Institute for Fiscal Studies

The Business Rates Revaluation, Appeals and Local Revenue Retention

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The views presented in this briefing note are those of the authors alone. Any errors or omissions are also their responsibility.

Executive Summary

For the last seven years, the business rates that occupiers of non-residential property have paid have been based on the value of their property in 2008. From April 2017, updated property values as of 2015 will be used to calculate rates bills. While the revaluation is meant, as far as possible, to be revenue-neutral (redistributing rates bills according to changes in *relative* rental values of properties), individual occupiers will see major changes in their rates bills. Because the changes in average value have varied significantly, there will also be big changes in the business rates revenues raised in different council areas, which requires that an adjustment is made to the business rates retention system (BRRS), which allocates a proportion of business rates to councils. Appeals by occupiers against their new rateable values will also pose a financial risk to councils, despite an increase in the headline business rates tax rate (the multiplier) to fund the cost of these appeals.

Key findings

Across England as a whole, revaluation will lead to an 11% (cash-terms) increase in the rateable value of the average non-domestic property.

Changes in values are very unevenly distributed though. At a regional level, the largest increases are in inner London (28.4%), with values falling in the North East (–0.9%). More generally, property values are estimated to have gone up by more in the south and midlands than in the north, and by more in the central parts of urban areas than in their hinterlands.

The business rates 'multiplier' will be adjusted so that the revaluation is revenue-neutral, after accounting for a forecast of the costs of appeals against the new values assigned to properties.

This means that the immediate effect of the revaluation will be to increase revenues and the average rates bill by around 4.6%, on top of inflation. The additional revenues raised up front will then be used to fund the cost of successful appeals further down the line. These costs include refunds for 'overpayments' of people who successfully appeal their rateable values.

Revaluation would lead to average bills increasing in London (16%), the South East (4%) and East Midlands (2%), and falling in the other regions of England, after this adjustment.

However, as ratepayers successfully appeal against their rateable values, these bills and revenues will eventually come down. The figures published by the government – which show London as the only region where average bills and revenues will increase (by 11%) – are based on assumed bills after appeals, under the assumption that each region sees appeals in line with the government's forecast for England as a whole.

A complex package of transitional relief will phase in the biggest increases in bills. After accounting for such reliefs, revenues and the average bill in London will rise by 12% above inflation in the first year following the revaluation, 2017–18.

Transitional relief is paid for by phasing in rates cuts for other taxpayers. In 2017–18, these 'caps' to cuts will fully offset the 6% reductions in revenues and average bills in the North West and Yorkshire & the Humber that are implied by the revaluation itself. Individual rates payers due a large cut in bills will, of course, still see some cut, just not as much as they would if the transitional relief scheme did not exist.

More frequent revaluation of properties could provide a better way of smoothing the shock of big overnight changes in values and bills than transitional relief.

This is because, in general, it takes time for large changes in property values to occur. More frequent revaluation would also mean that rates bills are based on more up-to-date information on local economic conditions – whereas transitional relief delays that adjustment process.

The impact of the revaluation on the amount of business rates retained by individual councils under the BRRS will be offset by changes to the redistributive 'tariffs' and 'top-ups' between councils, with the aim of leaving their budgets unaffected by revaluation.

This will prevent some large overnight cuts (and increases) to councils' budgets. It also avoids the risk that councils will try to constrain the supply of local properties to push up rents, values and hence their revenues. But it means councils have less incentive to boost demand for existing properties: they do not benefit from the resulting increases in rents and values. This suggests devolution of other revenues may need to be considered if broader incentives for growth are seen as desirable.

The unequal pattern of growth in rateable values and revenues means that the amount of redistribution of business rates revenues the BRRS needs to undertake will increase slightly.	The total amount of top-ups required will increase from £4.2 billion to £4.4 billion. London councils will see an increase in their net tariff of almost £400 million to £730 million, while councils in the north will get bigger top-ups. This reflects a more general trend towards greater reliance on London for government revenues.
For the majority of councils that see a relative reduction in the amount of business rates they collect following the revaluation (and an increase in their top-up or decrease in their tariff), fiscal incentives to boost local growth will weaken.	This is because their own business rates revenues will be a relatively less important source of their overall funding. Conversely, incentives will strengthen for those councils that see a relative increase in the amount of rates they collect. More generally, the BRRS implies very different fiscal incentives for growth in different parts of the country.
Presently, the BRRS requires councils to bear the risk associated with appeals against rateable values in their areas.	In order to cover the cost of appeals in their area, councils will retain their share of the additional 4.6% business rates raised by increasing the multiplier. This means they will bear the risk of appeals in their area being higher or lower than this forecast for the average cost across England as a whole.
During the first three years of the BRRS (2013–14 to 2015–16), there was significant variation in the amount councils put away in 'provisions' for appeals and in the proportion of these provisions they have had to use.	This suggests that the financial risk associated with appeals is large and difficult to forecast. Furthermore, appeals have been a little larger, on average, in areas that saw big increases in their bills at the last revaluation (in 2010). If this pattern holds again, areas that have seen large increases in rateable values and bills, such as inner London, may be especially likely to find the extra revenues collected up front insufficient to cover the costs of appeals.

The government is currently consulting on 'centralising' the risk associated with appeals that are backdated to the start of the relevant rating list, coming into effect when councils move to retaining 100% of business rates in April 2019.

This proposal would insulate councils from a risk – valuation errors – that is largely outside their control. It would also remove the temptation for councils to 'game' the appeals system by initially over-providing for appeals, claiming 'safety-net' payments from central government, and then releasing the provisions at a later date (a temptation that would have increased under 100% retention).

1. Introduction

For the last seven years, the business rates that occupiers of non-residential property have paid have been based on the value of their property in 2008. From April 2017, updated property values as of 2015 will be used to calculate rates bills. While the revaluation is meant, as far as possible, to be revenue-neutral (redistributing rates bills according to changes in relative rental values of properties), individual occupiers will see major changes in their rates bills, although a system of 'transitional relief' will phase in the biggest increases and biggest decreases in bills.

Because trends in property values have differed quite significantly across the country, the revaluation will also affect how much revenue different councils raise from business rates. When the last revaluation happened in 2010, this was of little concern, as although business rates were collected by councils, the revenues were pooled nationally and distributed to councils as part of their general grant funding from central government. However, since 2013, under England's business rates retention system (BRRS), councils retain a proportion of business rates revenues. The final Local Government Finance Settlement (published 20 February 2017) sets out, among other things, how the government proposes to update the BRRS to account for the shifting of business rates revenues across councils as a result of the revaluation.[1] It also describes how the government plans to find the money it and local government will need to refund occupiers who appeal against their new rateable values: by initially raising more from business rates, and using these extra proceeds to pay for the cost of successful appeals.

The rest of this briefing note proceeds as follows. Section 2 analyses the impact of the revaluation on rateable values and rates revenues around the country, explaining how the various steps in the process of incorporating the revaluation into the business rates system will affect rates bills and revenues. Section 3 focuses on how the revaluation interacts with the BRRS. After a brief description of the BRRS, it sets out how the impact of the revaluation on locally-retained rates will be 'stripped out' and discusses the appropriateness of this treatment approach and how it relates to debates about wider or further fiscal devolution to local government. Section 4 then discusses how appeals are treated in the BRRS and the implications of this for appeals as a result of the 2017 revaluation. It also discusses proposed changes to the way appeals are treated when the 100% BRRS begins in 2019. Section 5 concludes. Appendix A briefly discusses the potential for the economic incidence of business rates – who ultimately bears the burden of them in the form of higher costs or lower income – to differ from who is legally responsible for paying the business rates bill (which is the occupier of the property).

Please note that this briefing note focuses on the business rates system in England. Future work with partners in Scotland and Wales may examine business rates in those countries.

[1] See section 6 of Department for Communities and Local Government, *The Local Government Finance Report (England) 2017/2018*, 2017, available at https://www.gov.uk/government/publications/local-government-finance-report-2017-to-2018.

2. The Business Rates Revaluation

This section begins with a brief description of how the business rates system and the revaluation of business rates work. We then examine how the use of updated rateable values from April 2017 will redistribute the business rates tax base and revenues around the country, and discuss the transitional reliefs being used to phase in the biggest increases and reductions to rates bills.

Business rates and the revaluation process

Non-domestic rates, or 'business rates' as they are commonly known, are a tax levied on the occupiers of non-domestic properties, including shops, offices, warehouses, factories, schools, hospitals, etc., based on the estimated rental value of the property in question.[2] These rental values are assessed and updated on a periodic basis: the last revaluation took place in April 2010 (based on 2008 values) and the next comes into effect in April 2017 (based on 2015 values). If rateable values were not updated periodically, the business rates tax base would become increasingly divorced from actual property values.

In general, the amount of tax due on a property is equal to the most recent assessed value multiplied by a tax rate known as the business rates 'multiplier',[3] although numerous reliefs exist for certain types of occupiers or properties.[4] These reliefs include 'small business rates relief' for businesses occupying a single property that has a very low rateable value, and 'transitional reliefs' for properties that have seen big changes in their values at the time of revaluation, to gradually phase in big increases or decreases in rates bills. Each year between revaluations, by default, the business rates multiplier is increased in line with RPI inflation,[5] although the government can choose to increase it by a lesser amount if it wishes (legislation prevents a larger increase).

Depending on how the property market has performed during the period between revaluations, the aggregate rateable value of properties in England (and hence the rateable value of the average property) may be higher or lower following revaluation. Applying the same multiplier as before the revaluation could therefore lead to higher or lower revenues. However, the use of updated rateable values is designed to redistribute tax bills across taxpayers according to the *relative* change in the value of the property they occupy, but is not meant to lead to an increase or decrease in overall business rates revenues for England as a whole. To ensure this, the multiplier is adjusted so that

[2] Appendix A discusses whether occupiers of non-domestic property actually bear the burden of business rates: while they are formally liable to pay them, they may not actually bear the burden if property values and rents adjust.

[3] For instance, a property outside London with a rateable value of £100,000 would, in general, be liable to business rates of £49,700 given the current 0.497 multiplier for 'large' properties. (Outside London, there is a lower multiplier equal to 0.484 for small properties with a rateable value below £18,000. Different multipliers and thresholds apply in London.)

[4] See, for instance, https://www.gov.uk/apply-for-business-rate-relief/overview.

[5] The government has announced that from April 2020, default uprating will switch to the Consumer Prices Index (CPI) measure of inflation, which is generally lower than the Retail Prices Index (RPI) measure.

following revaluation, the same amount of revenue is raised nationally as under the existing values and multiplier. There are two stages to this adjustment:

- An initial value for the new multiplier is calculated so that when applied to the new rateable values, the same revenues would be raised as under the existing rateable values and multiplier.

- The second stage recognises that occupiers and landlords of properties can appeal against the rateable value assigned to their property by the Valuation Office Agency. In particular, based on a forecast of the revenue effects of successful appeals against the new values, an upwards adjustment is made to the initial figure for the new multiplier, so that, after accounting for appeals against the new valuations, the same revenues would be raised as under the existing rateable values and multiplier.

If the second adjustment were not made, revaluation would progressively erode the business rates tax base. Each revaluation would initially be revenue-neutral, given the newly-assigned rateable values, but as appeals against these values succeeded, bills would be reduced and revenues reduced. Instead, the two adjustments together mean that at the point of revaluation, the national amount of business rates due actually *increases*. These higher revenues are then used to provide the necessary resources to pay for the cost of successful appeals against the new rateable values by occupiers who disagree with the value assigned to their property.

It is also worth noting again that in order to limit the increases in rates bills faced by occupiers of properties that have seen large increases in their rateable value, a system of 'transitional reliefs' is used to phase in these increases. These reliefs are funded by capping the amount by which bills can fall for occupiers of properties seeing large decreases in their rateable value, in effect phasing in said decreases. The transitional relief scheme planned for the 2017 revaluation is discussed further below.

The impact of the 2017 revaluation on rates bills

The 1.86 million non-domestic property values on the business rating list (the official register of values) as at 25 September 2016 had a combined rateable value of £60.4 billion according to the 2008-based values used since 2010. Following revaluation based on 2015 values, the same properties will have a rateable value of £67.0 billion, an increase of 11%.[6]

If the same multiplier were kept, the initial revaluation would therefore lead to an 11% increase in English business rates revenues. As described above, the first adjustment made to the business rates multiplier at revaluation is to ensure the same amount would be raised as prior to the revaluation: this requires reducing the multiplier by a little less

[6] Valuation Office Agency, 'Non-domestic rating: change in rateable value of rating lists, England and Wales, 2017 Revaluation', https://www.gov.uk/government/statistics/non-domestic-rating-change-in-rateable-value-of-rating-lists-england-and-wales-2017-revaluation.

than 11%.[7] Presently, outside London, the multiplier is 0.484 for small properties (with a rateable value of less than £18,000) and 0.497 for larger properties. The first stage of the adjustment for revaluation sees these reduced to 0.436 and 0.449.[8]

Following this first adjustment, any property that saw its rateable value rise by 11%, in line with the national average, would see no change in rates bill. Any property that saw its rateable value go up by less than 11% or fall would see its bill fall, while any property that saw its rateable value go up by more than 11% would see its bill increase.

But recall that there is a second stage to the adjustment. Occupiers are able to appeal against the rateable value assigned to their property if they think it is too high. If their appeal is successful and their rateable value is reduced, the amount of rates they pay, and hence the revenues collected, would fall. After accounting for appeals, *less* would be raised under the new list of rateable values than under the existing list of rateable values. The government estimates that successful appeals against initial values will reduce business rates revenues by approximately 4.4% during the life of the new rating list (i.e. between 2017–18 and 2021–22). An equivalent upwards adjustment to the multipliers is therefore made to raise sufficient revenues to cover that estimated effect. (Note that this adjustment actually has to be 4.6% as any appeals against rateable values will also impact the revenues raised from this multiplier adjustment.) This takes the small business rates multiplier to 0.457 and the large business rates multiplier to 0.470.

