SOUTH EAST ENGLAND COUNCILS

COUNCILS IN PARTNERSHIP

Correspondence address:

South East England Councils
Room 215 County Hall
Penrhyn Road
Kingston upon Thames
Surrey
KT1 2DN

t: 020 8541 7553
e: heatherbolton@secouncils.gov.uk

Business Rate Review Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Email: businessrates.review@hmtreasury.gsi.gov.uk

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Dear Business Rates Review Team

I write as the Chairman of South East England Councils (SEEC) in response to the discussion paper on business rates published in March 2015.

My colleagues and I in SEEC welcome the review. We believe it is an opportune time to review the system as part of the discussions on further devolution to local government.

Business rates have a key part to play in this debate as a way of helping provide local authorities with the means and direct incentives to invest in the infrastructure and services businesses need to grow.

Please find attached our response to the review.

Yours sincerely

Gordon C. Keymer

Cllr Gordon Keymer CBE
Chairman, South East England Councils
Leader, Tandridge District Council

HMT Business Rates Review
Response from South East England Councils
June 2015

1. Introduction & principles for future reform of business rates

1.1 South East England Councils (SEEC) is a voluntary membership organisation representing the views of all tiers of local government across the South East.

1.2 The SEEC area makes a significant economic contribution to the UK, recording the highest net contribution to the Treasury over the 10 years 2002-2012. Both the South East's net contribution and the South East population are greater than comparable figures from London, for example:

- The South East is home to 8.9m residents compared to London's 8.6m
- The South East net contribution to the Treasury 2002-2012 was £80bn. This means the South East paid £80bn more in taxes than it received in public spending. London's comparable figure was £74bn.

1.3 SEEC calls for four key principles to underpin any changes to the business rate system:

- Maintain South East councils' role in collecting business rates.
- Maintain the links between business rates and South East council areas to ensure business rates help fund the local services and infrastructure required by businesses.
- Move to greater local retention of business rates, including the ability for councils to set rates locally. Ultimately SEEC supports full devolution of all business rate income, not just growth. SEEC also supports devolution of other property taxes to local government such as stamp duty and ATED (Annual Tax on Enveloped Dwellings).
- Greater business rate and property tax retention is important to incentivise South East local authorities to support economic growth.

1.4 In some areas of the South East there are also concerns that purely property-based business rates do not reflect the value of some business sectors. For example, parts of the hi-tech sector occupy small premises but deliver significant economic value and highly skilled jobs.

1.5 SEEC's high level response covers consultation questions 1- 10 as the topics most relevant to local authorities. Member councils may also provide more detailed local information in individual responses.

2. Evidence and data

Q1. What evidence and data can you provide to inform the Government's assessment of the trends in use and occupation of non-domestic property?

Q2. Is there evidence to suggest that changing patterns in property usage are affecting some sectors more than others?

2.1 Latest figures show the South East was home to 285,174 business rated properties in 2013, representing 16.1% of the English total. Only London has more. The number of properties in the South East has increased by 33,313 since 2007 when the South East recorded 14.6% of the English total.

2.2 The South East's business rate income in 2013-14 was £3.35bn. This was 16.3% of the English total. Projections carried out for SEEC by Local Government Futures estimate South East 2014-15 business rate income at £3.41bn. This would give 15.2% of the English total.

2.3 In 2014 the South East had 18.2% of the total number of English businesses. The South East total was 837,090 businesses and, of these, 353,720 were VAT and PAYE-registered. Although there has been an increase of 104,900 in the total number of South East businesses since 2010, the South East's national share of businesses has dropped from 18.9% in 2010.

2.4 Analysis of sectors (using SIC codes) shows how the balance between types of businesses in the South East has changed from 2010-2014. Four sectors show changes of more than 1% in their share of South East total businesses. The strength of Information & Communications and Professional, Scientific & Technical sectors suggests a move towards hi-tech businesses in the South East – sectors that frequently occupy premises with a relatively small footprint:

	2010	**2014**	**change**
	No (% of SE total)	*No (% of SE total)*	
Arts, Entertainment & Recreation	67,155 (9.2%)	85,595 (10.2%)	18,440 (+1%)
Construction	150,880 (20.6%)	143,510 (17.1%)	7,350 (-3.5%)
Information & Communications	44,520 (6.1%)	61,360 (7.3%)	16,840 (+1.2%)
Professional, Scientific & Technical	111,635 (15.2%)	146,530 (17.5%)	34,895 (+2.3%)

2.5 In some parts of the South East, this move towards hi-tech and often highly-skilled employment fits well with councils' economic ambitions. However where hi-tech businesses occupy small premises, for example as a result of flexible or home working this has an impact on business rate income. Councils – and indeed central government – will see reduced business rate income compared to space-hungry sectors such as warehousing as technology reduces the need for staff to be located in a central location.

