D BACKGROUND TO SUPPORT CHAPTER 8

INTRODUCTION

D.1 A general introduction to the technical annexes is given in Annex B. This particular technical annex reports on modelling work carried out on options relating to business taxation, as covered in Chapter 8 of the final report. It covers:

- full relocalisation of business rates;
- supplementary business rate;
- the impact of rents on rateable values;
- estimated yield from removing the business rates exemption for agricultural land and buildings; and
- breakdown of the empty property relief.

FULL RELOCALISATION OF BUSINESS RATES

Summary of modelling work

D.2 Modelling was carried out to examine what level of spending a local authority would have been able to undertake on the basis of local tax sources alone if they retained the business rates collected from local lists for their area for 2006-07, rather than paying them into the national pool and receiving an amount of redistributed business rates as part of Formula Grant. Revenues were distributed between the tiers and classes of authority within an area (e.g. counties, fire and police authorities).

Main findings

D.3 The national yield of business rates for 2006-07 was estimated as £17.411 billion. After redistribution between tiers and classes, full relocalisation would have resulted in 65 local authorities raising more revenue from local taxation (council tax and business rates) than their net budget requirement in 2006-07, with the remaining authorities raising less than their budget requirement.

D.4 Continuing with the present level of equalisation under a system of local business rates would therefore require some revenues to be transferred between authorities. This modelling is intended to be illustrative and does not reflect on the different options for the redistribution and pooling of revenues, or the redistribution of the remaining government Revenue Support Grant.

D.5 Table D1 shows how the yield varies by Government Office region. It reflects the pattern of business rate yield which is currently collected by billing authorities and paid into the pool.

Table D1: Local business rates yield by Government Office region

	Yield (£m)	Percentage of England total
North East	648	4
North West	2,029	12
Yorkshire & the Humber	1,473	8
East Midlands	1,208	7
West Midlands	1,599	9
East of England	1,760	10
London	4,455	26
South East	2,866	16
South West	1,373	8
England	**17,411**	**100**

D.6 Table D2 shows the number of authorities in each Government Office region for which over 100 per cent of budget requirement would be funded locally under full relocalisation of business rates, and Table D3 gives a breakdown by class of authority. Such authorities are most common in London and elsewhere in the south of the country, with shire counties being much more likely than shire districts to be over 100% per cent funded in two-tier areas.

Table D2: Number of authorities with more than 100% of budget requirement funded locally, by region

	Number
North East	0
North West	5
Yorkshire & the Humber	3
East Midlands	5
West Midlands	4
East of England	9
London	12
South East	16
South West	11
England	**65**

Table D3: Number of authorities with more than 100% of budget requirement funded locally, by class

	Number
Inner London	5
Outer London	7
Greater London Authority	0
Metropolitan districts	3
Metropolitan fire authorities	0
Metropolitan police authorities	0
Shire counties	28
Shire districts	3
Unitary authorities	19
Shire police authorities	0
Shire fire authorities	0
England	**65**

D.7 Data from this modelling for all local authorities is available in supplementary tables and charts on the Lyons Inquiry website, and Chart 8.5 in the main report shows the level of surplus or deficit for all upper tier authorities.

Data sources

D.8 The figures used for modelling were those submitted to Communities and Local Government (CLG) on NNDR1 returns for 2006-07 and Formula Grant figures as announced in the final 2006-07 Local Government Finance settlement. In addition, the model used data on mandatory and discretionary reliefs, collection costs and estimates of the take-up of small business rate relief provided by CLG. The Formula Grant figures were as announced in the 2006-07 local government finance settlement.[1] Redistribution between tiers and classes was done on the basis of the redistributable amount shares for business rates from the 2005-06 settlement (such shares no longer form part of the grant distribution system, so 2006-07 figures are not available). The model also used data on reliefs, and costs and losses from collection, from 2005-06 provided from NNDR returns submitted by billing authorities to CLG.

[1] Some figures were taken from the provisional, rather than the final, settlement, because they were the most up-to-date available figures at the time of carrying out the particular piece of modelling.

Description of methodology

D.9 The gross business rates yield for each billing authority was calculated by multiplying the total rateable value for the authority's area by the multiplier, and then scaling the amount downwards to reflect the effects of mandatory and discretionary reliefs, and costs and losses of collection, by means of a discounting factor for each billing authority, calculated using data from 2005-06.

D.10 The model then aggregated the local yield from business rates in each billing authority and distributed it between the different tiers and classes of authority using distributable amount shares, as used in the 2005-06 settlement.[2]

D.11 The resulting business rates yield for each local authority was added to its council tax requirement for 2006-07, to give a measure of its local revenues. This was then compared with the authority's budget requirement for 2006-07 Formula Grant to assess what level of spending the authority would have been able to undertake on the basis of local tax sources alone, if full relocalisation were to be implemented. An authority was regarded as being 'over-funded' if its local revenue from business rates and council tax exceeded the whole of its budget requirement.

