Appendix 1: Review of Current Business Rates Issues

Leeds CITY COUNCIL

Corporate Governance and Audit Committee
16 September 2016

1. Purpose of this note

1.1 At its meeting in June 2016, the Committee received a report of the Deputy Chief Executive presenting the 2015/16 Statement of Accounts prior to them being made available for public inspection.

1.2 Following discussion of the impact of business rates on the Council's financial position, the Committee requested a further report on business rates be prepared for consideration, to include:

- Background to the Council's current and future liabilities in respect of business rates retention;
- The roles, responsibilities and decision making processes of the Council and the Valuation Office;
- The risks to the Council's budget setting process associated with business rates retention;
- Current and future trends in respect of business rate income and liabilities arising from business rate valuation appeals;
- Any impact arising from the publication by the Valuation Office of the new ratings list.

1.3 Additionally, this note takes the opportunity to update the Committee on progress towards 100 per cent retention of business rates and discusses a number of related issues.

1.4 Where appropriate, assurances have been identified and these are summarized at **Annex 1** of this note.

2. Background

2.1 Business rates were taken out of local authority control in 1990 and replaced by the national non-domestic rate, although they continue to be referred to as 'business rates'. The Government set a rate, known as the 'multiplier', and revenue collected by local authorities was pooled in a single, national pot and redistributed based on an annual needs assessment through Revenue Support Grant. Under this system there was no specific incentive for local authorities to build up tax revenues through local economic growth. Business rates principles are explained at **Annex 2.**

2.2 In 2013/14, Government introduced the current Business Rates Retention (BRR) scheme. Government calculates how much funding each authority requires, with this being funded from two sources: Revenue Support Grant (RSG) and the BRR scheme. Local authorities retain 50 per cent of locally collected business rates, including 50 per cent of any growth, with 50 per cent being remitted to central government. However, local government also bears 50 per cent of the risk if business rates fall or fail to keep pace with inflation, although a safety-net mechanism is in place to limit losses.

2.3 In October 2015 the Chancellor announced a commitment to allow local government collectively to retain 100 per cent of business rates revenue by the end of this Parliament and, to match the resulting additional tax revenues, for it to take on 'new responsibilities'. Revenue Support Grant, the main central government grant for local authorities, is being phased out over the intervening period.

2.4 An initial consultation on the working of the new system is due to close on 26th September 2016 and the legislative framework is expected to be set out in the Local Growth and Jobs Bill to be published in early 2017. The Chancellor announced the move to 100 per cent business rates

retention in his "Devolution Revolution" speech at the Conservative Party conference in October 2015. The move was confirmed in the March Budget and the Queen's Speech announced that the relevant legislative changes would be included in the Local Growth and Jobs Bill to be published in spring 2017.

3. The current system: 50 per cent retention

3.1 How the current scheme impacts on the Council's finances: the business rates deficit

3.1.1 The current business rates scheme is explained in more detail at **Annex 3**. Whilst 50 per cent retention allows local authorities to retain 50 per cent of locally collected business rates, including 50 per cent of any growth, authorities are also exposed to 50 per cent of the risk. Business rate income is inherently volatile and the Council's financial position can be adversely affected by a range of factors. These include:

- Slower than forecast growth;
- The impact of mandatory reliefs, particularly issues regarding charitable relief and empty rates relief;
- Reductions in rateable value due to changes in local circumstances as determined by the Valuations Office Agency (VOA), for example the reductions applied to numerous retail properties in Leeds City Centre to reflect the impact of the opening of Trinity;
- Reductions in rateable value arising as a result of a successful appeal in one part of the country, where the basis for appeal applies more widely. In these circumstances the VOA instructs billing authorities to reduce rateable values of relevant properties in their area, whether or not they have appealed. One such recent decision related to purpose-built medical centres;
- But most significantly, reductions in rateable value due to appeals by ratepayers and their agents, as discussed in greater detail at paragraph 3.2.

3.1.2 Changes to large properties are a major cause of business rates volatility, particularly when a small number of properties dominate a local valuation list. For example, when a nuclear power station in Hartlepool had its rateable value reduced by 48% to correct an error in the original 2010 valuation that single change reduced their business rates income by 20% and resulted in them falling into safety-net. Leeds and others have argued that large, potentially volatile assessments should be placed in a Central List to protect vulnerable local authorities from large reductions, but some authorities argue that such properties should be retained in local lists so that they can benefit from growth if rateable values go up.

3.1.3 The role of the VOA is explained more fully in **Annex 2**, and it is important to note that the Council does not set rateable values, nor does it have any role in the appeals process, but it does have to deal with the financial impact of appeals, including the requirement to set aside funds to cover future losses. The Council is unable to make provision for income lost due to VOA decisions which are not appeals, as we cannot reasonably estimate them.

3.1.4 Local authorities are required by statute to account for council tax and business rates income in a 'Collection Fund', a separate accounting statement showing the amounts that each billing authority forecast it would collect and how that has been distributed. Councils recognise in their budget the amount they forecast they will collect and any actual surplus or deficit is carried forward to the following year's budget: so a surplus in 2015/16 would increase the amount of business rates income available to spend on services in 2016/17 and vice versa. This approach is intended to give local authorities time to plan for volatility in income rather than having to respond in year.

3.1.5 In 2016/17, the council's budget proposals include a net general fund cost of £12.6 million relating to business rates. This cost recognises the worsening position on business rates income in 2015/16, which resulted in a substantial deficit of £23 million requiring a contribution from the General Fund in

2016/17. The financial impact of the deficit is substantially offset by forecast business rates growth of £14.2 million in 2016/17 which recognises the continuing improvement of the economic climate across the city.

3.1.6 The following **assurances** are identified:

- *Business rates income is monitored in detail and reported to Financial Performance Group on a monthly basis. Financial Performance Group then highlights key issues to Executive Board;*

- *Both financial forecasting and the in-year budget are monitored through the Council's Corporate Risk process.*

3.2 Appeals risk under the current system

3.2.1 The Gross Rateable Value for the city is now estimated to be £912 million, which is less than the value prior to the opening of Trinity. Although there are now more rateable premises in the city, many have lower rateable values as a result of successful appeals or decisions by the VOA.

3.2.2 At 31st July 2016 there were 6,194 appeals outstanding in the Leeds City Council area affecting 4,500 properties. This means that rateable value of over £401million is subject to at least one appeal in Leeds, just under 45% of the total rateable value in the city. As a result the Council has had to set aside £23.38 million against future losses due to reductions in rateable value - funding that could otherwise be spent on services. Collectively, local authorities have set aside around £1.75 billion in the past three years to cover the risk of backdated appeals[1]. **Annex 4** explains the current appeals system in more detail.

