PO CH/NL/0435 PT B

Part B.

SECRET

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Begins : 20/1/89.
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PO CH/NL/0435 PT.B.

Chancellor's (Lawson) Papers:
Transitional Arrangements for a Uniform Business Rate.

DD's: 25 Years

31/1/96.

PO CH/NL/0435 PT.B.

lg.ph/docs/RFdft

SECRET

FELLGETT 20/1/89

FROM : R FELLGETT
20 January 1989

CHANCELLOR

cc **Chief Secretary**
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Culpin
Mr A Edwards
Mr Potter
Mrs Chaplin
PS/Inland Revenue
Mr Shutler (CVO)
Mr Pitts (Inland Revenue)
Miss Wheldon (T/Sol)
Mr Jenkins (T/Sol)

RATING APPEALS

The Solicitor General's letter of 19 January suggests that the removal of proposal and appeal rights against the existing 1973 rating list could fall foul of the European Convention on Human Rights. I have discussed this with the Treasury Solicitor's Department, who have spoken to officials in the Law Officers' Department. They have agreed that only a minor amendment to the scheme for removing proposal and appeal rights is needed to make it safe under the Convention.

2. The Law Officers' concerns apparently relate only to the suggestion that in 1989/90 changes in domestic rateable values of less than 20 per cent would be ignored. A householder who obtained a reduction of say 10 per cent in April 1989 would therefore have the benefit of a lower rates bill removed after the necessary legislation received Royal Assent the following October. This was likely to run into trouble with the Convention, which prohibits, broadly speaking, the removal of property rights without good cause.

3. The simplest way to deal with this problem is to continue to require the VO to keep domestic rateable values up to date, without any de minimis rule. There will be minor changes to rateable values during the last year of domestic rating, but the additional professional valuer's time involved would be very small as these changes are normally dealt with by non-professional staff. I recommend accordingly.

4. (Although the Law Officers' Department do not seemed to have focussed on this point, the same concern could presumably apply to a domestic or non-domestic ratepayer who successfully proposed and obtained on appeal a reduction in their value between the time of an announcement and Royal Assent to the necessary legislation. However, in practice the Valuation Office will themselves normally implement such a reduction in value even though the appeal would be retrospectively quashed. The ratepayer concerned would not therefore have any material loss about which he could complain under the terms of the Convention.)

5. The way is therefore clear for you to minute the Prime Minister ahead of the meeting planned for next week. A draft is attached which has been agreed with FP and reflects the comments of the Revenue. It incorporates the main points which I understand you wish to put to the Prime Minister, including the offer to maintain proposal and appeal rights for domestic ratepayers, if that would help meet her concerns.

6. The Revenue would also be keen to make the point that difficulties with the revaluation would come at the same time as difficulties over implementing the community charge, by adding "at the same time as we are introducing the community charge on the "domestic" side" at the end of paragraph 6(ii). You will wish to decide how best to handle this argument with the Prime Minster, but you may feel that it would be better to focus on the potential complaints from ratepayers throughout the period around the time of the next election rather than invite a discussion on the prospects for a successful launch to the community charge.

R.F.

R FELLGETT

lg.ph/docs/RFdft

SECRET

DRAFT MINUTE FROM THE CHANCELLOR TO :

Please type for signature

PRIME MINISTER

RATING APPEALS

I have seen Paul Gray's letter of 16 January recording your comments on Nick Ridley's minute of 6 January and have discussed them with Nick. We would like to discuss further with you and our offices have been in touch to arrange a meeting.

2. I ~~fully share~~ can understand your concern about removing from ratepayers the right to propose changes in, and appeal against, rateable values in the existing 1973 list. (There is of course no suggestion that we should remove equivalent rights in relation to the new rateable values that will be used from April 1990.) A series of other measures have been implemented to enable the Inland Revenue to deploy its resources most effectively on the rating revaluation. Nevertheless, after carefully considering all the options, I ~~have concluded~~ agree with Nick that the consequences of not taking this action would be far worse. It may be helpful to set out the main considerations in advance of our meeting.

3. The difficulty is that unless we take action now to prevent a continuing flow of proposals and appeals against the old 1973 rateable values, neither the Revenue nor the local valuation courts will be able to deal promptly with justified changes to the new valuations. If the limited number of professional valuers available have to deal in 1990 with a large backlog of old appeals, the system for amending new rateably values will become clogged with up to two to three years' work. Although when changes were finally made they would normally be retrospective to April 1990, business ratepayers would ~~no doubt~~ in no uncertain terms ~~vociferously~~ complain if they had to wait so long.

4. There would also be unpredictable effects on the yield of the national non-domestic rate, and probably delays in preparing for the next rating revaluation planned for 1995.

SECRET

5. You suggested that the Inland Revenue would have to find a rule of thumb multiplier for the rating of those properties they cannot resolve in time, with adjustment retrospectively once the new valuation is determined. This is indeed broadly the way they will have to value those properties they cannot assess fully in time; but we would be left with all the problems mentioned above.

6. We therefore face a choice between:

i. removing proposal and appeal rights against the 1973 rateable values (while continuing to charge the Revenue with keeping these values up to date until 1990), and facing some complaints now, to help get the reformed business rating system off to a much better start ; or

ii. running a very substantial risk that a large number of new rating valuations will not be put right for up to two to three years, with complaints from business ratepayers throughout 1990 to 1993.

As Nick's minute noted, many proposals to change the present list are opportunistic proposals which should have little chance of success against rateable values which have often stood for up to 15 years. We could not say that of the complaints we would face from 1990, which would often be about more justified changes.

7. Neither option is attractive, but I believe we should give priority to making a success of the new system.

8. In the light of Nick Lyell's letter of 19 January, which my officials have discussed with his, I suggest however that the Revenue should continue to keep the old domestic, as well as non-domestic, values up to date until 1990. I understand that his concern was only about the suggestion that changes to domestic values of less than 20 per cent would be treated as de minimis - which was not an essential part of Nick Ridley's suggestion - and Nick Lyell has no difficulty with other aspects of the scheme described in Nick Ridley's minute.

SECRET

9. I would also be content to make one other change to the scheme. Because non-domestic appeals absorb the bulk of ~~professional~~ valuers' time, we could maintain the rights of domestic ratepayers to propose changes in, and appeal against, old values, if you think it would help.

10. I am copying this minute to Nick Ridley, John Wakeham, Peter Walker, Malcolm Rifkind, Nick Lyell, and to Sir Robin Butler.

[NL]

35/1 lg1/lh.14.20.1 RESTRICTED

14 | 188

FROM: P M RUTNAM
DATE: 20 JANUARY 1989

MR MONCK

cc Mr A J C Edwards
Mr Moore
Mr Fellgett
Mr Potter
Mr M Williams
Mr Bent
Mr Guy
Mr Holgate
Mr A Hudson

BUSINESS RATES: NATIONALISED INDUSTRIES

You asked for more information on the likely effects of the business rating revaluation, in particular the review of formula rating, on nationalised industries.

2. The industries rated 'by formula' are those whose rateable values (RVs) are determined by specific secondary legislation. A list is at Annex: as you will see, it includes both public and private sector industries - some, but not all, of the latter formerly nationalised. The 'formula' in the legislation includes both initial determinations of the industries' RVs and factors for updating those values on an annual basis to reflect the expansion or contraction of the industries within the lifetime of the valuation list. There are also provisions specifying those sets of properties within an industry's estate which are included within the formula; other properties (eg offices on non-operational land) may be outside, and rated conventionally.

3. The rationale for most of the formulae currently applied to these industries is obscure, to say the least. The SIs now in force were laid mostly in 1975-77, as a corollary of the last general revaluation of business rates (in 1973). In the discussions beforehand, some attempt was made in most cases to arrive at new rateable values by rough and ready valuations using information on industries' overall profitability and/or asset bases. These were to act as proxies for the rental value of the

industries' property. In practice, however, the RVS were determined by DoE's 'Judgement of Solomon'.

4. In the case of British Gas, for example, the industry claimed that an asset or profit-based valuation pointed to a rateable value of only c £35m (compared to a value pre-valuation of £30m). The local authority associations claimed that their method justified a rateable value of £120m. DoE, acting as mediator, settled on £60m. The new RV of British Rail was settled in a similarly arbitrary fashion. When the previous RV was fixed in the '50s it reflected the 75% industrial derating applied to BR and some other industries. Though derating later was abolished for other industries, it effectively continued for BR as the SI was not revised. When the new RV was set in 1976, the local government side of DoE settled on a figure of £40m. The transport side, however, then lobbied successfully to cut this in half, to prevent BR's rates bill rising significantly. This was put down to a notional derating of track.

5. The Treasury's aim in the current review of formula rating (in which PE has been closely involved) has been to ensure that all these arbitrary and anachronistic arrangements are put on to a common and equitable basis. This basis should be as similar to conventional rating as possible. The arguments for doing this are self-evident and strong. There is no reason why the scarcity or absence of rental information for particular classes of property should mean a lower tax bill. Still less should the question of ownership, public or private sector, enter into it - though privatisation obviously gives us even stronger incentive to get the tax burden right. That said, it is to be expected that when ministers are directly involved in deciding a body's tax liability there should be downward pressure on the determination. Treasury ministers' involvement is therefore likely to be needed to defend the principle of comparability between formula and conventionally rated industries.

6. The approach that we favour in determining the new RVs and formula is to use CCA accounts to arrive at an estimate of the capital value (CAV) of the industry's rateable assets. A

percentage similar to a decapitalisation rate is then applied to the CAV calculate an approximate rental value. This procedure is similar to the contractor's basis used in rating a large number of properties under conventional (ie non-formula) rating, and thus better grounded both intellectually and practically than any of the alternatives available (methods based on eg profits or turnover). The contractor's basis proper, however, uses detailed capital valuations of each rateable property, calculated by the professional valuers of the VO. The CAV approach in formula rating would have to use broad-brush estimates of the CAV of each industry's rateable assets. Under both procedures, the decapitalisation rate, which is related to average real rates of return, should be the same: at present it is 5% for most industry (7% in Scotland), but from 1990 it is likely to be 6% (which means a 20% rise in the liability in England, other things being equal).

7. The principle of a CAV valuation is now quite well established for the Electricity industry. The difficulty is to arrive at an agreed or, at least, defensible figure for the rateable CAV. In the review the industry has argued for a CAV of c £12 billion, and using a decapitalisation rate of 4%, a new RV of £480m. This compares to a current RV of £190m, but implies a reduction (of 2/3) in the liability, as the rate poundage is likely to drop from c 240 pence to c 35 pence on the revaluation. The Government side has argued for an RV closer to £1800m, which would imply a rise in the liability from c £450m to c £630m. Clearly there is a lot to play for. The main points at issue are:

- what allowances should be made for non-rateable elements

- whether an allowance should be made for surplus capacity

- what should be done about pollution control equipment (is it rateable if not income-producing?), and the £5 bn reduction is the industry's asset base following write-offs in the 1988-89 accounts.

8. The position on BR and LRT is still less satisfactory. At the moment, their RVs are c £20m and c £3m respectively. The

industries have not been helpful in producing CCA accounting information. BR, in particular, has claimed that practically none is available. The CCA information on LRT (or, rather, LUL which is the formula rated part) would imply a new RV closer to £120m, but the industry disputes this. We shall certainly be pressing on both industries the use of some broad-brush CCA data such as that worked up for the CLRS. (This shows a CCA value for NSE alone of c £3 bn, but allowances would have to be made for non-rateable items, such as rolling stock). And I am sure that there is a good case for a severalfold increase in both industries' liability, but we shall have to be armed with as much good accounting data as possible if we are to achieve this. I will be discussing this further with PEAU.

9. You asked about the likely effect on public expenditure and/or prices of these rises in rates liabilities. This will obviously depend on how the negotiations over the months ahead are concluded, but a rise of, say, £150m in the ESI's liability (probably the maximum achievable) would increase the industry's operating costs by something over 1%. An increase of £40m (probably more than we will achieve) for LUL would be proportionately more serious: about 5% of LUL's operating costs. A trebling of BR's liability, to c £120m, would, increase its operating costs by over 2%. In each case, therefore, the achievement of a satisfactory rate of return will become appreciably a more difficult task unless there are corresponding gains in efficiency.

10. The extra burden will, however, be alleviated by transitional arrangements. These will be the same as for other businesses: the increase in rates liability will be limited to 20% of the liability in the year before (ie of the 1989-90 liability in 1990-91, thereafter the 20% rises will be compound) before the uprating of the poundage each year by the RPI or less. This arrangement will continue until at least 1995. Thereafter the arrangements have yet to be decided, but assuming the system planned for 1990-95 does continue, it will take 2 years from now for the ESI's liability to rise by £150m, and much longer (over a decade) for LRT's to rise by £40m and BR's to treble. In short, because the

transport industries' liability is currently so small, it will be a long time before it rises to a realistic level. The effect on the ESI is notable, but the relevance of the review to BR and LRT's EFLS, passenger fare levels in the near future and transition to an adequate rate of return is much more limited.

P M RUTNAM

ANNEX

Public sector	Private sector
Regional water authorities (not sewage works)	Water companies
British Rail	British Telecom (network only)
London Regional Transport	Mercury (network only)
Electricity	British Gas
British Waterways Board	Ports

chex.md/aa/36

SECRET

cc: **Chief Secretary**
Financial Secret
Sir P Middleton
Mr Anson
Mr Phillips
Mr Culpin
Mr A Edwards
Mr Potter
Mrs Chaplin
PS/IR
Mr Shutler CVO
Mr Pitts IR
Miss Wheldon TSol
Mr Jenkins TSol

CH/EX → PM RATING APPEALS 23/1

Treasury Chambers, Parliament Street, SW1P
01-270 3000

PRIME MINISTER

23/1/89.

RATING APPEALS

I have seen Paul Gray's letter of 16 January recording your comments on Nick Ridley's minute of 6 January and have discussed them with Nick. We would like to discuss further with you and our offices have been in touch to arrange a meeting.

I can understand your concern about removing from ratepayers the right to propose changes in, and appeal against, rateable values in the existing 1973 list. (There is of course no suggestion that we should remove equivalent rights in relation to the new rateable values that will be used from April 1990.) A series of other measures have been implemented to enable the Inland Revenue to deploy its resources most effectively on the rating revaluation. Nevertheless, after carefully considering all the options, I agree with Nick that the consequences of not taking this action would be far worse. It may be helpful to set out the main considerations in advance of our meeting.

The difficulty is that unless we take action now to prevent a continuing flow of proposals and appeals against the old 1973 rateable values, neither the Revenue nor the local valuation courts will be able to deal promptly with justified changes to the new valuations. If the limited number of professional valuers available have to deal in 1990 with a large backlog of old appeals, the system for amending new rateable values will become clogged with up to two to three years' work. Although when changes were finally made they would normally be retrospective to April 1990, business ratepayers would complain in no uncertain terms if they had to wait so long.

There would also be unpredictable effects on the yield of the national non-domestic rate, and probably delays in preparing for the next rating revaluation planned for 1995.

You suggested that the Inland Revenue might find a rule of thumb multiplier for the rating of those properties they cannot resolve in time, with adjustment retrospectively once the new valuation is determined. This is indeed broadly the way they will have to value those properties they cannot assess fully in time; but we would still be left with all the problems mentioned above.

We therefore face a choice between:

i. removing proposal and appeal rights against the 1973 rateable values, and facing some complaints now, to help get the reformed business rating system off to a much better start ; or

ii. running a very substantial risk that a large number of new rating valuations will not be put right for up to two to three years, with a chorus of complaints from business ratepayers throughout the period from 1990 to 1993.

As Nick's minute noted, many proposals to change the present list are opportunistic proposals which should have little chance of success against rateable values which have often stood for up to 15 years. We could not say that of the complaints we would face from 1990, which would often be about more justified changes.

Neither option is palatable, but I believe it is politically essential to give priority to making a success of the new system.

In the light of Nick Lyell's letter of 19 January, which my officials have discussed with his, I suggest however that the Revenue should continue to keep the old domestic, as well as non-

domestic, values up to date until 1990. I understand that his concern was only about the suggestion that changes to domestic values of less than 20 per cent would be treated as de minimis - which was not an essential part of Nick Ridley's suggestion - and Nick Lyell has no difficulty with other aspects of the scheme described in Nick Ridley's minute.

I would also be content to make one other change to the scheme. Because it is non-domestic appeals which absorb the bulk of Inland Revenue valuers' time, we could maintain the rights of domestic ratepayers to propose changes in, and appeal against, old values, if you think it would help. All we would then be doing would be to oblige non-domestic ratepayers to wait until the new list is published, when they would be completely free to appeal against their new rateable values. This seems an acceptable price to pay for ensuring that the new system is introduced successfully.

I am copying this minute to Nick Ridley, John Wakeham, Peter Walker, Malcolm Rifkind, Nick Lyell, and to Sir Robin Butler.

[NL]
23 January 1989

The situation is critical

That + private sector loan,
VO chronically short of
professional values - esp in
London & SE - & now
1st business rate revaluation
since 1973

1. Increased productivity
2. More overtime
3. Delegate to non-professionals
4. Retired valuers should help
5. Withdraw from 'triple A' work
   where pressure greatest
6. Withdraw from some work for
   other Govt Depts & LAs

This fills ½ shortfall, but still
275 posts short

Minute sets out any solutions
- after discussion, any options

Proposal

Business ratepayers (not domestic) will lose right to appeal against old list

---

VO still under statutory obligation to keep list up to date

Business ratepayers have had 15 yrs in which to appeal — and only another 14 months to go

---

Lot of [illegible] have full right to appeal against new — 1990 — valuation list

---

OTHERWISE introduction of new list will be a mess 2-3 yrs to get it right [illegible]

Everyone complaining

Potential revenue loss (1b = £100m)

lg.ph/docs/RF1

SECRET

FROM : R FELLGETT
DATE : 24 January 1989

CHANCELLOR

cc PS/Chief Secretary
PS/Financial Secretary
PS/Sir P Middleton
Mr Anson
Mr Phillips
Mr Culpin
Mr A Edwards
PS/Inland Revenue

RATING APPEALS

You are meeting the Prime Minister with Mr Ridley at noon tomorrow to discuss this issue. You will wish to speak mainly to your recent minute, but I also attach a short summary of the main points that you may wish to draw on in the discussion.

R.F.

R FELLGETT

SECRET

Problem

VO is chronically short of professional valuers, especially in London and South East. The available people need to devote their time to the top priority tasks - Revenue work on capital taxes and the business rating revaluation.

Management action already taken (partial list)

1. Productivity targets raised from 265 units per valuer in 1986-87 to 300 units in 1989-90.

2. More use of overtime, more delegation to non-professionals, more use of retired valuers.

3. Studies of contracting-out and out-housing London work underway.

4. VO withdrawn from "right to buy" work in hard-pressed areas.

5. VO withdrawn from some work for other government departments in London and South East.

Total saving since April 1988 from such measures 275 valuer posts (or 17 per cent of staff in post) but a projected shortfall of 275 valuers at 1 April 1989 and 220 at 1 April 1990 remains.

Your suggestion

To help get the reform of business rating off to the best possible start, from the date of announcement business ratepayers should lose formal rights to propose changes in, and in due course appeal against, the 1973 valuation list.

The VO would remain under a statutory obligation to keep the list uptodate (eg if a building is altered).

Business ratepayers would thus forgo formal rights for just 14 months over a list that is 15 years old. They would retain full rights in relation to the main list to be used from April 1990.

Should save c.250 valuers in 1990 (because proposals become appeals and absorb most professional time after a delay).

If this action is not taken

1. It will take up to 2-3 years to get the new rateable values right after April 1990.

2. There could be a revenue loss if the tax base of new values is undermined. (NB each 1 per cent of NNDR = £100 million).

3. The revaluation planned for 1995 would probably need to be postponed.

4. All accompanied by vociferous, and often justified, complaints from business ratepayers.

cst.ps/7ce18.1/mins

24/1/89.

CONFIDENTIAL

NON-DOMESTIC RATING

Note of a meeting held in the Chief Secretary's room on Wednesday 18 January 1989. Present:

Treasury	Department of the Environment
Chief Secretary	Secretary of State for the Environment
Mr A J C Edwards	Minister for Local Government
Mr Fellgett	Mr Osborne
Miss Evans	Mr Somerton
	Mr Britton

The Chief Secretary thanked the Secretary of State for his letter of 17 January. He was grateful for his agreement that the non-domestic rate poundage should be set at a level which would maintain the contribution of private businesses to the NNDR. It was an important objective of fiscal policy to avoid any diminution in the contribution of private businesses. His second main concern was to ensure that the increase in the decapitalisation rate, and the consequent increase in the central government rate bill, did not lead to an increase in the overall resources provided by central government to local authorities. In any event he was not convinced that the government should continue to pay contributions in lieu of rates. He would prefer to transfer the money into RSG.

2. The Secretary of State said that, on both the Treasury and the DOE proposals, the increases in the decapitalisation rate would lead to an increase of £280 million in the public sector contribution to the NNDR pool. Part of this would be rates payments by local authorities to themselves, and he saw no alternative but to allow local authorities to keep this rate income. He was prepared to concede that the increase in central government contributions should not lead to an increase in central government funding for local authorities. But, within a given total of central government support, he would prefer to keep contributions in lieu and reduce the remaining total of grant by

the amount of the increase in contributions. The Chief Secretary's proposal to abolish contributions in lieu and put an equivalent amount into RSG would lead local authorities to cry foul since they would not believe that the needs grant had been enhanced. It was more straightforward and much easier presentationally to increase central government contributions in lieu and reduce grant by the same amount. The end result would be the same as the Chief Secretary's proposed approach.

3. The Chief Secretary asked how, if we proceeded with contributions in lieu, we would ensure that the increase was offset by lower RSG. The only means of achieving this would be to bring together the decisions on all the components of central government support for local authorities and announce them as a single aggregate at the same time.

4. The Minister for Local Government said that it was very difficult to explain to businessmen that central government should not pay any rates. This was inconsistent with the Government's argument in favour of level playing fields generally since it would undermine competition between the public and private sectors since the public sector would have a lower rate bill.

5. The Secretary of State said that he agreed in principle that the Government should decide and announce the total of funds flowing from government to local authorities, within which contributions in lieu would be one of several components. But there was a problem about timing since he had this year undertaken to make an announcement about RSG in July. The best solution would be to announce the total of grants in July this year and possibly in October in following years.

6. The Chief Secretary said that further consideration was needed of the coverage of the total - he had all unhypothecated payments (including the NNDR) and hypothecated payments in mind - and the precise timing. But he was grateful for the Secretary of State's agreement to the principle that decisions on all central government grants should be taken and announced together, with increases in central government rates offset by lower RSG. If the announcement were made in July, it would not be possible to announce the individual components of the grant aggregate (RSG, NNDR etc) at that stage.

Private Sector Decapitalisation Rate

7. The Chief Secretary said that he was content on the substance of Mr Ridley's proposals for the private sector decapitalisation rate. He thought it would be better tactics to consult on a range of 6 to perhaps 7 per cent rather than offering 6 per cent and risking pressure for a lower figure. But he would be content if the outcome was 6 per cent. The Secretary of State said he was content to proceed on this basis.

Public Sector Decapitalisation Rate

8. The Chief Secretary said that the remaining question was the level of the decapitalisation rate for the public sector. The Secretary of State's proposal was for a rate of 6 per cent generally, except for all educational buildings (private as well as public sector) which would have a rate of 4 per cent. His proposal was for a rate of 5 per cent generally and a concessional rate for charitable schools. The effect on public expenditure was the same with both proposals - the increased public sector rate bill of £280 million would score as extra public expenditure.

9. The Secretary of State said that the rationale for his proposal was that there should be a level playing field between the private and public sectors. As a result of the education reforms there was a shifting boundary between the public and private sector in schools and accordingly he thought that all educational buildings should have the same rate. It was not practicable to increase the rate for charitable institutions. This argued for a rate of 4 per cent for schools in the private and public sectors. For all other buildings he thought that the private and public sectors should have the same rate as 6 per cent. The concession for schools was justified because schools were unique establishments, not easily converted to another purpose and their lower rateable value should reflect this.

10. The Chief Secretary said that the Secretary of State's proposals would create a 2 per cent percentage point differential between the private sector and a large part of the public sector. This was inconsistent with the level playing field objective and simply served to alleviate the local government rate bill. In his view it was easier to defend a continuation of the existing private/ public sector differential of 1 percentage point by setting the public sector rate at 5 per cent. The existing differential was based on court judgements that this was defensible on merits, given the lower risk in renting to the public sector.

11. The Secretary of State thought that the decapitalisation rate should reflect the value of the property, rather than the level of risk. It was easier to defend an across the board rate of 6 per cent with an exception for educational establishments.

12. The Chief Secretary said that a further disadvantage of the Secretary of State's proposal was that it led to the majority of the extra expenditure on higher rates falling on central government. This meant a higher increase on colleagues' programmes, and meant that a higher sum was at risk if in practice, bearing in mind that he and the Secretary of State could not commit colleagues in E(LA), the increase was not offset fully against RSG. The Secretary of State said that given the agreement to offset against RSG it made no difference how the increased rates bill was split between central and local authorities.

13. The Minister for Local Government said that a differential rate for the private and public sectors would give the wrong signals to local authorities and create distortions in relation to contracting out decisions. Moreover the effect of the Chief Secretary's proposal would be, for example, that a school which opted into the private sector would have a lower rate - this was clearly an anomaly. Mr Fellgett noted, however, that an opted out school would gain the benefit of charitable rates relief, which preclude a level playing field in this area.