2.6 Moving away from comparisons purely within the South East, analysis of 2014 BIS data also shows the South East has the highest number of businesses England-wide in two sectors:

- Production (including Manufacturing) with 45,060 businesses in 2014. This is 15.3% of the English total – a percentage that has not changed significantly since 2010. This indicates ongoing demand for production and manufacturing premises in the South East, which is counter to many perceptions of the area.
- Wholesale & Retail Trade (including Motor Repair) with 80,770 businesses. This is 17.1% of the English total, an increase from 16.4% in 2010.

2.7 In a further 11 sectors the number of South East businesses is second only to London, indicating continued demand for a wide range of business premises across the South East.

2.8 In some sectors businesses are spread across England broadly in line with the residents they serve (eg Education and Arts, Entertainment & Recreation). In other sectors, however, the South East is home to notably high proportions compared to the English average. In four sectors the South East hosts some 20% of the English total:

	2014	
	No of businesses	*(% of English total)*
Administration & Support Services	74,900	19.8%
Financial and Insurance	15,085	19.9%
Information & Communications	61,360	20.7%
Professional, Scientific & Technical	146,530	20.8%

2.9 Once again, these figures reflect the South East's strength in hi-tech and high skill sectors. South East local authorities are keen to continue to promote growth in these sectors – an ambition that could be enhanced by introducing targeted business rate incentives.

3. Fairness & sustainability

Q3. What, in your view, does this evidence suggest about the fairness and sustainability of business rates as a tax based on property values?
Q4. What evidence is there in favour of the Government considering a move away from property based business tax towards alternative tax bases? What are the potential drawbacks?

3.1 SEEC wants to maintain councils' role in collecting business rates and to move to a position where local authorities have the ability to set rates locally and retain the full income raised. Locally-set rates will allow councils to make their own decisions on fairness and sustainability of rates according to local circumstances.

3.2 Until the situation is reached where councils have full freedom to set and control business rates, SEEC believes that property should continue to form part of the business taxation system as it is tangible, easy to identify and has a clear link to geographical location. Local authorities have well established, successful systems in place to collect business rates. Maintaining the link between business rates and council areas is important to ensure rates contribute to the local infrastructure and services that businesses need to operate – eg transport, housing, broadband and skills.

3.3 However property does not always capture the value of different businesses and their contribution to the economy. This is most notable when comparing hi-tech, high-skill but small footprint businesses to warehousing operations with their large floor areas and often lower-skilled jobs.

3.4 Many South East local authorities would like to explore additional options to capture the value of hi-tech businesses. This would not only secure fair contributions to local services but would also act as incentive to councils to attract these types of businesses along with the high value jobs and economic success that they create.

3.5 The current business rates system based on floor space means that the highest income is generated by large developments such as warehousing or retail centres. In the South East, for example, warehouses have the highest average rateable value (RV) at £42,000 compared to an average South East RV of £32,000. A similar picture can be seen in all other areas of England except London. In London, offices have the highest average RV.

3.6 Many South East local authorities would like to explore options for business rates to be based on a 'property plus' approach. Maintaining property as a part of the taxation system would ensure a clear link to funding local services and would allow councils to build on existing staff knowledge of the system built up over many years. We would welcome discussions on options for creating such a hybrid system, for example based on property plus one other factor.

3.7 A phased approach to changing the basis of business taxation to 'property plus' would allow both councils and businesses time to adapt to a new system. Moving to a new system of business taxation – for example based entirely on Gross Value Added (GVA), turnover or staff – would require establishment of a radical new system for measuring, monitoring and calculating new business rates.

3.8 Completely replacing the current system would be more complex to administer, would require high levels of investment in training and new IT solutions and would need time to establish partnership working between central/ local government. For example in operating a system based on number of staff working in a business, turnover or profits, local government business rate teams would need access to central government data, such as HMRC records. Less tangible approaches, for example based on GVA, would be less likely to gain wide support as they would be seen by many as too theoretical as a base for calculating business taxes.