Assumptions

D.12 The 2006-07 transitional relief scheme is ignored.

D.13 The likelihood of qualifying for mandatory and discretionary reliefs within any authority is the same regardless of rateable value. This underlies the calculation of a discounting factor for each authority, as discussed below.

D.14 The reduction in the business rates yield due to reliefs, losses in collection and costs of collection, is the same proportion of total business rates revenue for each local authority in 2006-07 as it was in 2005-06 – the most recent year for which figures were available when the modelling work was done.

SUPPLEMENTARY BUSINESS RATE

Summary of modelling

D.15 Modelling was carried out to estimate the effect of allowing authorities to set a business rates supplement and for the amount raised as a result to be retained locally. A supplement of one penny was modelled using data for 2006-07. Results are provided below for two models:

- each billing authority retaining its own yield; and
- yields being passed to the upper tier areas in shire areas (i.e. to shire county councils where they exist) and to the Greater London Authority in London.

Main findings

D.16 A one penny supplement would result in an additional business rates yield of £415 million for 2006-07, assuming the supplement had no impact on rateable values. A breakdown of this total by Government Office region is given in Table D4.

[2] The method used for more recent settlements could not be easily replicated, due to business rates being redistributed through the four-block model from 2006-07. More details are given in Annex A.

Table D4: Yield from 1p supplement by Government Office region

	Yield (£m)	Percentage of England total
North East	15	4
North West	48	12
Yorkshire & the Humber	35	8
East Midlands	29	7
West Midlands	38	9
East of England	41	10
London	109	26
South East	67	16
South West	33	8
England	**415**	**100**

D.17 Table D5 shows how the yield from a one penny supplement would be distributed across the classes of authority under each of the options modelled.

Table D5: Yield from a 1p supplement by class of authority

	Model 1: Retained by all billing authorities		Model 2: Upper tier authorities and GLA	
	£ million	% England	£ million	% England
Inner London	72	17	0	0
Outer London	37	9	0	0
Greater London Authority	0	0	109	26
Metropolitan districts	78	19	78	19
Shire districts	159	38	0	0
Shire counties	0	0	159	38
Unitary authorities	69	17	69	17
England	**415**	**100**	**415**	**100**

D.18 Data from this modelling for all local authorities is available in supplementary charts and tables on the Lyons Inquiry website. Chart 8.6 in the main report shows the revenue from a one pence supplement for all upper tier local authorities (with revenue collected by London boroughs rather than the GLA).

Data sources

D.19 The figures used for modelling are those submitted to CLG on NNDR1 returns for 2006-07 and Formula Grant figures as announced in the final 2006-07 Local Government Finance settlement. Assumptions are as for the full relocalisation modelling described above.

Description of methodology

D.20 The supplement was calculated as the additional yield generated by increasing the national multiplier one penny and applying a factor to take account of reliefs, derived separately for each billing authority. No redistribution of Formula Grant was carried out.

THE IMPACT OF RENTS ON RATEABLE VALUE

D.21 In most cases it is the occupier of a property who is liable for paying business rates. However, economic theory suggests that the person who really ends up paying the tax is not necessarily the same as the person who hands over the money initially. In the case of property taxes, economic theory suggests that in the long run the owner is likely to bear the final burden, because he or she will receive lower rents if taxes on occupation are increased.

D.22 Various studies have assessed the degree to which the tax burden is shifted from tenants to landlords in reality, and concluded that it is possible that the adjustment in rents may fully offset the impact on tenants of higher rates over the long run. In the short and medium run, that effect is likely to be reduced by a series of rigidities such as long term leases and upward only rent reviews.

D.23 The Inquiry team modelled the potential effect of higher business rates on property values in order to assess the impact of changes in the business rate on businesses, and on the size of the business rates tax base. A model was constructed which calculated the likely impact on rateable values of a given change in the tax rate, depending on a given assumption about the degree to which an increase in taxation was passed through to lower rateable values.

D.24 The equation which forms the heart of this model is:

$$\Delta \mathrm{RV} = \frac{\mathrm{P} \times \Delta \mathrm{M} \times \mathrm{initialRV}}{1 - (\mathrm{P} \times \mathrm{initialM}) - (\mathrm{P} \times \Delta \mathrm{M})}$$

Where:

- RV = rateable value
- P = the degree to which changes in rates are passed through to rents (where 0 is no impact and –1 is complete offset)
- M = business rates multiplier

ESTIMATED YIELD FROM REMOVING THE BUSINESS RATES EXEMPTION FOR AGRICULTURAL LAND AND BUILDINGS

D.25 Agricultural land and buildings are exempt from paying business rates, and the Valuation Office Agency does not conduct valuations. It is therefore impossible to know for certain how much this exemption is worth.

