Consultation Response

Business Rates Review – discussion paper response by London Councils

London Councils represents London's 32 borough councils and the City of London. It is a cross party organisation that works on behalf of all its member authorities regardless of political persuasion.

Introduction

1. London Councils welcomes the opportunity to comment on the Government's strategic review of business rates. This response builds on our response to the Business Rates Administration review in June 2014[1].

2. London Councils is concerned that the scope of the discussion paper and terms of references risks being too narrowly focused on ratepayers and the broader business taxation system, without sufficient consideration of the impact that any potential reform could have on local government.

3. Firstly, the Government should be mindful that business rates are a principal funding stream for local government. The Government's recent introduction of its business rates retention scheme created a direct link between local funding levels for an individual authority and local business rates yield. In 2015-16 the Government expects London's local authorities to collect over £6.8 billion, which represents almost a third of the national yield of £21 billion; this is despite having just 16 per cent of the total number of properties in England. In 2015-16, business rates will fund around half of all local government revenue expenditure[2], and retained business rates will fund around a quarter of local government spending in London (almost £2 billion). As a consequence, and before implementing any change, consideration must be given to the impact on local funding levels.

4. Secondly, local authorities, as billing authorities, are also responsible for the collection and administration of business rates, and play a fundamental role in the proper functioning of the taxation system. Historically, business rates have had an in-year collection rate of around 98 per cent, which compares very favourably to other forms of taxation. For example, corporation tax has a tax gap of 9 per cent and VAT, 11 per cent. If the Government is minded to reform the system, due regard must be given to the operational and financial impact of any reforms on local processes.

5. London Councils recognises that this paper is designed to catalyse discussion and thinking on the potential options for reform. In the event that firmer proposals are developed, London Councils would expect that these proposals are supported by robust evidence and driven by detailed consultation and engagement with both ratepayers and local government.

[1] http://www.londoncouncils.gov.uk/download/file/fid/14798

[2] This excludes spending on schools and includes Revenue Support Grant which is funded from business rates

6. This response firstly sets out London Councils' overarching position with regard to business rates, and is followed by more detailed responses to the questions within the discussion paper.

Overarching principles

Stability, certainty and predictability

7. London Councils believes any funding system for local government should be underpinned by the principles of stability, certainty and predictability. These principles underpin more specific goals such as creating incentives to encourage economic growth. While, at the national level, business rates is a relatively stable tax that generates a steady income stream for central and local government, it can be particularly volatile at a local authority level.

8. London Councils recognises that the financial landscape is changing with the funding relationship between central and local government moving from one based purely on centrally allocated grants to one that recognises concepts such as financial incentive, underpinned by risk and reward. This has the potential to create greater incentives to support economic growth and is a principle that London Councils supports. However, if not implemented effectively it can produce unwanted side effects.

9. Uncertainty is one consequence of the current regime. Business rates retention has significantly increased the level of financial risk borne by local government without a corresponding uplift in the opportunity for financial gain. In particular, local authorities remain exposed to the risk of successful rating appeals. The volatility created by appeals, and the lack of clarity about the impact of revaluations on the dynamics of the business rates retention system, produce significant funding uncertainty for local authorities. As a result London local government was obliged to set aside over £500 million in provisions for backdated appeals in 2013-14.

10. The Government should be mindful that any changes it makes to the business rates system can have knock-on effects on local authority funding. For example, the Government's commitment to resolve 95% of outstanding rating appeals in England by July 2015 has created a spike in the number of appeals at the end of 2014-15: this has increased the level of funding uncertainty as London's local authorities have had to increase their appeals provisions.

11. Unpredictable variations in income at borough level are a second consequence of the current regime. Local authorities are at risk from a reduction in their local income from rate payers successfully appealing – a process led through the Valuation Office Agency – to move their hereditaments from local lists to the central list. The impact at a local level could be considerable with evidence that in some London boroughs this could be as much as £1.8 million; possibly higher for others.

12. London local government currently forecasts funding reductions of 60 per cent over the decade to 2020. As a result any major structural reform to this tax must address these issues of stability and predictability and should not create further downward structural pressure on local government funding.

Visibility and local accountability

13. London Councils agrees with the Government's preference for business rates to remain a tax based on property values. It remains a tax that benefits from high levels of collection and is a stable form of taxation. However, London Councils does recognise the claim that more could be done to aid ratepayers' understanding of how the tax is used to fund public services, with few business understanding how the rates they pay are spent by both local and central government. Demystifying the complexity around business rates and its system of reliefs and discounts would also support better relations between local authorities and local businesses.

14. An inclusive approach, that involves local government working with local business, should be at the heart of any future changes to the business rates system.

A stronger growth incentive

15. London Councils disagrees with the Government's contention that the business rates retention system has increased local government's "incentive to encourage enterprise and job creation". Incentives are based on the expansion of rateable floorspace and not on rateable values. The result is a tax regime that does not reward support for high value businesses that do not expand their floor space. London's economy is driven by high value businesses. This continued lack of direct financial incentive is evident by the fact that it has failed to deliver any substantial financial gain for London local government despite average growth in GVA of around 5% per annum since 2010[3].