These figures are a little less than 6% lower than the existing multipliers. This means that the revaluation and corresponding multiplier adjustments will lead to occupiers of properties whose rateable value has fallen or increased by less than approximately 6% paying less business rates, while those whose values have increased by approximately 6% or more, will pay more business rates.

Finally, it is worth noting that as in a normal year, the multiplier will be increased in line with the RPI in April 2017, so that overall business rates revenues keep pace with inflation. RPI inflation over the relevant period (September 2015 to September 2016) was 2.04%. Adding this increase to the adjustments made as a result of the business rates revaluation gives the final business rates multipliers for 2017–18: 0.466 for small businesses and 0.479 for large businesses.

The final multipliers for 2017–18 are a little less than 4% lower than the existing multipliers. Taken together then, if all that was changing in April were the business rates multipliers, occupiers of properties whose rateable value has increased by less than about 4% or fallen would see a fall in their rates bill from April, while those whose rateable values have increased by more than about 4% would see an increase in their rates bills.

The full set of adjustments to the 2016–17 multipliers is presented in Table 1.

7 More formally, the first stage is to multiply the existing multiplier by 1/1.11, so that when applied to the new rateable values, the same amount is raised. This is because $(1/1.11)\times1.11 = 1$.

8 Separate thresholds and multipliers apply in London. Note that the threshold for paying the standard rate of business rates will increase from £18,000 to £51,000 from April 2017.

Table 1. Adjustments to the business rates multiplier for 2017–18 (outside London)

	Small business multiplier	Large business multiplier
2016–17 multiplier	0.484	0.497
After adjustment for new rateable values	*0.436*	*0.449*
After adjustment for appeals against new rateable values	*0.457*	*0.470*
2017–18 multiplier (after adjustment for inflation)	0.466	0.479

Source: Department for Communities and Local Government; authors' calculations.

However, it is worth noting that in addition to the revaluation and annual inflationary adjustment to the multiplier, further changes to business rates are being made that will reduce the business rates bills of the occupiers of smaller properties:[9]

- The upper limit on rateable value for properties to receive 100% relief from business rates via the small business rates relief scheme is being increased from £6,000 to £12,000. Relief will be tapered from 100% to 0% between £12,000 and £15,000 (which means that rates liability will actually increase by more than £2 for every £1 increase in rateable value between £12,000 and £15,000).

- The threshold for which the large business rates multiplier applies is being increased to £51,000 across England.

Please note that the figures in the rest of this briefing note do not take account of these additional changes to business rates as disaggregated estimates of their impact are not available.

The impact of the 2017 revaluation across England

While the new multiplier is set with the aim of ensuring revenue neutrality for England as a whole (after accounting for expected revenue losses as a result of appeals), the revaluation will not be revenue-neutral at the regional or local level. In particular, more revenue will likely be raised on properties in areas where rateable values have increased by more than the national average, and less raised on properties in areas where rateable values have increased by less than the national average (or fallen).[10]

Figures from the Valuation Office Agency and the Department for Communities and Local Government (DCLG) show that the changes in rateable values vary significantly around the country. Table 2 shows how rateable values have changed by region and by 'functional

[9] See HM Treasury, *Budget 2016*, available at https://www.gov.uk/government/publications/budget-2016-documents.

[10] This is not an exact relationship because the rate of successful appeals may differ in different parts of England.

urban area' (which classifies different parts of England according to their economic relationships to major towns and cities).

Four key patterns stand out. First, rateable values have increased significantly more in London than they have elsewhere in the country. The same pattern of London economically outperforming the rest of the country, and especially the north, can be seen in many other indicators. Gross value added increased around three times as fast in real terms in London as in the rest of England between 2008 and 2015, for instance.[11] The number of people aged 16 or over in employment grew by 17.5% in London between 2008 and Autumn 2016, compared with 6% in the rest of England.[12] And of course, residential

[11] Authors' calculations using Office for National Statistics (ONS) data available at https://www.ons.gov.uk/economy/grossvalueaddedgva/datasets/regionalgrossvalueaddedincomeapproach.

[12] Authors' calculations using ONS data available at https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/regionallabourmarket/previousReleases.

Table 2. Mean change in rateable value between 2010 and 2017 rating lists, by region and by functional urban area

Region		
London	23.7%	
South East	9.6%	
East Midlands	7.4%	
South West	4.0%	
East	3.7%	
West Midlands	3.2%	
Yorkshire & the Humber	0.0%	
North West	0.0%	
North East	–0.9%	
Functional urban area	**City**	**Other parts of functional urban area**
London	23.7%	6.7%
Inner London	28.4%	N/A
Outer London	11.9%	N/A
Core cities	3.7%	0.5%
Other cities	4.9%	2.9%
Other cities (north)	1.5%	–0.8%
Other cities (south)	8.6%	6.7%
All other councils	4.4%	
Other councils (north)	2.0%	
Other councils (south)	6.2%	
Central List properties	40.6%	
All England (including Central List)	11.0%	

Note: The list of functional urban areas / cities used is the Urban Audit Functional Urban Areas groupings available at http://ons.maps.arcgis.com/home/item.html?id=ae839969ed4d4d57bc29092acca73524. The first column contains the change in rateable value for the city centre local authority (or, in the case of London, the authorities making up Greater London) and the second column the change for the rest of the corresponding functional urban area (excluding the city centre). Core cities are Birmingham, Bristol, Leeds, Liverpool, Manchester, Newcastle, Nottingham and Sheffield, which are members of the Core Cities Group, an advocacy group for large regional cities. Other cities (north) are Blackburn with Darwen, Blackpool, Burnley, Cheshire West & Chester, Coventry, Derby, Kingston upon Hull, Leicester, Lincoln, Middlesbrough, Preston and Stoke-on-Trent. Other cities (south) are Bournemouth, Brighton & Hove, Cambridge, Cheltenham, Exeter, Hastings, Ipswich, Norwich, Portsmouth, Reading and Southampton. All other councils are councils that fall outside these functional urban areas.

Source: Authors' calculations using Valuation Office Agency statistics, available at https://www.gov.uk/government/statistics/non-domestic-rating-change-in-rateable-value-of-rating-lists-england-and-wales-2017-revaluation.

property prices have risen far beyond their pre-Credit-Crunch peak in London but still lag in much of the rest of the country, especially in the north.

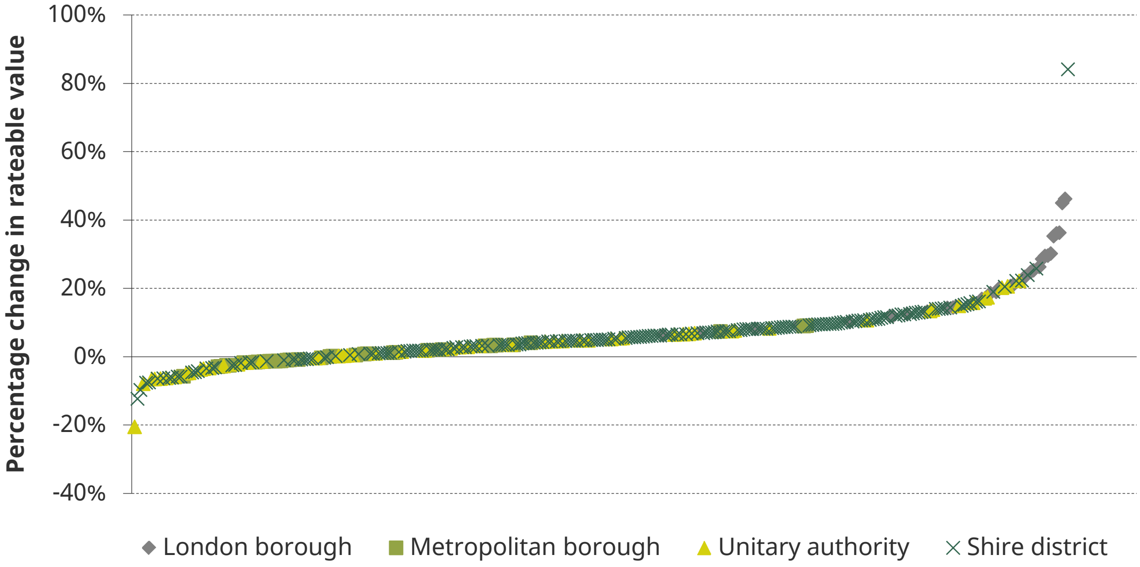
Second, even excluding London, rateable values have increased significantly more in the south and the midlands than they have in the north of England. And third, rateable values have increased more in the central districts of England's urban areas than in the surrounding suburbs and commuter areas. For instance, in London, rateable values have increased by an average of 28.4% in inner London, 11.9% in outer London and 6.7% in the rest of the functional urban area. Interestingly, in the north (and midlands) of England, rateable values increased by more, on average, in rural areas ('other councils') than in the smaller cities and the suburban hinterlands of cities. This pattern is not seen in the south of England.

Finally, properties on the Central Rating List – which covers big pieces of infrastructure related to things such as transport, utilities and telecoms, which span multiple local authorities – saw much larger increases in their rateable value than other types of property.

Figure 1 and Table 3 show that there is much greater variation at the level of individual local authorities (LAs) than at the regional level. Unsurprisingly, many of the areas experiencing the largest increases in value are inner London boroughs: nine out of the ten authorities experiencing the largest percentage changes in rateable value are inner London boroughs, the tenth being West Somerset, home to Hinkley Point power station. No London borough has seen a fall in its total rateable value despite more than one-in-five LAs (68 out of 326) doing so.[13] Twenty-five authorities – of which 16 are in London – have seen their rateable value increase by 20% or more, whilst 18 authorities have seen them fall by more than 5% (the largest fall is in Redcar & Cleveland, at 20.5%).

[13] Billing authorities only.

Figure 1. Change in rateable values, by local authority



Source: As for Table 2.

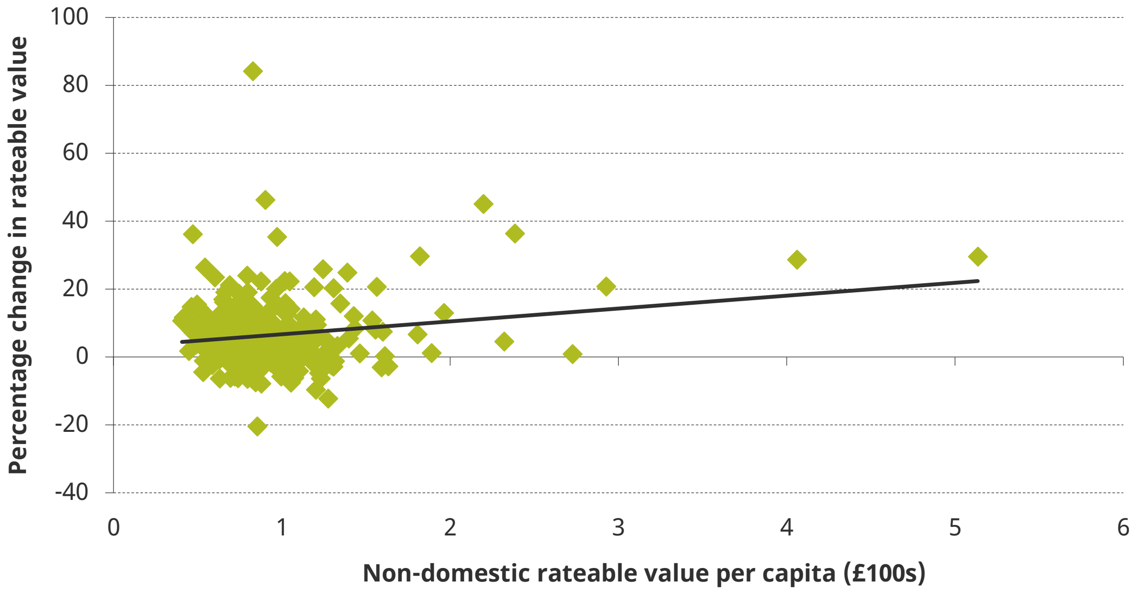
Table 3. Change in rateable value summary statistics, by local authority type

Council type	Mean	Median	Lowest	Highest
Shire districts	5.6%	5.7%	–12.3%	84.1%
Metropolitan boroughs	1.1%	–0.1%	–5.7%	9.1%
Unitary authorities	3.8%	2.9%	–20.5%	22.2%
London boroughs	23.7%	19.0%	0.8%	46.2%
Outer London boroughs	11.9%	12.6%	0.8%	26.3%
Inner London boroughs	28.4%	29.6%	19.0%	46.2%
All authorities	**9.6%**	**5.0%**	**–20.5%**	**84.1%**
All England (including Central List)	**11.0%**	**n/a**	**n/a**	**n/a**

Source: As for Table 2.

Table 3 also shows the disparity between mean and median changes in rateable values for different types of local authority. Means and medians can differ for a number of reasons: for example, outliers in one or other direction (which drag the mean up or down) or differences in patterns of growth between areas that already have high rateable values (which contribute more to the mean figure) than areas with low rateable values. For instance, the median change for metropolitan boroughs (covering urban areas in the north and midlands of England) is –0.1% while the mean is +1.1%, reflecting the fact that the core urban areas of these authorities, where aggregate rateable value is concentrated, have seen rateable values increase, while many of the surrounding suburban areas have seen rateable values decrease.

Figure 2. Change in rateable values, by initial non-domestic rateable value per person



Note: The City of London and Westminster are excluded from this figure because they are extreme outliers.

Source: As for Table 2.

