100% Rates Retention System

1. 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. It may be that the answers that were appropriate when local government retained 50% of the business rates and still received significant sums of Revenue Support Grant (RSG), are no longer the same.

2. Moreover, the move to 100% rates retention provides an opportunity to look again at the existing design parameters in the light of the experience of the operation of the scheme in the three years since 2013-14.

3. This paper explores the issues around setting up the 100% rates retention system to provide a basis for further discussions. It is not meant to be an exhaustive exploration of all the relevant issues, but rather an overview of the main issues identified to date.

Sharing Business Rates Income

4. 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.

5. 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.

6. It will also be a key component of the needs and redistribution system, and will determine how much of a council's funding is independent of changes to local tax bases; and whether and to what extent that funding grows over time.

7. 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.

Business Rates Volatility: Assessing and Managing Risk

8. Business rates income is variable in nature. Local business rates vary over time because of changes in the occupation of property and because of the construction of new business properties, renovations and demolitions. But, they are also affected by changes to the rateable value of property following appeals by ratepayers against the rating assessments made by the Valuation Office Agency (VOA). Such appeals can take several years to be resolved and can result not only in reductions to a council's tax base, but also in the council having to refund the ratepayer for payments in earlier years.

9. To deal with this contingency, local councils are required by proper accounting practice to estimate how much of any year's collectible business rates is likely to have to be repaid to ratepayers at some point in the future. This must be set aside as a "provision", and used to pay for the cost of appeals.

10. Experience has shown that appeal losses are not proportionate to the size of a council's rates base and can be very difficult to forecast – leading to some councils having to make large year-on-year changes in provisions, with a knock-on effect on income.

11. Separately, authorities have also been exposed to changes caused by the normal operation of the rating system and decisions by the VOA to move ratepayers from one local rating list to another or from local rating lists to the central rating list.

12. 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.

13. This suggests that in designing the 100% rates retention system there may be the need to consider whether there are ways of ensuring that councils are not unduly exposed to volatility in business rates income. In essence, this will mean either:
    a. Reducing or eliminating the extent to which the risk of volatility falls on individual councils (which in turn will eliminate or reduce councils' need to hold provisions); or
    b. Finding ways to better estimate the provisions that individual councils need to make and ensuring that the 100% scheme provides them with the funds they need, over and above the resource they need for service delivery.

Safety Net

14. 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. For example, where a council is faced with a significant loss of income following the closure of a major ratepayer. This situation will not (and cannot) be anticipated through an accounting provision.

15. 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

16. 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.

17. Depending on how appeal volatility and risk is dealt with, the system will also need to ensure that at a revaluation, authorities are placed in as good a position as possible to

forecast the provisions they will have to make; and that they are provided, through the system, with the funds they need to make those provisions without there being a significant impact on service delivery.

Central List

18. 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. Responsibility for billing and collecting business rates from these ratepayers rests with DCLG, and currently raises £1.3 bn of business rates per annum.

19. 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.

Enterprise Zones

20. 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.

21. 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.

Pooling

22. 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.

23. 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. This question will need to be considered as part of the work on the set-up of the rates retention system.

Systems and Set-up

24. Finally, it would be sensible to use the experience of setting up and running the current 50% rates retention scheme to design the set-up and operating systems for the new 100% scheme. This will need to include how business rates income is measured for the purposes of the initial redistribution, how and when income is to be measured for the purposes of budgeting, and how estimates and actuals are to be reconciled and recognised in a local council’s accounts.

Question: Does the Group have any initial steers on the issues raised or think that there are any additional issues that should be considered?

Question: In light of these issues what remit does the Group want to give to the technical working group?