**TONBRIDGE & MALLING BOROUGH COUNCIL**

**CABINET**

**19 March 2019**

**Report of the Director of Finance and Transformation**

**Part 1- Public**

**Matters for Information**

## 1 BUSINESS RATES RETENTION REFORM

**Alongside the 2019/20 provisional local government finance settlement, the Ministry of Housing, Communities and Local Government (MHCLG) confirmed the aim to introduce 75% Business Rates Retention for all in 2020/21 and published a consultation paper on possible changes to the system: "Business Rates Retention Reform". This report provides an overview of the consultation paper, together with our response that was agreed with the Cabinet Member for Finance, Innovation and Property.**

### 1.1 Introduction

1.1.1 As we approach the 2019 Spending Review, the implementation of greater Business Rates Retention and new funding baselines as part of the Fair Funding Review in 2020, the challenges for local government finance are greater than ever. It is vital that the Government uses the 2019 Spending Review to deliver truly sustainable funding for local government.

1.1.2 The MHCLG has stated its intention that there will be a reset of the Business Rates Retention (BRR) system and a move to 75% business rates retention from April 2020. As part of this process, the MHCLG has been reviewing the components of the BRR system and the role the system can play in continuing to provide an incentive for local authorities to grow the business rates in their area while minimising complexity.

### 1.2 Business Rates Retention Reform

1.2.1 Alongside the 2019/20 provisional local government finance settlement, the MHCLG confirmed the aim to introduce 75% Business Rates Retention for all in 2020/21 and published a consultation paper on possible changes to the system – *"Business Rates Retention Reform - Sharing risk and reward, managing volatility and setting up the reformed system"*.

1.2.2 The MHCLG has acknowledged that the existing BRR system is complex and has not always been flexible. It has also recognised that there is a level of disproportionate volatility in the current system and has stated that it is committed to reducing the impact on local authority income of factors outside of an authority's control. The proposals outlined in the consultation paper are in part intended to address some of these issues.

1.2.3 This consultation sought views on proposals for sharing risk and reward, managing volatility in income and setting up the reformed business rates retention system. The reform of the business rates retention system will sit alongside wider changes to the local government finance system which the MHCLG aims to introduce in 2020.

1.2.4 The consultation paper outlined further proposals to:

- Update the balance of risk and reward to better reflect the wider context for local authorities in 2020. It suggests a future approach to resets that would smooth potential 'cliff edges' in income, proposes reforms to the levy that would allow more authorities to keep more of their business rates growth, and reaffirms the Government's commitment to a safety net to protect authorities from sudden reductions in income.

- Mitigate volatility in income and simplify the system.

- Set up the new business rates retention system in April 2020 – specifically, inviting views from local authorities on the operational steps that may be necessary to set accurate Business Rates Baselines.

1.2.5 The consultation paper can be found at the following link:

https://www.gov.uk/government/consultations/business-rates-retention-reform

1.2.6 The deadline for responses was 21 February 2019. A copy of the responses agreed with the Cabinet Member for Finance, Innovation and Property under delegated authority can be found at **[Annex 1]**.

1.2.7 A summary of the key issues from the consultation paper are set out below.

- There is a full reset planned for 2020/21 that will see the "growth" within the current business rates system up to 2019/20 transferred to Baseline Need.

- Future resets could be on a quite different basis, seeing a proportion of the growth retained by local government (partial reset) with the determination of the business rates baseline possibly being on a phased basis.

- The safety net is to continue, at a level to be set at the end of the process.

- There will be no levy, but a growth threshold (not yet determined) above which all "growth" would be lost.

- Tier splits – MHCLG hopes that the sector can propose its own splits with the potential for a default position if no agreement can be agreed.

- There would appear to be significant issues (that may not be able to be overcome) to nationalising appeals under the current system. There are also concerns regarding how authorities' business rates baselines would be determined under a reset (any type).

- A modified version of the BRR system is proposed that would effectively nationalise appeals and establish a more objective method of setting the starting point for each authority (and therefore capture growth more accurately).

**1.3 Overview**

1.3.1 The paper is split into three main subject areas: Balancing risk and reward; Simplifying the system and reducing volatility; and Setting up the system, each of which is considered in turn below.

**Balancing risk and reward**

1.3.2 This chapter focusses on resetting the business rates baseline; the safety net; the levy; tier splits; and pooling.

*Resetting the business rates baseline*

1.3.3 The resetting of business rates baselines (BRB) determines the growth incentive for individual authorities, by determining the amount of business rates growth they retain and for how long. The intention of the reset is to ensure that the distribution of resources remains aligned with need. There is a trade-off between resets being too frequent and the growth incentive being weakened, and too infrequent resets could mean that relative need grows faster than local tax resources.

1.3.4 The MHCLG intend to carry out a full reset of BRB in 2020/21 and seeks views on the approach to resets after 2020/21, in particular, the type of reset (full or partial) and the time period that a reset should cover.

