Local Government Association

Resources Board

28 June 2018

Dealing with Losses Due To Appeals

Purpose of report

For decision.

Summary

This paper updates Resources Board members on the discussions on dealing with losses due to appeals under greater business rates retention and asks members to agree and comment on the submission at **Appendix A**.

Recommendation

That members of Resources Board comment on and agree the submission to MHCLG at **Appendix A**.

Action/s

Officers to reflect any comments in the submission to MHCLG.

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Dealing with Losses Due To Appeals

Introduction

1. The issue of spreading the risk of valuation losses across the local government sector to reduce volatility has been considered as part of the discussions between central and local government on the implementation of greater business rates retention from April 2020.

2. The risk from appeals has been the principal risk which has emerged under the 50 per cent business rates retention system. Before the introduction of the current rates retention system, all business rates raised locally were paid to central government. Losses on appeal, therefore, were borne centrally. When the 50 per cent rates retention system was established in 2013, authorities bore 50 per cent of the risk of appeals including backdated appeals, and were expected to make provisions for expected appeals losses, in line with normal accounting practice.

3. The Government adjusted for this nationally by reducing the business rates and funding baselines by £1.9 billion in 2013/14. That is the baselines were £1.9 billion lower assuming that there would be this amount of successful appeals (as all appeals on the 2010 list have not yet been settled we do not know whether this was sufficient). This was apportioned between authorities proportionately to their individual business rates baselines and not in accordance with the risk of appeals. So technically nationally and locally the impact of appeals was adjusted for. However, this is not particularly explicit and some authorities experience losses larger than their appeals adjustment and some experience losses smaller than the adjustment.

4. It is estimated that there was a total of £2.6 billion in appeals provision as at 31 March 2017. Not all of this may be needed, as over 70 per cent of appeals to the 2010 list which have been resolved (which amount to over 950,000) have resulted in no changes to the list. There are still over 130,000 appeals outstanding from the 2010 list. There is no information on whether the appeals that are still to be resolved are more or less likely to result in a change to a valuation.

5. A new system for appealing, Check, Challenge and Appeal (CCA) was introduced in April 2017. This requires business rate payers to go through a number of stages before an "objection" to a valuation becomes an appeal. It also, in theory removes the incentive for speculative appeals. It is too early to tell whether CCA has been effective in reducing appeals because it takes time to go through the pre-appeal processes, the systems to support it are not fully in place and it appears that rating agents, and consequently the Valuation Office Agency (VOA), have been focussing on appeals to the 2010 list. Therefore, councils have found that CCA has made it more difficult to assess the level of provision they need to make for appeals.

MHCLG proposals

6. The 2017 Local Government Finance Bill, which provided the enabling legislation for 100 per cent business rates retention, contained a new power for Government to hold a

provision to pay authorities for losses due to appeals. This would have meant that payments would be made to authorities to compensate them for valuation losses, when those losses occurred. The Bill fell with the dissolution of Parliament prior to the General Election last year and, therefore, the new power will not be available for April 2020. However, MHCLG officials consider that current powers to pay section 31 grant could be used instead to compensate for losses due to appeals.

Identifying valuation changes due to appeals

7. The main technical issue is to identify which losses are due to appeals and which are due to other reasons. MHCLG thinks that changes in rateable value that are due to physical changes, such as during the construction of an extension or refurbishment of a property, should not be protected in this way. However changes due to appeals which are completely beyond authorities' control could be protected.

8. At present, authorities are informed only of the change to the rateable value and the date from which this change takes effect. The information received by authorities on valuation changes does not identify the reason for this change e.g. as a result of valuation change or some other reason. The VOA has stated that it cannot provide this information to authorities or the MHCLG as they do not have the systems in place to identify the reasons nor could they easily put these in place. They also note that it may be better to base this on an objective measure rather than a VOA assessment of the reason for the change.

9. The proposal from the MHCLG and the VOA is that authorities should be compensated for those valuation changes which are backdated to the start of a list. The reason being that most challenges/appeals due to valuation methods are, if successful, backdated to the start of the list. Changes which are not backdated are not likely to be due to an appeal and according to MHCLG authorities should not be compensated for them. The proxy is not perfect but MHCLG are indicating that, in the absence of an alternative approach, they see it as the only feasible option. Therefore, the danger of arguing against this approach is that there is no alternative.

Funding valuation losses

10. The LGA and local authorities have pushed for business rates income from the central list to be used to fund valuation losses due to appeals. However, MHCLG consider that this would not be fiscally neutral, as central list income is already used indirectly to fund various grants to local government. In order to ensure fiscal neutrality, they say, funding these losses through central list income would need to be considered as part of the next Spending Review in 2019. We will consider whether it is a priority to continue to lobby for this including as part of Spending Review campaign.

11. Another way to fund valuation losses centrally would be to top-slice a certain amount from the total quantum of business rates. This could help reduce appeals volatility. It would have to be kept under review regularly and it could only be reconciled once all challenges/appeals on a given list had been resolved. The size of top-slice would need to consider the cumulative impact of funding other system design elements, such as the safety net, through a similar top-slice.

Other Issues concerning the centralisation of appeals loss

12. The introduction of 75 per cent business rates retention will fall in the middle of the 2017 list. MHCLG therefore suggest that the implementation of a central provision be made in 2021 when the next valuation takes place. This would mean that all appeals under the 2010 and 2017 lists would continue to be dealt with under local provisions until that time. MHCLG consider that to introduce it before the 2021 revaluation would require them to centralise local authorities' current provisions and this, or MHCLG picking up the cost, would not be fair to authorities that do not have many outstanding appeals. They recognise that making provisions to cater for 75 per cent of potential loss from 2020 will be challenging, and will consider further how other mechanisms within the system, such as the safety net, can be used to facilitate the transition.

13. MHCLG consider that centralising the impact of appeals is complex and they will need to take into account the recommendations of the Andrew Hudson Review[1] once it is complete. The local government side at the joint groups on business rates retention believe that the government must deal with the impact of appeals on local government despite any complexity.

14. In the paper to the joint MHCLG and LGA business rates retention groups, MHCLG stated that it is currently carrying out scoping work and would like to invite authorities to submit their views on how appeals should be dealt with in the future and propose any alternative approaches to separating losses as a result of valuation changes from those that result from development. MHCLG has asked for submissions by 1 July 2018. Officers propose that the LGA make a submission, in order to make the key point that we think that the proposed way of dealing with appeals is better than the current system because it reduces the risk to authorities and it reduces the need for authorities to hold provisions to cover appeals. This outweighs the risk of further complexity. The draft submission reflects the comments of the LGA's Task and Finish Group of Business Rates Retention and the Fair Funding Review and is attached as an **Appendix A** for members comment and approval.

Reform beyond 2020

15. As stated above, the 2017 Local Government Finance Bill contained a power which would have allowed the Government to hold a provision to compensate authorities for losses due to appeals. The Government may reintroduce this when parliamentary time permits. Members of the joint MHCLG and LGA groups on further business rates retention are generally in sympathy with these aims.

Recommendations and Next Steps

16. That members of Resources Board comment on and approve the submission to MHCLG at **Appendix A**.

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[1] This is the independent review of the processes and procedures that underpin the MHCLG's governance of the business rates system.

Implications for Wales

17. Local government funding is a devolved matter and further business rates retention applies only to England. The Welsh Local Government Association would work on these matters in Wales.

Financial implications

18. The work described in this paper is part of the core LGA work programme and as such is budgeted for within 2017/18 budgets.