District Councils' Network
The one voice of district councils in the LGA
Close to people, focused on place

DCN SUBMISSION TO SELECT COMMITTTEE ON THE LOCALISATION OF BUSINESS RATES

The District Councils' Network welcomes the opportunity to provide evidence to this inquiry. The Network is a cross-party member led network of 201 district councils. We are a Special Interest Group of the Local Government Association (LGA), and provide a single voice for district councils within the LGA.

All of our member councils collect and administer business rates as billing authorities and are funded in part from business rates. All DCN members therefore have a direct interest in the Government's proposals for 100% retention of business rates.

The place business rates retention plays in the wider local government funding landscape

1. **Population needs**

   Historically the local government grant system was strongly geared to population. Revenue Support Grant (RSG) and New Homes Bonus (NHB) both correlate well with changes in population.

   Recent changes to NHB and the effective phasing out of RSG mean that the link with population has now been weakened. Population has always been taken as a good proxy for need (as adjusted for deprivation, rurality etc). The increasing reliance on business rates as a significant source of local finance support, will result in a clear financial incentive to Local Authorities to increase business revenues - but not necessarily population via new homes.

   Given the importance of new homes to our society and economy and the policy priority it represents for the Government, it is assumed that Government is satisfied that the balance of funding between incentivising business growth and housing growth is appropriate.

2. **“Negative” RSG**

The reduction of RSG to the point where it is nil has presented a problem for Government. If, as part of fiscal policy, government seeks to reduce funding to local government and it cannot reduce RSG further, then it has to find a way to implement further reductions (“negative RSG”). This point has now been reached by 15 councils which have seen their business rates retention sums adjusted to effectively move them into “negative RSG”.

This will over time impact on more and more authorities.

The notion of 100% retention of business rates is undermined by this “negative RSG” situation.

The Business Rates Scheme

3. **A skewed tax base**

Typically a tax base is made up of a large number of payees contributing a sum which does not range too widely.

The business rates tax base is the exact opposite. A few very large payees can account for a massively disproportionate part of the tax take.

To illustrate this point a district tagged “the most typical town in England” has more than one-thirds of its business rates income paid by less than 0.5% of its taxpayers.

This amplified Pareto effect is even more pronounced when considered on a localised map. It makes the tax base particularly volatile if business closures or significant appeals occur.

4. (i) **Appeals including backdating**

Given 3 above, the impact of reductions on appeals disproportionately affect the tax base of an area.

However a particular problem arises with the backdating of appeals.

Where an appeal is backdated for say 6 years, the entire burden falls on the current collection authority – even though they did not retain that funding previously.

Thus those who never received an overpayment are held responsible for its repayment. This is as irrational as it is unfair.

Whatever scheme exists in the future, the Select Committee is asked to support the principle:-

> *Any overpayments or any repayments after successful appeal are met by those who received the money originally.*
>
> *In short, those who got the money, return it!*

5. **Taking a national view – Local & National rating lists**

Currently there are some very significant changes to local tax bases which arise solely from changes in national government policy; a good example being energy policy. Should a local community suffer the burden of the closure of a power plant as a result of a change in national government energy policy?

A review of what belongs on and off the National list of premises vs the Local list of premises could quickly rectify any anomalies.

Whatever scheme exists in the future, the Select Committee is asked to support the principle:-

"The National and Local List composition be reviewed to ensure that assets of national influence are on a National List and that such funding adjustments are made to ensure any changes are cash neutral".

6. **Taking a national view – net taxpayer perspective**

Currently very large payments are transferred from one part of the public purse to another. These are administratively cumbersome and time consuming. The net impact is a greater taxpayer burden than would otherwise exist, achieving nothing other than moving taxpayer money around the system.

A good and topical example is hospital trusts. The national taxper pays for the business rates paid by hospital trusts, which are locally collected. That sum then flows back to the Treasury in its entirety. Any new increases in business rates from new premises are subject to a small local retention but currently around 70% – 75% of those `new' rates typically flow back to the Treasury.

