



Ministry of Housing,
Communities &
Local Government

Business Rates Retention Reform

Sharing risk and reward, managing volatility and setting up
the reformed system



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Ministerial foreword

Local government is rightly ambitious for the places and people it represents and in its desire to be in the driving seat when it comes to boosting local economic growth.

To that end, councils have told us they want greater control over the money they raise locally. We have listened and responded by committing to greater business rates retention. This gives local authorities powerful incentives to grow and reinvest in their local economies; rewarding their efforts to plan ahead. Under the current scheme, local authorities estimate that they will receive around £2.4bn in business rates growth in 2018-19.

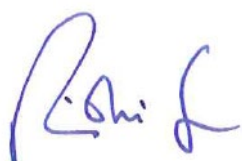
In the move to greater rates retention, we have worked with the Local Government Association and the sector to ensure we get the system that underpins it right; including supporting elements such as resets, the safety net and the levy, to ensure it is robust and less complex.

This work has helped us identify the main elements on which we are consulting. Local authorities, for example, told us they were concerned about the disproportionate volatility caused by appeals and other valuation change within the current business rates system and we have responded. As a result, this consultation outlines an alternative approach to the administration of the future business rates system; helping not only remove the impact of appeals on local authorities, but also provide certainty around funding and greater flexibility.

I hope councils and those who represent them will take the opportunity to respond to this consultation and help build a strong system that works well and enables local areas to thrive.

Minister for Local Government

Rishi Sunak MP



December 2018

Scope of the consultation

Topic of this consultation:	This consultation seeks views on options for the reform of elements of the business rates retention system in England from 2020-21 onwards.
Scope of this consultation:	Elements of the business rates retention system in England.
Geographical scope:	These proposals relate to England only.
Impact Assessment:	No impact assessment has been produced for this consultation.

Basic Information

To:	The consultation will be of particular interest to local authorities and representative bodies for local authorities. It may also be of interest to business rates payers responsible for network hereditaments, such as telecommunication and railway hereditaments.
Body/bodies responsible for the consultation:	Local Government Finance Directorate within the Ministry of Housing, Communities and Local Government
Duration:	This consultation will last for 10 weeks from 13 December 2018 to 21 February 2019.
Enquiries:	For any enquiries about the consultation please contact the Local Government Finance Reform System Design Team: BRRSystemDesign@communities.gov.uk
How to respond:	In order to respond you will need to complete the consultation response pro-forma published alongside this consultation paper. Additional information or evidence may be provided in addition to the completed pro-forma. Pro-forma responses and any additional information or evidence should be sent by email to: BRRSystemDesign@communities.gov.uk Written responses may also be sent to: Local Government Finance Reform

Local Government Finance Directorate
Ministry of Housing, Communities and Local Government
2nd floor, Fry Building
2 Marsham Street
London
SW1P 4DF

When you reply it would be very useful if you confirm whether you are replying as an individual or submitting an official response on behalf of an organisation and include:

- your name;
- your position (if applicable);
- the name of organisation (if applicable);
- an address (including post-code);
- an email address;, and
- a contact telephone number.

1. Introduction

1.1 Background

- 1.1.1 Business rates retention was introduced in April 2013 and was designed to recognise the vital role that authorities play in their communities by giving them more control over the money they raise locally; removing the ring-fencing of incorporated grants and promoting and rewarding local economic growth, thus increasing overall revenue in the system. Before this, business rates were paid over to central government before being redistributed to authorities according to the allocation of formula grant.
- 1.1.2 The Government is currently in the process of reviewing the components of the business rates retention system, both individually and in aggregate, and the role they can play in providing a strong incentive for local authorities to grow the business rates in their area while minimising complexity. This reform of the system fits well with the Government's aim to introduce 75% business rate retention in 2020, in a way that is fiscally neutral. However, the Government also believes that these reforms stand on their own merit.
- 1.1.3 There have been two previous consultations on greater business rates retention and the design of the system: [Self-sufficient local government: 100% Business Rates Retention](#), published in July 2016 and [100% Business Rates Retention. Further consultation on the design of the reformed system](#), published in February 2017. The Government published responses to these consultations in [February 2017](#) and [December 2017](#).
- 1.1.4 These previous consultations were intended to culminate in the implementation of measures in the Local Government Finance Bill, which fell in 2017 when the General Election was called. In the absence of short-term opportunities to bring forward primary legislation, the Government has been considering options for reform in 2020 within the existing legislative framework.
- 1.1.5 The Government would particularly like to thank the Local Government Association (LGA), as well as other stakeholders and individual authorities, for their work alongside the Ministry of Housing, Communities and Local Government to develop these proposals. This consultation is the culmination of a series of technical papers considered by the Business Rates Retention Steering and Working Groups, led jointly by the department and the LGA, over the past year. These papers are published by the [LGA on their website](#) and offer in depth consideration of each element of the system.

- 1.1.6 The reform of the business rates retention system will sit alongside wider changes to the local government finance system which the Government aims to introduce in 2020; notably the review of relative needs and resources, which will review the relative needs and resources of all local authorities, and the upcoming Spending Review, which will set the overall level funding for local government.

1.2 About this consultation

- 1.2.1 The Government's ambition for business rates retention remains two-fold: to **give local government greater control over the money it raises**, recognising that local authorities are best placed to decide local priorities, and to incentivise local authorities to **support local economic growth**. The Government's commitment to further business rates retention was re-confirmed in the [Industrial Strategy building a Britain fit for the future](#) in 2017.
- 1.2.2 As such, the business rates retention system is designed to transfer a level of **risk and reward** to local authorities, allowing growth or decline within a local economy to be reflected in an authority's business rates income. These are principles which will remain at the heart of the future system. [Chapter 2](#) of this consultation makes 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.
- 1.2.3 The Government acknowledges that the business rates retention system is complex and has not always been flexible. The Government also recognises that there is a level of disproportionate volatility in the current system and is committed to reducing the impact on local authority income of factors outside of an authority's control. [Chapter 3](#) of this consultation therefore makes a set of proposals designed to **mitigate volatility in income** and **simplify the system**, responding to the findings of the recent [Local government finance: review of governance and processes](#). These proposals will simplify the administration of business rates retention, significantly reducing the impact of valuation change and appeals on individual authority income and updating the balance between hereditaments held on the central and local lists.
- 1.2.4 Finally, [Chapter 4](#) contains the Government's initial proposals about **how to set up the new business rates retention system in 2020** – specifically, the chapter invites views from local authorities on the operational steps that may be necessary to set accurate Business Rates Baselines.

1.3 Scope

- 1.3.1 The scope of the consultation will be the reform of aspects of the business rates retention system in England, which the Government aims to implement in 2020.
- 1.3.2 How local authorities transition from the current system to a reformed system and how reforms are operationalised are not being consulted on at this point; the Government expects to consult on these in 2019.
- 1.3.3 The upcoming Spending Review will determine the spending envelope for local government and therefore the quantum of funding available to local authorities is outside of the scope of this consultation.
- 1.3.4 The Government notes the interaction between business rates retention and other policies such as Community Benefit for new nuclear power stations and incentives for renewable energy. These existing policies are outside of the scope of this consultation.

1.4 Next steps

- 1.4.1 It is the Government's aim to introduce reform of the business rates retention system in 2020-21. The table below sets out the key dates in the period prior to expected implementation.
- 1.4.2 The department will hold a series of events across England whilst this consultation is open, in collaboration with the Local Government Association, and encourages respondents to engage with these.

December 2018	This consultation on the reform of the business rates retention system opens. The Government invites responses by 21 February 2019. These responses will help shape specific proposals across all aspects of how the reformed system is designed and implemented.
Winter 2019	Whilst this consultation is open, MHCLG will continue to engage with the sector and interested parties on aspects of the consultation and be available to answer any queries respondents may have. A series of regional events will take place and respondents are also welcome to email questions to BRRSystemDesign@communities.gov.uk .

Spring 2019	After the consultation closes, the responses will be analysed. The department will continue to work with the Sector following this.
Summer / Autumn 2019	The Government will publish a further consultation on the proposed reform of the system including details of implementation and transition. Decisions will be taken, following this consultation, outlining the reforms to be implemented in 2020/21.
Winter / Spring 2020	The department will work with local authorities in helping them implement reforms, ready for 2020-21.

2. The balance of risk and reward

2.1 Introduction

2.1.1 The Government believes that if local authorities are going to keep a share of the benefits of growth through the business rates retention system then they should also take on a share of the risk. However, the context for local authorities will be different in 2020 than it was in 2013. This section of the consultation will cover how the system should be reset on a regular basis, the tier split between district and county councils, proposals to reform the levy and the level of the safety net. Together, these elements of the system help determine the balance of risk and reward within the business rates retention system.

