Department for Communities and Local Government

Localising support for council tax

Taking work incentives into account

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Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

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Contents

Preface to revised edition

About this guidance

- This guidance is intended to support local authorities in designing local council tax reduction schemes that support positive incentives to work, helping to make it clear that work pays and so making it worthwhile to enter work, work more, and rely less on benefits.

- Work incentives matter. A poorly designed scheme could lead to some people being worse off in work than on benefits. For example if the rate at which support is tapered away is increased to 35%, under the current benefits system it would leave many claimants worse off in work than on benefits. This is something that local authorities will want to avoid.

- Currently council tax benefit is designed to deliver positive incentives to work, and local authorities will want to consider carefully what changes they wish to make to the current rules, and whether these improve or worsen incentives to work. For example, increasing the rate at which council tax is withdrawn could - when combined with the withdrawal of other benefits, and increased tax and national insurance contributions - lead to very poor incentives. As the table below shows, this could lead to very high withdrawal rates and claimants keeping little or no additional income from increased earnings.

Marginal deduction rates under the current benefits system	**Council Tax Support Taper**				
	10%	**20%**	**25%**	**30%**	**35%**
With Housing Benefit, Income Tax and National Insurance	83%	90%	93%	97%	100%
With Housing Benefit and National Insurance	78%	87%	91%	96%	100%
with Income tax and National Insurance only	38%	45%	48%	52%	55%

- Local authorities will also need to consider how to take account of Universal Credit, which is being introduced from October 2013. Because Universal Credit is an in-work and out of work benefit, and because for some types of claimants, aspects of Universal Credit will be more generous than current benefits, it will not be sufficient to replace references to existing benefits with references to Universal Credit.

- The Department for Communities and Local Government and the Department for Work and Pensions have worked closely together to develop arrangements for taking into account Universal Credit in the default scheme, which comes into effect where a local authority fails to adopt a scheme by 31 January 2013.

- This approach helps to support work incentives by applying the council tax support taper to Universal Credit income, which has already been tapered by 65%. This helps to control maximum marginal deduction rates (the rate at which support is withdrawn) to around 81 per cent, taking into account a person's tax and national insurance contributions, and ensuring there is a financial benefit to increasing earnings.

- Local authorities are encouraged to consider adopting this approach, which is set out in detail in chapter four of this document and in the default scheme regulations[1], to help ensure that work pays.

[1] http://www.legislation.gov.uk/uksi/2012/2886/contents/made

Chapter 1

Introduction

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. Council tax benefit expenditure in England increased from £2.0 billion to £4.3 billion from 1997-98 to 2010-11 and reducing expenditure is an important contribution to the vital task of deficit reduction.

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. While it does not, for the most part, recommend a particular approach, setting out the considerations of scheme design that can impact on decisions about work, which local authorities may want to consider alongside other local factors, it does set out in chapter 4 a possible approach to taking into account Universal Credit which local authorities are encouraged to consider.

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 - 4.13)
- How other income is treated (paragraphs 4.14 - 4.18)
- The point and rate at which support is withdrawn (paragraphs 4.19 - 4.33)

1.9. It also considers other factors that can influence decisions about work, including how the scheme is administered and communicated to applicants. (paragraphs 4.34 – 4.36).

1.10. The guidance has been updated since it was first published in May 2012. The following sections have been added or significantly revised:

- **Impacts of increasing the taper rate on marginal deduction rates** (annex C)
- **Approach to treating Universal Credit under the default scheme regulations** (paragraphs 4.38 – 4.51)

While local authorities are free to design their own schemes, the approach to taking account of Universal Credit income set out in this document helps to ensure that work incentives are supported, and local authorities are strongly encouraged to consider taking the same approach as that provided for in the default scheme regulations.

1.11. A number of minor consequential changes, as a result of the inclusion of this new material and the publication of more information on Universal Credit, have also been made, including changing references to ‘earnings disregards’ under Universal Credit to ‘work allowances’.

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 disregards (or work allowances), 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.[2]

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[3].

Council tax benefits 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 Jobseeker'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[4] 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 (or work allowances) for earned and unearned income which determine how much council tax benefit is awarded.