Currently a great deal of time and effort is being expended by hospital trusts and their lawyers chasing appeals – no doubt with all the commensurate costs and substantial fees. At the end of that process, the best possible outcome is that resources move from one type of taxpayer-funded body to another – with a large proportion lost en route in administration and external fees.

There is a strong case for a national view to be taken on these types of taxpayer-to-taxpayer payments with any funding adjustments being made at a national level.

1. Treasury Funds to Department of Health.
2. Department of Health funds Clinical Commissioning Groups.
3. CCGs pay money to Hospital Trusts.
4. Hospital Trusts pay money to Local Authority.
5. Local Authority gives that money to Treasury.

The current money-go-round system adds no value and leaks scarce resources.

Whatever scheme exists in the future, the Select Committee is asked to support the principle:-

Unless it is proven to add value, all taxpayer-to-taxpayer transfer payments be rationalised out of the system with commensurable adjustments to leave parties in a cash neutral position (but administratively better off)

7. **Equal reward for equal actions**

The current system, introduced in 2013, has periodic "resets" where the local authority baseline is set. From that point growth in the local business rates base is measured and rewarded – until the next reset. We would question the need for resets altogether.

Resets are scheduled for 2020, and five-yearly thereafter. (Note this is different to the Business Rates Revaluation). Thus, under the current system, growth achieved at the beginning of the measurement period is rewarded very differently from growth at the end of the reward period. Other areas of local government finance provide a consistent level of funding for the same actions. It seems irrational to have the locally-retained payment for delivery of growth differentiated for no other reason than an accident of timing. All the locally-retained share of growth should be payable for a consistent period.

Apart from the fairness of this proposed approach, it helps smooth out changes in the local tax base, making a more predictable and stable funding stream.

Whatever scheme exists in the future, the Select Committee is asked to support the principle:-

Locally-retained stores of growth are consistent and not subject to variation merely on the basis of random factors, such as the point in the "reset" cycle the growth occurs.

8. **Recognising Regeneration efforts in the Business Rates Scheme**

Local authorities are often pivotal to delivering regeneration. This is particularly true in town centres. The current pressures on town centres mean it is particularly important that local authorities are able to pay a full and proper part in delivering regeneration schemes.

Unfortunately, the current scheme mitigates against such schemes. Typically to build, say, a new shopping centre – to replace a tired and outdated venue – requires the demolition of the old, followed by the building of a new.

On demolition the business rate tax is lost and the council loses its tax base. Of course once rebuilt and occupied, a hopefully higher tax base arises. However, the intervening period is a loss period and due to "resets" (see above) the marginal gain is often not felt for long enough. In some cases, even if it is, the organisation may not be able to bear the reduction – even if it's only a medium-term one.

There is a case for at least considering and consulting on treating certain types of regeneration schemes differently in the current or any future Business Rate Retention Scheme, to recognise the reductions in tax base invariably needed as part of regeneration re-build programs.

9. **New funding: New burdens**

The key issue in the long run is the extent to which the new burdens (as yet unspecified or costed) placed on local government are commensurate to the additional funding which may arise from changes to the business rates scheme.

If we take the recent `localisation' of council tax support cost as an example, its cost has proven to have increased in a number of areas. The additional funding placed in the RSG by government to meet that cost was transparent in year one. Thereafter it has not been. It is hard to see how a local authority which is now getting nil or arguably "negative" RSG is still receiving an embedded grant to cover the costs it still carries in this area.

If the new burden is different in its cost curve over time to the new income stream, and they respond to different economic levers, then the system becomes less transparent and long term service provision more difficult to plan.

A new burden around, say, – benefit support for the elderly – will have a greater accelerator (due to our ageing population) than an inflation-linked business rates tax.

Whilst the year 2020 seems a long way ahead, it will be within the financial and service planning horizons of most councils. It's probably fair to say most in local government have some concerns about the new burdens: new funding ratio.

Conclusions and summary

The incentivising of local authorities to enhance their business base is a straightforward policy objective. In many cases local authorities have gained a greater understanding and connectivity with their local business community as a result of seeing a direct financial benefit from improvement in the local business base. Most mature observers in local government would probably say that is a good thing.