2.2 Resetting Business Rates Baselines

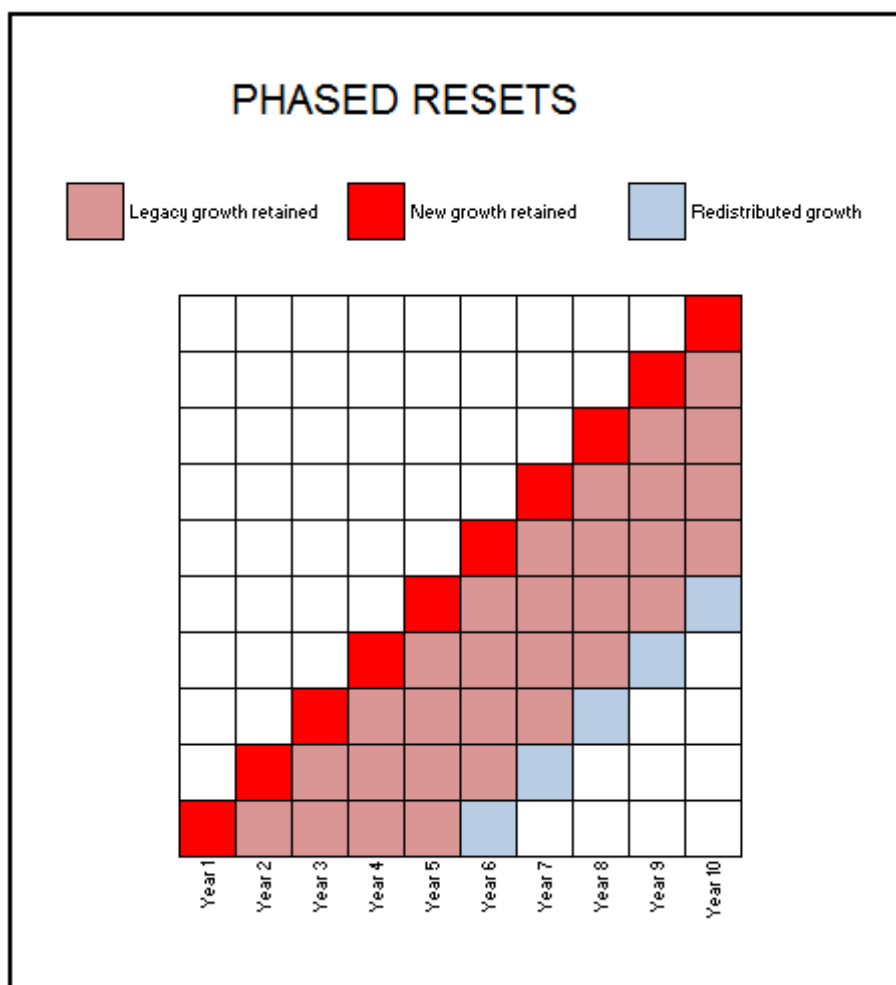
2.2.1 The resetting of Business Rates Baselines (BRBs) is one of the strongest levers determining the tone of the reformed system, because it will dictate the strength of the growth incentive for individual authorities by determining the amount of business rates growth they retain and for how long.

2.2.2 At an individual authority level, under the current 50% business rates retention system, the amount of business rates income retained is determined by the relationship between Baseline Funding Level (BFL) and Business Rates Baseline. Baseline Funding Level is the level of business rates income allocated to meet an authority's need, as determined by the Local Government Finance Settlement.

Business Rates Baseline is the amount of business rates income an authority is predicted to raise. Where a local authority's Business Rates Baseline is greater than its Baseline Funding Level, the authority pays the difference as a tariff and this is redistributed to the sector. Where Business Rates Baseline is less than Baseline Funding Level, the authority receives the difference as a top-up.

- 2.2.3 At a reset, Business Rates Baselines are re-calculated for the forthcoming reset period for all local authorities. During this period, growth in the authority's locally raised business rates (and so income) can be retained above its Baseline Funding Level (currently at 50%, which is the local share under 50% business rates retention).
- 2.2.4 The system requires resetting in order to ensure that the distribution of resource remains aligned with need. If the system is reset too frequently, then the growth incentive may be weakened and local authorities may be discouraged from building achieved growth into their base budgets or using growth for long-term investment. However, resetting too infrequently could mean that relative need grows faster than local tax resource.
- 2.2.5 As previously announced at the provisional local government finance settlement 2018 to 2019, the Government intends to carry out a full reset of Business Rates Baselines in 2020-21. This will allow full implementation of reforms to the business rates retention system, the findings of the review of relative needs and resources, and the Spending Review. The approach to the reset in 2020-21 and for the future resets after this point need not be the same; the way the system is set up to facilitate optimal implementation will not set a precedent for resetting Business Rates Baselines in the future. This consultation seeks views on resets *after* 2020-21 and not what happens at the transition to the reformed system, which will be consulted on later.
- 2.2.6 This consultation seeks views on:
- a. The most desirable type of reset; and
 - b. The time period that a reset should cover.
- 2.2.7 The Government's view is that the most desirable reset option will provide a strong incentive for growth, allowing authorities to see the benefit of their locally raised income and also incentivising local authorities to take a strategic and long-term view and align their policies and practices around maximising growth in business rates.
- 2.2.8 It is desirable that all growth is treated equally within the system, regardless of when it occurs in a reset cycle. Good planning is not supported by 'cliff edges' which arbitrarily determine if an authority will benefit from growth or not and create a perverse incentive as to when growth comes 'on stream'. The Government therefore favours options that minimise these 'cliff-edges'.

- 2.2.9 As with all elements of the system, a reformed approach to resetting Business Rates Baselines would not create unnecessary complexity, where possible. It is important that it is clear and predictable to authorities how the reset works. Reformed resets should also be as easy as possible to implement for both local and central government, minimising extra burdens and creating greater predictability in a transparent way.
- 2.2.10 The previous Further Consultation sought views on partial resets and full resets.
- 2.2.11 Under a **partial reset**: Business Rates Baselines 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 percentage retained by individual local authorities. This percentage is yet to be determined and the Government welcomes views on this. It is not expected that authorities experiencing decline in their rates would retain this entering a new reset period. The retention of some growth into a new reset period smooths 'cliff edges' and supports longer term planning. However, it is imagined that there would still be intermittent full resets (for example every 15 years). Partial resets were well received by respondents to the Further Consultation, with 83% indicating support.
- 2.2.12 Under a **full reset**: no growth is retained into the forthcoming reset period. This creates 'cliff-edges' at the end of each reset period and creates a perverse incentive for authorities to control when growth comes 'on stream'. Because this type of reset does not meet the Government's criteria outlined above and after consideration of sector support for partial resets over full resets when responding to the Further Consultation, full resets at the end of every reset period are being ruled out.
- 2.2.13 Partial resets remain in consideration. However, the Government also believes that phased resets could be more desirable on the application of the criteria outlined in paragraphs 2.2.7 - 2.2.9 and the Business Rates Retention System Design Working Group supported further scoping of this option. The advantage of this type of reset is that it would help to smooth out 'cliff-edges' and could offer improved stability and certainty for authorities, whilst still allowing them to benefit from local growth.
- 2.2.14 Under a **phased reset**: authorities retain each year's growth (or loss) in rates 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. The diagram below illustrates how a phased reset works. It uses a five-year period with a full, as opposed to partial, reset for illustrative purposes, although any time-period and any percentage of reset could be chosen. Each year, a new year's growth is added to the amount retained by the authority up to a maximum of five years' worth of growth. In the sixth year, the first year's growth is redistributed amongst all local authorities according to Baseline Funding Levels. Thereafter, each year sees the current year's growth added to the amount retained and an historic year's growth redistributed.



2.2.15 Further work will need to be carried out on reset options to scope transition from the current system, including how to reach year five if the Government implements phased resets.

2.2.16 The time period between resets will also need to be determined. The previous consultation proposed a 5-year time period between resets. This was well received by respondents, with 44% in support, 19% proposing a different time period and 37% expressing no opinion. Those in support felt this period struck a good balance between incentivising growth and providing for redistribution to meet need.

2.2.17 The Government has since announced that business rates revaluations will happen every three years. Aligning resets and revaluations could have some benefit because it reduces, marginally, the scale of the disruption to tariffs and top-ups in

any year. However, it is worth noting that as things currently stand, MHCLG will have to adjust tariffs and top-ups in the revaluation year, the following year and (to some extent) the year after that, to ensure accuracy. Therefore, in a three-year cycle, there will be adjustment to tariffs and top-ups every year (as there would be if a phased reset is implemented). Respondents are asked to consider whether the frequency of resets aligned with the frequency of revaluations are desirable (i.e. multiples of three years).

2.2.18 The Government is continuing to work to understand how reset options interact with future pending review periods and the output of the review of relative needs and resources.

Question 1: Do you prefer a partial reset, a phased reset or a combination of the two?

Question 2: Please comment on why you think a partial / phased reset is more desirable.

Question 3: What is the optimal time period for your preferred reset type?

2.3 The safety net

2.3.1 The Government believes that the business rates retention system should remain one of risk and reward for local authorities. A strong growth incentive means that local authorities should take on the risk of decline as well as the reward for any growth in business rates.

2.3.2 The safety net is the mechanism that ensures that this risk is proportionate and sustainable at an individual local authority level when shocks to the system occur, such as the closure of a major ratepayer. It ensures that no authority falls below a minimum level of their assessed need, currently expressed as a percentage of Baseline Funding Level.

2.3.3 The Further Consultation re-affirmed the current approach to the safety net: that it should continue to function as a 'simple' safety net whereby local authorities bear some of the risk but will receive help when business rates income reduces below a certain level. It asked respondents to consider the level at which the safety net should be set. 73% favoured raising the threshold to between 95% and 100% of Baseline Funding Level.

