H M Treasury: Business Rates Review

Submission from the Chief Economic Development Officers Society (CEDOS) and the Association of Directors of Environment, Economy, Planning & Transport (ADEPT)

May 2015

The Chief Economic Development Officers Society (CEDOS) represents Heads of Economic Development in upper tier local authorities throughout England. Membership includes county, city and unitary Councils in non-metropolitan areas. The Society carries out research, develops and disseminates best practice, and publishes reports on key issues for economic development policy and practice. Through its collective expertise, it seeks to play its full part in helping to inform and shape national and regional policies and initiatives.

The Association of Directors of Environment, Economy, Planning & Transport (ADEPT) represents local authority Strategic Directors who manage some of the most pressing issues facing the UK today. The expertise of ADEPT members and their vision is fundamental in the handling of issues that affect all our lives. Operating at the strategic tier of local government they are responsible for crucial transport, waste management, environment, planning, energy and economic development issues. ADEPT membership is drawn from all four corners of the United Kingdom.

BUSINESS RATES REVIEW

JOINT SUBMISSION FROM THE CHIEF ECONOMIC DEVELOPMENT OFFICERS SOCIETY (CEDOS) AND THE ASSOCIATION OF DIRECTORS OF ENVIRONMENT, ECONOMY, PLANNING AND TRANSPORT (ADEPT)

Introduction

1. This submission is made jointly by the Chief Economic Development Officers Society (CEDOS) and the Association of Directors of Environment, Economy, Planning and Transport (ADEPT). We welcome the decision to undertake a thorough, wide-ranging and robust examination of the existing business rates system and to explore options for future reform. We welcome the invitation to stakeholders to contribute to the review and we are pleased to take the opportunity to submit views to the initial stage of the work. In doing so, we have concentrated primarily on the questions set out in the HM Treasury Discussion Paper published in March 2015.

2. In framing our submission we have consulted with our members across the country. As professional societies, we have focused on those questions that relate directly to our expertise and experience in promoting local growth and delivering local economic development. We put our views in response to the specific questions within the overall context of the crucial role of local authorities in supporting local economic growth and the significance of business rate income in achieving and delivering this.

Significance of business rates for local authority action for local economic growth

3. Local authorities have a critical role in promoting economic growth, supporting business and enterprise, and providing and maintaining essential infrastructure. However, whilst councils across the country are committed to driving economic growth, their ability to do so risks being seriously compromised by the reductions in funding that have had to be absorbed. In this context the fact is that, as the Local Government Association has pointed out, business rates now account for around one-fifth of local government income. This underlines their significance to local authority actions to drive economic growth.

Individual consultation questions

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

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

CEDOS and ADEPT views

4. Undoubtedly significant changes are continuing to occur in working and shopping patterns with the development of out of town centre shopping and advances in digital technology and the growth of on-line businesses. Whilst we

have some information from individual members, we are not in a position to present definitive evidence as to the extent to which this is leading to changing patterns of property use that are affecting individual sectors differently.

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

CEDOS and ADEPT views

5. Although we are not in a position to provide definitive evidence, the fact that the focus of some service and retail industries is on their on-line operations places them at an advantage as far as business rates are concerned, compared to industries such as manufacturing that require more physical space. Inevitably this raises questions as to the fairness of a system of business rates based exclusively on property values.

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?

CEDOS and ADEPT views

6. The HM Treasury Discussion Paper[1] states that the government's preference is for business rates to remain a property tax, administered and collected by local authorities. As we have said, there are questions as to the fairness of a system of business rates based exclusively on property values and there are arguments for changing the basis of taxation so that it better reflects business performance rather than just physical presence by focusing, for example, on turnover and profit. However, as the Discussion Paper points out, business rates as a recurrent property tax have significant advantages compared to other forms of taxation including being relatively efficient to collect, easier to link to and finance local authorities and being a relatively stable and predictable tax.

7. In this context, we note that in a survey of councils by the Local Government Association in October/November 2014, 83% preferred the current property value-based system "as it is based on a visible and unavoidable asset, revenue was easily identifiable as related to a particular local area, and the benefits of tax buoyancy"[2].

8. The feedback we have received from our members supports this and is encapsulated in the following view received:

> "There is a clear increase in internet-based companies, which tend to require relatively small premises when compared to turnover. In contrast, other businesses may require more space at a higher rateable value (and higher business rates) but with a much lower turnover. However, we would not want to see a move away from a property based tax to another methodology such as turnover or profit levels. The benefits of a property based tax are that it is easy to collect and offers some certainty to business and local authorities about the payment due".