4. International comparisons

Q5. What examples from other jurisdictions and tax systems should the Government consider as part of this review? What do you think are the main lessons for the business rates system in England?

4.1 SEEC members strongly support much greater local control and retention of taxation. This already exists in many other countries and is shown in the table below, which academic Tony Travers presented to SEEC members in 2014. His work highlights the fact that UK local government retains only a tiny proportion of taxation compared to international competitor countries.

4.2 The UK's highly centralised approach to funding has also been criticised by the Congress of Europe, which reports that the UK system does not comply with the European Charter of Local Self Government. The Charter has been signed by the UK Government and is widely applied in neighbouring countries.

Sub-national taxation as a % of GDP

	Local government	State/regional government	Local + state/ regional	Central government	Social security	Total
Canada	3.1	12.2	15.3	12.8	2.8	31.0
France	4.6	0	4.6	14.9	23.2	42.8
Germany	2.8	7.6	10.4	11.3	14.0	36.0
Italy	6.5	0	6.5	22.7	13.4	42.9
Spain	3.0	5.8	8.8	11.2	11.9	32.2
Sweden	16.1	0	16.1	23.7	5.5	45.5
United Kingdom	1.7	0	1.7	26.2	6.6	34.8
United States	3.9	5.0	9.1	9.2	6.3	24.8
OECD total (2010)	3.8	5.0	8.8	20.1	8.2	33.7

Source: OECD Stats Index

4.3 SEEC believes the key principle of greater local control and retention of taxation, including business rates, is the main lesson the UK can learn from other countries.

4.4 Within the UK, recent decisions on devolution of taxation in Wales, Scotland and Northern Ireland leave English local authorities with the least local control over income and spending power. SEEC members would like to see the same principles of financial devolution applied to English local authorities via this review of business rates.

5. Incentives & impact

Q6. How can Government use business rates to improve the incentive for local authorities to drive local growth?
Q7. What impact would increased local retention of business rate revenue have on business growth? What would the impacts be on local authorities?
Q8. What other local incentives should the Government consider to further incentivise business growth?

5.1 SEEC wants to move towards full local retention of business rate income, and other property related taxes, as a way of funding and incentivising local economic growth initiatives. To avoid current disincentives where South East business rates are redistributed to other parts of the country we want to see redistribution within the South East.

5.2 **South East impact and incentives**: Research carried out for SEEC by Local Government Futures in 2015 shows that full retention of all business rate income would allow South East authorities greater ability to invest in local services and infrastructure. This income could replace non-ring-fenced central grants paid to South East councils, balancing the impact on central government.

5.3 The research addressed the impact and incentives of full devolution of property taxes to South East authorities, making the point that combined council tax, business rates, stamp duty and ATED would comprise 11% of taxation, leaving 89% available to the Treasury for wider UK-wide spending. Findings included:

- Across the South East, business rates are expected to raise **£3.41bn** in 2015-16, compared to ring fenced grants of **£2.7bn**. If allowed to keep business rates in lieu of ring-fenced grants this would allow South East councils to invest an additional £700m in infrastructure to support business growth in one year alone.
- For 2015-16 if South East councils kept 100% of business rates, SDLT and ATED they would generate income of **£5.8bn**. This is **£3.1bn** higher than the amount received in non-ring-fenced grants from central Government.
- In the South East's two-tier structure there would be wide variations in annual surpluses/ deficits for individual councils so a mechanism would be required to avoid funding reductions in some areas.
- At county/ unitary level 18 out of 19 councils would have a surplus. At either end of the scale are Surrey (surplus £699m) and Isle of Wight (deficit £9m).
- Among districts 60% would generate a surplus and 40% would have a deficit. At either end of the scale are Elmbridge (surplus £11.9m) and Thanet (deficit £7.4m).

5.4 **Incentives in ICLGF recommendations**: SEEC supports findings in the 2015 Independent Commission on Local Government Finance, which would increase business rate incentives by allowing councils more control over funds raised. Relevant proposals are:

- Over 10 years devolve powers, funding and ultimately taxes to local government.
- Freedom for all local authorities to set council tax and council tax discounts and retain 100% of business rates and business rate growth.
- The opportunity for 'Pioneer' areas to have single place-based budgets covering a full range of public services and to manage equalisation of taxation income across a sub-national area.
- An independent body to advise the government on the funding needs of local government and on the allocation of funding to local authorities and 'sub-national areas'.