2.3.4 The likelihood that an authority will require a safety net payment is very much a function of other elements in the system. For example, appeals and other valuation change have a strong bearing on volatility of income at a local authority level. Therefore, it is appropriate that the level at which the safety net is set be determined when decisions have been made on the wider system. At present the

safety net is set as 92.5% of Baseline Funding Level, the 100% business rates retention pilots have a safety net of 97% of Baseline Funding Level, and the 75% business rates retention pilots will have a safety net of 95% of Baseline Funding Level. Subject to the evaluation of the pilots, the Government expects the safety net in the reformed system to fit within this context.

- 2.3.5 Within the current system the safety net is funded through two sources: the levy and a top slice of Revenue Support Grant (RSG). Between 2013-14 and 2016-17 safety net payments totalled £439 million and levy payments raised £241 million. The Government expects that the safety net will continue to be funded through the levy account and a top-slice, this time on business rates income (as opposed to RSG). If the levy were to be reformed, as discussed in section 2.4 of this consultation, it would provide less income to fund safety net payments and so a higher proportion would need to be funded through a top-slice.
- 2.3.6 The Government believes that funding more of the safety net through a top-slice is fairer because the cost will be shared by all authorities – effectively a form of collective mutual insurance for all local authorities – and not just those who have achieved growth.
- 2.3.7 The level of the safety net will affect the size of top-slice that will need to be made. However, it is anticipated that the cost of safety net payments could be lower following the reform of other elements of the system, for example if phased resets were introduced alongside addressing appeals and other valuation change.

Question 4: Do you have any comment on the proposed approach to the safety net?

2.4 The levy

- 2.4.1 At the 2015 Conservative Party Conference the then Government committed to ‘scrap the levy on growth’. This Government strongly believes that providing a credible growth incentive should be a feature of reformed rates retention.
- 2.4.2 Scrapping the levy would require primary legislation. However, the Government remains strongly committed to rewarding growth and is minded to reform this element of the system within the current legislative framework. This would mean raising the threshold at which the levy falls due.
- 2.4.3 Following consideration of the options, the Business Rates Retention System Design Working Group asked that the department also consider how the levy could be reformed to ensure that ‘extraordinary growth’ does not distort the fairness of the

system. 'Extraordinary' is used here in its literal sense to describe growth outside of the ordinary, for example as a function of provisions made and released. As this growth cannot be attributed to an authority's management of their local economy it is reasonable and proportionate that the levy be used as an inverse of the safety net to limit gain.

2.4.4 It would be possible to use the existing legislative framework to reform the function of the levy to address 'extraordinary growth'. Reform can also be designed to simplify this element of the system.

2.4.5 The levy is currently calculated as follows and is paid only by tariff authorities:

Levy rate = $1 - (\text{Baseline Funding Level} / \text{Business Rates Baseline})$ or 0.5, whichever is lesser

Levy payment = $(\text{retained rates} - \text{Baseline Funding Level}) * \text{levy rate}$, if retained rates > Baseline Funding Level

2.4.6 The Government proposes 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. After this point the levy should be 100% and therefore function as a cap. This would be a simpler approach, with greater predictability for authorities and would provide a stronger growth incentive, as authorities would be able to retain all growth that can reasonably be attributed to their management of their local economy.

2.4.7 The higher the threshold at which the levy fell due, the smaller the number of affected authorities. For example, using 2016-2017 data, setting the levy at 150% Baseline Funding Level would have meant 18 authorities would have been subject to it, at 200% it would have affected 7 authorities and at 250% it would have seen only 4 authorities subject to the levy.

2.4.8 This consultation seeks views on the level at which the levy should fall due (e.g. 150%, 200%, 250%, or another level).

Question 5: Do you agree with this approach to the reform of the levy?

Question 6: If so, what do you consider to be an appropriate level at which to classify growth as 'extraordinary'?

2.5 Tier splits

2.5.1 The Government is minded to retain a national tier split as an appropriate mechanism to distribute business rates income in multi-tier areas between billing and precepting authorities.

- 2.5.2 Determining an appropriate level for the tier split between counties and districts is a decision that will need to be made later in the process, following decisions on other elements of the system.
- 2.5.3 The tier split between authorities determines their gearing. This is the relationship between an authority's Baseline Funding Level and Business Rates Baseline. The greater an authority's Business Rates Baseline is as a proportion of its Baseline Funding Level the more highly geared an authority will be and so that authority will enjoy a strong growth incentive but also be exposed to greater risk. The reverse is also true, i.e. the lower Business Rates Baseline is in proportion to Baseline Funding Level the more lowly geared an authority will be and so that authority will have a weaker growth incentive but be less exposed to risk.
- 2.5.4 When 50% business rates retention was introduced in 2013, the tier split between counties and districts was established with the objective of protecting counties (and adult social care and children's services, which they deliver) from risk and incentivising districts (which determine the majority of planning cases and therefore have a strong lever to affect growth). These objectives have been successful, with no county in receipt of a safety net payment and with districts experiencing a high level of growth retention.
- 2.5.5 It will need to be determined if these are the right objectives for the reformed system. Pooling and pilots of greater rates retention have shown that all authorities have a role to play in generating growth and so this should be reflected in their growth incentives. If the levy were to be reformed, the distribution of growth would be changed and so the fairness of this distribution must be considered.
- 2.5.6 It should be noted that the gearing of counties differs not only from districts but also from other authorities, such as unitaries and London boroughs, which deliver some of the same services. There is an opportunity to use these reforms to enable similar risk and reward profiles for all authorities. Respondents to the previous Further Consultation favoured amending the tier split by 31% to 9%, which indicates an appetite for change within the sector.
- 2.5.7 The safety net will continue to ensure that risk to individual authorities is not disproportionate. Additionally, if the approach to appeals and other valuation change is also reformed then risk would also be lowered.
- 2.5.8 There is an opportunity for this decision to be sector led, with the representative bodies for counties and districts determining what the appropriate tier split between them should be. The Government will continue to engage with these authorities and seek their views following decisions on the reform of other elements of the system.

2.5.9 However, the Government recognises the need for a suitable fall-back position to be developed for the national tier split between counties and districts, in the event that an agreement is not reached.

2.5.10 The Government is also minded to allow pooled authorities to continue to be able to change the distribution of growth within the pool, if locally agreed, and so this consultation seeks views on:

- a. Appropriate principles for the reform of tier splits between county and district councils; and
- b. Whether respondents would welcome the opportunity to set their own tier split and what this should be.

2.5.11 This consultation does not seek views on an appropriate tier split between London boroughs and the Greater London Authority. The Government currently makes this decision separately, in consultation with London authorities, and this will continue to be the Government's approach.

2.5.12 It is expected that Fire and Rescue Authorities will continue to retain 1% of business rates across the area they cover.

Question 7: What should the fall-back position be for the national tier split between counties and districts, should these authorities be unable to reach an agreement?

Question 8: Should a two-tier area be able to set their tier splits locally?

2.6 Pooling

2.6.1 The Government believes that pooling is desirable and offers many benefits. It allows better planning across a functional economic area, in particular facilitating joint decision making on the strategic spending of business rates growth. It also facilitates opportunities for collaboration and friendly scrutiny, such as in a joint approach to setting provisions for appeals and other valuation change.

2.6.2 If the levy were to be reformed, a key incentive to pool will be lessened. Therefore, this consultation seeks views on how pooling can be incentivised and improved.

2.6.3 The Government will also consider how best to encourage pooling as part of its wider approach to devolution policy.

Question 9: What fiscally neutral measures could be used to incentivise pooling within the reformed system?

3. Simplifying the system and reducing volatility

3.1 Introduction

3.1.1 The Government intends for the business rates retention system to be one of risk and reward, where business rate income can be seen to reflect the conditions authorities create. However, the Government recognises that high levels of disproportionate volatility are not desirable. Furthermore, following the findings of the Hudson Review, the Government would like to see the system simplified so that it is more easily understood, more responsive to change and more straightforward for local authorities and central government to administer. This section therefore covers: a review of hereditaments on the central and local lists, the options available to deliver the Government's commitment to address volatility caused by appeals and valuation loss, and, a proposal to simplify the administration of the business rates retention system.

3.2 The central and local lists

3.2.1 The resetting of the business rates retention system in 2020-21 provides an opportunity to reassess the allocation of classes of hereditaments between the central and local non-domestic rating lists.

3.2.2 Under the Local Government Finance Act 1988, the Secretary of State has the power to designate hereditaments to the central list. Criteria to assist in this decision are also already in existence. The Government previously committed to publish a detailed description of these criteria. This was presented to the Business Rates Retention Steering and Working Groups, who endorsed it, and is now published in [Annex A](#) of this consultation. These existing criteria, used in combination to guide decisions on whether a hereditament is suitable for listing in the central list, will continue to be used to inform the Secretary of State's decisions.

3.2.3 The Government re-affirms its view 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.

3.2.4 The Business Rates Retention System Design Working Group previously considered the inclusion of a further criterion, which would have allowed high value hereditaments to be listed in the central list if they posed a risk to an authority's

short-term financial stability. However, the Government is minded to rule this out, as the safety net serves as a simpler and more consistent lever to address this type of volatility.

