POLICY DEVELOPMENT: NOT A STATEMENT OF GOVERNMENT POLICY

100% Business Rates Retention

Systems Design Working Group: 31 July 2018

Simplification of the Business Rates Retention System

Not a statement of Government policy

A paper presented by:

Andy Moran (Oldham Council)

Michael Furness (Birmingham City Council)

Introduction

1.1 The Business Rates Retention system was created to give Councils more financial independence and reward them for increasing new business in their areas. However, recognising that some Councils earn more Business Rates than they need whilst others earn less, a system of tariffs and top ups was introduced to redistribute funding accordingly. Beyond this, Councils would be allowed to retain a proportion of growth in Business Rates achieved for their area (subject to a levy in tariff areas) but they would also bear reductions in revenue mitigated by the introduction of safety net arrangements.

1.2 The trade-off for allowing Councils to retain a proportion of Business Rates and gain from a growth incentive was to introduce an element of fiscal uncertainty into the Local Government Finance System which hitherto did not exist. It also meant the system was more complex to administer than the national pooling arrangements which preceded it.

1.3 Since the Business Rates Retention system was introduced in April 2013, events have conspired to add additional layers of complexity and uncertainty to the system to a point where there are deep-seated challenges which numerous working groups are trying to resolve in advance of a reset of the system in 2020. Furthermore, the design and operation of the system has reached a point where it is arguably now unfathomable to anyone beyond the specialists and practitioners who work with the system on a day to day basis. Issues that have added to the complexity since April 2013 include:

- **Appeals** – Whilst this had been raised as an issue prior to the introduction of the system, no-one quite envisaged just how intractable these challenges would be. Despite much effort, including a new check, challenge, appeal

process, no-one has yet found an acceptable solution that mitigates the need for Billing Authorities to set aside revenues which could otherwise be used to fund local services or compensate Councils for actual (realised) appeal losses that they have little or no ability to mitigate;

- **Policy Announcements** – Paradoxically, the transfer of Business Rates revenue to local authorities was followed by regular Government policy announcements to reduce the impact of Business Rates on bill payers. Policy announcements (usually in the form of Autumn Statement or Budget measures announced by the Chancellor of the Exchequer) capping multiplier increases or exempting certain types of hereditaments or business activity from Business Rates have been a regular feature of the new system. It has left in its wake a complex suite of Section 31 grants to compensate local authorities for losses resulting from these announcements culminating in the calculation error that has adversely affected Councils piloting 100% Rates Retention;
- **Revaluation** – The last revaluation exercise highlighted how challenging it is to rebalance the system following such an event. The challenge of adjusting tariffs, top ups and Section 31 grants to ensure Councils were no better or worse off was a complex exercise. This exercise is affected by the fact that it allows authorities to continue to retain gains from Renewable Energy Projects and Enterprise Zone areas regardless of the revaluation result, distorting the rebalancing impact outside of these areas. Although much effort was devoted to ensuring fiscal neutrality, in some cases it was only possible to use proxy calculations to determine no better/no worse positions. The same challenges (and more) need to be overcome for the forthcoming revaluation in 2021;
- **Devolution** – A series of deals covering the devolution of powers, funding arrangements and the piloting of 100% rates retention have added another layer of complexity that is challenging to accommodate following events such as revaluation or a reset of the system.

1.4 This is by no means an exhaustive list of challenges. As part of efforts to prepare for a reset of the system in 2020, additional challenges working groups are dealing with include:

- Determining whether the system should be fully or partially reset and on what basis;
- What criteria to apply for determining which hereditaments are included on central or local lists;
- The level at which levy and safety net thresholds should be set;
- How pooling can be incentivised in the absence of levies;
- How revaluation events (including transitional protection arrangements) should be accommodated within a reset of the system;
- Data, analysis and measurement challenges associated with resetting baselines.

1.5 This paper seeks to eliminate some of these challenges by setting out a proposal for simplifying the administration of the rates retention system from 1 April 2020. The proposal set out in this paper seeks to achieve this without compromising the original policy objectives underpinning Business Rates retention. Specifically, any simplification will need to:

Not a statement of Government policy

- Ensure the Local Government share of Business Rates Revenue remains 'localised' and that it is demonstrably funding the provision of local services;
- Include a reward element for local growth in Business Rate revenues;
- Honour existing commitments and agreements reached as part of the devolution agenda; and
- Operate within the existing legislative framework given there is no opportunity to revise primary legislation before the reset is due in 2020.