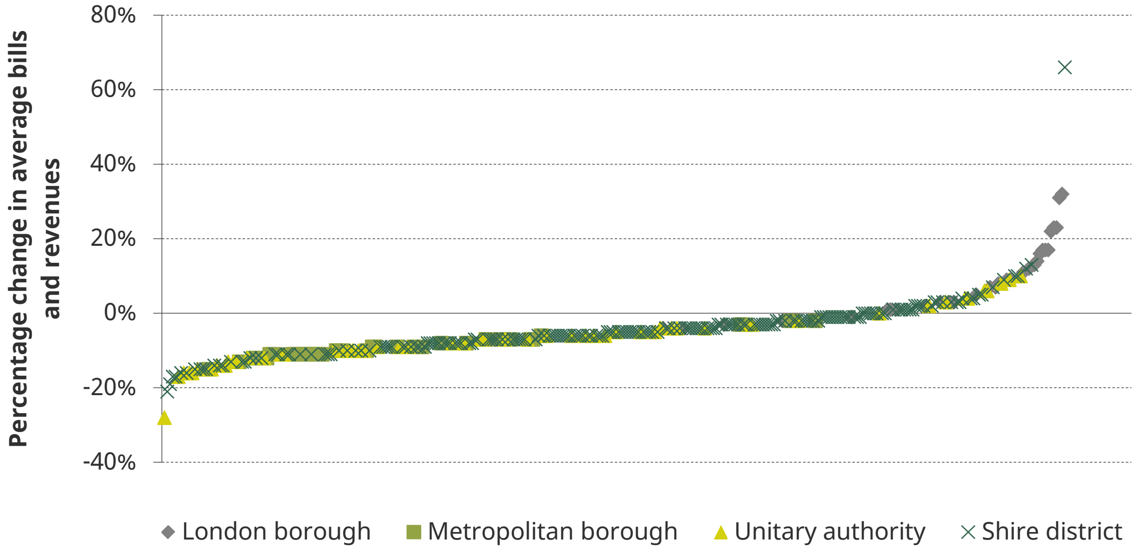
This is a more general pattern: Figure 2 shows that there is a positive (albeit modest) relationship between existing value of non-domestic property per person in an area (as of the 2010 rating list) and the percentage change in the rateable value of that property in the 2017 rating list. However, there is significant variation in the percentage change in values for areas that start with comparable values of non-domestic property per person in the current rating list.

Given the link between rateable value and business rates bills and revenues, another way of putting this is that those areas with the highest bills and revenues per person prior to the revaluation will generally see the largest percentage increase in business rates bills and revenues per person as a result of the revaluation.

Figure 3 shows DCLG estimates of the change in average rates bills and revenues as a result of the revaluation, by local authority. These estimates take into account the initial adjustment to the multiplier required to make the revaluation revenue-neutral given the new rating list (i.e. the 11% reduction to 0.436 and 0.449 for the small and large business multipliers respectively), but exclude the impact of the subsequent increase in the multiplier to raise the necessary revenues to cover the cost of successful appeals against the new values. The estimates also exclude the impact of any reliefs such as small business rates relief and transitional relief, and the impact of the usual inflationary increases in the multiplier each year.

On this basis, 252 LAs would see a fall in average rates bills and thus the amount of business rates collected. This includes all metropolitan boroughs, covering the major urban areas of the north of England and the Birmingham conurbation. In other words, reductions in the business rates multiplier would offset the (small) increases in average

Figure 3. Change in average rates bills and revenues as a result of the revaluation (before adjustment to multiplier to account for forecast appeals), by local authority



Note: Figures are before the adjustment to the multiplier for future appeal outcomes (this adjustment is discussed in detail in Section 4 of this briefing note) and the usual annual inflation adjustment. All bills are also before transitional relief and small business rate relief.

Source: DCLG, Business Rates Revaluation Consultation, ‘Transitional relief: supplementary tables’, available at https://www.gov.uk/government/consultations/business-rates-revaluation-2017.

Table 4. Change in average rates bills and revenues as a result of the 2017 revaluation, by region

Region	After initial multiplier adjustment	After multiplier adjustment for appeals	After 2017–18 transitional relief payments
London	11%	16%	12%
South East	−1%	4%	4%
East Midlands	−3%	2%	2%
South West	−6%	−1%	1%
East	−7%	−3%	1%
West Midlands	−7%	−3%	0%
Yorkshire & the Humber	−10%	−6%	0%
North West	−10%	−6%	0%
North East	−11%	−7%	−1%
Central List	27%	33%	15%
England	0%	4.6%	4.6%

Note: Figures in the last two columns are approximate and are based on authors' calculations using the rounded data published by DCLG.

Source: As for Figure 3, and authors' calculations.

rateable values in every district in Greater Manchester, Merseyside, South Yorkshire, Tyneside, the Birmingham conurbation and West Yorkshire. At the other end of the spectrum, average business rates bills and thus revenues would increase in all but seven of London's boroughs.

The first column of Table 4 shows DCLG's estimates of the change in average bills and revenues by region on the same basis as Figure 3. It shows that the effect of the revaluation itself is to increase rates bills and revenues for properties on the Central List and in London, on average, but to decrease bills and revenues for each of the other regions of England.

As discussed already, a second adjustment to the multiplier will be made when the revaluation takes effect: a 4.6% (2.1p) increase required to raise sufficient revenues to cover the expected cost of successful appeals against the new rateable values.[14] Across England as a whole, this means the revaluation will lead to business rates bills and revenues initially being 4.6% higher than previously. It is important to note, though, that in the long term as appeals come through, this extra revenue will be used to reduce bills and refund overpayments for those who have successfully appealed. If the government's

[14] Note that these figures are our best estimates given the (rounded) data published by DCLG.

forecast of appeals costs is right, appeals will completely (and exactly) offset the higher average bills charged and extra revenue raised up front, so that the revaluation would be revenue-neutral. And, if appeals costs in each of the regions of England are in line with the government's national forecast, the first column of Table 4 would also reflect the long-run impact of the revaluation on average bills and revenues by region, after accounting for the appeals adjustment to the multiplier *and* the cost of appeals. (If the government's forecast for appeals costs is wrong and/or appeals costs differ by region, the revaluation may not be revenue-neutral in the long run, and regional impacts may differ a little from the figures reported in that column.)

But appeals take time to be lodged and processed, while the multiplier adjustment for appeals takes place as soon as the revaluation takes effect in April 2017. The second column of Table 4 therefore shows our estimates of the changes in average bills and revenues accounting for the appeals adjustment to the multiplier, but before appeals actually materialise. It shows that bills and revenues would increase by 33% for the Central List and 16% in London from April. Small decreases in average bills and revenues in the South East and East Midlands prior to this adjustment would turn into small increases of 4% and 2% respectively. But there is one final piece of the puzzle in working out how revaluation will affect bills from April: transitional relief.

Transitional arrangements for the 2017 revaluation

The large differences in changes in rateable values and business rates bills/revenues at the region and local level reflect very large changes in values and bills for individual properties. For example, DCLG estimates that the 72,700 'small' properties that, following revaluation, will have a value of £20,000 or less (£28,000 or less in London) would have nevertheless seen rateable value increase sufficiently for their rates bill to rise by more than 64%.[15] Conversely, 17,700 such properties would see their rates bill fall by more than 44% as a result of the revaluation. Among larger properties with a new rateable value above £100,000, 8,800 would have seen an increase of more than 45%, while 9,700 would have seen a reduction of more than 23%.

As discussed in Appendix A, in the long run it is unclear whether the occupiers of properties actually bear the burden of business rates: rents and property values are likely to adjust. But in the short term, before such changes to rents can take place, occupiers could see very large changes in their costs of doing business.

To ease the burden, therefore, as with each revaluation since 1990, a system of 'transitional relief' will be used to phase in the increases of those seeing particularly large increases in their bills. As set out in Table 5, small properties will see the increase in their rates bills as a result of the revaluation capped at 5% in the first year, 2017–18, rising to 64% by the final year of the scheme, 2021–22 (the usual inflationary increases in the multiplier apply on top of these caps). Larger properties are subject to less restrictive caps

[15] Figures in this paragraph are taken from DCLG, 'Consultation on the transitional arrangements for the 2017 business rates revaluation', available at https://www.gov.uk/government/consultations/business-rates-revaluation-2017.

and thus could face significantly steeper increases – up to 42% before inflation in 2017–18 and 243% (before inflation) by 2021–22.

Table 5. The 2017 revaluation transitional relief scheme

	Property size	2017–18	2018–19	2019–20	2020–21	2021–22
Upwards cap	Small	5.0%	7.5%	10.0%	15.0%	15.0%
	Medium	12.5%	17.5%	20.0%	25.0%	25.0%
	Large	42.0%	32.0%	49.0%	16.0%	6.0%
Downwards cap	Small	20.0%	30.0%	35.0%	55.0%	55.0%
	Medium	10.0%	15.0%	20.0%	25.0%	25.0%
	Large	4.1%	4.6%	5.9%	5.8%	4.8%

Note: Table shows year-on-year caps on increases. Small properties are those with a new rateable value of £20,000 or less (£28,000 or less in London), medium properties are those with a new rateable value between £20,000 (£28,000 in London) and £100,000, and large properties are those with a new rateable value above £100,000.

Source: DCLG, 'Consultation on the transitional arrangements for the 2017 business rates revaluation: summary of responses and government's response', 2016, available at https://www.gov.uk/government/consultations/business-rates-revaluation-2017.

There is also a legal requirement to design the transitional relief scheme in such a way that it is expected to be revenue-neutral. In order to achieve this, the government is imposing caps on how much and how quickly a property's rates bill can fall. Thus, the big 'winners' from the revaluation will have to wait to see their full gains, in order to fund the transitional arrangements for those seeing large increases in their rates bills. Overall, the scheme of caps will apply to almost half of properties in 2017–18 and almost 5% even after five years, in 2021–22 – a long transition. It is also a costly transition: the cost of the caps on increases in bills (paid for by caps on reductions in bills) is estimated to be £1.6 billion in 2017–18 (around 6% of business rates revenues) and £3.6 billion by 2021–22.[16,17]

As with the caps on increases in bills, the caps on reductions in bills will also vary by property value: bills for small properties will be allowed to fall by as much as 20% in 2017–

[16] DCLG, 'Consultation on the transitional arrangements for the 2017 business rates revaluation: summary of responses and government's response', 2016, available at https://www.gov.uk/government/consultations/business-rates-revaluation-2017.

[17] Note that NNDR1 returns of forecast business rates revenues in 2017–18 (available at https://www.gov.uk/government/statistics/national-non-domestic-rates-collected-by-councils-in-england-forecast-for-2017-to-2018) imply that transitional relief for properties on the local lists controlled by councils will reduce revenues by a net £124 million in that year. Given that properties on the local lists are supposed to *contribute* a net £240 million to the transitional relief scheme (to pay for transitional relief for Central List rate payers), this implies that the scheme will not immediately be revenue-neutral in 2017–18. However, this does not mean it will not eventually be revenue-neutral for that year (and across the five years as a whole): as appeals against rateable values succeed, underlying rates bills will be reduced, reducing the scale of transitional relief required. The transitional relief scheme is supposed to be revenue-neutral after accounting for these post-appeals changes to transitional relief required.

18, while falls for large properties will be capped at 4.1%. After five years, these caps are 93% and 23%. The lower cap on reductions in bills for large properties, alongside the higher cap on increases in bills for such properties, means that as well as redistributing from those ‘winning’ to those ‘losing’ from the revaluation, the transitional relief scheme redistributes from the occupiers of large properties to the occupiers of small ones (this latter redistribution comes on top of the redistribution undertaken by the small business rates relief scheme, and the lower small business rates multiplier).

It is also important to note that as with the revaluation itself, while the system of transitional relief is designed to be revenue-neutral for England as a whole, it is not revenue-neutral at the local or regional level. Instead, the scheme will act to slow the increase in bills and revenues in areas that have relatively many properties with large increases in their bills (and relatively few that have seen large decreases in their bills), and vice versa. When announcing the chosen scheme, DCLG estimated that in its first year of operation, transitional relief will reduce the bills of properties on the Central Rating List (which has seen the biggest increases in values and bills as a result of revaluation) by around £240 million in aggregate and those in London by around £380 million.[18] In contrast, the transitional relief will increase bills by around £60 million in aggregate in the North East and by around £180 million in the North West.

In the last column of Table 4 above, we incorporate these estimates of the regional cost/yield as a result of the transitional relief scheme to produce a final estimate of the impact of revaluation on average rates bills and revenues by region in 2017–18. The transitional relief scheme reduces the average increase in the rates bill of properties on the Central List from 33% (after accounting for the adjustment to the multiplier for appeals) to 15%, and of properties in London from 16% to 12%. In contrast, in every other region, the transitional relief scheme pushes up bills and revenues, on average, turning 6% falls in the North West and Yorkshire & the Humber, for instance, to approximately zero change in 2017–18. In other words, the transitional relief scheme means these regions will have to wait for the cuts in average rates bills that would otherwise follow the revaluation.

Finally, it is worth considering whether the significant redistribution from occupiers and regions with properties that have fallen in value to those with properties that have increased in value entailed by such transitional relief schemes is the most appropriate way to reduce the impact of the large changes in rateable values that occur when properties are periodically revalued. Transitional relief does do that, but it does so by delaying reductions in the bills on properties that have seen particularly large reductions in their relative values, which were presumably at least in part due to relative reductions in the returns that occupiers can generate from said properties (e.g. due to a relative decline in local economic performance). Transitional relief therefore makes the business rates system less responsive to changes in local economic conditions than it otherwise would be.

[18] DCLG, ‘Consultation on the transitional arrangements for the 2017 business rates revaluation: summary of responses and government’s response’, 2016, available at https://www.gov.uk/government/consultations/business-rates-revaluation-2017.

An alternative approach may be to increase the frequency with which properties are revalued: more frequent revaluation should, in general, lead to fewer sharp changes in rateable values and thus rates bills, as changes in values take time to accrue. It would also make the business rates system *more* rather than less responsive to local economic conditions than it is presently.

