

## **COMMUNITIES AND LOCAL GOVERNMENT COMMITTEE**

### **LOCAL GOVERNMENT FINANCE: SUPPLEMENTARY BUSINESS RATE EVIDENCE FROM SIGOMA**

#### **1. SIGOMA**

1.1 SIGOMA, the Special Interest Group of Municipal Authorities, is a network of 45 local authorities representing large towns and cities in the northern, midland and south coast regions of England. SIGOMAs work is led by locally elected members supported by a group of council finance directors and informed by a network of local government finance practitioners in each of our member authorities.

#### **2. SUMMARY**

2.1 The proposal to establish a supplementary business rate comes at a very challenging time for the wider local government funding system, with the Government unwilling to address long term issues like council tax revaluation and council tax bands, as well as damping changes to the distribution of mainstream funding so that resources are poorly targeted.

2.2 There is some merit in the proposal, but we are concerned that a supplementary business rate could be used to by-pass these structural problems and fill holes in council budgets, rather than invest in growth.

2.3 For local authorities to be able to manage this situation properly, we would like to see supplementary business rates accompanied by parallel reforms to:

- Ensure that mainstream funding systems operate more efficiently, in particularly damping arrangements are removed in key areas like social services.
- The LABGI scheme is reformed and placed on a longer term footing so that it acts as an incentive to areas with a lower business tax base.
- There are clear controls in place to stop areas with a very large business tax base from subsidising council tax bills.

2.4 Without these changes, the proposals will be seriously compromised – for example, SIGOMA areas would have to set a 2.2 pence supplementary business rate just to make up for the funding shortfall of £227 million that we now lose through social services damping.

#### **3. CONTEXT**

3.1 The proposal to establish a supplementary business rate with some form of discretion for local authorities comes at a very challenging time for the wider local government funding system and this proposal needs to be understood in this larger context.

3.2 SIGOMA has supported Sir Michael Lyons' Inquiry into the roles and funding of local government since its inception, and welcomed the final report published in March this year. However, we have been disappointed with the Government's response to many of the key

proposals in the report, specifically on the reform of local government funding. In particular, the Government's immediate response to Lyons, in the Budget report, stated that it:

- will not remove council tax capping powers over local authorities and continue to cap if necessary, undermining the relationship between local and central government as well as the discretion and accountability of local councils;
- remains committed to not implementing revaluation for council tax in the lifetime of this parliament, meaning that council tax levels are based on information more than 17 years out of date and do not reflect the current patterns of property values across the country;
- does not see it as feasible to change the banding structure of council tax, in the absence of wider revaluation, meaning that council tax burden continues to fall unfairly upon less wealthy households.

3.3 In addition, SIGOMA is also working with the DCLG to illustrate the impacts of the Government's decision to damp changes to mainstream local government funding formulae, specifically for social services. This damping regime means that mainstream resources are not being targeted effectively or fairly to the areas that need them. For social services alone, it means that SIGOMA local authorities lost around £250 million of grant in 2006/07 and are currently under-funded by £227 million for 2007/08.

3.4 Based upon these ongoing and systemic weaknesses in the local government finance system, one response from the local government sector may be to reject any marginal changes until the Government has moved to make the overall system operate more effectively and fairly. However, there is clearly some merit in the proposal for a supplementary business rate and we feel that it could be introduced successfully if the Government also moved to address the current weaknesses in the wider local government funding system.

3.5 In line with this approach, the following sections address the questions raised by the DCLG Committee so that the supplementary business rate may be made to work in SIGOMA areas.

#### **4. Rationale for the introduction of a supplementary business rate**

4.1 SIGOMA supports the general analysis presented in the Lyons report and the justification it provides for establishing a new supplementary business rate set by local authorities within some form of national framework. In particular, we feel that the proposal for a supplementary business rate is pertinent when:

- Local authorities already have some, albeit limited, discretion on local business contributions with the powers to establish a Business Improvement District (BID) and to grant relief from business rates to charities and for hardship;
- Business rates have been falling as a proportion of local government spending, from about 29% in 1996 to 20% today, placing a greater burden on council tax payers;
- There is greater understanding of the need for local authorities to lead local economic development through strategic investment in new infrastructure, redevelopment and local services to nurture growth.

- The Corporation of London already has the power to raise a supplement on business rates, in consultation with local businesses, which it has used to generate resources to invest in its own priorities such as additional security.

