Communities and Local Government

Local Government Resource Review: Proposals for Business Rates Retention

Technical paper 7: Revaluation and transition

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August 2011
Department for Communities and Local Government

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Chapter 1

Introduction

1.1 On 18 July, the Department for Communities and Local Government (DCLG), published a consultation paper, *Local Government Resource Review: Proposals for Business Rates Retention*.

1.2 This set out proposals for a rates retention scheme to replace the current local government finance system, under which business rates are redistributed as part of formula grant.

1.3 The consultation paper outlined the principal features of the proposed rates retention scheme. It undertook to provide further detail in a series of technical papers, to be published in August.

1.4 Taken together, the consultation paper and technical papers raise a number of questions about the proposed rates retention scheme, on which the Government is seeking views. The **consultation will close on Monday 24 October 2011**. Details of how to respond can be found on page 7 of the main consultation paper[1].

1.5 This is one of eight technical papers. The full list is:

Paper 1: Establishing the Baseline
Paper 2: Measuring Business Rates
Paper 3: Non-billing Authorities
Paper 4: Business Rates Administration
Paper 5: Tariff, Top Up and Levy Options
Paper 6: Volatility
Paper 7: Revaluation and Transition
Paper 8: Renewable Energy

1.6 All technical terms in the papers appear in italics and are explained in the Glossary of technical terms, which is attached to each technical paper as an annex.

1.7 An outline of the eight papers can be found in *Business Rates Retention – Technical Papers: An Overview*.

[1] www.communities.gov.uk/publications/localgovernment/resourcereviewbusinessrates

Chapter 2

About this paper

2.1 This paper discusses the Government's proposals for managing the impact of five-yearly revaluations (including the transitional relief scheme used to phase in changes to business ratepayers bills at revaluation) within the rates retention scheme.

2.2 Business properties are re-valued every five years to reflect changes in the property market. The Government adjusts the national non-domestic multiplier rate to ensure that overall, the tax burden on business does not increase as a result of revaluation. This means that, whilst businesses in particular sectors or locations that have seen above average rental growth may see their contribution to the overall business rates yield increase, revaluations do not generate any additional revenue at national level. They simply adjust the contribution each business makes to the overall rates yield to reflect changes in the rental value of its property relative to that of others.

2.3 Generally, a transitional relief scheme is put in place at each revaluation to phase in significant increases in rates bills for businesses whose rental values have grown significantly more than the average. Transitional relief is funded by also phasing in reductions in bills for businesses that see significant decreases at revaluation because their rental values have grown significantly below the average.

Revaluation

2.4 As central government ensures revaluations do not generate any additional revenue, allowing the impact of revaluation to feed through would introduce significant turbulence in local budgets. Areas could see the value of business property in their area increase, yet still experience significant drops in income at revaluation; only those seeing above average growth in rental values would see their business rates increase. At the 2010 revaluation, over 200 authorities saw reductions in the amount of business rates collected locally.

2.5 The Government therefore proposes, as set out in the main consultation document and discussed in further detail in chapter 3, that *tariffs* and *top ups* should be adjusted at revaluation to ensure that, as far as possible, business rates income is unaffected.

Transitional relief

2.6 As the main consultation paper made clear, the Government does not propose to make any changes to the way in which the business rate is set or to the system of reliefs provided for the likes of small businesses, charities and certain business properties in rural areas. It does not intend to change the practice of putting a transitional relief scheme in place at revaluation to phase in significant changes in bills, or to make changes to the current scheme.

2.7 However, as chapter 4 explains, any transitional relief scheme could have significant implications for local authorities' *retained income*. The main consultation paper indicated that the Government would strip out transitional relief from the rates retention scheme. Chapter 4 explores the rationale for this in more detail and sets out how transitional relief might operate outside the rates retention scheme.