- 3.2.5 This consultation invites authorities and rate payers to consider whether, on application of the criteria of [Annex A](#), there are hereditaments that should be listed differently. Without prejudice to any future decisions, hereditaments which might be suitable for listing in the central list include large telecommunication networks and HS1 and examples of those which might be more suitable for listing in local lists include small independent energy networks.
- 3.2.6 Baselines will need to be adjusted where there is movement between lists, so that any movement will not impact on an authority's income. The Government therefore proposes that the most suitable time for hereditaments to move between lists is at a reset. Once a decision has been made on what type of reset will be implemented in the reformed system, options can be considered for how often it is appropriate to consider reallocating classes of hereditaments between the non-domestic rating lists.

Question 10: On applying the criteria outlined in [Annex A](#), are there any hereditaments which you believe should be listed in the central list? Please identify these hereditaments by name and location.

Question 11: On applying the criteria outlined in [Annex A](#), are there any listed in the central list which you believe should be listed in a local list? Please identify these hereditaments by name and location.

3.3 Appeals and other valuation change

- 3.3.1 The Government remains committed to addressing the impact of appeals and other valuation change on local authority income and has previously stated its intention to centralise this risk. 96% of respondents to the previous Further Consultation agreed with this approach.
- 3.3.2 Following the introduction of Check, Challenge, Appeal, the word 'appeal' has taken on a technical meaning which is narrower than the Government's previous proposals. This consultation therefore also refers to addressing 'valuation change', which covers not only changes made at the appeal stage of Check, Challenge, Appeal, but also at the check and challenge stages and also updates made outside of this process by the Valuation Office Agency (VOA).
- 3.3.3 Authorities are required, under international accounting standards, to make provisions against valuation change. Both overestimating and underestimating these provisions can cause volatility in income at a local level. It is therefore

necessary to reform how provisions are addressed alongside centralising appeals and other valuation change.

3.3.4 In order to address volatility caused by valuation change and associated provisions, MHCLG has worked with the Chartered Institute of Public Finance and Accountancy (CIPFA) to scope options to answer two central questions:

- a. How to measure the compensation due to local authorities, if business rates losses due to valuation change were to be centralised; and,
- b. How to mitigate the impact of provisions on authorities' ability to spend on services in-year using accounting adjustments.

3.3.5 The Government believes the first question can be addressed using a proxy. Under this proxy, the Government is minded to top-slice business rates income in order to compensate all changes to an authority's local list backdated to the first day of the list (i.e. the beginning of the revaluation cycle), as a 'valuation only change'. Changes not backdated to the start of the list would therefore be classified as physical changes and not compensated. Although any proxy cannot be 100% accurate, in the absence of better information, the Government believes that this proxy represents the best way to ensure that authorities are fairly compensated for valuation change outside of their control. Further detail is available in the [technical paper](#) prepared for the Business Rates Retention System Design Working Group.

Question 12: Do you agree that the use of a proxy provides an appropriate mechanism to calculate the compensation due to local authorities to losses resulting from valuation change?

3.3.6 However, options to address the second question have proved complex. Four options have been considered:

- a. **Accounting through the Movement in Reserves Statement:** the Government has considered with CIPFA whether it would be possible for authorities' provisions to be switched into an adjustment account, which would not be cleared until after appeals were settled and a compensation grant paid by central Government. This would operate in a similar way to that in which the accounting arrangements worked for the "5 year spread" of the "backdated provision", incorporated into the set up of the current system in 2013-14. Unlike the arrangements for the 5-year spread, which involved a single number identified in the 2013-14 NNDR3s, arrangements to strip out the impact of appeals would need to deal with numbers that were changing every year as authorities reassessed the provision that they needed to make. It has, so far, proved impossible to design an operational model, that can deal with this level of change. In practice it would add considerable complexity to the system and would probably require significant redesign of data requirements.

- b. **The alternative accounting solution:** the Business Rates Retention System Design Working Group suggested that an alternative solution could be to allow authorities to simply show MHCLG as a debtor in their accounts for the amount of their provision. This is being ruled out because the Government's view is that it is unacceptable under proper accounting practices which local authorities have a legal duty to follow. This is because the operative event for an authority recognising a debtor and MHCLG recognising a liability remains the point that an award is made following an appeal, not the point at which the billing authority provides funds.
- c. **Reimbursement to authorities for provisions made:** the Business Rates Retention System Design Working Group also proposed that the department could reimburse authorities for provisions made by paying Section 31 grant into their Collection Funds. All relevant authorities would then take their share of the grant and it would appear in General Funds. At the point of charging the provision, it would be paid into the Collection Fund and redistributed to relevant parties, including central government. This is being ruled out for several reasons. It is unlikely to be acceptable under proper accounting practices which local authorities have a legal duty to follow. The department would find it difficult to justify making payments to local authorities to compensate them for probable losses that, in some cases will not be realised for some years. [Managing Public Money](#) defines payments in advance of need as novel and contentious, requiring specific approval from Her Majesty's Treasury. In addition, this approach would mean that the department would pay a cash grant to offset a non-cash expense that may never be realised, which would be very difficult to justify on value for money grounds. A further concern for the department is that this approach would incentivise overestimating provisions and there would be no incentive to bring the provision back. It would also not make a distinction between the different types of list alterations (valuation only changes and developmental ones as a result of physical change to a hereditament).
- d. **Using 'line 6' of NNDR3 forms:** Part 2, line 6 of the NNDR3 currently asks authorities to provide the amount that has been charged to the provision for appeals. The Government considered whether it might be possible to use this as a proxy for the amount of compensation grant that should be paid to authorities in any year. This would not, however, achieve the primary purpose, which is to remove the impact of changes to the appeal provision from the calculation of non-domestic rating income. This is because there is no correlation between the amount charged to the appeal provision in any year and the change made to that provision for on-going appeals. In addition, not all authorities return a value for line 6 and MHCLG has been advised by others that the value returned is an "estimate", because IT systems are not capable of generating the full reduction in liability resulting from changes to rating lists.
- 3.3.7 Following the work described above, it is the Government's view that the alternative approach outlined in 3.4 below is the only option available to address the volatility arising from appeals and other valuation change.

3.4 Reforming the administration of the system

3.4.1 The Government would like to consult on a proposal to reform the way the business rates retention system is administered. This proposal was originally worked-up by members of the Business Rates Retention System Design Working Group and provides a number of benefits compared to the way the system currently operates. It offers a way of addressing the issue of volatility caused by appeals and other valuation change. It would also simplify the system and give more certainty to authorities of the level of income they can expect to see on a year to year basis. In proposing a change to the way in which business rates retention is administered, the Government is committed to retaining the core principles of the current system. These are: that business rates retention should give local authorities more control over the money they raise; that it should incentivise behaviours that boost local economic growth and that the system should reward local authorities that grow their business rates income. It is the Government's view that the reform outlined here meets this test and does not fundamentally change the nature of business rates retention.

Outline of how the reform would work

3.4.2 The business rates retention system currently operates through a system of fixed baselines and fixed top-up and tariff payments. Business Rates Baselines were calculated for each local authority at the set-up of the current system in 2013-14 based on business rates income in 2010-2011 and 2011-12. They have remained constant in real terms since set-up. Similarly, a fixed Baseline Funding Level was established, based on the Settlement Funding Assessment of local authority 'need' in 2013-14. The difference between these two figures, the top-up or tariff payments, have remained constant in real terms. Before calculating Business Rates Baselines, the Government top-sliced £1.9 billion from which authorities could make provisions for appeal losses. The distribution of the top-slice to individual authorities has therefore also remained fixed since this point.

3.4.3 Many of the reported problems in the operation of the current system are a direct consequence of these fixed elements of the system. Specifically, the provisions that local authorities are required to make to account for the impact of appeals on their business rates income mean that their actual income can differ from their notional Business Rates Baseline, solely due to the difference between actual provisions made and their share of the presumption. Increases in provisions can even wipe out the growth in business rates that authorities would otherwise have seen. The change on a year-to-year basis in provisions creates volatility in local authority income which bears no relation to actual economic conditions because top-ups and tariffs are fixed and inflexible. These are issues which have been discussed at the Business Rates Retention Steering and Working Groups on a number of occasions. The Government's proposed reform would seek to replace these fixed elements of

the system with a more flexible and responsive alternative, without fundamentally altering the overall objectives of the system or diminishing the incentive for local authorities to grow their business rates.

- 3.4.4 Firstly, the reform proposes to use local authorities' own estimates of their income from business rates – after provisions have been made – to set an accurate Business Rates Baseline each year. The Baseline Funding Level (the assessment of 'need') will be fixed, based on the outcome of the review of relative needs and resources and the Spending Review. A local authority's top-up or tariff payment will continue to be set as the difference between the two figures (Business Rates Baseline and Baseline Funding Level) but will therefore be calculated using the most up-to-date information on actual business rates income. 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, see 3.4.9 to 3.4.11). Accordingly, provisions will no longer adversely impact on an authority's income, as described in paragraph 3.4.3 above, and any perverse incentive to underestimate provisions in order to protect income levels in the short-term will be removed.
- 3.4.5 To implement this change there may need to be a change in the date that local authorities provide their estimates of business rates income and provisions. Currently this is provided through the NNDR1 forms submitted by local authorities in January. The date these forms are submitted would most likely have to be brought forward, to around September each year, for the information provided to be utilised in setting the annual provisional local government finance settlement. This is a change that can be enacted simply through secondary legislation. The department will continue to work with the sector to understand the impact on authorities, were this to be implemented, and to ensure that an unreasonable administrative burden is not created.
- 3.4.6 Secondly, a system of floating top-up and tariff payments would be used to reconcile differences between the initial estimates of business rates income provided in the NNDR1 form and the out-turn figures available after the end of the financial year through NNDR3 forms. NNDR1 estimates of individual local authority income from business rates will invariably differ from actual income recorded in NNDR3 forms for good reasons. 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, i.e. the difference between the estimates at NNDR1 and the out-turns at NNDR3 in year 1 will be incorporated into the setting of the top-up/tariff in year 2. Local authorities will have certainty of funding through business rates in any given year having provided the out-turn figures in annual NNDR3 forms.
- 3.4.7 Such a system of floating top-ups and tariffs would also provide more flexibility in how other elements of the system could be administered. For example, any future changes to business rates reliefs could be reflected in adjustments in top-ups and

tariffs in subsequent years, rather than relying on separate Section 31 grants. In a similar way, the Government could also dispense with the need for separate transitional protection payments following revaluations.

