A technical note on the treatment of the Community Charge and Non Domestic Rates in the National Accounts

Introduction

Under the terms of the Abolition of Domestic Rates Etc. Act (Scotland) 1987 and the Local Government Finance Act 1988, domestic rates are to be abolished throughout Great Britain (but not Northern Ireland) and replaced by the "community charge". The community charge is an amount, levied by each local authority on the adults living in its area. Almost every one over 18, including foreigners living in Great Britain, will be liable to pay the community charge. The main exceptions will be those under 19 but still at school and for whom child benefit is payable, convicted prisoners and resident hospital patients. Also people on low incomes will get relief from part of the charge, on a sliding scale, whilst students will be required to pay one fifth of the full rate. People will, in general, pay the community charge to the district or borough where they live.

This change took effect in Scotland on 1 April 1989 and will come into force in England and Wales on 1 April 1990. At the same time non domestic rates are being reformed with the introduction of a national non domestic rate in England and Wales which the Government also proposes to extend to Scotland following transitional arrangements already introduced there.

This technical note discusses how these various changes will be handled in the national accounts. It starts by examining the current classification of government receipts, concluding that the community charge should be treated as a special category which reduces the disposable income of the personal sector. The article goes on to examine the impact of the abolition of rates and the introduction of the community charge on GDP estimates, noting the reduction in GDP at current market prices (often known as "Money GDP") whilst GDP at current factor cost is not affected. Finally the article explains the treatment of non domestic rates as a central government tax on expenditure under the new arrangements.

Current classification of government receipts

General government consists of central government and local authorities and each of these can be subdivided into trading and non trading subsectors. Government receipts from non trading activities, other than rent, dividends and interest, are subdivided in the national accounts into two broad categories.

First receipts from sales of goods and services are netted off in the estimation of government consumption of goods and services. Examples of charges netted off in this way are entrance charges to swimming pools and leisure centres, charges for welfare services such as "meals on wheels", prescription charges, charges for pay and amenity beds in hospitals etc. These charges are in all cases made in direct exchange for the provision of specific goods and services which purchasers have discretion whether to purchase or not. These receipts are seen as reducing the cost of government expenditure, rather than general purpose finance. Such charges, when incurred by households, are included in consumers' expenditure and are taken to be met out of peoples' discretionary income, known as their "personal disposable income".

The second broad category of government receipts consists of taxes and other similar revenue which are subdivided in the UK accounts into the following:

- **Taxes on income:** Income tax, Corporation tax, Petroleum Revenue Tax, etc.
- **Taxes on expenditure:** Value Added Tax, excise duties on alcoholic drink, tobacco, petroleum products and gambling; vehicle excise duties, car tax, stamp duties, local rates, customs duties etc.
- **Social security contributions:** National Insurance contributions etc.
- **Other current transfers:** Driving licences, public service vehicle licences, heavy goods vehicle licences, Passport fees, gun licences, court fines and penalties.
- **Taxes on capital:** Death duties, Capital Transfer Tax, Capital Gains Tax, Inheritance Tax.

The classification of taxes and social security contributions in the national accounts is discussed in sections 9.25 to 9.30 of *"United Kingdom National Accounts: Sources and Methods: Third Edition"*, CSO, 1985. This includes classification of rates which is covered in section 9.27.

Classification of Domestic Rates

Domestic rates may be seen, like non domestic rates, as a contribution towards the cost of local services. However they are not considered to be a charge to be netted off in the estimation of local authorities' final expenditure because they are seen as a means of financing the expenditure rather than as payments made by individual householders for services they consume.

As indicated earlier, rates, including domestic rates, are treated as a tax on expenditure. Taxes on expenditure are defined in the UK system as taxes which enter into the costs of production and distribution. Taxes on final buyers associated with the purchase, possession or use of particular goods and services are also treated as taxes on expenditure.