As with many sound policy initiatives (local and national), the challenge is always to ensure there are no unintended consequences or irrationalities in the implementation mechanics.

In the foregoing we have focused on key areas where we respectfully suggest irrationality and/or negative features have crept in. In particular, ones which are relatively easily avoidable – without creating other problems down stream.

We suggest that these points read across both the existing scheme and the design of any new scheme.

We offer no criticism of the architects of the existing scheme.

The first version of anything is usually improved upon after testing and application in practice. Additionally, tapping into the expertise of those at the coal face when designing schemes is not always as systematic as it might be. Perhaps one of the key ways in which we can assist is by bringing our practitioner knowledge and experience to the design process for any future scheme as well as offering ideas to improve the existing scheme. That offer has been made and remains open to CLG colleagues.

We would appreciate the opportunity to give further oral evidence to the Select Committee.

Further information and DCN contacts

Further information relevant to this submission can be found in our technical appendix (see pages 9 – 18).

For any additional information or help, please contact the DCN Office in the first instance:

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The District Councils' Network is a cross-party member led network of 201 district councils. We are a Special Interest Group of the Local Government Association (LGA), and provide a single voice for district councils within the LGA. We lobby central government, the political parties and other stakeholders directly on behalf of our members, as well as commissioning research, providing support, and sharing best practice.

District councils in England deliver 86 out of 137 essential local government services to nearly 22 million people – 40% of the population – and cover 68% of the country.

Technical Appendix– The Government's Business Rates Proposals – a submission to the Communities and Local Government Committee's inquiry

Summary of Technical Appendix

1 The Government's proposal to change the system of local government finance which would move towards 100% retention of business rates (by 2010) is generally welcome. If the revised system is to provide adequate funding for local government services as well as providing the necessary levers to incentivise business growth, it will need to be developed very carefully and in close consultation with local government professionals.

2 Therefore, to be successful with its proposals to allow councils to retain 100% of business rates the DCN and Districts want to work with Government to implement a radically new system of local government finance.

3 Key features would include:

a) Implementing the change sooner than 2020, in 2019 or possibly even 2018, to smooth the impact of the massive reductions in grant that many district councils (and other councils) will experience before 2020;
b) Accepting that there must be some local control of the poundage in all areas, not only a power to cut business rates. We set out a proposal for how this might work;
c) If there is not a power for councils to increase the poundage, an automatic uprating mechanism linked to a measure of inflation such as RPI is essential and must be retained;
d) If there is to be a genuine move away from a uniform business rate and to promote local self-sufficiency, redistribution should – except in the most extreme cases – be dealt with through sub-regional areas, e.g. clusters of Districts.

e) securing a realistic apportionment of business rate income between different local government bodies. This would normally be decided locally or regionally as part of any agreement on redistribution. If it is necessary to have a default prescribed apportionment that would apply in the event of any failure to reach local agreement, it should protect overall levels of income that district councils receive, adjusted to take account of any new responsibilities transferred;
f) Ensuring that any responsibilities transferred to district councils as part of the move to full retention of business rates leave discretion for change and local decision-making, and that funding follows function. In this respect, any delegated functions and duties should be open to local freedoms and flexibilities, rather than prescribed nationally;
g) Introducing arrangements for handling challenges about business rates that are much speedier than envisaged in the recent Government consultation paper;
h) Legislating for reform of council tax to promote local decision-making and accountability on a wide range of issues such as valuation bands, exemptions and discounts.

The role of business rates

4 Since they were introduced centuries ago, rates on businesses have helped to fund local public services. Business rates serve an important role to provide adequate funding for local government services as well as providing the necessary levers to incentivise business growth. Whilst income from business rates is not only used solely to fund services that benefit businesses, but also support wider services such as social care, fire and rescue services and leisure services, it is often used to fund those services that make a difference to businesses such as highways and street lighting, economic development and planning. The DCN seeks no change in this approach. Business rates are part of the funding mix for the full range of local government services. While they are subject to local control only in marginal ways at the moment, business rates can and should continue to play their part in funding everything that councils and other local government bodies do.