3. The Revaluation and the BRRS

The last section described how the business rates revaluation will affect rateable values in different areas of England, redistributing the amount of business rates collected between areas. In this section, we discuss how this interacts with the business rates retention system, whereby local authorities now retain a proportion of the business rates raised in their area. The section begins with a brief description of the BRRS. We then discuss how the BRRS will be updated to account for the revaluation of non-domestic property. This includes a discussion of the pros and cons of the approach adopted, summary figures on how the revaluation will affect the degree of redistribution of business rates revenues being undertaken, and variation in the strength of incentives to grow business rates revenues. The issue of appeals against valuations is discussed in Section 4.

The business rates retention system (BRRS)

Between 1990–91 and 2012–13, business rates were collected by local government but then transferred to Whitehall to be distributed to councils as part of their grant funding from central government. This meant there was no direct link between the amount of business rates raised in a local area and the amount of funding local authorities in that area received. That changed from 2013–14, when the business rates retention scheme was introduced in an effort to create a ‘fiscal incentive’ for councils to promote commercial property and wider economic development in their areas.

As part of this scheme, local government as a whole keeps half of business rates revenues (the other half is still handed over to central government to be redistributed to councils as part of their grant funding). However, individual councils do not keep half of the business rates raised in their areas. Instead, at the time the scheme was introduced, an assessment was made of how much income each council needed to ensure it neither gained nor lost from the system at the point of introduction: this was its ‘baseline funding level’. Those councils whose initial share of business rates revenues (their ‘business rates baseline’) exceeded that level of funding were subject to a ‘tariff’, which redistributed part of their revenues in the form of a ‘top-up’ to councils whose own revenues were below their baseline funding level. Each year since, these tariffs and top-ups have been increased in line with RPI inflation.

The upshot of this is that individual councils have, in effect, retained a proportion of the growth in business rates revenues in their areas that results from new developments or refurbishments (rather than the existing stock of business rates revenues, which gets redistributed via the inflation-linked tariffs and top-ups). They also bear a proportion of the losses if there is a net reduction in the amount of non-domestic property in their area (e.g. due to demolitions or conversions).

The proportion of growth/losses retained by each council depends on two factors:

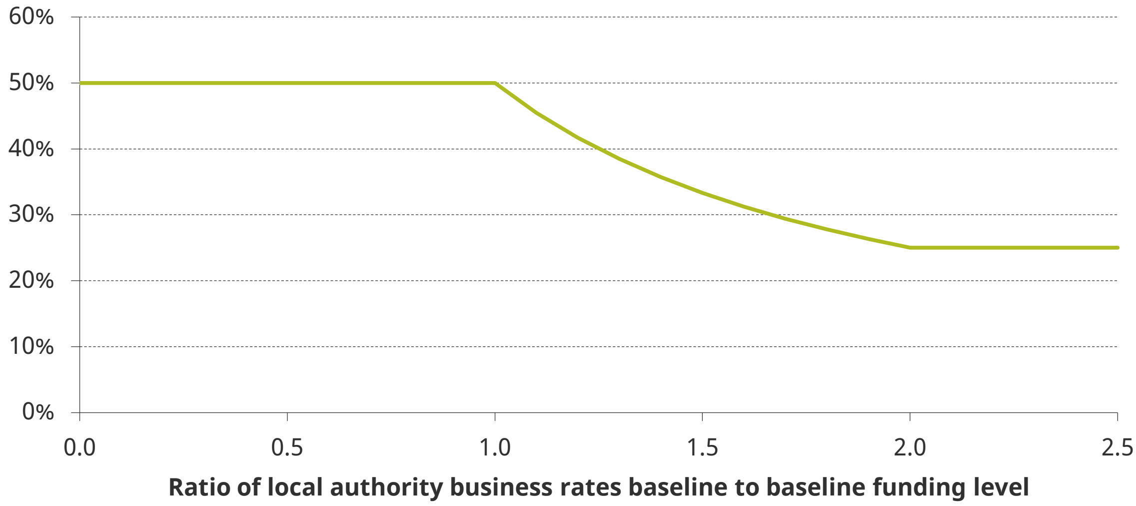
1. *What type of council it is.* Metropolitan boroughs and unitary authorities retain up to 49% of the growth (with 1% being retained by the fire authorities covering their areas).

In areas with two-tier local government, districts retain up to 40% of the growth and counties up to 10% (although some counties retain up to 9% if there are separate fire authorities). And in London, boroughs retain up to 30% and the Greater London Authority (GLA) up to 20%. These allocations to different types of councils are meant to reflect the degree of influence they have over local economic development (which was felt to be largely, but not exclusively, a responsibility of lower-tier councils due to their role in the planning system).

2. *The ratio of a council's 'business rates baseline' to its baseline funding level.*[19] If its business rates baseline was below its baseline funding level, then it keeps the share reported in (1) above. If the business rates baseline was above the baseline funding level, then the council is subject to a 'levy' on growth, and the percentage retained is gradually reduced, down to half the level reported in (1). The impact of these 'levies' on the percentage of business rates growth retained is illustrated in Figure 4.[20]

Note that the levies do not apply to losses, so, at least initially, all councils bear a percentage of losses equal to the relevant percentage for their council type reported in (1). However, the levies were put in place to fund 'safety-net payments'. These are set such that if a local authority's income under the scheme falls below 92.5% of its baseline funding level (uprated by RPI), central government will make a payment to bring its income up to that 92.5% level. The expressed aim of this feature is to 'protect those authorities which faced significant shocks in rates income', i.e. 'limiting risk'.[21]

Figure 4. Share of revenue from new developments retained locally



[19] The business rates baseline is a notional measure of a council's business rates revenues in year 1 of the scheme (2013–14) given its share of business rates (e.g. 40% for a district, 9% or 10% for a county, etc.) and before tariffs and top-ups are taken into account. It was calculated based on forecasts for business rates revenues for England as a whole in 2013–14 and a council's historical average share of business rates revenues.

[20] DCLG, *Business Rates Retention: A Step-by-Step Guide*, 2012, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/5947/2182691.pdf.

[21] DCLG, *Business Rates Retention: Policy Statement*, 2012, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/14939/Business_rates_retention_policy_statement.pdf.

Source: S. Adam and H. Miller, 'Business rates', in C. Emmerson, P. Johnson and H. Miller, *The IFS Green Budget: February 2014*, IFS Report R91, 2014, available at https://www.ifs.org.uk/publications/7072.

The BRRS and revaluation

Our report in October 2016 examined how different councils were faring under the BRRS during its first four years of operation (2013–14 to 2016–17) when 2008-based property values were used for business rates bills.[22] As already discussed, next year, 2017–18, is the first year for which 2015-based property values will be used. Section 2 of this briefing note described how the business rates multiplier (i.e. the tax rate) will be adjusted with the aim of ensuring that the revaluation is revenue-neutral for England as a whole, at least once one allows for expected appeals against the new rateable values. It also showed, however, that the fact that average rateable values have changed very differently in different parts of England means that the revaluation will be far from revenue-neutral at a local level: some councils will see substantial increases and others substantial decreases in the amount of business rates raised in their areas.

Under the BRRS, these changes in revenues at the local level would, in part, feed through into higher or lower retained business rates income for councils. These changes could be large: DCLG's estimates of the changes in business rates revenues imply that Westminster's retained income (given its 30% share of rates) would increase by £62 million as a result of the revaluation (before any adjustments to the multiplier for appeals and any transitional reliefs), whereas Leeds's retained income (given its 49% share of rates) would be reduced by £20 million.[23]

To avoid this, the Final Local Government Finance Settlement sets out how adjustments will be made to the BRRS's tariffs and top-ups to offset the immediate effects of the revaluation on councils' revenues from the BRRS.[24] The precise workings are complex but the gist is simple. It means, for instance, that a council that is expected to see its retained rates revenue increase by £62 million as a result of the revaluation and the initial adjustment to the multiplier made as a result of the revaluation would see a £62 million reduction in its business rates top-up (or a £62 million increase in the tariff it is liable to pay): the overall effect of the revaluation on its retained business rates income would therefore be expected to be zero.[25]

[22] N. Amin-Smith, D. Phillips, P. Simpson, D. Eiser and M. Trickey, *A Time of Revolution? British Local Government Finance in the 2010s*, IFS Report R121, 2016, available at https://www.ifs.org.uk/publications/8705.

[23] DCLG, 'Business rates revaluation top ups and tariffs calculator 2017 to 2018', 2016, available at https://www.gov.uk/government/publications/business-rates-revaluation-top-ups-and-tariffs-calculator-2017-to-2018.

[24] See section 6 of the DCLG's final *Local Government Finance Report (England) 2017-18*, available at https://www.gov.uk/government/publications/local-government-finance-report-2017-to-2018.

[25] The word 'expected' is important to note. There are three potential sources of uncertainty when making the adjustment to the tariff and top-up. First, one needs an estimate of how much business rates income would have been generated in an area in the absence of the valuation. Income generated in 2015–16 is used as an initial proxy for this, with 2016–17 income being used to provide an updated estimate in April 2018. Actual income in the absence of the reform may differ from both these annual figures. Second, one needs to estimate how much business rates revenues will change as a result of revaluation. This estimate is calculated

The government argues that stripping out the effects of revaluation from the BRRS by adjusting top-ups in this way is required to prevent councils from seeing sharp overnight changes in their funding, and thus in their ability to deliver public services, due to factors 'outside their control'.[26] The examples of Westminster and Redcar & Cleveland show that the changes in revenues could be large indeed.

Another reason for offsetting the impact of revaluation on local revenues relates to the fiscal incentive the BRRS is meant to provide: to support local economic development and, in particular, the provision of new non-domestic property 'floor space'. The rental – and hence rateable – value of floor space in an area is a function of both the supply and demand for floor space: higher demand will tend to push up rents as occupiers compete for available space, while higher supply will tend to push down rents as landlords compete to attract occupiers. If the effects of revaluation on councils' revenues were not 'washed out' by corresponding adjustments to top-ups and tariffs, councils would have a less strong incentive to encourage new building (additional 'supply') and could instead have some incentive to do the opposite: to restrict new developments in order to constrain supply, and thereby support the rental/rateable value of existing business property, and thus the amount of business rates that would be due on this property, come the revaluation.[27]

However, there is also a drawback from stripping out the effects of the revaluation on councils' business rates income: it will contribute to the tendency of the BRRS to incentivise councils to promote some forms of local economic development more than others. In particular, in between revaluations, local authorities can only increase their business rates revenues through encouraging increases in the amount of non-domestic floor space subject to business rates (which will exclude small properties for which occupiers can claim small business rates relief) or material changes in the usage of floor space from lower-value uses (such as basic industrial units) to higher-value uses (retail

ignoring the various reliefs (such as charity and small business rates relief) that apply to particular properties, the effects of which may change as a result of the revaluation (for instance, if smaller properties have seen larger or smaller falls in value than average). Third, as discussed in more detail in Section 4, the adjustment in effect assumes that appeals losses are evenly distributed across England. Thus while the aim is to fully compensate councils for changes in their business rates income by changing their tariffs and top-ups, these adjustments are unlikely to be exact. Indeed, an exact adjustment is probably infeasible.

[26] DCLG, 'The 2017/18 Local Government Finance Settlement: technical consultation paper', 2016, available at https://www.gov.uk/government/consultations/local-government-finance-settlement-2017-to-2018-technical-consultation.

[27] How big an issue this would be would depend, in part, on just how responsive local rents were to the supply of local non-domestic property. In principle, the degree of responsiveness can be quantified as 'the elasticity of rental price / rateable value, with respect to property supply': this measures the percentage by which rents / rateable values would fall for a 1% increase in the quantity of non-domestic property available in a local area. Higher values for this elasticity (in absolute magnitude) would mean new development would push down rents / rateable values more, thus creating a bigger financial disincentive to councils for approving new developments. If the elasticity were greater than 1 (in absolute magnitude), a 1% increase in the stock of non-domestic property would push down rents / rateable values by *more than* 1%, leading to the aggregate rateable value in the local area actually falling as the amount of property increased. New development would therefore push down a council's overall business rates revenues. Conversely, an elasticity of less than 1 (in absolute magnitude) would mean the aggregate rental / rateable value of properties in a local area would increase as the stock of non-domestic property increased.

warehouses): increases in the value of given property of a given type, as a result of demand from occupiers able and willing to pay higher rents, cannot be accounted for until the properties are revalued. When properties are revalued though, the changes in rates bills and thus local revenues that would follow could subsequently provide an incentive to councils to promote increases in demand for and hence the value of existing properties. However, if BRRS tariffs and top-ups are adjusted to 'strip out' the immediate effects of the revaluation on councils' revenues, councils' financial incentive to promote increases in the demand for and value of existing property is likely to be reduced.[28]

Therefore while there may be good reasons to 'strip out' the overnight effects of revaluation on councils' revenues, doing so narrows the incentives provided by the BRRS to, in effect, a 'floor space' incentive. In this context, a number of organisations have highlighted that growth in 'floor space' subject to business rates is not the only indicator, or perhaps even the best indicator, of a council's performance in boosting local economic performance.[29] Increases in the intensity of use of existing floor space of a given type, increases in the number of small properties (occupiers of which may not have to pay any business rates due to the small business rates relief scheme), and increases in productivity or employment associated with either more home-working or more commuting to neighbouring council areas, could all boost the local economy but are not incentivised by the BRRS.

If one wanted to provide an incentive to councils to encourage these other routes to local economic development, one option would be to design a complex series of indicators and rewards (or penalties) for meeting (or failing to meet) related targets for development – a system of payment by results for councils. An alternative could be to consider devolving (part of) the revenues from further taxes, which might have stronger links to performance in terms of economic development more broadly defined. For example, a local component to income tax could encourage councils to promote employment, productivity and wage growth in order to expand their local income tax base. In fact, many countries use some form of local income tax to generate revenue for local government.[30] In subsequent work, IFS researchers will examine the costs, benefits and potential effects of devolving additional taxes to councils, considering both the fiscal incentives and fiscal risks – due to the volatility of some tax streams, for instance – such devolution could entail.