1.6 The proposal presented below should be regarded as an 'evolution' of the system based on what the MHCLG and the Local Government sector has learned since 2013 through operating rates retention both as a 50/50 scheme and as a full retention system as piloted in specific areas since 2017/18.

Basis of Simplification Proposal

2.1 The proposal set out below is based on separating out the 'reward' and 'devolution' elements of the system from 'mainstream' Business Rates revenue. Whilst these two elements are undoubtedly driven by Business Rates yield, there are many more factors affecting yield which are outside of the control of individual Local Authorities, for example:

- Central Government Policy announcements;
- Appeal losses;
- Academy conversions;
- The closure of major facilities (e.g. power stations) which can have a devastating impact on local revenues;
- NHS Trust claims for charitable relief.

2.2 It is also worth noting that there remains many aspects of the system which Local Authorities have no discretion or influence over including:

- The operation of the VoA and the basis of rateable valuations;
- The setting of multipliers and thresholds;
- The design of transitional protection arrangements following revaluation;
- The criteria for awarding mandatory relief.

2.3 Dealing with 'reward' and 'devolution' through separate arrangements paves the way for radically simplifying how baselines are determined and mainstream Business Rates revenues are accounted for. This is set out in the next section below.

Accounting for Mainstream Business Rates Revenue

3.1 By rewarding Business Rates growth and funding devolution commitments through separate and distinct arrangements (e.g. by Section 31 grants specifically designed for this purpose), it is possible to set up a system for managing mainstream Business Rates Revenue which neutralises gains and

Not a statement of Government policy

losses at an individual local authority level without compromising the original policy objectives underpinning the system. From a financial planning perspective, this approach provides Councils with much greater certainty than exists at present.

3.2 Setting aside the growth and devolution issues for the moment (this is dealt with later in the paper) but working within the current legislative framework, the first step in establishing the new system is to determine Business Rates baselines.

3.3 Since Business Rates baselines are one of the drivers behind tariff and top up calculations, these would need to be determined in advance of the Local Government Finance Settlement for 2020/21 (published provisionally November/ December 2019).

3.4 Theoretically, it is possible to construct Business Rates baselines from data supplied via NNDR 1 returns. If Local Authorities are protected from losses arising from differences between forecast and actual Business Rates revenue and rewarded for growth via a separate mechanism then in principle there should be no objection to using NNDR 1 data to establish Business Rates baselines for the fiscal year ahead.

3.5 In order to achieve this, it would be necessary to bring forward submission of NNDR 1 returns to late September/early October (similar to the CTB 1 return deadline) in order for this data to be used for setting baselines and thus tariffs and top ups included as part of the Local Government Finance Settlement.

3.6 As is the case now, NNDR 1 returns would split Business Rates forecast revenues between Central Government, the Billing Authority and Major Preceptors based on either existing or amended tier splits to arrive at annual Individual Authority Business Rates Baselines. Government could then use the actual NNDR 1 forecast NDR income as business rate baseline for the following year in the settlement and everyone can recognise their number.

3.7 The baseline funding levels could be established from by calculating the SFA based on the Fair Funding review needs assessment for each LA. The total spending review amount would allocate baseline funding levels between authorities using the fair needs funding formula.

3.8 A tariff/top up is then calculated as the difference between each LAs forecast income and the baseline funding level in order to get them back to their SFA. This means that there is a deviation from the current approach as tariffs/top ups will not go up in line with inflation but be recalculated each year. This should address the issue of having to rebalance the system after revaluation – if the top-up/tariff is recalculated each year then there will be no need to rebalance the system.

3.9 The estimated surplus/deficit forecast (as now) on the NNDR 1 would also get rolled into the following years' assessment of total business rates income for calculation of the following year's tariffs/top ups. This ensures that LAs retain all business rates locally and requires less changes when compared to the current system. LAs would still receive the appropriate amount of SFA for the year.