---

[1] Business rates review: terms of reference and discussion paper March 2015

[2] *Business rate retention: the story continues* Local Government Association March 2015

9. Whilst we welcome discussion on how the business rate system can be made fairer to different sectors and types of business, we recognise that, despite its imperfections, the current system helps to provide for stability for public finances, both locally and nationally, and for businesses. Any changes must provide for predictability and stability of income and be simple and efficient to administer.

10. On balance, in our view the best way forward is to retain business rates as a property based tax but with provision for more local control and flexibility to enable more locally determined incentives for key business sectors. The issue of fairness in the treatment of internet-based companies in comparison with those requiring significant physical space could perhaps be better dealt with at national level and explored in the context of the corporation tax system rather than the business rate system, with consideration being given to an element of local distribution of a percentage of corporation tax income generated nationally.

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?

CEDOS and ADEPT views

11. Whilst we do not have a comprehensive knowledge of other jurisdictions and tax systems, we note that the HM Treasury Discussion paper refers to business rates being set locally in both France and the Republic of Ireland. In this context, we note that the Discussion Paper also cites the example of Germany where both federal and municipal rates apply. It also refers to Northern Ireland, where business rates comprise a regional rate set annually by the Northern Ireland Executive and applied to each district council area in Northern Ireland plus a district rate set annually by each single tier district council. This provides an element of local accountability and independence in the business rating system and for local government in Northern Ireland to be able to respond to local issues. We would suggest that the experience of Northern Ireland is worthy of further investigation in a UK wide context.

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

CEDOS and ADEPT views:

12. Designed to encourage councils to grow their local economies, the government introduced the business rates retention scheme in April 2013, enabling local authorities to keep 50% of all business rates growth. Business rate revenue is divided into the 'local share' and the 'central share'. The central share is redistributed to councils in the form of revenue support grant and in other grants. The local share is kept by local government, but is also partly redistributed. In designated enterprise zones, local authorities are able to retain 100% of business rate growth within the zone for 25 years to encourage borrowing and reinvestment in the local economy, although whilst this goes some way to assist in bringing enterprise zones to market, the complexity of some sites requires additional local intervention.

13. We note that in a survey of local authority chief finance officers conducted by the Local Government Association (LGA) in October/November 2014, more than two thirds of respondents agreed that the retention scheme has created a strong incentive to grow the business rate tax base[3]. However, at the same time it has resulted in more risk and uncertainty to local authorities and on this we note the LGA survey showed that 74% of respondents named risk arising from appeals and 66% said their councils were dependent upon a small number of large businesses for their business rate income. Indeed, the LGA suggests these reasons in particular account for the fact that the scheme made a deficit in its first year.

14. Having regard to these findings and to the soundings we have taken from our members, we consider there are a number of issues that need to be addressed to improve the incentive for local authorities to drive local growth:

- the percentage of business rate receipts retained by local authorities;
- the risks to local authority income;
- the distribution of business rates in two-tier areas;
- the use of retained business rates for economic development purposes.

Percentage of business rate receipts retained by local authorities

15. In consulting with our members across the country we have received a spectrum of views ranging from a preference for 100% retention ("full retention of business rates is a key element of self-sufficiency for local authorities and would deliver genuine local incentives for growth"); through maintaining the current approach; to opposing any increase in the retention rate ("if the Government decided to increase the percentage of business rates that local authorities retain it would undoubtedly risk further ingraining regional divides which is counter to building a strong, resilient economy"). Perspectives depend, perhaps inevitably, on the position of member authorities in terms of 'top-up' and 'tariff'.

16. On balance, we consider there is a case for increasing the percentage of business rate retention to improve the incentive to drive growth in non–enterprise zone areas. At the same time, this will need to be accompanied by a revision of the top-up and tariff arrangements to ensure that the system offers protection to areas with lower business rate tax bases and higher needs. Moreover, if the Government decides to increase the local retention rate it would be prudent to approach this in stages in a measured way, taking into account any lessons from the three 100% business rate retention pilots, which started in April 2015. We also see merit in the proposal by the Local Government association that an independent body should be established for the distribution of funding to councils to 'take the politics out of financial distribution' and redistribute business rates income across the country in a way which would ensure those areas with less business activity do not lose out[4].

[3] Business rate retention: the story continues Local Government Association March 2015
[4] Ibid

Reducing risks to local authority income

17. As the Local Government Association has pointed out, the number of business rate appeals and the time they take to resolve is a major issue which is restricting the ability of councils to invest in economic development and support business. The concern about the appeals process is reflected in the soundings we have taken amongst our members. There is a clear need for the Government to take action and reform the appeal system.