3.2.3 Successful appeals are most commonly backdated to the start of the current Valuation List, i.e. 1st April 2010, greatly increasing the in year impact on local authorities. As a result of this backdating, the Council needs around £6 of rateable value growth for every £1 of rateable value lost in 2016/17 just to maintain its level of income. This is illustrated at **Annex 4.**

3.2.4 A further complication is that the process for submitting appeals is changing from 1st April 2017. The Government hopes that the new 'Check, Challenge, Appeal' process will reduce the number of long-term appeals in the system and discourage speculative appeals. However, at first sight the new procedures appear cumbersome and could make it more difficult for us to make accurate provisions for appeals.

3.2.5 The following **assurances** are identified:

- *Detailed monthly monitoring of the adequacy of appeals provisions with reference to the most recent settlement data, which is reported to Financial Performance Group;*

- *Liaison with the Council's Business Rates team to discuss issues and assist in our approach to calculating appeals provisions;*

- *Regular meetings with the VOA, which give us some forewarning of local and national issues and improve our understanding of how the appeals system is operating;*

- *The Collection Fund is audited by both Internal and External Audit, and this includes audit of the methodology used to estimate provisions for appeals;*

- *Leeds continues to discuss the current and future appeals issue with government and with local government representative bodies.*

[1] LGA responds to CLG Committee report on business rates, Local Government Association, 14 June 2016

4. Revaluation 2017

4.1 The revaluation of business properties planned for April 2015 was delayed by the Coalition Government but will take place with effect from 1st April 2017. Under the revaluation, the rateable value of every non-domestic property is being reviewed in the light of rental and other evidence as at 1st April 2015 ("the antecedent date"). Rateable values may go up or down depending on movements in property values, but the aim is to adjust the multiplier so that the national business rates "take" is the same before and after the revaluation. This is illustrated by the simple model at **Annex 5**. In practice, there will be a small upward adjustment to try to take account of the effect of successful appeals over the lifetime of the ratings list.

4.2 A draft 2017 ratings list will be available in early October. Whilst this will give us an initial understanding of the impact of the new list for Leeds and throughout the country we will not be able to do any detailed analysis until new baselines, tariffs and top-ups are confirmed later this year.

4.3 As has been the case in the past, the 2017 revaluation is likely to bring a fresh wave of business rate appeals which will increase the financial volatility faced by councils further.

4.4 The following **assurances** are identified:

- *Leeds has participated in discussions with DCLG to address concerns arising from the 2017 revaluation;*
- *Corporate Financial Management will carry out initial analysis of the data available in October and more detailed work once baselines, tariffs and top-ups are published;*

5. 100 per cent retention of business rates

5.1 Main proposals

5.1.1 The move to 100 per cent business rates retention, accompanied by a fundamental reassessment of needs and resources, probably represents the biggest change to local government finance in a generation. It is therefore imperative that the new system is both workable and fair, and that incentives for growth are properly balanced against the needs of our most deprived communities.

5.1.2 The main proposals for the new business rates system are as follows:

- By the end of this Parliament (now thought likely to mean 2019/20, but could be 2020/21) local authorities will be allowed to retain 100% of business rates;
- Revenue Support Grant (RSG) will be phased out and local authorities will be given new responsibilities so that, overall, the switch to 100 per cent retention will be revenue neutral;
- Individual local authorities will be given powers to reduce (but not increase) the national multiplier in their areas;
- In combined authority areas directly elected mayors will be able to add a small premium (up to 2p) to raise funds to support infrastructure projects provided they secure a majority vote of the business members of their Local Enterprise Partnership. The power will <u>not</u> apply to combined authorities without an elected mayor;
- The changes will be accompanied by a "fair funding review" of needs and resources so that each authority has a fair starting point;
- The current equalization arrangements through tariffs and top-ups will continue, as will some sort of safety-net arrangement to protect authorities from severe losses of income from year to year. However, safety nets will no longer be partially funded from levies on growth in tariff authorities, as levies are to be abolished.

5.2 Progress to date

5.2.1 In April 2016 a joint DCLG/LGA steering group was established to provide information and expert advice on the development of the new system, overseeing a set of technical working groups, all of which are now meeting regularly.

5.2.2 An initial consultation paper "Self-sufficient local government: 100% Business Rates Retention" was issued by DCLG on 5th July 2016 with a closing date of 26th September 2016. A further, more technical consultation is promised in the autumn.

5.2.3 Alongside the 2016/17 Local Government Finance Settlement, the Government announced the Fair Funding Review, which is intended as a thorough review of what the needs assessment formula should be under 100 per cent retention. "Fair Funding Review: Call for evidence on Needs and Redistribution" also closes on 26th September.

5.2.4 The questions asked in these two consultations are provided at **Annexes 6 and 7**, should the Committee wish to feed into the Council's responses.

5.2.5 From April 2017 the Government plans to pilot 100 per cent retention in Greater Manchester and Liverpool City Region, and will increase the share of business rates retained in London. It is intended that these pilots will provide an opportunity to test elements of the 100% scheme. The offer to pilot the approach is only open to areas that have ratified their devolution deals and have committed to elected mayors. Other areas expressing interest in pilots are Sheffield City Region and Cornwall[2].

5.2.6 The following **assurance** is identified:

- *Leeds will submit detailed responses to Government in response to these current and future consultations concerning the proposed system.*

5.3 Additional Responsibilities

5.3.1 The Government expect the move to 100 per cent retention to be fiscally neutral between central and local government. In order to achieve this, the main local government grants will be phased out and additional responsibilities devolved to local authorities to match the additional funding from business rates. The likely size of the transfer is uncertain: DCLG have suggested it could be around £8.3 billion, but this will depend on levels of economic growth between now and 2019/20 and on government policy in the intervening period. Measures in the 2016 Budget, for example, included permanently doubling Small Business Rate Relief (SBRR) and increasing thresholds, taking over 600,000 businesses out of business rates taxation and a further 250,000 out of the higher rate. As a result around a third of business ratepayers in Leeds will pay nothing at all, and will have little financial stake in local democracy.

5.3.2 In Leeds, by 2019/20, the figure to transfer could exceed £100 million, but again this will depend on local and national economic changes, and also on how tariffs and top-ups change following the reassessment of needs.

5.3.3 To date a set of guiding principles have been agreed by the DCLG/LGA steering group to shape discussions. Much of the discussion to date on transfers has focused on grants rather than identifying new responsibilities.

5.3.4 Discussions on transferring responsibilities have concentrated on Skills (including further education and careers guidance) and Welfare. The group has been very clear that it would be inappropriate to

[2] Two more 100% pilots on cards as areas set out their demands, Local Government Chronicle, 4 August 2016

take on responsibility for any nationally-set benefits such as Attendance Allowance, but this remains one of the potential devolved functions listed in the consultation document.

