TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

12 October 2011

Report of the Director of Finance

Part 1- Public

Executive Non Key Decisions

1 LOCAL GOVERNMENT RESOURCE REVIEW: PROPOSALS FOR BUSINESS RATES RETENTION CONSULTATION PAPER

The Department for Communities and Local Government recently published a consultation paper entitled 'Local Government Resource Review: Proposals for Business Rates Retention'. This report outlines the main proposals set out in the consultation paper. Also attached to the report for endorsement is a draft response to the questions asked in the consultation paper and the accompanying eight technical papers.

1.1 Introduction

1.1.1 On 18 July 2011 the Secretary of State for Communities and Local Government made a statement in Parliament and launched a consultation paper concerning proposals for business rates retention. The consultation paper sets out the Government's proposals for a business rates retention system and how the New Homes Bonus and Tax Increment Financing will work within such a system. A series of eight 'technical' papers concerning further details of the scheme were subsequently published in late August 2011.

1.1.2 The consultation paper sets out and seeks views on the Government's proposals for how a business rates retention scheme would operate. The document is lengthy (some 48 pages) so rather than reproduce in hard copy, the consultation paper can be found at the following link:

http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf

1.1.3 The DCLG have also published A Plain English Guide to accompany the Consultation Paper. A copy of which can be found at **[Annex 1]**. An overview of the accompanying eight technical papers can be found at **[Annex 2]** and the full set of technical papers can be found at:

http://www.communities.gov.uk/localgovernment/localgovernmentfinance/lgresourcereview/

1.1.4 The return date for responses to the consultation paper is **24 October 2011**. A copy of our draft responses to the questions asked in the consultation paper and the eight technical papers can be found at **[Annex 3]** and **[Annex 4]** respectively.

1.2 Current Arrangements and Principles for Reform

1.2.1 Currently, councils in England collect and pay some £19bn of business rates each year to the Treasury which is subsequently redistributed to councils according to a complex formula. The Government's view is that current arrangements deny councils control over locally raised resources; deprive them of the certainty they need to plan their finances for the longer term; and create a disconnection between the success of local businesses, and the state of their own finances. Enabling local authorities to retain a share of the growth in business rates in their area will provide a strong financial incentive for them to promote economic growth. **The Secretary of State has stated that 'Any council that grows its local economy will be better off under the new system.'** The essence of the proposed change is that it is intended to encourage local government to promote economic growth, but just by way of information this authority is not doing anything to discourage economic growth at the moment.

1.2.2 The principles for reform as set out by the Government are:

- To build into the local government finance system an incentive for local authorities to promote local growth over the long term;
- To reduce local authorities' dependency upon central government by producing as many self sufficient authorities as possible;
- To maintain a degree of redistribution of resources to ensure that authorities with high need and low taxbases are still able to meet the needs of their areas; and
- Protection for businesses and specifically, no increase in locally imposed taxation without the agreement of local businesses.

1.3 Key Points

1.3.1 In summary the Government's intentions are as follows:

1.3.2 The Government intends to bring forward legislation with a view to introducing business rates retention from **April 2013**.

1.3.3 For the first two years of the business rates retention scheme (**2013/14 and 2014/15**) local authorities will **retain a share** of the growth in business rates in excess of the forecast national business rates. Business rate revenues in excess of the spending control totals set out in the Comprehensive Spending Review 2010 up to the forecast national business rates will be set aside to fund other grants to local government.

1.3.4 For **2015/16 and beyond**, the Government intends to make changes to the system, in terms of the business rates income that authorities retain, however, **no further details are provided** in this consultation paper.

1.3.5 Businesses will see **no difference** in the way they pay tax or the way tax is set.

1.3.6 The police and, possibly, single purpose fire and rescue authorities will not be affected by fluctuations in business rates and will receive the level of funding for 2013/14 and 2014/15 that was agreed as part of the 2010 Spending Review. The way in which they are funded will be reviewed in time for changes to be made at the next Spending Review.

1.3.7 The main elements within the proposed system are as follows:

- When establishing the new system, the Government will need to establish '**baselines**' for each authority. Put simply, each authority's baseline will be calculated according to whether its income from business rates is greater or less than its government formula grant funding. **The baseline will be 'constructed' from the 2012/13 Formula Grant allocation** (with adjustments for the 2013/14 control totals). From a reading of articles/comments on this subject elsewhere, I believe it is the intention that the baseline level of funding would be set so that at the start of the system all local authorities receive the same level of funding as they would have done under the current arrangements.