[28] It is not removed entirely, because although the overnight effects of a revaluation are undone by adjusting the tariffs and top-ups, revenues from new developments will be affected by the new higher rateable values.

[29] See for instance, L. McGough and H. Bessis, 'Beyond business rates: incentivising cities to grow', Centre for Cities, 2015, available at http://www.centreforcities.org/publication/beyond-business-rates-how-fiscal-devolution-can-incentivise-cities-to-grow/.

[30] In Germany, for instance, the rate of income tax is set by the federal government but a percentage of the revenue is retained at both *Land* level and local government level. Thus all levels of local government have an incentive to increase the income tax base in their area. A number of other countries go further, allowing local and regional governments to independently set local income tax rates, which are levied on top of national income taxes. In both Sweden and Denmark, for instance, the various levels of local government derive approximately 70% of revenue from locally set and retained income taxes. For more details, see: page 51 of D. Brand, *Local Government Finance: A Comparative Study*, Sun Press, 2016; Standard & Poor's, 'Public finance system overview: Swedish local and regional governments', 2011, http://kommuninvest.se/wp-content/uploads/2015/06/5.2-SP-Public-Finance-System-Overview_May-2011.pdf; Local Government Denmark, *The Danish Local Government System*, 2009, http://www.kl.dk/ImageVaultFiles/id_38221/cf_202/Background_Paper_-_Local_Government_in_Denmark.PDF.

The BRRS and the 2017 revaluation

As it stands though, the significant differences in changes in rateable values and business rates revenues around England mean that in order to strip out the effect of the revaluation on locally-retained revenues, significant changes in tariffs and top-ups will be required in some instances. Tables 6 and 7 show the largest changes in tariffs and top-ups in both cash terms and as a percentage of local authorities' business rates baseline (their notional share of local business rates revenues) following the revaluation (note that, as in other years, there will the usual inflationary adjustments to tariffs and top-ups on top of these changes).[31]

As is to be expected, the biggest absolute increases in tariffs / reductions in top-ups have occurred in inner London, where rates revenues are relatively high to begin with and will change substantially in percentage terms as a result of the revaluation. So, for example,

Table 6. Largest changes in tariffs and top-ups as a percentage of business rates baseline

Largest shifts towards tariff (–) [pre- and post-revaluation tariff (–) / top-up (+)]		Largest shifts towards top-up (+) [pre- and post-revaluation tariff (–) / top-up (+)]	
West Somerset	–69% [–£3.1m, –£5.9m]	Copeland	23% [–£14.3m, –£10.5m]
Hackney	–32% [£75.1m, £66.6m]	Redcar & Cleveland	22% [£8.5m, £14.0m]
Islington	–31% [£20.6m, £2.6m]	Preston	19% [–£21.9m, –£16.8m]
Hammersmith & Fulham	–25% [–£3.0m, –£17.7m]	Blackburn with Darwen	18% [£18.0m, £22.1m]
Lewisham	–24% [£71.6m, £67.8m]	South Holland	17% [–£6.8m, –£5.1m]

Source: See footnote 31.

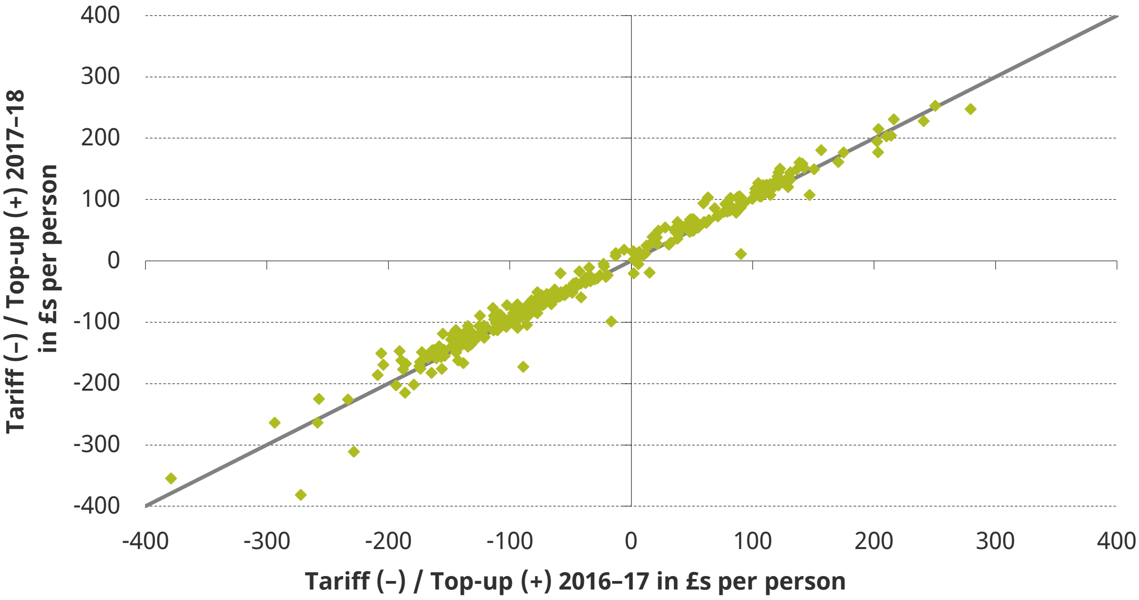
31 These tables and the rest of the tables and figures in this subsection use the tariffs and top-ups reported in the Provisional Local Government Finance Settlement (available at https://www.gov.uk/government/consultations/provisional-local-government-finance-settlement-2017-to-2018). We do this to isolate the effects of revaluation on the BRRS: the Final Local Government Finance Settlement includes further adjustments to the tariffs and top-ups of those areas that are piloting 100% business rates retention (because the responsibilities for funding devolved alongside 100% retention do not exactly equal the additional revenues devolved).

Table 7. Largest changes in tariffs and top-ups, cash terms

Largest shifts towards tariff (–) [pre- and post-revaluation tariff (–) / top-up (+)]		Largest shifts towards top-up (+) [pre- and post-revaluation tariff (–) /top-up (+)]	
Greater London Authority	–£156.0m [–£358.6m, –£514.6m]	Leeds	£20.0m [–£33.2m, –£13.1m]
Westminster	–£62.3m [–£465.4m, –£527.7m]	Birmingham	£12.2m [£127.1m, £139.2m]
City of London	–£44.4m [–£209.9m, –£254.3m]	Hillingdon	£10.4m [–£60.8m, –£50.4m]
Camden	–£26.3m [–£65.6m, –£91.9m]	Trafford	£10.2m [–£44.5m, –£34.3m]
Islington	–£18.0m [£20.6m, £2.6m]	Sheffield	£9.7m [£29.1m, £38.8m]

Source: See footnote 31.

Figure 5. BRRS tariffs/top-ups for different local authorities, before and after revaluation (£s per person)



Note: Population estimates used are for mid 2015. The City of London and Westminster have been excluded from this graph for scaling reasons. Both have seen already-substantial tariffs increase significantly. The grey line (*y*=*x*) shows where councils would lie if their tariff and top-up were unaffected by the revaluation.

Source: See footnote 31.

the revaluation leads to the Greater London Authority's, Westminster's and the City of London's tariff payments going up by £156 million (to £515 million), £62 million (to £528 million) and £44 million (£254 million), respectively. Relative to their business rates baselines, the biggest changes are in those areas that see the biggest percentage change in their business rates: West Somerset and four inner London boroughs. On the other hand, areas where rateable values have grown more slowly or fallen will see changes in the opposite direction. In cash terms, the biggest reductions in tariffs and increases in top-ups are generally in big cities in the North and Midlands. For example, in Leeds the 1.2% fall in rateable values leads to its tariff being reduced by £20 million from £33 million to £13 million, and in Birmingham the 4.1% growth in rateable values still means a £12 million increase in top-up funding (to £139 million).

Figure 5 shows the relationship between pre-revaluation tariff/top-up and post-revaluation tariff/top-up for all local authorities, again stripping out adjustments for inflation. The grey line represents where all authorities would be if there had been no change to their tariff or top-up; those above the line have seen an increase in their top-up or a reduction in their tariff, while those below the line have seen a reduction in their top-up or an increase in their tariff.

Several results stand out:

- There are relatively more LAs above the line than below it. The relatively large group of LAs seeing increases in their top-ups or reductions in their tariffs reflects the fact that the revaluation will lead to falls in the amount of rates collected in most LA areas (see Figure 3).

- Although a significant minority of LAs see very large changes in their tariffs and top-ups as a result of revaluation, in most LAs, changes are relatively modest: in 230 out of 383 LAs in the BRRS, the change is equivalent to £10 or less per resident (compared with tariffs and top-ups averaging £94 per resident in absolute terms, prior to the revaluation).[32]

- Relatively few authorities switch from being tariff authorities to top-up authorities (three) or vice versa (three). This means that, while the scale of contributions to or receipts from the system of tariffs and top-ups by each local authority will change as a result of revaluation (and sometimes substantially), very few councils go from being net payers to net recipients of transfers, or vice versa.

Table 8 shows how the net tariff and top-up received by councils in each region of England will change as a result of the revaluation. It shows that the only region to see an increase in its tariff is London, up by almost £400 million. In contrast, in each of the other regions, the net tariff has been reduced (the South East, the South West and the East) or the net top-up has been increased (all other regions). This reflects the pattern shown in the first column of Table 4: before accounting for the adjustment to the multiplier to account for expected appeals, the revaluation will mean lower business rates revenues (and therefore a greater need for top-ups) in each of the regions of England outside London. It means that council services in the midlands and north of England will become more dependent on business rates revenues raised in London, which are then redistributed around the country. The regions of the south outside London will contribute less to this redistributed pool.

[32] This is an unweighted average across LAs, excluding Westminster and the City of London.

Of course, on top of the £390 million of additional 'tariff' levied on councils' share of business rates in London, taxpayers in London will be contributing an additional £390 million to the other half of business rates, controlled by central government (and

Table 8. Changes in tariffs and top-ups by region

	Pre-revaluation tariff (–) or top-up (+)	Change in tariff (–) or top-up (+)	Post-revaluation tariff (–) or top-up (+)
East	–£179.7m	£75.6m	–£104.1m
East Midlands	£111.3m	£25.0m	£136.4m
London	–£344.8m	–£388.1m	–£732.9m
North East	£246.3m	£43.0m	£289.3m
North West	£348.7m	£133.5m	£482.1m
South East	–£504.4m	£22.1m	–£482.4m
South West	–£90.9m	£61.2m	–£29.7m
West Midlands	£239.0m	£72.0m	£311.0m
Yorkshire & the Humber	£185.6m	£95.0m	£280.7m

Source: See footnote 31.

taxpayers in the other regions of England will be contributing less). This increasing reliance on revenues generated in London is part of a more general pattern resulting from London's economic outperformance of the rest of the country (briefly discussed in Section 2). For instance, research by the Centre for Cities published last year suggests that between 2004–05 and 2014–15, the share of 'economy taxes' paid by London increased from 25% of the UK total to 30%, as employment, earnings and economic growth outpaced those in the rest of the UK. Indeed, while the research suggests revenues in London grew by 25% during this period, revenues in the next four biggest urban areas (Greater Manchester, the Birmingham conurbation, Greater Glasgow and Leeds) are estimated to have been unchanged over the same 10 years.[33]

More generally, business rates revaluation will lead to a small increase in the overall scale of tariffs and top-ups: before accounting for inflation, the aggregate tariff on tariffed authorities will increase from £4,156 million to £4,210 million, while the aggregate top-up to topped-up authorities will increase from £4,167 million to £4,360 million.[34] This is because the revaluation will lead to a slight redistribution of the business rates tax base

[33] L. McGough and G. Piazza, '10 years of tax: how cities contributed to the national exchequer from 2004/05 to 2014/15', Centre for Cities, 2016, available at http://www.centreforcities.org/publication/10-years-tax/.

[34] The larger increase in aggregate top-ups than aggregate tariffs means that the net top-up received by councils across England as a whole will increase from £11 million to £150 million as a result of revaluation. This reflects the fact that the revaluation itself will lead to a reduction in the overall revenues raised from local rating lists managed by councils, on which the BRRS is based, and an increase in revenues raised from the Central Rating List managed by central government. Councils are being compensated by this, and central government is paying for this compensation using its higher Central List revenues.

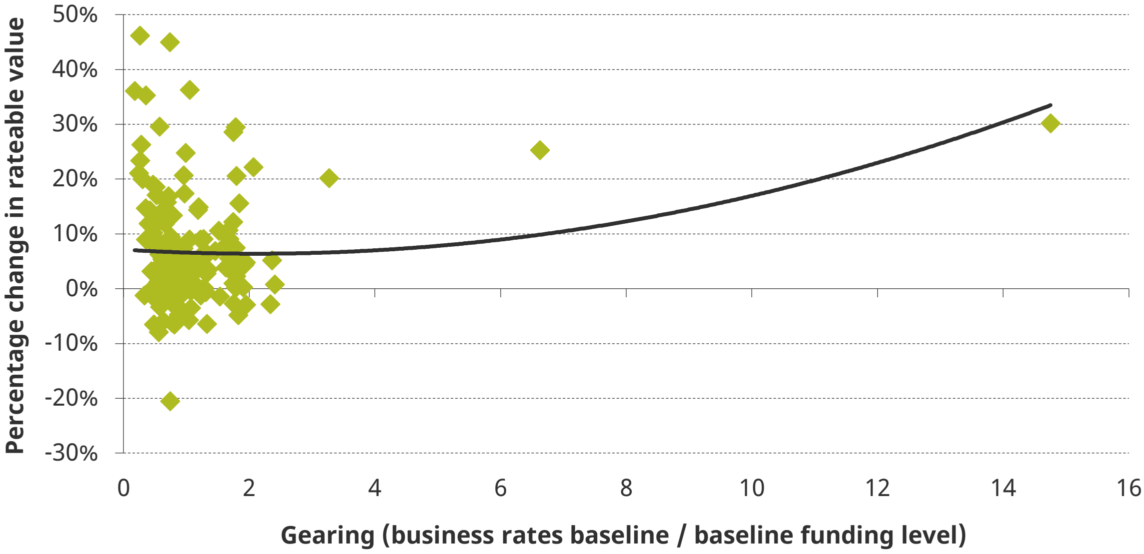
and revenues from areas with relatively high needs / low revenues to areas with relatively low needs / high revenues.