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[2] 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.

[3] Details on duties towards vulnerable groups are set out in the accompanying note, available from www.communities.gov.uk.

[4] 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[5].

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.[6]

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

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

[6] 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.

Work allowances

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 work allowance. 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 work allowances have been adjusted upwards[7]. The box below sets out the detail of these changes. These higher allowances 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 Work Allowances

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 (or work allowances) 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.

Final work allowance figures were published in the revised Universal Credit Impact Assessment on 10 December 2012.

[7] 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 will be phased in over a number of years starting in October 2013. The precise levels of Universal Credit income thresholds and tapers will be set out in regulations.[8]

[8] http://www.dwp.gov.uk/policy/welfare-reform/legislation-and-key-documents/welfare-reform-act-2012/welfare-reform-regulations/

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.[9]

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

[9] For more analysis on participation tax rates, see the Local Government Finance Bill: Localising Support for Council Tax Impact Assessment https://www.gov.uk/government/consultations/localising-support-for-council-tax

how much of each additional pound of gross earnings is lost through higher taxes and withdrawn benefits, discounts or tax credits[10] 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.[11]

[10] 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

[11] 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**
  - how income and living allowances are treated in the scheme
  - the point at which support starts to be withdrawn
  - 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. Paragraphs 4.38 to 4.51 set out how the default scheme regulations[12], which will come into effect where a local authority fails to adopt a scheme by 31 January, take account of Universal Credit, and how this approach supports positive work incentives. While local authorities are free to design their own schemes, this approach to treating Universal Credit will help them to ensure that work incentives are supported.

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.[13] To support local authority decisions about scheme design **annex C** sets out the impact on marginal deduction rates of changes to the taper rate for council tax support.

4.4. The considerations below use current arrangements and the terminology of council tax benefit to highlight principles that may be applied to local

[12] http://www.legislation.gov.uk/uksi/2012/2886/contents/made

[13] 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.

schemes, including those of simpler design. Different design features may be combined to different effect.

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 or work allowances to disregard additional earned income and increase the financial benefit of additional work. Earnings are considered in more detail in paragraphs 4.19 – 4.25, 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. Universal Credit will be based on a number of elements including personal allowances, a housing element and a disability element. These elements will together make up the Universal Credit maximum amount.

4.13. The Government is finalising arrangements for data sharing solution where local authorities are informed of Universal Credit claimants' circumstances, provided the information was relevant to the Universal Credit award, including details of the income assessment underpinning the Universal Credit award.

'Other' types of income

4.14. 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.

4.15. Depending on the approach, 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). The approach being taken to taking Universal Credit into account in the default scheme minimises the impact of this, because the Universal Credit award is reduced pound for pound by any income which is brought to account for both the calculation of the Universal Credit award and council tax support.

4.16. 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[14].

[14] 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-

'Other' income disregards

4.17. 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 effectively disregards in full some circumstance-specific additional living costs, such as child benefit and Constant Attendance Allowance.

4.18. 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[15]. For example, spousal maintenance is wholly brought to account in Universal Credit.

Operation: The point at which support starts to be withdrawn

4.19. 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.

4.20. 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.

4.21. Extended payments or run-ons are where the benefit continues to be paid even when circumstances have changed, for a set period[16]. 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;
- 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.

4.22. 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

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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

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

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

avoid multiple benefits or entitlements stopping or tapering off at the same time. Local authorities will also want to ensure that the implications of a run-on are clearly communicated to the claimant.

4.23. 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[17]. High marginal deductions rates act as a disincentive to increasing hours or earnings.

4.24. 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.

4.25. 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, and in particular the level of any work allowance offered, 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

4.26. 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.

4.27. 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.

4.28. Options for removing support include:

- a percentage taper resulting in a smooth withdrawal rate
- reducing support in steps at particular thresholds.

4.29. **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

[17] 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

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.