5 It might also be helpful to dispel another myth about the system of business rates. They do not ensure that similar businesses face similar bills. This is because rateable

values vary from area to area, reflecting the estimated rental that can be achieved from a property. Thus two similar business properties could face significantly different rates bills, even within the same district let alone if they are further apart. Businesses often say that they support the uniform business rate because it gives businesses certainty. However this needs to be put in the context of revaluations that generally happen every five years (and revaluations can lead to significant upwards or downwards shifts in rateable value) and the current annual uprating mechanism – which is based on the Retail Prices Index and, therefore, introduces a further element of unpredictability.

Details of the Government's proposals

6 The Government has so far published very few details of its proposals. Following the Chancellor's announcement in October, the only details available are: that there would be 100% retention of business rates by 2020; councils would have the power to cut business rates (they already have such a power in section 47 of the Local Government Finance Act 1988 as amended by the Localism Act 2011); and elected Mayors would be able to raise them subject to agreement with the local enterprise partnership (but then by only 2% and only for infrastructure). In addition to this, the District Councils' Network would like to see full local control over business rates, including the poundage.

7 The Government has portrayed the changes as the end of the uniform business rate. However, under the proposals, only in a few areas that have elected mayors might there be an increase in business rates, while few councils will be able to afford to reduce business rates given the severity of cuts in grant over the lifetime of this Parliament. The reality is that most areas would be likely to continue charging the same poundage as each other – and, therefore, the uniform business rate will linger on. We would, therefore, like to work with Government to develop an uprating mechanism which could apply in the absence of local flexibility to set the poundage; and how the poundage would be set following a revaluation.

8 It is essential that, if there is not going to be local control over the poundage, an uprating mechanism is maintained. This is presently based on the Retail Prices Index,

in accordance with paragraphs 3 to 5 of Schedule 7 to the 1988 Act; and the DCN would support this as a fair measure to ensure buoyancy in the tax. There needs to be annual growth in the poundage as, otherwise, in any given area the only growth will come from additional business properties being constructed or significant upward shifts in rateable values at a revaluation. For areas that experience dynamic growth, such changes can produce significant increases in business rate income over time. In less dynamic areas, including the very areas that tend to have higher needs (as a result of deprivation, rurality, peripherality etc), the absence of a guaranteed mechanism to ensure some buoyancy could be disastrous for the funding position for local public services.

9 The DCN's preference is that district councils should have the ability to vary the poundage, whether upwards or downwards, to a level agreed locally, rather than a nationally restricted level. Upwards variation should not be available only for infrastructure. The principal reason why all councils should have the ability to increase the poundage is that business rates are now going to be central to the funding of local public services. Because rateable values are set by a Government agency and there are vagaries in that process, in particular the unpredictable results of revaluations and appeals, councils will be exposed to the risk of significant overnight reductions in their income for reasons outside their control. If appeals or economic shocks such as the closure of major businesses mean that business rate income locally has declined, councils would need to have their own tools to rectify the position if they wished – by increasing the poundage. Nonetheless, there should be some mechanism to support those authorities who face a major reduction in business rates. The current safety net provisions operate at such a high level (a council must experience a reduction of 7.5% before it can access support) that it is not sufficiently helpful for most councils experiencing losses in business rates. We would like to work with Government to agree a suitable threshold for this.

10 In contrast, it is highly unusual for councils to experience a significant reduction in their council tax base as virtually all areas see at least some housing growth every year – thus council tax tends to be a far more buoyant tax in most areas than business rates. Yet all councils have the ability to protect themselves from reductions in the

council tax base by raising the council tax if they wish. The DCN contends that it would expose councils to an unmanageable level of risk in a system of 100% retention of business rates if they did not have an equivalent power to vary business rates, preventing their ability to invest in growth and deliver those services that residents value the most.

11 The DCN supports continuation of the existing power to reduce business rates and no limit needs to be set on this – it is a matter for local decision and affordability.