1.3.5 Under a partial reset the BRB and Baseline Funding Levels are held constant for a set number of years and, at a reset, a percentage of the growth achieved over the previous period is redistributed, with the remaining growth retained by local government. The retention of some growth into a new reset period would potentially smooth 'cliff edges' and support longer term planning. The percentage to be retained is yet to be determined and MHCLG asks for views on this. However, it is recognised there would still be intermittent full resets (using, for example, a period of 15 years, which could mean after two partial resets if these were spaced 5 years apart).

1.3.6 Under a full reset, no growth is retained into the forthcoming reset period. As this type of reset does not meet MHCLG preferred criteria and sector support for partial resets over full resets when responding to previous consultations, full resets at the end of every reset period post 2020/21 are being ruled out.

1.3.7 An alternative suggested is a phased reset where each year's growth (or loss) is retained for a set number of years and, thereafter, that growth (or loss) is redistributed. Under this option, it would not matter when growth came 'on stream', as all growth would count equally, regardless of timing.

*Safety net*

1.3.8 The intention of the safety net is to ensure that no authority falls below a minimum level of their assessed need, currently expressed as a percentage of Baseline Funding Level and is both proportionate and sustainable when income declines, e.g. because of the closure of a major ratepayer.

1.3.9 Given the likelihood that an authority will require a safety net payment is very much a function of other elements in the system, e.g. appeals MHCLG believe the level at which the safety net is set be determined when decisions have been made on the wider system.

1.3.10 The MHCLG expect the safety net to be funded through the levy account and a top-slice of business rates income. If the levy is reformed as discussed in the paper it will provide much less income to fund safety net payments and a higher proportion would need to be funded through a future top-slice. It is anticipated that the cost of safety net payments will, in future, be lower following the reform of other elements of the system.

*Levy*

1.3.11 To remove the levy from the new system would require primary legislation and as such MHCLG are minded to reform this element of the system within the current legislative framework by raising the threshold at which the levy falls due and, in doing so, to consider how the levy could be reformed to ensure that 'extraordinary growth' does not distort the fairness of the system.

1.3.12 The MHCLG propose that the level at which an authority becomes eligible to pay the levy should be raised so that only growth that could be considered 'extraordinary' would be subject to it, above which the levy should be 100% and, therefore, function as a cap. MHCLG believe that this would be a simpler approach and would provide a stronger growth incentive and seeks views on the level at which the levy should fall due.

*Tier Splits*

1.3.13 MHCLG is minded to retain a national tier split to distribute business rates income in multi-tier areas. Again the level for the tier split between counties and districts

is to be decided later in the process, following decisions on other elements of the system; and an opportunity for this decision to be sector led and MHCLG asks what should the fall-back position be in the event that an agreement is not reached and should a two-tier area be able to set their tier-splits locally?

*Pooling*

1.3.14 If the levy is reformed, a key incentive to pooling will be lessened and the consultation seeks views on how pooling can be incentivised and improved within the reformed system?

**1.4 Simplifying the system and reducing volatility**

1.4.1 This chapter focusses on a review of hereditaments on the central and local lists; options to address volatility caused by appeals and valuation loss; and a proposal to simplify the administration of the business rates retention system.

*Review of hereditaments on the central and local lists*

1.4.2 Resetting of the BRR system in 2020/21 provides an opportunity to reassess the allocation of classes of hereditaments between the central and local non-domestic rating lists.

1.4.3 MHCLG view is that the reform of the central and local lists should create a rational and transparent system which is uniform throughout the country and that the central list should be used to list hereditaments, which, by their nature, are unsuitable for listing in local lists; and asks on applying the criteria outlined in the consultation, there are hereditaments that should be listed differently?

*Options to address volatility caused by appeals and valuation loss*

1.4.4 To address the volatility relating to appeals the MHCLG has previously stated its intention to centralise this risk. Two separate but key issues are identified: how to measure the compensation due to local authorities for business rates losses due to valuation change and how to mitigate the impact of provisions on authorities' ability to spend on services in-year using accounting adjustments?

1.4.5 MHCLG believes the first issue can be addressed using a proxy. Under this proxy, MHCLG propose is minded to top-slice business rates income to compensate all changes to an authority's local list backdated to the first day of the list, as a 'valuation only change'. Changes not backdated to the start of the list would, therefore, be classified as physical changes and not compensated.

1.4.6 MHCLG outlines four options relating to the second issue, all of which it considers are impractical stating in its view the proposal to simplify the administration of the business rates retention system outlined in the consultation is the only option available to address the volatility caused by appeals and valuation loss.

*Proposal to simplify the administration of the business rates retention system*

1.4.7 MHCLG believe a proposal originally worked-up by members of the Business Rates Retention System Design Working Group offers a way of addressing the issue of volatility caused by appeals and other valuation change and would also simplify the system and give more certainty as to the level of income authorities can expect to see year on year.

1.4.8 How the reformed system would work –

- Proposes to use local authorities' own estimates of their business rates income – after provisions have been made – to set Business Rates Baseline each year.