This pattern is illustrated in Figures 6 and 7, which show how the percentage change in the rateable value of properties in an LA area – the key determinant of how its tariff or top-up will change – is related to that LA area's initial business rates 'gearing'. Business rates 'gearing' is an LA's initial notional share of business rates at the start of the BRRS in 2013–14 (its initial 'business rates baseline') divided by its initial assessed need for business rates at the start of the scheme (its initial 'baseline funding'). Those LAs with a gearing ratio below 1 have needs that exceed their share of locally-raised revenues, and therefore receive top-ups, and those with a ratio above 1 are subject to tariffs.

Figure 6 shows that for England as a whole, there is little relationship between 'gearing' and the percentage change in rateable values at revaluation for the bulk of councils with a 'gearing ratio' of between 0 and 2. The figure suggests that it is only a few authorities with both very high gearing ratios (especially Westminster and the City of London) and large percentage increases in rateable values that drive the overall divergence in gearing, reflected in the growth in aggregate tariff and top-up payments.

But this is a somewhat misleading picture, reflecting the fact that many other London boroughs initially had low business rates bases (because of the concentration of so much economic activity in a few central boroughs such as the City and Westminster) and therefore low 'gearing', but shared in the more general increase in rateable values in London, and especially inner London. Figure 7 shows that if one excludes councils in London, there is a clear positive relationship between 'gearing' and the percentage change in rateable values at revaluation: those areas of England outside London with

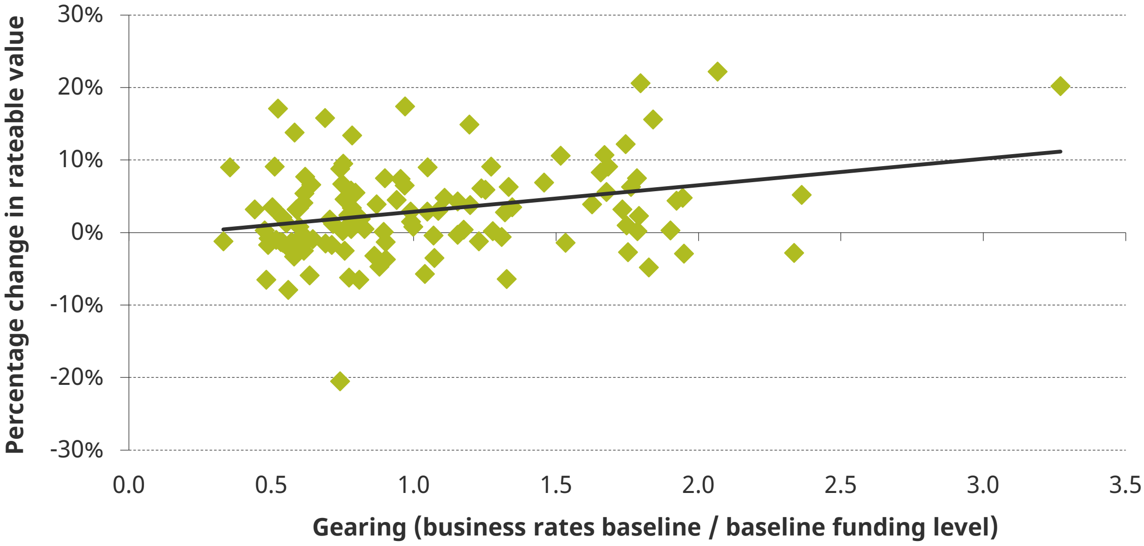
Figure 6. Percentage change in rateable value, by local authorities' business rates 'gearing' ratios



Note: Lower-tier and upper-tier authorities in two-tier areas are combined in this figure. Within London, the GLA's business rates baseline and baseline funding level have been apportioned to London boroughs according to their business rates baseline. All other billing authorities are included with their gearing figures directly derived from the figures used in the business rates retention scheme.

Source: See source to Table 2. In addition, information on business rates baselines and baseline funding levels is available in the 2013–14 Local Government Finance Settlement, available at: http://webarchive.nationalarchives.gov.uk/20140505104649/http:/www.local.communities.gov.uk/finance/1314/settle.htm.

Figure 7. Percentage change in rateable value, by local authorities' business rates 'gearing' ratios, excluding London



Note and Source: As for Figure 6.

already high local business rates income relative to their assessed funding needs will see, on average, a larger increase in the rateable value of local property. This will feed through into higher local business rates income and an increase in their tariff. Conversely, those areas reliant on top-ups will, on average, see a small increase in their top-up. Taken together, this is what will slightly increase the degree of 'gearing' in the system (reflected in the small increases in aggregate tariffs and top-ups).

Differences in 'gearing' between authorities also have another significant effect: they mean that the relative size of fiscal incentives to grow the business rates tax base varies substantially between authorities. In particular, for those authorities that receive a substantial proportion of their BRRS income from a large top-up payment, the incentive to grow their business rates base is smaller because any growth will be small as a percentage of their overall income (much of which is made up of top-up). For example, for an authority that derives 80% of its BRRS income from a top-up, 2% growth in its business rates base will only increase its BRRS income by 0.4%, as the top-up would be unchanged. On the other hand, for an authority that pays 80% of its business rates revenue as a tariff and thus keeps only 20%, 2% growth in its business rates base will increase its BRRS income by 10%, or by 5% after taking into account the (extra) levy it will pay on the growth in its business rates income. The latter thus has a significantly greater incentive to actively promote growth in its business rates base. Of course, the flip side of this is that the tariff authorities see their income fall much more if their business rates revenues fall: the flip side of stronger incentives is greater risk. In this context, the fact that tariffs and top-ups will increase somewhat relative to business rates income post-revaluation will increase the extent to which incentives and risks are unevenly distributed across LAs in England.

In a recent study, the Institute for Public Policy Research (IPPR) suggests the dependence of incentives on an LA's 'gearing' is a flaw of the current BRRS and advocates major changes to the calculation of the revenues to be retained by individual councils.[35] Rather than retaining their share of local rates revenues plus or minus any top-up or tariff, councils would retain an amount equal to: (1 plus the percentage growth in business rates revenues in their local area) multiplied by their baseline funding needs. Implicitly, this means that each council's tariff or top-up would be increasing in line with its own business rates revenue growth each year (rather than by inflation).

IPPR argues that this would provide a more equal incentive to grow business rates revenues across the country. For instance, 2% real-terms growth in local business rates revenue would translate into 2% extra funding from the scheme in all councils. In contrast, under the sort of scheme proposed by DCLG, 2% real-terms growth in local business revenues would translate into less than 2% extra funding in areas reliant on large top-ups for most of their income from the BRRS, and much more than 2% extra funding in areas subject to large tariffs.[36]

[35] A. Stirling and S. Thompson, *Better Rates: How to Ensure the New Business Rates Regime Promotes Growth Everywhere*, Institute for Public Policy Research, 2016, http://www.ippr.org/files/publications/pdf/better-rates_June2016.pdf.

[36] For example, if half of a council's income from the BRRS is its own revenues and half is 'top-up' funding, 2% growth in its own revenues translates into 1% growth in overall income from the BRRS. On the other hand, if

Whether such a radical change to the BRRS should be seen as a good idea depends on what incentives one wants the scheme to create. IPPR's proposed scheme would provide stronger incentives to grow the business rates tax base in areas with small tax bases, and weaker incentives to grow the business rates tax base in areas with large tax bases, relative to the type of scheme proposed by DCLG. It might therefore be better targeted at encouraging poorer areas with smaller tax bases to 'catch up' with richer areas. On the other hand, it would be less well targeted at encouraging areas with bigger tax bases to grow them further. To the extent that such areas generate a large proportion of national business rates revenues, it may therefore be less well targeted at generating growth in overall revenues nationwide. Such a scheme would also, in areas with two-tier local government, reduce the strength of incentives for revenue growth faced by district councils (which currently have large tariffs) and increase the strength of incentives faced by county councils (which currently rely on large top-ups). This shift of incentives may be seen as undesirable if it is felt districts have more of the levers for affecting local property development and business growth.[37]

half of a council's own revenues are taken from it as a 'tariff', 2% growth in its revenues translates into 4% growth in the retained portion of revenues.

37 Further discussion of options for reform of the BRRS, especially in the context of moves towards 100% local rates retention, can be found in N. Amin-Smith, D. Phillips, P. Simpson, D. Eiser and M. Trickey, *A Time of Revolution? British Local Government Finance in the 2010s*, IFS Report R121, 2016, available at https://www.ifs.org.uk/publications/8705.

4. Business Rates Appeals and the BRRS

As already mentioned, one feature of the business rates system is that it allows for occupiers of properties to appeal against the values assigned to their properties if they consider them too high. Section 2 described how, when the new rateable values are used from April, the business multiplier will be set higher than would be required for revenue neutrality if there were no appeals, to raise the necessary funds to cover the expected cost of successful appeals that will subsequently occur. In particular, for the 2017 revaluation, the multiplier will be set 4.6% higher to consider the cost of appeals. In this section, we discuss how appeals relate to the BRRS and provide some descriptive statistics on how the cost of appeals has varied around the country since the BRRS began in 2013–14. We also discuss the government's plans to insulate councils from appeals risk when the 100% business rates retention system is introduced in April 2019.

How appeals fit into the BRRS

Occupiers and landlords can appeal against the rateable value assigned to their property for two main reasons: a material change in the property (or certain changes to its surrounding area, such as road access) that is not reflected in the current value; or a perceived error in the initial valuation of the property. In this briefing note, we focus on these 'valuation error' appeals.

When an appeal is successful, the occupier's future rates bill is reduced and they also receive a refund of any 'overpayments' that they have already made as a result of the valuation error. This reduces the future revenue stream from business rates for both central and local government, as well as creating an obligation to pay back the backdated overpayments.

Prior to the introduction of the BRRS, these appeals simply affected rates revenues as and when they occurred. With the introduction of the BRRS, councils have gone from being 'collection agents', collecting the rates on behalf of central government, to being in the position where their income is directly affected by appeals. As a result, they are required to make provisions for the costs that future appeals might impose on them. These provisions are netted off the revenues that councils pay over to central government and that are used in the calculations required by the BRRS to determine how much business rates income they retain. The provisions are then held in a special reserve to pay the costs of appeals as they subsequently arise.

At the time the BRRS was set up, DCLG made an estimate of the impact of appeals against rateable values on business rates revenues in England, consisting of two separate elements. First, appeals losses in respect of previous years, prior to the start of the BRRS, were forecast to reduce revenues by 2.5% (this was part of a more general estimate of revenue losses amounting to 5.43% as a result of differences between forecasts and out-turns, where only the latter take account of such appeals losses).[38] Second, there was an

[38] The 2.5% figure has been provided to us by DCLG. See also DCLG, 'Business rates retention and the local government finance settlement: a practitioners guide', 2013, available at

additional 2.65% adjustment for *future* losses as a result of outstanding appeals. DCLG decided to subtract both these amounts from the business rates revenue then forecast to be collected when calculating how much councils would have to pay over to central government (as the continuing central-government share of business rates revenues) and when working out how much tariff they would have to pay or how much top-up they would receive.

This, in effect, provided a buffer equal to around 5.15% (2.5% + 2.65%) of business rates revenues for councils to cover the cost of appeals (as part of a more general buffer of 8.08% to cover all differences between revenue forecasts and out-turns). However, councils have borne the risk (on the locally-retained portion of business rates revenues) of the costs of appeals in their areas coming in higher or lower than this amount (which is based on national estimates). Councils are also required to independently assess how much they should set aside as provisions for appeals.

On average, during the first three years of the scheme (2013–14 to 2015–16), councils made provisions equal to 6.2% of business rates revenue – a little more than the 5.15% estimate made by DCLG. Taken at face value, this would suggest that councils estimate that appeals are likely to cost them a little more than the 'buffer' built into the BRRS.[39]

Figure 8 shows that there was also significant variation in the proportion of business rates revenues that councils set aside in provisions for appeals. Around half of councils set aside less than 5.15% of business rates revenue in their area. On the other hand, six councils (South Hams, West Somerset, Hartlepool, Copeland, Lancaster and Great Yarmouth) made provisions of more than 20% of the value of their revenues. Whilst there is no obvious pattern to provisions with regards to the type of local authority (and the average level of provisions by type of authority varies little), it is worth noting that many of the councils making the largest provisions relative to their revenues are areas where one big – and hard-to-value – property dominates the rating list. For instance, in four of the six councils making the largest proportionate provisions (West Somerset, Hartlepool, Copeland and Lancaster), the rating list is dominated by a nuclear facility, and in the other two (South Hams and Great Yarmouth), gas-fired power stations are the single most valuable properties.