- 3.4.8 Together, if implemented, these changes in the way the business rates retention system is administered would ensure that each local authority has certainty of the amount of business rates income it will have to spend on delivering services in any given year. This will help all local authorities set their budgets and ensure that retained rates are being spent on public services in an efficient way. It would provide for a more responsive and potentially 'tidier' business rates retention system.

Risk and reward under the alternative reform

- 3.4.9 As outlined earlier in this consultation document, the Government remains committed to rewarding local authorities that grow their business rates and to a business rates retention system that balances risk and reward for local authorities. Under this reform to the administration of the business rates retention system, the Government would need to introduce a new calculation to identify the level of business rates growth (or decline) to be retained by individual authorities.
- 3.4.10 The proposal made here is designed to ensure that the growth achieved and retained by local authorities would more closely represent the actual growth achieved and would not be affected by changes in provisions. We know that in some years, for some local authorities, provisions have the impact of reducing the amount of growth that a local authority retains and this reform would reduce the likelihood of this happening. It should be noted that, whether this improvement to the operation of the system is implemented or not, the Government intends that local authorities will continue to see the benefit of the growth achieved in their local area. In other words, the system will be designed to ensure that, under 75% business rates retention, local authorities would keep 75% of their business rates growth (notwithstanding decisions taken on the levy and tier splits) and 75% of any decline (notwithstanding decisions taken on the level of the safety net).
- 3.4.11 Under the proposed reform, the Government 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 in a local area would be recognised by adjusting the following year's top-up and tariff payments, i.e. top-ups and tariffs would be used both to redistribute business rates to ensure determined need is provided for and to reflect growth. This means that 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. 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. The department will continue to engage with the sector on the details of what implementation could look like.

Further explanation

3.4.12 A more detailed guide to the proposal summarised here can be found in Annex B of this consultation. This explains the key differences between how the system would operate compared to how it currently operates. It also explains how many elements of the system can continue to operate in the same way as it currently does and how the Government would continue to ensure in a transparent way that local authorities are rewarded for the growth they achieve.

3.4.13 Regardless of whether this proposed reform is implemented, the other elements of the system being consulted on would continue to be relevant. It would still be necessary to determine the appropriate balance between risk and reward, through consideration how resets will work in the future, the future tier splits in two tier areas, and how the safety net and the levy will operate. The Government would continue to review hereditaments on the central and local lists. It may not, however, be necessary to set new Business Rates Baselines at an individual authority level, the subject of the next chapter.

Question 13: Do you believe that the Government should implement the proposed reform to the administration of the business rates retention system?

4 Setting up the system

4.1 Introduction

4.1.1 If the system is not reformed in the way set out in section 3.4, the Government will need to set new business rate baselines for 2020-21. In order to provide sufficient time for local authorities to input into the proposed approach to setting new baselines, if it is needed, the lead proposal is set out in this consultation and local authority views are invited.

4.1.2 This Chapter explains the Government's current proposal for the operational process of setting new Business Rates Baselines for the financial year 2020-21 onwards. The Government has separately committed that there will be a full reset of the business rates retention system in 2020 and therefore that all business rates growth achieved by individual authorities will be redistributed at that point, as part of

the implementation of the review of relative needs and resources. The question of transition from one system in 2019-20 to new baselines in 2020-21 will be considered separately.

4.2 Resetting baselines

- 4.3 The Business Rates Retention Steering and Working Groups have been looking at the detailed calculation of Business Rates Baselines. Any calculation will largely rely on the data provided by authorities in NNDR3 returns. Because of timing lags and the need to include within the calculation, figures for non-collection and provisions, which are accounting estimates, it is inevitable that the baselines set will be imperfect.
- 4.4 The Government proposes that, if the system is not reformed as set out in Chapter 3, baselines should represent authorities' retained business rates income as at 2019-20, the year before the reset. In this way, any growth in 2020-21 – the first year of the new reset period – will be available to authorities above their Baseline Funding Levels. The alternative of setting Business Rates Baselines as at 2020-21 would mean that any growth in 2020-21 would be built into tariffs and top-ups and would not be available to authorities.
- 4.5 Because outturn data (NNDR3s) for 2019-20 will not be available in time to set the new baselines, the Government proposes to use 2018-19 NNDR3s and uprate them by the change in the small business rating multiplier. The Government proposes to use a single year's data to set baselines, rather than an average of two years data, as was done in 2013-14. It also proposes to construct baselines "bottom-up" – i.e. for each individual authority based on its 2018-19 NNDR3, rather than setting an aggregate that is then divvied-up between authorities, as happened in 2013-14.
- 4.6 In calculating billing authority baselines the Government will use data for net rates payable from 2018-19 NNDR3s. As set out above, from this it will be necessary to make deductions for non-collection and appeal provisions. Further deductions will also be made for "disregarded amounts" based on 2018-19 NNDR3s – i.e. Designated Areas, amounts retained in respect of renewable energy and shale gas, the cost of collection allowance and the City of London offset.
- 4.6.1 In summary therefore, the calculation will be:
- a. Net rates payable
 - b. (less) amount for allowance for non-collection
 - c. (less) amount for "provisions"
 - d. Less disregarded amounts

- 4.7 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.
- 4.8 The two most difficult deductions to calculate accurately are those for non-collection and appeal provisions. In working out the deduction for non-collection, because NNDR3 figures for non-collection can change considerably from one year to another, it would not be optimal to rely on a single year's data to fix the baseline. The Government proposes therefore to use an average of more than one year's data. Respondents are asked to consider how many years' data should be used in constructing the average.
- 4.9 There is a similar difficulty in working out the deduction for the appeal provision. The deduction needs to be the best possible estimate of the amount of businesses rates that is currently collectible from ratepayers but cannot be counted as "income" because, ultimately, it will be repaid to businesses following successful appeals. This amount is potentially large – nearly £900 million was added to provisions in 2017-18 – and therefore the impact on Business Rates Baselines of over- or under-estimating the deduction is potentially significant.
- 4.10 There are a number of possible options for working out the deduction – three of which are set out here:
- a. The Government could base the deduction on authorities' own estimate of provisions as evidenced by their 2018-19 NNDR3s. In NNDR3s authorities provide a figure for the change to their provision. This reflects both their view of the provision needed for future appeal losses and any one-off change needed as a result of having previously under- or over-provided for appeal losses. It also reflects changes made to provisions for both 2010 and 2017 list appeals. In order to determine the adjustment to be made to the net rates payable figure on NNDR3s, the Government would need to be able to deconstruct the figure, so that only the element of the provision that relates to future appeal losses on the 2017 rating list is deducted.

Therefore, the Government would ask authorities in completing NNDR3s for 2018-19, to provide a breakdown of the figure in Part 2, line 7: "Changes in provision for appeals" between the 2010 and 2017 rating lists. The Government would then take the 2017 list figure and apply the same methodology employed when calculating changes to tariffs and top-ups following the Revaluation. Effectively, this would break the figure down between one-off and on-going changes. To do this, the Government would take the closing balance for provisions in Part 5, line 17 and divide this by the sum of the multipliers for 2017-18 and 2018-19, in order to determine authorities' latest view of the future rateable value loss. The Government

would then take this number and multiply it by the 2019-20 multiplier to determine the value of the ongoing change to provisions.

This would provide a value for the deduction for provisions / appeal losses based on authorities' own best estimates, albeit that those estimates are difficult to make at present given the lack of challenges against the 2017 rating lists. Furthermore, authorities' estimates would be based on 2018-19 data and would necessarily ignore any revision to estimates made in 2019-20. Moreover, because the deduction would be based on NNDR3 data, it would reflect and possibly be distorted by any differences in accounting and auditing approaches. For example, any authority that is providing only for "challenges" that have actually been made to rating lists, instead of providing for challenges that have yet to materialise, will be making very much smaller provisions. This would result in a smaller deduction and, hence a larger Business Rates Baseline (and, therefore, a higher tariff, or smaller top-up).

- b. An alternative approach would be for Government to base the deduction on its own estimate of future appeal losses. To do this, the Government could take as a starting point the estimate that was made at the Revaluation of the total potential loss against the 2017 list and then deduct the value of changes already made and backdated to the first day of the list. Whilst this would give an aggregate figure, it would then be necessary to apportion that figure between individual authorities. It could be apportioned in proportion to the size of authorities' rate bases. But, the size of an authority's rate base is not a good indicator of appeal loss, Nor is historic data about losses against previous lists a robust indicator of likely losses against the current list. Just because an authority lost significant rateable value on one list does not mean that its current list is similarly vulnerable.
- c. Another option might be to ask authorities to make a one-off estimate of their provision on a centrally-determined basis, albeit that authorities might still be faced with having to make an estimate despite knowing very little about the number of challenges likely to be made to the list and little indication of how well their list is holding-up to challenge.