4.2 BIDs have limitations. They are generally shorter term and limited to individual projects or sub areas within an authority, so greater discretion is needed to provide additional funding on a wider scale. A supplementary business rate would help provide this. There is also a general belief that businesses would be prepared to pay a fair price for additional quality and efficient services and so contribute to a supplementary rate. The success of BIDs in many areas has illustrated this.

4.3 However, given the failings of the current local government funding system (set out above) and the Government's inability to address these, we are concerned about introducing a supplementary business rate at the current time. In particular, we feel that the supplementary business rate may be interpreted by some Government departments and local authorities as a way of by-passing the structural problems with the wider funding system, enabling some councils to raise money to deal with the funding challenges that these problems cause. The use of the supplementary business rate to make up for the failings of the wider funding system would undermine the principle of equalisation that is at the heart of local government funding as well as the relationship between local councils and their business partners, diluting the potential impact on economic development and regeneration that they are designed to address.

4.4 As such, we recommend below that weaknesses in mainstream funding needs to be addressed alongside any new supplementary business rate, as well as some measures to ensure that the supplementary rate is not used to cross-subsidise council tax.

## **5. Accountability and approval mechanisms for the introduction of a supplementary business rate at a local level – the role of business in the wider community**

5.1 The introduction of a supplementary rate would place a duty on local authorities to make transparent, accountable and widely supported decisions to vary their local business rate. At the local level, the development of local strategic partnerships in all major towns and cities over the last six to seven years has made it possible for councils to take a stronger community leadership role and make difficult decisions in this way. LSPs are the most suitable forum in which the proposal for a supplementary business rate could be discussed and developed, and are also a good mechanism for holding local councils to account over the way that the supplementary business rate is implemented and monies are used.

5.2 One of the key challenges at the local level will be for local councils and LSPs to show leadership on these issues, setting out a clear case for the use of a supplementary business rate as well as communicating how it will be used and the impact that it is having. There may also be some cases where local partners choose to ring-fence the proceeds from the supplementary rate for particular projects, to create greater confidence and ensure accountability. However, local authorities need to have the discretion to make this decision locally and determine how the proceeds can best be utilised. The importance of local government services to business success and economic growth is well understood in LSPs and will be the basis for making the case for a supplementary rate.

## **6. Consideration of implementation issues, including the impact on local authority tax bills**

6.1 The ability to raise, and determine the level of, a rate will depend on the economic stability of the area. Raising and collecting a supplementary rate will create additional administrative expenses such as in staffing, technology, changes to current software systems and general collection costs. This could have an impact on the viability of raising an additional charge and, given the very different tax bases in different local authority areas, suggests that the rate will need to be carefully set in each local area (see below).

6.2 As the Lyons report argues, ultimately the levying of supplementary rates could be borne by property owners in the shape of lower rental from their properties. Over time, lower rental values will affect the Rateable Values of property in an area and reduced property values will then impact on the potential for LABGI (Local Authority Business Growth Incentive Scheme) gains in a local area.

6.3 It is also important to note that business rates are a more significant tax on business property than comparable taxes in most other European countries. Increases to the level of business rates needs to relate to the wider tax burden on businesses and the Treasury will be required to assure business leaders that that supplementary business rates at the local level are offset by other tax burdens at the national level.

6.4 Overall, it will be important for all revenues from a supplementary rate to be retained locally in order to provide an incentive and enough local business support to raise the charge.

## **7. The impact of a supplementary business rate on equalisation**

7.1 SIGOMA has always argued that equalisation is a core principle for the wider local government funding system. The National Non Domestic Rates pooling arrangements provide for rates to be equalised through centrally distributed grants. However, a supplementary business rate needs to be seen as a quite separate element of the system, the main aim of which is to provide an incentive to local authorities to support and invest in economic growth, as well as provide some of the finance to be able to do this. As such, our understanding of the proposal is that it will not contribute to equalisation and the national pooling system.

7.2 In this case, it is important to understand the very different potential to implement a supplementary business rate in different local areas. Given the disparities between local and regional economies across the country, there is clearly a much greater potential for the supplementary business rate to be significant in larger cities, which have a much larger tax base of local business, as well as in the south east and eastern regions where economic growth has been stronger<sup>1</sup>. The table below illustrates this by showing the rateable values across a number of different local authorities and the additional funding gained from a 1 pence rise in the multiplier.

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<sup>1</sup> See SIGOMA Profile for analysis of disparities between SIGOMA areas and other regions.