4.30. Local authorities may consider increasing the taper rate to reduce the costs of providing support. However, increases in the taper rate impact on the marginal deduction rate. When combined with the withdrawal of other benefits and the loss of income through taxation, a very high council tax support taper rate may significantly erode the additional income from working, removing the incentive to work. However, tapering support off more quickly, may ensure that council tax support is tapered away before Universal Credit is withdrawn, avoiding dual tapering. Annex C sets out the impact of increases in the council tax support taper rate, when combined with Universal Credit and, where appropriate, income tax and national insurance.

4.31. **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.

4.32. 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 could be a significant disincentive to work.

4.33. 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

4.34. 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.

4.35. 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.

4.36. 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, where accompanied by clear communications. 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

4.37. The Government is finalising arrangements for data sharing solution where local authorities are informed of Universal Credit claimants' circumstances, provided the information was relevant to the Universal Credit award, including details of the income assessment underpinning the Universal Credit award. Further information on this will be published as it becomes available on the Department for Communities and Local Government website[18].

Treatment of Universal Credit in the Default Scheme

Overview

4.38. Where a local authority fails to adopt a scheme by the deadline of 31 January 2013, a default scheme will come into effect. The default scheme[19], prescribed in regulations, largely recreates current council tax benefit regulations. However, some adjustments have been made to reflect that, from April 2013, a Universal Credit pathfinder scheme will commence, and from October 2013 Universal Credit will begin to replace a number of income-related benefits.

4.39. These provisions for Universal Credit were set out in draft regulations published in July 2012[20]. Since then The Department for Communities and Local Government has worked closely with the Department for Work and Pensions to ensure that the default scheme complements the work incentives that Universal Credit is designed to promote. Minor amendments to these provisions were published in mid-October alongside an explanatory note. [21]

4.40. Local authorities are free to design alternative ways of dealing with people claiming Universal Credit, and we expect that approaches will evolve over

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[18] https://www.gov.uk/government/organisations/department-for-communities-and-local-government
[19] http://www.legislation.gov.uk/uksi/2012/2886/contents/made
[20] Prescribed requirements: https://www.gov.uk/government/publications/localising-support-for-council-tax-prescribed-requirements-draft-regulations
Default scheme:
https://www.gov.uk/government/publications/localising-support-for-council-tax-default-scheme-draft-regulations
[21] Re-stated default scheme Universal Credit provisions:
https://www.gov.uk/government/publications/localising-support-for-council-tax-restated-default-scheme-universal-credit-provisions
https://www.gov.uk/government/publications/localising-support-for-council-tax-explanatory-note-on-restated-default-scheme-universal-credit-provisions

time. However, rather than developing entirely new methods the simple framework set out in the default scheme provides a starting point.

Provision for Universal Credit in the default scheme

4.41. Under the default scheme, council tax support will be calculated in the same way as the existing council tax benefit system by comparing income to the applicable amount.

4.42. The default scheme regulations contain provisions about applicants with an award of Universal Credit. For the applicable amount of such applicants the default scheme uses the amount of the maximum award calculated for the purposes of Universal Credit. This ensures that there is a consistent approach between the amount that Universal Credit determines a person needs to live on and the amount that council tax reduction schemes assume a person needs to live on.

4.43. The income assessment made by DWP for Universal Credit will be re-used, with the Universal Credit payment itself being included as income. The treatment of income and earnings between Universal Credit and the default scheme have been aligned as far as possible. This includes removing any income disregards in council tax benefit regulations which are not needed because this income is not taken into account in Universal Credit – for example, child benefit.

4.44. Applicants will lose 20p for every £1 of income over and above their applicable amount, subject to any earnings disregards that may be applied under the default scheme.

Supporting Work Incentives

THE TAPER

4.45. Taking into account Universal Credit as income in the way set out above supports positive work incentives by mitigating the risk of having high marginal deduction rates.

4.46. As set out above, the default scheme regulations provide for support to be tapered away at a rate of 20 per cent for every additional pound of (Universal Credit plus Universal Credit-assessed) income over and above the applicable amount (once any additional disregards have been applied under council tax reductions). Since the 20 per cent council tax support taper applies to the Universal Credit income which has already been tapered by 65 per cent, marginal deduction rates will be around 81 per cent, taking into account a person’s tax and national insurance contributions.