4.11 The Government continues to work with the Business Rates Retention Implementation Working Group to determine the best way to calculate the deduction for appeal losses/provisions and would be interested in respondents' views on the three approaches outlined above, and ideas for any other possible approaches.

Question 14: What are your views on the approach to resetting Business Rates Baselines?

5 Equalities impacts of the proposals presented in this consultation paper

5.1.1 The Public Sector Equality Duty requires Ministers to have due regard to the need to eliminate discrimination and other conduct prohibited under the Equality Act 2010, advance equality of opportunity and foster good relations between persons who share protected characteristics and those who do not.

Question 15: Do you have any comments at this stage on the potential impact of the proposals outlined in this consultation document on persons who share a protected characteristic? Please provide evidence to support your comment.

6 Summary of questions

- Question 1:** Do you prefer a partial reset, a phased reset or a combination of the two?
- Question 2:** Please comment on why you think a partial/ phased reset is more desirable.
- Question 3:** What is the optimal time period for your preferred reset type?
- Question 4:** Do you have any comment on the proposed approach to the safety net?
- Question 5:** Do you agree with this approach to the reform of the levy?
- Question 6:** If so, what do you consider to be an appropriate level at which to classify growth as 'extraordinary'?
- Question 7:** What should the fall-back position be for the national tier split between counties and districts, should these authorities be unable to reach an agreement?
- Question 8:** Should a two-tier area be able to set their tier splits locally?
- Question 9:** What fiscally neutral measures could be used to incentivise pooling within the reformed system?
- Question 10:** On applying the criteria outlined in [Annex A](#), are there any hereditaments which you believe should be listed in the central list? Please identify these hereditaments by name and location.
- Question 11:** On applying the criteria outlined in [Annex A](#), are there any listed in the central list which you believe should be listed in a local list? Please identify these hereditaments by name and location.
- Question 12:** Do you agree that the use of a proxy provides an appropriate mechanism to calculate the compensation due

to local authorities to losses resulting from valuation change?

- Question 13: Do you believe that the Government should implement the proposed reform to the administration of the business rates retention system?**
- Question 14: What are your views on the approach to resetting Business Rates Baselines?**
- Question 15: Do you have any comments at this stage on the potential impact of the proposals outlined in this consultation document on persons who share a protected characteristic? Please provide evidence to support your comments.**

About this consultation

This consultation document and consultation process have been planned to adhere to the Consultation Principles issued by the Cabinet Office.

Representative groups are asked to give a summary of the people and organisations they represent, and where relevant who else they have consulted in reaching their conclusions when they respond.

Information provided in response to this consultation, including personal data, may be published or disclosed in accordance with the access to information regimes (these are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 2018 (DPA), and the Environmental Information Regulations 2004).

If you want the information that you provide to be treated as confidential, please be aware that, as a public authority, the department is bound by the Freedom of Information Act and may therefore be obliged to disclose all or some of the information you provide. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the department.

The Ministry of Housing, Communities and Local Government will process your personal data in accordance with the law and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties. A full privacy notice is included at [Annex D](#).

Individual responses will not be acknowledged unless specifically requested.

Are you satisfied that this consultation has followed the Consultation Principles? If not or you have any other observations about how we can improve the process please contact us via the [complaints procedure](#).

Annex A - Central list criteria

Introduction

1. The starting principle for the updating of the central non-domestic rating list is that, as much as is practical, authorities and rate payers will see no loss and no gain as a result of movement between lists.
2. Under the Local Government Finance Act 1988 the Secretary of State has the power to designate hereditaments to the central non-domestic rating list. A change to legislation is not proposed in 2020-21; instead reform will be carried out using this existing wide-ranging power. Ministerial decisions are likely to be informed by the following criteria, which currently form the primary basis of consideration:

- a. The nature and use of the property;
- b. The size and geographical spread of the property; and
- c. The suitability or otherwise for assessment of the property on local non-domestic rating lists.

3. These criteria will remain the primary basis on which suitability for listing in the central list is assessed, in the majority of cases. Typically, properties meeting these criteria are likely to be used for **infrastructure** or **utilities**; be considered to be **networks**; and/or be **administratively difficult to assess** as single entities. The criteria will be used in combination to inform the overall suitability of hereditaments for listing in the central list.

Criterion a - The nature and use of the hereditament

4. The central list is used for networks. Although there is no specific definition of a network, they are typically: cables for electricity and communication; pipelines for water, gas and other materials; railways; and certain items associated with those networks (electricity and gas meters).
5. Generally, the occupiers of network hereditaments are statutory undertakers but that is not always the case. Statutory undertakers are companies or other bodies with legal powers to undertake works such as install electricity cables or dig up the road in order for them to fulfil their statutory function (usually the provision of a utility such as water and gas). Occupiers may be considered similar to statutory undertakers in other circumstances, such as where they are involved with the provision of a utility and they have to comply with certain regulatory conditions set by a regulator.

Criterion b - The size and geographical spread of the property

6. Networks can vary in size and not all merit assessment on the central list. In some cases, it will be clear that they belong on local lists – perhaps because they are contained entirely within a single local list boundary or because they have a small rateable value. For larger networks the Secretary of State must decide at what point they more appropriately belong in the central list. In doing this, it will not normally be appropriate to develop standard rules (such as length or number of local authorities crossed) as that may lead to arbitrary outcomes, but rather to look at the overall size and spread of the property and how it fits within the local lists system. However, some assessments with small rateable values may still span several rating list areas. Therefore, the Secretary of State may consider only moving assessments whose rateable value is more than a particular level, so as to ensure the use and number of ratepayers on central rating list remains proportionate.
7. Although the number of lists over which the property crosses would form part of this consideration, in many cases it will not be possible to determine precisely how many rating lists are crossed by a network due to the administrative practices of the occupier.

Criterion c - The suitability or otherwise for assessment of the property on local non-domestic rating lists

8. As business rates is a local tax, if a hereditament can reasonably be assessed on the local list then it should stay on the local list.
9. The rules for properties which cross rating list boundaries provide for them to appear in the list which the valuation officer believes contains the largest part of the rateable value. In most cases this will provide a reasonable outcome. A property is very unlikely to span more than one boundary and, therefore, in that normal case, at least half of the rateable value of the property will be within the area of the local authority which contains the full rating assessment.
10. However, where hereditaments cover large areas and many local authorities, the largest part of the rateable value falling within an area may still only be a small proportion of the total rateable value of the property. As a result, the rateable value which is attributable to a local list area in which the property is assessed may be small in comparison to the total rateable value of the rating assessment. This means that it may be difficult to identify a single local rating list on which assessment of a network would be a reasonable outcome.
11. Furthermore, networks most appropriately listed in the central list may be contiguous units of property, for example in a telecommunication network where data is transmitted throughout the network as part of a single operation. An attempt to accurately capture the rateable value of the networks for each local rating list would therefore create artificial assessments unrelated to the actual business.

Annex B – Reform to the administration of business rates retention

1. This Annex should be read in conjunction with the main consultation document, '*Business Rates Retention Reform: sharing risk and reward, managing volatility and setting up the reformed system*'. Through this consultation, the Government is seeking views on potential reforms of the business rates retention system from 2020. This Annex provides further detail for a proposed change to the way the business rates retention system is administered.

Introduction

2. The Government recognises that the sector is keen to understand the impact that the proposed change to the administration of the system could have on local authorities and this annex will cover the proposed reform in more detail. It will cover:
 - a. The **scope of the reform**, including what elements of the system would be administered differently, and what elements would remain the same.
 - b. A short summary of **how the business rates retention system will work under the reform**. This will include a summary of a three-step change in the way that the business rates retention system will be administered. These changes will cover:
 - Setting Business Rates Baselines;
 - Setting top-ups and tariffs;
 - Reconciling out-turn adjustments.
 - c. It will also then explain how these three changes will result in the following **outcomes** for local authorities:
 - Removing the impacts of appeals and valuation change;
 - Guaranteeing local authorities see the benefit of growth;
 - Replacing Section 31 Grants.
 - d. A final short section highlighting the changes to NNDR1 forms that would need to be enacted to **implement** the reform.

A. Scope

3. There are several key aspects of the business rates retention system and wider local government finance system that would remain unaltered by the administrative changes proposed. These include:
 - The Government would continue to set a central share and a local share of business rates. The Government's aim is to devolve grant funding to achieve 75% business rates retention in 2020-21. The changes set out here would work whatever local share of business rates is set.
 - The review of relative needs and resources will set new Baseline Funding Levels for local authorities based on an assessment of their relative needs and resources; this will determine the basis on which retained business rates are redistributed between local authorities. The overall level of funding available for redistribution at the 2020/21 local government finance settlement will be subject to the outcome of the 2019 Spending Review. It is the Government's intention to introduce new funding allocations alongside reform of the business rates retention system in April 2020.
 - Annual top-up and tariff payments would remain the mechanism by which business rates are redistributed between local authorities to ensure that they have the resources they need to deliver services.
 - Local authorities will continue to benefit from growth (and absorb a proportion of decline) in business rates in their area.
 - There will still be resets, tier splits between billing and precepting authorities and a safety net, whether the changes outlined here are implemented or not. The main consultation document seeks local government's views on the options for reform of many of these system design elements from 2020. Similarly, the options presented regarding the future of the levy are applicable however the system is administered.
 - The Government will still compensate local authorities for any tax policy changes in relation to business rates that result in a change in business rates income i.e. the introduction of new reliefs.
4. However, some elements of the business rates retention system would be administered differently:
 - The current system of fixed Business Rates Baselines for each local authority established at the start of the system would be changed. Business Rates Baselines would be replaced by local authorities' **own estimates of net rates payable** provided through NNDR forms.