Chapter 3

Revaluation

Introduction

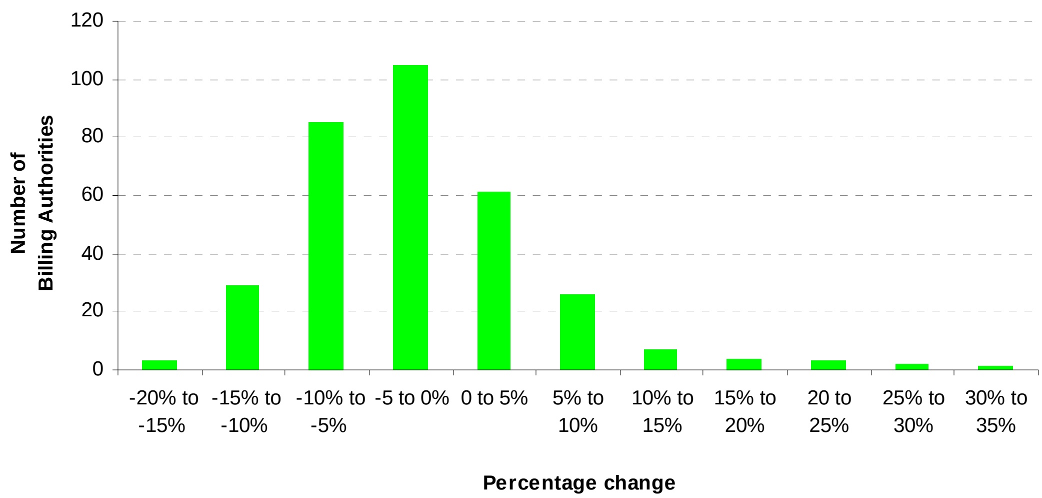
3.1 Rateable values are based upon rental values and are assessed independently by the Valuation Office Agency. All rateable values are reassessed every five years at a general revaluation.

3.2 For businesses, revaluation is an important part of the property tax system. Most businesses know the value of their property and know when those values fall out of step with their rateable value. Revaluations ensure that tax assessments and actual values stay broadly in line which, in turn, delivers consistency and fairness across the business rates system. The Government therefore has no plans to change the system of five-yearly revaluations.

3.3 At revaluation, the overall increase in aggregate yield is capped by the Retail Prices Index (RPI) as in all other years, and the multiplier is reset to achieve that effect. As different properties' rateable values will change by different proportions at a revaluation, the tax charge is re-distributed across England. This means the business rates yield in each authority could go up or down significantly, depending on whether rateable value growth in their area has been greater or less than the national average.

3.4 The chart below provides an indication of the impact of revaluation on the level of business rates collected by billing authorities. The chart shows that at the 2010 revaluation, over 200 billing authorities experienced a fall in the rates they collected.

Chart 1: Distribution of changes in business rates collected at 2010 revaluation



Source: 2010 ratings list

3.5 Therefore, allowing the impact of revaluations to feed through into the business rates retention scheme could result in significant changes to authorities' *retained income*. Prior to 1990, local authorities might have compensated for any loss of income, by adjusting their rating multipliers (which were set locally). Since 1990, however, a single multiplier has been set nationally by central government in order to provide business with the stability and certainty that it needs.

3.6 The Government is not proposing any changes to the national multiplier. This means that potentially significant changes in the business rates collected could lead to budget volatility in the year immediately following a revaluation.

3.7 To deal with this risk, we propose to adjust each authority's *tariff*, or *top up*, following a revaluation, to ensure that their *retained income* is the same after revaluation as immediately before. This will ensure that the growth incentive, created by the rates retention scheme, will not be weakened by losses of income outside the control of authorities.

Adjusting tariffs and top ups

3.8 In making an adjustment to *tariffs* and *top ups* at a revaluation, we will need to have regard to several factors. The change in an authority's rates income at revaluation is comprised of:

- the change in the total rateable value on their local rating list between the "old" and "new" rating lists, and

- the change in the business rates multiplier between the last year of the old list and the first year of the new list

3.9 Therefore, we would need to adjust *top ups* and *tariffs* to compensate for the difference in rates income as a result of these factors.