Not a statement of Government policy

3.10 This approach should also solve the appeals issue as including a forecast of appeals in the NNDR1 means that they are reflected in the top-up/tariff amount. Any variation in the appeals provision between NNDR 1 and NNDR 3 will be reflected in the surplus/deficit for the year and this will be included as part of the next submission of the NNDR1 in the estimate of surplus/deficit for the current year and total business rates income available.

3.11 Including the estimated surplus/deficit into the top-up/tariff calculation would automatically take account of the latest estimate of appeals, including any settled along with the backdates over and above that provided for. Any difference between estimated and actual surplus/deficit (and therefore appeals provision) would be covered in the following year's estimate as now. As income is fixed in year, whatever provision is created at outturn would not impact on resources either in year or the following year because of having to balance back to SFA (other than potentially on reward grant).

3.12 Once 2020/21 is underway, the cashflows would operate as they do now with Councils receiving or paying tariffs and top ups either to Central Government or to their local pool. Billing Authorities and Major Preceptors would also precept the Collection Fund for their share of Business Rates revenues. Under this simplified system, the amounts precepted would match Individual Authority Business Rates Baselines.

3.13 In terms of proper accounting practice, at year end, the NNDR 3 returns will capture actual rates in the same way it currently does. The accounting for NNDR 3 actual figures in the CIES under proper accounting practice and adjustment to the NNDR 1 figures in the general fund via the Movement in Reserves statement to the Collection Fund Adjustment Account would continue as normal.

3.14 The estimate of surplus/deficit for the current year would continue to be recorded on Part 4 of the NNDR 1 form as now to be incorporated into the calculation of the following year's tariff/top.

3.15 Appendix One includes a worked example to illustrate this proposal.

Not a statement of Government policy

Reward Grants

4.1 Dealing with 'reward' separately from mainstream Business Rates revenues not only simplifies administration, it provides an opportunity to design a smarter more sophisticated reward mechanism than exists at present. Rather than simply allowing authorities to retain growth in net rates revenue (and suffer losses in reductions regardless of cause), the grant could incorporate a suite of rewards to support a range of policy objectives. Some examples are set out below and they are not necessarily without their challenges, such as

needing a robust measure of growth to compare to the established business rates baselines. Ultimately the design of the reward system would depend on whatever policy objective government wished to employ:

Reward Measure	Policy Objective
% growth in aggregate rateable value	Growth in tax base/business activity within local area (growth will need defining)
% growth in aggregate rateable value multiplied by ratio of Baseline Funding Level to IABRB	Growth in tax base/business activity within local area. Elimination of 'gearing' issues and equalisation of fiscal incentive to grow Business Rates
SqM of empty property brought back into use	Growth in tax base/business activity within local area Reuse of derelict property/ brownfield sites
Identification and correction of omissions from rating list	Broaden tax base / fairness in distribution of tax liability.
% improvement in collection rate	Consistent improvements in collection efficiency. Fairness for tax payers
Growth in Business Rates derived from direct investment in local and national priorities (e.g. HS2, Broadband)	Growth in tax base/business activity within local area Fairness in returns on public sector investment

Not a statement of Government policy

4.2 The reward grant would be paid out of the tariffs collected when authorities achieve growth. The approach of top-up/tariff being the difference between actual income and SFA will mean any additional amount (growth) is collected via tariff and can be redistributed via the reward methodology, however that is determined. It will be necessary to determine how long reward payments last and how they are phased out if time-limited. The nature of such a system means it would be necessary to pay reward grant in arrears (or at the very least paid on account based on a half year forecast).

4.3 Arguably, some of the reward elements set out above could net HM Treasury additional tax revenues that it would not otherwise have received. As part of planning for the next Spending Review, perhaps a proposal could be assembled which argues that the local authority sector as a whole ought to be allowed to retain a share of growth in tax revenues (via a spending control increase) if it can be demonstrated that growth is the direct result of local authority intervention. Local authority direct investment and the identification by local authorities of rating list corrections and omissions have measurable

cause and effect and are perhaps the best candidates for putting a case to HM Treasury for a share of additional revenue growth that results from such interventions.

Funding for Devolution

5.1 Whatever system is agreed for 2020/21 onwards, it will be necessary to recognise and honour any commitments that have been made as a result of devolution. There are three broad approaches for financing and honouring such commitments:

- Via the calculation and payment of a support grant;
- Via the Local Government Finance Settlement regime by allocating a tier split to Combined Authority areas;
- Via a combination of these two mechanisms.