5.3.5 The following **assurance** is identified:

- *Leeds is participating in the discussions about additional responsibilities through SIGOMA and other representative bodies. In our response to the current consultation we intend to make clear that we do not support the transfer of Attendance Allowance or any similar nationally-set benefits.*

5.4 Needs and Resources

5.4.1 The introduction of the new business rates system is intrinsically linked to the Government's review of needs and resources. The Government states that the Fair Funding Review will address a series of important issues:

- What do we mean by relative 'need' and how should we measure it?
- What are the key factors that drive relative need?
- At what geographical level should need be assessed?
- How should resets of the needs assessment be done (discussed in paragraph 5 below)?
- How – and what – local government behaviours should be incentivised through assessment of relative needs?

5.4.2 Needs and resources were last assessed for the 2013/14 finance settlement using the complex set of relative needs indicators that had been refined over the previous decade. Although the Needs and Redistribution Group have met a number of times, they have not yet got beyond trying to identify a suitable set of indicators to be used to begin to model a new needs formula.

5.4.3 It is acknowledged that this area of work is likely to take longer than other aspects of the proposed system, and it is expected that a technical consultation on the assessment of needs will not be issued until the summer of 2018, building on the issues explored in the current call for evidence.

5.4.4 The outcome of the fair funding review will establish the funding baselines for the introduction of 100 per cent retention. There are likely to be transitional arrangements to give councils time to adjust to changes in their level of funding.

5.4.5 The following **assurances** are identified:

- *Leeds is participating in the discussions about needs and resources through SIGOMA and other representative bodies.*

- *Leeds will submit a detailed response to the current "Fair Funding Review: Call for evidence on Needs and Redistribution" consultation.*

5.5 Resets

5.5.1 Over time the relative needs and resources of authorities will diverge from the starting position, improving for some and deteriorating for others. Therefore the system needs to be reset periodically to take account of these changes in relative needs and resources. Between resets local authorities would retain any growth, but at a reset this growth could be equalized away.

5.5.2 The 100 per cent retention consultation suggests three reset options for the new scheme:

- full and frequent resets which would prioritise need, with growth lost at each reset;
- full but infrequent resets which would enable retention of growth over a longer period, however any reduction in income could affect local service delivery over an extended period;

- partial but frequent resets whereby adjustments would be made for growth and relative need frequently but to a lesser extent, retaining some incentive for growth but also taking some account of changes in relative needs.

5.5.3 The following **assurance** is identified:

- *In responding to the consultation, Leeds has expressed support for the partial reset approach. There are a number of ways to implement the partial reset option and we will be looking at the suggested approaches in detail and contributing to the wider system design process over the coming months.*

5.6 Devolution

5.6.1 The current consultation makes clear that there are a number of connections between devolution deals and the proposal for 100 per cent retained business rates. One emerging concern is that DCLG appear to be considering the possibility of devolving different responsibilities to different areas depending on whether or not there is a mayoral combined authority in place. There will be pros and cons to this; but there are fears that it could lead to a two-speed and inconsistent system, with areas with elected mayors being given greater freedoms and wider responsibilities, leaving other areas behind.

5.6.2 Indeed, the consultation document identifies some of the functions currently devolved:

- Investment funds for devolution deals
- Adult Education Budgets
- Transport Capital Grants – consolidated Transport funding including highways maintenance funding and bus service operators grant
- Local Growth Fund

and asks whether some or all of the commitments in existing or future deals could be funded through business rates under 100 per cent retention.

5.6.3 Another concern emerging from the consultation is that DCLG appear to be considering allocating resources at regional rather than local authority level, arguing that needs vary less between regions than they do between authorities within regions. Clearly this approach would rely on the relationships between authorities in a region who would then need to distribute those resources fairly and it could potentially lead to different distribution approaches throughout the country.

5.6.4 The following **assurance** is identified:

- *Work is planned with colleagues in Economic Development to further analyse need at a regional level. This analysis will help to inform our response to Government on this issue.*

5.7 The design of the new system

5.7.1 Alongside these wider considerations, some more specific aspects of system design need to be considered. These include the proposed powers to vary the multiplier, the abolition of the current levy and discussion concerning the nature of the safety net, the operation of reliefs and discounts and the increased exposure to business rates volatility and appeals risk.

5.7.2 Individual local authorities will be given powers to reduce the national multiplier in their areas. In mayoral combined authority areas only, directly elected mayors will be able to add a small premium (up to 2p) to raise funds to support infrastructure projects provided they secure a majority vote of the business members of their Local Enterprise Partnership. The Government's expectation appears to be that any reduction would apply right across an authority rather than being targeted by area or by sector, with authorities continuing to use existing local discount powers for targeted relief.

5.7.3 Local government representatives have argued strongly that billing authorities should be given powers to vary the multiplier upwards as well as downwards and to target reductions within their areas. There is also concern about the accountability of LEP business representatives to agree an infrastructure premium.

5.7.4 The Chancellor has announced that levy payments will be abolished under 100 per cent retention. This removes the rationale for business rates pools which allowed levies that would otherwise be passed to Whitehall to be retained locally, and calls into question the future of the Leeds City Region Business Rates Pool.

5.7.5 Perhaps more significantly, levies from non-pooled tariff authorities currently contribute to the funding of safety-nets for authorities that suffer reductions in their income below 7.5% of their assessed spending needs – their baseline funding. Some form of safety-net will continue to be essential under 100 per cent retention, but DCLG have made it clear that this will have to be funded from a top-slice elsewhere in the system. The level of the safety net threshold has also been questioned. Leeds has argued that it should be reduced – perhaps to 5%.

5.7.6 Local authority representatives have argued for greater discretion over the level of business rates reliefs and discounts, in particular for powers to vary the 80% mandatory discount for registered charities and to vary the period before empty rates become due. Such powers would allow local authorities to combat empty-rate avoidance schemes more effectively and to better target charity relief to where it is most needed. DCLG have listened to these arguments with some sympathy, but have pointed out that the business community and the third sector are also powerful lobbyists and are likely to oppose any significant changes.

5.7.7 The nature of the appeals risk is discussed in paragraph 3.2. Clearly there is concern that exposure to these risks could double under 100 per cent retention. DCLG do recognize this problem and have suggested that appeals that are backdated to the 1st April 2017 (the start of the new Valuation List) should be compensated for centrally under 100 per cent retention. Whilst this would remove much of the volatility for individual authorities it would be funded by a top-slice from elsewhere in the system, so that authorities that would otherwise suffer large losses through appeals would effectively be compensated by authorities with lower levels of appeals.