Work Allowances

4.47. Universal Credit will include more generous work allowances (or earnings disregards) than current income-replacement benefits. This means that people entering work will not have their Universal Credit withdrawn until they earnings exceed the disregard. Because of this, the standard earnings disregards currently provided for in council tax benefit are no longer needed for people in receipt of Universal Credit. Indeed, removing them means that the risk that council tax support and Universal Credit are withdrawn simultaneously is reduced, which help to control maximum marginal deduction rates. The default scheme therefore does not provide for the standard work allowances for claimants in receipt of Universal Credit.

Hours/income rules

4.48. A number of income and hours rules previously applicable under council tax benefit (for benefits Universal Credit is replacing such as Jobseeker's and employment and support allowances) no longer apply for recipients of Universal Credit under the default scheme regulations.

4.49. Under council tax benefit these rules controlled the way income was calculated and made staged adjustments (extended payments) at points where income increased – for example, due to a return to work). Whilst these measures did provide some support for work incentives, the extended taper in Universal Credit provides better support smoothed over a longer period, meaning claimants will not experience cliff edges and their household income will always increase if they have increased earnings.

Housing / child care costs

4.50. Housing and childcare costs will be taken into account in both the maximum award and assessed income.

4.51. Universal Credit already provides support for childcare. Households increasing their working hours may face increased childcare costs, which will be partially offset by Universal Credit. Since Universal Credit is taken into account for both the applicable amount and income calculations of the default scheme, a further adjustment in the council tax support calculation for 'childcare costs' is not needed. Any disregards of income (not already taken into account under Universal Credit) have been adjusted for.

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[22]. 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.

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

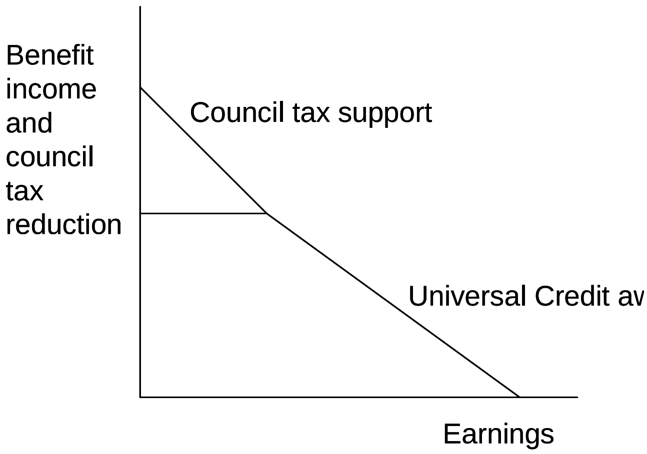
Scenario where council tax support and Universal Credit do not overlap

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.

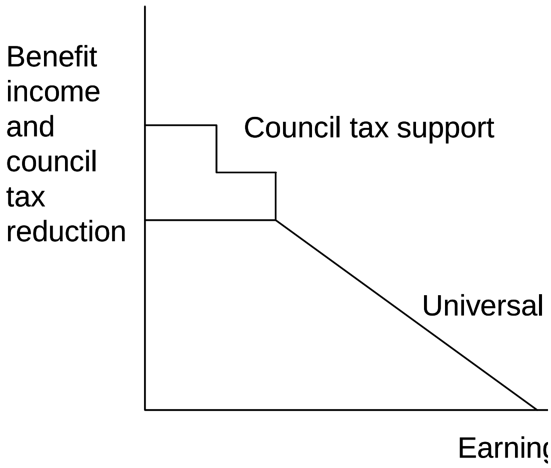
Diagram 1: smooth taper, no overlap with Universal Credit



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[23]. 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.

