

FINAL REGULATORY IMPACT ASSESSMENT

LOCAL GOVERNMENT ACT 2003 - SMALL BUSINESS RATE RELIEF

Purpose and intended effect

(i) The objective

The objective is to alleviate the impact of business rates on small businesses. The intention is to implement the provisions in the Local Government Act 2003 and introduce the small business rate relief scheme on 1 April 2005, at the same time as the new valuation of non-domestic properties comes into effect.

Outline of the scheme.

- (a) It offers rate relief of 50% to eligible hereditaments (units of assessment for rating purposes) under £5,000 rateable value, with the relief decreasing at the rate of 1% per £100 of rateable value up to 0% at £10,000.
- (b) The relief is funded by a supplement of 0.7p per pound of rateable value on the rate bills of all ratepayers not eligible for the relief. This will be incorporated in to the non-domestic rating multiplier used to calculate the bill or added as a supplement in the calculation of the transitional bill.
- (c) There is a buffer zone for eligible hereditaments between £10,000 and £15,000 (£21,500 within London) that meet the eligibility criteria. These ratepayers will not have to contribute to the cost of the scheme.
- (d) The conditions governing eligibility are that:
 - the property must be eligible on 1 April of the chargeable year concerned;
 - the relief is only available to ratepayers with either one property, or one main property and other additional properties, providing those additional properties have rateable values less than £2,200 and the total value all the properties remains under the appropriate threshold.
- (e) Ratepayers must apply to their local billing authority for the relief for each chargeable year.
- (f) Applications must be received within six months of the end of the chargeable year concerned, or within six months of notification of an

alteration to their rateable value made by the Valuation Officer which has allowed the hereditament to be eligible.

(g) The scheme applies in England only.

(ii) The background

The rate relief scheme for small businesses was first proposed in the Green Paper *Modernising Local Government Finance* (September 2000), and confirmed in the White Paper *Strong Local Leadership – Quality Public Services* (December 2001). They reflected the fact that rates are a heavier burden for small businesses than for larger businesses. This is borne out by research - *The Impact of Rates on Businesses* - published by the Department of Environment in 1995. This showed that rates were a significantly heavier burden on businesses with turnovers of less than £100,000, than they were on larger businesses. For these small businesses, rates represent more than 30 per cent of profits. This is over twice as great as for larger businesses generally.

The scheme as set out in the White Paper proposed that rate relief should be available at 50% for properties with a rateable value up to £3,000 with relief declining in percentage terms on a sliding scale until £8,000 at which point there would be no entitlement to relief. It was agreed that the relief would be paid for by other business ratepayers and it was considered that the increase in rate bills as a result should be no more than 2½%. As a result, the relief could only be made available to small hereditaments. In addition, the proposal wanted to exclude large businesses that occupied many small properties with low rateable value. Therefore, the White Paper proposed that ratepayers would only be eligible if they occupied one property in England. The White Paper also indicated that ratepayers would have to apply for the relief before 31 December preceding the chargeable year in order to obtain the relief in the subsequent chargeable financial year.

During the passage through Parliament of the Local Government Bill, concern was expressed that the thresholds were too low, particularly since a revaluation of properties would take effect from 1 April 2005. An undertaking was therefore given to review the thresholds once the effects of the 2005 revaluation were known. This information is now available and the total rateable value for England is estimated to increase by about 18%.

In addition, certain groups suggested a reconsideration of:

- raising the overall threshold;
- introducing a buffer zone to exempt those small businesses near to, but over, the threshold from paying the additional supplement;
- the single property criterion;
- the registration criteria.

ODPM incorporated some of these suggestions and in August 2004 published a consultation paper inviting comments on the proposed Small Business Rate Relief Scheme and on the draft Non-Domestic Rating (Small Business Rate Relief) (England) Order 2004. The closing date for responses was 4 October 2004.

(iii) Risk Assessment

Business rates are a heavier burden for small businesses than for larger businesses. Small business rate relief (SBRR) is intended to reduce that burden. Not introducing a relief scheme for small businesses would mean a continuation of this disproportionate burden.

Options

A number of options were considered in the August 2004 consultation paper.

1. Do nothing.
2. Keep the threshold at £8,000.
3. Increase the threshold to £10,000
4. Increase the threshold beyond £10,000.
5. Introduce a buffer zone to exempt those small businesses near to, but over, the threshold from paying the additional supplement.
6. Review the single property criterion.
7. Review the registration criteria.

These options are not mutually exclusive.

Option 1 - Do nothing

In response to the consultation in 2000 on the idea of a small business rate relief scheme, some business groups commented that there were better ways to help small businesses than through a rate relief scheme. However, there was significant demand from small businesses to introduce some level of rate relief. ODPM considered the impact that doing nothing would have on the rate burden of small businesses. We did not consider other ways in which assistance might be given to small businesses.

Not introducing a small business rate relief scheme would mean that small businesses would continue to spend a disproportionate percent of their profits on business rates. There would therefore be no redistribution of financial burdens within the business sector.

The proposed relief would be funded by a small increase in the bills of larger businesses that do not qualify for small business relief. If the relief were not introduced, these larger businesses would not have any increase to their bill. However, the cost of SBRR to these other ratepayers would be minimal.

Option 2 - £8,000 threshold

The initial White Paper proposal suggested that as many as 900,000 properties would be eligible for the small business rate relief at a cost of about £425m. This would be paid for by a supplement on the multiplier of 1.1p, about a 2.5% increase on the rate bills of all ratepayers.