16. Analysis of publicly available data on business rates suggests that the financial impact of business rates retention appears limited at best. In overall terms, London local government (excluding the GLA) retained £1.833 billion of business rates in 2013-14, representing a shortfall of £85.4 million (4.5 per cent) when compared to the Government's expected target of £1.918 billion. Eighty per cent of boroughs reported a decline in business rates against their target baselines. In 2014-15, boroughs forecast net growth of only £13 million beyond the baseline position (with only half estimating positive growth), and only modest net growth of £49 million in 2015-16. Again only half of London's boroughs are reporting growth.

17. The direct financial incentive for local authorities to grow their local business rates remains weak for several reasons, including:
    - the negative impact of appeals eats into any true growth;
    - the definition of growth only applies to physical rather than revaluation growth;
    - local government is bearing the cost of the RPI inflationary increase on the funding baselines;
    - growth could potentially be removed after 7 years at a reset; and
    - the 50 per cent retention rate remains low.

18. London Councils would advocate a series of immediate changes and refinements to the system that the Government could implement to improve the growth incentive.

19. Firstly, the Government should take steps to mitigate the more negative impact of appeals, either through further adjustments to the system or through changes to the appeals process itself. Appeals cause undue uncertainty in financial planning terms, particularly when three quarters of appeals are unsuccessful. Such a low success rate does suggest there is room for the process to be made more efficient.

20. Secondly, the Government should broaden the definition of "growth" to include revaluation growth, rather than just physical growth. This narrow approach currently makes it incredibly difficult for local authorities, particularly in built-up areas, to benefit financially from the current system as there is a general scarcity of land and any additional physical growth often requires the demolition of existing buildings first.

21. Thirdly, the definition of growth should include the annual RPI increase which is currently lost via an effective requisite cut to Revenue Support Grant.

22. Fourth consideration should be given to how local authorities could keep any additional growth for a fixed period of time to avoid the "cliff edge" effect in the years before a system reset. The current uncertainty of its timing risks acting as a disincentive for developments in those years. Arguably, a system of rolling retention could seek to manage this in a more effective way.

---

[3] https://www.london.gov.uk/sites/default/files/GVA%28I%29%20%26%20GVA%28P%29%20estimates%20for%20London%20current%20issues%20note%20update%2043.pdf

23. These reforms could create a far stronger platform on which to increase incentives to support economic growth and link councils more closely to their communities. All local authorities should retain 100 per cent of business rates growth, building on the three pilot areas that were announced at Budget 2015. In the longer term, London Councils advocates a fully devolved system where London government retains 100 per cent of all business rates (see next section).

Business rates devolution

24. In the longer term, London Councils would like to see a fully devolved system of business rates where London government retained 100 per cent of business rates collected. London Councils supports the London Finance Commission's call for the full suite of property taxes to be devolved to London Government. Such an approach would include control over setting the tax rates as well as issues such as revaluation, banding and discounts. As made clear in the report of the London Finance Commission, any devolved settlement should be fiscally neutral at the outset of the reforms.

25. London Councils supports recent attempts to ease the financial burden on businesses through the use of the business rates system. That said; the Government should be mindful of the growing number and complexity of the reliefs system and the impact that this could have on local government and the business rates retention system. The wide variety of relief schemes not only causes confusion, it impacts on local authorities' ability to implement local growth plans around, for example, high street regeneration.

26. In the short term, London Councils urges Government to simplify the system of reliefs, to increase understanding of rates bills, and improve local government financial planning. In particular, the Government should also consider reforming charitable and empty property reliefs, the exploitation of which accounts for the vast majority of business rates avoidance and significantly affects some local authorities' retained funding.

27. As part of any longer term devolution, London Councils believes a devolved system should include the freedom for local authorities to tailor all discounts and reliefs to meet the needs of their specific local economies. This would give local areas the ability to create new reliefs and discounts, and alter the suite of existing mandatory reliefs in order to encourage and incentivise certain types of business to their area.

28. In 2013-14, mandatory and discretionary reliefs totalled £663 million in London. London Councils believes that this funding could be used more constructively by local areas to improve local economies if its use were devolved to London boroughs.

29. Combined with a system of 100 per cent retention of business rates, this would also enable greater dialogue and engagement between local government and businesses. Local authorities would become better placed to respond to and enhance local economies. This in turn could reduce perceived unfairness by business.

Detailed response to questions

Business rates as a tax on property values

1) What evidence and data can you provide to inform the government's assessment of the trends in use and occupation of non-domestic property?

London Councils has no comment.

2) Is there evidence to suggest that changing patterns in property usage are affecting some sectors more than others?

London Councils believes the information supplied by the Valuation Office Agency's experimental data (used in Charts 2a, 2b, and 2c in the discussion paper), is useful but that there is a clear need to improve access to VOA and HMRC data in order to ensure compatibility with open data initiatives which can seek to match it with other data sets to create more useful information.

3) What, in your view, does this evidence suggest about the fairness and sustainability of business rates as a tax based on property values?