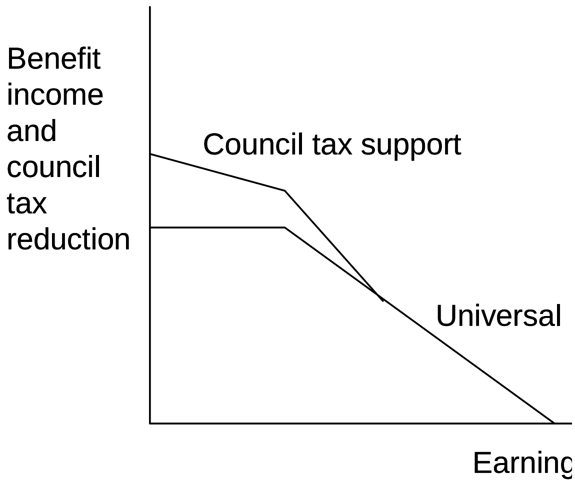
5.12. For example, where the current council tax benefit taper of 20 per cent was applied at the same time as the Universal Credit taper of 65 per cent, even if the 20 per cent reduction was applied to extra earnings net of the Universal Credit taper, there is still a marginal deduction rate of around 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.

[23] 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[24]. 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



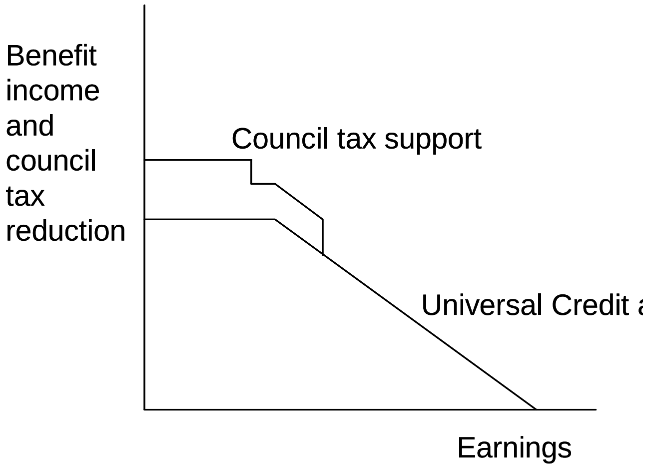
5.15. **Diagram 4** below looks at the same scenario, where the withdrawal rates overlap, but showing a stepped withdrawal of council tax support rather than a smooth taper.

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.

[24] 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, Jobseeker's 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 or work allowances

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, Jobseeker's Allowance (income based) or Employment Support Allowance (income related)
- 15 per cent - second adult's gross income is under £183.00 per week
- 7.5 per cent - second adult's gross income is between £183.00 and £239 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, combined with council tax support tapered away at 20%, will produce a marginal deduction rate (the impact on income of the combined effect of tax and benefits being withdrawn) on earned income of 81 per cent for those paying national insurance and income tax. This is 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 work allowances (or 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 work allowances and taper ensure that people should see a clear financial gain to working and progressing in work.

Annex C

Impact of increased taper rates on marginal deduction rates

1. The taper is the rate at which benefit is reduced to take account of earnings. Local authorities are free to make changes to taper rates to reduce the costs of support, but in doing so, they will want to consider carefully the potential impacts of any increase in the taper rate on marginal deduction rates.

2. The following tables set out the impact on marginal deduction rates of different council tax support taper rates – under the current benefits system and Universal Credit.

Table 1: under the current benefits system	**Council Tax Support Taper**				
	10%	**20%**	**25%**	**30%**	**35%**[1]
With Housing Benefit, Income Tax and National Insurance[2]	83%	90%	93%	97%	100%
With Housing Benefit and National Insurance	78%	87%	91%	96%	100%
with Income tax and National Insurance only	38%	45%	48%	52%	55%

Table 2: under Universal Credit	**Council Tax Support Taper**				
	10%	**20%**	**25%**	**30%**	**35%**
With Income Tax and National Insurance	79%	81%	82%	83%	85%
No Income Tax and National Insurance	69%	72%	74%	76%	77%

[1] The council tax benefit and housing benefit taper are currently applied simultaneously. As the housing benefit taper is 65%, council tax support tapers above 35% will result in Marginal Deduction Rates exceeding 100%.

[2] Under the current system, council tax benefit is not withdrawn until the claimants income exceeds their applicable amount and they are no longer entitled to a passporting benefit such as Jobseeker's Allowance(Income-Based), Employment and Support Allowance or Income Support. In most cases at these levels of earned income National Insurance will be in payment.