5.7.8 The following **assurance** is identified:

- *These design issues are discussed in the current consultation and Leeds City Council is represented on the Systems Design Group and is contributing to the other groups through Yorkshire and Humberside Treasurers, Core Cities and SIGOMA.*

Annex 1: Summary of Assurances

Para.	Issue	Assurances	Responsible
3.1	Business rates deficit	Business rates income is monitored in detail and reported to Financial Performance Group (FPG). Key issues highlighted to Executive Board.	CFM: FPG; Executive Board
		Financial forecasting and the in-year budget are monitored through the Council's Corporate Risk procedures.	Deputy Chief Executive; Cllr J. Lewis
3.2	Business rates appeals risk	Detailed monthly monitoring of the adequacy of appeals provisions, reported to Financial Performance Group	CFM; FPG
		Liaison with the Council's Business Rates team to discuss issues and assist in calculating appeals provisions	CFM; Business Rates Team
		Regular meetings with the VOA, to identify local and national issues and improve our understanding of the appeals system	
		Internal and External Audit of the Collection Fund, including audit of the methodology used to estimate provisions for appeals.	CFM
		Ongoing discussions with Government concerning the impact of appeals on local authority finances.	
4.	Impact of the 2017 revaluation	Participation in discussions with DCLG to address concerns arising.	CFM
		Analysis of initial data in October and more detailed work once baselines, tariffs and top-ups are published.	
5.2	Development of 100% retention system	Leeds will submit detailed responses to Government in response to current and future consultations.	CFM
5.3	Additional Responsibilities	Leeds is participating in the discussions about additional responsibilities. We will be clear in our response to the current consultation that we do not support the transfer of Attendance Allowance or any similar nationally-set benefits.	CFM
5.4	Needs and Resources	Leeds is participating in the discussions about needs and resources through SIGOMA and other representative bodies.	CFM
		Leeds will submit a detailed response to the current Fair Funding Review consultation.	
5.5	Resets	Leeds will be looking at the suggested approaches to resetting the system in detail and contributing to the wider system design process.	CFM
5.6	Devolution	Work with Economic Development to analyse regional need.	CFM; Economic Development
5.7	Design of the 100% retention system	Design issues are discussed in detail in the current consultation.	CFM
		Leeds is represented on the Systems Design Technical Group and contributes to other representative bodies.	CFM

Annex 2: Business rates principles

1. Business rates as a tax

1.1. Business rates are a tax on all non-domestic property except for those categories specifically exempted by statute, such as agricultural land. The ratepayer is the occupier of the property unless it is vacant, at which time empty rates become payable by the owner after a short period of exemption. Each ratepayer's basic liability to tax is determined by multiplying the rateable value of the property by the relevant business rates multiplier and there are then a series of reliefs that can reduce this basic liability depending on the property or the ratepayer's circumstances.

2. Rateable Value (RV)

2.1. The rateable value (RV) of a property broadly represents the annual rent that can be expected from a property on a given date on the open market, as assessed by the Valuation Office Agency (VOA) in accordance with legislation and case-law. Billing Authorities, like Leeds City Council, have no input into this valuation.

2.2. In general the VOA collects rental information from ratepayers in an area and inspects individual properties, using this data to arrive at valuations for each property. However for some types of property a different method has to be used because there is insufficient comparable rental information in an area, such as the "contractor's method" (a measure of the interest that would be charged on the capital required to replace the premises) or the "receipts and expenditure method" (where the VOA deem RV to be related to a measure of profits likely to be generated from the property).

3. Rating Lists

3.1. Non-domestic rateable properties fall either into a local rating list or the central rating list. There is a single local rating list for each billing authority in England and Wales, and two central rating lists, one for England and one for Wales. The majority of rateable value is contained in local rating lists (over 95 per cent across England and Wales). The total rateable value in Leeds exceeds £900 million.

3.2. Some properties are deemed by the Secretary of State to form part of a network across the country, such as utilities, telecommunications and the railway network including railway stations. These are listed on a Central List and the business rates yield from these properties is collected by the Secretary of State and paid into the Treasury's Consolidated Fund.

3.3. According to the Local Government Finance Act 2012 all business rates income received from properties on the Central List, along with all income from Central Government's share of business rates from local lists, must be redistributed to local government. In 2015-16 the amount of business rates income credited to the Government's accounts from the Central List was £1.3 billion.

4. The Multipliers

4.1. The multipliers, or poundage, are set by Government each year and there are two basic rates, the small business rates multiplier, which applies to properties with a rateable value below £18,000, and the higher national business rates multiplier for properties above £18,000. In the Budget in 2016 it was announced that the threshold of £18,000 is to be increased to £51,000 from 1st April 2017.

4.2. Each April the small business rates multiplier is increased by the retail price index although the Government has the power to limit these increases, which it did in 2014-15 and 2015-16. Billing authorities have no control over the level of the small business rates multiplier. In 2016-17 the small business rates multiplier is 48.4p.

4.3. The higher national business rates multiplier is set so that it theoretically generates sufficient extra revenue nationally to fund the small business rates relief scheme. In Leeds City Council's area this supplement generated an additional £9.89 million in 2015-16. In 2016-17 the national business rates multiplier is 49.7p.

5. Reliefs

5.1. There are various relief schemes that can reduce a ratepayer's basic liability depending on the property's or the ratepayer's circumstances. Some of these schemes are mandatory and a billing authority has no choice but to award them if they apply to a ratepayer's circumstances; others are discretionary, with the billing authority having the ability to set its own policy regarding when to award them. A list of the various reliefs is given in **Figure 2.1** below alongside their cost in the Leeds City Council area in 2015-16.

5.2. Since the introduction of the business rates retention scheme, Leeds City Council has to meet 49% of the cost of all reliefs. The exceptions are small business rates relief, where half of the cost to the authority is funded by central government, and those reliefs that have been introduced by the Government since the beginning of the business rates retention scheme in 2013-14, which are fully funded by the Government.

5.3. In recent years there has been concern about the use of rules around mandatory reliefs by ratepayers to evade or avoid taxation, especially the rules around mandatory charity relief and empty rate relief.

6. Revaluations

6.1. Revaluations of RVs are normally undertaken by the VOA every five years. New valuations are made across the country as at the date two years before those valuations come into effect. So, for example, the last revaluation became effective from 1st April 2010 but was based on valuations assessed as at 1st April 2008.

6.2. When a revaluation takes place the total tax take across the whole country must remain constant and the multiplier is adjusted to compensate for increased or reduced total RV. A revaluation does, however, redistribute national yield between areas, meaning that

regions that have experienced growth in property values above the national average will pay a higher share of business rates than other areas.

6.3. The Government delayed the revaluation due to take effect from 1st April 2015 to 1st April 2017. The delay caused some opposition because the valuation date of the 2010 ratings list was just before the global financial crisis, and property values then fell in many areas of the country. The revaluation process is illustrated in a simple model at **Annex 5**.

6.4. Following a revaluation, ratepayers who experience a large increase in their RV will receive transitional relief to cushion the increase, with the relief gradually decreasing over five years. This relief is theoretically funded by restricting the gains that other ratepayers, who have experienced large falls in their RV, experience over the same five years.