5.2 It may be helpful to distinguish between temporary and permanent commitments, the latter example being where Combined Authorities have assumed responsibility for particular statutory functions and activities. Permanent commitments could be incorporated into the Local Government Finance Settlement process (e.g. using a tier split) whereas separate grant funding could be utilised to fund temporary commitments.

Pooling of Business Rates

6.1 Under the simplified regime set out in Section 3, Councils have no fiscal incentive to pool mainstream Business Rates revenues. It is worth noting at this point that the Government's policy position is that levies on growth should be abolished. The Government's own policy position in the absence of other arrangements would also leave Councils with no fiscal incentive to pool Business Rates.

6.2 At the SDWG meeting of 27 June 2018, colleagues' overwhelming view was that Authorities were pooling Business Rates primarily to secure potential gains from Levy payments for the local area. Without such an incentive, pooling would not be as widespread.

6.3 If the Government wishes to incentivise 'pooling' then rather than pooling mainstream Business Rates revenue, Councils could be provided with the option of pooling Reward Grant. As an incentive to pool, reward grant could be designed to be more generous for pooled areas (although this would require an additional top slice from Local Government resources to fund it). An alternative 'cost neutral' approach could be based on providing more funding freedoms and flexibilities for areas that pool. Such incentives could include:

Not a statement of Government policy

- De-ringfencing key funding streams, particularly in relation to Health, Education and Transport. Examples include de-ringfencing Public Health Grant or allowing Councils to decide locally how to allocate and deploy DSG resources between different funding blocks;
- Removing time limits and similar restrictions for utilising ringfenced funding;
- Allowing Capital Resources (e.g. Capital Receipts) to be utilised for revenue purposes.

Advantages of the approach set out in this paper

7.1 The proposal set out in this paper is designed to:

- Simplify the process of resetting the system from 1 April 2020, particularly with regard to setting new Business Rates Baselines;
- Simplify the ability to handle (more frequent) revaluation events (which required the recalculation of tariffs and top ups as well as section 31 grants);
- Abolish the need for Section 31 grants paid in lieu of Business Rates arising from existing and future Government interventions/policy changes;
- Protect Local Authorities from the fiscal burden of appeal losses (although accounting practices mean it will still be necessary to calculate and make provision for appeals);
- Eliminate the need for a Safety Net regime;
- Minimise opportunities to 'game' the system;
- Provide an opportunity to simplify NNDR 1 and NNDR 3 returns.

7.2 It will, however, be necessary to clarify with HM Treasury that spending control totals for Local Government will not be adjusted during a Spending Review period for aggregate losses in Business Rates revenue. This would instantly remove concerns that the Local Government sector as a whole is expected to cover losses arising from:

- Rateable Value Appeals;
- Central Government policy announcements;
- Academy Conversions;
- Court cases and resulting precedents (e.g. the NHS Claim for Charitable Relief).

Not a statement of Government policy

Transition Issues

8.1 Regardless of the approach taken to resetting and operating the Business Rates Retention system from 1 April 2020, there are a number of transition issues which will need to be addressed and resolved; largely relating to legacy issues arising from the current system. Without disrupting the proposal set out in section 3, arrangements will need to be made to:

- Address what happens to the myriad of current Section 31 Grants;
- Carry forward a proportion of growth achieved under the current system as envisaged by a partial reset of the system;
- Protect growth achieved in Enterprise Zones or other Designated Areas to the extent this has been agreed under devolution arrangements;
- Handle the release of appeal provisions from resources set aside from the current retention system. After April 2020, it will be necessary to separately identify the element of appeal provisions which relate to the current rates retention system;
- Revisit tier splits and determine whether adjustment is required; particularly from the perspective of allocating reward grant as opposed to mainstream Business Rates revenue which is adjusted/ equalised via the Tariff/ Top Up mechanism.

Next Steps

9.1 SDWG / IWG colleagues are asked to comment on the proposals set out in this paper and determine what further work needs to be undertaken prior to consultation on proposals for resetting the Business Rates Retention system for 1 April 2020.

Not a statement of Government policy