Figure 9 shows how charges to the provision for appeals (which occur when successful appeals actually materialise) varied across England in 2014–15 and 2015–16. On average, appeals equivalent to 3.1% of revenues were charged during these two years. But there is significant variation across councils. Excluding those reporting no charges against provisions (which is likely to reflect shortcomings in the accounting software of councils, as set out in footnote 39), 34 councils have charged appeals equivalent to less than 1% of

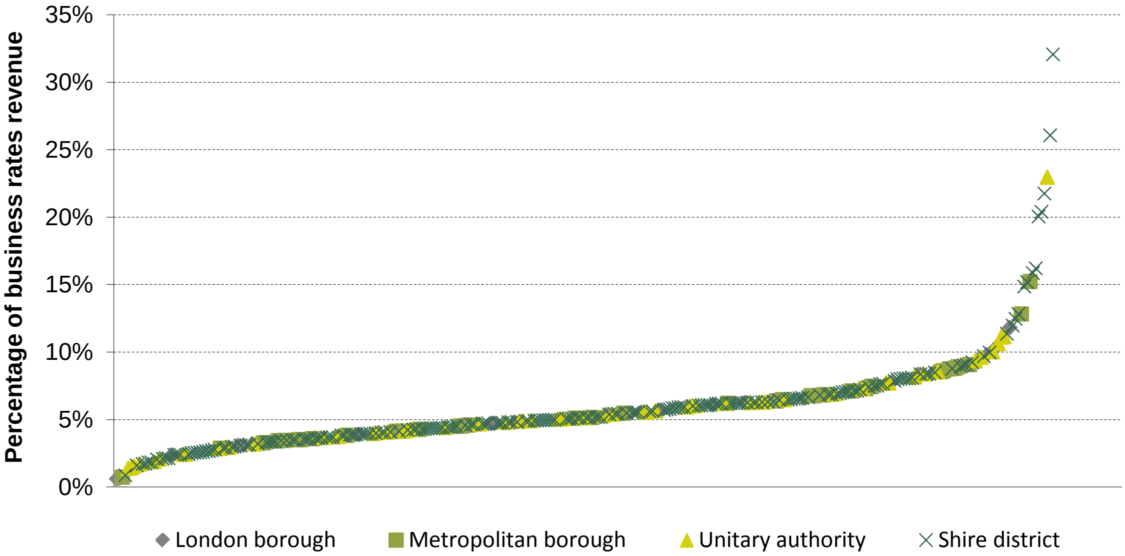
https://www.gov.uk/government/publications/business-rates-retention-and-the-local-government-finance-settlement-a-practitioners-guide.

[39] Note that the accounting software used by some councils does not allow them to separately make and charge against provisions: in that case, the provisions are a net figure (provisions minus charges), and therefore an underestimate of actual provisions made. Such councils will record zero charges against their provisions, which may be a significant underestimate of the actual number of successful appeals charged to their provisions.

revenues to their provisions, while 41 have charged more than 5%; Hartlepool, West Somerset and Copeland have all charged over 30% during those two years: they were clearly well informed when making large provisions for appeals.

Figure 10 shows that charges against provisions (as successful appeals arise) vary substantially across councils as a percentage of the provisions they have put aside. Excluding those councils that have charged nothing to their provision for appeals, 53 councils have used less than 20% of the provisions set aside, whilst at the other end of the scale six authorities have used more than 80% of the provisions set aside.

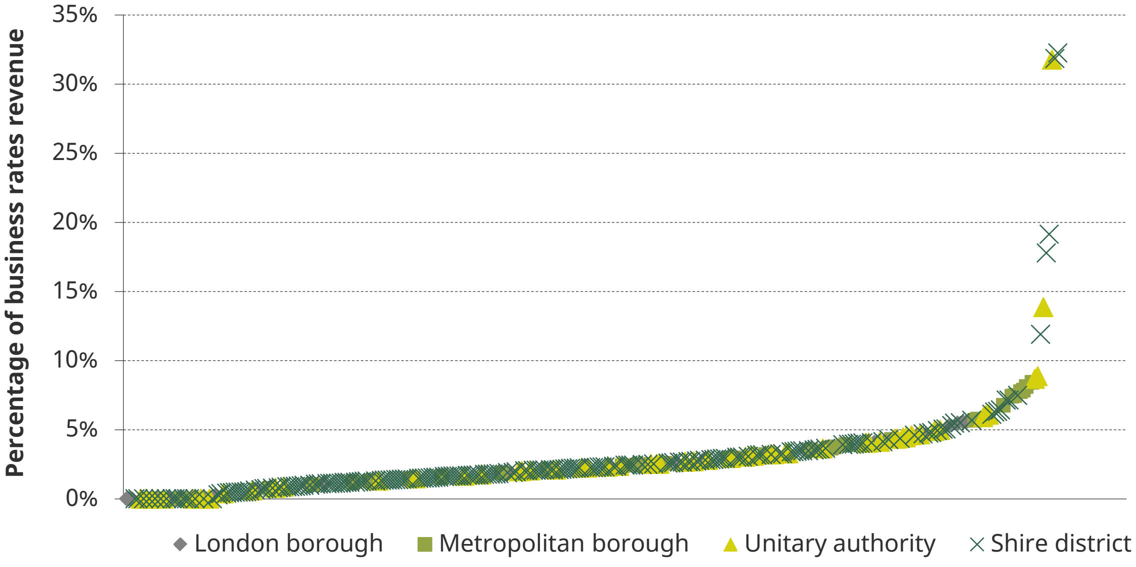
Figure 8. Provisions for appeals as a percentage of business rates revenue, 2013–14 to 2015–16, by authority



Note: Provisions for appeals include provisions for backdated appeal costs made in 2013–14. Total business rates income is calculated here as non-domestic rating income plus provisions for appeals minus rating value list amendments charged to provisions for appeals.

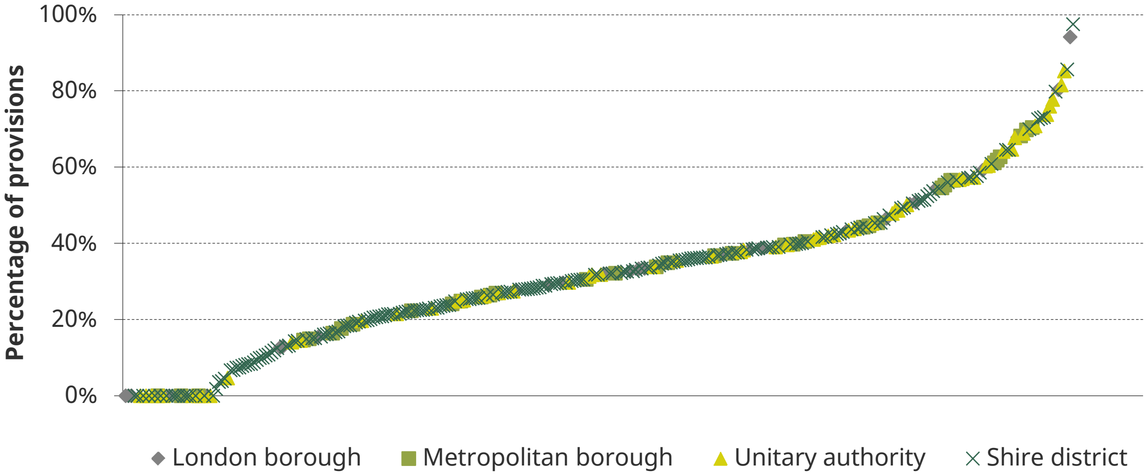
Source: NNDR3 forms for 2013–14, 2014–15 and 2015–16.

Figure 9. Charges against provisions for appeal as a percentage of business rates revenue, 2014–15 and 2015–16, by authority



Note and Source: See Figure 8.

Figure 10. Charges against provisions for appeal as a percentage of provisions, 2013–14 to 2015–16, by authority



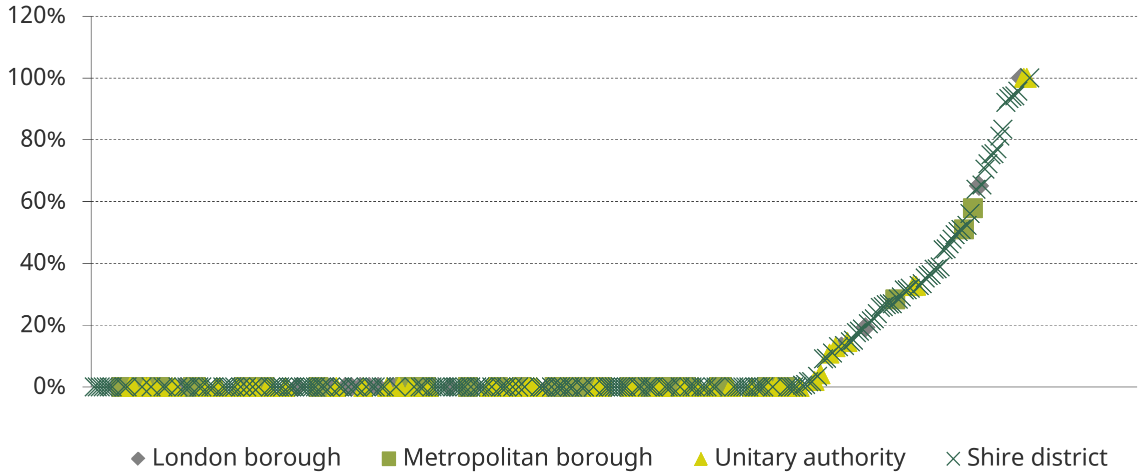
Note and Source: See Figure 8.

Such significant variation, and the fact that charges against provisions are relatively low in many authorities, could result from three factors. First, because appeals can be lodged at different times, and the process of appealing takes some time, it is possible that successful appeals are materialising at different rates in different local authorities – relatively quickly in some, but taking longer in others. Second, it is possible that many authorities have erred on the side of caution when making their provisions for appeal. Third, it is possible that authorities have been failing to charge at least some successful appeals against their provisions when they materialise.

Given that provisions for appeal must be held in a separate reserve and thus cannot be used for spending on services, it may seem both surprising and worrying that such large provisions are being made up front. For authorities with large business rates bases, the cash amounts involved can be substantial. Westminster is an extreme example of this, putting aside £393 million in provisions for appeals between 2013–14 and 2015–16 (although it is important to note this is only 7.8% of the business rates revenues collected in Westminster during these same years, a bit above the national figure of 6.2%). Under the BRRS, this reduces the business rates income it has been able to retain and spend by £118 million (30% of £393 million).[40]

But these provisions do not necessarily represent the amount that local services are being deprived of, since the reduced business rates income resulting from making such provisions may qualify some authorities to receive a safety-net payment under the BRRS. Such payments are payable to any authority where business rates income falls below 92.5% of its baseline funding level. Westminster, for instance, received safety-net payments that fully compensated it for the reduction in business rates income as a result of the provisions it has made. Figure 11 shows that Westminster is somewhat unusual though: around three-quarters of councils have had none of their provisions covered by safety-net payments, while only 25 have had more than half covered and four (including

Figure 11. Percentage of the cost of provisions for appeals covered by safety-net payments, by local authority



Note and Source: See Figure 8.

Westminster) have had them all covered. Thus the safety net provides insurance against the largest (cash and percentage) costs of appeals provisions, but councils still bear a significant proportion of the cost and risk themselves.

40 Westminster is set to receive £178 million in safety-net payments between 2013–14 and 2015–16, as in addition to losses of income associated with provisions for appeals, there have been other factors leading business rates income to fall below 92.5% of baseline funding.

The receipt of large safety-net payments by some authorities with substantial unused provisions for appeal may indicate a separate potential problem of the current system: there may be an incentive to deliberately over-provide for appeals in order to artificially depress business rates income to qualify for a safety-net payment. Having received a safety-net payment, authorities would eventually be able to move leftover provisions back into their income stream and thus end up with considerably higher income than they otherwise would have.

It is not possible to say whether any individual authorities have deliberately exploited the system in this way (although the large number of councils with either none or relatively small amounts of their provisions being covered by safety-net payments suggests that such exploitation is unlikely to be occurring in many councils). But, combined with the difficulty of accurately predicting appeals when making provisions, it is perhaps unsurprising that there are a number of authorities whose provisions have far outstripped the appeals they have subsequently had to pay and which have then also received safety-net payments.

The revaluation, the BRRS and appeals

As described in Sections 2 and 3, the revaluation of properties coming into effect in April 2017 means changes to the business rates multipliers and an accompanying adjustment to the top-ups and tariffs in the BRRS. Two adjustments are made to the multiplier: one to make the revaluation revenue-neutral *given* the new rateable values assigned to properties; and a second, upwards adjustment to raise additional revenues to cover the cost of successful appeals against rateable values. When updating the tariffs and top-ups, the multiplier used to assess councils' post-revaluation business rates revenue is that after the first stage of this adjustment process.