Domestic rates are levied on the occupier of each domestic hereditament (usually the head of household) and his liability is calculated as the product of the rateable value of the domestic hereditament occupied and the "rate poundage" levied by the local authority in which the hereditament is situated. The rateable value of each domestic hereditament is determined as the rent which it may be expected to fetch (with the landlord meeting repair and insurance costs and the tenant meeting rate bills) less a standardised amount to represent the cost of repairs and insurance. Rateable values are determined, in England and Wales, by the Valuation Office of the Inland Revenue and have been based on levels of rents as at 1 April 1973. In Scotland domestic rateable values were determined by local assessors and lately reflected rent levels as at 1 April 1985. In Northern Ireland domestic rateable values are set by the Valuation and Lands Office of the Department of Finance and Personnel, based on rent levels on 1 April 1976.

It will be seen therefore that domestic rates are levied in each local authority area, in a direct relationship with the estimated rental value, as at 1 April 1973, of domestic properties occupied and they can therefore be regarded as a tax on the cost of consuming housing services, including housing services in both the rented and owner occupied sectors. (In the case of the latter the cost of these housing services is represented in the national accounts as consumers' expenditure on imputed rent in line with the conventions the United Nations System of National Accounts (SNA) and the European System of Integrated Economic Accounts (ESA)). Domestic rates are therefore appropriately classified as a tax on expenditure. They are not, incidentally, considered to be a tax on rental income because rates are levied on the basis of occupancy not of ownership.

Classification of the Community Charge

The community charge, like domestic rates, may be seen as a contribution towards the cost of local services. Moreover an individual has a choice where he lives and therefore, within certain limits, how much he pays and what local services are available to him. Within each area however there is no direct link between the charge levied on an individual and the services he receives. The community charge is not considered therefore to be the receipt from the sale of goods and services which should be netted off in estimation of local authorities final expenditure. Within the national accounts the community charge is more akin to a tax.

However, the community charge cannot be treated as a tax on expenditure since it does not enter into the cost of production and distribution of any good or service, nor is it a tax on final buyers associated with the purchase, posession or use of a particular good. In particular the size of the community charge levied on an individual is not connected with his consumption of housing or other services.

The community charge is also clearly not a tax on capital. Equally it is not a social security contribution.

The community charge is also not a tax on income. Its impact is related to income for those on low incomes as a result of the rebate scheme already mentioned. For other adults charge levels are independent of income.

The community charge is also not considered to come within the category of miscellaneous current transfers which covers such items as driving licence fees, passport fees, gun licence fees etc. Such fees relate to the cost of regulating certain activities and are not devices to raise revenue for general purposes. Moreover they are requited on an individual basis since each individual has a choice whether or not to participate in the activity which has to be licensed and he has to pay only if he wishes to participate.

Thus the community charge does not fall satisfactorily within the current system of classification of taxes and similar payments in the UK accounts and the Central Statistical Office has decided, therefore, that it should appear as a separate category in its own right. It has been further decided that the community charge should be treated, in the personal sector account, as a deduction from income, along with other compulsory payments such as taxes on income and social security contributions, in calculating personal disposable income.

The UK classification of government receipts broadly follows the current United Nations' SNA and the European Community's ESA recommendations though there are some minor differences which are not discussed here. The SNA is currently being reviewed and, when this is completed, ESA will also be reviewed by the Statistical Office of the European Communities. Following these reviews, UK national accounts practices, including the current system of classification of government receipts, may be reconsidered if they depart from the new international recommendations.

This article has discussed the community charge in terms of the "personal community charge" which is the type of charge which most people will pay. However there is also a "standard community charge" and a "collective community charge". The "standard community charge" will be paid by persons owning domestic property which is not the main residence of an individual. The "collective community charge" will be payable in certain circumstances where a building is mainly occupied by individuals residing there for short periods. For convenience it has been decided that, for the time being, these community charges will be treated in the national accounts in the same way as the "personal community charge". At a later stage, the treatment of the "standard" and "collective" community charges will be reviewed in the light of the incidence of these charges.

The impact of the introduction of the Community Charge on National Accounts estimates

As already discussed, domestic rates are classified as a tax on housing services and part of consumers' expenditure, whereas the community charge will be treated as a deduction from income and therefore not part of consumers' expenditure. The abolition of rates will reduce consumers' expenditure by the amount of rates that would otherwise have been paid and thereby also the measurement of GDP expressed at current market prices. The "adjustment to factor cost" (taxes on expenditure less subsidies) will be reduced by the same amount. The measurement of GDP at current factor cost will therefore be unchanged.

