Business rates retention
Note 4: Safety net and levies

This is one of four briefing notes about the Government's proposals to radically overhaul local government finance by introducing 100% Business Rates retention. Their prime purpose is to aid understanding of the proposals and rural issues arising. They are based upon research commissioned from Pixel Financial Management.

Current local authority funding from business rates

In essence the current system has two stages. The first stage is formula driven, where central Government (DCLG) calculates: a) what share of business rates each authority should receive based upon needs; and b) what share of business rates income it expects each to collect given their business base.

With some local authorities the expected income outstrips the assessed need and vice versa. A top-up is paid to an authority where assessed need exceeds rateable income; and a tariff is paid by an authority where income exceeds need. The tariff is re-distributed through a national pool. Across all local authorities these top-ups and tariffs must cancel each other out.

The second stage is based on the actual income collected locally through business rates. For a variety of reasons this will always differ from the predicted (or target) amount, which is where the safety net and levies come in, as further adjustments.

How the safety net and levies work

In practice:

- If the rates collected are more than 7.5 per cent below target the safety net kicks in. One reason for this could be a major economic shock or closure affecting the local rates base. In practice this means an authority receives a safety net payment;
- If rates collected are above the target (by any amount) there is a levy deduction made, which the local authority pays over to central Government but remains in the local government finance system (to fund the safety net). Each authority has its own levy rates, which are calculated by comparing the needs and rates baselines. The maximum levy rate is 50%; top-up authorities do not pay a levy.

One complexity is that the top-up and tariff system is used to help redistribute business rates from billing District Councils to non-billing County Councils. In two tier areas this has the odd effect of making districts subject to levies whilst most counties are not. Many (though not all) shire areas manage to reduce the levies due by operating a ‘pooling arrangement’ for district and county business rates.

Rural authorities and the safety net

The bulk of safety net payments go to urban authorities (indeed the picture is distorted by central London, where business rates income appears to be volatile and affected by rating appeals).

Nonetheless, there were twenty-three rural local authorities (classified as R80 or R50) that qualified for a safety net payment in 2014/15. The safety net remains a useful feature for rural (as well as urban) authorities.

Rural authorities and levies

Levies are greater in rural than in urban local authorities. This is partly because many are in two tier areas, with tariff district councils that are subject to levies. The average levy in the most rural (R80) authority areas costs the authorities £2.90 per head of population, compared with £0.40 per head in the most urban areas. In practice, though, the difference is reduced by pooling arrangements in many shire areas.

In all, thirty-one rural local authorities (classified as R80 or R50) paid levies in 2014/15, which collectively cost them £10.4 million.

Overall, then, the operation of the safety net and levies slightly widens the gap between rural and urban authorities in terms of the income they derive from business rates (known as ‘retained rates’). Levies are another reason why shire district councils do not benefit as much as they ought to financially from local economic growth.

RSN asks of Government

To address these issues the Rural Service Network view is that Government should consider the following:

- If levies are to feature in the new system, they should be reforming so it does not penalise certain types of areas (most obviously shire district councils);
- As mentioned in note 2, introducing banded targets for business rates growth, which could be based on past performance and adjusted for any major development sites.

Briefing note number one provides an overview of the proposed business rate changes, whilst notes two and three look at further specific aspects of business rates and the rural issues that arise from a funding system dependent on them.

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