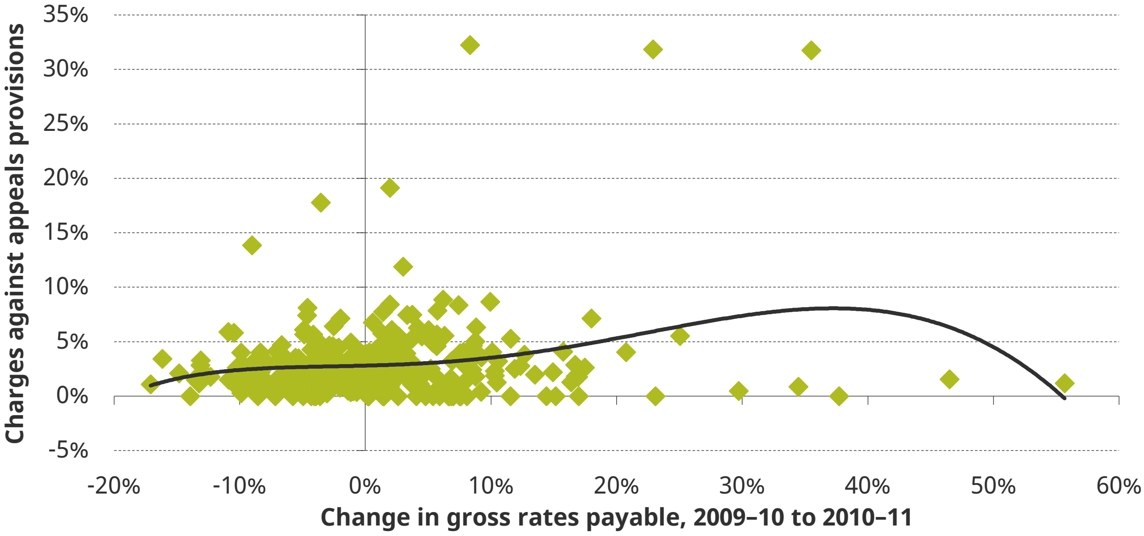
The upshot of this is that each council keeps its share (e.g. 40% for a district council, 49% for a metropolitan borough or unitary authority) of the additional revenues raised from the second adjustment to the multiplier. As discussed in Section 2, the second adjustment increases the multiplier by approximately 4.6%, so that each council has the equivalent of 4.6% additional business rates revenues with which to fund the cost of appeals. As when the BRRS was set up, councils will have to bear the risks associated with appeals in their area being higher or lower than this level. Those councils that see relatively few appeals will actually gain revenue as a result of revaluation (the revenues from the higher multiplier will more than cover the cost of appeals), while those that see relatively many and costly appeals will lose as a result of revaluation (the revenues from the higher multiplier will be insufficient to cover the cost of appeals), although the BRRS 'safety net' will offer some protection.

Figures 7 and 8 indicated that this risk is substantial: if history is anything to go by, the costs of appeals, and the amount councils feel they need to make as provisions, are likely to vary significantly across councils. For councils with large business rates bases (and which are above the safety-net threshold), appeals losses just a couple of percentage points higher than the 4.6% allowance made in the BRRS could lead to losses of several million pounds per year. The wide variation in charges against provisions shown in Figure

9 suggests that councils will also find it difficult to accurately judge the cost of successful appeals and may find they have either under- or over-provided.

One might expect that occupiers and landlords of properties that have seen increases in their rateable values and bills will be more likely to appeal against their rateable values than those seeing falls. If this is the case, councils where values and/or bills are going up will be more likely to see above-average levels of appeals. Thus, in addition to their ratepayers paying higher bills, councils in these areas may find themselves out of pocket as the cost of appeals eats into their revenues.

Figure 12. Charges to provisions for appeals as a percentage of business rates revenues (2014–15 and 2015–16), by percentage change in gross rates payable between 2009–10 and 2010–11



Source: NNDR3 forms for 2009–10, 2010–11, 2014–15 and 2015–16.

Figure 12 shows some evidence for such a pattern at the last revaluation in 2010. It indicates how charges against appeals in 2014–15 and 2015–16 varied across councils according to how their rates revenues changed between 2009–10 and 2010–11, which proxies the effect of the revaluation on average bills and thus on revenues in their area. The pattern is noisy: for any given change in revenue between 2009–10 and 2010–11, there is a very wide variance in the appeals that councils subsequently charged against their provisions in 2014–15 and 2015–16. But there is some evidence of a positive relationship, with a trend line indicating that moving from a 10% fall in revenues around the time of the revaluation to a 10% increase is associated with an increase in appeals in the two years in question from around 2.5% of business rates revenues to 3.5% of business rates revenues. Given that we are only able to proxy the change in values at revaluation, and only observe losses on appeals charged at least four years after the revaluation took effect, one might expect this to be an *underestimate* of the true correlation between change in values at revaluation and subsequent appeals costs.

Appeals under 100% retention

As already briefly mentioned, the government plans to move from the current system whereby local government retains 50% of business rates to a system of 100% retention by 2020, with April 2019 the current preferred start date.[41] IFS researchers examined a number of issues related to this plan in a report in October 2016 (and further work is planned during the coming year),[42] including how appeals should be treated once local government bears 100% of the risk and the reward from business rates growth. In particular, without reform of their treatment, appeals would represent a potentially bigger risk to councils' budgets, and there would be an even stronger incentive for some councils to 'game' the system by over-providing for appeals in order to obtain safety-net payments.

In its most recent consultation on moves to 100% retention, the government has therefore announced a consultation on plans to centralise the revenue risk associated with appeals that are backdated to the start of the rating list for the relevant period (i.e. to April 2017 for the period covered by the 2017 rating list). The rationale for this is that such appeals are likely to be appeals against valuation errors, which are outside councils' control. Councils will continue to bear the risk associated with other appeals – those due to subsequent changes in properties or their surrounding areas. The rationale for this is that such appeals are more likely to reflect factors (such as economic performance, or disruption due to council-controlled infrastructure works) that the council has at least some control over. The proposal also means that appeals resulting from 'valuation errors' of properties created after the start of the rating list will be borne by councils. Given that it would be difficult to argue that councils should benefit from errors that lead to valuations for new properties initially being set too high, this seems a sensible approach.

Full details on the mechanics of the scheme have yet to be published. However, it seems that it will require several changes to be made to the current operation of the BRRS.

Currently, the funding for councils' provisions for appeals is provided on an equal basis using the following approach:

1. When setting up (and, in principle, resetting) the BRRS, the needs-based funding allocated to councils (their 'baseline funding') was calculated by apportioning to them a needs-based share of the overall business rates to be retained by local government across England, after an adjustment had been made for appeals (the 5.15% reduction

[41] See DCLG, '100% business rates retention: further consultation on the design of the reformed system', 2017, available at https://www.gov.uk/government/consultations/100-business-rates-retention-further-consultation-on-the-design-of-the-reformed-system. This consultation is referred to frequently in the rest of this section.

[42] N. Amin-Smith, D. Phillips, P. Simpson, D. Eiser and M. Trickey, *A Time of Revolution? British Local Government Finance in the 2010s*, IFS Report R121, 2016, available at https://www.ifs.org.uk/publications/8705.

discussed above).[43] This in effect 'top-sliced' the amount of funding to be distributed according to need to provide a buffer to pay for appeals.

2. At the same time, the amount of rates revenue that councils were assumed to be able to raise (their 'business rates baseline') – and hence the tariffs and top-ups required to make each council's income equal to its baseline funding level – were based on assuming that each council's revenues would take the same proportionate hit (5.15%) as a result of appeals.

This meant that, in effect, each council kept a share of the 'top slice' to pay for appeals, equal to 5.15% of the local share of business rates raised in its area. Similarly, at the time of revaluation, by allowing each council to retain the local share of the additional revenue raised by increasing the multiplier, each council will keep the same share of revenues (4.6%) to pay for appeals following revaluation.

The government's plans involve retaining the 'top slice' centrally and then redistributing it to authorities according to need as successful backdated appeals arise – rather than distributing it according to business rates revenues. To do this, stage 2 of the above process needs to be adjusted:

2b. Rather than basing councils' 'business rates baselines' on how much they would raise after allowing for an estimate of the average cost of appeals nationally, 'business rates baselines' will be based on how much would be raised *before* allowing for appeals.

Because the amount to be distributed according to need (the 'baseline funding') would still be based on the lower national revenues *after* accounting for expected appeals, this system means that, across England as a whole, councils are assumed to be able to (initially) raise more business rates revenues than they need. In other words, the approach generates a net tariff on councils' business rates income. This net tariff can then be used by central government to centrally fund the cost of appeals.

A similar change would occur when a revaluation takes place. Rather than basing the new tariffs and top-ups on the impact of the revaluation on councils' business rates income using the multiplier *before* it is upwardly adjusted to raise revenue to pay for appeals (e.g. 0.436 in the 2017 revaluation), one would use the multiplier *after* that adjustment (0.457). Because baseline funding would not be upwardly adjusted at the same time, this would also generate a net tariff on councils' business rates income that central government could use to centrally fund the cost of appeals.

A question then arises of what will happen, given that the government is highly unlikely to fully accurately predict the cost of appeals. If its estimate of appeals costs is too low, the net tariff generated will be too small to pay the costs (and vice versa). If this is the case, central government could make up the difference (or retain the difference if it overestimated appeals costs). Alternatively, it could retrospectively alter the top slice

[43] Note that, as discussed above, this 5.15% adjustment was part of a (larger) overall adjustment of 8.08% that accounted for other factors that could lead to differences between forecast and out-turn revenues.

applied to baseline funding, making the local government sector as a whole bear the risk of appeals across all councils coming in over or under initial forecasts. The first of these approaches generally seems preferable, as it would prevent councils (as a group) seeing their income reduced or increased compared with initial expectations, if the government initially under- or over-estimated the cost of successful appeals – errors that councils would not have been responsible for, and a risk over which they had no control. Top-slicing baseline funding to cover an underestimate of likely appeals would also, in general, have a greater impact on relatively poorer councils with smaller council tax bases which, under 100% retention, will rely on the BRRS (including top-ups) for more of their overall budget.

There are therefore clearly significant decisions still to be taken with the system of centralising the handling of appeals risk under the 100% BRRS. But overall, the proposed reform appears sensible, removing a significant source of risk and uncertainty for councils, and significantly reducing the potential for the BRRS to be 'gamed' to generate safety-net payments.

5. Conclusion

This note has looked at how the revaluation of non-domestic properties coming into effect this April will affect business rates bills and revenues in different parts of England, and how this may affect councils, which, as a group, retain 50% of business rates revenues.

In part because it has been delayed by two years, revaluation will lead to a significant redistribution of rates bills and revenues between taxpayers and between different parts of the country. Inner London, in particular, will see large increases in rates bills. Transitional relief will phase in the largest increases in bills – providing the most protection for the occupiers of small properties – but at the cost of delaying cuts to the bills of those occupying properties whose relative value has fallen – and especially the occupiers of large properties whose value has fallen. Transitional relief, by its very nature, slows down the adjustment of business rates bills to changes in property values and local economic conditions.

Councils' budgets will also be insulated from the immediate impacts of the revaluation on locally-retained business rates revenues: those seeing an increase in revenues will have to pay a bigger 'tariff' on these revenues, or receive a smaller 'top-up'; those seeing a decrease in revenues will pay a smaller 'tariff' or receive a bigger 'top-up'. The upshot is that revaluation will require more rates revenues to be redistributed from London to councils in the midlands and the north.

The greater reliance on 'top-ups' from London and other areas that will see increases in their rates bills and revenues will have longer-term impacts on the councils whose own revenues will fall. First, because 'top-ups' are only increased in line with inflation, councils increasingly reliant on them have less scope for real-terms increases in the income they receive from the BRRS. In the longer term, they could see their budgets fall behind those of councils with increasingly valuable property. Second, because their own business rates revenues will be a less important source of income to them, the incentives they have to grow revenues by encouraging local development will be somewhat weakened.

Councils' budgets will also be affected by the volume of successful appeals against the new rateable values in their area. This is because while additional revenues will be raised up front to cover the cost of future appeals, these are being allocated to councils in proportion to their revenues, and historical experience suggests that different councils are likely to face significantly different costs as a result of appeals. With this in mind, plans to shift the revenue risk associated with appeals against initial valuations from individual councils to central government seem sensible.

More generally, though, moves towards councils retaining 100% of business rates will increase the revenue and spending risks councils face, especially in the long term. This is the flip side of providing more powers and stronger financial incentives to boost revenue growth and address underlying spending needs. Later this year, IFS researchers will examine these risks, and how the particular design of the 100% BRRS adopted – such as which services are devolved alongside the new revenues; the process for periodically 'resetting' the system; the annual uprating of the tariffs and top-ups between resets; and the safety net provided – will affect the scale of the risks and the strength of the incentives councils face in different parts of England. The move to 100% retention will involve much bigger changes to how business rates work than the 2017 revaluation.

Appendix A. The statutory and economic incidence of business rates[44]

Business rates are statutorily incident on the occupiers of the property in question: they are the ones legally obliged to pay them, not the owner of the property, if that is different (although some landlords might agree to pay rates bills as part of the rental contract). However, in the long run, the economic incidence of business rates – who is ultimately made worse off by them – depends on how sensitive the demand for and supply of business property are to changes in its price.

Because demand for property is likely to be more responsive to price than the supply of property – which will be constrained to a significant extent by the amount of available land with relevant permissions – in the long run we would expect the tax to be mostly passed on to the owners of properties via lower rents. Moreover, the effect of business rates will be felt by initial property owners, as the prices that properties command show falls as soon as the introduction of or changes in business rates are announced; people who subsequently purchase a property will pay a price that is already lower (by most of the net present value of the tax) and so, with the tax liability (or the correspondingly lower rent from their tenants) offset by that lower purchase price, subsequent purchasers of the property may be little worse off.

In the short run, there are likely to be rigidities in property rents (because, for example, there are contracts in place). As a result, a change in business rates will not be immediately reflected in rents and will therefore be incident on occupiers. In the context of transitional reliefs, this implies that the benefits of the reliefs are likely to accrue largely to occupiers.

Empirical evidence supports this theoretical analysis. In a study of how the estimated rents assigned to properties by their owners changed after reforms to business rates, Bond et al. (1996) concluded that 'much of the burden of business rates is shifted on to property owners in the long run. However, the short-run impact of changes to business rates affects tenants more than landlords'.[45] Subject to obtaining the necessary data, in future work, IFS researchers hope to examine how actual (as opposed to estimated) rents change in response to changes in business rates, and the speed at which this adjustment occurs.

[44] Adapted from S. Adam and H. Miller, 'Business rates', in C. Emmerson, P. Johnson and H. Miller, *The IFS Green Budget: February 2014*, IFS Report R91, 2014, available at https://www.ifs.org.uk/publications/7072.

[45] Page 21 of S. Bond, K. Denny, J. Hall and W. McCluskey, 'Who pays business rates?', *Fiscal Studies*, 1996, 17(1), 19–35, http://www.ifs.org.uk/publications/1562.