14. The Secretary of State said that his main concern was that there should be a level playing field, in the sense of a common decapitalisation rate, between similar properties in the public and private sectors. If the Chief Secretary was concerned about comparisons with hospitals it would be possible to extend the 4 per cent concessionary rate to hospitals in both the public and private sectors. This would ensure that rates for the caring services were comparable in both sectors. If he was concerned about the increase in government expenditure, a 4 per cent rate could be used for military installations was well. Mr Edwards pointed out that this would mean extending the lower rate to practically all of the public sector, leaving a differential of 2 percentage points between the bulk of the public sector and most of the private sector. It was for consideration how a differential on this scale could be defended.

15. It was agreed that the Chief Secretary and the Secretary of State would reflect on the arguments on the options for decapitalisation rates for buildings found mainly in the public sector, and consider whether there was scope to reach agreement without reference to E(LF).

Inland Revenue's Survey

16. The Chief Secretary thanked the Secretary of State for his letter and his agreement that the Treasury and the DOE should look at ways of reducing the amount of detail to be published. The

Secretary of State said that he had given the commitment to publish under considerable pressure in Committee. The information released would need to be sufficient to be convincing as a basis for the Government's decisions. The Chief Secretary suggested that Treasury officials produce a draft for consideration by Ministers of a document which might be published.

MISS C EVANS
Private Secretary

H M Treasury
24 January 1989

Distribution:

Chancellor
Sir Peter Middleton
Mr Anson
Mrs Lomax

CONFIDENTIAL

FROM: R FELLGETT
DATE: 24 JANUARY 1989

PWP

1. MR EDWARDS
2. CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Scholar
Mr Monck
Mr Phillips
Mr C D Butler
Mr Culpin
Mr A J C Edwards
Mrs Case
Mrs Lomax
Miss Peirson
Mr Robson
Mr Luce
Mr Olney (RGPD)
Mr Potter
Mr S Wood
Mr A Hudson
Mrs Chaplin
Mr Call

I agree with this, subject to one point. No one is likely to take exception to a concessionary 4% rate for hospitals and education establishments. A concessionary rate for military bases, however, would risk making the whole approach controversial. You may wish to reflect on this.

AJCE
24 i

NON DOMESTIC RATING

At your successful meeting with Mr Ridley last week you reached agreement on the main points discussed:

(i) Mr Ridley agreed with you that the NNDR poundage in England should be set in 1990-91 so as to maintain the yield of business rates from the private sector. (This arrangement could not be extended to Scotland without primary legislation, but the amounts at stake are relatively small).

(ii) He would consult on a range of possible decapitalisation rates for the contractor's basis of rating, as a tactic with the aim of settling on 6% (ie assuming rateable value is 6% of capital value) for virtually all private sector valuations.

2. He also accepted (albeit with some uncertainty about the details) that in future Surveys Ministers would reach decisions first on the total of government funding for local authorities, with RSG set as a residual after the other items had been fixed. (Mr Edwards has forwarded a separate submission on this point).

3. You accepted that in view of his previous commitments it would be necessary to publish the results of the Inland Revenue survey of all the likely effects of the forthcoming business revaluation and move to National Non Domestic Rate. You offered to prepare a short document to show to him; we will work with the Revenue to produce something around half a dozen type script pages. The aim will be to describe broadly the likely main effects, support the announcement of the policy on transition which Mr Ridley is to make, and include extensive technical caveats about the information which is available at this stage.

4. The two items remaining to be settled are:

(i) The decapitalisation rates to be used in valuing certain types of buildings which are mainly in the public sector, notably education establishments, hospitals and military installations;

(ii) whether Mr Ridley has offered you sufficient assurances to enable you to agree to make a government contribution in lieu of rates payment to the NNDR pool under the new system.

5. Neither point has to be settled before Mr Ridley makes his announcement on transition, tentatively scheduled for 31 January, although it would be desirable to do so if possible.

Decapitalisation Rates

6. Mr Ridley and Mr Gummer were very keen that the same decapitalisation rate should apply to similar properties whether in the public or private sector. In view of commitments effectively made to schools with charitable status during the passage of the Local Government Finance Act they felt that 4% was the maximum possible rate for all eduction establishments.

7. Given their strong views, and the likely difficulty of persuading E(LF) to amend primary legislation, I suggest that you do not press your arguments for a 5% public sector rate. Instead, you can build on their willingness to extend 4% from education to much of the rest of the public sector indirectly. Although

technically harder to justify and possibly more awkward in Scotland where 5% is currently the lowest rate, this can have more limited effects on gge and reduce the risk to the Exchequer compared to a 5% public sector rate.

8. You discussed whether to apply to hospitals and other NHS properties the same low rate as for schools. The arguments for doing so are that it would:

(i) Moderate the likely increase in recorded general government expenditure by about £120 million (compared to a rating assessment based on a 6% decapitalisation rate);

(ii) Reduce also by £120 million the risk to the Exchequer if Mr Ridley did not deliver in full his promise to offset in lower RSG any higher government contribution in lieu of rates;

(iii) Be popular with the Department of Health and supporters of the health service, and assist private sector hospitals as well.

9. The argument against is that it is difficult to think of a convincing rationale for reducing the valuation of hospitals etc by the equivalent of a full two percentage point reduction in the decapitalisation rate. The argument would have to be broadly that a landlord would rent a building like a hospital or school for only two thirds of the rent on another building with a similar construction cost. The reduced rates bill could be criticised as a device for reducing recorded public expenditure, at least by someone expert in both valuation practice and public expenditure classifications.

10. However, there are unlikely to be many such experts, and a concession to hospitals and schools is less likely to be criticised as undermining the integrity of the public expenditure figures than a more blatant adjustment for every part of the public sector. We therefore recommend that you agree to a 4% decapitalisation rate for hospitals and other health-related buildings to which the contractor's basis of rating is applied as well as to education establishments; we will need to clarify the exact definitions with the VO and DOE.

I agree AJCE

11. You also discussed with Mr Ridley whether a low decapitalisation rate should apply to the other main type of public sector buildings valued in this way - military installations. Some of the pros and cons are similar to the arguments about hospitals etc. The saving in general government expenditure (and reduced risk to the Exchequer) would be £70 million; under present arrangements this would also avoid a rise of this size in Treasury public expenditure because Treasury, not MOD, pays defence rates.

12. A lower rate for military installations would not need to be prescribed in secondary legislation, if one assumes that there are no such installations in the private sector, because government contributions in lieu of rates are extra-statutory. But it might be hard not to announce the decapitalisation rate for Government property at the time that Mr Ridley was taking his regulations through Parliament.

13. There are two difficulties with a low rate for military installations which do not apply to schools and hospitals:

(i) It could not be treated as a special concession for essentially philanthropic social services;

(ii) military installations in fact include many properties similar to ones in the private sector, which would not have the same low rate. Examples are airports (RAF and Heathrow), wireless installations (service and the BBC) and so on. Any low rate would have to be defended by reference to more specialised military buildings.

14. There is therefore quite a fine balance between the arguments for and against a low decapitalisation rate for military installations.

15. If you conclude that schools and hospitals etc (public and private) should have a 4% rate but decide that, on balance, military installations should not, the increase in general government expenditure as a result of new decapitalisation rates should be about £200 million. (Less than the £280 million which would flow from both your option and Mr Ridley's mentioned in correspondence.) Within this about £80 million would fall on

central government and the rest on local authorities. Overall, the government contribution in lieu payment to the NNDR pool would rise by perhaps £200 million (£80 as a result of decapitalisation rates, and perhaps £120 for other reasons).

16. If, on the other hand, you decide that schools, hospitals etc and military installations should all have a low 4% decapitalisation rate, the increase in general government expenditure would fall to about £130 million, largely for local authority properties. The government contribution in lieu of rates payment would still rise by perhaps £130 million, although mainly for reasons other than the decapitalisation rates used.

Government Contribution in Lieu of Rates

17. You argued to Mr Ridley that there was no logic in the government paying a contribution in lieu of rates, which would be RSG under another name; and there would be a risk to the Exchequer if a variety of different unhypothecated payments to local authorities enabled colleagues to argue for a higher total of government support than would otherwise be paid. He said that he thought it very important for the government to continue to appear to pay like the private sector, and offered to offset an increased government contribution in lieu in full in lower RSG. The amount at stake is around £200 million, coincidentally the estimate in my submission of 20 December on which the Chancellor commented on 22 December, falling to £130 million if a 4% decapitalisation rate is used for military installations.

18. The conclusion of my earlier submission was that, on balance, the government should continue to make a contribution in lieu provided that RSG and other unhypothecated payments to local authorities are decided and announced together as a single 'envelope' without all the components being specified independently. You will now wish to reach a final conclusion on whether Mr Ridley's undertaking to do so is sufficient; and make his undertaking a firm condition to continuing a contribution in lieu if that is your conclusion.

Conclusion

19. There remains a risk from paying a higher government contribution in lieu of rates that it will not be fully offset in lower RSG, because DOE may have a hidden objective to achieve a certain percentage increase in RSG (which they regard as their grant they give to local authorities) whatever the mechanisms for setting this quantum. But they clearly attach great importance to the presentational argument about continuing to pay such a contribution.

20. There is quite a fine balance of argument between the various options. I suggest that you agree to continue to make a government contribution in lieu of rates payment provided both (1) total Government finance for local authorities is decided without regard to its components, to achieve a full offset in RSG for any increase in contributions in lieu, and (2) hospitals and schools etc are valued on the low 4% decapitalisation rate to reduce the risks to the Exchequer. There are arguments, which on balance I favour, for valuing military installations on the same low rate, to reduce the risk further. Mr Ridley said at the meeting that he would agree to such a package. A draft letter is attached which assumes this will be your conclusion.

21. If you reach agreement with Mr Ridley, the next step would be for him to minute the Prime Minister recording that he had resolved all these matters bilaterally with you, as she requested him to do. We can clear a draft on your behalf with his officials.

R.F.

R FELLGETT

CONFIDENTIAL

DRAFT LETTER FOR THE CHIEF SECRETARY'S SIGNATURE TO THE SECRETARY OF STATE FOR THE ENVIRONMENT

NON-DOMESTIC RATING

I was most grateful to you and John Gummer for the opportunity last week to discuss the issues raised in the correspondence which culminated in your letter of 17 January to me.

As I said at the meeting, I was grateful for your agreement that the NNDR poundage should be set in 1990-91 so as to maintain the yield of business rates from the private sector. This is, as you kindly recognised in your letter, an important fiscal matter. We will need to make it clear from now on that we intend to interpret our statements about the NNDR poundage in this way, notably I suggest by emphasising that we intend to meet the essential commitment to business that the rates on an average business property will not increase in real terms after 1989-90. The only real increases in the yield of business rates paid by the private sector will therefore come from the natural buoyancy in the tax base, as a result of new and expanded properties etc.

In view of the commitments you have made, I accepted that it would be necessary to announce the results of the Inland

Revenue survey into the effects of the rating revaluation and move to NNDR, when you make your forthcoming announcement about the transition. Officials here are preparing a draft, which they will forward to yours very shortly.

We also agreed on a decapitalisation rate, to be prescribed in secondary legislation for the contractor's basis of rating valuation, of 6% for the bulk of private sector properties. As a tactic to this end, we were minded to consult on a range of six upwards.

The remaining issues on which we agreed to consider our views, were the precise decapitalisation rates to be applied in the public sector, or to private and public sector education establishments, hospitals and similar health-related properties, and military installations; and whether to make a Government contribution in lieu of rates payment to the NNDR pool under the new local government finance system. I have now considered the various options carefully.

My main concern here has been to ensure that there should be no change in the total of Government funding for local authorities as a result of any change in a contribution in lieu payment. At the meeting you recognised this concern, and kindly undertook to ensure that any change in a Government contribution in lieu of rates payment would be offset in full in the amount of RSG to be paid. To this end, you offered to take decisions on Government funding in total

first, with RSG set as a residual within this total after the size of any contribution in lieu and other payments had been set. Officials are discussing this mechanism further, and I hope to write to you and colleagues with a precise proposal for implementing it shortly.

I am nevertheless concerned that, because we cannot commit all colleagues in all E(LA) discussions in future years, the prospect of a substantial rise in any Government contribution in lieu of rates poses some risk for the Exchequer. Much the most logical approach would be to cease to make a separate contribution in lieu payment, and subsume the total paid at present within RSG, because a contribution in lieu and RSG would be effectively identical under the new system.

You were, however, considerably concerned about the possible presentational disadvantages of this approach, and therefore suggested that to minimise the risk to the Exchequer a special low decapitalisation rate should be applied to properties which are found mainly in the public sector.

To meet your presentational concern, I would therefore be prepared to continue to make a Government contribution in lieu of rates payment to the pool, based in 1990-91 on a revaluation incorporating 4% decapitalisation rates for educational establishments, hospitals and other health-related properties [and military installations], provided we reach agreement on ~~a mechanism for reaching a conclusion on Government funding for local authorities as a~~

~~whole before we have regard to its components,~~ arrangements to ensure that any change in the contribution in lieu would indeed be offset in full in RSG. I shall be writing separately about this.

I hope this approach, which you indicated at the meeting would be acceptable to you, will provide a satisfactory way forward. The next step might be for you to minute the Prime Minister recording our joint conclusions, as she previously remitted to you a request for these points to be resolved bilaterally if possible. My officials would be happy to discuss a draft with yours.

[J.M]

ind.rj Jan CX.23

CONFIDENTIAL

NBR @ end

FROM: N MONCK

DATE: 24 January 1989

CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
Sir P Middleton
Mr Anson
Mr Scholar
Mr Phillips
Mr Culpin
Mr A J C Edwards
Mr Bent
Mr Potter
Mr Fellgett
Mr Hudson
Mr Rutnam
Mr Call
Mr A Prior (VO)

Ch
Not at all clear to me why it is equitable to increase NI's rate bills so much (see table) when on average the revaluation will leave non-domestic bills unchanged. AM

BUSINESS RATES : NATIONALISED INDUSTRIES

You asked for my comments on Mr Rutnam's minute of 18 January. These DOE proposals are likely to be contested by the nationalised industries and have some disadvantages (see below). But to my mind the proposals meet the relevant criterion - that the treatment of nationalised industries should be broadly comparable with the treatment of the private sector generally and that the nationalised industries should benefit from the same transitional arrangements.

2. It makes sense to replace the existing arrangements which have little rationale, as Mr Rutnam's supplementary note of 20 January, attached to top copy, explains. Basing rateable values on current cost capital valuations seems reasonable - and is certainly better than any of the alternatives currently available (eg methods based on profits or turnover). It will in due course mean some large percentage increases, as Mr Rutnam pointed out and as the attached table confirms. But the percentage increase in any one year will be limited to 20 per cent as for the private sector.

3. It is unfortunate that the rate increases are likely to feed through into public expenditure to the extent that they cannot be quickly reflected in prices (eg LRT, British Rail and British Coal). But this effect of the rating changes is not peculiar to nationalised industries. Depending on decisions about decapitalisation rates etc the addition to GGE for CG & LAs is likely to be between £240m-320m. The effect on nationalised industries' EFRs is unlikely to exceed £150 million a year.

4. There could be an effect on water and electricity privatisation proceeds to the extent that rate increases are not passed into prices. The price regime, which is not yet settled, is likely to allow rates to be passed on. But this may not happen in practice if price rises are already very high for other reasons.

5. The main argument put forward by the nationalised industry Chairmen at the dinner before Christmas was that the rates burden would be higher for the nationalised industries in relation to turnover or profits or perhaps value added than for the private sector average. As Mr Rutnam says, this is not surprising since rates are a capital related tax and the nationalised industries are relatively capital intensive. A further reason, so far as the percentage of profits goes, is that the nationalised industries earn a much lower return on capital than the private sector.

6. To sum up, I think the changes proposed are in principle sensible and also defensible, even though the industries and sponsor Ministers may contest them and they will add to the public expenditure impact of the rate changes on central and local government. A stage of negotation is still to come and it would be a mistake to make any concessions in advance of that.

N MONCK

This explains why existing relative position. But why does relative position deteriorate so strikingly as a result of revaluation? Have they got more capital intensive since 1973?

Thanks. These are very substantial increases for the NIs. As I understand it, they arise because the formulae which the panel followed in deciding on notional values for NIs has resulted in them being under-rated, and the opp[ortunit]y is now to be taken to correct this & put them as far as possible on a capital value basis "as similar to conventional rates as possible". That is defensible; but there is no case for going to the opposite extreme & over-rating them. M.

lg.jb/rutnam/reports/table

	(i) Current rates liability[1]	(ii) Industry's current proposal	(iii) DOE proposal	(iv) % increase in liability (iii) cf to (i)	(v) increase as % of operating costs	Effect on EFRs or prices
Electricity	460	170	630	37%	1.5%	To be determined but expect most/all to be passed through to customers
BR	45	-	90-135	100-200%	1.5-3%	No doubt some scope for absorption, but expect to see addition to EFR
LRT	8	-	42	400%	5%	"
Coal	50	-	65	30%	0.3%	"
Water	155	150	275	75%	7%	passed on to customer
Gas	150	-	250-300	60-100%	1.5%	Passed on to customer
BT	75	-	150	100%	1%	?

ALL FIGURES INDICATIVE

1.Figures relate to formula rated element of industries' rateable value, except in case of Water (30% conventionally rated) and Coal (to be 100% conventionally rated). For all other NIs conventionally rated element very small.

SECRET

26/1

10 DOWNING STREET

25/1/89.

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SECRET

SECRET

10 DOWNING STREET

LONDON SW1A 2AA

From the Private Secretary

25 January 1989

Dear Alex

RATING APPEALS

The Prime Minister held a meeting this morning with the Chancellor, the Secretary of State for the Environment and the Solicitor General to discuss the Chancellor's minute of 23 January and the preceding papers.

I should be grateful if you and copy recipients would ensure that this letter is seen only by named individuals with a clear need to know.

The Chancellor said that, following further discussions with colleagues, the package put forward in his minute of 23 January incorporated some changes from the earlier proposals, in particular to leave the rights of domestic ratepayers unchanged. He believed that the proposals to limit the rights of non-domestic ratepayers to appeal against rateable values in the existing 1973 list were justifiable. The safeguard was that, if a non-domestic ratepayer faced a fundamental change in his circumstances, there was a statutory obligation on the Valuation Office to keep the 1973 list up to date. It was not satisfactory to take no action in the face of the severe difficulties the Valuation Office faced; that would result in severe disruption to the 1990 re-valuation with an outcome that would be much worse for the business community at large. The difficulty was exacerbated because, under present plans, it was envisaged that the rates of businesses during the initial transitional period for the new regime would be determined by the final valuation under the 1973 list; this gave an incentive to businesses to come forward with appeals against the 1973 valuations.

Continuing, the Chancellor said that he had already taken a number of actions to reduce the pressures on the Valuation Office, for example by providing for maximum overtime working, the re-employment of retired staff, the withdrawal of work on Right to Buy business, and the reduction of work undertaken for other Government Departments. This meant that the Valuation Office would now be concentrating only on valuations for tax purposes and the 1990 re-valuation for non-domestic properties. But, given the shortage of professional valuers both in the Valuation Office and in private practice, and coupled with the

expected stimulus to the number of appeals against the 1973 list, all the measures taken were expected to deal with only about a half of the anticipated short-fall in Valuation Office resources.

The Solicitor General said that an extremely difficult dilemma was faced. If no action was taken to relieve the pressure on the system there was a likelihood of major injustices from 1990 onwards since the Valuation Office would have been unable to complete an orderly re-valuation. Opportunist appeals against the 1973 valuations would snarl up the system. Fairness and justice therefore demanded finding some mechanism for easing the position. He was satisfied that the latest proposals, including the statutory obligation on the Valuation Office to bring forward proposals to change the 1973 list where there were identifiable and meritorious changes in circumstances, was defensible and represented a satisfactory means of resolving the dilemma. But a key requirement was that the Valuation Office should ensure that they continued to process appeals in a businesslike and timely way.

The Prime Minister said that she remained most concerned about the proposed restriction on the rights of appeal for non-domestic ratepayers. In effect, the proposals meant there was a guillotine hanging over appeals; those cases which had not been completed prior to Royal Assent being given to the proposed legislation would be cut off in an essentially arbitrary way. Such arrangements would expose the Government to charges of authoritarianism and arbitrariness. There was a serious danger that, whatever was said about the proposed intention of the Valuation Office with regard to the processing of appeals, these assurances would not be believed. And it would only need one case where the Valuation Office procedures were found to have been lacking for the whole system to be exposed to judicial ~~reform~~ REVIEW.

In discussion, the following points were raised:

- although it might be possible for the Valuation Office to adopt broad rules of thumb in carrying out a new valuation for domestic properties this would not be satisfactory for non-domestic properties. There had been major changes in property values and circumstances since 1973 and any attempt to adopt a broad brush basis to non-domestic re-valuation was likely to lead to a mass of appeals;

- it should be borne in mind that the appeal procedure was not just limited to the Valuation Office. Ratepayers had a right to go to the Superintending Valuer if they felt that legitimate cases were not being carried forward, and in the last resort to make representations to their Member of Parliament;

- it was recognised that, unlike residential property, for most businesses non-domestic rates could be offset against tax;

- particular attention had to be given to the position faced by small businessmen, for whom rates were often a major cost. It was essential that in whatever solution was adopted due attention was given to this problem.

In further discussion a number of possible alternative approaches were mentioned:

- rather than limiting all appeals by non-domestic ratepayers an attempt might be made to limit appeals to cases where there was "an identifiable and meritorious case". One variant of this appraoch would be to provide for penal costs against those who appealed and lost their case.

- as a quid pro quo for restricting appeals for lower 1973 valuations to identifiable and meritorious cases, the Valuation Office might make clear that they would not propose any increases in non-domestic valuations during the remaining 14 months, however justified such cases might be on merit;

- a statement might be made that, given the difficulties faced, the Valuation Office would from now on have to give first priority to the 1990 re-valuation and, as a result, appeals against the 1973 valuations would take longer to process, possibly lasting well into the 1990s;

- as a means of relieving the position of small businesses, provision might be made to maintain the rights of appeal for businesses below a given size or for particular classes of business;

- the proposed handling of the transitional arrangements for the new non-domestic rate might be reconsidered. Rather than the rates of businesses during the transitional period being determined by the final 1973 valuation, they might be based on the valuation actually in force on the day the proposals were announced. Appeals by non-domestic ratepayers against the 1973 valuations might still be allowed but any change would only then apply for the period to the end of 1989-90; this would greatly reduce the incentive for non-domestic ratepayers to appeal.

Summing up the discussion, the Prime Minister invited the Secretary of State for the Environment, in consultation with the Chancellor and the Solicitor General, to consider the position further. They should explore the various alternative approaches identified in the discussion, and come forward with revised proposals.

I am copying this letter to the Private Secretaries to those present at the meeting and to Sir Robin Butler.

Yours
Paul

(PAUL GRAY)

Alex Allan, Esq.,
HM Treasury.

cst.ps/5jm25.1/drfts

CONFIDENTIAL

PRP 18.1
the minutes of mtg we received today, pls

Treasury Chambers, Parliament Street, SW

PWP

cc:
Chancellor
Sir Peter Middleton
Mr Anson
Mr Scholar
Mr Monck
Mr H Phillips
Mr C D Butler
Mr Culpin
Mr A J C Edwards
Mrs Case
Mrs Lomax
Miss Peirson
Mr Robson
Mr Luce
Mr Olney
Mr Potter
Mr S Wood
Mr A Hudson
Mr Fellgett
Mrs Chaplin
Mr Call

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

25 January 1989

Dear Secretary of State

NON-DOMESTIC RATING

I was most grateful to you and John Gummer for the opportunity last week to discuss the issues raised in the correspondence which culminated in your letter of 17 January to me.

As I said at the meeting, I was grateful for your agreement that the NNDR poundage should be set in 1990-91 so as to maintain the yield of business rates from the private sector. This is, as you kindly recognised in your letter, an important fiscal matter. We will need to make it clear from now on that we intend to interpret our statements about the NNDR poundage in this way, notably I suggest by emphasising that we intend to meet the essential commitment to business that the rates on an average business property will not increase in real terms after 1989-90. The only real increases in the yield of business rates paid by the private sector will therefore come from the natural buoyancy in the tax base, as a result of new and expanded properties etc.

In view of the commitments you have made, I accepted that it would be necessary to announce the results of the Inland Revenue survey into the effects of the rating revaluation and move to NNDR, when you make your forthcoming announcement about the transition. Officials here are preparing a draft, which they will forward to yours very shortly.

We also agreed on a decapitalisation rate, to be prescribed in secondary legislation for the contractor's basis of rating valuation, of 6% for the bulk of private sector properties. As a tactic to this end, we were minded to consult on a range of six upwards.

The remaining issues on which we agreed to consider our views were the precise decapitalisation rates to be applied in the public sector, or to private and public sector education establishments, hospitals and similar health-related properties, and military installations; and whether to make a Government contribution in lieu of rates payment to the NNDR pool under the new local government finance system. I have now considered the various options carefully.

My main concern here has been to ensure that there should be no change in the total of Government funding for local authorities as a result of any change in a contribution in lieu payment. At the meeting you recognised this concern, and kindly undertook to ensure that any change in a Government contribution in lieu of rates payment would be offset in full in the amount of RSG to be paid. To this end, you offered to take decisions on Government funding in total first, with RSG set as a residual within this total after the size of any contribution in lieu and other payments had been set. Officials are discussing this mechanism further, and I hope to write to you and colleagues with a precise proposal for implementing it shortly.

I am nevertheless concerned that, because we cannot commit all colleagues in all E(LA) discussions in future years, the prospect of a substantial rise in any Government contribution in lieu of rates poses some risk for the Exchequer. Much the most logical approach would be to cease to make a separate contribution in lieu payment, and subsume the total paid at present within RSG, because a contribution in lieu and RSG would be effectively identical under the new system.