3.10 At a revaluation, the Valuation Office Agency expects to complete its valuations in the previous summer – so, in summer 2014, for the 2015 revaluation. As has happened at previous revaluations, they will thereafter maintain both the "live" 2010 rating list and the "draft" 2015 rating list until the first day proper of the new rating list. Therefore, we will need to consider how to capture the local impact of the revaluation in time to adjust the *tariffs* and *top ups* for 2015-16 and at subsequent revaluations.

3.11 Having adjusted *tariffs* and *top ups* immediately prior to the list coming into force, the Government would not propose to make any further changes to reflect subsequent appeals against either rating list. Therefore, any appeals made to the pre, or post-revaluation rating lists, which subsequently change the local revaluation impact will be treated as part of the normal volatility on rating lists, with which authorities will be expected to deal. (See *Technical Paper 6: Volatility*, for a discussion on volatility and *Technical Paper 5: Tariff, Top Up and Levy Options*, for details of the support that might be available through a *safety net* to help authorities deal with volatility).

3.12 Any adjustment would also need to take account of other considerations which will impact upon the amount of business rates retained by authorities including:

- *adjustments* for the New Homes Bonus
- *adjustments* to reflect the funding of police and, possibly, single purpose fire and rescue authorities
- the sharing of business rates between billing and non-billing authorities (see *Technical Paper 3: Non-billing Authorities*; and
- any *allowable deductions* made locally for national reliefs etc (see *Technical Paper 2: Measuring Business Rates*)

3.13 These considerations and adjustments will add complexity to the revaluation adjustment, but our intention would be to ensure that, as far as possible, local authority finances were unaffected by the revaluation.

3.14 The Government will consult further on the details of any revaluation ahead of the next revaluation in 2015.

TP7 Q1: Do you agree that *tariffs* and *top ups* should be adjusted at a Revaluation to ensure that authorities' *retained income* is, so far as possible, unaffected by the impact of the revaluation?

TP7 Q2: Do you agree that, having made an adjustment to *tariffs* and *top ups*, there should be no further adjustments to reflect subsequent appeals against the rating list?

Chapter 4

Transitional relief

Introduction

4.1 Overall, revaluation does not raise any extra rates revenue, because the multiplier is adjusted to offset any increase in the aggregate rateable value of non-domestic property in England. However, at the property level there may be significant changes in the bills of individual ratepayers following a revaluation. Broadly speaking:

- those ratepayers who see their rateable value increase more than the average will see their rates bill go up at revaluation, whereas
- those ratepayers who see their rateable value increase less than the average will see their rates bill go down.

4.2 Historically, revaluations have generated large changes in rates bills – both increases and reductions. As a result, many ratepayers would face immediate and significant increases in their business rates with, at most, only six months to plan for their new bills. This could damage, in particular, small businesses who have less flexibility and who may, therefore, struggle to adapt to their new rates bill without assistance. Since 1990, successive Governments have provided assistance to ratepayers through transitional relief, which is now a statutory requirement.

4.3 A transitional relief scheme works by phasing-in any increases in rates bills over a number of years, based on annual "caps" on the percentage by which an individual ratepayer's bill can increase from one year to the next.

4.4 The cost of transitional relief is paid by similarly phasing-in the reductions in bills that other ratepayers would have seen as a result of the revaluation (so-called "downward phasing").

4.5 The adopted scheme for 2010 has the following caps on increases and decreases in bills:

Transitional Arrangements 2010 revaluation (before inflation)						
		2010/11	2011/12	2012/13	2013/14	2014/15
upward cap (transitional relief)	small properties	5%	7.5%	10%	15%	15%
	large properties	12.5%	17.5%	20%	25%	25%
downward cap (downward transition)	small properties	20%	30%	35%	55%	55%
	large properties	4.6%	6.7%	7%	13%	13%
Note: there are year on year caps on increases. For instance, the maximum increase for small properties over five years would be 64%. But a small property with an increase of 7% would reach their full bill in year 2.						

