
# Business Rates Update

**This briefing updates on government reforms to business rates and on planned reforms to the business rates retention scheme, as well as the London business rates pool, within the context of the ongoing impact of the pandemic.**

## Overview

The coronavirus pandemic has highlighted existing flaws with business rates as a tax and as a funding source for local government. This briefing provides an update on government reforms to business rates and on planned reforms to the business rates retention scheme, as well as the London business rates pool.

### A recap of planned reforms to business rates retention

Since 2013/14 local government has retained 50 per cent of business rates through the business rates retention scheme. The government's original intention was to reset local authority baselines (the target level of business rates it expects each local authority to collect each year) in 2020. In 2015, the government set out ambitions to allow local government to retain 100 per cent of business rates by 2020, consulting on these proposals in 2016. Primary legislation had been planned through a Local Government Finance Bill, and a detailed consultation on technical reforms was published in 2017. However, the snap general election in May of that year led to the legislation being abandoned and the government scaling back reform ambitions to 75 per cent retention, to be implemented by 2019/20. A further consultation on technical reforms to the retention scheme, proposing a simpler administrative scheme, was published in December 2018.

Since then, delays to the Brexit process meant the deadline for implementing further retention and the reset of business rates baselines, alongside the wider reform of the distribution of funding through the Review of Relative Needs and Resources (the "Fair Funding Review"), was initially moved back to 2020/21 and then again to 2021/22. The coronavirus pandemic has led to further delay by at least a year. While the Government has confirmed its commitment to the reforms at the 2021/22 Local Government Finance Settlement, it has been unable to commit to implementing reforms in 2022/23.

One consequence of these repeated delays is that the actual levels of business rates collected by local authorities have become increasingly decoupled from their baselines (target levels), which were set in 2013. The forthcoming "reset" of the system could therefore see significant changes in baselines meaning, for those authorities whose rates are significantly above baseline levels, a sharp "cliff edge" reduction in funding.

LONDON COUNCILS

## The impact of Covid-19

The pandemic had a huge impact on business rates revenues in 2020/21 with the government stepping in and providing around £10 billion of additional business rates reliefs in the March 2020 Budget, increasing retail discount to 100 per cent and expanding the eligibility to hospitality and leisure businesses and new 1 year discount for nurseries across England. In doing so, the government effectively underwrote a third of the business rates yield. Businesses were supported, more generally, by grant schemes worth £20 billion during 2020/21, which will have enabled many businesses not eligible for rates reliefs to continue paying rates bills. The March 2021 Budget extended 100 per cent reliefs for retail hospitality and leisure businesses to the end of June, continuing at 66 per cent for the remainder of the year.

Despite this government support, London boroughs, who have been reporting estimated income losses on a monthly basis to government, estimated gross business rates losses of over £500 million in 2020/21. At Spending Review 2020, the government set out plans to cover 75 per cent of irrecoverable business rates and council tax losses in 2020/21, and for any deficits to be spread over the next three years rather than being paid in 2021/22. While the final outturn position isn't yet known, boroughs will likely need to cover retained business rates losses of over £50 million relating to 2020/21.

The position would have been far worse had the government not intervened in relation to the issue of businesses appealing their rates bills based on a Material Change of Circumstance (MCC) in the underlying value of property as a direct result of the pandemic. Many ratepayers – particularly in the office sector – had begun to lodge these types of appeal against the value of their property, which meant local authorities would have to make provisions in their accounts to cover potential losses of income that could have arisen. In London alone it was estimated this could have seen losses in retained income of £400 million over the course of the next year *despite* the 75 per cent income guarantee scheme.

London Councils, working with London borough finance directors, made representation to the government on this issue in February, and on 25 March the government announced proposals to change the legislation around pandemic-related MCC appeals. The Valuation for Rating (Coronavirus) (England) Regulations 2021 (laid before Parliament in March) have already ruled out these appeals prospectively, and primary legislation (the Rating (Coronvirus) and Directors Disqualification (Dissolved Companies) Bill) is currently going through Parliament, which will rule out these appeals retrospectively. At the same time, the government announced a new relief scheme worth £1.5 billion which will be a discretionary scheme to support local businesses in sectors that have been affected by Covid-19 but not eligible for other reliefs or grants.

Despite all this support, the position remains very uncertain in 2021/22. With no tax income guarantee scheme in place, business support grants coming to an end and the Coronvirus Job Retention Scheme ending in June, business rates income is very unlikely to bounce back to previous levels.

## The London Business Rates Pool

A series of 100 per cent retention pilots were established across the country from 2017/18 onwards, to test how greater retention might work, including the pan-London 100 per cent pilot pool in 2018-19. A further series of 75 per cent pilots were implemented in 2019/20, when the retention level for the London pool was downgraded to 75 per cent.

The London pilot pool included all 33 London local authorities and the GLA and was a successful exercise in collaboration across both tiers of government, with the aim of supporting longer term fiscal devolution to London Government. The pilot delivered £397 million of net financial benefit in 2018/19 (£216 million of which was retained directly by London boroughs and the City of London), and around £212 million in 2019/20 (with £115 million retained by London boroughs and the City of London). It also supported direct spending totalling around £280 million on strategic projects aimed at driving economic growth.