You were, however, considerably concerned about the possible presentational disadvantages of this approach, and therefore suggested that to minimise the risk to the Exchequer a special low decapitalisation rate should be applied to properties which are found mainly in the public sector.

To meet your presentational concern, I would therefore be prepared to continue to make a Government contribution in lieu of rates payment to the pool, based in 1990-91 on a revaluation incorporating 4% decapitalisation rates for educational establishments, hospitals and other health-related properties and military installations, provided we reach agreement on arrangements to ensure that any change in the contribution in lieu would indeed be offset in full in RSG. I shall be writing separately about this.

I hope this approach, which you indicated at the meeting would be acceptable to you, will provide a satisfactory way forward. The next step might be for you to minute the Prime Minister recording our joint conclusions, as she previously remitted to you a request for these points to be resolved bilaterally if possible. My officials would be happy to discuss a draft with yours.

Yours sincerely

Carys Evan

JOHN MAJOR

(approved by the Chief Secretary and signed in his absence)

chex.u1/aa.ph/11

FROM: A C S ALLAN
DATE: 25 JANUARY 1989

CHANCELLOR

E(LF): BUSINESS RATES IN SCOTLAND

The line to take is very simple:

- business rates in Scotland are higher because local authority spending is higher; see table.

- Quite unreasonable in these circumstances that Scottish business ratepayers should be bailed out by English taxpayers, through more grant; grant in Scotland already far higher than in England (see table).

- Prime Minister acknowledged these points in September 1988 letters, cautioning on both "the underlying problem of high local authority spending", and on timing. (See letters, provided by Cabinet Office).

- If Rifkind wants to take action before the community charge has brought down spending, must pay from elsewhere in Scottish block.

1988-89:

per head (£)	England	Scotland	Wales
LA spending	690	825	685
Financed by:			
Grant	280	465	440
Rates (*)	410	360	245

(*) and balances

A C S ALLAN

chex.rm/aa1/2 CONFIDENTIAL

FROM: A C S ALLAN
DATE: 25 January 1989

MR MONCK

cc PS/Chief Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Scholar
Mr Culpin
Mr A J C Edwards
Mr Bent
Mr Potter
Mr Fellgett
Mr Hudson
Mr Rutnam
Mr Call
Mr A Prior (VO)

BUSINESS RATES: NATIONALISED INDUSTRIES

The Chancellor was grateful for your minute of 24 January. He noted that the increases proposed are very substantial indeed for the nationalised industries. As he understands it, they arise because it is believed that the formulae devised in the past were not only irrational but resulted in the nationalised industries being under-rated, and the opportunity is now to be taken to correct this and put them as far as possible on a capital value basis "as similar to conventional rating as possible". That is defensible; but there is no case for going to the opposite extreme and over-rating them.

A C S ALLAN

dm1.ph/minute/ph.1.30.1

SECRET

FROM: R FELLGETT
DATE: 31 January 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Culpin
Mr Edwards
Mr Potter
Mrs Chaplin
PS/Inland Revenue
Mr Shutler (VO)
Mr Pitts (IR)
Mr Jenkins (T.Sol)

Ch

Since we have missed the deadline for the introduction of the Bill, it seems most unattractive to continue to press for a curtailment of appeal rights: that requires a motion to amend the long title, & could no doubt cause great difficulties with the business managers. Do you want to press this? (*)

AA

RATING APPEALS

(* I'm also pretty dubious about the numbers: surely it's not worth appealing if rates will reduced for only a short period? So why does 'rebasing' save only 100 cases?)

Following the Prime Minister's meeting on 25 January, we have been working with the VO, IR and DOE on the options identified towards the end of Paul Gray's letter summarising the meeting. An agreed note by officials is still being prepared (annex A is an incomplete draft); but the issues have been sufficiently clarified to offer advice on the way forward.

2. We have identified the best available method of implementing the option canvassed at the end of the PM's meeting - rebasing the transitional arrangements to reduce the incentive to appeal - and DOE officials believe Mr Ridley will commend it to the PM. Although it looks less satisfactory than the curtailment of appeal rights, we recommend that you support it. But we suggest you push for other options as well in order to keep them in play and to achieve something closer to the full savings in valuer time which would have been achieved with a complete curtailment of proposal and appeal rights.

Rebasing the transition

3. Paul Gray's record notes that "rather than the rates of businesses during the transitional period being determined by the final 1973 valuation, they might be based on the valuation actually in force on the day the proposals [on transition] were announced."

4. This is potentially useful, and is estimated to save some 100 valuers. However, if all changes in rateable values after the date of announcement were ignored it would be much more inequitable than curtailing proposal and appeal rights (which would save 250 valuers). Where there is a substantial change in rateable value between now and March 1990 (eg where half a building is demolished and the business has only half the income from which to pay its rates) there would need to be some change in the base for transitional protection. One could not therefore ignore every change in rateable value.

5. The best variant of this option may therefore be to say that changes in rateable values resulting from ratepayers proposals made after the date of announcement would not be taken into account in calculating the base for the transition, but changes in values resulting from the VO's proposals to change the list would be fully reflected. This would meet the essential objective of the scheme to remove proposal and appeal rights, by giving ratepayers a strong incentive to pursue their arguments for change informally with the VO rather than through the expensive and cumbersome process of their own proposals and appeals.

6. This approach would have to be defended quite openly as a method of encouraging ratepayers not to pursue their formal rights of proposal. It is not clear that it would be any easier to sell than a straightforward curtailment of those rights, and it would achieve less.

7. Another difficulty is that an awkward ratepayer who had not persuaded the VO to change his value might appeal anyway if he retained the right to do so. It would be embarrassing if he then succeeded, but such cases would hopefully be rare (particularly if there was simultaneously a limited curtailment of appeal rights).

Legislative implications

8. All the options canvassed at the Prime Minister's meeting would require primary legislation. The natural legislative

vehicle would be the Local Government and Housing Bill, which is to be introduced on Wednesday 1st February. A separate Bill, even if it included some other items such as amendments to the Local Government Finance Act 1988 which it would be desirable to enact before the Summer Recess, would presumably be most unwelcome to the business managers.

9. The curtailment or restriction of proposal and appeal rights would not be within the scope of the Bill as it is to be introduced. Government amendments would therefore require a motion on the floor of the House to extend its long title, normally implying I understand a half day debate. We believe that other options, including amendments to existing regulation making powers in order to rebase the transition, could be added to this Bill by Government amendment without extending its long title, although that will need to be checked in each case with Parliamentary Counsel as any instructions are prepared and clauses drafted.

10. The Bill is unlikely to receive Royal Assent before the end of the overspill session next October or November. If it amended the powers to make transitional regulations, these regulations would then have to be taken through Parliament in December and possibly even January, very close to the time in late December when the new rating list will be published. There is therefore a danger that these regulations will be subject in Parliament to additional pressure for concessions, resulting from the complaints of individual business ratepayers to their constituency MPs about their personal position after April 1990. The regulations would also not be in force until very shortly before the start of 1990-91, in which they are to apply. Not withstanding the additional complexity, it would therefore be much better to enact the transition in the Bill rather than rely on later secondary legislation.

The Prime Minister's concern

11. The Prime Minister, according to the record of the meeting, was mainly concerned that Royal Assent to legislation to remove

proposal and appeal rights would form a deadline; those appeals that have been agreed before hand would stand, whilst those that were still being considered would fall. There is no way round this problem if proposal and appeal rights are indeed to be restricted. Furthermore, the nature of the deadline would have to become apparent sometime beforehand. As Mr Ridley's minute of 6 January said, the VO would normally reinstate any appeal that was successful before Royal Assent, even if the legislation retrospectively nullified it. (If the VO did not take such action there would be potential contravention of the European Convention on human rights). The legislation would need to contain a power for the VO to act in this way, because at present their own amendments to the rating list are retrospective only to the beginning of the financial year in which they were made (1989-90 in this case) whereas a successful appeal on the basis of a proposal made in 1988-89 would have been retrospective to the beginning of that financial year.

12. This concern would not apply to the option for rebasing the transition that we have identified; ratepayers would know at the moment they made a proposal what its effect would be if it succeeded.

13. If, in addition or instead, you were minded to argue again for curtailment of proposal and appeal rights you would need to argue to the PM that the Royal Assent deadline would have little practical effect. The vast bulk of appeals are unsuccessful, made by agents on behalf of rate payers with little hope of success, and spurred on by the fear that rate payers would claim their agents were negligent if they did not pursue every conceivable avenue for obtaining a reduction. Extra statutory arrangements to allow rate payers to obtain justified reductions in their value would therefore achieve much the same for them as the present statutory arrangements.

Other options

14. Two of the options listed by Paul Gray do not appear at all attractive. First, it was suggested that as a quid pro quo for

restricting appeal rights the VO might not propose any increase in non-domestic valuations during the remaining 14 months of the present rating list, however justified such cases might be. The difficulty is that this would be unlikely to reduce the number of complaints. Those who avoided increases in their rates would no doubt applaud quietly, while those who had been unable to obtain reductions (or claimed so) would complain just as loudly. Indeed, losers might feel even more aggrieved if they saw fellow ratepayers with expanded premises paying nothing more. There would also be a revenue loss of £15 million a year.

15. Second, the VO would welcome action to avoid the clerks in local valuation courts speeding up the hearing of appeals as April 1990 approaches, but see considerable practical difficulties in deferring appeals against the 1973 list until well into the 1990s. It might then be very difficult to resolve appeals, for example if the premises had changed hands or been substantially altered in the interim. In any case, this approach would only defer work and not address the underlying problem that they have too much to do with the number of professional staff available.

16. Another option - maintaining proposal and appeal rights only for small businesses - would be very helpful in theory, because generally large businesses are those making regular opportunistic proposals. But this option would be awkward to implement in practice. The criterion would have to be based on the rateable value of the premises concerned, and not the size of the business itself. There would inevitably be hard cases around the dividing line. We would not, therefore, recommend this approach unless you felt that the political attractions were so great as to outweigh the disadvantages.

17. The more hopeful other options are therefore: a more limited curtailment of proposal and appeal rights than hitherto suggested; and substantial costs against those who appealed and lost.

18. The front-runner among limited curtailments of proposal and appeal rights, is to retain them only for a material physical change in the hereditament or its locality exceeding 20% of rateable value. This is estimated to be only about half as

effective as a full curtailment of proposal and appeal rights. It would still give rise to the Prime Minister's concerns (albeit moderated) and to complaints; we have not therefore hitherto recommended it. But it might form part of a useful compromise package.

19. You have already commended the idea of costs for those who lose to Mr Ridley. They could not, however, be introduced without primary legislation, and are therefore more likely to have to apply to the 1990 rateable values than to proposals and appeals against the current list. We suggest that you press this option again, while recognising that it would do little to ease the immediate problem.

Conclusion

20. No approach is attractive (except by comparison with the hiatus in business rating from 1990 if nothing is done). A full curtailment of appeal rights remains the only option that would meet the VO's problem and it remains tempting to argue that all options will be hard to present, so it would be best to pick the only one that is expected to be fully successful.

21. If, however, alternatives are needed in the light of the PM's meeting - the remit calls for revised proposals - a method of rebasing the transition has been found which, while not at all satisfactory, should meet the Prime Minister's concerns highlighted at the meeting, and which we understand Mr Ridley is likely to be willing to commend to her. In addition, imposing costs against those who appeal unsuccessfully should be helpful, although not in the short-term. But even taken together these two measures will deal with no more than half the problem the VO face in 1990.

SECRET

22. The remaining serious option is some curtailment of formal proposal and appeal rights, probably by restricting them to a material physical change in the hereditament or its locality of more than 20%. A draft letter to Mr Ridley is attached which assumes that you will wish to press this option also.

R.F.

R FELLGETT

dm1.ph/letter/1.31.1

SECRET

DRAFT LETTER FOR THE CHANCELLOR'S SIGNATURE

Secretary of State for the Environment

31 January 1989

RATING APPEALS

I have considered the further work which our officials have done following up our meeting with the Prime Minister on 25 January.

We then considered that it would be helpful to amend rebase the transitional arrangements, in order to reduce the incentive on business ratepayers to propose changes in the 1973 list. The best approach seems to be to say that changes in rateable values resulting from ratepayers' proposals made after the date of your announcement of the transitional arrangements would not be taken into account in calculating the base for transition, but changes in values resulting from the Valuation Office's proposals would be fully reflected. This would give ratepayers a clear incentive not to pursue claims for reductions through the cumbersome and costly route of a formal proposal and appeal, but deal with them informally with the VO instead. I understand that legal advice is that this would require an amendment to your present regulation making powers in the Local Government Finance Act 1988; rather than amend those powers and then take regulations through Parliament very late in the day, it

SECRET

seems to me that it would be much better [I think] to enact the precise transitional scheme in the Local Government and Housing Bill.

I have written to you previously about the option of [recovering] substantial [full] costs [from] ratepayers who appeal unsuccessfully. I recognise that this could not be implemented immediately, but we need to press ahead with it quickly.

(check)

But these two measures together will go no more than half way to solving the problem that we face in introducing the reforms of business rating successfully in 1990. Nor would [amending] rebasing the transition be easy to present. I therefore see no choice but to pursue also the idea of a curtailment in formal proposal and appeal rights. [not withstanding the views that were expressed to us during the Prime Minister's meeting.] I believe that [the Prime Minister's her] concerns can largely be met, particularly by pointing out that the deadline of Royal Assent (about which she was particularly concerned) would be more apparent than real, since so many ratepayers' proposals are unsuccessful and the VO will remain charged with making all justified changes to the 1973 rating list.

I would, however, be prepared to make one further change to the scheme we outlined at the Prime Minister's meeting. In order to limit appeals to the more meritorious cases, we could retain formal proposal and appeal rights in relation to the 1973 list in all cases where there was a material physical change in the hereditament or its locality of more than, say, 20%. This should exclude the great bulk of

opportunistic appeals while retaining formal rights for more substantial changes.

I am copying this letter to Nick Lyell.

[NL]

Annex A

RATING APPEALS

Option 1: Non domestic rate payers would loose formal rights to propose changes in the 1973 list from the date of announcement, with the VO retaining a statutory duty to keep the list up to date.

This is the option suggested by the Chancellor in his minute of 23 January to the Prime Minister.

The advantages are that, alone among the options considered at the Prime Minister's meeting on 25 January, this is expected to deal with the problem. If it were adopted, there should be no shortfall of professional valuers in 1990 and no undue backlog of amendments to the new 1990 rateable values either in the VO or in the local taxation courts.

The disadvantages are that non domestic rate payers would loose formal rights to propose change in the list, albeit for about 14 months in relation to rateable values that were largely 15 years old and with an extra statutory right to make representations to the VO and regional superintending valuers. Primary legislation would be needed, retroactive to the date of announcement, either in the Local Government and Housing Bill (requiring a motion on the floor of the House to extend its scope) or possibly in a separate Bill which could also cover amendments required to the Local Government Finance Act 1988 which it would be desirable to make before the summer recess. Royal Assent to the Bill would form a deadline: those proposals and appeals which had been processed before hand and resulted in changes would stand or be re-instated by the VO, and those which had not would be nullified, although the VO would be required to make subsequent changes on their merits.

Option 2: as option 1, but with formal proposal rights retained for any identifiable and meritorious case.

This option was canvassed at the Prime Minister's meeting. Much the easiest way to interpret the idea of individual meritorious cases is to retain formal proposal rights for any case involving a material physical change to the heridatament or its locality which would result in a change in rateable value in excess of, say, 20%. This would be somewhat similar to the present position in Scotland and in England/Wales after 1990, where proposals can only be made in the case of a material change of circumstance once a rateable value has stood for more than 6 months. The VO advise that a tighter definition, including a deminimis percentage, would be needed in England and Wales initially to make it clear to potential proposers that the definition was indeed tighter than hitherto.

The advantages are that it would reduce the projected shortfall in professional valuers to about [100] staff, with backlogs of amendments to the new list in the VO and local taxation courts reduced to about [2] years. Proposal and appeal rights would be retained for all significant changes in rateable values, including all but a small proportion of the limited number of proposals which are truly meritorious.

The disadvantages re as for option 1, although they would generally be less serious. The necessary legislation would, however, be more complex, and to the extent that encouraged non domestic rate payers to believe it might be amended in Parliament they might continue to make proposals "just in case".

Option 3: As option 2, plus the VO would not make any increases in non domestic valuations during the remaining months of the 1973 list.

This option was also discussed at the Prime Minister's meeting.

The advantages are that the projected shortfall in professional valuers would be reduced to about [60] and the backlog of amendments to new rateable values to around [1½] years. In addition, there would be a benefit to those whose rateable values would not be increased before 1990 (and thereafter if the benefit was carried forward under the transitional arrangements), although those who could represent themselves as losing from the announcement would no doubt still complain as they are unlikely to be the same businesses who would benefit from not avoiding increases.

The disadvantages include all those for option 2. In addition, it would be seen as inequitable for, say, a completely new building or a very substantial enlargement to an old one to escape the additional rates burden completely. There would also be a revenue loss estimated at £15 million in 1990-91 (because of the majority of changes in rateable values are upwards), which would be carried forward into later years given the governments' commitment over setting the National Non Domestic Rate poundage thereafter.

Option 4: A statement will be made that the VO would from now on give first priority to the 1990 revaluation and proposals to change the 1973 list would therefore take longer to process, possibly lasting well into the 1990s.

The VO have already requested DOE to discourage local valuation courts from speeding up the hearing of appeals ahead of 1990. This option, which was mentioned at the Prime Ministers meeting would go much further by deliberating delaying (and announcing a delay in) the processing of changes to the 1973 list.

The advantages are that the VO would be able to devote some more priority to the new list, with a consequent improvement in its initial quality, and some non domestic rate payers might be deterred from making proposals if they realised how long it would take to process them, ~~although~~ a major announcement would not be necessary to bring this to the attention of professional chartered surveyors (who act for almost all non domestic rate payers in these matters).

The disadvantages are that there would be little if any significant effect on the shortfall of professional staff in 1990 and the backlog of work of all types in the VO and local valuation courts thereafter. The combined backlog of work on the old and new lists would still add up to around 2 to 3 years; furthermore, some of the proposals against the 1973 list would not be dealt with for up to 4 years after they were made with consequent practical difficulties in establishing their merits where, for example, the property had changed hands or been substantially altered in the interim. Primary legislation [would/might] be required to amend the General Rate Act 1967.

S E C R E T

RATING APPEALS: REBASING THE TRANSITION

1. An alternative to curtailing directly rights of appeal would be to rebase the transitional arrangements for the introduction of the business rate in order to remove the incentive for ratepayers to appeal. The proposition is that the base to which the transition would be applied would be calculated by taking the relevant local poundage for 1989/90 and the rateable value of the property at a specified date set sufficiently early to remove any incentive to appeal just in order to get advantage under the transition. Changes in RV after the specified date would still be reflected in pre-1990/91 rate bills.

2. Rebasing the transition would only solve part of the problem. While it should prevent a further surge in appeals, it would not stop the flow of appeals from ratepayers whose main concern was not the transition, but simply to reduce their rate bill for the remainder of the currency the present list.

Vires

3. Section 57 of the LGF Act 1988 provides the power to make regulations to effect the transition. Lawyers advise that because these powers were granted for the specific purpose of mitigating the effect on ratepayers of the new business rate, it would almost certainly be ultra vires to use them for the quite different purpose of reducing the workload of the Valuation Office, even if the reason for doing so was to ensure that the revaluation was properly carried out. So although it might be possible to justify using RVs at a date earlier than 31 March 1990 in order to simplify local authorities' administrative task in applying the transition, there is only limited room for manoeuvre. Specifying a date much before, say, 31 December 1989 might lead to difficulties with the Joint Committee or a

challenge by way of judicial review. But a date as late as this would not deter appeals. To be effective, the specified date would need to be the date of any announcement. Even if we specified 31 December, justifying it on grounds of administrative convenience, we could well be open to challenge if there was no provision for recalculating the base in any individual case where the RV subsequently changed.

4. If rebasing the transition is to be used in order to deter appeals therefore, Section 57 needs to be amended to make it clear that regulations can be made for that purpose. Such an amendment would be within the scope of the Local Government and Housing Bill as at present drafted, so there would be no need to rush to draft a provision in time for introduction on 1 February.

SECRET

Implications of Delaying the Regulations

10

5. The intention has been to lay the regulations on the transition, which are subject to affirmative resolution, in May after consultation. The aim was that they should come into force as soon as possible so that businesses would have an early, if very approximate, indication of their likely rate bills and would be able to budget ahead. Local authorities also need certainty as soon as possible in order to plan the computer systems necessary to implement such complex transitionals.

6. However, if Section 57 were amended, it would not be possible to lay the transition regulations until late October or early November. We should face strong criticism if they were to come into force as late as December. And it would be difficult for the Government to argue that business and local authorities could plan with certainty on the basis of its proposals without inviting the retort that it was pre-judging the Parliamentary process. Besides, leaving these complicated and potentially controversial regulations so late would mean that if anything went wrong we should be in serious difficulties.

SECRET

Providing for the Transition in the Local Government Bill

7. A partial way round the difficulties caused by delay might be to legislate for the transition in the Local Government and Housing Bill itself. If the Bill were amended in May, following the consultation, local Government and business would have slightly more certainty at an early stage, though not absolute certainty because the provisions might still be amended during the passage of the Bill. The disadvantages of this course are that the complexity of the provisions are such that the drafting would impose quite an extra burden on Parliamentary Counsel; and that the whole issue of the transition would be exposed to more extensive debate in Parliament than affirmative resolutions alone would entail.

Other Issues: Later changes in RV

8. The other major problem to consider is the case where the RV is altered for legitimate reasons after the specified date. There are two aspects: increases in RV to reflect the extension or refurbishment of a building; and reductions to reflect eg partial demolition or a change in the environment, for instance the shop or filling station whose turnover drops substantially as the result of the building of a bypass.

9. One might argue that no provision should be made for these cases; that an element of rough justice for some would be offset by gains for others; and that any potential reduction in the yield from not reflecting increases in RVs could be made good by setting the poundage slightly higher. But this approach could produce some absurd results. In cases where the RV had been reduced, the effect would be that losers under the NNDR/revaluation would move more quickly to their post-transition rate bill or might fall to be treated as gainers, while gainers would realise their gains more slowly since in the early years it

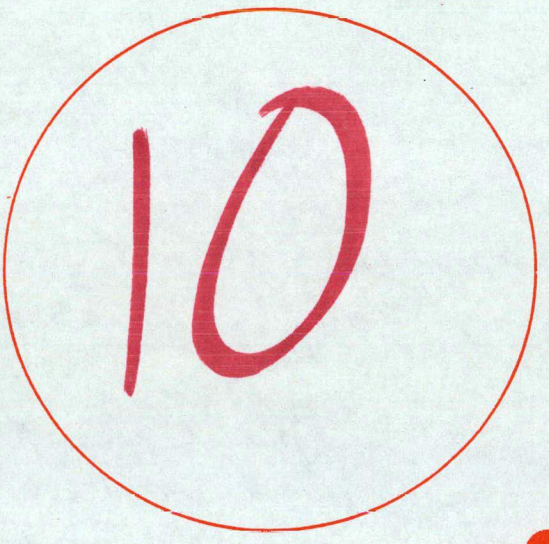
would be the reduction resulting from the partial demolition that was being phased. It would be anomalous too, in cases where the RV had risen, for a business to have a lower rate bill over a long period than the business next door in an identical property.

10. Increased RVs, which invariably result from a VO proposal, are easily dealt with. These could all be taken into account; or certain specified increases only could be counted to achieve symmetry with the treatment of reductions.

11. Reduced RVs are much more of a problem. A mechanism would be needed for distinguishing between "meritorious" cases and others. But this raises the question (which, admittedly, applies equally to the proposals to curtail appeals) can any successful appeal be unmeritorious? If the appeal is successful, the old RV must have been wrong. The reason why it was wrong ought not to be material. And if it is unacceptable to deprive a ratepayer of the benefit of a reduced rate bill for 1989/90, which is in effect what the Prime Minister has said in relation to nullifying appeals, would not depriving the ratepayer of lower rate bills through the potentially longer period of the transition not also be open to this objection? It is certainly true that a distinction can be drawn between removal of an accrued right and a decision not to confer a right. But this argument may be difficult to present.

12. Setting aside these difficulties, the only practicable way of distinguishing meritorious cases is probably to fix a threshold (say 20%) below which any change in the RV would not be reflected in the base for the transition. This is clear cut and easy to operate. The alternative of trying to distinguish, for instance, cases where there had been a physical change in the hereditament is much less attractive because the concept is so elastic and it requires someone to judge whether there has been a change.

13. New buildings entering the list after the specified date would not pose problems: the initial RV would be used (we have said that all buildings first occupied by 31 March 1990 will be subject to transition).



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FROM: A C S ALLAN
DATE: 1 February 1989

BF 7/2

MR FELLGETT

PWP

cc PS/Chief Secretary
PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Culpin
Mr A J C Edwards
Mr Potter
Mrs Chaplin

PS/IR
Mr Shutler (VO)
Mr Pitts - IR
Mr Jenkins - T.Sol.

RATING APPEALS

The Chancellor was grateful for your minute of 31 January. In the circumstances he does not want to continue to press for a curtailment of appeal rights, given that we have secured some of the savings by another route and that curtailing appeal rights would now require a motion to amend the long title of the Bill.

2. Instead, he feels we must clearly go for the Ridley idea of rebasing the transition, and legislate (in the current Bill) for this as soon as possible. Insofar as this produces fewer staff savings, we will have to accept that the 1990 list will be subject to a greater degree of error.