- A local authority's top-up or tariff payment will continue to be set as the difference between the Business Rates Baseline and Baseline Funding Level. The result will be that each local authority will have certainty each year that their income net of provision will be equal to their needs assessment (before growth or decline in business rates is accounted for) and provisions will no longer adversely impact on an authority's income. To implement this change the date that local authorities provide their NNDR1 forms would most likely have to be brought forward to around September each year.

- A system of floating top-up and tariff payments to reconcile differences between the initial estimates of business rates income provided in the NNDR1 form and the outturn figures available after the end of the financial year through NNDR3 forms. Top-up and tariff payments would be adjusted in the following year to take account of any such difference when the following year's top-up or tariff is set. Such a system of floating top-ups and tariffs would also provide more flexibility in how other elements of the system could be administered.

1.4.9 Risk and reward under the reformed system –

- Under 75% BRR, local authorities are to keep 75% of their business rates growth (subject to decisions taken on the levy and tier splits) and 75% of any decline (subject to decisions taken on the level of the safety net).

- A new calculation to identify the level of business rates growth (or decline) to be retained by individual authorities would be required. MHCLG is minded to measure growth and decline based on outturn figures provided in NNDR3 forms net of provisions.

- Any growth or decline in business rates income would be recognised by adjusting the following year's top-up and tariff payments. A local authority would see the benefit, by way of budgeted additional income, of any growth in the year following the submission of outturn data.

1.4.10 This proposal would provide certainty to local authorities of the income they can expect to receive at the point of the provisional local government finance settlement. Only changes in business rates due to actual changes in the business rates base in an area, as opposed to appeals and changes in valuation, would be recognised, improving the accuracy of the system.

**Setting up the System**

1.4.11 If the system is not reformed in the way suggested MHCLG will need to set new Business Rate Baselines for 2020/21. However, it should be remembered a full reset of the BRR system is planned in 2020 and the transition to new baselines in 2020/21 will be considered separately at a later date.

1.4.12 If the system is not reformed it is proposed baselines be based on authorities' retained business rates income as at 2019/20. However, as outturn data for 2019/20 will not be available in time to set the new baselines MHCLG propose to use 2018/19 NNDR3s and uprate them by the change in the small business rating multiplier. In addition, propose to use a single year's data to set baselines, rather than an average of two years' data, as was done in 2013/14.

1.4.13 In calculating baselines, MHCLG will use data for net rates payable from 2018/19 NNDR3s, with deductions for non-collection and appeal provisions and for "disregarded amounts" i.e. the cost of collection allowance. The resultant number will be the total Business Rates Baseline at the billing authority level. This will then be apportioned between billing authorities and their major precepting authorities in accordance with the relevant tier-split shares.

1.4.14 MHCLG considers the two most difficult deductions to calculate accurately to be non-collection and appeal provisions. For non-collection MHCLG propose to use an average of more than one year's data and in the case of appeals there are a number of possible options and asks for views on the approach to resetting Business Rates Baselines?

## 1.5 Summary

1.5.1 We remain clear that extra business rates income should go towards meeting the funding gap facing local government.

1.5.2 The level of safety net support, the levy, tier-splits in two tier areas and future resets yet to be decided.

1.5.3 The consultation paper makes a strong case for an alternative BRR system (adjusting back to baseline figures and having a separate measure of growth) being introduced in 2020/21.

1.5.4 The current difficulties around setting new individual authority business rates baselines after the reset and the problems in attempting to nationalise appeals under the current system make an alternative BRR system (adjusting back to

baseline figures and having a separate measure of growth) attractive both from a financial planning perspective and because it could establish a more transparent and fair way to reward actual growth in business rate revenues. The proposed alternative system is still very much in its infancy and further work is needed, especially around how to measure growth, but if a robust and transparent measure can be identified, it would arguably make business rates retention a much fairer and more stable system.

**1.6 Legal Implications**

1.6.1 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.

1.6.2 The Local Government Finance Act 2012 and regulations that followed introduced the current Business Rates Retention scheme.

**1.7 Financial and Value for Money Considerations**

1.7.1 A key part of the jigsaw is the Council's baseline funding level and how this then compares to that reflected in the Medium Term Financial Strategy taking into account transfer of any new responsibilities?

1.7.2 Of further (probably greater) concern is the ongoing uncertainty about the future of New Homes Bonus which we again ask be made a permanent part of overall funding rather than open to potential change year on year. The current arrangement does not aid financial planning and at worse could put financial sustainability at risk.

1.7.3 The level of funding any one authority receives in future could decrease markedly and place financial sustainability at risk where transitional arrangements in the form of damping will be a prerequisite.

**1.8 Risk Assessment**

1.8.1 There is so much uncertainty and volatility that financial planning is becoming increasingly difficult with the increased risk of significant variances compared to projections; and the consequent implications on the level of reserves held.

Background papers: contact: Neil Lawley

Nil

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