12 In respect of a power to increase the business rates poundage, the DCN proposes that it should be for local areas to decide whether to consult local businesses on potential changes. Nonetheless, the DCN would propose that the consultation of businesses could act as one of the checks and balances for local authorities that government is seeking through the localisation scheme. Councils should be able to increase the business rate poundage for any year by no more than the average increase in council tax for that area for that year. The "average increase in council tax" would be the average of the council tax increases set by the district council and any major precepting authorities, such as the county council and fire and rescue authority, which receive a share of business rate income. This mechanism ensures that business rates would not go up faster than council tax and directly addresses any concern that businesses would be subjected to higher taxation increases than local residents.

13 Unlike council tax, where successive Governments have shirked the need for revaluations, business rates are subject to regular revaluations. The DCN supports that regular revaluations should continue as a feature of the new system. Given that 100% of the income will be retained by local government, it should be for local areas to determine the cycle of revaluation. We also believe that there should be no centrally prescribed system of transitional relief and that transitional relief (and all other reliefs from business rates) should become a matter for councils to decide locally. In other words, the new system needs to allow councils the flexibility to deliver reliefs, whether by setting different poundages for different businesses or by giving discounts of variable amounts from a common poundage.

14 The current arrangements for revaluation are designed to ensure that, overall, there is no increase in business rates liability as a result of revaluation. Thus, if rateable values increase at the national level, the poundage is reduced, and vice versa. While that is one possible model for the new system, it would have to operate in future at the sub-national level i.e. across whatever footprint redistribution was happening on. However, the DCN would argue that a different model needs to be explored, which would better reward areas for growth that they have achieved. Rateable values rise on revaluation because an area has demonstrated that it is more attractive to business. In principle, we do not see any difficulty with the benefit of that being felt by local government – in other words, that there would be no adjustment of the poundage at revaluation, and that there would not be a neutral outcome for revenue raised from business rates in that area. We recognise that such an approach would also have to be applied in areas where rateable values have fallen. This will sharpen the incentive for councils to make their areas attractive to business and the impact would, in any case be capable of some mitigation because of the proposal in our submission that all councils should have the power to increase the poundage. Nonetheless, a measure would need to be put in place to support the most deprived areas.

15 The Government has set itself a timetable for implementing change by 2020. The DCN believes that change should be implemented sooner than 2020, in 2019 or possibly even 2018, to smooth the impact of the reductions in grant that many district councils (and other councils) will experience before 2020.

16 Our final point is that whatever arrangements are put in place should be a co-designed solution with local government – including representative bodies such as the District Councils' Network

What responsibilities and functions should be devolved to local authorities to take account of the increase in their funding?

17 While there will be a financial transfer to local government as a result of the proposal, in the context of overall local government spending, this is still likely to have fallen by 2020 as a result of grant reductions since 2010. The Government's presentation of the Spending Review as "flat cash" in local government spending power

across the period to 2020 depends on significant increases in council tax, which will rely on local decision-making, and cannot be guaranteed.

18 The Spending Review in December and announcements since then have hinted that the Government is considering transferring to local authorities responsibility for housing benefit for pensioners, public health and attendance allowances. The latter two would relate to county councils while the former would affect district councils.

19 The DCN's position is that there should be full discussion and negotiation with local government about what responsibilities and additional burdens are transferred; and that any responsibilities transferred to district councils as part of the move to full retention of business rates leave discretion for change and local decision-making, and funding to follow responsibilities. In this respect, the DCN would want to see the delegation of functions and duties, only if they are open to local freedoms and flexibilities, with necessary funding for delivery. To take housing benefit for pensioners as an example, councils would need the ability to vary support, in line with the flexibility they already have for local council tax support for working-age people. If such discretion was not permitted, some councils could face significant financial difficulties of having to meet costs – but find their income to pay for it from business rates suddenly decreased, for reasons mentioned earlier in this submission.

Other possible changes to the definition and collection of business rates

20 Paragraph 2.118 of the Spending Review mentioned that "DCLG will also work closely with the Valuation Office Agency to digitise the collection of local taxes, funded through up-front capital investment. This will generate efficiencies and support the move to full business rates retention." No further details have been released.