3. If we were <u>not</u> to provide for any exceptions to the rebased rules for the transition (ie if we were not to follow the variant in your paragraph 5 whereby changes in value resulting from Valuation Office proposals would be reflected in the transitional arrangements), how much would this help on manpower?

4. The Chancellor would also be grateful for further information on the comparative manpower savings from rebasing the transition and from curtailing appeals. Your note said that rebasing would save some 100 valuers whereas curtailing appeals would save 250.

The Chancellor found this surprising. It implies that only 40 per cent of the savings from curtailing appeals would result from the ending of opportunistic appeals designed to improve a firm's position over the transitional period. The remaining 60 per cent are presumably "genuine" appeals, which would continue to be made even though the benefit would last only for a little over a year. The Chancellor had the impression from earlier advice that the main danger came from opportunistic appeals. He would be grateful for more information.

5. He would also be grateful for a revised draft letter to Mr Ridley.

A C S ALLAN

dm1.ph/minute/1.2.2

SECRET

FROM: R FELLGETT
DATE: 2 FEBRUARY 1989

CHANCELLOR

cc Chief Secretary
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Culpin
Mr A J C Edwards
Mr Potter
Mrs Chaplin
PS/Inland Revenue
Mr Shutler (VO)
Mr Pitts (IR)
Mr Jenkins (T.Sol)

Ch/ Content with to adopt recommendation in para 7(c) and to write as suggested?

RATING APPEALS

You asked (Mr Alex Allan's minute of 1 February) about the comparative manpower savings from rebasing the transition and from curtailing appeals.

2. The Valuation Office advise that they estimate that if the flow of ratepayers' proposals to change rateable values projected from recent experience were curtailed, they would save roughly 250 professional valuers' time. In addition the announcement of transitional arrangements is liable to provoke a surge of additional proposals and appeals equivalent to some further 100 valuers. Their costings have therefore assumed that curtailing appeals would prevent both flows of work, saving 250 valuers, whereas rebasing the transition would remove the surge following the announcement of the transition, thus avoiding an additional requirement of about 100. The comparison is thus, I understand, roughly 350 to 100.

3. These estimates are of course very broad-brush; they depend on an assessment of ratepayers' and their agents' behavioural reaction to Government announcements and other circumstances. They are therefore a guide rather than anything too precise.

4. It is perhaps also worth noting that a successful proposal to change a rateable value now would have effect for two years

Ch/ These figures haven't changed, just the basis of comparison. 350/100 are both compared to doing nothing. LG privately believe the 100 saving from rebasing is an underestimate but Val. Office (of course) disagree.

(because the effect is back dated to the beginning of the financial year in which the proposal is made). Any additional benefit from the transition would also typically last around two years - just over half of properties will have completed the phased change to new rates bills by April 1992 - but one would expect a smaller number of ratepayers' agents to react to the incentive of the transition, because many will have put in proposals already.

5. The VO also advise that the great majority of appeals against 1973 rateable values are ultimately unsuccessful, and made only because chartered surveyors acting for business ratepayers:

(a) hope they will obtain some reduction in rateable value, even against a value which has stood since 1973, if the VO are not able to defend it properly or the Local Valuation Court happens to feel kind on a particular day; and

(b) even though their administrative costs may not be covered by their fees - many are paid by results - they wish to press every opportunity for a reduction to retain their clients for more lucrative work following the revaluation, and to avoid any suggestion that they were acting negligently by not pressing their clients interests in every possible way.

Sixteen years after the list was first published, "opportunistic" proposals and appeals for these two reasons therefore form the bulk of both the regular flow of work and the anticipated surge.

6. You also asked about the relative effects on manpower of different options for rebasing the transition. The VO advise that the difference between different options is not large - probably no more than a range equivalent to $\pm$ 20 valuers (ie a saving, compared to the number that would otherwise be needed to deal with the surge, of 80 to 120 valuers, around the average of 100 mentioned above). The more draconian options obviously save more, but are harder to sell.

7. Rebasing could simply take the rateable value recorded for each property on the date of announcement. This would be most effective and most arbitrary, and save about 120. Modifications could allow for the effect of subsequent changes in rateable values arising from:

(a) proposals and appeals already in the pipeline on the date of announcement (to avoid discriminating against London and the South East where the backlog is greatest); saving 100; and

(b) any proposal made after the date of announcement which led to a change in rateable value of more than say 20%; saving 80; or

(c) any proposal made by the Valuation Office, but not a proposal by a ratepayer, made after the date of announcement; saving 80.

8. As the difference in manpower savings is relatively small, we favour making the concession at (a); the bulk of proposals in any financial year are made in February and March so provided an announcement is made quickly they will be equally deterred whether or not this concession is made.

9. We also feel it is essential to be able to take some account of significant changes in rateable values after the date of announcement - it would be almost indefensible not to change the base for transition if a substantial part of a building was burnt down or expanded dramatically. As between the second and third options, we favour the third. Although the second appears more even-handed, the third avoids the arbitrary 20% cut-off and is consistent with the continuing statutory duty on the VO to keep the list up to date.

10. There is also an alternative approach, which is estimated to save 100 valuers. The transition could be based on rateable values for 31 March 1988, because they are the most recent values which ratepayers can no longer seek to change. A mechanism - eg

(b) or (c) above - would be needed to deal with later significant changes. Although in some ways more equitable, we do not favour this approach because it would be seen as more retrospective, and thus harder to present.

11. I now understand that Mr Ridley is firmly committed to minuting the Prime Minister supporting a rebasing of the transition, with legislation in the Local Government and Housing Bill (assuming the Law Officers' Department confirm that legislation is needed). He has also taken the view that some method of allowing for significant changes in rateable values after the date of announcement must be incorporated. DOE officials share our view on the best method, although Mr Ridley has not yet taken a view on this himself.

12. I should be glad to know whether you agree with our views that the best option is 7(c).

13. A revised letter is attached; as you are substantially in agreement with Mr Ridley on the way forward this is quite short.

R.F.

R FELLGETT

dm1.ph/letter/2.2.2

SECRET

pls type

ds/32

DRAFT LETTER FOR CHANCELLOR'S SIGNATURE

Secretary of State for the Environment

2 February 1989

RATING APPEALS

I have considered the further work which our officials have done following up our meeting with the Prime Minister on 25 January.

In the circumstances in which we now find ourselves

I have concluded, as I understand you have also, that the best approach would be to rebase the transitional arrangements, in order to reduce the incentive on business ratepayers to propose changes to the 1973 list.

If this requires an amendment to your present regulation making powers in the Local Government Finance Act 1988, rather than amend those powers and then take regulations through Parliament very late in the day, it would seem best (as again I understand you have also concluded) to enact the precise transitional scheme in the present Local Government and Housing Bill.

Among the other options canvassed at the Prime Minister's meeting, I have written to you already (on 23 December) about imposing substantial costs on ratepayers who appeal unsuccessfully. I

recognise that this could not be implemented immediately, but we do need to press ahead with it quickly.

I am copying this letter to Nick Lyell.

[NL]

COPY LIST as covering minute

CONFIDENTIAL

FROM: A P HUDSON
DATE: 3 FEBRUARY 1989

1. MR EDWARDS AJCE 3/2
2. CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Scholar
Mr Culpin
Mr A J C Edwards
Mrs Lomax
Mr Potter
Mr Fellgett
Mrs Holmans
Mr Rutnam
Mrs Chaplin
PS/IR
Mr Morgan IR
Mr Gonzalez IR

Ch/ Your views sought on questions in para 6.

Mr Hudson: I have misread how this might be published! I agree with X.

PUBLICATION OF INLAND REVENUE SURVEY ON REVALUATION AND THE MOVE TO A UNIFORM BUSINESS RATE

You agreed with Mr Ridley at your 18 January meeting that we would provide a draft summary, for publication, of the results of the Inland Revenue Survey of the effects of the rating revaluation and the move to a Uniform Business Rate (UBR). I attach a draft which Mr Edwards, Mr Fellgett, Mr Potter and I have put together in consultation with the Inland Revenue.

Content

2. As the Chancellor said in his 7 December minute to the Prime Minister there is potential for considerable damage if anything like the full Survey, which ran to hundreds of pages, were published. We have therefore kept the draft short and broad-brush, with much emphasis on the uncertainties surrounding all the figures. We have also sought to explain why the percentage limit on annual gains under the transitional arrangements (estimated at 11 per cent) is bound to be lower than that on annual losses (20 per cent), within a self-financing system, with the aim of

deflecting requests for an "even-handed" 20 per cent for both gainers and losers, which would carry a substantial cost.

3. Even so, the representative bodies are bound to latch onto the fact that a significant number of properties face large percentage increases in their rates bills (although they will not all be large in cash terms). We could, in principle, reduce that risk by dropping Table 2. But people would be bound to ask for it, and it would be difficult to refuse to make the information available. If the Table stays, we have to decide how far to go in breaking down the largest block of losers in the last line of Table 2. One possibility would be to show as a single category those facing increases in rates bills of 100 per cent or more. Inland Revenue statisticians, however, feel strongly that this category should be broken down into two: increases of between 100 and 200 per cent; and increases of 200 per cent or more. They think we will be asked for more detail, eg in PQs, and say that they could not honestly refuse to break down the "100 per cent or more" category on the grounds that the data was not robust enough. We think that, if pressed, you could point to the general uncertainties surrounding all these figures. And revealing that 68,000 properties face an increase averaging nearly 400 per cent runs straight into the Chancellor's concern that the publication will be combed for indications of massive losses. The table in the draft shows both presentations.

4. Mr Ridley is likely to argue that rather more should be published, including much more detailed tables - some examples are attached. In one sense, this might be helpful: apart from the one showing revaluation effects only, which will confuse the picture, the detailed tables do not add much useful information, and may blind people with science! But they do add a spurious air of precision, which would make it harder to present the Survey as preliminary and broad-brush. So on balance we would prefer to stick to the summary tables in the text.

Next Steps

5. Mr Ridley proposes to publish the summary of the Survey when he announces the details of the transitional arrangements probably by Written Answer. He will also be publishing a consultative document on the mechanics of the transition. We shall obviously make sure you see the full package before it is announced.

6. We would much appreciate guidance from you and the Chancellor on:

(a) the broad approach in the draft paper;

(b) the order: would it be better for the sections on effects by property type and region to precede the Section on the overall distribution of gainers and losers?

(c) the appended tables: should these be included or not?

(d) table 2: should the table show rate bill increases of 200 per cent or more?

(e) tables 5 and 6: should the tables indicate how small a proportion of the eventual gains will come through in the first year?

In the light of your guidance we would propose to show the draft paper, revised as necessary, to DOE officials, with the aim of putting an agreed version to you and Mr Ridley shortly. The text of the document may need to be adapted if DOE cover the same points in their covering announcement and paper.

A P HUDSON

CONFIDENTIAL

DRAFT of 3 February

THE 1990 RATING REVALUATION AND THE MOVE TO A UNIFORM BUSINESS RATE

RESULTS OF INLAND REVENUE SURVEY

Introduction

The Inland Revenue has carried out a preliminary sample survey of the likely combined effects of the new (1990) revaluation of non-domestic properties and the introduction of a Uniform Business Rate (UBR) in England and Wales. This note sets out the results.

2. All the results need to be interpreted with great caution. The new valuations supplied for the sample of properties were best estimates based on information then available to valuers. They were not the actual valuations that will be used in the new system, but were made before any actual revaluations had taken place. So the results should be taken as providing only the broadest indication of possible changes in average rate bills for particular categories of property and particular regions.

3. Estimates of rate bills are given throughout in 1988-89 prices and assume no changes in the population of business properties. No allowance is made for properties for which full rates will not be paid, for example because they are vacant, or occupied by charities.

The Yield of Non-Domestic rates under the new system

4. Ministers have announced that their broad aim is that the total amount of rates paid by private sector businesses and nationalised industries in 1990-91 should be the same as for 1989-90, with adjustments for inflation and "buoyancy" (the extra net yield that arises as the number size and quality of business properties increase or diminish). The overall amount raised from business properties will therefore remain similar, in real terms, and the rates bill for the average business property in 1990-91 will be the same, in real terms, as in 1989-90.

5. Within that overall picture, there are likely to be significant changes in the rates bills for different properties, and the transitional arrangements will ensure that larger changes are phased in over a period of years. Whether an individual property sees a reduction or an increase in its rates bill will depend on two things:

- first, whether the relative increase in its rateable value, as a result of the revaluation, is more or less than the average increase for non-domestic properties as a whole;

- second, whether its local authority currently charges a high or low rate poundage, relative to the national average.

The results reported in this note seek to take account of both these changes.

Aggregate changes in rateable values and poundages

6. Rateable values at present reflect the rental value of property at the last general revaluation, which was based on April 1973 values. Rental values have, of course, increased considerably since that time, and the Survey suggests that, on average, new rateable values will be about 7½ times their present levels in England and about 8 times their present levels in Wales.

7. Since the aim is to keep the yield broadly constant in real terms, with an adjustment for buoyancy, the increase in average rateable values will be matched by a corresponding reduction in the rate poundage. Thus, on the basis of the rateable values suggested by the Survey, the Uniform Business Rate poundage would be between one-seventh and one-eighth of the average current poundage in England, and about one-eighth of the average poundage in Wales. On this basis, the UBR would have been of the order of 32 pence in the pound, in both countries, if it had been introduced in 1988-89, compared to an average rate poundage of around 240 pence in the pound in England and around 260 pence in Wales.

— and more importantly the 2 tables —

Ch/ You are asked whether the next 2 sections should be relegated to end, after the analysis by property type & region.

Overall distribution of gainers and losers

8. Table 1 shows estimated numbers of properties facing reduced rates bills ("gainers") and increased rates bills ("losers"), and the amounts of the reductions and increases, before taking account of the transitional arrangements.

If so, since the property/region analyses are conducted after adjustment for transition, it would seem sensible to collapse the next 2 sections into one, and draw less attention to the figures before adjustment for transition.

Table 1: Numbers and amounts of reductions and increases

	Number of properties 000s	Pre-reform rates bill £m	Average pre-reform rates bill £	Aggregate reduction(-)/increase(+) £m	Overall reduction (-) /increase(+) %
England					
Gainers	620	4,600	7,420	-1550	-34
Little change	110	660	6,000	-	-
Losers	820	2,950	3,600	+1550	+53
Wales					
Gainers	28	150		-43	-28
Little change	7	56		-	-
Losers	58	120		+43	+32

As the Table shows, very few businesses are expected to find their rates bills unchanged. More are projected to face increases than reductions. But since (as explained above) the total yield of business rates is to remain broadly constant, total increases in rate bills will be matched by the total reductions. Compared to present rates bills, the percentage increase for the losers is greater than the percentage reduction for the gainers, because the losers as a group have a substantially lower rates bill at present.

9. Table 2 shows the distribution of gainers and losers in more detail, again before taking account of the transitional arrangements.

Table 2: Distribution of changes in rate bills

	Number of properties (000s)	Present rates bill	Change in rates bill	
		£m	£m	per cent
Reductions				
50% or more	122	947	-573	-61
5% to 50%	503	3649	-975	-27
Little change (less than +/- 5%)	109	657	negligible	negligible
Increases				
5% to 50%	421	1982	+457	+23
50% to 100%	193	630	+447	+71
100% or more	205	335	+647	+193
[100% to 200%	137	262	355	135
200% or more	68	73	292	398]

The transition to the new system

10. As explained, the above estimates make no allowance for the transitional arrangements. These arrangements, announced today, will give ratepayers time to adjust to the changes.

11. The transitional arrangements will ensure that no property will see its rates bill increase by more than 20 per cent a year, in real terms, in the first five years of the system. The government will be reviewing the operation of the transitional arrangements prior to the next revaluation in 1995.

12. For smaller properties, the Government has decided that increases in rates bills should be phased in at a slower rate. Thus for properties whose new rateable value is below £5000, or in London below £7500, increases will be limited to 15 per cent a year, in real terms. The Survey suggests that this may cover 60 per cent of properties in England and 70 per cent in Wales.

13. To keep the total yield broadly constant these limits on increases in the rates bills of the losers will need to be matched by limits on the reductions in the rates bills of gainers. Preliminary indications from the survey suggests that the annual limit on gains in England could be around 11 per cent for larger properties.

14. The Government has decided that the gains of smaller properties should be phased in more quickly, with the annual limit set at 5 percentage points above that for larger properties. Hence the annual limit on gains would be likely to be around 16 per cent for smaller properties. The arrangements within Wales will also be self-financing, and the survey suggests that the limits on reductions may be slightly higher.

15. Table 3 summarises the Government's proposed limits on increases and the present estimates of limits on reductions.

Table 3: Limits on annual increases and reductions in real terms

	Proposed limit on increases	Estimated limit on reductions
	per cent of previous year's bills	
England		
- smaller properties	15	[16]
- larger properties	20	[11]
Wales		
- smaller properties	15	[18]
- larger properties	20	[13]

16. The limits mean that increases in rate bills totalling about £500 million are likely to come through in the first year, with larger amounts in later years. The limits on reductions have been set so that cash reductions come through at broadly the same rate. Since, at present, the gainers have a rates bill per property which is about twice as large as the bill per property for the losers, the limits for increases and reductions are bound to differ when expressed as a percentage of existing rates bills.

17. Table 4 shows very broadly how the transition is projected to work, based on the preliminary indications from the Survey.

Table 4: Effects of the transitional arrangements

Year	Actual shift in rates bills† £m	Shift deferred by transitional arrangements £m	Properties affected (000s) with full increases deferred	with full reductions deferred
1990-91	500	1060	680	520
1991-92	860	700	490	380
1992-93	1100	460	350	270
1993-94	1260	300	240	190
1994-95	1360	200	160	120
Post-transition*	1560	-	-	-

†This represents the total of all reductions coming through in the year, or equivalently the total of all increases.

*Once the transition is complete, the rates bills for the gainers will be £1560 million lower than at the outset, the rates bills for the losers £1560 million higher.

18. As the table illustrates, only about one-third of the total shift in rates bills is likely to come through in the first year. Nearly 700,000 properties benefit from having their increases spread beyond the first year, at the cost of deferring reductions for some 500,000 properties.

19. In each year after 1990-91, more business properties will reach the full level of their new rates bills. Correspondingly, more properties will also realise their full gains in terms of lower rate bills.

Distribution of Changes by Property Type and Region

20. Within the broadly constant overall yield, the survey suggests that there are likely to be significant shifts in rates bills, between different types of property and different parts of the country.

21. Table 5 gives estimates of the projected change in the overall rates bill for broad types of property, both in the first year, and once the transition is complete. As can be seen, the estimates indicate significant reductions, after the transitional period, in the rates bills of factories and warehouses, balanced by increases in the bills of the other types of business property.

Table 5: Possible Changes in rates bills by property type

Property Type	Overall reduction (-)/increase in rate bill per cent			
	England		Wales	
	First year	Full change	First year	Full change
Factories	-5	-25	-5	-16
Warehouses	-3	-12	-5	-9
Shops	4	+14	6	+18
Offices	3	+14	negligible	+ 5
Other properties	2	+ 7	1	+ 6

Ch/ In this and next table you are asked whether to keep first year cols?

But it must be stressed that the outcome for each category will be made up of a very wide range of results for individual businesses. Some factories are likely to see a reduction of more than

Admittedly, they draw attention to how little of the gains come through in year 1, but – more importantly – they emphasise to losers that the transitional arrangements are integral to the proposals.

25 per cent; others may see their rates bill increase. Similarly, although shops and offices as a whole are projected to pay more, some individual shops and offices are likely to pay less.

22. Table 6 gives similar projections of how rates bills might shift between the different regions in England and Wales, again both in the first year and once the transition to the new system is complete. The North West, the West Midlands, the East Midlands, Yorkshire and Humberside, and the Northern region and the Welsh Valleys are projected to see reductions; rates bills are likely to be higher in East Anglia and the South of England, and the rest of Wales.

Table 6: Projected changes in rates bills by region

Region	Overall reduction (-)/increase in rates bill, per cent	
	First Year	Full Change
North West	-7	-31
West Midlands	-5	-25
East Midlands	-5	-21
Yorkshire and Humberside	-5	-20
Northern	-3	-11
East Anglia	+5	+16
South West	+8	+24
Inner London	+5	+27
Outer London	+2	+6
Rest of the South East	+6	+15

[Wales to follow]

Keep?

Again, each broad category is likely to mask a wide range of changes in the rates bills on individual properties.

23. For statistical reasons, it is not possible to estimate likely changes in the rates bills of individual business properties or types of property in particular regions by marrying together the estimates in tables 5 and 6.

Should following tables be included?

PRIVATE SECTOR ONLY FILE - 1988-89 PRICES

REGIONAL ANALYSIS OF REVALUATION

COUNTRY	REGION	1973 RATEABLE VALUE (£M)	1973 RATEABLE VALUE % OF NATIONAL TOTAL	1990 RATEABLE VALUE (£M)	1990 RATEABLE VALUE % OF NATIONAL TOTAL	AVERAGE REVALUATION FACTOR	MEAN REVALUATION EFFECT (%)	MEDIAN REVALUATION EFFECT (%)
ENGLAND	NORTHERN	155	5	1,301	5	8.4	+13	-6
	YORKSHIRE & HUMBERSIDE	240	7	1,780	7	7.4		+12
	EAST MIDLANDS	220	6	1,449	6	6.6	-11	+2
	EAST ANGLIA	110	3	903	4	8.2	+11	+24
	INNER LONDON	796	23	5,659	23	7.1	-4	+9
	OUTER LONDON	336	10	2,383	9	7.1	-4	+8
	REST OF SOUTH EAST	660	19	5,626	22	8.5	+16	+20
	SOUTH WEST	221	6	2,093	8	9.5	+28	+29
	WEST MIDLANDS	320	9	1,823	7	5.7	-23	-19
	NORTH WEST	346	10	2,101	8	6.1	-18	-6
	COUNTRY TOTAL	3,409	100	25,122	100	7.4		+8
WALES	REGION	30	24	226	22	7.4	-8	+9
	WELSH VALLEYS	97	76	798	78	8.2	+2	+21
	REST OF WALES	128	100	1,024	100	8.0		+17
	COUNTRY TOTAL	3,537	100	26,147	100	7.4		+9
ENGLAND AND WALES								

More detailed presentation of tables, likely to be proposed by D.o E.

Median % change

PRIVATE SECTOR ONLY FILE - 1988-89 PRICES

REGIONAL ANALYSIS OF BURDEN CHANGE BEFORE TRANSITION

		1988-89 PRE-REFORM RATE BILL		1988-89 POST-REFORM RATE BILL		CHANGE IN RATE BILL	
		(£M)	% OF NATIONAL TOTAL	(£M)	% OF NATIONAL TOTAL	(£M)	(%)
COUNTRY	REGION						
ENGLAND	NORTHERN	477	6	423	5	-54	-11
	YORKSHIRE & HUMBERSIDE	728	9	578	7	-150	-21
	EAST MIDLANDS	601	7	472	6	-129	-22
	EAST ANGLIA	255	3	293	4	38	15
	INNER LONDON	1,451	18	1,839	23	388	27
	OUTER LONDON	726	9	774	9	47	7
	REST OF SOUTH EAST	1,593	20	1,828	22	235	15
	SOUTH WEST	548	7	680	8	132	24
	WEST MIDLANDS	792	10	592	7	-199	-25
	NORTH WEST	990	12	682	8	-307	-31
	COUNTRY TOTAL	8,166	100	8,166	100		
WALES	REGION						
	WELSH VALLEYS	83	25	72	22	-10	-13
	REST OF WALES	245	75	256	78	10	4
	COUNTRY TOTAL	329	100	329	100		
ENGLAND AND WALES		8,495		8,495			

DISTRIBUTION OF GAINERS AND LOSERS

COUNTRY ENGLAND

SUMMARY CHANGE IN RATE BILL	CHANGE IN RATE BILL	1973 RATEABLE VALUE: NUMBER OF PROPERTIES (000)	1973 RATEABLE VALUE: (£M)	1990 RATEABLE VALUE (£M)	1988-89 PRE-REFORM RATE BILL (£M)	1988-89 POST-REFORM RATE BILL (£M)	CH. (£M)	
REDUCTIONS	AT LEAST 50%	121	330	1,138	939	369	-569	
	25% BUT LESS THAN 50%	262	786	4,075	2,078	1,324	-753	-361
	15% BUT LESS THAN 25%	238	640	4,078	1,546	1,325	-220	-141
	10.5% BUT LESS THAN 5%	57	168	1,162	387	377	-10	-3
NO GAIN/LOSS	LESS THAN +/- 10.5%	14	24	175	57	57		
INCREASES	10.5% BUT LESS THAN 5%	37	105	721	228	234	5	2
	5% BUT LESS THAN 10%	51	150	1,084	330	352	22	7
	10% BUT LESS THAN 15%	55	118	936	271	304	32	12
	15% BUT LESS THAN 20%	57	136	1,057	293	343	50	17
	20% BUT LESS THAN 25%	57	97	859	229	279	50	22
	25% BUT LESS THAN 50%	199	401	3,503	839	1,138	299	36
	50% BUT LESS THAN 75%	113	161	1,811	364	588	224	62
	75% BUT LESS THAN 100%	81	117	1,503	265	488	222	84
	100% BUT LESS THAN ~~200%~~ 150%	137	127	1,874	259	609	350	135

Divide pro rata?

