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Evidence session on Business Rates and the High Street

I write following my appearance at the joint evidence session you held on business rates and the high street on 19 December. I agreed to go back to the Committees on a number of points.

Number of ratepayers
As you know, properties are valued for business rates purposes by the Valuation Office Agency (VOA), and billing and payment is administered by individual local authorities. The VOA and local authorities hold data on the number of properties liable for business rates (hereditaments), but not on the number of businesses occupying these properties.

Data for England and Wales published by the VOA in 2011 and 2018 (for the 2010 and 2017 lists of rateable hereditaments respectively) shows that the number of hereditaments on the local authority list increased from 1.8 million to just over 2 million, and the total amount of rateable value on the local authority and central lists rose from £62.5 billion to £69.7 billion. It does not follow from this that there were 200,000 new businesses between the two revaluation dates.
Hereditaments merge and divide over time, and a single business may occupy multiple hereditaments. The accompanying rateable value may also vary slightly due to quantum as hereditaments merge into larger entities. These figures are merely a snapshot taken on the two valuation dates, reflecting the market rental valuation on those dates. This may be influenced by a range of issues, for example the economic health of the area and improved infrastructure.

MHCLG also collects and publishes an annual snapshot of figures from local authorities on the number of hereditaments in receipt of relief. This data shows that on 31 December 2017, over 275,000 hereditaments were in receipt of mandatory relief, over 172,000 of discretionary relief, and over 702,000 of small business rate relief.¹ Some properties may be in receipt of a combination of mandatory, discretionary and small business rate relief.

As announced at Spring Statement 2018, the government is committed to the linking of local authority business rates billing systems to HMRC’s digital business tax accounts at the earliest opportunity after the start of the first three-year revaluation cycle in 2024. This will pave the way for better centrally coordinated information on ratepayers.

Implications of a fixed business rates yield
In the session, you raised the EEF’s (formerly the Engineering Employers’ Federation) argument that because the yield from business rates is fixed, as commercial floor space declines, driven in part by a shift to online retailing, the burden of rates will be shouldered by fewer properties.

At revaluation the government is required by law to adjust the multiplier to reflect the change in rateable value as a result of the revaluation, including taking into account inflation and the impact of future appeals against these values. The objective, as far as possible, is to ensure the revaluation is revenue neutral. Therefore at revaluation, the burden of rates shifts towards sectors and locations

¹ Figures exclude transitional relief
with relatively higher economic value. A consequence could be that the burden of rates shifts onto fewer properties. The adjustment to the multiplier is calculated using a subset of properties that exist on both the previous and the updated list of rateable values, so a change in the number of properties will not affect the revaluation multiplier adjustment.

In addition, between revaluations, rateable values will change for physical factors, including buildings coming out of non-domestic use, demolition, and alterations (the likely physical consequences of business closures) as well as growth through new builds and refurbishments. Between revaluations the multiplier is linked to inflation but is not adjusted to reflect these changes in rateable values, and in this respect the revenue from rates is not fixed. Therefore, we would not expect a reduction in the number of businesses to lead directly to a corresponding increase in rates paid by other businesses.

**Mechanism for compensating local authorities**

Local authorities are currently compensated for applying business rates reliefs under Section 31 of the Local Government Act 2003. This is a separate grant mechanism to Revenue Support Grant and it will continue to be available for this purpose even if Revenue Support Grant is devolved as part of the reforms to the business rates system.

**Preferential creditor status**

The Budget 2018 measure referenced in the session (‘Protecting Your Taxes in Insolvency’), is specifically targeted to certain withholding and indirect tax liabilities held in trust by businesses. This is to ensure more of the taxes that have been paid in good faith by businesses’ employees and customers are collected by the government to fund public services, rather than be distributed amongst other creditors alongside other assets when a business enters insolvency. The government considers it fair that it should remain an unsecured creditor for tax liabilities owed by the business itself, including business rates.
Pooling business rates

Through pooling local authorities are able to share the benefits of growth in rates revenue. Local authorities have said that pooling can help facilitate better planning across functional economic areas, and can help enable joint decision making on the strategic spending of business rates growth.

The benefits are realised when pooling at the local level because it allows local authorities to coordinate their actions across a functional economic area. To pool at the national level would not achieve this objective, would reduce the local incentive effect of business rates retention, and would work against the government’s localism agenda.

A further benefit of pooling is that it helps local authorities to manage the risk of any decline in business rates, which is an important part of local government becoming self-sufficient in the way that it is funded.

The business rates retentions scheme includes a further safety net to ensure the risk posed to individual local authorities is proportionate. The rates retention system ensures that authorities will receive 92.5% of their baseline funding level even if their business rates income declines significantly.

The government is currently consulting on future reform to the business rates retention system. This consultation seeks local authorities’ views on providing incentives to pool going forwards. The consultation is also seeking views on proposals to tackle the impact of business rates appeals on local authorities and on the future of the safety net.

State aid implications of an Online Sales Tax

The Committees raised the suggestion of an Online Sales Tax. I understand that the proposal raised would apply a 20% tax to online sales where the business making the sales conducts at least 20% of its sales online. Conversely, if a business made less than 20% of its sales through online channels it would not need to pay
the new tax. You asked for further detail about the government’s assessment on the legal risk posed by State aid rules.

Broadly a State aid occurs when a transfer of state resources provides an advantage to specific undertakings in a way that is selective, and distorts or could distort competition, thereby affecting intra-EU trade. In assessing the Online Sales Tax proposal against this principle, the government can identify a number of potential risks.

First, tax proposals, including new taxes, have been judged to constitute State aids in the past.

Second, the tax could apply in a different way to two taxpayers performing substantially similar activities, implying selectivity. For example, consider two businesses which sell books. Business A sells 19% of its books online, whereas Business B sells 21% of its books online. Overall the two businesses are conducting similar activities, but Business B would face an additional 20% tax liability.

Third, this could distort competition. The extent of this would need to be judged on the basis of a detailed proposal. However using the example above, Business B could argue that its offering would be substantially less competitive as a result of the tax.

Fourth, these distortions could then potentially affect intra-EU trade, if for instance, non-UK resident businesses were less likely to have a substantial store-based presence in the UK.

The government would note that this assessment is based on the high-level principle set out in the hearing, rather than a consideration of a detailed tax proposal. Ultimately a definitive assessment would require a legal and factual analysis of the relevant detail. Nonetheless the government considers there is a high risk that such a tax would be found to be a State aid.
I trust these answers fully address your questions. I would of course be happy to provide further clarifications if required. I am copying this letter to Rishi Sunak MP as minister responsible for local authority funding, as well as the members of the Treasury and Housing, Communities and Local Government Select Committees.

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RT HON MEL STRIDE MP