Business Rates Retention – Business Interests Sub-Group Paper

1 Reforming the local government finance system

1.1 In October 2015 the Government announced that, by the end of this Parliament, local government as a sector will keep 100% of the income raised through business rates – worth up to an additional £13 billion of funding per annum. To ensure that the reforms are fiscally neutral, local government will take on new responsibilities to be funded from this additional income while government grants are phased out.

1.2 The design of a new finance system will shape the future of local government. This move away from dependence on central government and towards a more self-sufficient local government is something that councils have been calling for over a number of decades.

1.3 In addition, the Government has announced that:

- Local areas will retain 100% of any growth in their local tax bases, giving them a **strong incentive to maintain and grow their local economies**. To this end, Government intends to scrap the "levy" which, under the current scheme, taxes some authorities on their growth in business rates income.

- Authorities will be free to **reduce their local multipliers where they wish to support local economic development.** Directly elected metro mayors will be able to **add a supplement** to business rates to help fund new infrastructure projects, provided they have the support of the local business community through their **Local Enterprise Partnership.**

- **Redistribution of resources** between authorities will remain. **Protection** will remain within the new system for those authorities who experience significant reductions in business rates income.

1.4 The Local Growth and Jobs Bill, announced in the Queen's Speech on the 18th of May, is intended to include the legislation necessary to underpin these reforms. It will be introduced to Parliament later in the Session, after a planned summer consultation on the outline of the scheme.

1.5 The LGA and the Department for Communities and Local Government are working with local authorities, businesses and other interested parties to consider the reforms. A joint Steering Group meets monthly to consider the mechanisms needed to set up and run the system, as well as the timetable and implementation of the reforms. The Group oversees four technical sub-groups which advise on the technical detail. These are: new service responsibilities; the design of the retention system including the operation of the multiplier; needs and redistribution; and accounting and accountability.

1.6 In addition, we have established **this Business Interest sub-group** to contribute to the policy and technical debate and to ensure the views of the business community are taken in to account when designing the system. For these reforms to be successful it is important that they deliver not only for local government, but also for businesses and ratepayers.

1.7 In developing these reforms, the Government is keen to hear from interests across wider business community – both in the lead up to a summer consultation and beyond – to help shape policy development.

2 Overview of the reforms

Devolution of Responsibilities

2.1 This reform presents an opportunity to enhance authorities' role in promoting growth and service provision. The functions and responsibilities devolved as part of the reforms will set the shape and form of local government for the future. The aim should be to devolve a package that fits well with the local government system in England.

Issues to consider

2.2 Local government will need to take on responsibilities to be funded from the additional income, form 100% retained business rates, as central government grants are phased out. This will ensure that the proposal for 100% retention of business rates is cost neutral (in other words, the cost of any new responsibilities should match the increase in business rates income).

2.3 At the Autumn Statement the Government committed to piloting approaches to 100% Business Rates Retention in London, Manchester and Liverpool from as early as 1st April 2017.

2.4 Details of these pilots have yet to be agreed between central government and the local authorities concerned. These pilots will help to develop the mechanisms that will be needed to manage risk and reward under 100% rates retention and will help authorities to build financial capacity to reform core services and invest in long term economic growth from 2017 – three years ahead of schedule. The offer is open to any area that has ratified its devolution deal.

Criteria for the devolution of responsibilities to a local level

2.5 Views on the below proposed criteria are welcomed, including what else should be taken into account and whether some of these criteria are more important than others.

1) Devolution of a responsibility should build on the strengths of local government

2) Devolution of a responsibility should support the drive for economic growth

3) Devolution of a responsibility should support improved outcomes for service users or local people

4) Devolution of responsibilities should be made with consideration for the medium-term financial impact on local government.

Responsibilities under consideration:

2.6 Several responsibilities and funding streams have already been put forward as candidates for transfer to local government, to be funded from retained business rates. These include the administration of housing benefit (c. £150m) for pensioners and responsibility for funding public health (c. £3,100m).

2.7 In addition, the sector has expressed an interest in the **devolution of skills, employment and wider transport funding**, to give local government the flexibility to respond to local needs and **drive local growth**. This funding is currently provided through a number of channels, including by the Department for Business, Innovation and Skills, Department for Transport, Department for Work and Pensions and Department for Education.

2.8 The LGA and DCLG would like businesses, local authorities and other interested parties to share their views on these responsibilities as candidates for devolution to local government, in particular:

- the extent to which the devolution of responsibilities could support economic growth, cost efficiencies or improved outcomes at the local level;
- whether there is a case for 'bespoke devolution', where certain responsibilities are devolved in some areas but not others;
- the potential future costs of delivering new responsibilities; and
- how ongoing pressures on existing services can be taken into account.

2.9 The reform debate should **not be limited to the handful of responsibilities discussed above.** Wider evidence and views provided to the LGA and DCLG are welcome and will be used to consider all of the options.