7. Appeals

7.1. All ratepayers have the right to appeal to the VOA if they consider that their RV has been set too high at the time of the revaluation or if there has been "a material change of circumstance" that they consider should result in the RV of their property being reduced. Appeals can result in reductions being backdated to the point at which the valuation became effective. They can be made by a ratepayer, or their agent, at any time until a year after the next revaluation. Billing authorities have no right to present evidence at an appeal. A more detailed account of the appeals system and how it is affecting Leeds City Council's income from business rates is given at **Paragraph 3** of the briefing note.

8. The role of the billing authority

8.1. Leeds City Council, as a billing authority, has no role in setting the RV of properties in the city or setting the multipliers and therefore has no role in setting ratepayers' basic liability for business rates. It also has no role in the appeals process when an RV is challenged by the ratepayer.

8.2. A billing authority's role is limited to calculating and collecting the business rates owed by a ratepayer and deciding what rules to set about discretionary reliefs within the statutory framework. Where a ratepayer does not pay their business rates liability to the authority, it has a range of powers to recover the sums owed.

8.3. Before the business rates retention scheme councils collected business rates purely as an agent of the Government passing all the net revenue to the Department for Communities and Local Government. Since 2013-14, however, councils act as both principal and agent, collecting business rates both to keep (a 49% share) and to pass to central government and the fire authority. As a result councils have needed to set aside funds to make provision to meet the cost of future repayments to ratepayers following successful appeals.

Figure 2.1: Reliefs and their cost in Leeds

Reliefs	Max relief to be awarded	Amount awarded by Leeds City Council in 2015-16	Net cost to Leeds City Council in 2015-16	Comments
		£	£	
Mandatory Reliefs				
Mandatory Charity Relief	80%	23,824,601	11,674,054	Must be awarded to charitable organisations using non-domestic property for charitable purposes
Empty Rate Relief	100%	23,630,873	11,579,128	Must be awarded to owners of empty property for up to 3 months (6 months for industrial properties) immediately after a property becomes vacant
Small Business Rates Relief	100%	17,134,684	4,197,998	100% for properties with an RV less than £6,000 and then on a sliding scale up to an RV of £12,000. 50% of the cost reimbursed by central government.
Partially Occupied Properties	N/A	574,509	281,509	Available for distinct parts of a building that are vacant and certified by the VOA
Community Amateur Sports Clubs	80%	345,776	169,430	
Rural Rate Relief	50%	10,599	5,194	
Subtotal - Mandatory Reliefs		**65,521,042**	**32,105,311**	
Discretionary Reliefs				
Non-profit making bodies	up to 100%	423,539	207,534	Available to organisations that are not charitable but are not for profit at the billing authoritys discretion as set out in its published policy
Charitable occupation top up	top up to 100%	53,339	26,136	Available to organisations that receive the mandatory relief to top up to 100% at the billing authority's discretion as set out in its published policy
Community Amateur Sports Clubs top up	top up to 100%	50,424	24,708	Available to organisations that receive the mandatory relief to top up to 100% at the billing authority's discretion as set out in its published policy
Rural shops	up to 100%	5,620	2,754	
Small rural businesses	up to 100%	4,982	2,441	
Localism Act reliefs	up to 100%	194,147	95,132	At the billing authority's discretion reliefs can be awarded to any ratepayer in accordance with the authority's published policy if it considers it is in the interests of council taxpayers to do so
Hardship relief	up to 100%	278,162	136,299	
Subtotal - Discretionary Reliefs		**1,010,213**	**495,004**	
Government mandated reliefs				
"New Empty" properties	100%	48,068	0	Available to the owners of all new buildings that remain empty after completion for up to 18 months
"Long-term empty" properties	100%	277,639	0	Available to all ratepayers occupying premises that had been empty for more than 6 months
Retail relief	£1,500	4,452,373	0	Available to all retail premises with an RV below £50,000 up to 2015-16
Flooding relief	100%	955,395	0	Government funded reliefs introduced after the storms in winter 2015
In lieu of transitional relief	N/A	71,838	0	Normal transitional relief no longer existed after 31 March 2015, so the Government introduced a replacement relief for smaller properties
Subtotal - Government mandated reliefs		**5,805,313**	**0**	
Total reliefs awarded		**72,336,568**	**32,600,315**	

Annex 3: The Current System - 50 per cent retention

1. The current Business Rates Retention Scheme (BRR) was introduced in 2013/14.

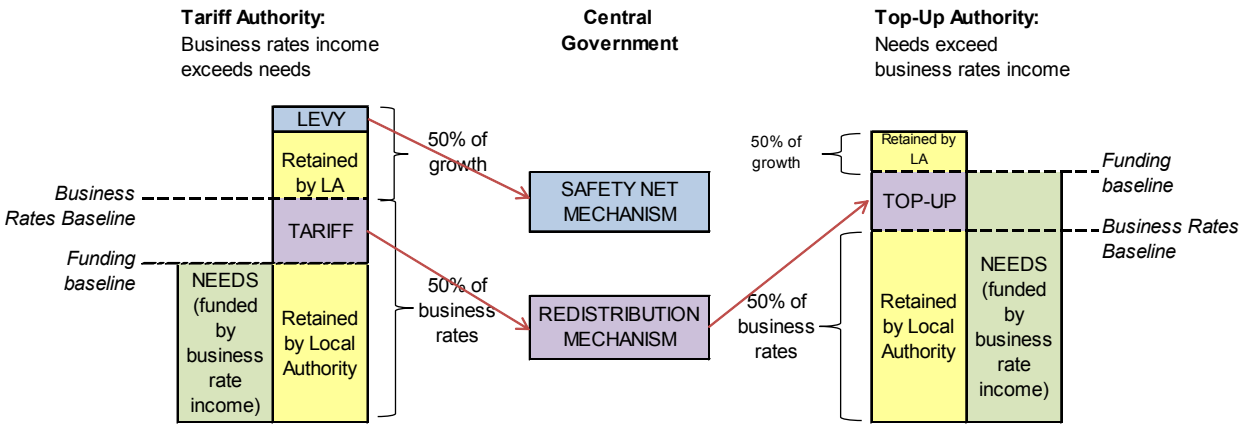
2. When the scheme was set up, a 'start-up funding assessment' (now known as the 'settlement funding assessment') calculated how much funding each authority required on the basis of an assessment of needs carried out in 2012/13. This is then the Funding Baseline for the authority. The Funding Baseline increases each year in line with the Retail Price Index (RPI) until the system is reset. The first reset was planned to take place in 2020.

3. This funding then comes from two sources: Revenue Support Grant and Business Rates Baseline Funding, also known as an authority's 'local share' of business rates. The Business Rates Baseline is the amount of business rates income the system calculates the authority will achieve. Income collected in excess of this is business rates growth.