(CONTINUED)

PRIVATE SECTOR ONLY - 1988-89 PRICES

DISTRIBUTION OF GAINERS AND LOSERS

COUNTRY ENGLAND

SUMMARY CHANGE IN RATE BILL	CHANGE IN RATE BILL	1973 RATEABLE VALUE: NUMBER OF PROPERTIES (000)	1973 RATEABLE VALUE (£M)	1990 RATEABLE VALUE (£M)	1988-89 PRE-REFORM RATE BILL (£M)	1988-89 POST REFORM RATE BILL (£M)	CHANGE IN RATE BILL (£M)	CHANGE IN RATE BILL (%)
INCREASES	~~200%~~ BUT LESS THAN ~~100%~~ 200	37	16	342	33	111	78	236
200% and more	~~100%~~ BUT LESS THAN ~~500%~~	24	12	325	22	105	83	380
	~~500%~~ AND MORE	8	11	470	19	153	133	679
SUMMARY CHANGE IN RATE BILL								
GAINERS		680	1,925	10,453	4,952	3,397	-1,554	-31
NO GAIN/LOSS		14	24	175	57	57		
[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	4,710	1,554	49
[illegible]		[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
TOTAL		1,555	3,409	25,122	8,166	8,166		

chex.md/aa/57 CONFIDENTIAL

FROM: A C S ALLAN
DATE: 8 February 1989

PS/CHIEF SECRETARY

cc Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Culpin
Mr A J C Edwards
Mrs Lomax
Mr Potter
Mr Fellgett
Mrs Holmans
Mr Hudson
Mr Rutnam
Mrs Chaplin
PS/IR
Mr Morgan IR
Mr Gonzalez IR

PUBLICATION OF INLAND REVENUE SURVEY ON REVALUATION AND THE MOVE TO A UNIFORM BUSINESS RATE

The Chancellor was most grateful for your minute of 3 February. He was content with the broad approach in the draft paper and with the order. He would prefer to stick to the summary tables in the text, and not include the appended tables.

2. He had the following comments on the details of the paper:

(i) In table 1, insert "(+)" immediately after "increase" in the headings of the final two columns; and insert "+" before the relevant figures in those columns.

(ii) In table 2, delete the last two lines (ie stop the table at "100% or more" rather than "200% or more"; show the £million change in rate bills for those properties having

little change, rather than simply saying "negligible"; and insert "+" before the relevant numbers in the final two columns.

(iii) In table 5 delete the first and third columns showing the first year effects; and add "+" before the relevant figures in the second and fourth columns.

(iv) In table 6, reverse the order of the two columns; and insert "+" where appropriate.

ACSA

A C S ALLAN

dm1.ph/docs/hudson2

SECRET

FROM: A P HUDSON
DATE: 10 FEBRUARY 1989

1. **MR FELLGETT** RF 10/2
2. **CHANCELLOR***

cc Chief Secretary*
Paymaster General*
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Scholar
Mr Culpin
Mr A J C Edwards*
Mr Potter*
Mr Gieve
Mr Fellgett*
Mr Rutnam*
Mrs Chaplin*
PS/IR
Mr Morgan - IR*
Mr Heggs - IR*
(* with attachments)

NON-DOMESTIC RATES: ANNOUNCEMENT OF TRANSITION

Mr Ridley proposes to announce the details of the transition to the new system of non-domestic rates in England and Wales next week, probably on Wednesday (15 February) in an Oral Statement. This will incorporate an announcement on rating appeals, as agreed between you and the Prime Minister.

2. I attach the three parts of the announcement:

- the draft Oral Statement;

- a DOE consultation paper on the nuts and bolts of the transitional arrangements;

- the summary of the Inland Revenue survey

3. The Oral Statement reflects comments we and the Revenue have given to DOE officials, particularly on rebasing the transition (which remains the most awkward aspect to present). Mr Ridley has not seen the draft, and we will let you know if he makes any changes of substance. In the meantime, we will pass on any points you and the Chief Secretary have.

4. The consultation paper also incorporates our comments. It is designed to explain the practicalities to local authorities and business organisations. I do not think you need to read it.

5. The summary of the Inland Revenue survey reflects comments from you and the Chief Secretary, and a handful of drafting changes since you last saw it. We fended off suggestions from DOE to expand the coverage, particularly to include material on the revaluation separately. However, Table 5 is expanded to show the changes by region in cash as well as percentage terms. These could anyway be calculated from the percentages and published yields of business rates by region. Apparently, DOE Ministers want to draw attention to the benefits of reform for "the North". Provided they treat the figures with due caution, there seems no harm in expanding the table to make this immediately apparent. Are you content?

6. Mr Ridley may raise with you one point of substance about the starting point for determining the yield of the UBR in the first year. As you know, the announced policy is that the yield in 1990-91 should be the same as the yield of business rates in 1989-90, uprated for inflation, and adjusted for 'buoyancy'. Mr Ridley is concerned, however, that local authorities may make abnormally large increases in rates in 1989-90, to drive up the base for the yield of the new UBR. He may want to make clear that he has power to set a poundage which would produce a lower yield from 1990-91, if local authorities manipulated the change in the system at the expense of business ratepayers.

7. We have told DOE that this would be a change of policy, which Mr Ridley would need to clear with you. There are, of course, disadvantages in any change in the announced line. Rate rises generally may not be large - there are county elections, and as happened in Scotland, some Labour authorities may moderate rate increases in the year before the community charge - Strathclyde even froze its rates. But any hint that the power may be used to set a lower poundage would encourage additional lobbing from the CBI and others.

8. However, it would not be credible for Mr Ridley to argue that the Government would in no circumstances (100% rates rises?) reconsider basing the UBR yield on that in 1989-90. A similar power was available before the reform in Scotland in 1988-89, and indeed used in relation to an extraordinary rise in Shetland. Arguably it would therefore be better to have written in the documentation that the Government would reconsider its line - with no promise that it would change it - only in tightly defined circumstances, rather than find that Mr Ridley had offered something more generous under pressure in the House. We shall let you have final advice if and when Mr Ridley writes, and we can see precisely what he has in mind.

9. After the Oral Statement, Mr Ridley will give a press conference and meet Mr Banham and others in London. Mr Gummer has an ambitious scheme for simultaneous press conferences by himself and three other DOE Ministers in four regional centres. Mr Ridley may scale this down, but Environment Ministers appear to be looking for extensive press coverage, probably with the main emphasis on gains approaching £1 billion for the Midlands and North (although in fact slowly and at the expense of the South, notably central London). There is some danger that the message will be all gains and no losses, which will raise false hopes. We shall let IDT have some briefing, emphasising that it has been agreed that the transitional arrangements are self-financing.

10. Are you content with the package for announcement on Wednesday, subject possibly to hearing from Mr Ridley what he proposes to say about the base line for the yield?

A P HUDSON

S E C R E T

BUSINESS RATES: TRANSITION

Draft Statement

With Permission, Mr Speaker, I shall make a statement on business rates.

The Local Government Finance Act 1988 provides for a uniform business rate in England and in Wales and for a revaluation of non-domestic property. These changes will take effect on 1 April 1990. [Under the uniform business rate, once transition to the new system is complete, all businesses will benefit from being able to plan on the assumption of steady and predictable rates, with increases from year to year of no more than the level of inflation. Future increases in local authority spending will fall not on business ratepayers but on the community charge payers to whom the authority is accountable through the ballot box. The new arrangements will mean the end of wide variations in rate poundages between different areas; and rateable values will be brought up to date to reflect accurately the relative benefits of different types of property in different locations. This will provide a welcome incentive for businesses to expand in the currently less economically buoyant areas. Overall business in the North and Midlands will enjoy rate reductions of about £850m a year once the transition is complete].

My Rt Hon friend the Secretary of State for Wales and I have considered the Inland Revenue's preliminary sample survey of the likely combined effects of the 1990 revaluation and the introduction of the unified business rate. The results of the survey must be interpreted with caution: they give only a general indication of possible changes in rate bills from 1990. Subject to that important qualification, the survey suggests that

rateable values will increase from 1973 levels by around 7½ times on average in England and by around 8 times on average in Wales; but, as expected, there will be wide variations around these averages. The business rate poundage will therefore be only about one seventh to one eighth of the poundage necessary to raise the same revenue using 1973 rateable values.

[Further LG suggestions.] ↓

The survey suggests that the broad effects of the unified business rate and the revaluation taken together will be that [manufacturers and] businesses, premises in the North and Midlands will tend to [gain; pay less [retailers] and] businesses in southern England will generally face increases. In Wales businesses in the Valleys will tend to gain, but the shift in burden between the Valleys and the rest of Wales will not be very large.

As a general rule, factories and warehouses will tend to pay, while shops and offices will tend to pay more.

To give businesses time to adjust to their new rate bills, we are proposing [generous] transitional arrangements to introduce the changes gradually. These arrangements will be self-financing. There will be limits on the percentage by which the rate bill for any property may change from one year to the next, for the first five years of the new system at least. For properties in England and Wales facing increases the limit will be 20% generally, but to help smaller businesses there will be a lower limit of 15% for small properties, those with new rateable values below £7,500 in London and £5,000 elsewhere.

For properties in England due to benefit from rate reductions , I shall decide finally on the percentages by which changes will be phased when I have fuller information in the summer; but present projections imply that limits on annual reductions of 15% for small properties and 10% for large would offset the cost of the protection for losers. Mr Rt Hon friend will similarly base his final decision on phasing of reductions for Welsh ratepayers on later information; but present ~~forecasts~~ projections indicate ~~that~~ slightly higher limits ~~on annual reductions of 10% for small properties and 13% for large~~ in Wales would be sufficient to offset the cost of protection for losers.

WO officials agree it would be best not to focus on a 3 point differential, in case it is altered by later information.
R.F.

~~in Wales~~. Compared to present rate bills, the percentage increase for losers is greater than the percentage reduction for the gainers because the losers as a group have substantially lower rate bills at present. All these limits are net of the annual change in the rate poundage resulting from the link to the Retail Price Index; and they are compound, in that after the first year the maximum percentage increase or decrease would be calculated from the rate bill in the preceding year.

We wish to give the highest possible priority to preparing fully and promptly for the new business rating system and have therefore concluded that it would be right to reduce the incentive for business ratepayers to propose changes in the old 1973 rating list, if the sole purpose is to secure a slightly better position under the transitional arrangements. We therefore propose that in 1990/91 the base bill to which the transitional limits will be applied should be calculated using the rateable value in the list today, adjusted only for changes resulting from ratepayer proposals to amend the value received by the Valuation Office by yesterday and those resulting from any existing or future proposals by valuation officers.

Ratepayers would still of course retain the right to propose changes, and if such proposals led to reductions in value would get the benefit until March 1990, although not thereafter. Furthermore, the Valuation Office will remain under a statutory duty to keep the 1973 list up to date; any significant change in the rateable value of a building will therefore be reflected in their own proposals to alter the list, and hence carried forward into the transition. We believe business ratepayers as a whole will welcome our intention to concentrate on getting the new system right and thus to discourage further attempts to change rateable values which have stood for up to 16 years.

The powers in the 1988 Act to make regulations are inadequate to facilitate transitional arrangements of the kind I have described. We shall therefore propose amendments to the Local Government and Housing Bill. In order to give businesses and local authorities as much certainty about the transition as possible, it is our intention after consultation to bring forward amendments setting out the arrangements in the Bill itself rather than in subsequent regulations.

We are today issuing and placing in the Library a consultation paper setting out the details of the transitional arrangements and inviting comments, which includes the results of the Inland Revenue survey referred to earlier.

DRAFT OF 10/2/89

CONFIDENTIAL

LOCAL GOVERNMENT FINANCE ACT 1988

NON-DOMESTIC RATING : TRANSITION

CONSULTATION PAPER

1. This paper sets out the Government's proposals for the phasing over time of changes in rate liability resulting from the 1990 revaluation and introduction of the uniform business rate. It includes firm proposals for the ceilings to be set on the percentages by which the rate bill for any property may increase from one year to the next, and projections of the corresponding limits on the percentages by which rate bills may fall for those occupiers who benefit from the reductions. Except where noted in paragraph 11, the proposals apply to both England and Wales. It is intended that the proposals should be given effect by amendment to the 1988 Act, in the Local Government and Housing Bill currently before Parliament, rather than in regulations - which, because of the proposal in paragraph 16 below, could not in any case be made without amendment to S.57 of the Act and thus not before Royal Assent to the Local Government and Housing Bill, which is scheduled for the autumn.

GENERAL

2. The purpose of the arrangements is to give ratepayers whose rate liability will increase substantially time to adjust before they pay the full amount. In order that the expected yield from non-domestic rates should not be reduced, the phasing of increases will be balanced by postponing the full implementation of the reductions in rate liability due to accrue to other ratepayers.

3. The Government set out during the passage of the Local Government Finance Bill its proposals for the broad structure of the arrangements. It was envisaged that there would be a ceiling on the percentage by which the rate bill for any hereditament would be allowed to rise as between any two years from 1989/90 to 1994/95 and that there might be a different ceiling for hereditaments below a specified new rateable value. There was also to be a

limit on the percentage by which a rate bill might fall from year to year throughout the same period; this would be calculated to balance the cost of the ceiling on increases (and might thus not be the same percentage as that ceiling). A power was taken, in Schedule 7 paragraph 7 of the Act, to meet all or part of the cost of the ceiling by a premium on the poundage ("multiplier") - which will be set by the Government at a uniform level throughout the country : but Ministers have indicated that they prefer to avoid using this power because its effect would be to cause substantial numbers of people who would otherwise gain from the reforms to lose. It was however intended that rate bills generally, would rise from year to year, irrespective of whether transitional arrangements applied, by no more than the rate of inflation.

4. The Government has now formulated detailed proposals in the light of a preliminary sample survey carried out by the Inland Revenue of the projected effects of the 1990 revaluation, together with the move to the uniform business rate. The results of the survey are set out as an Appendix to this paper. The Government has sought to give the maximum protection to those facing substantial increases that is consistent with ensuring that the large majority of occupiers reach their full new rate liability by 1995, and not unduly delaying the benefits to gainers; the proposals also take account of the special difficulties that small businesses could face in coping with large increases over a short period.

5. The arrangements will run for the first five years of the new system, and it is proposed that the same percentage ceiling on increases should apply in each year. There is power in section 58 of the 1988 Act to make new transitional arrangements in 1995, taking account both of any changes from 1990 still not fully implemented and of changes resulting from the 1995 revaluation. The Government will decide on the use of that power at a later stage in the light of information on the likely effects of the 1995 revaluation.

6. Hereditaments affected, in broad terms, will be those which are occupied on 31 March 1990 or have been occupied before that date. Paragraphs 12 and 13 consider this point in more detail. Whether an individual hereditament is affected in any year will of course depend on whether, but for the transitional arrangements its rate bill would differ from the previous year's bill by more than the specified percentage.

7. There is a numerous class of very small hereditaments which do not constitute businesses in their own right, for example separately-let parking spaces and advertising hoardings. In such cases the administrative cost of operating the transitional arrangements might outweigh any benefit to the ratepayer and the effect on an owner/occupier's cash flow will be small however large the cash increase in rates is in percentage terms. It may therefore be appropriate to exclude entirely from the transitional arrangements all hereditaments below a specified new RV, set at a level at which no genuine small business premises could expect to be excluded. This might be £200, equivalent to a present RV of about £25.

8. The arrangements will be operated, as now, by local authorities (known as 'charging authorities' under the new system), who will calculate the transitional rate bills for individual hereditaments. The overall effect, positive or negative, on individual authorities' rate income will be allowed for in calculating the payments that authorities are required to make into the national non-domestic rate pool.

THE CEILING ON INCREASES

9. The Government proposes that the ceiling on increases for hereditaments generally should be 20% per year in real terms throughout the five-year period. For small hereditaments, there will be a lower ceiling of 15%. Small hereditaments will be defined as those with a new RV for 1 April 1990 below £7500 in London and £5000 elsewhere; these levels have been selected to ensure that the vast majority of premises occupied by small businesses are subject to the lower limit. The Inland Revenue survey suggests that 60% of all business premises in England, and 70% in Wales, may fall in this lower size band.

10. The ceiling will be prescribed as a percentage of the previous year's deemed rate liability (see paragraphs 15-20 for how this is calculated), and will therefore operate on a compound basis, i.e. a business subject to the upper ceiling facing a large increase will pay 20% over and above the 1989/90 bill in 1990/91, 44% in 1991/2, 72.8% in 1992/3, and so forth until the full new rate liability is reached or until 1994/5. This means that large premises facing increase of more than 149%, and small premises facing increases of more than 101%, will still be receiving protection in 1994/5. The ceilings will be specified exclusive of any annual increase in the business rate poundage resulting from the link to the RPI; thus, if in any year the RPI increase is for instance 4%, the actual percentage increase in bills for large premises

subject to transition would be (1.2 x 1.04), i.e. 24.8%. (In the first year, an inclusive percentage will be prescribed, but the same principles will apply).

THE LIMIT ON GAINS

11. The limit on gains, i.e. on the percentage by which the rate bill may fall between any two years, will be specified in the same manner as the ceiling on increases. The purpose of this limit is to delay a proportion of gains to the extent necessary to balance the effect on the pool of the ceiling on increases. As with the ceiling on increases, the Government proposes to make rather more generous provision for small businesses by allowing reductions for small hereditaments to come through rather more quickly than those for large. A final decision on the limit on gains will not be made until later this year, to take account of the latest information. Initial estimates based on the Inland Revenue survey, however, are that the pool would be balanced, in England, taking the 5 years as a whole, by limits of 10% for large hereditaments and 15% for small, defined as for the ceiling on increases. The limit would similarly operate in a compound manner but would be net of annual increases in the poundage in line with inflation. At the percentages forecast above, only those gainers due to benefit from reductions of more than 41% (for large premises) or 56% (for small premises) would still be subject to phasing in the fifth year. In Wales, the initial estimates suggest that the pool would be balanced over the 5 year period by limits on gains of 13% for large hereditaments and 18% for small; on this basis, only the very small number of gainers due to benefit from reductions of over 50% (for large premises) or 63% (for small premises) would still be subject to phasing in the fifth year.

QUALIFYING HEREDITAMENTS

12. It is proposed that the transitional arrangements should apply to hereditaments which are or have been occupied and liable to rates (other than empty property rates) on or before 31 March 1990. There is an argument that hereditaments first occupied before 1989-90 but unoccupied for a lengthy period prior to that financial year should be excluded. The Government would welcome views on this. Representations have been made that the arrangements should apply also to hereditaments first occupied after 31 March 1990, in order to avoid market distortions. The Government does not consider this justified, for two reasons. First, the purpose of the arrangements is to protect existing occupiers from sudden large increases in their rate bills at the point of introduction of the new system : there is no need for such

protection where the initial occupier has not paid rates before 1 April 1990, and in most cases will have been able to forecast the new rate bill with reasonable accuracy before taking the tenancy. Secondly, in the case of new buildings there would be no baseline from which to calculate transitional liability; it would be possible to assess a hypothetical 1973 value, but this would become increasingly artificial over time.

13. The reason for proposing to limit eligibility to hereditaments first occupied on or before 31 March 1990, and excluding those entered in the list but only ever liable to empty property rates, is that the date of first occupation is more readily ascertainable and less open to manipulation; moreover, empty property rates are not levied in all areas. Where a hereditament has been occupied before 31 March but entry has been made in the list on that date, a 1973-based value will be entered in the normal way, not only for transitional purposes but also for calculating liability to rates in 1989/90; the savings regulations under section 147 of the 1988 Act will permit this to be done.

14. Once a hereditament has qualified for the transitional arrangements, it is proposed that it should continue to qualify throughout the transitional period, regardless of changes of occupier or structural alterations (though in the latter case the amount of liability may be adjusted - see paragraphs 25 and 26 below). This rule is necessary to avoid erecting factitious incentives for occupiers not to move. The only departure from this will be where a hereditament effectively changes its nature entirely through demolition and reconstruction. It is proposed that in such cases, where the building is demolished or gutted and the RV in the list is deleted or reduced to a nominal level, the transitional arrangements should no longer apply. It would be possible to except from this rule cases where, when the building is reinstated at full value in the list, the occupier is the same as before; the Government is however not persuaded that this extra complication would be justified. Where new hereditaments are created by division or merger, the arrangements will continue to run with appropriate adjustments : see paragraph 27.

THE BASELINE

15. This section considers the baseline for the transitional arrangements, i.e. the deemed 1989-90 liability to which the various percentage limits will be applied to assess eligibility for inclusion in the transitional scheme. This cannot simply be the actual rates levied on the hereditament in 1989/90 since, for example, some hereditaments will have been altered during that year

or have been unoccupied for part of it : and the total amount payable would not accurately reflect a full annual liability. Indeed, because of the possibility of changes in rateable values throughout 1989-90, there is no specific date within the financial year on which liability could be conclusively assessed for all ratepayers. So whatever date was chosen, detailed provision would need to be made for appropriate adjustments in some cases where the rateable value of a hereditament changed during the year. And, of course, there is still the possibility of retrospective changes in value, arising from appeals decided after 31 March 1990.

16. Businesses and local authorities will want to be certain at the earliest opportunity of the way in which the baseline for transitional purposes is to be derived. The Government also needs to be able to estimate accurately the rateable value base for 1989-90 in order to set the national non-domestic rate multiplier for 1990-91 at the appropriate level to produce the required yield. And it has a wider concern that the change to the new system of local government finance in April 1990 should take place smoothly so as to ensure that the full benefits are felt by both businesses and community chargepayers as soon as possible. The Government has decided, therefore, for the reasons given by the Secretary of State for the Environment to Parliament on 15 February (and quoted in the News Release which accompanies this consultation paper), that the rateable value base to be used for the calculation of transitional liability should be that at the date of the Secretary of State's announcement, adjusted only for changes resulting from proposals by ratepayers received before the date and those resulting from any existing or future proposals by valuation officers. Arrangements will be made for VOs to inform charging authorities of those changes in RV made after 15 February which are to be taken into account in the transitional arrangements.

17. There are some cases where the general rules set out in paragraphs 9-11 above may need adaptation. Firstly, special provision will need to be made for hereditaments which are composite under the new system, to ensure that the old RV used in calculating the baseline relates only to the non-domestic part of the hereditament. The Government's preferred approach is for valuation officers (VOs), on request by charging authorities or ratepayers, to certify the proportion of the 1973 list RV which relates to the non-domestic part. Certification will be on request, to avoid the need for VO's to spend time on those properties where the change in rate liability is not so large as to qualify for transition. Where a charging authority is unaware that a hereditament is composite, it will be entitled to assume that the hereditament

falls in this category and is outside transition, unless informed to the contrary. In many cases apportionment will be straightforward; and the apportioned 1973 RV will be used in calculating the baseline rate bill as for any other property. However, where, in assessing the new 1990 RV, there is a change in the proportion of the hereditament used for non-domestic purposes, this would be treated just like any other alteration to the list (see paragraphs 24-27 below).

18. A simpler alternative, not requiring legislation, would be to apportion by reference to the proportion treated as domestic for the purpose of domestic rate relief under the present system; but this would not be universally applicable since many hereditaments to be treated as composite under the new system, for example residential institutions such as boarding schools, have been treated as wholly non-domestic rather than 'mixed' under the present system.

19. Secondly, there is a practice whereby some hereditaments have their RV temporarily reduced to nil or a nominal level while they are incapable of occupation because of major building works or other cause. (Paragraph 14 above refers to the position where this happens on or after 1 April 1990). If such hereditaments were treated in the normal way, they would effectively be outside the scope of transitional arrangements, since the increase in RV when they were revalued on completion of the work would be treated as an alteration and would not be phased (see paragraph 24). This consequence might be accepted, on the basis that the renovated building is equivalent to a new one, and that after renovation it is likely to be occupied by a different occupier who has taken the tenancy knowing the new RV and who therefore does not need protection, or it could be provided that in such cases the old RV which had effect before commencement of the works should be used in calculating the baseline. A possible compromise would be to take the latter approach only where the occupier was the same before commencement and after completion of the works.

20. Mandatory and discretionary reliefs will not be taken into account in calculating the baseline, since they are personal to the occupier. Instead, the baseline and therefore the transitional liability will be calculated by the general rules, and any reliefs will be applied to the resulting figure. This will mean that where relief continues to be given at the same percentage, changes in liability will be phased at the same rate as for hereditaments generally. In practice, the mandatory relief percentage for charities is to

increase to 80%; this change will not be phased, so almost all charities, apart from the few which receive full discretionary relief now, will benefit from an immediate reduction in their bills, depending on the change in poundage and RV.

TRANSITIONAL LIABILITY

21. Once the 1989-1990 deemed liability has been ascertained, it will be compared with the full rate liability for 1990-91 (calculated by multiplying the uniform poundage by the new RV) without regard to any reliefs or remission, and, if the latter is above or below the former by more than the prescribed percentage, a transitional rate bill will be calculated. This process will be repeated in succeeding years comparing each current year with the full future year liability until the correct new rate bill is reached. If the full 1990-91 rate liability is above or below the baseline liability by, or by less than, the prescribed percentage, the full amount, subject to any reliefs or remission, will be payable in 1990-91.

22. As noted in paragraph 20 above, where an occupier benefits from a relief or remission, this will be applied to the transitionally-adjusted rate bill; it will have no effect on liability if the occupier or a new occupier ceases to be eligible for the relief/remission. The same applies to empty property rating : the owner of empty property subject to rates will pay 50% of the transitionally-adjusted rate bill.

23. Where the baseline 1973 RV is altered retrospectively in the circumstances described in paragraph 16, it will be necessary to repeat the calculation and, where appropriate, to adjust the transitional liability. Where the 1990 RV is altered on appeal with retrospective effect to 1 April 1990, the calculation will again need to be repeated and a new full rate liability will have to be recalculated retrospectively. In many cases where the transitional arrangements apply there will not be an immediate change in actual payment, since the change in RV will not be sufficient to shift the 'eventual' full rate liability to a point where the transitional rate bill would cease to override it. For example, if the old rate bill was £100, the transitional limit 20%, and the eventual full rate liability £200, then a reduction in RV which led to a reduction in the eventual liability of up to 40% would not affect the actual bill in 1990/1, which would remain at £120.

