APPENDIX 1

100% Business Rates Retention – Further consultation on the design of the reformed system

Policy Context

1. The proposal supports the vision for Gateshead as outlined in the Sustainable Communities Strategy, Vision 2030 and the Council Plan. In particular, it supports the priority to ensure a sustainable Gateshead by building capacity across the Council and ensuring the best use of resources.

Background

2. At the beginning of July 2016, the Government published a consultation entitled “Self-sufficient local government: 100% Business Rates Retention”. A report to Cabinet on 11 October 2016 outlined the Council’s response to this consultation. This report outlines a brief summary of the Government response to that consultation and then provides a further response to the next phase of consultation on the design of the reformed system.

3. The first stage consultation covered a number of broad areas relating to the retention of 100% of the business rates collected by local authorities. The themes covered were; issues connected with the devolution of responsibilities to local government to ensure fiscally neutrality, the design and operation of the new business rates retention system; the design and operation of new flexibilities over business rates tax; and, consequences of a reformed local government finance system, particularly in terms of accounting and accountability.

4. The Government have made a number of decisions following their response to the first stage of the consultation:

   - All councils will be invited to apply to participate in piloting aspects of 100% Business Rate Retention from April 2018. More information will be published about this process shortly.
   - Subject to Parliamentary approval, the Government aims to introduce the new system for the financial year 2019/20. Note that this timeframe currently overlaps the last year of the multi-year settlement offer.
   - The Government has now published and introduced into Parliament primary legislation which is intended to provide a framework for the reforms building on similar legislation which underpinned the current 50% rates retention system. The Bill provides for detailed aspects of the system to be set out in secondary legislation.
   - A response to the call for evidence on the Fair Funding Review will be published shortly.
   - The Government has confirmed that Revenue Support Grant, Rural Services Delivery Grant, the Public Health Grant and the Greater London Authority Transport Grant are to be funded through retained

business rates. The Government will further consider whether any transitional measures for devolving these grants are required. Taken together, these announcements account for around half of the anticipated additional retained business rates quantum. The Government will continue to explore areas of remaining responsibilities identified in the first consultation and will consult further if necessary. The aim is to decide on a package of grants and responsibilities to be devolved in spring 2018 for potential implementation in April 2019.

- The Government has also confirmed that the devolution of Attendance Allowance funding is no longer being considered as part of the reforms.
- The Government has confirmed that the new burdens doctrine will continue post 2020.
- The Government will look to build fixed reset periods into the system. In addition, the Government will explore how a partial reset could help to establish a reasonable balance between rewarding growth and redistribution for changing need.
- The Government intends for redistribution of resources to continue through a system of tariffs and top-ups.
- The Government will continue to explore the options for local authorities to work together over a wider geographical area, with appropriate governance arrangements in place.
- Risks and volatility in relation to appeals have been recognised by the Government. The Bill introduces legislation that allows the Government to assist local authorities to manage the risk and income volatility associated with appeals. To do this, the Bill includes a provision for “loss payments” that will be funded through a top-slice and held and distributed centrally. Details about how loss payments are calculated and made will be set out in further proposals later in the year.
- The level of safety net that currently operates for the 50% business rates retention scheme is 92.5% of baseline funding levels. The 100% business rates retention pilots for 2017/18 will be trialling a safety net set at 97% of baseline funding.
- Ahead of the introduction of 100% Business Rates Retention, the Government intends to set out a clear statement of policy for which properties should be assessed to the central list.

5. The second phase of the consultation looks in more detail at:

- Partial resets
- Measuring growth
- Pooling and local growth zones
- Tier splits
- Safety Net
- Central list

6. The deadline for response to this second phase of consultation is 3 May 2017. The Council's proposed response is shown in the attached annex.

Consultation

7. The Council has been represented on the Association of North East Councils (ANEC) working group.

Alternative Options

8. There are no alternative options.

Implications of Recommended Option

9. **Resources:**

   a) **Financial Implications -** The Strategic Director, Corporate Resources confirms that any financial implications are subject to the outcome of the consultation and the call for evidence and will be the subject of future reports. The Council is clear that fairness in funding should be given precedence within the new framework and that "fair funding" must be reflective of need and be transparent.

   b) **Human Resources Implications –** None.

   c) **Property Implications –** None.

10. **Risk Management Implications –** Whilst the Government has outlined that the move to 100% business rates retention will be fiscally neutral on local government financing, there is a significant risk facing individual authorities in particular concerning the fairness of the needs assessment and the eventual baseline funding level at day one of the system.

11. **Equality and Diversity Implications –** None.

12. **Crime and Disorder Implications -** None.

13. **Health Implications –** None.

14. **Sustainability Implications –** None.

15. **Human Rights Implications -** None.

16. **Area and Ward Implications –** None.

17. **Background Information –** Government publications - Self-sufficient Local Government: 100% Business Rates Retention Consultation Document, Business Rates Reform Fair Funding Review: Call for evidence on Needs and Redistribution and 100% Business Rates Retention – Further consultation on the design of the reformed system.

Annex

100% Business Rates Retention – Further consultation on the design of the reformed system

The Council welcomes the opportunity to respond to the further consultation on 100% Business Rates Retention.