100% Rates Retention System

2.10 In delivering 100% rates retention, we will need to look again at the critical issues and decisions taken in setting up the 50% rates retention system. Moreover, the move to 100% rates retention provides an opportunity revisit the existing design parameters in the light of the experience of the operation of the scheme in the three years since 2013-14. Below is an overview of some of the key issues around setting up the 100% rates retention system to provide a basis for further discussions.

Sharing Business Rates Income

2.11 Currently, all principal tiers of local government (county councils, district councils, metropolitan district councils and London Boroughs), stand-alone Fire and Rescue Authorities and the Greater London Authority (GLA) are funded, in part, by retained business rates income. In designing the 100% rates retention scheme, we could consider whether other tiers of local government – e.g. combined authorities – should be funded directly from retained business rates income.

2.12 Determining the assigned business rates shares due to authorities under the 100% rates retention system will be critical to the reward that authorities earn from growth in business rates, the incentive they have to grow their economies (and with them, their business rates bases) and the risk to which they will be exposed if business rates fall.

2.13 We will therefore need to consider which authorities should receive an assigned share of business rates; the considerations to be taken into account in determining assigned shares; and how business rates could be shared between authorities.

Enterprise Zones

2.14 Under 100% rates retention, the Government intends that Enterprise Zones and other designated areas will continue to operate as now and, therefore, will be guaranteed 100% of business rates growth for 25 years, notwithstanding how frequently tariffs and top-ups are reset to reflect changes in needs and redistribution.

2.15 This means that for the purposes of the scheme, any income above current baselines in Enterprise Zones and designated areas will be disregarded for the purposes of calculating “cost neutrality” when devolving new responsibilities to local government and for the purposes of working out tariffs and top-ups.

Central List

2.16 The majority of properties appear on local rating lists and are billed by local councils. A smaller number of, mainly, network properties (e.g. telecoms networks) are placed on a central rating list, where responsibility for billing rests with DCLG and currently raises £1.3 bn of business rates per annum. The move to 100% rates retention raises a number of issues about the Central List, including about the properties that should appear on Central or local lists respectively. This could affect issues of risk and reward and incentives for growth.

Pooling

2.17 It will need to be considered whether, under 100% rates retention, there would be advantages in more systematic pooling of risk and reward and, if voluntary, how this might be incentivised. Some authorities have asked if elements of the new local government finance system – including redistribution, the management of volatility, and the safety net, would work better at a regional, sub-regional or combined authority level, with local areas being given greater local discretion to determine the allocation of resources.

Business Rates Volatility: Assessing and Managing Risk

2.18 Business rates income is variable in nature due to changes in the occupation of property, constructions and renovations, as well as changes to the rateable value following appeals by ratepayers against the assessments made by the Valuation Office Agency (VOA). Under 100% rates retention the potential instability of rates income becomes even more critical to authorities, since a larger proportion of their service funding is dependent on their rates income – and this is particularly true for authorities who are heavily dependent on their assigned share of business rates, rather than top-up funding.

2.19 This suggests that in designing the 100% rates retention system there may be the need to consider ways of ensuring that councils are not unduly exposed to volatility in business rates income. This could mean either reducing the risk that falls on individual councils, or finding ways to better estimate provisions that councils need to make.

Safety Net

2.20 Notwithstanding any measures under 100% rates retention to reduce volatility, it is likely that some form of “safety net” will still be needed to provide for authorities in the event that the loss of business rates income is too great for them to continue to deliver appropriate services. In designing the new 100% retention scheme, it will need to be determined whether a safety net is still needed, and if so, how any future safety net should operate and be funded in the absence of a levy or RSG.

Revaluation

2.21 In developing the 100% rates retention scheme, a decision is necessary on whether, in the same way as currently, the effect of revaluations is stripped out and with it any reward for economic growth.

Are there any other issues, particularly from the business perspective, related to the set up of the new system which should be considered?

Fair Funding Review

2.22 As part of the Final Local Government Finance Settlement for 2016-17, the Government announced that, as part of the transition to 100% business rates retention, there would be a 'Fair Funding Review' of authorities' funding needs.

2.23 Based on a detailed review of the literature on this topic, the work done during last fundamental review of needs in 2000 and analysis of councils' responses to the consultation on the provisional settlement, we believe that the key first order questions that we will need to consider and that will be on the minds of local government for the Fair Funding Review are:

i. What do we mean by 'need'?
ii. What should the approach be for doing needs assessment for different services?
iii. At what geographical level should we do a needs assessment?
iv. How should 'resets' of the needs assessment be done?
v. How, and what, incentives should be built in to an assessment of councils' need?

2.24 The needs and redistribution technical group is currently exploring the questions above and helping to identify what the key drivers of need to spend are for particular services. This will help inform any data collection that needs to be done for assessing council needs. Following this data collection, we will begin the detailed analytical and modelling work required to produce funding formulae.

