Local Government Resource Review: Proposals for Business Rates Retention Consultation - Government Response

A Plain English Guide

How are councils currently funded?

At the moment, councils receive their funding from three main sources:

- grants from central government
- council tax
- other locally generated income (such as fees and charges for services)

Central government grants can be received as:

- ‘specific grants’, which can come with restrictions on how they are spent
- ‘formula grant’, which has no restrictions and can be used by a council for any purpose

Formula grant funds a wide range of local services, including children’s services, adult social services, police, fire and rescue services and highways maintenance. It is given to all councils through a complicated technical process.

The biggest component of formula grant funding is redistributed business rates (also known as National Non-Domestic Rates). Business rates are collected by local authorities from businesses in their areas (like shops, offices, warehouses and factories) but they are then paid into a central pool and then given back to all local authorities as part of formula grant.

This system means that the levels of funding councils currently receive is not connected to the level of business rates they are able to collect.

Why are we changing the system?

Our local government finance system is one of the most centralised in the world with councils getting more than half of their income from central government grant.

Local authorities have no direct financial incentive to promote business growth in their area as they do not receive any of the business rates receipts from new developments.

Councils can actually face a financial disincentive because of the increased costs to them of having more businesses in an area, for example because of more traffic and the cost of providing services to those businesses.

This can make it very difficult for councils to get support from their communities for new business developments. That can mean that new businesses are not given the support they need to grow.

The changes we are making will enable councils to keep a share of growth in business rates in their area. This will make councils more financially independent and give them a strong financial incentive to promote local business growth.

We do not propose to make any changes to the way businesses pay tax or the way that this tax is set. Rate setting powers are under the control of central government and will remain so.

There will also be no changes to the existing reliefs available to eligible ratepayers including small businesses, charities, sports clubs and the voluntary sector.

Managing the scheme within the current financial climate

The new business rates retention scheme must not put our deficit reduction programme at risk. To ensure this, when setting up the scheme in 2013-14, we will decide what share of business rates can be kept by councils – *the local share*. The remaining share of business rates, *the central share*, will be paid into a central pool and then redirected to the local government sector through other grants.

This will allow us to ensure that the scheme operates within spending review control totals and protect the interests of the wider economy.

We will be able to alter the size of the local share in future years if this is necessary to maintain affordability and protect the interests of taxpayers.

In setting the local share, the Government will take into account the need to create a strong incentive to encourage councils to promote local growth.

Our proposals

At the start of the scheme there will need to be a stable starting point for all councils so that no council is worse off because it has a lower business rates income than other councils.

Where councils have a larger business rates base than their current spending we will take away some of this business rate income as a *tariff*.

Where councils have a smaller business rate base then their current spending, we will *top up* those authorities.

Tariffs and top ups will be paid by local authorities every year. The level of tariff and top up will remain fixed but will increase in line with the Retail Price Index

A council's spending level in year one (at the start of 2013-14) will be called their *baseline funding level*.

By fixing the level of tariffs and top ups we will ensure that the growth in business rates that a council achieves will be kept by them. By increasing the tariff and tops ups in line with inflation we will go some way to protecting the ability of top up authorities to maintain the services they deliver.

In addition to retaining the local share of their business rates baseline, councils will also be able to keep the local share (x percent) of all their business rates growth. This means that the more an authority grows its business rates base the better off it will become.

Some councils, who have a large amount of business property in their area, may stand to gain a disproportionate increase in their spending power from business rates growth. Where this happens, we will take back a share of their growth (called a *levy*).

We will set the levy so that for every council, the percentage increase in their business rates growth cannot result in more than the same percentage increase in their spending power.

The money collected through this levy will be used to give financial help, *a safety net*, to authorities who see their income drop by a set percentage below their baseline funding level. This might happen, for example, if a major business in their area closes.

Councils' baseline funding levels will be increased by inflation (measured through the Retail Price Index) when we decide whether a council is eligible for financial support from the safety net. This will ensure that the protection given to councils by the safety net remains the same in real terms over time.

There may come a time when the spending needs of councils become out of balance with the resources that they receive. In this situation, we could *reset* the tariffs and top ups of business rates on councils. We could also choose to reassess local service needs.

Our aspiration is that the system would only be reset every 10 years. However, in exceptional circumstances, a reset could be required outside of this period.

Some areas of the country have both county council and district councils. These are called *two-tier areas.* To ensure that our proposals provide a strong incentive to increase growth it is right that the greatest reward, and risk, is placed on the tier of government which has the most levers over growth.

District councils in two-tier areas are generally responsible for planning decisions and therefore have the strongest levers over growth.

In two-tier areas, district councils will retain the greatest share, around 80%, of business rate growth on the local share in the area. This will ensure that the incentive to grow business rates is placed on the right councils.

County councils in two-tier areas, who deliver key services such as childrens services and adult social care, will all be top up authorities. This will go some way to protecting their ability to maintain these services.

Councils will be able to group together voluntarily to pool their business rates and collaborate on promoting growth in their area. This could be particularly the case for areas where there are local enterprise partnerships which are joint bodies made up of councils and local businesses. These pools would share both the risks and rewards of the scheme.

Our proposals will give councils the certainty they require to borrow money if they wish to against future business rate growth so that they can fund key infrastructure projects in their areas. This is called Tax Increment Financing in the consultation document.

What do these proposals mean for you?

Members of the general public will find that their local council's budget is more strongly linked to local business growth. The more local authorities grow their business rates, the more they will have to provide local services and to invest in communities. Our proposals will also protect the spending power of councils to ensure that they are able to meet local service needs even if they suffer a significant decrease in their business rates base.

Businesses will see no change to the way in which their business rate bills are calculated. We are not proposing any changes to the way in which properties are valued or business rates levels are set. But you will have more impact on the council budgets in your area. Councils will also have more incentive to work closely with the Valuation Office Agency to ensure that all businesses in the area are having their properties valued correctly and are paying the right amount of tax.

Developers will find that councils have greater incentives to grant planning permissions for appropriately-sited and well-planned non-residential development and to push for more growth. This is especially true of new renewable energy projects that start paying business rates from year one of the system, as councils will keep all of the business rates paid by the projects. Councils will also have more opportunity to borrow against future growth in business rates, through Tax Increment Financing which allows authorities to borrow against future growth in business rates, in order to finance infrastructure development.
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Billing authorities (district councils and unitary authorities) will still bill and collect rates as now. But instead of giving all their rates to government for a central pool they will get to keep a proportion of their business rates. Their baseline level of funding will be set so that at the start of the new system their budget is equivalent to what it would have been under the current system. From then on, if their business rates base grows then their funding will grow, and if their business rates base decreases then their funding could decrease although they may be entitled to protection from the safety net.

County councils will receive a share of business rates from the district councils in their area and a top up, if this is relevant rather than receiving formula grant. Their baseline level of funding will be set so that at the start of the system your formula grant funding is equivalent to what it would have been under the current system. From then on their funding will grow if the business rates base in your area grows, but their funding could also fall if their business rates base declines although they may be entitled to protection from the safety net.

The police sector will receive the level of funding in 2013-14 and 2014-15 agreed in the spending review. Their funding will not be affected by fluctuations in business rates in your area. The way in which they are funded will be fully reviewed in time for changes to be made at the next Spending Review, from 2015-16.

All fire and rescue authorities will be funded through a percentage share of each district or borough council's billing authority business rates baseline before any tier split has occurred. They will be given a top up to bring their funding up to their baseline funding level.

Published by the Department for Communities and Local Government,
December 2011.

ISBN: 978 1 4098 3284 3