5.5 **Avoiding disincentives:** In reviewing incentives for growth it will also be critical to ensure that a new system avoids disincentives. At present in the South East, the small amount of permitted business rate retention fails to act as an incentive as it is often outweighed by the operation of top ups and tariffs. These act as a significant disincentive for many South East councils who feel that they see little of the benefit of increasing local economic growth. The complexity of the tariffs and top ups leaves the current system lacking transparency and accountability, both to local voters and the businesses who provide funding through non domestic rates.

5.6 There will remain a need for distribution of business rate funding within the South East and across England. A new local government-led body should be established to lead this work, allowing the sector to agree a more transparent, accountable system for allocating funding. Moving control from central Government to local government will give councils more confidence in the outcomes.

5.7 **Increasing incentives**: SEEC members believe greater devolution of business rate income should be used as a key incentive to encourage councils to invest more in economic growth. Our members support the principle of incentives that link funding to clear deliverables – for example via the New Homes Bonus – and would welcome a similar approach to business rate retention.

5.8 To deliver a genuine incentive, future business rate retention needs to be on a larger scale than the current system, which allows councils to keep only a proportion of growth.

5.9 The ability to set business rate levels locally would allow councils the option of offering discounted or differential rates to encourage economic growth in particular locations or sectors.

5.10 Greater retention of business rate income would enhance councils' ability to meet the needs of local businesses and support their growth. Increased retention would allow councils to invest in local services needed by businesses. In the South East this is particularly important given the area's significant net contribution to the Treasury. The South East's net contribution of £80bn over the period 2002-2012 is the UK's highest and helps fund public spending UK-wide. In the same period London made a net contribution of £74bn.

5.11 To protect this South East contribution to wider public spending, local authorities need the ability to invest in the local infrastructure and services that businesses need to grow – for example local transport, housing, broadband, apprenticeships and wider skills. Without access to additional funding, South East global competitiveness will decline, risking a reduction in South East contributions to Treasury.

5.12 SEEC welcomes incentives available to city areas to drive economic growth but wants to see these also made available to the South East. The South East GVA in 2012 at £203bn exceeded the combined £147bn GVA generated by all eight English core cities combined. Helping cities grow their economies must not be at the expense of investing in the South East where public funding will deliver a high return on investment.

5.13 **Factors outside local control**: It should also be noted, however, that while directly linking a local authority's funding to the performance of its economy overall has its merits, it is not without its flaws. At the moment, a local authority can be rewarded or punished for economic events that are largely out of its control, creating something of a funding lottery. Although a local authority has a level of control and influence on its economy – for example through the planning process or the work of its economic development department – the fate of a local economy, especially a smaller economy, can be disproportionately impacted by events where the local authority has very little or no control.

5.14 The following case study from SEEC member Tonbridge and Malling BC illustrates the point. Recent closure of local business Aylesford Newsprint came with no warning. It was caused in most part by international competition and the strength of the pound, and certainly not due to local issues where the local authority could have had an impact. However, because of the business size and rateable value, closure will have a hugely detrimental impact on a small local authority which is supportive of local business and invests what it can in helping grow the local economy.

5.15 Situations like that faced by Tonbridge and Malling are a double-blow to the community - not only is there the loss of 230 jobs from a business that has been part of the local area for around 100 years, but the local authority is hit financially, thus reducing its ability to help reinvigorate the economy. We would welcome an exceptions policy that takes into account special circumstances such as this to ensure that any incentives or disincentives linked to business rates are fair and proportionate.

6 Alternative approaches to business rates

9. Should business rates be reformed to make them more closely reflective of wider economic conditions and if so, how?
10. If business rates remain a property tax, how do you suggest business rates could take into account the individual circumstances of businesses such as their size or ability to pay rates?

6.1 Many South East local authorities would like to explore options for business rates to be based on a 'property plus' approach. Maintaining property as a part of the taxation system would ensure a clear link to funding local services and would allow councils to build on existing staff knowledge of the system built up over many years. We would welcome discussions on options for creating such a hybrid system, for example based on property plus one other factor.