The DCN would be interested in exploring a centrally-funded portal that allowed businesses to pay their business rates online, so long as the Government also met any costs of linking individual councils' systems to it; and we would welcome discussions about extending such an approach to council tax as well. This is on the basis that digital collection of local taxes would not affect councils' ability to set or vary taxes.

21 Under the new system, there needs to be much swifter resolution of challenges, as the DCN has argued in its response to the Government's recent consultation paper "Check, challenge, appeal – reforming business rates appeals".

The consultation paper set out proposals which involved a timetable for appeals that could take three years or more – which is far too lengthy. DCN could not support the proposals at a time when local government is going to be even more dependent on business rate income. Our proposals would see a much shorter timetable for resolution of challenges of no more than about 12 months, which would benefit ratepayers as well. In addition to this, the 100% retention of business rates should be preceded by the introduction of an equitable needs-based formula for 2017-18.

Effects of the retention of business rates in the context of the local authority financial settlement

Differences in outcomes in richer and poorer areas and inter-authority competition

Long-term future of redistribution to poorer areas and impacts on development

22 Our comments on these topics relate mainly to the sub-national system of redistribution that we believe should be introduced. However, given the significance of the changes to the local government system, we also believe that the opportunity should be taken to reform other aspects of local government finance and taxation. The DCN supports reform of council tax to promote local decision-making and accountability on a wide range of issues such as revaluation, valuation bands, exemptions and discounts. We also fully support the Local Government Association's position in calling for the end of central control over decisions on council tax, including removal of the mechanism for referenda on "excessive" increases.

23 The final report of the Independent Commission on Local Government Finance (February 2015) argued for a sub-national basis for redistribution and noted that an LGA analysis demonstrated how 85% of redistribution could be dealt with on an intra-regional basis. This analysis needs to be updated in light of future Government spending plans and whatever responsibilities are transferred to councils alongside introduction of 100% business rates retention. However the essential point – that the focus should be on designing a system that is based on sub-national redistribution – remains relevant.

24 If there is to be a genuine move away from a uniform business rate and to promote local self-sufficiency, redistribution should – except in the most extreme cases – be dealt with at the sub-regional level.

25 The new system needs to secure a realistic apportionment of business rate income between different local government bodies. District councils are well-used to a system under which most of the business rates (and council tax) they collect are passed over to other bodies, such as the county council and fire and rescue authority. The apportionment would normally be decided locally as part of any sub-national agreement on redistribution. It may be necessary to have a national prescribed apportionment with a tolerance of plus/minus an agreed percentage to allow flexibility for local circumstances. We would suggest it should be for the local government sector to prescribe this, rather than be set by central government. This does not necessarily mean that district councils' current share of business rates should be maintained. In the context of fundamental reform of the system, there is the opportunity to rebalance how council tax is shared between different local government bodies. What is important is that district councils' overall level of income should not be adversely affected, at the point of introduction of the new arrangements, by whatever default apportionment methodology is put in place.

26 The DCN would question the need for "resets" in the reformed system. The concept runs counter to the central principle of 100% business rate retention, that areas should be incentivised to secure growth in the economy as measured by business rates. If the benefit of such growth might be removed or watered down after a period by a system of resets, the incentive would likewise be reduced. This is not to say that, for areas experiencing strong and continual growth, there might not be a greater propensity for them to redistribute some of that growth within sub-national (or even national) redistribution arrangements.

Role of directly elected mayors and LEPs

27 Our proposal would be for all areas to have the ability to increase the business rate poundage, rather than this being limited to areas with elected mayors.

28 We do not support a requirement to obtain the agreement of Local Enterprise Partnerships to secure increases in business rates. Councils are democratically-elected and accountable. This gives councillors and elected mayors democratic legitimacy to take decisions for their areas, including decisions that affect businesses.

Changes to the local role of businesses as a result of the proposals

29 The DCN strongly supports that businesses, their representative bodies and LEPs, should be consulted about local government's spending plans including any decision on the business rate poundage. Such consultation is a requirement of current legislation but generally results in poor participation by businesses, probably in the main because councils do not have the power to set the poundage. Thus giving all councils the power to vary the poundage upwards or downwards would be likely to increase engagement with businesses about local public services and how they are funded.