ALTERATIONS IN RV AFTER 1 APRIL 1990

24. Special provision will be needed to cover the cases where the new RV changes as a result of a material change of circumstances after 1 April 1990. Clearly it is not desirable to phase such changes; this would mean that an occupier whose hereditament was subject to the transitional ceiling on increases could improve it without incurring any extra rate liability, whereas one subject to the limit on gains would get no benefit if part of the hereditament was demolished.

25. It is proposed that in the case of a hereditament subject to the ceiling on increases, if the RV increases following an alteration etc, the transitional rate bill will rise by the amount of the change in RV multiplied by the uniform poundage, i.e. the benefit of transitional protection will be retained in relation to the unaltered part of the RV but it would not extend to the effect of the alteration. If the effect of an alteration is to reduce the RV, the rate bill to be paid will be the lower of the bill calculated under the transitional arrangements without regard to the alteration, and the rate bill calculated in the normal way by applying the uniform poundage to the new RV. In the latter case, the transitional arrangements would thenceforth cease to apply to the hereditament because full liability will have been reached. Worked examples of the proposals in this and the next paragraph are at Annex A.

26. Where the hereditament is subject to the limit on gains, the mirror image will apply, i.e. a reduction will be implemented in full by reference to the phased bill, as will an increase, calculated by reference to the eventual unphased bill, unless this would still give a liability lower than under the transitional arrangements, in which case the unadjusted transitional liability will continue to apply.

27. Where a new hereditament is created by the combination of two or more previous hereditaments, the eventual full liability and the transitional bill will need to be recalculated from the date of the change as if there had been one hereditament throughout. Where one hereditament is divided into more than one, a similar recalculation will be necessary, with a new baseline being determined by apportioning the old RV in the proportion that the new RVs of the parts form to the previous new RV of the whole.

28. Only exceptionally will an alteration affect whether the hereditament falls to be treated as "large" or "small" for determining which percentage limit applies. This will continue to be determined by the RV on 1 April 1990, and can be changed only by a successful appeal backdated to that date; or, where a large and a small hereditament are merged into one, this will be treated as wholly large.

SPECIAL CASES

FORMULA-RATED HEREDITAMENTS

29. In the case of certain formula-rated industries, the entire industry is to be treated as having a single rateable value, to be entered on the central list; the Secretary of State is to act as collecting authority. In these cases the industry is to be treated as a whole for the purposes of transitional arrangements also. The Secretary of State will include in the formula rating orders, where appropriate, provision for changes in the aggregate rateable value for the industry to be phased so as to produce the same level of change in rate bills as for hereditaments generally; and he will calculate the effect, if any, of the limit on increases in the rate bill.

30. No special rules are needed for individual formula-rated hereditaments not on the central list, nor for any hereditaments which cease to be formula-rated where the formula was previously applied to individual hereditaments which therefore have a value in the 1973 list; in both cases the general rules will apply. Where hereditaments become individually rateable for the first time as a result of a redefinition of the ambit of the formula, no transitional arrangements will apply to those hereditaments, because of the impossibility of determining an appropriate baseline; but the effect may be taken into account in calculating the transitional liability of the formula - rated industry. Where hereditaments become individually - rateable on disposal by a formula-rated industry to another occupier, no transitional arrangements will apply.

MINERAL HEREDITAMENTS

31. The assessments of mineral producing hereditaments are revised annually to reflect the variation from year to year in the quantity of minerals extracted or sold. Consideration will be given to the need for special transitional arrangements which take account of annual variations in the level of rateable value.

CROWN HEREDITAMENTS

32. The detailed treatment of Crown property under the new system, and whether any transitional arrangements should apply, remains under consideration. If transitional arrangements are to apply, they will be given effect extra-statutorily. No transitional arrangements will apply to hereditaments which cease to be subject to Crown exemption by virtue of s.64(5)-(7) of the Act - court buildings and police stations - because of the difficulties associated with using as a baseline the non-statutory 'value' by reference to which a Crown contribution is calculated. Nor will transitional arrangements apply where a hereditament moves out of Crown occupation after 1 April 1990.

FORMERLY EXEMPT HEREDITAMENTS

33. It is proposed that no transitional arrangements should apply where a hereditament which is exempt from rating on 1 April 1990 under Schedule 5 of the 1988 Act subsequently ceases to be exempt. In most such cases, there will have been no entry in the 1973 list to provide a baseline for phasing. In a few such cases - hereditaments used for the disabled and those in Enterprise Zones - there is such an entry, because the exemption operates at present as a 100% relief. In such cases it would be practicable to apply transitional arrangements, but in the Government's view this departure from the general principle would not be justified. In the case of hereditaments used for the disabled this is because the exemption would be lost only on a change in mode of occupation. In the case of hereditaments in EZs, the zones do not begin to terminate until 1991, so occupiers will be aware in advance of prospective new rate bills; moreover, only a small number of occupiers - those facing "increases" over 44% or over 32% if in small properties - would stand to benefit from phasing, and then only to a limited extent.

CITY OF LONDON

34. In the City, alone among authorities, the non-domestic rate poundage will include a small locally-determined element. If the transitional arrangements were applied without adaptation, this would mean that for several years many City businesses would not perceive any difference there may be between the City's poundage and the national poundage. It is therefore proposed that in the City, the arrangements will apply so that the transitional bill varies from the eventual liability calculated at the City's poundage by the same cash amount as it would have varied from the liability calculated at the national

poundage if the City's poundage had been the same as elsewhere. This also means that the cost of transition in the City is the same as it would have been, regardless of the level of the City's poundage.

OPERATION

35. The operation of the transitional arrangements will be entirely a matter for charging authorities. All the rules for billing, collection and enforcement will apply to transitionally-adjusted rate bills exactly as to any other bills. The formal avenue of appeal against an authority's application of the transitional rules to a particular hereditament will be by way of a defence to enforcement proceedings for non-payment of the disputed bill. In practice, most disputes will no doubt be settled by negotiation between the ratepayer and the charging authority without recourse to legal proceedings.

36. The amount of transitional liability will be a matter of law, with no scope for discretion, and the statutory provisions will therefore need to cover all possible circumstances. The Department will however be issuing a guidance note.

37. Authorities should not gain or lose financially from applying the transitional provisions. The regulations to be made under Schedule 8 paragraph 4 of the 1988 Act, on which separate consultation papers for England and Wales are being issued, will therefore provide for authorities to adjust for the effect of the arrangements on the amount of rates collectable in their area in calculating their payments into the pool.

CONCLUSION

38. Comments are invited on the proposals in this paper, which has been sent to the representative bodies listed in Annex B and is available to others on request.

39. Comments on the Consultation Paper should be sent not later than ~~31 January~~ [14 April] 1989 to:

Mr C I Pickard
Finance, Local Taxation Division
Department of the Environment
Room N6/07
2 Marsham Street
LONDON SW1P 3EB

Mr H F Rawlings
Finance, Local Government Division
Welsh Office
Cathays Park
Cardiff CF1 3NQ

Telephone enquiries 01-276-3118 0222 825013
(comments concerning Wales)

40. Ministers are sometimes asked to release details of respondents' views. It would therefore be helpful if you would indicate, in your response, the answers to the following questions:

(a) Do you propose to publish your response or make it available to the media?

(b) Do you agree that the Department may, if required, place copies of your response in the Libraries of both Houses of Parliament and in its departmental library? If so, please will you supply three extra copies for this purpose.

If you answer no to both questions, your response will be treated as in confidence to the Government; it may however be counted in any nummerical summary of views received which does not identify individuals' comments.

Finance, Local Taxation Division A
Department of the Environment

February 1989

doc529sr

CONFIDENTIAL

DRAFT of 10 February

THE 1990 RATING REVALUATION AND THE MOVE TO A UNIFORM BUSINESS RATE

RESULTS OF INLAND REVENUE SURVEY

Introduction

The Inland Revenue has carried out a preliminary sample survey of the likely combined effects of the new (1990) revaluation of non-domestic properties and the introduction of a Uniform Business Rate (UBR) in England and Wales. This note sets out the results.

2. All the results need to be interpreted with caution. The new valuations supplied for the sample of properties were best estimates based on information then available to valuers. These estimates are not the actual valuations that will be used in the new system, but were made before any actual revaluations had taken place. So the results should be taken as providing only the broadest indication of possible changes in rate bills for particular categories of property and particular regions.

3. The transitional arrangements will ensure that no property will see its rate bill increase by more than 20 per cent a year, in real terms, for the first five years of the new system at least. The government will be reviewing the operation of the transitional arrangements prior to the next revaluation in 1995.

4. Estimates of rate bills are given throughout in 1988-89 prices and assume no changes in the population of business properties. No allowance is made for cases in which full rates will not be paid, for example because properties are vacant, or occupied by charities.

The Yield of Non-Domestic rates under the new system

5. The Government has decided that the broad aim should be that the total amount of rates paid in 1990-91 by private sector businesses and nationalised industries - those properties covered by this note - should be the same as for 1989-90, with adjustments for inflation and "buoyancy" (the net change in yield that arises as the number, size, and quality of business properties increase or diminish).

6. Within that overall picture, there are likely to be significant changes in the rate bills for different properties, and the transitional arrangements will ensure that larger changes are phased in over a period of years. Whether an individual property sees a reduction or an increase in its rate bill will depend on two things:

- first, whether the relative increase in its rateable value, as a result of the revaluation, is more or less than the average increase for non-domestic properties as a whole;

- second, whether its local authority currently charges a high or low rate poundage, relative to the national average.

The results reported in this note seek to take account of both these changes.

Aggregate changes in rateable values and poundages

7. Rateable values at present reflect the rental value of property at the last general revaluation, which was based on April 1973 values. Rental values have, of course, increased considerably since that time, and the survey suggests that, on average, new rateable values will be about 7½ times their present levels in England and about 8 times their present levels in Wales.

8. Since the aim is to keep the yield broadly constant in real terms, with an adjustment for buoyancy, the increase in average rateable values will be matched by a corresponding reduction in the rate poundage. Thus, on the basis of the rateable values suggested by the survey, the uniform business rate poundage would be between one-seventh and one-eighth of the average current poundage in England, and about one-eighth of the average poundage in Wales. On this basis, the UBR would have been of the order of 32 pence in the pound, in both countries, if it had been introduced in 1988-89, compared to an average rate poundage of around 240 pence in the pound in England and around 260 pence in Wales.

Overall distribution of gainers and losers

9. Table 1 shows estimated numbers of properties facing reduced rate bills ("gainers") and increased rate bills ("losers"), and the total amounts of the reductions and increases, before taking account of the transitional arrangements.

Table 1: Numbers and amounts of reductions and increases

	Number of properties	Aggregate rates bill	Aggregate reduction(-) /increase (+)	Overall reduction (-) /increase (+)
	000s	£m	£	£m
%				
England				
Gainers	630	4,600	-1550	-34
Little change (less than +/- 5%)	110	660	-4	-
Losers	820	2,950	+1550	+53
Wales				
Gainers	30	150	-40	-28
Little change (less than +/- 5%0)	10	60	-	-
Losers	60	120	+40	+36

NOTE: Columns may not sum due to rounding. This may also lead to small differences between numbers derived from different tables, and between cash changes and percentage changes within tables.

As the Table shows, very few businesses are expected to find their rate bills unchanged. More are projected to face increases than reductions. But since (as explained above) the total yield of business rates is to remain broadly constant, total increases in rate bills will be matched by the total reductions. Compared to

present rate bills, the percentage increase for the losers is greater than the percentage reductions for the gainers, because the losers as a group have a substantially lower rate bill at present.

10. Table 2 shows the distribution of reduction and increases in more detail, again before taking account of the transitional arrangements.

Table 2: Distribution of changes in rate bills.

	Number of properties (000s)	Present rates bill	Change in rate bill: reduction(-)increase(+)	
		£m	£m	per cent
ENGLAND				
Reductions				
50% or more	120	950	-570	-61
5% to 50%	500	3650	-980	-27
Little change (less than +/- 5%)	110	660	-4	negligible
Increases				
5% to 50%	420	1980	+450	+23
50% to 100%	190	630	+450	+71
100% or more	210	340	+650	+191
WALES				
Reductions				
50% or more	2	20	-12	-58
5% to 50%	26	130	-30	-23
Little Change (less than +/- 5%)	10	60	-	-
Increases				
5% to 50%	31	90	+18	+20
50% to 100%	17	25	+16	+70
100% or more	10	5	+8	+160

The transition to the new system

11. As explained, the estimates above make no allowance for the transitional arrangements. These arrangements will give ratepayers time to adjust to the changes.

12. No property will see its rate bill increase by more than 20 per cent a year, in real terms. For smaller properties, the Government has decided that increases in rate bills should be phased in at a slower rate. Thus for properties whose new rateable value is below £5000, or in London below £7500, increases will be limited to 15 per cent a year, in real terms. The survey suggests that this may cover 60 per cent of properties in England and 70 per cent in Wales.

13. To keep the total yield broadly constant, these ceilings on increases in the rate bills of the losers will be matched by limits on the reductions in the rate bills of gainers. Preliminary indications from the survey suggests that the annual limit on gains in England could be around 10 per cent for larger properties.

14. The Government has decided that the gains of smaller properties should be phased in more quickly, with the annual limit set at 5 percentage points above that for larger properties. Hence the annual limit on gains would be likely to be around 15 per cent for smaller properties. The arrangements within Wales will also be self-financing, and the survey suggests that the slightly greater annual reductions might be possible.

15. The ceilings mean that increases in rate bills totalling about £500 million are likely to come through in the first year, with larger amounts in later years. The limits on reductions have been set so that cash reductions come through at broadly the same

rate. Expressed as a percentage of existing rate bills, the limits for increases and reductions are bound to differ, since, at present, the gainers have an aggregate rate bill which is much larger than the aggregate bill for the losers, as Table 1 shows.

16. Table 3 shows very broadly how the transition is projected to work, based on the preliminary indications from the survey.

Table 3: Effects of the transitional arrangements

Year	Actual shift in rate bills† £m	Shift deferred by transitional arrangements £m	Properties affected (000s) with full increases deferred	with full reductions deferred
ENGLAND				
1990-91	500	1050	680	520
1991-92	850	700	490	380
1992-93	1100	450	350	270
1993-94	1250	300	240	190
1994-95	1350	200	160	120
WALES				
1990-91	15	25	50	20
1991-92	27	13	35	10
1992-93	34	6	25	4
1993-94	37	3	15	2
1994-95	38	2	10	1

†This represents the total of all reductions coming through by the year, or equivalently the total of all increases.

17. Thus, in England , only about one-third of the total shift in rates bills is likely to come through in the first year. Nearly 700,000 properties benefit from having their increases spread beyond the first year, at the cost of deferring reductions for some 500,000 properties.

18. In each year after 1990-91, more business properties facing increases will reach the full level of their new rate bills. Correspondingly, more properties will also realise their full gains in terms of lower rate bills.

Distribution of Changes by Property Type and Region

19. Within the broadly constant overall yield, the survey suggests that there are likely to be significant shifts in rate bills, between different types of property and different parts of the country.

20. Table 4 gives estimates of the projected change in the overall rate bill for broad types of property, once the transition is complete. As can be seen, the estimates indicate significant reductions, after the transitional period, in the rate bills of factories and warehouses, balanced by increases in the bills of the other types of business property.

Table 4: Possible Changes in rate bills by property type, England and Wales

Property Type	Overall reduction (-)/increase (+) in rate bill per cent	
	England	Wales
Factories	-25	-16
Warehouses	-12	-9
Shops	+14	+18
Offices	+14	+5
Other properties	+7	+6

But it must be stressed that the outcome for each category will be made up of a very wide range of results for individual business properties. Some factories are likely to see a reduction of more than 25 per cent; others may see a smaller reduction, or even an increase. Similarly, although shops and offices as a whole are projected to pay more, some individual shops and offices are likely to pay less.

21. Table 5 gives projections of how rate bills might shift between the different regions in England, both in the first year and once the transition to the new system is complete. The North West, the West Midlands, the East Midlands, Yorkshire and Humberside, and the Northern region are projected to see reductions; rate bills are likely to be higher in East Anglia and the South of England.

Table 5: Projected changes in rate bills by region, England

Region	Pre-reform rate bill	Overall reduction (-)/increase (+) in			
		Full Change		First Year	
	£m	£m	%	£m	%
North West	1000	-310	-31	-67	-7
West Midlands	790	-200	-25	-42	-5
East Midlands	600	-130	-21	-28	-5
Yorkshire and Humberside	730	-150	-20	-40	-5
Northern	480	-50	-11	-15	-3
East Anglia	260	+40	+16	+13	+5
South West	550	+130	+24	+42	+8
Inner London	1460	+390	+27	+76	+5
Outer London	730	+50	+6	+11	+2
Rest of the South East	1600	+230	+15	+88	+6

Again, each broad category is likely to mask a wide range of changes in the rate bills on individual properties.

22. For statistical reasons, it is not possible to estimate likely changes in the rates bills of individual business properties or types of property in particular regions by marrying together the estimates in tables 4 and 5.

chex.rm/aa1/17

SECRET

FROM: A C S ALLAN
DATE: 13 February 1989

MR HUDSON

cc PS/Chief Secretary
PS/Paymaster General
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Scholar
Mr Culpin
Mr A J C Edwards
Mr Potter
Mr Gieve
Mr Fellgett
Mr Rutnam
Mrs Chaplin

PS/IR
Mr Morgan - IR
Mr Heggs - IR

NON-DOMESTIC RATES: ANNOUNCEMENT OF TRANSITION

The Chancellor was grateful for your minute of 10 February. He was content with Mr Ridley's draft statement, subject to the additional amendments you and Mr Fellgett proposed.

2. He was also content with the summary of the Inland Revenue survey, and in particular with the expansion of table 5 to show the changes by region in cash as well as percentage terms.

ACSA

A C S ALLAN

COPY 12 OF 16.

SECRET

CH/EXCHEQUER
REC. 13 FEB 1989
ACTION CST
COPIES TO

AA/ I agree with your views. Since business consultees CST.

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:
Your ref:

The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

13 February 1989

Ch
I can see point, but this sounds v dangerous to me
AA

Dear Chief Secretary

BUSINESS RATES

I am now planning to announce in an oral statement on 15 February the transitional arrangements for the introduction of the Uniform Business Rate (UBR) and the revaluation.

Our present intention is to fix the UBR poundage for 1990/91 at the level necessary to raise broadly the same amount of rates from business in real terms as in 1989/90. Both you and I have said this publicly. I am however concerned about potential local authority rate rises in 1989/90 and in particular the risk that authorities will increase rates in the last year of the old system at the expense of business in order to benefit community charge payers later. Merely repeating without qualification our earlier statements about the post-1990 yield from business rates may indeed encourage authorities to do this.

On the other hand, to simply leave the matter vague in my statement is unsatisfactory, not least because the CBI and others who are concerned about this issue are bound to press for clarification. I therefore propose to say that it is still our intention to base the 1990/91 yield on that in 1989/90, but that if a significant number of local authorities impose unreasonably large rate increases next year, the Government might wish to consider using the 1988/89 yield, uprated for inflation, instead so as not to disadvantage business.

I should be grateful to know urgently whether you would be content for me to say this. I enclose a copy of my proposed statement. Copies of this letter and enclosure go to the Prime Minister, to members of E(LF), and to Sir Robin Butler.

Yours sincerely
R Bright

NICHOLAS RIDLEY
(Approved by the Secretary of State and signed in his absence)

S E C R E T

BUSINESS RATES: TRANSITION

Draft Statement

With Permission, Mr Speaker, I shall make a statement on business rates.

The Local Government Finance Act 1988 provides for a uniform business rate in England and in Wales and for a revaluation of non-domestic property. These changes will take effect on 1 April 1990. The new arrangements will mean the end of wide variations in rate poundages between different areas; and rateable values will be brought up to date to reflect accurately the relative benefits of different types of property in different locations. This will provide a welcome incentive for businesses to expand in the currently less economically buoyant areas. Overall business in the North and Midlands will enjoy rate reductions of about £850m a year once the transition is complete.

My Rt Hon friend the Secretary of State for Wales and I have considered the Inland Revenue's preliminary sample survey of the likely combined effects of the 1990 revaluation and the introduction of the uniform business rate. The results of the survey must be interpreted with caution: they give only a general indication of possible changes in rate bills from 1990. Subject to that important qualification, the survey suggests that rateable values will increase from 1973 levels by around 7½ times on average in England and by around 8 times on average in Wales; but, as expected, there will be wide variations around these averages.

As it is our intention to fix the business rate poundage in 1990/91 so as to raise in real terms broadly the same amount of rates from private business and nationalised industries as in 1989/90, the increase in rateable values will be matched by a corresponding reduction in the rate poundage of between one seventh and one eighth. On this basis the poundage would be in the range 30-35 pence if the business rate were introduced today. However if a significant number of local authorities impose unreasonably large rate increases next year, we may wish to consider using the 1988/89 yield, uprated for inflation, instead of that for 1989/90 so as not to disadvantage business.

The survey suggests that the broad effects of the uniform business rate and the revaluation taken together will be that businesses in the North and Midlands will tend to pay less and businesses in southern England will generally face increases. As a general rule, factories and warehouses will tend to pay less, while shops and offices will pay more. In Wales businesses in the Valleys will tend to gain, but the shift in burden between the Valleys and the rest of Wales will not be very large.

To give businesses time to adjust to their new rate bills, we are proposing transitional arrangements to introduce the changes gradually. These arrangements will be self-financing. There will be limits on the percentage by which the rate bill for any property may change from one year to the next, for the first five years of the new system at least. For properties in England and Wales facing increases the limit will be 20% generally, but to help smaller businesses there will be a lower limit of 15% for small properties, those with new rateable values below £7,500 in London and £5,000 elsewhere.

For properties in England due to benefit from rate reductions , I shall decide finally on the percentages by which changes will be phased when I have fuller information in the summer; but present projections imply that limits on annual reductions of 15% for

small properties and 10% for large would offset the cost of the protection for losers. Mr Rt Hon friend will similarly base his final decision on phasing of reductions for Welsh ratepayers on later information; but present projections indicate slightly higher limits would be sufficient in Wales to offset the cost of protection for losers.

Compared to present rate bills, the percentage increase for losers is greater than the percentage reduction for the gainers because the losers as a group have substantially lower rate bills at present. All these limits are net of the annual change in the rate poundage resulting from the link to the Retail Price Index; and they are compound, in that after the first year the maximum percentage increase or decrease would be calculated from the rate bill in the preceding year.

We wish to give the highest possible priority to preparing fully and promptly for the new business rating system and have therefore concluded that it would be right to reduce the incentive for business ratepayers to propose changes in the old 1973 rating list, if the sole purpose is to secure a slightly better position under the transitional arrangements. We therefore propose that in 1990/91 the base liability to which the transitional limits will be applied should be calculated using the rateable value in the list today, adjusted only for changes resulting from ratepayer proposals to amend the value received by the Valuation Office by yesterday and those resulting from any existing or future proposals by valuation officers.

Ratepayers would still of course retain the right to propose changes, and if such proposals led to reductions in value would get the benefit until March 1990, although not thereafter. Furthermore, the Valuation Office will remain under a statutory duty to keep the 1973 list up to date; any significant change in the rateable value of a building will therefore be reflected in their own proposals to alter the list, and hence carried forward into the transition. We believe business ratepayers as a whole

will welcome our intention to concentrate on getting the new system right and thus to discourage further attempts to change rateable values which have stood for up to 16 years.

The powers in the 1988 Act to make regulations are inadequate to facilitate transitional arrangements of the kind I have described. We shall therefore propose amendments to the 1988 Act in the Local Government and Housing Bill. In order to give businesses and local authorities as much certainty about the transition as possible, it is our intention after consultation to bring forward amendments setting out the arrangements in the Bill itself rather than in subsequent regulations.

We are today issuing and placing in the Library a consultation paper, which includes the results of the Inland Revenue survey referred to earlier, setting out the details of the transitional arrangements and inviting comments.

dm1.ph/hudson/2.14.2

CONFIDENTIAL
(covering Secret)

Pup.

FROM: A P HUDSON
DATE: 14 FEBRUARY 1989

I agree. On balance I think it would be better to agree a fallback, rather than risk reading something more forthcoming in Hansard of Mr Ridley decides he cannot maintain a firm line.
R.F.
14/2

1. MR FELLGETT
2. CHIEF SECRETARY

cc Chancellor
Sir P Middleton
Mr Anson
Mr Monck
Mr Phillips
Mr Scholar
Mr Culpin
Mr A J C Edwards
Mr Potter
Mr Gieve
Mr Fellgett
Mr Rutnam
Mrs Chaplin
PS/IR

[Spoke to Ch, APH & PS/CST AA 14/2]

NON-DOMESTIC RATES: ANNOUNCEMENT OF TRANSITION

Mr Ridley wrote to you yesterday enclosing a revised draft of his proposed statement announcing the transition to the Uniform Business Rate for tomorrow.

2. The only point of substance is the one raised in his covering letter. He wants to make clear that if a significant number of local authorities were to impose unreasonably large rate increases for the coming year, the Government might consider basing the yield of non-domestic rate in the first year of the new system not on the 1989-90 yield, as previously agreed and announced, but on the 1988-89 yield, uprated for inflation.