4. The BRR scheme permits local authorities to retain 50 per cent of locally collected business rates, so 50 per cent of income collected to achieve the Business rates Baseline and 50 per cent of any business rates growth (the Local Share), with the remaining 50 percent remitted to government as the Central Share.

5. However, because authorities spending needs vary widely and do not match how much an authority will collect in business rates, there are mechanisms within the system to redistribute funding according to authorities' assessed spending needs.

Figure 3.1: The Business Rates Retention Scheme



6. This redistribution is achieved through a system of top-ups and tariffs. Tariff authorities like Leeds are expected to collect more business rates income than they need and pay a tariff to government. These tariffs are intended to meet the costs of providing top-up funding to authorities who need more funding than they can generate.

7. Tariffs and top-ups are calculated by comparing an authority's Funding Baseline with their Business Rates Baseline, so they do not take account of business rates growth.

8. Some authorities could achieve very high levels of business rates growth, whereas others might experience significant decline in business rates income, for example as a result of the closure of a major business in their area. A separate system of levies and safety net was established to adjust for such disproportionate gains and losses.

9. Authorities experiencing business rates growth will pay a levy on the 50 per cent of growth income they retain. Government use this levy income towards funding a safety net which guarantees that, each year, all local authorities will receive at least 92.5 per cent of their original baseline funding.

Business rates pools

10. The BRR scheme permits local authorities to voluntarily seek designation as a 'pool', allowing them to pool their resources under the scheme (which they could do anyway), but also ensuring that they are treated as if they were a single entity for the purposes of calculating tariffs, top-ups, levies and safety net payments.

11. The Leeds City Region business rates Pool was established in April 2013 with the aim of furthering economic development activities across the region. It has seven members:

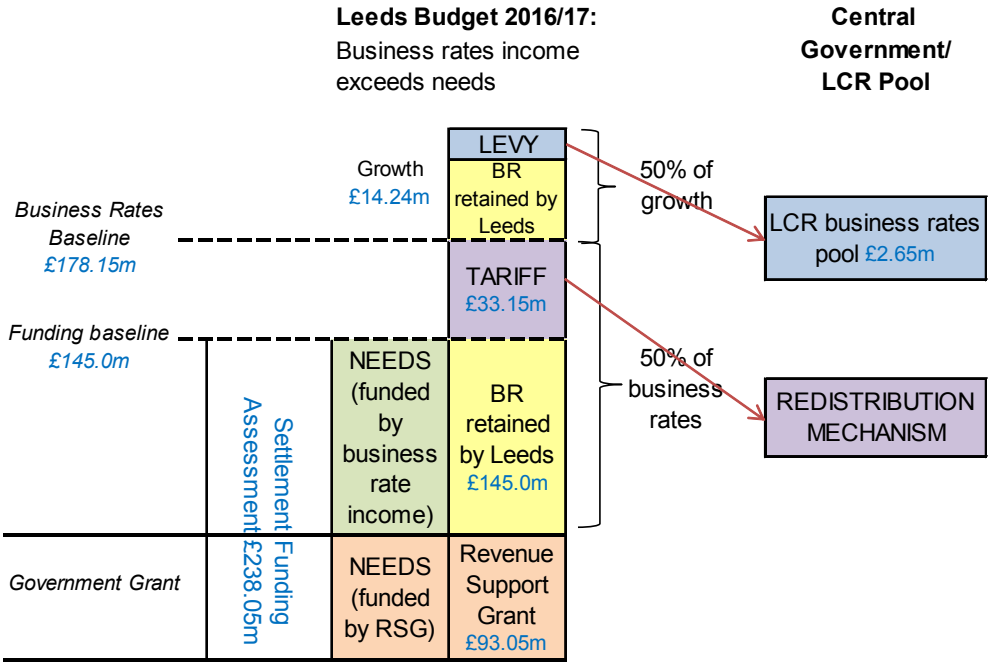
    - the City of Bradford Metropolitan District Council;
    - Calderdale Council;
    - Harrogate Borough Council;
    - Kirklees Council;
    - Leeds City Council;
    - Wakefield Council; and
    - City of York Council.

    The pool is led by a Joint Committee made up of the leaders of the seven authorities and is administered by Leeds City Council.

12. The pool is funded from levies which would otherwise be paid over to central government. Conversely, should any of the member authorities fall into safety net the pool would need to meet any necessary costs as these would not be funded by government.

13. Figure 3.2 shows the budgeted Settlement Funding Assessment for Leeds in 2016/17. The amount actually paid to the business rates pool will depend on the amount of growth achieved in the year.

Figure 3.2: Leeds Budget 2016/17 – Settlement Funding Assessment



Annex 4: Business rates appeals and their effect on Leeds City Council's business rates income

1. Appeals against rateable values

1.1 Every non-domestic property subject to business rates has a rateable value (RV) as assessed by the Valuation Office Agency (VOA) in accordance with legislation. This RV is then taxed using a percentage rate, called the multiplier, set by central government to give a ratepayer's basic liability for business rates. It is therefore in the ratepayer's interest to have as low an RV as possible.

1.2 There are often disputes between ratepayers and the VOA about the RV a property should have, and it is open to a ratepayer to enter a formal process to try and have their RV reduced. A ratepayer can enter this process at any time from when a new valuation comes into effect until a year after the next valuation comes into effect. There are two stages to the appeals process.

2. The stages of the appeals process

2.1 Officially the first stage in the formal dispute process is a proposal, when the ratepayer, or their agent, and the VOA enter into discussions about what the correct RV should be. Minimal information has to be submitted by the ratepayer to enter the proposal stage. If no agreement can be reached the ratepayer can then lodge a formal appeal with the Valuation Tribunal for England (VTE), a judicial body, for a ruling. The VTE is further supervised by the higher courts.

3. Successful appeals

3.1 The VOA has released data estimating 28.4% of appeals in Yorkshire and the Humber are successful and these can be categorised into two main types.

3.2 The first involve reductions that are backdated to the time the valuation came into effect, i.e. the beginning of the current ratings lists. Fundamentally these are correcting valuation errors made by the VOA and have been termed "tone of the list" appeals. Under the current list, these successful appeals result in backdated reductions to April 2010 with a refund stretching back seven years. Local authorities have to meet 50% of the costs of settling these backdated appeals back to 2010, despite the current business rates scheme only having being introduced in April 2013 so authorities had not shared the original benefit in full.

3.3 "Tone of the list" appeals are currently overshadowing Leeds' achievements in attracting growth to the city because of the 'gearing effect' of losses caused by backdating. If Leeds suffers a loss of £1 in RV from a successful appeal that is backdated to 1st April 2010 it must achieve approximately £6 in growth in RV to compensate for the cost. This is illustrated in **Figure 4.1** below.