- Once the baselines have been established, a system of **tariffs and top-ups** will be introduced. An authority whose business rates income (however that is defined) exceeds its baseline (as is likely to be the case in Tonbridge and Malling) would pay the excess to central government in the form of a **tariff**. An authority with business rates income below its baseline would receive the deficit in the form of **a top-up grant** from central government. It is proposed that the tariffs and top-up amounts would remain fixed. There are, however, technical issues surrounding whether the tariffs and top-up amounts should be uplifted for inflation. Clearly, as the Government's intention is that the changes to the current system should encourage authorities to promote economic growth, the tariffs must be set so that it is worthwhile for them so to do. Similarly, the top-ups should not be set so that an authority has no incentive to promote growth. Therefore, total income would grow if the business rates base in an area grows, but could fall if the business rates base declines. A diagrammatic example of how tariffs and top-ups will be determined can be found at **[Annex 5]**.

- **County councils** will receive a share of business rates income from the districts in their area. **The percentage of their share will be determined by central government** and will be either a percentage applicable to all two-tier authorities or a percentage based on the circumstances of each billing authority within the two-tier area.

- A **levy** would be collected by central government from those authorities considered to have **disproportionate financial gain** from the new system. The proceeds of a levy would be used to help manage large, unforeseen negative volatility (safety net) in individual authorities' budgets. There are options as to how a levy could be calculated. It could be set at a flat rate for all relevant authorities; or banded according to the level of disproportionate benefit; or set at an individual authority level according to its baseline.

- A **safety net** will be in place to protect authorities from year-on-year volatility or longer term decline.

- The system would be adjusted to take account of changes in the distribution of business rates yield resulting **from five-yearly revaluations**.

- There will be a **reset mechanism** to realign resources with need. The resets could be either at predetermined intervals or as and when required.

- Local authorities could choose to form **voluntary pools** within the system, allowing them to share the benefits of growth and smooth the impact of volatility over a wider economic area. It would be the responsibility of members of the pool to decide how revenues were distributed among members of the pool.

- The business rates system currently contains a number of mandatory reliefs and discretionary reliefs which reduce the liability of the ratepayer. **No changes are proposed to the current system of reliefs**, including eligibility. This will mean that tariff and top-up calculations will need to take account of reliefs.

- It would appear that there will be no reduction in the **amount of information** that will still have to be returned to central government concerning such matters as anticipated and outturn yields from business rates.

- Aside from the levy, not all growth in business rates income will be distributed amongst local authorities – sufficient **resources to fund the New Homes Bonus scheme** will be held centrally.

1.4 New Homes Bonus

1.4.1 The Government is committed to continuing to fund the New Homes Bonus scheme within a business rates retention system. The Government propose to deliver this commitment by fixing local authorities' tariffs and top-up amounts at a level which leaves a **sufficient sum aside to fund the future cost of the New Homes Bonus**.

1.4.2 To ensure that the tariffs and top-ups are able to remain fixed, it will be necessary to take out from year one the total required to fund the New Homes Bonus at its steady state. So, in the early years of the business rates retention scheme, this adjustment will remove significantly more than is actually required. The Government, therefore, propose to make an annual forecast of the surplus New Homes Bonus funding and return it to local authorities in proportion to their baseline funding levels.

1.5 Tax Increment Financing

1.5.1 The paper also brings forward proposals to implement Tax Increment Financing as a way of **funding infrastructure investment** to unlock economic growth and regeneration.

1.5.2 This initiative is where local authorities would be able to **borrow against future growth in business rates** to help fund the necessary infrastructure. Following responses to this consultation, the Government will publish a technical paper setting out more detail on Tax Increment Financing. This may or may not be protected from the levy/resets depending on the option chosen.

1.6 Other Proposals

1.6.1 The Government also propose to allow billing authorities to: publish certain statutory information which accompanies business rates bills online, instead of sending hard copies; operate multi-year billing for business rates; and clarify legislation on business rates refunds, so that billing authorities are permitted to offset outstanding liabilities from previous years, before offering refunds.

1.7 Overall Impressions

1.7.1 The **ethos** behind the proposal seems to be for councils to **say 'yes' to development** and thereby deliver growth, and, as a consequence, reduce the reliance on central government support.

1.7.2 However, this produces a risk of replacing known grant income with a **much more volatile income stream** dependent on growth, which will make medium term financial planning much less reliable, especially for smaller districts.

1.7.3 Furthermore, agreeing to development does not necessarily immediately lead to an increased business rates income stream; as the development might not commence for some considerable time. It is my understanding, having consulted my colleagues in Planning Services that we do not have a shortage of potential development land within the Borough but that the prevailing national/international economic conditions prevent those development opportunities being exploited.