3. How much this would cost would obviously depend on the gap between rate increases and the relevant rate of inflation - consistent with the new system, this should be the RPI to September 1988, of 5.9 per cent. Each percentage point between the two would cost some £90 million. So if rates were to increase by, say, 8 per cent, compared with a September 1988 RPI of nearly 6 per cent, Mr Ridley would be looking for a £180 million reduction in the yield of non-domestic rates. Within any given total for Government funding for local authorities, that would mean an equivalent amount of extra grant each year.

4. In practice, if local authorities did impose abnormally large rate increases - say into double figures - the Government would be bound to look at the question of the base yield again. But we would prefer not to say so now. Rate rises generally may not be large - there are County elections, and as happened in Scotland, some Labour authorities may moderate rate increases in the year before the Community charge - Strathclyde even froze its rates. A hint that the Government was minded to use a different starting point would undoubtedly intensify the pressure from the CBI and others - which will be strong in any case - for a lower starting point.

5. Even if Mr Ridley were to give some hint of the possibility of a lower starting point, his proposed form of words is too specific.

- "A significant number of local authorities" are almost bound to impose unreasonably large rate increases. What matters for business as a whole is the average increase imposed by local authorities.

- Specifying an alternative - Mr Ridley suggests the 1988-89 yield - would provide a focus for lobbying.

6. That said, it would arguably not be credible for Mr Ridley to try to maintain that in no circumstances would the Government reconsider its decision - not least because Mr Rifkind took the power to override excessive rate increases in the last year of the old system in Scotland, and exercised it, in the case of Shetland. We see no need - and considerable danger - to say anything about this in the Statement itself. But rather than risk Mr Ridley making some concession under pressure in the House, it would perhaps be better to agree with him a form of words, for use if pressed, that is as non-committal as possible, but is sufficiently forthcoming to carry credibility.

CONFIDENTIAL

7. On a smaller point, the last sentence of the first substantive paragraph of the Statement gives a lot of prominence to a figure from the Inland Revenue survey, before any of the caveats are made. You might suggest to Mr Ridley that the sentence should come later on, so it will look more like a projection and less like a commitment to cut rates in the North.

8. I attach a draft letter.

A P HUDSON

dm1.ph/hudson/3.14.2

SECRET

DRAFT LETTER FROM THE CHIEF SECRETARY

Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
2 Marsham Street
LONDON
SW1P 3EB

14 February 1989

BUSINESS RATES

Thank you for your letter of 13 February.

I quite take the point that, in practice, we would be bound to look again at the starting point for the yield of non-domestic rates in 1990-91, if the overall rate increase in 1989-90 turned out to be abnormally ~~and excessively~~ high, and particularly if local authorities were abusing their powers in the last year of the present system by imposing unreasonable extra burdens on business ratepayers. But I see little advantage, and considerable danger, in volunteering this now.

It is too early to say how rate increases generally are likely to turn out. And I am sceptical that repeating our earlier statements about the yield will actually encourage local authorities to go for higher rate increases. Each authority will realise that the level of its individual rates in 1989-90 will have only a very marginal effect on its receipts from the NNDR. Collectively they will know ~~and~~ that we have the power to set a lower yield if we choose. Other

factors, not least the County elections, will be far more important. Stepping back from our earlier statements would have a much bigger impact on the business organisations, who would immediately treat the lower yield not as a minimum but as a maximum, and focus their lobbying on that. So we would be putting ourselves on the defensive before we know what rate increases will be, and before people have had time to consider our proposals.

I feel suggest, therefore, that your statement should not go beyond the commitment that has already been given, and that the Prime Minister agreed to, in response to your 3 February minute. This would mean simply omitting the last sentence of the third full paragraph. But if you are pressed hard - as I realise you may be - I would with some reluctance accept that you have no objection to your saying might say that, if rate increases overall turned out to be abnormally high - and we do not expect them to be - and there was evidence of local authorities abusing their powers in the last year before the new system, the Government would consider whether these should feed through in full into the yield of business rates under the new system.

On a smaller point, it is obviously very important for us to stress the benefits of this reform to businesses in the North and the Midlands. But I wonder if the figure of £850 million appears too precise at the moment, since it is based on the Inland Revenue sample survey, and thus can only be a broad indication of the effect of the change, rather than an objective. It might be better for that sentence to come

after the caveats on the Survey are explained. I also suggest you replace "will" with "is projected to" and perhaps "about £850 million" with "some £800 million".

I am copying this to the Prime Minister, members of E(LF), and Sir Robin Butler.

[JM]

cst.ps/16jm14.2/lets

SECRET

000138

cc:
Chancellor
Sir Peter Middleton
Mr Anson
Mr Monck
Mr H Phillips
Mr Scholar
Mr Culpin
Mr A J C Edwards
Mr Potter
Mr Gieve
Mr Fellgett
Mr Hudson
Mr Rutnam
Mrs Chaplin

PS/IR

Treasury Chambers, Parliament Street, SW1P

The Rt Hon Nicholas Ridley AMICE MP
Secretary of State for the Environment
Department of the Environment
2 Marsham Street
London
SW1P 3EB

14 February 1989

Dear Secretary of State

BUSINESS RATES

Thank you for your letter of 13 February.

I accept that, in practice, we might need to look again at the starting point for the yield of non-domestic rates in 1990-91, if the overall rate increase in 1989-90 turned out to be abnormally high, compared to real increases in the last few years, and particularly if local authorities were abusing their powers in the last year of the present system by imposing unreasonable extra burdens on business ratepayers. But I see little advantage, and considerable danger, in volunteering this now.

It is too early to say how rate increases generally are likely to turn out. And I am sceptical that repeating our earlier statements about the yield will actually encourage local authorities to go for higher rate increases. Each authority will realise that the level of its individual rates in 1989-90 will have only a very marginal effect on its receipts from the NNDR. Collectively they will know that we have the power to set a lower yield if we choose. Other factors, not least the County elections, will be far more important. Stepping back from our earlier statements would have a much bigger impact on the business organisations, who would immediately treat the lower yield not as a minimum but as a maximum, and focus their lobbying on that. So we would be putting ourselves on the defensive before we know what rate increases will be, and before people have had time to consider our proposals.

I feel therefore, that your statement should not go beyond the commitment that has already been given, and that the Prime Minister agreed to, in response to your 3 February minute. This would mean simply omitting the last sentence of the third full paragraph. But if you are pressed hard - as I realise you may be - I could accept your saying that, if (against expectations) rate increases overall turned out to be abnormally high and there was evidence of local authorities abusing their powers in the last year before the new system, the Government would consider whether these should feed through in full into the new system.

On a smaller point, it is obviously very important for us to stress the benefits of this reform to businesses in the North and the Midlands. But I wonder if the figure of £850 million appears too precise at the moment, since it is based on the Inland Revenue sample survey, and thus can only be a broad indication of the effect of the change, rather than an objective. It might be better for that sentence to come after the caveats on the Survey are explained. I also suggest you replace "will" with "is projected to" and perhaps "about £850 million" with some £800 million.".

I am copying this letter to the Prime Minister, members of E(LF), and Sir Robin Butler.

Yours sincerely

Cathy Ann

JOHN MAJOR
(Approved by the Chief Secretary
and signed in his absence)

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB
01-276 3000

My ref:

Your ref:

Carys Evans
Private Secretary to
The Rt Hon John Major MP
Chief Secretary
HM Treasury
Parliament Street
LONDON
SW1P 3AG

CH/EXCHEQUER
REC. 15FEB1989
ACTION CST
COPIES TO

15 February 1989

Dear Carys

BUSINESS RATES

Further to my Secretary of State's letter of 13 February to the Chief Secretary, I now enclose a final version of the statement my Secretary of State plans to make this afternoon on business rates. This takes account of comments from the Chief Secretary and the Secretary of State for Scotland.

Copies go to Paul Gray, to the private secretaries of members of E(LF), to Murdo MacLean and to Trevor Woolley in Sir Robin Butler's office.

Yours ever

R BRIGHT
Private Secretary

STATEMENT ON BUSINESS RATES

With Permission, Mr Speaker, I shall make a statement on business rates.

The Local Government Finance Act 1988 provides for a uniform business rate in England and in Wales and for a revaluation of non-domestic property. These changes will take effect on 1 April 1990. The new arrangements will mean the end of wide variations in rate poundages between different areas; and rateable values will be brought up to date to reflect accurately the relative benefits of different types of property in different locations. This will provide a welcome incentive for businesses to expand in the currently less economically buoyant areas.

My Rt Hon friend the Secretary of State for Wales and I have considered the Inland Revenue's preliminary sample survey of the likely combined effects of the 1990 revaluation and the introduction of the uniform business rate. The results of the survey must be interpreted with caution: they give only a general indication of possible changes in rate bills from 1990. Subject to that important qualification, the survey suggests that rateable values will increase from 1973 levels by around 7½ times on average in England and by around 8 times on average in Wales.

It is our intention to fix the business rate poundage in 1990/91 so as to raise in real terms broadly the same amount of rates from private business and nationalised industries as in 1989/90. So this increase in rateable values by 7 to 8 times does not mean that rate bills will go up by 7 or 8 times. That is because, to secure the same overall yield as in 1989/90, the rate in the pound will fall to between one seventh and one eighth of the present national average poundage. On this basis the poundage would be in the range 30-35 pence if the business rate were

introduced today. This means that the average rate bill payable by businesses will be the same as now in real terms. But there will of course be wide variations in actual bills, depending upon how the rateable value of the particular property changes relative to the average and whether the present local rate poundage is above or below the average.

The survey suggests that the broad effects of the uniform business rate and the revaluation taken together will be that businesses in the North and Midlands will tend to pay less and businesses in southern England will generally face increases. As a general rule, factories and warehouses will tend to pay less, while shops and offices will pay more. Overall business in the North and Midlands is projected to enjoy rate reductions of some £800 million once the transition is complete. In Wales businesses in the Valleys will tend to gain, but the shift in burden between the Valleys and the rest of Wales will not be very large.

To give businesses time to adjust to their new rate bills, we are proposing transitional arrangements to introduce the changes gradually. These arrangements will be self-financing. There will be limits on the percentage by which the rate bill for any property may change from one year to the next, for the first five years of the new system at least. For properties in England and Wales facing increases the limit will be 20% generally, but to help smaller businesses there will be a lower limit of 15% for small properties, those with new rateable values below £7,500 in London and £5,000 elsewhere. Arrangements in Scotland are of course a matter for my Rt Hon Friend, but he proposes comparable protection for business ratepayers facing increases in rates as a result of the revaluation in Scotland in 1990.

For properties in England due to benefit from rate reductions , I shall decide finally on the percentages by which changes will be phased when I have fuller information in the summer; but present projections imply that limits on annual reductions of 15% for small properties and 10% for large would offset the cost of the protection for losers. My Rt Hon friend will similarly base his final decision on phasing of reductions for Welsh ratepayers on later information; but present projections indicate slightly higher limits would be sufficient in Wales to offset the cost of protection for losers.

Compared to present rate bills, the percentage increase for losers is greater than the percentage reduction for the gainers because the losers as a group have substantially lower rate bills at present. All these limits are net of the annual change in the rate poundage resulting from the link to the Retail Price Index; and they are compound, in that after the first year the maximum percentage increase or decrease would be calculated from the rate bill in the preceding year.

We wish to give the highest possible priority to preparing fully and promptly for the new business rating system and have therefore concluded that it would be right to reduce the incentive for business ratepayers to propose changes in the old 1973 rating list, if the sole purpose is to secure a slightly better position under the transitional arrangements. We therefore propose that in 1990/91 the base liability to which the transitional limits will be applied should be calculated using the rateable value in the list today, adjusted only for any changes resulting from ratepayer proposals to amend the value received by the Valuation Office by yesterday. Ratepayer proposals to amend the 1973 list received by the Valuation Office today or in the future, including those posted before today but not received until today, will not be reflected in the transi-

tion. Any changes in rateable values in the 1973 list resulting from existing or future proposals made by the Valuation Office will however be taken into account in the transition.

Ratepayers will still have the right to propose changes to the 1973 list and if such proposals lead to reductions in value will get the benefit until March 1990 but not thereafter. They will also of course have the right to make proposals in relation to the 1990 list.

We believe business ratepayers as a whole will welcome our intention to concentrate on getting the new system right and thus to discourage further attempts to change rateable values which have stood for up to 16 years.

The powers in the 1988 Act to make regulations are inadequate to facilitate transitional arrangements of the kind I have described. We shall therefore propose amendments to the 1988 Act in the Local Government and Housing Bill. In order to give businesses and local authorities as much certainty about the transition as possible, it is our intention after consultation to bring forward amendments setting out the arrangements in the Bill itself rather than in subsequent regulations.

We are today issuing and placing in the Library a consultation paper, which includes the results of the Inland Revenue survey referred to earlier, setting out the details of the transitional arrangements and inviting comments.

CONFIDENTIAL

SIR PETER MIDDLETON

FROM : A J C EDWARDS
20 February 1989

cc Mr Anson
Dame Anne Mueller
Mr Monck
Mr Phillips o/r
Mr Scholar
Mr C D Butler
Mrs Case
Mr Culpin
Miss Peirson
Mr Potter
Mr Fellgett

DEPARTMENTAL RESPONSIBILITY FOR BUSINESS RATES

You confirmed last week that you wished to take the Chancellor's mind on Departmental responsibility for the taxation of business property (business rates) before Mr Phillips' review of Government Valuation Services reaches its critical stage. Business rates yield about £10 billion a year (gross) but are an allowable expense for corporation tax purposes.

Existing responsibilities

2. Responsibility for business rates is at present divided somewhat uneasily between Departments. In England and Wales, Mr Ridley and DOE have the main policy responsibility. Mr Walker is due to assume responsibility in Wales from 1990. However, the Chancellor will from 1991 share with Mr Ridley the responsibility for annual uprating of the business rates poundage. The Chancellor also has the main executive responsibility within the Government (compare the DSS's position on national insurance contributions) in that he has Ministerial responsibility for the Valuation Office, which will from April 1990 assume complete responsibility for the assessment of business rates liabilities apart from the poundage. In Scotland, Mr Rifkind is responsible for policy and local authorities for assessment.

New system of business rates

3. In times past, business and domestic rates have been a local tax paid to local authorities at rates set by the individual authorities themselves. With the replacement of the existing business rates in England and Wales from 1 April 1990 by the new national non-domestic rate (NNDR), however, what has been a local

tax, levied by local authorities, will become a national business property tax, collected by local authorities and earmarked for redistribution to them, but in practice a source of public sector revenue alongside all other sources.

4. In contrast with existing business rates, the poundage (that is, the ratio of tax liability to assessed rateable value) will be common throughout each of England and Wales; and in practice the poundages for England and Wales will be very close or even identical. The tax will be collected by local authorities on behalf of the central Government, which will then distribute it between local authorities just like extra revenue support grant. Any change in the national yield will be offset in the Survey by a change in RSG.

5. From the point of view of businesses, therefore, the NNDR will in effect be a national tax on business properties without regional variations (once transition is complete). From the Government's point of view, too, it will in effect be a national tax.

6. In Scotland, local authorities will notionally retain control of their own rate poundages and keep their own rate incomes. In fact, the distribution of grant and rates will be exactly as in England; and E(LF) has agreed that Scottish poundages should over time be brought down to the English level, effectively creating a GB-wide rate.

Issues for consideration

7. Against this background, there are inter-related longer and shorter term issues which need to be considered.

8. So far as the longer term is concerned, the underlying issue of substance is where policy responsibility for the taxation of business property should best lie under the new system. If it is thought that responsibility would best be transferred from the Environment Secretary to the Chancellor, the further questions arise of how much priority should be attached to achieving such a transfer, whether it is worth fighting for, and if so how and when.

9. So far as the shorter term is concerned, the most immediate issue is how the Treasury should try to steer the Review of Government Valuation Services which Mr Phillips is chairing.

Commissioned by the Chancellor last summer, Mr Phillips' review is due to make recommendations by Easter on how Government valuers should be deployed in future. The critical question is what the review would best say about the deployment of business rates valuers, who account for nearly one-half of the total of Government valuers.

10. The broad possibilities for future deployment of those valuers which the Government needs to employ itself are:

i. make all valuers employees of the Departments for whom they work, while possibly appointing a Chief of Government Valuation Services;

ii. bring all valuers together in a single agency which would provide valuer services on repayment to Departments; and

iii. some mixture of the two models such as

a. broadly the existing deployment (although with efficiency savings, including the absorption of RGPD into a department other than Treasury) or

b. the existing deployment plus efficiency savings but with rating valuers transferred from the Valuation Office to the DOE.

Options i. and iii. b. would both involve transferring some 900 valuers, including a substantial regional network, from the Valuation Office to DOE, with a corresponding transfer of Ministerial responsibility from the Chancellor to Mr Ridley. This transfer would not only raise considerable issues in its own right but would also make a subsequent transfer of policy responsibility for business rates to the Chancellor significantly more difficult and disruptive. It would therefore be extremely helpful to have guidance from the Chancellor on these matters before work on the review enters its critical stage.

Attitudes of other players

11. We do not know what view Mr Ridley takes on either of the issues discussed above. There must clearly be a risk, however, that he would fight hard to retain his present responsibilities.

His officials were unhappy about the decision to give the Chancellor responsibility for the under-indexing of business rates from 1991 onwards, which they recognised was symbolic of the Chancellor's claims to a leading role. He, and more so his Department, are also not yet prepared to acknowledge that business rates are no longer in the nature of a local tax. We believe that some DOE officials, at least, would wish to resist transfer of policy responsibility to the Inland Revenue (or another Chancellor's Department) and would like, on the contrary, to bring rating valuers from the Inland Revenue into DOE. We believe that the Valuation Office, on the other hand, would resist such a transfer.

Policy in longer term

12. The Chancellor's Departments would appear, in principle at least, to have three considerable interests in inheriting policy responsibility for business rates from DOE, Welsh Office and the Scottish Office.

13. First, there is no question that under the new system the Chancellor will have the main policy interest. If we were setting up a business property tax from scratch, there is I think no question that responsibility for the tax would be placed with the Minister responsible for taxation and not the Minister responsible for local government. As implied above, the fact that the proceeds will be distributed to local authorities is no more than a fig-leaf of presentation. These considerations received some recognition in last year's Act, which makes the Chancellor responsibile for proposing if he sees fit that business rates be uprated each year by less than the growth of the RPI.

14. Local authorities will admittedly continue, for the time being at least, to collect business rates. But their functions will be routine. The key task is assessment of the tax, for which the VO will become almost completely responsible in England and Wales. There is moreover no reason why local authorities should necessarily continue to collect this property tax for the rest of time.

15. The second consideration relates to the decision-making process. With the present allocation of responsibilities, the Chancellor has nothing like the wide discretion which he has with other major taxes to decide what the policy should be. In the last

few months, for example, we have had arguments with DOE and other Departments about the starting level for the new business rates. Although we appear to have won this battle, other Departments predictably enough all clamoured for concessions to business. We have also had to go through protracted discussions on proposals and appeals, decapitalisation rates and other matters. There are good reasons why the Government has special procedures for reaching decisions on tax matters.

16. It is arguable that the Chancellor's responsibilities for the annual uprating of business rates in relation to the RPI will give him the key policy lever. This is probably, however, an oversimplification. We are likely to face repeated calls over the next few years to relax the principle of self-financing transitional arrangements so as to enable special treatment of hard cases without making other business ratepayers suffer. Other concessions to special interests will be pressed. DOE Ministers will be able to announce any concessions, while the Exchequer foots the bill. They may therefore lobby strongly over the next few years for such changes. There are also considerable issues about the place of business rates in company taxation generally - business rates are, as noted earlier, a deductible expense for corporation tax - and indeed about the cost-effectiveness of the tax.

17. The third consideration relates to management. The existing division of responsibilities, with Mr Ridley leading on policy and the Chancellor being responsible for assessment, is less than satisfactory from a management point of view. There would be much to be said for bringing policy and assessment together within a single organisation, comprising some 900 valuers and 25 administrators, responsible to one Minister. For reasons discussed above, it seems clear that the one Minister should be the Chancellor. In that case, the organisation could in principle be part of either the Inland Revenue or Customs.

18. The above arguments add up to a powerful case in principle for transferring full policy responsibility for business rates from DOE to the Chancellor. Such a transfer would most naturally take place either on 1 April 1990, when the new system takes effect, or in the context of a future change of stewardship at the DOE.

19. It is, however, clearly a separate question whether it would be useful, or desirable, actively to seek such a transfer at this stage. There are certain contrary considerations which need to be weighed in the balance. As noted above, Mr Ridley might strongly resist a transfer. In addition, Treasury Ministers may see business rating as something of a poisoned chalice, especially in the short term. Many business ratepayers are likely to feel aggrieved and angry over the next few years of transition, and there could be a considerable balance of pain over pleasure in taking on this function now. The workload on Treasury Ministers might also increase in some degree (though the amount of wearisome argument with DOE Ministers would be much reduced). There could also be dangers of exacerbating the Inland Revenue's overload problem if business rating were placed there. This might not, however, be a serious problem. The Inland Revenue's Valuation Office already do the lion's share of the work on business rates and the Inland Revenue could doubtless inherit the four DOE officials (grades 5-7) who currently work on this policy and probably their Scottish counterparts as well.

Possible transfer of valuers

20. The more immediate issue, as explained above, is what line the Treasury should take in the interdepartmental Review of Government Valuation Services. We may (or may not) come under pressure from DOE to recommend there that Departments should generally employ their own valuers or at least that DOE, as being the department with policy responsibility, should inherit from the Valuation Office the valuers who work on rating.

21. The arguments in favour of such a transfer are that there must be considerable merit on management grounds in

i. bringing policy and executive responsibilities together in one place with accountability to a single Minister able to direct the organisation towards his priorities, and

ii. helping valuers to identify themselves with the Department's policies and objectives by becoming employees of the Department.

22. The contrary arguments are:

i. the scope for an umbrella organisation like the Valuation Office to deploy valuers flexibly and efficiently across the field of changing Government requirements (though the Valuation Office would better charge Departments who use their services);

ii. the benefits from transfer of information from rating to other valuers dealing with capital taxes within a single organisation;

iii. the benefits to the valuers themselves in moving between different kinds of valuation work;

iv. the quasi-judicial role which the valuer has frequently to perform, not only on tax and rating assessments but also (prospectively) in relation to possible future capital charging; and

v. the disturbance involved in redeploying valuers at this critical stage in relation to the 1990 revaluation and introduction of the NNDR, which would be further compounded if policy responsibility were subsequently transferred in the opposite direction.

23. Treasury Ministers may feel that the best way ahead will be for the interdepartmental review report to keep Treasury Ministers' options open, and thus avoid prejudicing the longer term issue of policy responsibility, by avoiding any recommendation which could imply a transfer of the rating valuers from the Valuation Office to DOE. The report could limit itself to presenting the general pros and cons of the various models of valuer deployment, along the lines sketched above, without reaching hard and fast conclusions. It could also underline the disadvantages in undertaking major redeployments at such a critical time in relation to the NNDR. If it leans towards any reductions in the VO's role, these might better be confined to housing and other services to LAs (which could more easily be transferred to DOE or to the LAs themselves). On a more positive note, the report will be able to recommend the introduction of charging for valuer services, absorption of RGPD and rationalising the valuation of Government property.

Provisional conclusions

24. The principal conclusions which we would be inclined to draw as officials are:

i. there would seem a strong case in principle for transferring full policy responsibility for business rates to the Chancellor and his Departments;

ii. that is not to say that there is any urgent need to bid for such a transfer at this stage, especially as such a bid could leave bruises and the extra duties could be less than totally agreeable;

iii. it would however seem desirable to keep the options as open as possible by avoiding a recommendation in the Review of Government Valuers Report which implied a transfer of rating valuers from the Valuation Office to DOE.

These are, however, matters on which Ministers may well have firm views, and we would much appreciate any guidance which the Chancellor can give us.

Trish Hall

pp **A J C EDWARDS**

CONFIDENTIAL

MR SARGENT

FROM : A J C EDWARDS
20 February 1989

cc Mr Anson
Dame Anne Mueller
Mr Monck
Mr Phillips o/r
Mr Scholar
Mr C D Butler
Mrs Case
Mr Culpin
Miss Peirson
Mr Potter
Mr Fellgett

DEPARTMENTAL RESPONSIBILITY FOR BUSINESS RATES

As promised at Sir Peter Middleton's meeting last week, I have revised my earlier minute to Mr Phillips into a form more suitable for Ministers. The revised version attached reflects not only some of the points made in Sir Peter's discussion but also the results of some further researches and a somewhat expanded treatment of the immediate issue of the line to take in the Valuation Services Review Report.

Tusk Hall

pp A J C EDWARDS

(dictated by Mr Edwards and signed in his absence)

pso.jt/Middleton/1.21.2

CONFIDENTIAL

From: SIR PETER MIDDLETON

Date: 21 February 1989

CHANCELLOR

cc Chief Secretary*
Financial Secretary*
Economic Secretary*
Mr Anson
Dame A Mueller
Mr Monck
Mr Phillips
Mr Scholar
Mr C D Butler
Mrs Case
Mr Culpin
Mr A Edwards
Miss Peirson
Mr Potter
Mr Fellgett

*with attachments

Ch

I can see very little gain at all from taking over business rates, given that you have established the central point of control over poundages. Definitely a reserved choice.

DEPARTMENTAL RESPONSIBILITY FOR BUSINESS RATES

... You will wish to see these papers, which are self-explanatory. It is very much a matter for Ministers whether we make a bid for policy responsibility: there are good arguments either way which you may wish to discuss with us. In logic, responsibility should come to the Treasury, but on the other hand it is a dreadful can of worms.