4.6 Overall the scheme is set-up to be self-financing in each year (in other words the cost of providing transitional relief in any year is matched by the additional rates that are paid by those in downward transition). However, in practice schemes have tended to run at a deficit (discussed at paragraph 4.21). Moreover, schemes have only ever been designed to be self financing at the national level, not at the local authority level.

The effect of transitional relief on local authority rates income

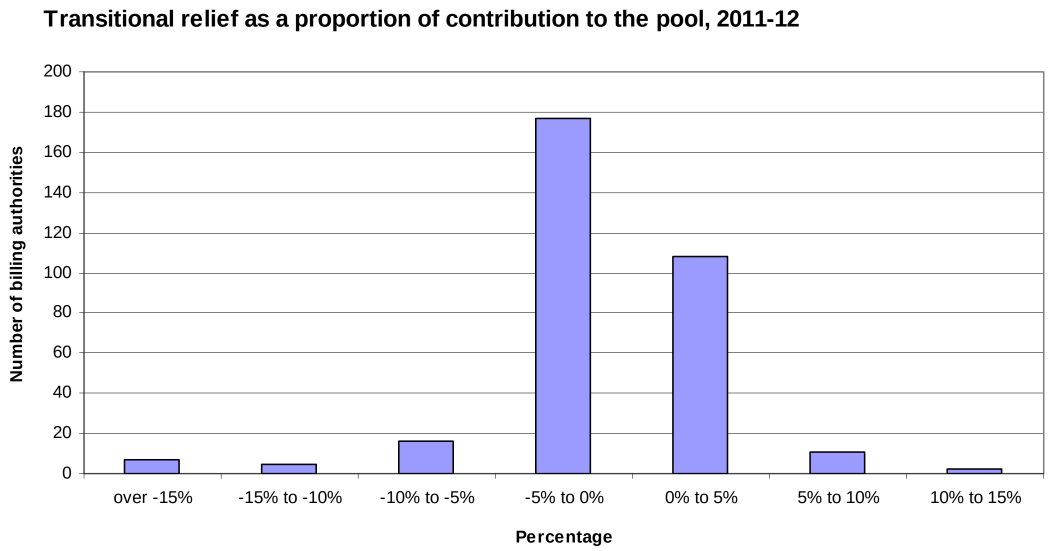
4.7 At the local authority level:

- some authorities collect less in business rates than would have been the case in the absence of transition. This happens where the amount of transitional relief being given to ratepayers who would otherwise have faced higher rates bills, exceeds the additional rates income collected from ratepayers in downward transition; and

- some authorities collect more in business rates than would have been the case in the absence of transition. This happens where the amount of transitional relief being given to ratepayers who would otherwise have faced higher rates bills, is less than the additional rates collected from ratepayers in downward transition

4.8 This would have potentially significant implications for a business rates retention scheme, because the phasing, which is a feature of a transitional relief scheme, means that the rates income collected by authorities over the life of the scheme will increase, or decrease from year-to-year depending on the unwinding of transitional relief, rather than on any underlying changes in local rates bases.

4.9 As the scheme unwinds over the life of the rating list, the impact diminishes. The following diagram shows the effect of the 2010 Transitional Relief Scheme on the contribution to the pool in 2011-12.



4.10 By the first year of the rates retention scheme in 2013-14, we would expect most local authorities to see little variation in their rates income due to the transitional relief scheme (although there will be exceptions to this).

4.11 We cannot predict what will happen at the 2015 and future revaluations but we might anticipate that future transitional relief schemes would have similar implications for local authorities' rates income as previous schemes.