3.4 The second main type of successful appeal is a "material change in circumstance" following a change in the specific building or the surrounding area. An example of this in Leeds is the reductions in RV following the opening of the Trinity shopping centre. The VOA consider that a city centre like Leeds has a certain capacity for retail and the provision of further retail space inevitably, therefore, leads to reductions in RV elsewhere in the city centre. The consequent reductions in the RV of shops in the city centre are ongoing and are backdated to April 2013 when Trinity opened, and include shops that have not lodged a formal proposal or appeal. We currently

hold provisions of £3.52 million, on the advice of the VOA, for all the properties that have not been dealt with by them yet.

4. Valuation Officer Reports

4.1 Linked to reductions because of successful appeals are Valuation Officer Reports which occur when an appeal in one part of the country have a more generalised effect in other parts of the country. The VOA will issue instructions to billing authorities to reduce the RVs of the relevant properties even though these other properties have not previously lodged an appeal.

4.2 A recent example of these types of reductions followed a Court of Appeal ruling that changed the methodology of assessing the RVs of purpose-built medical centres and doctors surgeries. This has led to this kind of building experiencing reductions in their valuations of between 50% and 75% across England, backdated to 1st April 2010. Leeds currently holds provisions of £1.23 million for these properties.

4.3 Before Leeds City Council becomes aware of these generally reductions it cannot make a provision for them because they are highly volatile costs and the consequent losses are a significant cost to in-year income.

5. Reform of the appeals system

5.1 The Government has made attempts to reform information sharing between the VOA and billing authorities to help with the management of appeals risk (see para 6.2 below) but as yet this does not seems to have helped local government manage the risk they must carry.

5.2 The Government has therefore recently proposed a major reform of the appeals system itself called “Check, Challenge, Appeal” to attempt to reduce the time lag between the lodging of an appeal and its outcome. The Government hopes that this will reduce the amount of backdated repayments that have to be made and has confirmed it will be introduced from April 2017.

5.3 As the name suggests the new procedure will involve three stages and the Government intends that if an appellant or the VOA do not introduce evidence at an early stage then they shall not be allowed to do so during the final appeals stage. The three stages are: -

- **Check** – where the ratepayer can check the information held by the VOA and attempt to agree changes, or at least agree where they disagree.
- **Challenge –** where the VOA and ratepayer, or agent, will enter into formal negotiations about the correct RV. The ratepayer will have to submit a proposed alternative RV with evidence and there will be penalties for providing misleading information. The VOA will respond only to a complete ‘challenge’**.**
- **Appeal –** where disagreement persists, the ratepayer will be able to submit an appeal to the VTE, but the right to submit new evidence will be restricted.

5.4 The first two stages alone will still be able to continue for up to 34 months before the formal appeal is to be lodged, and it cannot as yet be estimated what effect the new system will have on backdated appeals costs. It is interesting to note that of the 4,500 properties subject to appeal in

the city of Leeds as at 31st July 2016, only 275 (just over 6%) first entered the process more than 34 months ago.

6. Appeals costs in Leeds

6.1 Since April 2013 the cost to the collection fund of settling appeals has been £90.11 million, Leeds' share of this cost being £44.16 million, although this has varied from £12.95 million in 2013-14 (Leeds' share £6.34 million) to £39.06 million in 2015-16 (Leeds' share £19.14 million). This volatility has further added to the difficulty of managing the costs of appeals in the city.

6.2 Leeds City Council, as a billing authority, receives a refreshed list of all proposals and appeals lodged with the VOA and VTE every month. It is this list that forms the basis of the provision that the Council makes each year, holding back income for future repayments due to successful appeals. In line with accounting rules Leeds City Council only makes provisions for appeals and reductions in RV about which it has specific knowledge.

6.3 Unfortunately the information received from the VOA is difficult to assess because the detail is limited. The VOA state that this is because of their duty of confidentiality to taxpayers, as they are a part of HMRC. Despite recent legislation allowing the VOA to release further information to certain bodies, including billing authorities, there has, as yet, been little change in the exchange of that information. Assessing the cost to the Council therefore needs to be based on this limited information, some further advice at meetings with the VOA and the professional judgement of the business rates department.

6.4 As at 31st July 2016 there were 6,194 appeals outstanding in the Leeds City Council area affecting 4,500 properties. This means that RV of over £401million is subject to at least one appeal in Leeds, which is a little under 45% of the total RV in the city and does not include other specific advice we have received about properties, such as retail properties in the city centre. As at 31 July 2016 Leeds City Council has felt it necessary to hold back £23.38 million against future losses due to reductions in ratepayers' RV.

Figure 4.1: Illustration of the gearing effect of backdated appeals

Loss of Rateable Value in 2016-17 backdated to 1 April 2010		**£1,000**
multiplied by small business rates multiplier for: -		
2016-17	0.484	
2015-16	0.480	
2014-15	0.471	
2013-14	0.462	
2012-13	0.450	
2011-12	0.426	
2010-11	0.407	
TOTAL	3.180	
Total cost of refunding ratepayer: -		**£3,180**
Growth in Rateable Value needed in 2016-17		**£6,570**
multiplied by 2016-17 small business rates multiplier: -	0.484	
to meet costs arising from appeal		£3,180
Rateable Value has to grow by £6.57 to meet loss in RV of £1.00 due to backdated appeal		

Annex 5: Revaluation

1. Revaluation is the point in the system at which economic changes in property values are reflected in rateable values. Between revaluations, rateable values only change through appeals and physical changes to the property or location. The Government is required at the point of revaluation to reset the multiplier to ensure no more is raised in total business rates, although rates payable for individual properties can change.

   Figure 5.1: Simple Revaluation Model

	Authority A	Authority B	Authority C	Authority D	Total
Before Revaluation					
Property 1	800	250	900	800	
Property 2	1,000	1,200	900	700	
Property 3	1,500	600	1,000	600	
Total RV before revaluation	3,300	2,050	2,800	2,100	10,250
Multipier	0.48	0.48	0.48	0.48	
Income generated	**1,584**	**984**	**1,344**	**1,008**	**4,920**
After Revaluation					
Property 1	1,000	300	1,000	1,011	
Property 2	2,000	1,300	1,000	885	
Property 3	2,000	700	1,000	758	
Total RV after revaluation	5,000	2,300	3,000	2,654	12,954
New Multiplier	0.38	0.38	0.38	0.38	
Income generated (unchanged)	**1,899**	**874**	**1,139**	**1,008**	**4,920**
% increase in RV	52%	12%	7%	26%	26%
% change in income	20%	-11%	-15%	0%	0%

2. As the illustration shows, a revaluation will increase the business rates income generated for some authorities but others will lose income. The Government then adjusts each authority's **tariff** or **top-up** to ensure that their retained income is the same after revaluation as immediately before.