- Top-ups and tariffs which have been ‘fixed’ in real terms since the establishment of the business rates retention system in 2013-14 would be replaced with **‘floating’ top-ups and tariffs** which would vary annually and are used to reconcile differences between estimates and outturns. These ‘floating’ top-ups and tariffs would be the mechanism through which business rates are redistributed to meet need and also the mechanism which ensures that local authorities retain the growth they achieve.

B. Proposed changes

5. The following section summarises how the business would be administered under a system of ‘floating’ top-ups and tariffs.

Setting Business Rates Baselines

6. The current 50% retention system has used Business Rates Baselines for each local authority since its inception in 2013. Essentially, Business Rates Baselines were set for each authority by calculating an average of business rates income for 2010-2011 and 2011-2012 (the most recent previous two years where out-turn data was available upon set up of the system). Since 2013-14 these baselines have been ‘fixed’ in real terms.
7. In the future, it is proposed that Business Rates Baselines would be replaced by the NNDR1 estimate of ‘non-domestic rating income’ for each year. This will mean that baselines are no longer ‘fixed’ but instead vary year on year depending on local authorities’ estimates of their income in that given year.
8. For this to work, the date which NNDR1s have to be submitted would have to be brought forward, to around September, so that the information provided could be used at the provisional local government finance settlement.

Setting top-up and tariff payments

9. In order to ensure that each local authority has the business rates required to deliver services a system of top-ups and tariffs will remain.

At the moment, top-ups and tariffs reflect the difference between a ‘fixed’ Baseline Funding Level and a ‘fixed’ Business Rates Baseline, and therefore also remain ‘fixed’ in real terms themselves. If the changes outlined here are implemented, upon set-up of the system in 2020 a local authority’s top-up or tariff would represent the difference between its determined need (the outcome of the review of relative needs and resources and the 2019 Spending Review) and the local authority’s own estimate of its income provided through NNDR1s (after provisions). Top-ups and tariffs will therefore be ‘floating’ or variable each year.

Reconciling out-turn adjustments

10. Local authorities currently provide out-turn data through NNDR3s. Any difference between the non-domestic rating income set in NNDR1s and the NNDR3 out-turn data will result in a surplus, or deficit on the Collection Fund, which is shared between central and local government according to their rates retention shares. Local authorities are required to provide their estimate of the previous year's surplus, or deficit on the Collection Fund as part of a current year's NNDR1. This determines the amount of additional income they will receive in the current year, or the repayment they will have to make; and authorities have to take this into account in setting their budgets.
11. Under the alternative approach outlined here, authorities would still be required to estimate the previous year's surplus/deficit on the Collection Fund, but this would be taken into account in setting the current year's tariffs and top-ups. Top-ups and tariffs would be further adjusted to strip out the impact of the previous year's surplus/deficit, leaving authorities free to budget in line with their Baseline Funding Level/need.
12. The mechanism of 'floating' top-ups and tariffs can, by this means, deal with the risk under the current system that unanticipated appeal losses between NNDR1 and NNDR3 can result in significant deficits on the Collection Fund, which then impact on local authority budgets.

C. Outcomes for local authorities

13. The following section indicates how these changes to the administration of the system can lead to a business rates retention system that is more flexible and responsive. It would provide local authorities with budgetary certainty of the business rates income that they will have to spend on services in any given year.

Removing the impact of appeals and valuation change

14. The main consultation document summarises the work MHCLG officials have been undertaking, with the input of local authorities and others, on potential routes to mitigate the impact of appeals. It is the Government's view that the administrative changes explained here may be the only way to do this effectively and is certainly the most simple and effective way of stripping out the impact of appeals on local authorities' income from business rates.
15. Before outlining how the three steps outlined earlier will achieve this outcome it is worth summarising how appeals under the current system can negatively impact on local authorities.

Current system

16. IAS 37 requires local authorities to make a provision against future appeal losses. Section 151 officers must use their professional judgement to determine the appropriate provision for their local authority.
17. Upon the set-up of the business rates retention system in 2013-14 an assumption was made, and incorporated into the system, about the future impact of backdated appeals on local authorities. It was assumed £1.9 billion would be lost nationally by authorities as a consequence of future appeals. This figure was distributed between authorities in proportion to their Business Rates Baselines. Thus every authority had a share of £1.9 billion, over and above the business rates income they were determined to need in order to deliver services, from which to finance their appeal provisions.
18. However, actual appeal losses may not have matched individual authorities' share of the £1.9 billion. Moreover, the difficulty faced by authorities in forecasting appeal losses and thus accurately making provisions has inevitably meant that appeals and provisions have impacted to a greater or lesser extent on the growth that all authorities have achieved under the rates retention scheme since 2013-14. For example, larger than anticipated reductions in rateable value through appeals have at times reduced the amount of growth a local authority would otherwise have retained under the current arrangements. In extreme instances it has resulted in income being reduced sufficiently to trigger a safety net payment. Similarly, significant changes to provisions that an authority may have been forced to make in any year – perhaps because of a view that provisions had previously been underestimated – will have impacted on its income in that year. This has led to year-on-year volatility in business rates income at individual local authority level.
19. Although the accountancy requirements laid out in IAS 37 would apply regardless of how business rates retention is administered, the potential negative impact this has on the amount of income a local authority has to spend on local services and the amount of growth it retains in any given year can be mitigated..

Proposed changes

20. Instead of incorporating a disaggregated national estimate of the impact of appeals and valuation change into the initial set-up of a 'fixed' business rates retention system, the proposal to move to 'floating' top-ups and tariffs will enable reconciliation of year-on-year differences in provisions and appeal losses.
21. Earlier submission of NNDR1 forms would allow a local authority's latest estimate of provisions and appeal losses to be taken into account in the setting up of top-ups and tariffs. Instead of these estimates affecting an authority's income, as happens now because top-ups and tariffs are 'fixed' at the beginning of a reset period, the

tariffs and top-ups would be adjusted every year to take account of authorities' latest estimates of provisions and appeal losses. This would mean that they no longer have an impact on authorities' *useable* income from business rates, which would be available to meet authorities' assessed needs regardless of provisions and appeal losses estimated by Section 151 officers.

22. The inherent difficulty in estimating the potential loss from appeals at NNDR1 stage and the difference between that estimate and the actual losses that occur – which can give rise to deficits on the Collection Fund – would also be managed through this system of varying top-ups and tariffs. Any prior-year deficit on the Collection Fund, which currently creates a liability that an authority must recognise in setting its current year budget, would instead be recognised in setting the current year's top-up or tariff. So too would any prior-year surplus, which would remove any incentive to 'game' the system.
23. In future, it would therefore be possible to measure growth in business rates income, *before* accounting adjustments (including provisions) – e.g. by measuring either 'gross rates payable' or 'net rates payable', in order to judge whether an authority's business rates yield was growing or not. On its own this would not solve the problem presented by appeals, because both gross and net rates payable will reflect appeal losses and backdated refunds made to rate payers. But by removing the impact of provisions, it opens up the possibility of stripping out the impact of appeals through a simple adjustment to the way that growth is measured.

Guaranteeing local authorities see the benefit of growth

24. To ensure that local authorities can continue to see the benefits of growth but in a way that minimises the impact of appeals on the amount of growth retained, two things are required:
- An accurate baseline in any given year from which growth can be measured against; and
 - A mechanism through which differences between estimates and out-turn data can be reconciled (such as the model of 'floating' top-ups and tariffs explained earlier).

Identifying an accurate baseline

25. The nature of the business rates system, and in particular the appeals process, means that any changes to the business rates liability of businesses are often backdated. It was recognised upon the set-up of the current business rates retention system in 2013-14 that setting baselines from which to measure any growth was difficult. The decision was taken to set Business Rates Baselines based on the average of business rates

income for the previous two years for which data was available through NNDR3s (2010-11 and 2011-12)..