London Councils does not wish to make value judgements about the fairness of the tax, however the evidence supplied in Chapter 2 of the paper does suggest that business rates as a tax based on property values remains sustainable.

4) What evidence is there in favour of the government considering a move away from a property based business tax towards alternative tax bases? What are the potential drawbacks of such a move?

As stated above, London Councils would be concerned if the Government was minded to move away from a property based business tax towards alternative tax bases without any strong evidence and an understanding of the potential impact on local government funding levels. The Government should be mindful to avoid jeopardising the stability and predictability of the revenue that this current tax generates and the likelihood that any replacement tax would be as efficient to collect as business rates.

5) What examples from other jurisdictions and tax systems should the government consider as part of this review? What do you think are the main lessons for the business rates system in England?

London Councils has no comment.

How business rates revenues are used

6) How can government use business rates to improve the incentive for local authorities to drive local growth?

See paragraphs 15 to 29 (above).

7) What impact will increased local retention of business rate revenue have on business growth? What will the impacts be on local authorities?

See paragraphs 15 to 29 (above).

8) What other local incentives should the government consider to further incentivise business growth?

Government should commit to work with business and local government on a detailed protocol for the far wider use of tax increment finance (TIF), particularly the way in which risk is managed and ensuring a clear business mandate for spending priorities. The objective of this will be to make TIF a far more widely available and locally-driven tool for leveraging additional investment in the drivers of economic growth.

How business rates raise revenue

9) Should business rates be reformed to make them more closely reflective of wider economic conditions and if so, how?

As stated above, London Councils would urge against any wholesale reform of the method or timescale for revaluations without sufficiently robust evidence and an understanding of the impact on local government and ratepayers. A revaluation is likely to have a significant impact on local business rates yields, either upwards or downwards. This will have a significant impact on the architecture of the business rates retention scheme and have profound consequences for the risk profiles of those authorities most affected. Increasing the frequency of revaluations would increase the level of uncertainty for local authorities.

As with changes to valuation methods, the frequency of property valuations has an impact on the volume of business rates appeals which disproportionately affect London boroughs. There is currently no evidence to suggest that increasing the frequency of revaluations would reduce the number of appeals or benefit ratepayers as a whole. At the very least, more frequent valuations would lead to the potential for more appeals - as there would be more valuation lists to appeal against.

In relation to the suggestion that CPI rather than RPI should be used as the measure of business rates inflation, London Councils would be question how this move would be funded. London Councils would expect that any such move would be funded by central government, rather than by local government (in a similar way to the 2 per cent cap in 2014-15 and 2015-16).

London Councils would also suggest that consideration should be given to where business rates sit within a broader analysis of property costs. Many businesses make fixed payments to property owners, which include rent, business rates, and service charges. As such, the Government should be mindful that it is not guaranteed that businesses would feel the benefit of linking business rates more closely with changing economic conditions.

Who pays business rates

10) If business rates remain a property tax, how do you suggest business rates could take into account the individual circumstances of businesses such as their size or ability to pay rates?

London Councils believes that local authorities are best equipped to take into account individual circumstances of businesses in their areas, and that devolution of responsibility for setting the rate, as well as the parameters and extent of local reliefs and discounts, would benefit more businesses than the current centralised system.

11) How does the proportion of total operating costs accounted for by business rates vary by the sector and size of a business?

London Councils has no comment.

12) What is the impact of the business rates system on the competitiveness of UK businesses? Are there any particular impacts on SMEs?

London Councils has no comment.

13) How could the government better target support for SMEs given that the size of a company may not be reflected in the rateable value of a property it uses?

London Councils has no comment.

14) Should investment in plant and machinery, energy efficiency improvements or other similar property improvements be treated differently by the business rates system? If so what changes could be made?

The current system provides a disincentive for some businesses to improve their properties. London Councils believes that local authorities should be able to determine locally whether investment in property improvements should be treated differently within the business rates system.

15) What evidence and analysis should the government take into account when evaluating the impact of and any changes to the range of reliefs and exemptions present in the business rates system?

London Councils believes local areas should ultimately have full control over the suite of discounts and reliefs (see paragraphs 23-27 above). In the shorter term, there could be scope to reduce the number and complexity of different reliefs, and focus on the two reliefs that are most commonly subject to avoidance: charitable relief and empty property relief.

When evaluating the impact of any changes to reliefs and exemptions, the Government should take into account data that shows the distribution of charities and empty properties across local authorities. This includes academies, which qualify for charitable relief. For example, local areas with larger brownfield industrial areas or with high streets that are economically challenged may be subject to greater exploitation of these two reliefs.

There is considerable variation in the concentration of businesses claiming these reliefs both between local authority areas, and within each local authority. To illustrate across London boroughs in 2013-14, reliefs in one authority represent 14 per cent of gross rates payable, while at the other end of spectrum they only represent 5 per cent on gross rates payable.

While the initial business rates baselines took these characteristics into account (based on the distribution in 2010-11 and 2011-12), changes since then will not be captured and will be impacting on growth for certain authorities. This would be particularly true of areas that have seen a large proportion of schools become academies in recent years.