Distribution of rates in two-tier areas

18. There is concern in two-tier local authority areas at the inequity of the current system whereby upper-tier authorities receive only a small proportion of retained business rates despite the fact that they undertake significant economic development activity, particularly in relation to the delivery of critical strategic infrastructure, which is vital to sustainable growth. An example is Hampshire, where under the current system less than 10% is retained by Hampshire County Council, despite its strategic responsibilities which have a significant impact on the wider economy. In our view, the distribution of retained business rates, or indeed any other form of business growth incentive in two-tier areas should reflect fairly the respective contributions of the upper and lower tier authorities in promoting and supporting economic growth.

Use of retained business rates for economic development purposes

19. If local business rate retention is enhanced, to ensure it is an effective measure for driving local growth, there should be an expectation that increased business rate revenue would be used for investment and activities that support local economic development and business growth.

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

CEDOS and ADEPT Views:

20. Increased local retention of business rate revenue should have a positive impact business growth and on local authorities and their ability to promote economic development across the whole of their areas providing that it is accompanied by an adjustment of the current equalization mechanism to ensure that the system protects areas with lower business rates tax bases, higher needs and vulnerable economies, and providing that:

- the appeal system is reformed to reduce the risk to local authorities;
- local authorities in all areas have the freedom to respond to their business and growth needs by providing locally appropriate business rate discounts and reliefs (see below);

- there is a fairer distribution of business rate revenue in two-tier areas to reflect the respective contributions of the upper and lower tier authorities in promoting and supporting economic growth;

- there is an expectation that increased business rate revenue would be used for investment and activities that support local economic development and business growth.

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

CEDOS and ADEPT Views:

21. In our view, local authorities should have more freedom and control over the business rate system to be able to pursue local incentives for business growth. In enterprise zones, the Government has enabled local authorities to offer businesses a discount on business rates of up to the State Aid de minimis limits over a five year period. We consider that local authorities in all areas should be able to respond to local circumstances by providing business rate discounts, reliefs and other incentives to support local businesses and key business sectors and promote local growth.

22. The Local Government Association has gone further and proposed that the setting of business rates should be devolved to local authorities. It has published details of research by ComRes, which found that 68% of businesses across the UK agree that business rates should be set locally in discussion with local businesses, with only 7% of businesses surveyed disagreeing[5]. In our view, the setting of business rates locally to reflect and respond to local circumstances rather than the present one-size-fits-all approach imposed nationally should be considered seriously by Government. If the Government does not feel able to go this far, it should enable local authorities to set at least a proportion of the total amount of business rates and look seriously at extending the 'dual' approach used in Northern Ireland to the rest of the UK.

23. On a specific issue, there is a need to ensure that the business rating system does not inhibit speculative commercial development. Previous changes to business rates mean that the owners of all vacant business premises have to pay business rates three months after they become empty. Even though industrial premises are exempt for a further three months, in areas and sectors where turnover of premises is slow, the cost of paying for business rates on empty properties is a disincentive for speculative development.

24. On a similar issue, the Government's announcement in the 2012 Autumn Statement on extending the exemption from empty property rates to all newly built commercial property completed between 1 October 2013 and 30 September 2016 from 3 months to the first 18 months was welcomed as it removed a serious disincentive to speculative developers. We would suggest that this exemption could be extended beyond 2016 and consideration given to whether the exemption period could be increased.

---

[5] *Majority of businesses agree councils should be able to set business rates locally* Local Government Association 2 March 2015

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

CEDOS and ADEPT Views:

25. The HM Treasury Discussion Paper states that the Government continues to welcome views on the extent to which changing the frequency of revaluations could increase the economic responsiveness of business rates. From the soundings we have taken, a view has emerged that more frequent revaluations at two or three yearly intervals would be welcomed and would enable business rates to more accurately reflect wider economic conditions and could also help to reduce the number of appeals and the need for transitional relief schemes. More broadly, it is essential that the timing of revaluations, the appeals process and periods for back dating payments are clear, transparent and consistent to enable councils to make the most accurate possible business rate receipt projections and enable them to invest in economic growth by undertaking borrowing on a medium to long-term basis with greater security that this can be repaid through future retained business rates.

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?

CEDOS and ADEPT Views:

26. If business rates remain a property tax it is difficult to see how they could take into account the individual circumstances of businesses. Moreover, any move to account for a business' ability to pay would be complex, administratively demanding and likely to be impractical. It is important, however, that the needs of SMEs as a whole are taken into account. The term SME in fact covers quite a wide range of business sizes including micro businesses, whose needs will inevitably vary. In this context it would be sensible for the existing small business rate relief scheme to be reviewed. In the meantime there is a case for retaining the 100% relief for properties with a rateable value of £6,000 or less beyond the currently stated date of 31 March 2016.