Business rates retention scheme: The Safety Net and Levy

A Statement of Intent

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Any enquiries regarding this document/publication should be sent to us at:

Department for Communities and Local Government
Eland House
Bressenden Place
London
SW1E 5DU
Telephone: 030 3444 0000

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LOCAL GOVERNMENT FINANCE BILL

STATEMENT OF INTENT

Rates Retention Scheme: The Safety Net and Levy

Introduction

1. The Rates Retention Scheme will include a safety net to protect local authorities from significant negative shocks to their income by guaranteeing that no authority will see its income from business rates fall beyond a set percentage of its spending baseline.

2. The safety net will be funded by a levy on the disproportionate financial benefits that some authorities will experience as a result of business rates growth, caused by the uneven distribution of business rates bases and the different spending needs of local authorities.

3. The Local Government Finance Bill provides for the safety net and levy through the making of regulations about the calculation and operation of safety net and levy payments due to and from authorities. This Statement of Intent provides information about the Government's current proposals for the content of those regulations and reflects discussions on the detail of the scheme held to date with the sector in the Local Government Finance Working Group and Systems Design Sub-Group. A glossary of key terms as used throughout this paper is attached at Annex A.

Policy background

4. The Government's consultation *Local Government Resource Review: Proposals for Business Rates Retention*[1] set out the intention to levy a share of the disproportionate financial benefit that some local authorities with greater business rates bases than their spending baselines could experience as a result of increases in the business rates base.

5. The proceeds of the levy would be used to fund a safety net to help manage large, unforeseen negative volatility in individual authorities' income. *Technical Paper 5: Tariff, Top up and levy options*[2] sets out in more detail various options for applying the levy, and the operation of a safety net.

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[1] http://www.communities.gov.uk/documents/localgovernment/pdf/1947200.pdf
[2] http://www.communities.gov.uk/documents/localgovernment/pdf/19695901.pdf

6. The Government consulted on three different levy applications:

- fixed rate: a levy based on pence in the pound with the same rate for all authorities;

- banded: a levy based on pence in the pound but with a banding approach that would see authorities assigned into different bands with different levy rates; or

- proportionate: creating an individual levy rate for each local authority which allowed the retention of increases in spending baseline in an equivalent proportion to increases in the business rates base.

7. And two safety net approaches:

- a safety net triggered if an authority experienced a drop of more than a certain percentage in its business rates compared to the previous year; or

- a safety net triggered if an authority's business rates dropped by more than a certain percentage below its spending baseline.

8. Following consultation, and having regard to the responses received, the Government concluded that:

- a proportional levy would best serve the overall incentive effect that the rates retention scheme seeks to create, whilst ensuring the most equitable approach to ensuring authorities receive the benefits of the efforts they put in to achieve business rates growth; and

- a safety net providing support when a local authority's income drops by more than a set percentage below its spending baseline would best ensure the balance between protection for services and maintaining the incentive effect.

<u>Local Government Finance Bill</u>

9. Parts 6 and 7, (paragraphs 17 to 29) of new schedule 7B to the Local Government Finance Act 1988, as inserted by Schedule 1 to the Local Government Finance Bill, provide the framework for the operation of the safety net and levy within the rates retention scheme.

10. Part 6 creates the accounting framework for the safety net and levy. It requires the creation by the Secretary of State of a separate levy account, the credits and debits to which are tightly controlled to ensure transparency. There is no scope for funds in the levy account to be used for any other purpose than to make safety net payments to local authorities, or in the event that the account is left with a surplus, for that surplus to be returned to local authorities.

11. Part 7 puts the operational framework in place, with provision for the calculation, and making of, safety net and levy payments to and from local authorities to be set out by the Secretary of State in regulations. Requirements are placed on the Secretary of State in paragraphs 21 and 24 to make the calculations each year and paragraphs 22 and 25 require authorities and the Secretary of State to make levy and safety net payments respectively if the calculations show such payments are due.

Regulations

12. The regulations will set out the detailed calculations the Secretary of State will make to determine whether an authority is to:

    - make a levy payment to the Secretary of State; or
    - receive a safety net payment from the Secretary of State.

13. In order to calculate whether an authority is liable to make a levy payment, or will receive financial support from the safety net, the Government will first need to be able to measure the change in an authority's income during that financial year. Given the known volatility in the rating system, the Government proposes to measure this change by comparing an authority's income for the year against its index linked spending baseline for the year.

14. The Bill provides for the calculations to be carried out after the end of each financial year and the Government therefore proposes to make the safety net and levy payment calculations after the end of each financial year on the basis of final outturn data. This will avoid the need for multiple calculations to be carried out – first using forecast data, and then reconciling those forecast calculations against the outturn position.

15. Having measured the change in income, the safety net threshold and levy ratio and levy parameters will be applied to determine whether a payment is due to or due from the authority.

Safety net threshold

16. Safety net payments will ensure that an authority's income does not drop below more than a set percentage of its index linked spending baseline. Where an authority's income for the year is less than its spending baseline for the year, the change in income will be compared against the safety net threshold to determine whether a safety net payment is triggered, and the amount of safety net payment due.