D.26 However, a proxy for the rateable value of agricultural land and buildings can be developed using data from the Defra Farm Business Survey (FBS) on rental values. This collects information on the finances of a sample of about 1,850 English farms.[3] The FBS collects data on the actual rent paid by tenant farmers as well as an estimated rental value of owner-occupied farms. The latter is a basic judgement linked to the rents paid by similar farms that are tenanted. If it is assumed that these rents/estimated rental values are good proxies for rateable value, then the total rateable value for farms in England is estimated at £1.07 billion. These data also suggest that only a very small proportion of the total rateable value is for farms with rateable values less than £5,000. This implies that the Small Business Rate Relief – used where the rateable value is less than £5,000 - would have little impact on total business rate charges.

D.27 A rough indication of the total business rates that would be payable by agriculture can therefore be achieved by multiplying the £1.07 billion total rateable value by the standard business rate multiplier of 43.3 pence in the pound. Table D6 shows the calculated yield from business rates on these assumptions. In reality, one would expect rental values to fall to reflect the increase in taxation. Using the approach set out earlier in this annex, the likely change in rateable values (assuming full pass through of rates to rental values) and hence in overall yield was also calculated. This is also shown in Table D6.

Table D6: Broad estimate of business rates yield foregone by exemption of agricultural land and buildings

No adjustment	
Rateable value of agriculture (£m)	1,070
Multiplier (p)	43.3
Expected yield (£m)	463
Rents adjust	
Assumed change in rateable value (£m)	-323
New rateable value (£m)	747
New expected yield (£m)	323

[3] The FBS covers only farms with a labour requirement of at least half a full time equivalent. This means that spare-time farms are not included in this analysis. Although there are many of these spare-time farms they account for just 4% of agricultural production and 10% of total agricultural land area. While the total cost to such farms of paying business rates would be small relative to larger farms, the financial impact on individual farms could be more significant.

D.28 This is a very broad estimate of the likely revenues and includes a number of simplifications and omissions. In particular, no assessment is made of the impact on other taxes, such as income tax and national insurance.

BREAKDOWN OF THE EMPTY PROPERTY RELIEF

D.29 National level data is collected from billing authorities on the total cost of empty property relief. However, no national breakdown exists of the contribution to that overall cost made by the different aspects of that relief – how much, for example the 100% relief for industrial hereditaments is worth. A small sample of billing authorities was approached by the Inquiry and they were able to provide details of the cost of empty property reliefs in their areas for 2005-06. These figures were used to provide broadly indicative figures of the national breakdown of the types of empty property relief.

D.30 Table D7 gives the overall figures for the six billing authorities included in the sample (Birmingham, Bury, Manchester, Oldham, Rochdale and Stockton-on-Tees). The billing authorities included in the sample together accounted for £89 million, or 6.7 per cent of the national total of £1,322 million. Table D8 gives equivalent national totals if the breakdown across the six billing authority areas was representative nationally.

D.31 According to the scaled-up estimates, about 80 per cent of the relief was accounted for by either the industrial exemptions, or the 50 per cent relief on longer term empty property. The very small size of the sample and its lack of geographical balance mean, however, that these findings should be treated with great caution. On that basis no attempt has been made to develop a breakdown of these figures by region or by individual authority.

Table D7: 2005-06 empty property relief figures for the sampled authorities

Type of empty property	Liability liability	Rateable value (£m)	Loss in rate yield % England
Industrial hereditaments	Exempt	91.7	37.5
Empty – 50% exempt	50%	157.3	33.1
Listed buildings	Exempt	22.4	9.4
Initial three month period	Exempt	8.9	3.5
Insolvency and debt admin	Exempt	5.2	2.1
RV less than £2,200	Exempt	4.7	2.0
Other, including land only	50%	2.9	0.6
Occupation prohibited by law	Exempt	1.3	0.5
Representatives of deceased	Exempt	0.2	0.0
Sample total		**294.5**	**88.8**
National total		**47,094**	**1322**
Sample as % of national		**0.6**	**6.7**

Numbers may not sum due to rounding

Table D8: Estimated figures for England (based on grossed up sample)

Type of empty property	Liability liability	Loss in rate yield (£m)	% of total % England
Industrial hereditaments	Exempt	559	42
Empty – 50% exempt	50%	493	37
Listed buildings	Exempt	140	11
Initial three month period	Exempt	52	4
Insolvency and debt admin	Exempt	31	2
RV less than £2,200	Exempt	29	2
Other, including land only	50%	9	1
Occupation prohibited by law	Exempt	8	1
Representatives of deceased	Exempt	1	0
Total		**1,322**	**100**

D.32 Data sources are NNDR1 for 2006-07 (which shows national RV total as at 31 December 2005) and NNDR3 returns for 2005-06 for national empty relief total.