The retention of 100% business rates is an important step towards achieving fiscal devolution but it is essential that it be underpinned by a fair funding framework which takes into account local needs and demographics, recognising different areas capacity for growth and the ability to raise income locally. Poor economic performance is intrinsically linked with higher incidence of health and social issues that directly drive the demand for local authority services[1]. From the outset of the new system, only genuine fair funding that meets the needs of the Borough of Gateshead and the wider region will enable the concept of fiscal devolution to succeed. The Fair Funding assessment will be the primary determinant of retained funding and the importance of the review should not, therefore, be underestimated.

Question 1: What are your views on the proposed approach to partial resets?

The approach of a partial reset is supported by the Council in principle, but with a number of caveats:

- Any approach should support and not hinder the effects of encouraging economic growth. The retained element needs to be sufficient to encourage growth and modelling will be needed to understand the impact on the Council, enabling a more informed response. As outlined in the Council's response to the previous consultation, resets need to include updates of needs and equalisation and should be aligned to revaluations.

- The proposed 100% BRR system is fundamentally flawed in that it rewards areas for economic growth regardless of their economic power, geographic and demographic situations. As a result, councils could be rewarded for growth where this is unrelated to their activities in more affluent areas and conversely, poorer areas may suffer unnecessarily despite delivering strong results due to factors outside their control. It is possible that this will result in a two-tier system where inequalities become further entrenched.

- Related to the point above, there is an implicit assumption that councils use the additional funding to support services. However councils will not be able to rely long-term on any funding streams associated with growth due to the reset mechanism. This could provide councils with very little opportunity or incentive for long-term planning.

[1] CIPFA Insights; developing local economies

- A system based on local economic factors has no link to changes in needs / statutory service provision. The danger is that funding becomes linked to national and international macro-economic conditions and as such becomes dislocated from need. There can be very significant changes in a 5-year period, in particular due to the current instabilities and uncertainties and the system will not be able to act responsively.

- The consultation documentation is unclear as to what happens following a reset to any additional business rates income generated in the 5-year period between resets:

Question 2: What are your views on how we should measure growth in business rates income over a reset period?

Any measurement of growth needs to be made against a fair baseline and needs to be simple and transparent. Although both are important it is clear that fairness in funding needs to take precedence over incentives.

The National Audit Office (NAO) report; Planning for 100% local retention of business rates raises (29 March 2017), outlined that the link between business rates and economic growth is not direct, raising the point that increases in tax base growth does not necessarily generate economic growth. This raises the issue of the definition of 'growth' before it can be determined and how it can be measured.

The report went on to outline that the Government has made no formal assessment of whether the current 50% scheme has promoted economic growth and assessing the growth impact will be complex because it is difficult to control for the impact of the growth incentive in the context of other factors acting on local authorities. These issues need to be clarified before growth can be incentivised as part of the proposed reset period under the 100% scheme.

The Government also needs to be careful that a reset does not remove the rewards from councils. A rolling 5-year reset would be more sensible, and would smooth the impact of economic shocks.

Question 3: What are your views on the Government's plans for pooling and local growth zones under the 100% Business Rates Retention system?

The Council does not agree with the ability of the Secretary of State to designate pools of authorities. Councils should not be put in a position where they may be forced into a pool at the command of the Secretary of State and it considers this ability to be against the spirit of localism. Councils should not be forced to compete against each other and the Government must acknowledge that it is not always possible for councils to work together in a complementary way. However, councils are generally keen to work together, and as such the Council welcomes the intention to explore additional rewards for pools of authorities.

Allowing councils to keep a proportion of business rates growth received from the locally established 'growth zone' area would be seen as beneficial but further information is needed on the parameters to be set by the Government.

Question 4: How can we best approach moving to a centrally managed appeals risk system?

The Council welcomes the new provision to provide for 'loss payments'. Aligning these payments to councils who have been subjected to 'valuation errors' will be seen as a step towards sharing risk on appeals, however, the definition of a 'valuation error' would need to be clearly defined.

A centralised appeals system is a sensible approach, but obviously the top-slice would need to be fairly apportioned. The top-slice will also need to be proportionate and returned to councils if not being fully utilised.

Question 5: What should our approach be to tier splits?

Not applicable

Question 6: What are your views on proposals for a future safety net under the 100% Business Rates Retention system?

The safety net system is intended to support councils 'that experience shocks to the system, such as the closure of a major ratepayer'. The current system is haemorrhaging income due to avoidance techniques and companies using insolvency to avoid payment of rate liabilities. Tackling some of these issues would further reduce need for safety net in some areas.

The safety net needs to incorporate an element of change in relative needs. Whilst it is designed to support councils that experience shocks to the system due to the closure of a major employer and the sudden loss of business rates income, it takes no account of the potential sudden increase in demand for council services from those residents who become unemployed.

Question 7: What are your views on our proposals for the central list?

A key issue regarding the central list is how baselines are to be set if the Government decides to move a major asset on to the central list; such councils must not be put at a disadvantage as a result. Additionally, councils should not benefit from national decisions e.g. a new airport or power station location – these should go on the central list and the benefits shared out to all (or perhaps to fund those councils requiring the safety net in the first instance). Any such increases in the list should be shared fairly based on an agreed approach. Any approaches to redistribution should be in line with the fair funding approach and based on a full needs assessment.