Expressed at constant 1985 market prices GDP will not be affected by the abolition of domestic rates because the constant price estimates are produced incorporating the indirect taxes and subsidy structure in place in the base year. Constant 1985 price estimates of consumers' expenditure will therefore continue to include rates at the levels applicable in the base year. This conclusion may at first sight seem odd since domestic rates will not exist. However, it should be remembered that domestic rates are a tax on housing services and consumers' expenditure on housing services includes rate bills as a tax on expenditure. Once their rate bills have ceased, consumers' expenditure on housing (rent including the imputed rent of owner occupiers, rates, water charges, repairs and maintenance etc) will fall sharply. However the volume of housing services consumed will remain the same: total consumers' expenditure and GDP at constant prices will therefore also remain unchanged.

The introduction of the community charge (as distinct from the abolition of rates) has no impact on consumers' expenditure since it is being treated as a deduction from income and not part of consumers' expenditure.

The combined impact of the abolition of rates and the introduction of the community charge will thus be a step change downwards in consumers' expenditure and GDP when expressed at current market prices, whilst corresponding estimates at constant 1985 market prices are unchanged. The implied deflators for consumers' expenditure and GDP at market prices will therefore be reduced. GDP expressed at factor cost will not be affected either at current prices or constant 1985 prices and therefore the GDP factor cost deflator will also be unaffected.

The size of these effects can be illustrated by looking at national accounts estimates for 1988 and considering what the impact would have been if the community charge (net of rebates) had been in operation in 1988 raising exactly the same revenue as domestic rates (net of rebates) actually raised. It will be seen from Table A that consumers' expenditure at current market prices would have been 2.8 per cent lower last year and GDP at current market prices some 1.8 per cent lower. Although not shown in the table the consumers' expenditure deflator and GDP market price deflator would also have been reduced by the same percentage amounts respectively because these aggregates are unaffected when calculated in constant price terms.

TABLE A

Impact on National Accounts aggregates for 1988 if domestic rates (excluding water and sewerage charges) had been replaced in Great Britain by Community Charge with same revenue raised

	Actual Values (£m)	With rates replaced by community charge (£m)	Percentage change
Consumers' expenditure at current market prices	293600	285400	-2.8
of which domestic rates (net of rebates)	8300	100	-98.8
GDP(E) at current market prices	461900	453700	-1.8
Adjustment to factor cost (taxes less subsidies)	69200	61000	-11.2
GDP(E) at current factor cost	392700	392700	0.0

Note: The small amount of domestic rates continuing after the introduction of the community charge in Great Britain relates to Northern Ireland where rates continue to be levied.

The personal sector account will also be affected. Personal disposable income expressed at current prices, will be reduced by the amount of community charge payments and consumers' expenditure, expressed at current prices, will be reduced by the disappearance of rates bills. If community charges raised the same revenue as the rate bills they replaced there would be no impact on personal sector saving since the income and expenditure sides of the current account of the personal sector would be reduced by equal amounts. Nevertheless the saving ratio, which is the ratio of saving over disposable income, would rise fractionally since the denominator in this ratio would decline whilst the numerator would be unchanged. The size of these effects is shown in Table B which shows that personal disposable income would have been 2.6 per cent lower last year if the community charge had been in place and raised the same net of rebates as the rates actually raised net of rebates.

Whilst personal disposable income, expressed at current prices, will be reduced by the switch from rates to the community charge real personal disposable income (RPDI), which is personal disposable income at current prices, deflated by the consumers' expenditure deflator, will remain broadly the same, if the community charge raises the same revenue as the rates it replaces. This is because the consumers' expenditure deflator falls by a broadly similar proportion to the fall in personal disposable income.

TABLE B

Impact on Personal Sector estimates for 1988 if domestic rates (excluding water and sewerage charges) had been replaced by Community Charge with the same revenue raised

	Actual values (£m)	With rates replaced by community charge (£m)	Percentage change
Personal disposable income	307100	298900	-2.6
Consumers' expenditure at current market prices	293600	285400	-2.8
Balance: saving	13500	13500	0.0
Saving ratio	4.4%	4.5%	
Consumers' expenditure deflator	113.8	110.6	-2.8
Real personal disposable income at constant 1985 prices	269800	270100	+0.1

As already explained the community charge replaced domestic rates in Scotland with effect from 1 April 1989 whilst the change will take effect in England and Wales from 1 April 1990. Thus the impact on national accounts aggregates will be staged with about 8 per cent occurring between the first and second quarters of 1989 and 92 per cent between the first and second quarters of 1990.