17. If an authority's income has dropped below the safety net threshold, the authority will receive safety net payments to take income to the threshold level. If the income has not dropped below the safety net threshold, no safety net payment will be made.

18. The Government proposes to set the safety net threshold in the range 7.5% to 10% below spending baseline. The final safety net threshold percentage is yet to be decided, but by way of example, a 10% safety net threshold would mean that no authority would see more than a 10% drop in retained income from business rates. (i.e. safety net payments would be made to take the authority's income up to 90% of its spending baseline where income had dropped below that level).

19. The Government will be discussing the safety net range with the local government sector in the coming weeks before publishing the proposed safety net threshold in summer as part of its consultation on the detail of the rates retention scheme.

Levy ratio

20. The safety net will be funded by the proportional levy which will recoup a share of the disproportionate financial benefit some authorities will see as a result of business rates base increases. Where an authority's income for the year is greater than its index linked spending baseline for the year, the authority's levy rate will be applied to the difference.

21. The Government proposes to set the proportional levy ratio at 1:1, meaning that for every 1% increase in business rates base, an authority would see no more than a corresponding 1% increase in income as measured against its spending baseline. At the 1:1 levy ratio, only tariff authorities can be levied, since top up authorities, by their very nature, will not be able to achieve more than 1% increase on their spending baseline for every 1% increase in business rates base.

22. The formula for calculating an individual authority's levy rate will be:

$$1 - \left(\frac{\text{spending baseline}}{\text{business rates base}} \right)$$

If the above calculation produces a negative levy rate, a zero levy rate will apply (i.e. the authority will not be levied).

Income definition

23. Alongside the safety net threshold and levy ratio, the definition of income for the purposes of measuring the change in income against the spending baseline will be a key feature of the regulations.

24. The Government intends that the definition of income used to measure the change in an authority's income should be the same for the purposes of calculating both whether a levy payment or safety net payment is due to be made to ensure consistency of approach. The definition of income will however be different for billing authorities and major precepting authorities.

25. Major precepting authorities will have two income streams under the rates retention scheme: income received from billing authorities, reflecting the major precepting authority's share of the business rates collected in its area, and any top-up payments due from the Secretary of State and the intention is that the income definition will reflect this[3].

26. For billing authorities, the Bill provides that the regulations may make provision for the calculations of the levy and safety net payments to be made by reference to the total paid to it in respect of the year under sections 43 and 45 of the Local Government Finance Act 1988[4], subject to such adjustments as may be specified and/or any payments received from the Secretary of State.

27. Taking the total paid to a billing authority in respect of the year under these sections without adjustment would simply give the gross amount of rates due to a billing authority. It would not reflect the amount collected or retained by the billing authority after central share and major precepting authority payments have been made for example.

28. As such, the Government intends that the definition of income for billing authorities will include a number of adjustments to deal with a range of issues, including:

- Central share payments
- Payments to major precepting authorities
- Tariff and top ups
- Reliefs (mandatory and discretionary)
- Costs of collection
- Losses in collection
- Income in respect of areas and classes of hereditament as set out in Part 10 of the Bill

29. The precise treatment of these issues in the income definition is still being considered and the Government has been working through the detail of the business rates retention scheme with the Local Government Finance Working Group. The Government will consult on the precise definition of income for the purposes of calculating levy and safety net payments over the summer.

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[3] The Government intends that major precepting authorities will be top-up authorities. However, in theory it is possible for such authorities to be required to pay a tariff and the precise definition of income will reflect this possibility.

[4] Section 43 of the Local Government Finance Act 1988 is the ratepayer's liability to pay business rates in respect of occupied hereditaments on the local rating list. Section 45 is the ratepayers liability to pay business rates in respect of unoccupied hereditaments on the local rating list.

Annex A

GLOSSARY OF KEY TERMS AS USED IN THIS PAPER

Business rates base
Derived by dividing the national business rates base between billing authorities on the basis of their average contribution to the current national pool over several years.

Central share
The percentage of business rates that will be paid to central government and re-distributed to local government.

Disproportionate financial benefit
The relationship between an authority's business rates base and its spending baseline. Authorities with a business rates base significantly higher than its spending baseline will experience disproportionate financial benefits to its spending baseline when compared with an increase in its business rates base.

Income
Used throughout this paper to mean to an authority's income from business rates after taking account of central share, major precepting authority payments, tariffs and top ups as appropriate to that authority.

Local share
The percentage of business rates retained by local government.

Spending baseline
Based on the formula grant distribution. An authority's spending baseline level will provide a stable starting point for the rates retention scheme.

Tariffs and top ups
Achieve a one-off rebalancing of resources to ensure that no authority is worse off as a result of its business rates base at the outset of the scheme. An authority will pay a tariff if its business rates base is more than its spending baseline level. An authority will receive a top up if its business rates base is less than its spending baseline level. Tariffs and top ups will be self-funding, fixed at the start of the scheme and index linked to RPI in future years.

Tariff authority
An authority with a higher business rates base than its spending baseline level, and which therefore pays a tariff.

Top up authority
An authority with a lower business rates base than its spending baseline level, and which will therefore receive a top-up.