Department for Communities and Local Government

Business rates retention and the local government settlement

A plain English guide

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Department for Communities and Local Government

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Business rates retention and the 2013-14 local government finance settlement

Introduction

Local government accounts for a quarter of all public spending. This year, English councils will spend £114.5bn. That's a bigger budget than the NHS and twice the defence budget. So it's vital that councils continue to play their part in tackling the inherited budget deficit by making sensible savings through better procurement, shared services and greater transparency, while continuing to protect frontline services.

Over the past year, councils have called for stability and limited changes, and we have listened to those concerns. Nearly all other parts of government and other local services are facing a further 1% reduction in funding next year. Local government has been protected from that in order to give councils time to transform service delivery and make the savings needed for the future.

This is the first financial settlement that reflects the entirely new financial relationship between central and local government. We have ended the complex and unfair system which redistributed the proceeds of local growth which meant councils had no incentive to support local businesses, and which encouraged a 'begging bowl' mentality that kept them dependent on central government. For the first time in a generation, local government will get a direct financial benefit from helping to deliver local business growth. Councils will now be able to keep half of any increases in business rates to invest locally. Over the next seven years, this has the potential to add £10bn to the national economy.

Most importantly of all, this is a fair settlement which protects hard working families and the most vulnerable. For the third year in a row, we are providing funding so that all councils can freeze council tax and help families with the cost of living. Decisions about funding have been carefully calculated so that it fairly reflects the different needs of different parts of the country - rural and urban, north and south. The average reduction in spending power is 1.7% with no council seeing a reduction of more than 8.8% as a result of efficiency support grant.

Why have we changed the system?

The local government finance system is one of the most centralised in the world with councils getting more than half of their income from a central government grant. Under the existing system, all businesses - shops, offices, warehouses and factories - pay a tax to their local council (called business rates). Although the local council collects this tax, it doesn't keep the money. It goes into a Treasury pot and is then redistributed back to local authorities, via an extremely complex formula.

There are a number of problems with the current arrangements. It fails to reward councils at all for increasing and supporting business in their area. No matter how many new businesses start up in their locality, councils don't get a penny extra. They could even lose out for having to stump up the cost of providing additional services to new companies.

Instead of encouraging businesses, the system encourages a ‘begging bowl’ mentality with councils looking to be rewarded for being worse off. It’s a system in need of reform.

The government is giving councils more freedoms and flexibilities, because we want to reduce Whitehall interference and give more power to local people. We also want to give councils stronger incentives to create and support local jobs and local firms.

So we are shifting more financial power from Whitehall to the town hall, allowing councils far greater influence over the money they collect. An estimated 70% of local authority income will now be raised locally compared to about half under the existing arrangements. Overall, councils will get to keep 50% of all business rates growth, giving them a real incentive to go for growth and encourage enterprise and job creation. If economic activity increases, the total amount of money raised from business rates will grow too. This means there will be more money ‘in the pot’ for councils to invest in local services.

Councils will also have much greater flexibility to pool their business rates to encourage growth across their areas. The scheme also enables local authorities to borrow money against future business rate growth to fund infrastructure projects in their area.

Protecting all councils

Some councils collect a lot more business rates than others. So we are evening up the odds to encourage enterprise in councils whatever their starting position through a system of top ups and tariffs. Authorities who have more business rates than their baseline funding level will pay a tariff to government. This will be used to fund top-up payments to those authorities whose business rates are less than their baseline funding levels.

Similarly, there are some councils who currently have lots of business property and who will be able to make large gains for relatively small investment in further growth. Conversely other councils which are starting from a low level of business rates revenue might see only relatively small returns for bold and imaginative investment decisions.

Where a council's increase in revenue from business rates outstrips the increase in its funding level, it will pay a levy on that disproportionate benefit. This will be used to fund a safety net, providing support to councils whose business rates receipts fall by more than 7.5% below their baseline funding level. Government is capping the levy at 50p in every £1 of growth to ensure that a strong economic incentive remains for all councils.

The baseline will be uprated each year to take account of inflation, but apart from this, the government does not intend to reset the system before 2020. This will give local government the stability and certainty they need to support long-term investment decisions and promote economic growth.

The new system of business rates retention is part of an overall framework of incentives and support for councils to go for growth. Further reforms provide councils with further rewards for growth:

- £650m under New Homes Bonus next year to reward councils for house building
- £1bn in Community Infrastructure Levy,
- a £2.6bn regional growth fund, and

- a £770m growing places fund to support local infrastructure

Alongside new powers, freedoms and flexibilities, this financial system frees councils from their historic dependence on central government and gives them the ability to invest in and support the needs of their local communities - without being told what to do.

Supporting the most vulnerable communities

Government grant is, of course, not the only way that councils receive their money. A local council has income from various sources, from business rates through the new retention system, fees and charges and from the local council tax. The government has looked at these funding sources in the round in assessing the relevant spending power of each council. It has taken account of council income from council tax, start-up funding assessment, grants, and money that is coming from the NHS to support social care and benefit health. It is therefore fairest and most accurate to look at a council's overall 'spending power' rather than simply their grant levels.

Through an Efficiency Support Grant, we will ensure no council sees their overall spending power decrease by more than 8.8%. We have also retained the 'damping' system which protects councils from sharper grant reduction they would otherwise have had. There are four 'damping' floors, grouping councils by their relative reliance on government grant. This year, those floors have been altered to ensure that the councils who are most dependent get the most support and protection.

How can councils respond?

Looking towards 2014/15 and beyond, councils need to continue to think of new ways to find and deliver savings while protecting local services and delivering value for money for the tax payer. Local government has already delivered many savings but more can be found by more councils. Councils should learn from each other to route out the savings which are so keenly needed. There are already many examples through procurement savings, shared offices, services or though increasing local tax collection rates and cutting fraud which allows councils to deliver more for less. The government has published a document "50 Ways to Save" to assist local government in identifying savings.

What do these proposals mean for you?

Local residents should see greater investment in local services as authorities benefit from increased business rates revenue; will be protected if their council experiences a significant downturn; and we expect that the vast majority will benefit from council tax bills being kept down for a third successive year.

Businesses will see no change in the way their business rate bills are calculated, but have a much greater incentive to work with local councils in making the right business decisions for their area.

Charities and voluntary groups which currently receive tax relief on their business rates bills will see no change as this relief will continue under the new system.

Councils will have much greater incentive to promote economic growth in their areas and much greater certainty about their future funding - allowing them to plan ahead, manage risk, budget for the long term and plan for worst case scenarios. They will also want to work more closely with the Valuation Office Agency (the body which helps calculate the amount of business rates that firms should pay) to ensure local firms are having their properties valued correctly and paying the right amount of tax.

Developers will benefit from councils actively seeking to encourage appropriate and well-planned business development.

The **police** will continue to be funded through a central government grant and therefore will not be affected by fluctuations in business rates in their area.

All single purpose **fire and rescue authorities** will be funded through a two percent share of each district or borough council's business rates income, and topped up by central government.