Domestic rates will continue to be levied in Northern Ireland and these will continue to be classified as a tax on expenditure.

Treatment of the Community Charge in the Retail Prices Index

It has been decided that the community charge should be included in the coverage of the Retail Price Index (RPI) following the recommendation of the RPI Advisory Committee (*Treatment of the Community Charge in the Retail Prices Index Cm644* March 1989 HMSO). The Committee's recommendation centred on the need for continuity with the treatment of local authority rates and public expectations. One consequence of this decision is that it adds to the differences between the measure of price changes provided by the RPI and the implied deflator of consumers' expenditure.

Changes to non domestic rates

Whilst domestic rates in Great Britain are being abolished, non domestic rates are being retained but reformed. Hitherto non domestic rate bills, like domestic rate bills, have been determined by local authorities who have set the "rate poundage"

in their areas to be applied to rateable values to determine individual occupiers' rate bills. (Non domestic rateable values, like domestic rateable values, have been established by the Valuation Office of the Inland Revenue in England and Wales and local assessors in Scotland.) Changes to this system have taken effect from 1 April 1989 in Scotland and will take place in England and Wales with effect from 1 April 1990. The nature of the changes in England and Wales on the one hand and Scotland on the other are slightly different. For convenience the changes in England and Wales are discussed first.

Next year standard "non domestic rating multipliers" also known as "uniform business rates" will be determined for England by the Secretary of State for the Environment and for Wales by the Secretary of State for Wales. These "non domestic rating multipliers" will be applied to rateable values to determine occupiers' rate liabilities. Under the terms of the Local Government Finance Act 1988 the multipliers for each of these countries will thereafter be indexed to the Retail Prices Index, though the Chancellor of the Exchequer will be able to override the indexation and set lower multipliers if he wishes. Local authorities will continue to be responsible for the collection of non domestic rate revenue, but the revenues will, broadly speaking, be pooled centrally (in a national pool) and redistributed to each charging authority as a flat rate payment per adult paying the community charge.

Non domestic rates, like domestic rates, are currently treated in the national accounts as a local authority tax on expenditure. Non domestic rates will continue to be a tax on expenditure since they will enter into the costs of businesses in the production and distribution of goods and services. However the Central Statistical Office has decided that it will not continue to be appropriate to show them as local authority tax receipts once the national non domestic rates come into being and that from 1 April 1990 non domestic rates should be treated as a central government tax receipt.

This is because central government will determine the "multipliers" or "uniform business rates" for each country and, although local authorities will be collecting non domestic rates, the revenue they receive will be pooled centrally in a national pool before it is redistributed by central government as a flat amount per adult paying the community charge.

Changes to the non domestic rating system in Scotland are slightly different from those for England and Wales. In Scotland local authorities will be continuing to determine their own non domestic rate poundages subject to a maximum laid down by the Secretary of State for Scotland in respect of each authority. Under the terms of the Abolition of Domestic Rates Etc (Scotland) Act 1987 the maximum poundage for each authority will be raised each year in proportion to movements in the Retail Prices Index.

In Scotland non domestic rates receipts will be kept by local authorities and will not go into a national pool as in England and Wales. As hitherto the distribution of Rate Support Grant will however take account of authorities' incomes from non domestic rates.

It may be argued that these arrangements, in particular the fact that local authorities will continue to determine their own domestic rate, mean that, for the present, non domestic rates should continue to be treated as a local authority tax in Scotland. However local authorities' freedom is substantially restricted by the maxima prescribed by the Secretary of State for Scotland and the Government's announced intention to achieve a common rate poundage for Scotland at the same level as in England and Wales over a period of years. In these circumstances the Central Statistical Office has decided to treat Scottish non domestic rates as a central government tax with effect from 1 April 1990 in line with the changes at the same date for English and Welsh non domestic rates.

Non domestic rates in Northern Ireland will continue to be treated as a local authority tax since no changes to the rating system are currently being implemented in the province.