4.12 There are essentially two options for dealing with transitional relief under a business rates retention scheme. We could:

- ignore it completely, allowing individual authorities' rates income to be affected by the pattern of transitional relief locally; and to vary over the life of the scheme as it unwound; or

- take transitional relief outside the rates retention scheme and deal with it by means of a separate series of financial adjustments

4.13 The first option would mean that a local authority's *pre-levy income* could be significantly affected by the unwinding of the transitional relief scheme. The Government believes that, potentially, this could undermine the rates retention scheme by obscuring the incentive effect; authorities might find that, in any year, their *individual authority business rates* could rise or fall, solely as a result of changes in transitional relief. In extremis, this could mean an authority seeing a reduction in its *individual authority business rates*, despite having seen growth in its local business rates base. For this reason, as the main consultation paper explained, the Government is minded to take transitional relief outside the rates retention scheme.

Dealing with transitional relief

4.14 Taking transitional relief outside the main rates retention scheme would necessitate a system of separate *transitional adjustments* for its impact on the rates revenue collected by billing authorities.

4.15 *Technical Paper 2: Measuring Business Rates*, explains how billing authorities' *proportionate share*, of the *forecast national business rates* will be calculated on the basis of a billing authority's business rates yield. It goes on to explain that the yield will be calculated, excluding the effect of transition.

4.16 This means that the business rates yield on which, ultimately, an authority's *tariffs* or *top ups* is calculated will, because of transitional relief, be higher, or lower, than the business rates that the billing authority will actually collect in any year in which transitional relief operates.

4.17 Therefore, to ensure that local authorities within the rates retention scheme do not experience losses, or make windfall gains, as a consequence of transitional relief, we will put in place a system of *transitional adjustments.* These will work, by comparing the rates income of a billing authority excluding transitional relief, with the rates income of a billing authority inclusive of transitional relief.

4.18 If billing authorities' rates income inclusive of transitional relief is less than billing authorities' rates income exclusive of transitional relief, the billing authority will receive an additional payment from central government, which will be distributed between billing and non-billing authorities on the basis of the pre-determined *tier-split shares*.

4.19 But if billing authorities' rates income inclusive of transitional relief, is higher than their income exclusive of transitional relief, they will need to pay the balance to central government. Any transitional payment, will be similarly apportioned between billing and non-billing authorities on the basis of *tier-split shares.*

4.20 Reflecting the fact that transitional relief will change over time as the occupation of property changes, the *transitional adjustments* would be made, each year, on the basis of forecasts and re-adjusted at the end of each year on the basis of outturn figures. *Technical Paper 4: Business Rates Administration*, provides further details.

Deficits

4.21 Although transitional relief schemes are set-up to be self-funding, over their lifetime, as paragraph 4.6 explains, in practice they have often run at a deficit, because:

- when devising a scheme, allowance is made for the fact that over its lifetime, appeals will reduce the total rateable value of rating lists and, with it, the amount of transitional relief to which a ratepayer is entitled. Before appeals have been settled, therefore, the scheme tends to carry a deficit in its early years, which unwinds in later years as appeals are settled and their effect backdated; and

- forecasting the cost of transitional relief is inherently difficult as it has to be done early in the process when we cannot easily predict how the rating list, and therefore the cost of transitional relief, will change

4.22 Currently, the cost of any deficit is borne by the rating pool. Under a rates retention scheme, the costs might be met from the levy pot and, deficits in one year would become a charge on the levy income collected in the next.

TP7 Q3: Do you agree that transitional relief should be taken outside the main business rates retention scheme?

TP7 Q4: Do you agree with the Government's proposal for a system of *transitional adjustments*?

TP7 Q5: Do you agree that any deficit on *transitional adjustments* should be charged to the levy pot?