**“With no tax income guarantee scheme in place, business support grants coming to an end and the Coronvirus Job Retention Scheme ending in June, business rates income is very unlikely to bounce back to previous levels”**

Despite losing the benefits of greater retention that came with being a pilot, the London pool continued in 2020/21, with all 34 authorities committed to the wider strategic benefits that come with pooling. It was initially forecast to deliver around £36 million of financial benefit to London boroughs prior to the pandemic. However, the impact of the pandemic means this is likely to be much lower now, although the 75 per cent guarantee scheme will insulate the impact on the pool considerably. Outturn figures won't be available until later in the summer.

> **The ongoing uncertainties over business rates income meant that Leaders and the Mayor agreed collectively in January not to continue to pool business rates in 2021/22**

The ongoing uncertainties over business rates income meant that Leaders and the Mayor agreed collectively in January not to continue to pool business rates in 2021/22. There will be further opportunity to reconstitute the pool in 2022/23 and in subsequent years, were there to be a more obvious financial benefit and should the strategic case become stronger. It was therefore agreed to continue monitoring a "shadow pool" in 2021/22 to understand whether pooling would indeed have been beneficial, to inform the decision that will be required in the autumn about whether or not to reconstitute the pool in 2022/23.

### Fundamental review

The Treasury had sought to deliver a "fundamental review" of business rates by the March Budget earlier this year, having held a call for evidence from July to October 2020. The review focused on reducing the burden on ratepayers, suggesting that, whatever the outcome, the intention is for the tax to have a lower yield, which consequently means local government would have fewer resources, unless other taxes are raised to fill the void. The review suggested two: a Capital Values Tax (CVT) and an Online Sales Tax (OST). The CVT is more closely comparable with business rates, and could potentially replace it entirely (in terms of overall yield), whereas, given the overall quantum of online retail sales (the LGA estimated £3-4 billion)[1], the OST can only be seen as a partial replacement.

London Councils and the GLA responded jointly to the review, stressing that any reforms should only be implemented once the impact of the pandemic has subsided, but again restating long term ambitions for greater local control over setting of the tax through devolving the multiplier and system of mandatory reliefs to London Government. It also supported more frequent valuations, but suggested for this to be realistic it would either require significant extra resources for the Valuation Office Agency or a different approach to valuations. It broadly supported the introduction of an OST as part of a more balanced approach to business taxation that reflects the 21st century economy. However, as it is difficult to link to specific geographic areas, it is difficult to see how local authorities could be incentivised to grow the tax in the way they are, theoretically, with business rates – as it would effectively be a central tax.

The ongoing impact of the pandemic led to the outcome of the review being postponed until later in the year - most likely alongside the 2021 Spending Review in the autumn. An interim report was published at the March Budget summarising representations to the review.

## Commentary

Long before the pandemic, business rates was in need of reform. The tax has three major pitfalls.

Firstly, it is overly complex for ratepayers and local authorities with a multitude of reliefs and exemptions and qualifying thresholds which can vary from year to year. The tax has been repeatedly altered at fiscal events in recent years making it difficult for ratepayers to understand which reliefs they are eligible for. It also adds complexity for local authorities to administer the tax and weakens the relationship between local economic success and retained revenues.

Secondly, it is overly concentrated on particular sectors and geographies. The national multiplier is set to ensure that, at each revaluation, the total yield does not exceed a Treasury-determined level. In practice this means that London (particularly central London) has borne an increasing share of the overall burden in the last 20 years. London now accounts for around a third of the total rates yield in England. This is inherently unstable. The growth in online

1 https://www.local.gov.uk/councils-and-e-commerce-why-what-and-how-local-e-commerce-levy

sales has meant that tax increases have been felt harder by retailers with a physical presence (particularly on the high street) who have struggled in recent years. This longer-term impact on retail shopping habits and commercial office use, particularly in the centre of cities, further highlights the fragility of the tax.

> **It would make sense for the government to pause any further reforms to the business rates retention scheme while the impact of the pandemic on the property market plays out**

Thirdly, as it is centrally controlled, it is not responsive enough to local economic conditions or the needs of local businesses and communities that local authorities serve. A single national multiplier covers a huge variety of local economies. This inflexible approach results in central government attempting to support particular sectors by using the blunt instruments of nationally set thresholds which fail to take into account variations in rental values and local economies.

The pandemic has exacerbated these issues. The level of government support required to prop up the business rates system, the additional complexities of different relief schemes, and inconsistencies in which types of busines qualified for reliefs, have increased underlying concerns that the tax is not fit for purpose. The complexity of the system has no doubt provided a greater administrative burden on local and central government during the pandemic, particularly when compared to the relative simplicity of the furlough scheme. The fact that new legislation was needed to prevent a huge volume of MCC appeals – which would have had a big impact on local government funding - has further highlighted issues with the way properties are valued.

It remains to be seen how fundamental the reforms to the tax will be when the Treasury reports in the autumn. The tax should be reformed to be less complex; more closely linked to economic performance; more supportive of local high streets; and – importantly - must provide a stable and predictable funding source for local government. With so much uncertainty about the future of the tax, it would make sense for the government to pause any further reforms to the business rates retention scheme while the impact of the pandemic on the property market plays out and reforms to the tax as a result of the fundamental review are implemented.

**Author:** Paul Honeyben, Interim Director: Local Government Finance & Improvement
**Click here to send a comment or query to the author**

## Links:

## This member briefing has been circulated to:

**Portfolio holders and those members who requested policy briefings in the following categories: Local Government Finance**