3 Local Tax Flexibilities

3.1 A key part of the reforms to make local authorities **better able to drive local growth** and more self sufficient is the devolving of tax-setting powers. Authorities will therefore be able to tailor their own tax regime to fit the local economic environment.

The power to reduce the business rates tax rate (the multiplier)

3.2 These reforms build on the introduction of the local discounts powers in 2011 and will provide authorities with the power to provide an across the board tax cut through a reduction in the multiplier for the relevant year.

Background

3.3 Under the old local rates system authorities had the ability to set a local tax rate. Since the introduction of the business rates system in 1990 a uniform business rate – also known as the multiplier - has applied across the country. It is known as the multiplier as a bill is calculated by multiplying the property's rateable value by the "multiplier". The multiplier for 2016-17 is 48.4p and, therefore, a property with a £15,000 rateable value would pay a bill, subject to reliefs, of £7,260. Increases in the multiplier are capped by inflation (a higher multiplier which includes a supplement to pay for Small Business Rate Relief is paid by higher value properties but in this paper the multiplier in question is the lower multiplier).

Issues to consider

3.4 To allow authorities to reduce the multiplier a number of policy decisions need to be taken. The LGA and the Government **would like businesses, local authorities and other interested parties** to help identify and resolve the issues raised by allowing local authorities to set a local multiplier.

3.5 The below summarises the main issues:

- This reform has been envisaged as a power to reduce the multiplier **across the board** as authorities have their local discount powers to provide targeted relief. Therefore, a reduction in the multiplier would not be state aid as it is across an administrative area but targeted local discounts would be and have to be granted under the de minimis rules. **Are there any issues around that distinction?**

- While the decision to reduce the multiplier would obviously be one for the relevant authority in single tier areas, there is a question about **who should be able to take the decision in two tier areas**. So the District, County or a combination of both could be the decision taker. There are similar issues to be considered in respect of London and combined authority areas. The position of fire authorities will also need to be taken in to account. Appropriate financial arrangements will also need to be put in place in respect of the costs.

- An authority may reduce the multiplier in order to **encourage business in to the area**. That could potentially have an impact on neighbouring authorities. That could be regarded as healthy competition or instead something for which safeguards should be introduced.

- If an authority reduces the multiplier there is a question of whether that should be considered **permanent; reversible on an annual basis; or fixed for a period of time**. However, if reductions were not permanent, where an authority did reduce the multiplier there is a question about how the multiplier could subsequently be increased to catch-up with the “normal” inflation linked multiplier.

Infrastructure Levy

3.6 This power will provide combined authority mayors with the ability to levy a 2p in the pound supplement on business rates bills to fund new infrastructure projects, provided they have the support of the business community, through a majority of the business members of the Local Enterprise Partnership. The new powers can be envisaged as a modernised version of Business Rates Supplements in line with the new devolution and growth agenda.

Background

3.7 The Business Rate Supplement Act 2009 provides a discretionary power for county councils, unitary district councils and, in London, the Greater London Authority to levy a supplement on business rates, subject to a national upper limit of 2p per pound. Levying authorities can retain the proceeds to fund additional projects to promote the economic development of their local area. Authorities cannot levy a Business Rate Supplement on properties with a rateable value below £50,000. All levies are subject to a ballot. The power has only been used once to date, in London, to fund the Crossrail project.

Issues to consider

3.8 As with the power to reduce the multiplier, a number of policy decisions still need to be taken to provide combined authority mayors with the ability to levy a supplement. The LGA and the Government would again like **businesses, local authorities and other interested parties** to help identify and resolve the issues raised by allowing combined authority mayors to levy a supplement.

3.9 The below summarises the main issues:

- It has been announced that **approval of the relevant LEP** should be required in order for a levy to be raised. LEPs already play a strategic role in determining the priorities for infrastructure investment through the Strategic Economic Plan (SEP), and would act as representatives of local business communities to ensure that **proposed infrastructure projects will benefit ratepayers.** Decisions will need to be taken on how to deal with cases where LEP boundaries are not co-terminous with combined authority areas.

- The intention is that the power should give combined authority mayors similar powers to levy that are available to certain authorities through the Business Rates Supplement Act 2009. That in itself raises questions about the role of the existing Business Rates Supplements powers.

- It is envisaged that the levy would be limited to fund **infrastructure**. The meaning of infrastructure will therefore need to be defined.

- The levy could be restricted to one per area for one specific infrastructure project or, alternatively, the powers could allow for a single levy for multiple infrastructure projects.

- The levy will need to be in place long enough to support the funding of the infrastructure project. However, a limit on the duration could be agreed at the introduction of the levy, perhaps with a process for it being renewed.

- **Further boundaries** could be placed on the levy such as with Business Rates Supplements. For example, there could be a **minimum rateable value threshold** to protect small businesses. However, that may limit the amount that could be raised and could impact differently on different areas of the country. It would also restrict local decision making.

Are there any other issues related to local tax flexibilities which should be considered?