Annex 6: Self-sufficient local government: 100% Business Rates Retention Summary of Questions

Question 1: Which of these identified grants/ responsibilities do you think are the best candidates to be funded from retained business rates?

The grants/ responsibilities identified in the consultation document are:

- *Revenue Support Grant*
- *Rural Services Delivery Grant*
- *Greater London Authority Transport Grant*
- *Public Health Grant*
- *Improved Better Care Fund*
- *Independent Living Fund*
- *Early Years Grant*
- *Youth Justice funding*
- *Local Council Tax Support Administration Subsidy and Housing Benefit Pensioner Administration Subsidy*
- *Attendance Allowance*

Question 2: Are there other grants/ responsibilities that you consider should be devolved instead of or alongside those identified above?

Question 3: Do you have any views on the range of associated budgets that could be pooled at the Combined Authority level?

Question 4: Do you have views on whether some or all of the commitments in existing and future *(devolution)* deals could be funded through retained business rates?

Question 5: Do you agree that we should continue with the new burdens doctrine post-2020?

Question 6: Do you agree that we should fix reset periods for the system?

Question 7: What is the right balance in the system between rewarding growth and redistributing to meet changing need?

Question 8: Having regard to the balance between rewarding growth and protecting authorities with declining resources, how would you like to see a partial reset work?

Question 9: Is the current system of tariffs and top-ups the right one for redistribution between local authorities?

Question 10: Should we continue to adjust retained incomes for individual local authorities to cancel out the effect of future revaluations?

Question 11: Should Mayoral Combined Authority areas have the opportunity to be given additional powers and incentives, as set out above?

The identified powers and incentives in the consultation document are:

- *An enhanced role in achieving growth*
- *Greater responsibility for the distribution of resources within the Combined Authority area*
- *Greater role in deciding how 'growth' is redistributed across the area*
- *A single area wide 'baseline' of relative need with a single top-up or tariff for the area*

- *Greater responsibility for determining the relative needs baseline itself*

Question 12: What has your experience been of the tier splits under the current 50% rates retention scheme? What changes would you want to see under 100% rates retention system?

Question 13: Do you consider that fire funding should be removed from the business rates retention scheme and what might be the advantages and disadvantages of this approach?

Question 14: What are your views on how we could further incentivise growth under a 100% retention scheme? Are there additional incentives for growth that we should consider?

Question 15: Would it be helpful to move some of the 'riskier' hereditaments off local lists? If so, what type of hereditaments should be moved?

Question 16: Would you support the idea of introducing are level lists in Combined Authority areas? If so, what type of properties could sit on these lists, and how should income be used? Could this approach work for other authorities?

Question 17: At what level should risk associated with successful business rates appeals be managed? Do you have a preference for local, area (including Combined Authority), or national level (across all local authorities) management as set out in the options above?

Question 18: What would help your local authority better manage risks associated with successful business rate appeals?

Question 19: Would pooling risk, including a pool-area safety net, be attractive to local authorities?

Question 20: What level of income protection should a system aim to provide? Should this be nationally set or defined at area levels?

Question 21: What are your views on which authority should be able to reduce the multiplier and how the costs should be met?

Question 22: What are your views on the interaction between the power to reduce the multiplier and the local discount powers?

Question 23: What are your views on increasing the multiplier after a reduction?

Question 24: Do you have views on the above issues or on any other aspects of the power to reduce the multiplier?

The issues discussed in the consultation document are:

- *The appropriate scale for reducing the multiplier could be determined by Mayoral Combined Authorities, alongside decisions on an infrastructure levy;*
- *Whether arrangements should be put in place to limit the impact of decisions to reduce the multiplier on neighbouring areas.*

Question 25: What are your views on what flexibility levying authorities should have to set a rateable value threshold for the levy?

Question 26: What are your views on how the infrastructure levy should interact with existing BRS *(Business Rates Supplement)* powers?

Question 27: What are your views on the process for obtaining approval for a levy from the LEP?

Question 28: What are your views on arrangements for the duration and review of levies?

Question 29: What are your views on how infrastructure should be defined for the purposes of the levy?

Question 30: What are your views on charging multiple levies, or using a single levy to fund multiple infrastructure projects?

Question 31: Do you have views on the above issues or on any other aspects of the power to introduce an infrastructure levy?

The issues discussed in the consultation document are:

- *Extension of the power to raise an infrastructure levy beyond Combined Authority Mayors;*
- *To extend the business consultation requirements more widely;*
- *Inclusion of a discount power for Business Improvement Districts;*
- *Amendment of the definition of infrastructure to provide authorities with greater flexibility.*

Question 32: Do you have any views on how to increase certainly and strengthen local accountability for councils in setting their budgets?

Question 33: Do you have views on where the balance between national and local accountability should fall, and how best to minimise any overlaps in accountability?

Question 34: Do you have views on whether the requirement to prepare a Collection Fund Account should remain in the new system?

Question 35: Do you have views on how the calculation of a balanced budget may be altered to be better aligned with the way local authorities run their business?

Question 36: Do you have views on how the Business Rates data collection activities may be altered to collect and record information in a more timely and transparent manner?

(Text in italics has been added to clarify the questions as originally written.)

Annex 7: Fair Funding Review: Call for evidence Summary of Questions

Question 1: What is your view on the balance between simple and complex funding formulae?

Question 2: Are there particular services for which a more detailed formula approach is needed, and – if so – what are these services?

Question 3: Should expenditure based regression continue to be used to assess councils' funding needs?

Question 4: What other measures besides councils' spending on services should we consider as a measure of their need to spend?

Question 5: What other statistical techniques besides those mentioned above should be considered for arriving at the formulae for distributing funding?

The techniques discussed in the consultation document are:

- ***Expenditure based regression*** *– This technique attempts to explain the variation in spending between local authorities by using the characteristics of areas and their populations.*
- ***Non-expenditure based regression*** *– This is where indicators of need are calculated using data from key service statistics.*
- ***Multi-level modelling*** *– This technique takes account of the nested sets of data available on local authority services. It allows needs indices to be calculated based on how well they predict expenditure within a typical local authority, as opposed to between them.*

Question 6: What other considerations should we keep in mind when measuring the relative need of authorities?

Question 7: What is your view on how we should take into account the growth in local taxes since 2013-14?

Question 8: Should we allow step-changes in local authorities' funding following the new needs assessment?

Question 9: If not, what are your views on how we should transition to the new distribution of funding?

Question 10: What are your views on a local government finance system that assessed need and distributed funding at a larger geographical area than the current system – for example, at the Combined Authority level?

Question 11: How should we decide the composition of these areas if we were to introduce such a system?

Question 12: What other considerations would we need to keep in mind if we were to introduce such a system?

Question 13: What behaviours should the reformed local government finance system incentivise?

Question 14: How can we build these incentives in to the assessment of councils' funding needs?

(Text in italics has been added to clarify the questions as originally written.)