Annex A

Business Rates Retention: Glossary of technical terms

Adjustments
After deducting the *set aside* from the *forecast national business rates* further adjustments will be made to fund the New Homes Bonus, police authorities and potentially single purpose fire and rescue authorities.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 4

Allowable deductions
A deduction made to a billing authority's business rates income, when calculating its *proportionate share*. Examples of where allowable deductions will be made are for rate reliefs and cost of collections.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 4

Banded levy
Authorities assigned to their different levy bands with different pence in the pound levy rates based on the ratio of their *individual authority business rates baseline* and their *baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Baseline funding level (or **individual authority baseline funding level**)
A fair starting point based on formula grant distribution, within the overall expenditure controls set out in Spending Review 2010.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 5

Billing authority business rates baseline (pre-tier split)
Derived by dividing the *national business rates baseline* between *billing authorities* on the basis of their *proportionate shares*.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 5

Flat rate levy
The same pence in the pound levy rate for all authorities.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Forecast national business rates
Forecast of national business rates for England in 2013/14 and 2014/15. Based on the 2012/13 national non-domestic multiplier, uprated for *Retail Prices Index* and the latest published information from the national non-domestic rates returns.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 3

Gearing effect
The relationship between *individual authority business rates baseline* and the *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 2

Individual authority business rates baseline
Derived by apportioning the *billing authority business rates baseline (pre-tier split)* between billing and non-billing authorities on the basis of *tier splits*.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 5

Individual authority business rates
The amount of business rates income which each authority receives before payment of *tariffs and top ups*.

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 5

Interactive Calculator
Enables users to explore the principal features of the proposed rate retention scheme by entering their own inputs and varying components.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 7

Levy
To manage the possibility that some local authorities could see disproportionate financial gains, the *levy* will recoup a share of this disproportionate benefit. Applied to the change in *pre-levy income* (either all growth or growth above *Retail Prices Index*), as measured against the *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

National business rates baseline
The *forecast national business rates* less *set aside* and *adjustments*.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 5 and
Technical Paper 2: Measuring Business Rates, Chapter 5

Post-levy income
Individual authority business rates minus/plus the *tariff* or *top up*, minus any *levy*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 3

Pre-levy income
Individual authority business rates minus/plus the *tariff or top up*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 3

Proportional levy
Individual pence in the pound levy rate for each authority so that percentage growth in *retained income* is proportional to growth in *individual authority business rates*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Proportionate shares
Used to apportion the *set aside*, *adjustments* and *national business rates baseline* between billing authorities. Equals a billing authority's business rates income (after *allowable deductions*) as a proportion of total business rates yield (after *allowable deductions* and exclusive of the impact of transitional relief).

Reference: *Technical Paper 2: Measuring Business Rates*, Chapter 4

Retail Prices Index
A measure of inflation in the UK.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 2

Retained income
Individual authority business rates minus/plus *tariff* or *top up*, minus any *levy*, plus any *safety net* payments.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 4

Revaluation adjustment
An adjustment to tariffs and top ups to ensure that authorities do not experience gains or losses as a consequence of a revaluation.

Reference: *Technical Paper 7: Revaluation and Transition*, Chapter 3

Safety net
The safety net offers: i) annual protection against a decline in *retained income* and ii) protection against a decline in *retained income* relative to the *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 5

Set aside
The share of the *forecast national business rates* that will be set aside to meet the overall expenditure controls set out in Spending Review 2010. The set aside will be apportioned between billing authorities and non-billing authorities on the basis of their *proportionate shares*.

Reference: *Technical Paper 1: Establishing the Baseline*, Chapter 3

Tier splits or **tier split shares**
Applied to *billing authority business rates baseline (pre-tier split)* to establish the *individual authority business rates baseline.*

Reference: *Technical Paper 3: Non-Billing Authorities*, Chapter 3

Tariffs and top ups
Assigned to a local authority to achieve a fair starting point. An authority will pay a *tariff* if their *individual authority business rate baseline* is more than their *baseline funding level*. An authority will receive a *top up* if their *individual authority business rate baseline* is less than their *individual authority baseline funding level*.

Reference: *Technical Paper 5: Tariff, Top Up and Levy Options*, Chapter 3

Transitional adjustment
An adjustment to ensure that authorities do not experience gains or losses as a consequence of granting transitional relief.

Reference: *Technical Paper 7: Revaluation and Transition*, Chapter 4

Volatility
The degree to which individual authority business rates in a particular area may change.

Reference: *Technical Paper 6: Volatility*, Chapter 3

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