2. I would not be keen to make any moves until the question of the CSO is settled; but that need not take long.

P E MIDDLETON

chex.ps/aa/20 **CONFIDENTIAL**

FROM: A C S ALLAN
DATE: 2 March 1989

SIR P MIDDLETON

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
Mr Anson
Dame A Mueller
Mr Monck
Mr Phillips
Mr Scholar
Mr C D Butler
Mrs Case
Mr Culpin
Mr A J C Edwards
Miss Peirson
Mr Potter
Mr Fellgett

DEPARTMENTAL RESPONSIBILITY FOR BUSINESS RATES

You and the Chancellor discussed your minute of 21 February and Mr Edwards' minute of 20 February.

2. The Chancellor said he accepted the case that, in logic, responsibility for business rates should come to the Treasury. But the disadvantages to this, particularly at a time when the impact of the revaluation and the transition to the uniform business rate would be raising major and complex issues. He felt that the main battle had been won in securing the right to set the poundage (though that was, of course, subject to severe restrictions). He accepted that there were potential dangers in leaving DoE responsible for the coverage, but felt that this was probably something we could continue to live with.

3. If this line was followed, the Chancellor said he would have no objection in principle to rating work being moved from the Inland Revenue Valuation Office to DoE, if that made clear management sense. But he thought the best approach would be for Mr Phillips' review to keep the options open on this.

ACSA

A C S ALLAN

CONFIDENTIAL

CHIEF SECRETARY

FROM: B H POTTER

Date: 14 March 1989

Ch/ Ending formula rating seems sensible on economic grounds. If timed correctly it could generate additional NNDR revenue – but at the possible cost of reducing privatisation proceeds (but some loss is probably inevitable given that the formulae have – whatever happens – to be reviewed in 1990). There is also the problem of whether this would impose too great a burden on the VO.

Any comments at this stage or shall we wait to hear officials' deliberations (para 12 below)?

cc: Chancellor
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr Moore
Mr Edwards
Mr Fellgett
Mr Bent
Mr Hoare
Mr Hudson
Mr Rutnam
Mrs Chaplin
Mr Call

FORMULA RATING

The attached submission from Mr Rutnam seeks guidance on an important aspect of rating policy - formula rating.

2. At present some ten large utilities pay total rates bills set by various formulae rather than on the individual rateable values of their properties. Roughly £1 billion in rates is paid through formula rating. The formulae (of various types and origin) are being reviewed as part of the 1990 revaluation. Ministers will shortly need to decide on the policy approach, in the light of official work to date.

3. In LG's view formula rating is inherently unsatisfactory. All the technical approaches are flawed: and the formulae have in practice been negotiated between the industry, the sponsoring department within Whitehall and the DOE. We favour returning all the industries to conventional rating. This might increase their real rate burden (over a phasing-in period) by as much as 20-50%.

4. The principal advantage would be parity of tax treatment: all industries, private and public sector would then face a level playing field on this national indirect tax. There could also be a secondary gain - an increase in NNDR income and thus the contribution to the cost of Exchequer support for local government met from the business ratepayer vis-a-vis taxpayers in general.

5. The other interested divisions in the Treasury (PE and FP), support the principle of a move to conventional rating for the formula-rated industries. So do the Valuation Office (VO) and (we think) DOE. And the sponsoring departments, though worried about the consequent increase in the rates burden for their industries, will find it difficult to object to the principle.

6. But there are difficult practical considerations on both timing and transition.

7. On timing, a move to conventional rating cannot now be undertaken as part of the 1990 revaluation - VO lack the manpower resources. Even if it were practical, it would not add to NNDR pool income under the arrangements already announced for the 1990 introduction of the NNDR: the higher relative burden on the industries concerned would be matched by lower rate burdens elsewhere.

8. LG favour moving the industries to conventional rating in the early 1990s, ie after the 1990 but before the 1995 revaluation, because:

- it is the earliest practical date for "harmonizing" rate burdens across industry;

- additional rate revenue would be generated which could be taken as extra NNDR yield feeding into the NNDR pool; within any given AEF envelope, this would reduce the amount of RSG and the contribution from the general taxpayer;

- it would mean that the (as yet unquantified) VO resources required to undertake the exercise would not be needed until then: (if the transitional proposals described below were adopted, it would also be possible to free some resources over the next year or so to help the VO); however the VO is still likely to be hard pressed in the early 1990s even to handle a phased programme of switching from formula to conventional rating.

9. The transition also needs to be considered. If a decision in principle to shift to conventional rating in 1990s were taken, there are two options on the current review of the formulae.

(i) Abandon any attempt to revise the formulae: instead the existing formulae would be uprated in line with the general revaluation factor (ie the rough 7½ times increase in average rateable values). One implication would be a marginally higher NNDR poundage for the private sector than DOE have hitherto been expecting.

(ii) Revise the formulae in the light of available information. This might make it more difficult to defend a subsequent move to conventional rating early in the 1990s. Also to the extent that there was an increase in relative rateable values through application of the revised formula in 1990, a later change to conventional rating would add less to the NNDR pool in the mid 1990s.

10. The submission argues in favour of the former transitional approach. It is possible that DOE will favour the latter, however, not least so as to keep the NNDR poundage down in 1990. And DOE officials have been in negotiation with the industries for over a year on the formulae.

ie. LG have missed the boat.

11. Decisions on formula rating may also have implications for privatisations, including that of water and electricity. In principle, price regulations should allow any extra rates costs to be passed on to customers. A decision to move to conventional rating may therefore generate some extra uncertainty about the final size of the industries' liability. In practice, if political constraints set a cap on future price rises, a big or uncertain increase in these liabilities could have an adverse effect on privisation proceeds. It is not possible at this stage to say how big such an effect on privatisation proceeds might be. This problem could be reduced of course by arrangements for phasing in the rise in each industry's rates liability.

12. I suggest you might like to hold a meeting with us, PE and FP divisions as the next step. The main issues to be considered would be as follows:

(i) should the Treasury aim for a firm policy commitment to moving towards conventional rating in the mid 1990s; if so should it be announced;

(ii) what should be the timing of any move to conventional rating: is it best to aim for between the 1990 revaluation and that of 1995;

(iii) what should be done about the formula rating review now: should it be aborted;

(iv) how should this issue be handled: should we approach DOE officials with these proposals; or do you wish to speak or write to Mr Ridley?

Barry H. Potter

BARRY H POTTER

35/1 lg1/tb.4.15.2

CONFIDENTIAL

FROM: P M RUTNAM
DATE: 14 MARCH 1989

1. MR POTTER BTP 14/3
2. CHIEF SECRETARY

cc Chancellor
Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr Moore
Mr Edwards
Mr Fellgett
Mr Bent
Mr Hoare
Mr Hudson
Mrs Chaplin
Mr Tyrie
Mr Call

REFORM OF BUSINESS RATES: FORMULA RATING REVIEW

This submission seeks your views on an esoteric but important aspect of the reform of business rates. This is the review of rating 'by formula' applied to a number of large industries, including most utilities. Specifically we seek guidance on:

- the long-term future of formula rating;

- how rateable values should be set for these industries in 1990 in the review currently under way.

A potential addition of up to £200-£500 million to the total yield of non-domestic rates may be at stake.

Background

2. 'Formula rating' is the term used to describe a variety of special arrangements that currently exist for rating about ten large industries, including most utilities (list at Annex A).

3. In theory, an industry's rateable value (RV) should reflect the annual rent that its property could command on the open market. In practice, rental information is often lacking particularly for large capital intensive industries with specialised assets, such as utilities.

4. Formula rating was introduced (in the 1950s) partly to counter this difficulty. It was also intended to reduce the difficulty of valuing by local authority complex networks which cover the whole country, such as the railways, and gas and water mains.

5. Industries rated by formula have their RVs determined directly by specific secondary legislation. In each case, the 'formula' in the legislation includes an initial determination of the industry's aggregate RV, a means of adjusting it annually and a method for apportionment between rating authorities. About 10% of the non-domestic rateable base is currently assessed in this way (yielding almost £1000 million pa).

6. No assessment is made of the individual properties of an industry under formula rating. Whatever calculations there are, are done at an aggregate level. At best they are, therefore, very broad-brush. The Valuation Office (VO) may advise the Government on the appropriate level of each industry's RV, but the tax assessment is made - and has to be justified before the House - by Ministers.

Problems of formula rating

7. In LG's view, formula rating has never worked, and can never work satisfactorily because:

(i) There is no mechanism for setting an aggregate RV that can be as robust as the conventional valuation of individual properties.

(ii) The fact that Ministers themselves are directly responsible for determining formula RVs introduces an undesirable element of negotiation into tax assessment. As well as presenting the Government with an extra and unwelcome set of political problems, this form of assessment provides obvious scope for lobbying and consequent distortion of the tax base. We are not aware of any similar instance where Ministers are directly involved in determining a body's tax liability.

8. In theory, with a good deal of time and effort, it should be possible to arrive at a formula assessment that is broadly comparable to a conventional valuation. We could, for example, use CCA asset values to calculate notional rental values for the industries' assets. These could then be used as a substitute for market rental information (which is generally used to determine rateable values in conventional rating but is not available for these industries). But there would be numerous severe practical and technical problems with this approach. We do not believe these can satisfactorily be overcome - neither in 1990, for the revaluation currently under way, nor more generally. As a consequence, we are convinced that it will never be possible to have a formula assessment that is exactly on a par with a conventional valuation - if only because of the numerous difficult judgements involved in any valuation of a complicated asset. (Annex B discusses the issues here in more detail).

9. For the same reason, we think that, under any formula rating regime, Ministers will generally be inclined to set RVs that are lower than would be set under conventional rating. The industries concerned will be too lightly assessed as a consequence.

10. These problems would disappear if these industries were rated conventionally. Ministers would be saved the awkward and unnecessary task of determining these bodies' tax liability. And the Exchequer would receiver exactly that revenue to which it was entitled - no more, no less.

Options for change

11. In our view, it would almost certainly be possible to put the rating of these industries on to a conventional, or almost conventional, basis. The rationale for assessing them by formulae as now does not stand up. There are techniques of conventional assessment for valuing assets when rental information is lacking (See Annex B). And the problem of apportioning the RV of a network to individual rating authorities (a major reason for the existence of formula rating in the first place) will disappear with the introduction of a Uniform Business Rate.

12. There would be technical problems in extending conventional rating, given the special nature of some of these industries. It might be necessary to make some statutory provisions to 'underpin' a conventional assessment (eg by prescribing some of the principles on which the valuation should be conducted). But, even if this is necessary, it should still be possible to devise a system that will avoid the main disadvantages of formula rating, by:

- making valuers, not Ministers, responsible for the assessment;

- calculating the industries' liabilities on the basis of a (more or less) conventional assessment of their assets, not as a number 'plucked from the air' as now.

13. One important caveat should, however, be entered here: the extension of conventional assessment to the formula industries would add significantly to VO's workload. No information is available on the precise resource implications: to a large extent, these will depend on the exact form of assessment used (special statutory provisions such as those mentioned above might reduce the resources required significantly). But, on current plans, the VO will already be suffering from a shortage of valuers in the early 1990s - without taking into account any additional work generated by the formula industries. This implies that resources would have to be diverted from other tasks to bring the formula industries into a more conventional system of rating.

14. Another factor is, however, relevant here: there could be considerable advantage to the Treasury if these industries were moved out of formula rating over a certain timescale. This is discussed in detail below (para 17 ff). You may feel that this points to attaching a higher priority to moving these industries out of formula rating than to other tasks undertaken by the VO.

15. The VO will be considering over the next few months the resource and other implications of moving these industries out of formula rating. These factors will clearly need to be borne in

mind in deciding what system should replace formula rating. They do not however, affect our strongly held view that:

- formula rating is a lost cause and should be abandoned as soon as possible;

- moving these industries back into conventional assessment, or a system closer to this, should be a major objective of the current reform of business rates.

16. If you share our views, the important question is not whether formula rating should be replaced but:

- when this change - whatever precise form it takes - should be made, and;

- what should be done about these industries' RVs in the interim.

Treasury interests

17. A shift in the form of assessment applied to these industries from formula to a more conventional system of rating is likely to produce a sizeable increase in their liability from current levels. The increase may be as much as £200-£500 million.

18. The question is: can we secure any or all of this increase as an increase in the aggregate yield of the NNDR? If we can, then within any fixed envelope of finance for LAs, there will be that much less grant, which has to be financed from central taxation. The burden on central taxation would be reduced by £200-500 million a year, indefinitely.

19. As you know, the Government is committed to a fixed yield from business rates in 1990. The yield is to be fixed so that, in real terms, it is the same as in 1989-90, after allowing for any buoyancy in the tax base. You have agreed with Mr Ridley that this commitment is to be interpreted as meaning a fixed yield from private sector non-domestic rates (including nationalised industries), to prevent unwelcome shifts in the tax burden between rates and other forms of taxation.

20. You decided recently not to pursue with Mr Ridley the possibility of excluding from the commitment any increase in 1990 in the amount paid by formula rated industries. However, the question of how to deal with any increases in these industries' liability after 1990 remains open. Hence the importance of the timing of any change to a different system of rating.

Timing

21. A move to a more conventional system of rating in 1990 would not be feasible, given the continuing shortage of VO resources.

22. There are two options for the timing of a move to conventional rating that probably are feasible:

(a) 1995, in the next revaluation;

(b) between 1990 and 1995.

23. If these industries move into a more conventional system of rating only in 1995, it would not be possible to make sure that total NNDR revenue increased as a result. Assuming that present policies continue, there will be a commitment to a constant (real terms) yield from the tax in 1995 as well as in 1990. It would be difficult for the Treasury to argue that the formula rated industries should be treated as an exception then when we have not done so now.

24. It would be much easier to run this line if the move to conventional rating, or a system closer to this, took place gradually between 1990 and 1995. Though the gain to us, in terms of higher NNDR and hence lower grant, would still be large over five years, in any one year it might be no more than £50-100 million. Sums of this kind could easily be swept up in the increase of the tax base through buoyancy, or even in rounding. It would be difficult for DoE to argue seriously that the poundage should be increased by less than RPI simply to

reflect this small amount of extra income. (The power to uprate the poundage by less than RPI rests, of course, with the Chancellor).

25. There are other reasons for favouring a timing between 1990 and 1995:

- the extra yield would come sooner

- the distortions in the tax base would disappear sooner,

26. We are clear that the balance of advantage, on revenue grounds, points to a change between 1990 and 1995, rather than 1995.

Interim arrangements

27. The next question is: what RVs should we set for the industries in the interim, in 1990? Again, there are basically two options:

(i) pursue further the various approaches raised by DoE and the formula rated industries themselves in the review of formula rating currently under way, in particular the asset values method discussed in Annex B;

(ii) set new RVs on the basis of only the average increase in RV for businesses generally between the 1973 and 1990 valuation, acknowledging that this is simply an interim measure pending the move to conventional valuation.

28. In our view, option (ii) would be more consistent with the aim of moving away from formula rating altogether, and returning these industries to a more conventional system of assessment. No assessment under the current formulae even if based on asset values, could be as robust as a more conventional valuation. It would be odd to give formula rating a new lease of life in 1990 by setting new RVs, on the basis of an asset values or other method, at the same time as we planned to abandon formula rating for a

more conventional system of assessment. We would feel obliged to defend the new formula RVs as in some sense a fair and impartial tax assessment even though:

- we knew that the method differed materially from conventional rating;

- we thought that formula rating was so flawed that it should be abandoned as soon as possible.

29. If, on the other hand, we set new formula RVs in 1990 simply on the basis of the average increase in non-domestic RVs, we could make it clear that:

- the Government viewed formula rating as an unsatisfactory form of assessment;

- we proposed to extend a more conventional system of rating to these industries as soon as possible, to ensure that liability for rates was fairly distributed (for the first time) between all sectors of business;

- this was therefore an interim measure.

30. There are other arguments for setting formula RVs in 1990 in this way:

(i) VO resources are currently being used in the formula rating review. These resources would be freed to help implement the 1990 revaluation if we simply set new RVs on the basis of the average increases in rateable values since 1973.

(ii) If formula RVs are set on an asset value or other basis in 1990, they will be significantly higher in real terms than the current RVs. To the extent that the liability is then closer to the liability that would arise under more conventional assessment, there will be less scope for the Treasury to benefit from moving these industries into conventional assessment later. We might even lose most of the £200-£500 million extra yield that would otherwise follow.

31. We feel that the arguments point to setting new RVs on the basis of average uplifts in rateable values since 1973, moving the industries into a more conventional system of rating thereafter. This would secure as extra NNDR revenue the full increase in these industries' liability following the correction of their past under-assessment.

Relevance to privatisation

32. Electricity and Water are formula rated. Rates are a significant proportion of their costs. Major changes in their liability would be material information, in the context of privatisation. The Government will have to disclose its intentions (including an estimate of the change in the industries liabilities) in the relevant prospectuses, when these are published.

33. Changes in the industries rates liabilities will also have a bearing on decisions about price regulation, and thus (albeit indirectly) privatisation proceeds. In principle, price regulation should allow extra rates costs to be passed on to consumers, thus avoiding any effect on profitability/privatisation proceeds. But in practice, if political constraints set a cap on price increases, a big rise in rates liabilities would clearly have some unquantifiable effect on proceeds.

34. This problem would also arise if we set new formula RVs in 1990 on the basis of asset values, or some other approach considered in the formula rating review. (RV's set on one of these bases would almost certainly be substantially higher than current RVs). But a decision to return to a more conventional system of assessment may qenerate some extra uncertainty about the industries' future liability. Given the privatisation timetable, the position on this will need to be settled by early Summer at latest. (Annex C shows possible effects on each industry of increases in rates liabilities. All figures are tentative. You will note that there will also be EFR effects for some NIs, though these will largely be offset by transitional arrangements in the early years.)

35. Conventional rating may disadvantage some independent electricity generators relative to the CEGB successor companies. This may have some effect on competition. But this would only be consistent with our policy of taxing all bodies fairly, and on the same basis.

Mr Ridley's interests

36. Mr Ridley is likely to argue for:

- continuing to work up formula RVs in 1990, probably on the basis of the asset values approach

- considering later the case for a move to a more conventional system of rating, to be effected in 1995.

37. DOE officials are generally sympathetic to the case for a more conventional system of rating. They will however, be hostile to any attempt to cut short the work of the review (which has been under way for 2 years already) - e.g. by setting interim RVs in 1990 on the basis of the average uplift in rateable values since 1973. The whole thrust of the review has been towards the 'improvement' of formula rating through the use of asset values or other proxies for rateable values.

38. Moreover, DoE:

- unlike us, has no interest in maximising the yield of rates over the medium to longer term

- does have an interest in securing a large increase in the formula industries' liability in 1990, given the nature of the commitment that has been given about the total yield of business rates.

An increase of £200-500m in these industries' liability in 1990 would imply a reduction in the poundage applied to the non-domestic sector as a whole of 2-6%.

39. Mr Ridley might accept a commitment to moving the industries into conventional rating between 1990 and 1995. He would, however, resist setting interim RVs on the basis of the average increase in rateable values since 1973.

40. We think that there is a respectable practical and pragmatic case for setting interim formula RVs in 1990 in precisely that way - which would also be highly advantageous to the Treasury.

Conclusion

41. Mr Ridley is currently considering the future handling of the formula rating review. If you agree with the way forward on the review that we have proposed above, you will wish to consider how best we might approach DoE.

42. FP and PE are content with the way forward proposed here. The VO has been consulted on our proposals (though it has not seen this submission), and is content that we should put them to DoE.

P M RUTNAM

INDUSTRIES CURRENTLY ON FORMULA RATING

ANNEX A

Public sector	Private sector
Regional water authorities (not sewage works)	Water companies
British Rail	British Telecom (network only)
London Regional Transport	Mercury (network only)
Electricity	British Gas
British Waterways Board	Ports

ANNEX B

POSSIBLE BASES OF FORMULA ASSESSMENT

Various methods have been put forward in the formula rating review for determining formula RVs on an "equitable" basis. These include assessments based on turnover, profitability and CCA asset values.

Professional advice (from the Valuation Office (VO)) is that methods based on turnover and/or profitability may be workable. They would be analogous to certain techniques of conventional assessment, and the information needed to calculate new RVs (i.e. data on profits, turnover etc.) would be readily available. The discretionary element in the tax assessment would, as a consequence, be confined simply to the choice of an equitable percentage of profits or turnover to be taken as equal to the new RV.

Our view (shared by DoE, which has policy responsibility) is that methods based on turnover or profits have no theoretical basis, and would be arbitrary if applied to derive new formulae RVs. Where profits or turnover methods are used as techniques of conventional assessment, some rental information is usually available for properties of that type. This can be used to derive percentages for use in the assessment of other properties in the same class. No rental information is, however available for most formula rated industries, and the choice of percentage would, as a consequence inevitably be arbitrary.

Only one method of assessment in formula rating comes close to conventional valuation in terms of robustness: the use of CCA asset values to calculate a hypothetical rental value for rateable assets.

In many ways this method resembles an important technique of conventional rating, called the "contractor's test". The contractor's test is a means of assessing properties for which rental evidence is lacking. Capital values of assets are used to calculate imputed rental values, by applying a decapitalisation rate roughly equal to the RRR.

There are, however, some important practical differences between a formula assessment based on CCA asset values and a contractor's test assessment. These mean that the former can never be defended as robustly as the latter. In particular:

- valuers have the concept of 'effective capital value', which involves making different allowances for depreciation under the contractors test from those made under CCA;

- there are numerous problems involved in distinguishing rateable from non-rateable assets within a set of current cost accounts, and in excluding eg values attached to alternative uses (rating is conducted on an existing use basis);

- there is an element of subjectivity and discretion, peculiar to valuers, which it would be impossible to reproduce in a formula assessment.

In our view, these differences mean that no formula assessment could ever be defended as robustly as a conventional assessment.

35/1 lg1/cc.22.2.3

POSSIBLE EFFECTS OF ABANDONING FORMULA RATING ON INDUSTRIES CONCERNED

ANNEX C

£m	Current liability (1)	Range of possible new liability (2)	Increase	Increase as % of operating Costs	Effect on EFRs or prices
Electricity	460	500-630	40-170	0.4-1.5%	To be determined but expect most/all to be passed through to customers ; price rises of 0·3 - 1·4%.
Water Authorities	105	105-200	0-95	0-5%	To be determined but expect most/all to be passed through to customers : price rises of 0 - 3% (see note 1).
British Rail	45	90-135	45-90	1.5-3%	No doubt some scope for absorption but expect to see addition to EFR
London Regional Transport	8	20-40	12-32	2-5%	No doubt some scope for absorption but expect to see addition to EFR
Gas	150	225-275	75-125	1-2%	Passed on to customer
British Telecom	75	100-115	25-40	0·3-0·5%	?
Ports	16	32-48	16-32	-	?
			213-584		

ALL FIGURES INDICATIVE

NOTES:

(1) Figures relate only formula rated elements of industries' rates bills. Some industries (Water Authorities, BT) have sizeable assets rated conventionally. In the case of the Water Authorities these conventionally rated assets may also experience a large rise in liability - perhaps equivalent to a further 1% on prices.

(2) Figures reflect DoE estimates of possible range of liabilities under new formulae based on asset values, not conventional valuations. Conventional valuations may lead to higher liabilities, but no sampling or other exercises have been conducted to check that this is so.

chex.ps/ds/3 CONFIDENTIAL

FROM: D I SPARKES
DATE: 17 March 1989

PS/CHIEF SECRETARY

cc PS/Financial Secretary
Sir P Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr D J L Moore
Mr A J C Edwards
Mr Fellgett
Mr Bent
Mr Potter
Mr Hoare
Mr A Hudson
Mr Rutnam
Mrs Chaplin
Mr Call

~~PPP~~ I think CST has since minuted officials

~~BF 31/3~~

FORMULA RATING

The Chancellor has seen a copy of Mr Potter's minute of 14 March to the Chief Secretary, covering a submission by Mr Rutnam, concerning the ending of formula rating. He agrees that returning the industries concerned to conventional rating is clearly right and that it is a pity that this issue has surfaced so late in the day.

2. The Chancellor does not believe that we should use the opportunity presented by the ending of formula rating to secure a rise in capital NNDR revenue; this would be seen as dishonest. Instead, we should accept a reduction in the poundage applied to the non-domestic sector as a whole.

3. The Chancellor looks forward to seeing the results of officials' further deliberations.

D.I.S.

DUNCAN SPARKES

cst.ps/14ce22.3/mins

CONFIDENTIAL

FROM: MISS C EVANS
DATE: 22 March 1989

MR POTTER

24
NTR
BF NNR/4

[Mr Potter draft fin letter to Ridley]

cc: Chancellor
Financial Secretary
Sir Peter Middleton
Mr Anson
Mr Phillips
Mr Monck
Mr Moore
Mr A Edwards
Mr Fellgett
Mr Bent
Mr Hoare
Mr Hudson
Mr Rutnam
Mrs Chaplin
Mr Call

FORMULA RATING

The Chief Secretary spoke to you about this yesterday. He agrees that we should aim for a firm policy commitment to move towards conventional rating and that we should announce the move. He would like to write to Mr Ridley proposing this.

2. The Chief Secretary has no strong views as to the two options for handling formula rating in the interim (set out in paragraph 9 of your submission of 14 March) and would like to put both options to Mr Ridley. He is not sure whether we should wait until 1995 or make the change sooner, again he would like to put the options to Mr Ridley.

3. The Chief Secretary feels that in presenting this we should take credit for the fact that we do not propose to allow the higher nationalised industry rate bill to increase the NNDR yield, but that it will instead reduce the burden on private businesses.

Mike Pls establish from CST's office how Mr Potter's letter is being progressed. TO.

CE

MISS C EVANS
Private Secretary