<b>Selected top tier authority areas</b>	<b>Total RV 2005* £million</b>	<b>Extra £million from 1p supplement**</b>	<b>Extra £million from 4p supplement**</b>
Rotherham	152	1.52	6.08
Derby	179	1.79	7.16
LB of Bromley	195	1.95	7.82
Newcastle	309	3.09	12.38
Kensington & Chelsea	502	5.02	20.07
Leeds	774	7.74	30.98
Birmingham	948	9.48	37.91
Westminster	2,641	26.41	105.64

\* taken from VOA rating lists for 2005 [www.voa.gov.uk](http://www.voa.gov.uk)

\*\* calculated on RV without any adjustments for reliefs

7.3 Given this reality, there is a potential mis-match between areas that can raise a significant amount of funding from the supplementary business rate and areas that need the investment in infrastructure to strengthen the local economy. This is a point made by London Councils for the London region, but is also applicable to the wider national economy.

7.4 For local authorities to be able to manage this situation effectively, we would argue strongly that the implementation of a supplementary business rate needs to be accompanied by a three parallel reforms to local government finance:

- Firstly, a more serious effort from the Government to ensure that the mainstream local government funding system operates more efficiently and is fit for purpose. Equalisation is a key aim of the system and so undermined when the system fails to operate effectively. For example, this means removing the current damping applied to key local service areas like social services so that the system is allowed to operate effectively, as well as a proper timetable for revaluing domestic properties for council tax so that councils have an up to date and fair base for raising local revenue.
- Secondly, greater thought is given to how areas without a large business tax base, or with less robust local economies, can be incentivised and rewarded for successful economic growth. This may be by placing the current LAGBI scheme on a longer term footing and ensuring that it is more transparent so local authorities have greater confidence in its operation.
- Thirdly, with the potential to raise such large sums in some local areas, there must be clear controls in place to ensure that these are not used to subsidise council tax rates. Although the agreement with business partners on a supplementary rate at the local level will militate against council tax subsidies, there is also a point of principal that has to be guarded against.

## **8. The appropriate scale of the supplement**

8.1 There will be a need to strike a balance between providing sufficient flexibility to enable local authorities to make a real difference to local investment, and ensure that tax rates remain within acceptable limits at the macro economic scale. Current annual rate increases, through use of the PRI cap, provide stability which is essential for businesses in their financial planning. The scale of a supplementary rate should provide similar predictability to ensure businesses do not experience large unplanned increases.

8.2 It is estimated that a one pence supplement across England would raise something over £400 million each year, assuming no impact from the higher tax rate on rateable values. A levy based on penny supplements would provide a uniform increase which would provide businesses with some degree of predictability. However, our calculations in the table above show the very different amounts of money that different local areas will be able to raise from a 1 penny increase. As such, we would support the introduction of an upper limit for the business rate supplement of around 4 pence, within which individual councils are left to set their local rate, which would be shaped by the strength of the local economy and the types of projects that would be funded.

8.3 Finally we also need to understand the context of these proposals and the wider government finance system. As noted above, SIGOMA areas currently see some £227 million of social services funding being lost by damping. We calculate that a supplementary business rate of around 2.2p will be required in SIGOMA areas as a whole just to make up for this shortfall in the current financial year. Clearly this type of budgetary problems in SIGOMA areas is a barrier to wider spending on economic growth and infrastructure. This underlines the need for supplementary rates to be introduced in parallel with reforms to the mainstream system.

## **9. The threshold for payments and whether small businesses should pay**

9.1 The question as to whether small businesses should receive any discount or exemption from a business rates supplement requires serious consideration to ensure that the benefits presented by the recent changes to charges are not lost, but that the system remains as simple and transparent as possible.

9.2 Small business relief has provided a valuable contribution to reducing the rates burden on small businesses. Levying a supplementary rate would proportionally impact more on smaller businesses than larger businesses. Figures suggest that the smallest 90 per cent of properties only represent a little over 30% of rateable value, so a discount or exemption for smaller businesses would not in most places substantially reduce the yield from a supplement.

9.3 However, larger businesses may consider this unfair as they would effectively have to subsidise smaller businesses. Different local areas are also structured very differently, with more or less reliance on smaller businesses as a proportion of the wider local economy. In many former industrial areas, the demise of heavy industry has meant the loss of larger businesses and the more recent growth of many different, often smaller, enterprises.

9.4 As such, we would like to see individual local authorities deciding whether or not to apply a threshold for small businesses, based upon their knowledge of the local economy and its make up. This would also consider the need to keep any supplementary rate simple and clearly understandable for local partners.

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