a clear financial gain to working and progressing in work.