1.7.4 In the rates retention system, after the setting of tariffs and top-ups in year one, any additional business rates growth would sit in the area in which it is generated, but be subject to a levy to recoup a share of disproportionate benefit. Tariffs and top-ups remain fixed for a period, but can be adjusted for revaluation or reset completely to re-align resources with need.

1.7.5 As referred to above, the fact that funding above a minimum amount is dependent on growth in an authority's business rates base clearly makes **it difficult to predict future funding levels for medium term financial planning purposes**. This is not made easier by the inclusion of what are requisite elements of a business rates retention system, e.g. safety net, levy and 'reset' button and how these work in practice could have a significant impact on funding levels.

1.7.6 Decisions about the safety net, the levy and the setting of tariffs and top-ups are inextricably linked. For this reason it is, arguably, anyone's guess as to what this means for Tonbridge & Malling. **All we can do for the time being is assume we will be no better or worse off under this system than under the current arrangements**, but with the added risk of a much more volatile income stream which we will need to take due regard of in our financial planning.

1.7.7 The accuracy and fairness of the **starting point is critically dependent** on the baseline figure that is set and it is not clear how the Government intends to address any discrepancies between estimates and final totals. The fact that the Government might retain for itself both inflationary increases in business rates yield up to 2014/15 and an element of forecast growth above inflation is disappointing.

1.7.8 It has been suggested that **incentives could be eroded** by the amount Government propose to 'siphon off'; by the complicated nature of the redistribution system; and the fact that the proposals appear to confirm fears that few councils would stand to gain from the changes. It can be envisaged that under such a system in some years an authority would 'do well' and in others 'not so well' (funding would be 'lumpy'), but that over the medium to long-term there will be a large group of authorities for whom the change does not make a great difference.

1.7.9 When drafting the response, we have erred towards an even 'balance' between incentive and protection. If more weight is towards incentive, this can be beneficial in the 'good times', but very risky in 'bad times'. Too much protection could erode the benefits of incentives as suggested above. There is also a risk that the system could be a disincentive to growth particularly at certain times in order for the optimum benefit to be derived from that growth.

1.7.10 A diagrammatic example of the money flows under the proposed scheme can be found at **[Annex 6]** and any additional process costs for local authorities should be funded as a new burden.

1.7.11 On the question of **pooling**, this, to a large extent I would suggest, depends on whether it would be beneficial to do so, taking into account the perceived level and appetite for risk. As I understand it, there will be discussions at Kent Leaders and Chief Executives level to consider the merits, or otherwise, of pooling within Kent.

1.7.12 In summary, this has been a complex and extremely time consuming consultation paper to respond to. It has not been helped by the delay in the release of the 8 very complex technical papers. I hope, however, that the work undertaken primarily by my Chief Accountant, Neil Lawley, and my Revenue & Benefits Manager, Paul Griffin, will assist Members in making a response to this very significant set of proposals.

1.8 Legal Implications

1.8.1 The legislative framework for the billing, collection, recovery and administration of national non-domestic rates (business rates) is set out in the Local Government and Finance Act 1988.

1.9 Financial and Value for Money Considerations

1.9.1 As referred to in the report it is difficult to quantify exactly what this might mean for Tonbridge & Malling. All we can do for the time being in updating our Medium Term Financial Strategy is to assume that we will be no better or worse off under this system than under the current arrangements, but acknowledging that there could be an added risk of a much more volatile income stream.

1.10 Risk Assessment

1.10.1 The proposal produces a risk of replacing known grant income with a much more volatile income stream which we will need to take due regard of in our financial planning.

1.11 Equality Impact Assessment

1.11.1 See 'Screening for equality impacts' table at end of report

1.12 Recommendations

1.12.1 Members are **RECOMMENDED** to:

1) Consider the draft responses to the questions asked in the consultation paper and the accompanying eight technical papers at **[Annex 3]** and **[Annex 4]** respectively outlining the Government’s proposals for a business rates retention system;

2) make amendments as appropriate; and

3) approve a final draft for submission to the Department for Communities and Local Government by the return date of 24 October 2011.

Background papers:

Nil

contact: Neil Lawley
Paul Griffin
Sharon Shelton

Sharon Shelton
Director of Finance

Screening for equality impacts:		
Question	**Answer**	**Explanation of impacts**
a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community?	No	This report outlines the main proposals for a business rates retention system set out in a consultation paper published by the Department for Communities and Local Government. Attached to the report is a draft response to the consultation paper.
b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?	No	See above.
c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?		Not applicable.

In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above.