26. To be able to accurately measure growth without the impact of appeals in any one year, the 'gross rates payable', or 'net rates payable' needs to be known at the start of that particular year, i.e. the net business rates income after all appeals have been determined. In the real world, it is not possible before the event to know what impact appeals will have on any year's net rates payable. But, once the appeal is heard, its impact on each year's net rates is known. This information is already captured in NNDR3s in the form of 'prior-year adjustments'.
27. At present, NNDR forms do not require local authorities to separately identify 'prior-year adjustments' for 'gross rates payable' although it is a component of the 'gross rates payable' figure that is provided in NNDR3 forms. Whilst local authorities do provide figures for prior-year adjustments for reliefs in NNDR3 forms, they are provided as a single figure for all years (i.e. they are not posted to individual years). We will need to update NNDR forms so that we can collect this data from local authorities. If this reform was implemented, MHCLG officials will continue to work with local authorities on practical considerations, such as any changes that would be required to software to allow changes to NNDRs.
28. If prior-year adjustments were posted to individual years, it would be possible to calculate a 'baseline' based on either a local authority's gross rates payable or net rates payable for a given year. This 'baseline' could be re-calculated after each NNDR3 to reflect changes to that year's gross / net rates payable as a result of appeals and other valuation change. By comparing a local authority's net rates payable for a year with that year's re-calculated baseline, it will be possible to measure any growth in business rates consistently across years, without there being any impact from appeals.
29. The introduction of 'floating' top-ups and tariffs would allow this growth, once known through NNDR3s, to be recognised within the following year's top-up or tariff. This means that at each provisional local government finance settlement, a local authority's top-up and tariff will be set in a way that guarantees a local authority will retain any growth (subject to a future approach on resets) without the impact of appeals.
30. It should be noted that this reform would result in a 'lag' of an additional year for growth materialising through the business rates system. A reliance on out-turn date provided by NNDR3s leads to such a 'lag' being a necessity if the impact of appeals is to be stripped out of growth.

Recognising decline in business rates

31. Under this reform any decline experienced can also be recognised through altering the local authority's 'floating' top-up or tariff in the following year from the year it

materialises (so in the same way as growth there would be a 'lag' to decline being recognised in the business rates retention system).

Replacing Section 31 grant payments

32. The use of 'floating' top-ups and tariffs also offers the opportunity to streamline any payments associated with future changes in the business rates tax base (i.e. changes to reliefs, transitional arrangements as a result of future revaluations).
33. For example, under current arrangements, changes to the threshold of the small business rates relief have resulted in compensation payments to local authorities through Section 31 grants. These separate payments have had to be calculated on an annual basis and have to be processed separately. Under a system of 'floating' top-ups and tariffs such changes could be incorporated into the annual 'floating' top-up or tariff, if desirable. Even so, Section 31 grants might still be required to compensate any in-year changes in the income a local authority collects from business rates if the Government made changes to tax policy, e.g. new relief, after authorities have submitted NNDR1s for that year.

Operationalising other system elements

34. The proposed changes would also remove the need to make separate levy and safety net payments to local authorities. Instead these payments could be incorporated into the 'floating' top-ups and tariffs.
35. The options presented in the consultation for future approaches to resets or any future change to the tier split could both be easily implemented in a business rates retention system that was administered in this alternative way.

D. Implementation of the changes

36. To implement the changes described above there would need to be two changes to NNDR data collections, implementable through secondary legislation:
- The date that NNDR1 forms are submitted would have to be brought forward to around September each year.
 - There would need to be a change to the information that is requested through NNDR forms. Specifically, local authorities would have to provide figures, posted to individual years, covering prior-year adjustments incorporating appeals and valuation change for "gross rates payable".
37. It is the Government's view that any additional effort required to implement these changes to NNDR forms would be offset by the outcomes the reform would deliver.

38. Government officials will continue to work with the sector on the practical considerations of how to implement these changes if the decision is taken to change the administration of the system in the way outlined in this annex.

Annex C – Glossary of technical terms

Appeals and other valuation change	Changes to the rateable value of a business property (hereditament) by the Valuation Office Agency, often as a result of the Check, Challenge and Appeal process by the ratepayer.
Baseline Funding Level (BFL)	<p>This is part of the assessment of how funding should be redistributed between authorities within the current business rates retention system.</p> <p>The government established how much funding to allocate to each authority, taking account of the formula for determining authorities' relative needs and the total amount of income available for local government.</p> <p>This 'baseline funding level' is then compared against an authority's expected income from business rates (its business rates baseline). This will determine whether the authority must pay a sum into the redistribution system via a tariff, or receive a payment to top up its income.</p>
Billing authority	A local authority empowered to collect tax, whether that is business rates or council tax on behalf of itself and other local authorities in its area. In England, shire districts, metropolitan districts, the Council of the Isles of Scilly, unitary authorities, London boroughs and the City of London are billing authorities.
Business rates	Business rates is the usual term for the National Non-Domestic Rate, a property tax charged on all properties which are not used for residential purposes.
Business Rates Baseline (BRB)	The amount of business rates income local authorities is predicted to raise.
Central list	A list of hereditaments that pay business rates directly to central government, as opposed to a local billing authority.
Collection Fund	An account maintained by a billing authority, recording the amounts collected in council tax and non-domestic rates.
Community Benefit for new nuclear power stations	Government policy outlined in Written Ministerial Statement of 17 July 2013 . The community benefit package recognises the role of communities that are being asked to host such large

	infrastructure projects that will contribute significantly to national energy generation and growth, and the reduction of the UK's carbon emissions.
Gearing	The ratio between an authority's Baseline Funding Level and its Business Rates Baseline.
General Fund	The main revenue fund from which the 'cost of services' is met.
Hereditament	The legal name for the unit of non-domestic property that is, or may become, liable to national non-domestic rates, and thus appears on the rating lists.
Hudson Review	A review commissioned by the former Secretary of State of MHCLG and that was led by Andrew Hudson, formerly of both HM Treasury and the VOA. It considered "the internal processes and procedures that underpin its oversight of the business rates system including policy decision-making and analysis and modelling". The review was published on 25 October 2018. The review provided recommendations for improvements within the Local Government Finance directorate in these areas.
Business Rates Retention Implementation Working Group	A working group run in partnership with the Local Government Association, made up of representatives of the local government sector, which focuses on the implementation of the reform of the local government finance system.
Local list	A list of hereditaments that pay business rates to the local authority.
NNDR forms (National Non-Domestic Rates forms)	The forms that MHCLG uses to collect information from local billing authorities on the income they expect to collect or have collected from business rates. NNDR1 provides a forecast of business rates income, whilst NNDR3 provides certification of business rates income.
Precepting authority	An authority that sets a precept to be collected by billing authorities through Council Tax. County councils, police and crime commissioners, the Greater London Authority and combined fire authorities are known as major precepting authorities. Parish and town councils are known as local precepting authorities.
Pooled authorities / Pool	This is a facility for groups of authorities to join together and be treated as a single authority for the purposes of the business rates retention system. Doing so may enable authorities to share any risk and growth related to their collective business rates income in any given year.
Proxy	Within this consultation the proxy refers to an approximation of valuation only change, i.e. a change in the value of a hereditament not due to physical change.

Resets	The point at which the local government finance system will be reset, and baselines will be updated.
Review of relative needs and resources	A review being carried out by the Ministry of Housing, Communities and Local Government, to set new baseline funding allocations for local authorities by delivering an up-to-date assessment of their relative needs and resources.
Revenue Support Grant (RSG)	Introduced in 1990, this is the central grant given to local authorities to support their services. In recent years, local authorities' income from grant has decreased and a higher proportion comes from business rates and council tax.
S31 (Section 31) grants	Government has power under s.31 of the Local Government Act 2013 to pay grant to local authorities. This is a mechanism used to pay compensation to local authorities for income they may have lost as a result of changes to business rates reliefs.
Safety Net	A government set amount that ensures local authorities can always provide essential services; even if they see their funding levels drop.
Business Rates Retention System Design Steering and Working Groups	Steering and working groups run in partnership with the Local Government Association, made up of representatives of the local government sector, with focus on the system design elements of the reforms for the Local Government Finance system.
Tariff and top-up	Part of the redistribution system under business rates retention. Authorities whose income exceeds their assessed need will pay a tariff. Authorities whose income is less than their assessed level of need will receive a top up payment.
Tier splits	The proportions by which local business rates income is split between billing and precepting authorities. For example, the current tier split between a district and a county in a two-tier area where the county has fire responsibilities would be 80:20 to the district.
Top-slice	An amount of money taken off excessive growth on a local authorities' business rates income.
Valuation Office Agency (VOA)	A government agency that gives the government the valuations and property advice needed to support taxation and benefits.

Annex D – Personal Data Protection

The following is to explain your rights and give you the information you are be entitled to under the Data Protection Act 2018.

Note that this section only refers to your personal data (your name address and anything that could be used to identify you personally) not the content of your response to the consultation.

1. The identity of the data controller and contact details of our Data Protection Officer

The Ministry of Housing, Communities and Local Government (MHCLG) is the data controller. The Data Protection Officer can be contacted at dataprotection@communities.gov.uk

2. Why we are collecting your personal data

Your personal data is being collected as an essential part of the consultation process, so that we can contact you regarding your response and for statistical purposes. We may also use it to contact you about related matters.

3. Our legal basis for processing your personal data

The Data Protection Act 2018 states that, as a government department, MHCLG may process personal data as necessary for the effective performance of a task carried out in the public interest. I.e. a consultation.

4. For how long we will keep your personal data, or criteria used to determine the retention period.

Your personal data will be held for two years from the closure of the consultation.

5. Your rights, e.g. access, rectification, erasure

The data we are collecting is your personal data, and you have considerable say over what happens to it. You have the right:

- a. to see what data we have about you;

- b. to ask us to stop using your data, but keep it on record;
- c. to ask to have all or some of your data deleted or corrected;
- d. to lodge a complaint with the independent Information Commissioner (ICO) if you think we are not handling your data fairly or in accordance with the law. You can contact the ICO at <https://ico.org.uk/>, or telephone 0303 123 1113.

6. Your personal data will not be sent overseas.

7. Your personal data will not be used for any automated decision making.

8. Your personal data will be stored in a secure government IT system.