More detailed modelling based on research conducted into eligibility and using the latest 2005 valuation data from the Valuation Office Agency showed that take-up was more likely to be about 360,000 ratepayers. The cost would be about £170m and the supplement would be about 0.4p, an increase of about 1% on all rate bills.

There was clearly margin for extending the thresholds in line with the increases in rateable value as a result of revaluation.

Option 3 - £10,000 threshold

Increasing the threshold to £10,000 would extend the eligibility to about 400,000 ratepayers and increases the cost to about £250m. The supplement would rise to 0.6p and rate bills increase by 1.4%. This would still be well within the commitment made to business in the White Paper to limit the maximum bill increase to 2.5%, and the Government was inclined to adopt this threshold.

Option 4 - higher thresholds

A threshold of £15,000 would raise the supplement to 0.81p (an increase in bills of 1.9%) and one of £20,000 would raise the supplement to 1.15p (an increase in bills of 2.8%).

As the research underlying these estimates was based only on properties with a rateable value of under £8,000, and therefore a number of assumptions had to be made about properties with higher rateable values, some caution should be exercised in the interpretation of these figures. The true costs of these thresholds could actually be higher and push the supplement beyond the limit committed to in the White Paper.

Option 5 - Buffer Zone

Many small business groups have pressed for a buffer zone so that those small businesses that are just over the threshold, but still meet the qualifying criteria, would not be obliged to pay the supplement. Setting a buffer zone of £15,000 would result in a fractional increase in the supplement and an overall increase in rate bills of 1.6%. Expanding the buffer zone still further would impose additional costs on other ratepayers. While this could still be within the 2.5% commitment, there was no clear reason why the protection should be extended further.

Option 6 - Single Property Criterion

The purpose of the single property criterion was to ensure that large businesses that occupied many small hereditaments would not qualify for the relief. This relief was intended to be targeted at genuine small businesses. Any ratepayer wanting the relief would have to declare that they only occupied one hereditament on the rating lists in England.

Some groups have argued that the single property criterion would exclude genuine small businesses from claiming the relief if they occupied two small hereditaments. Careful consideration was given to this issue but, on balance, the Government considered that the single property criterion was a practical method of targeting the relief where it was most needed. Extending the relief to businesses occupying more than one hereditament would increase complexity and bureaucracy and increase the scope for fraud.

Option 7 - Registration Criteria

The original proposal for registration was that eligible businesses would have had to register by 31 December of the previous year in order to qualify for the relief in the next chargeable financial year. A key reason for this was to enable the relief to be applied to bills when they were sent to ratepayers at the beginning of the financial year. Allowing businesses to apply for the relief after bills had been issued would have resulted in considerable additional work for billing authorities in recalculating the liability and reissuing the bills.

However, there was some perceived unfairness in instances where rateable values were altered after 31 December in such a way that a ratepayer might become eligible were it not for the registration criteria.

The Government therefore proposed to extend the registration period to six months after the end of the relevant chargeable year for any property that was under the threshold on 1 April of the chargeable year.

Preferred consultation option

The Government favoured a combination of Options 3, 5, 6 and 7. The Government did not support Option 1 which would maintain the current situation where rates represent a higher burden for small businesses than for larger businesses without offering any form of assistance.

In terms of the threshold, Option 3 was seen to have advantages over both Options 2 and 4. Not only would it extend the relief to a larger number of small businesses than Option 2, but the increase in bills for those businesses paying for the relief would be well within the 2.5% limit specified in the White Paper, unlike Option 4. Option 5 offered further protection to small businesses through the introduction of a buffer zone and Option 6 ensured that the focus of the relief was on genuine small businesses. The Government was also concerned that the registration criteria should not be unduly restrictive, and therefore proposed to introduce the measure set out in Option 7.

Benefits of preferred consultation option

It was estimated that over 400,000 businesses would benefit from the small business relief as proposed and the introduction of a buffer zone meant that a further 50,000 businesses would not have to pay the additional supplement. About 250,000 ratepayers were expected to see their rate bills halve. Businesses stood to benefit from the scheme to the tune of around £250 million.

Costs of preferred consultation option

The new relief is designed so that the cost will be met wholly by non-domestic ratepayers rather than taxpayers generally. Overall, the effect is a transfer of costs from small businesses to larger businesses. This will be done by adding a supplement on the multiplier (or rate poundage) for those ratepayers that do not benefit from the small business rate relief. It will therefore be the business community that bears the cost of the policy rather than central or local government.

The proposed thresholds in the consultation paper of £5,000 and £10,000 would result in a revenue shortfall of about £250m. This would be paid for by a supplement of 0.6p in the pound on the rate bills of all other ratepayers (around 1.3 million ratepayers). The supplement represents a bill increase of 1.4%. In addition, the buffer zone between £10,000 and £15,000 would raise the supplement further to about 0.67p (a 1.6% increase on rate bills).

Response to consultation

Over 90 replies were received in response to the August 2004 consultation paper, broadly welcoming the proposed scheme.

However, many respondents disagreed with the single property criterion. They felt that it penalised those genuine small businesses with one or more hereditaments with combined rateable values within the thresholds. Respondents drew attention to small businesses with associated storage units, offices with a car parking space or, in the case of Bed & Breakfast accommodation, a separate advertising sign. These might be separately rated and therefore not only ineligible for relief but would also be liable to pay the supplement.

Many respondents also felt that the thresholds for the Buffer Zone should be aligned with those proposed for the transitional relief scheme which defines small properties as those with a rateable value of less than £15,000 outside London and £21,500 inside London. No such distinction was made in the consultation paper for the small business rate relief scheme.

Also, in terms of the process for applying for small business rate relief, many respondents felt that the application form should not be prescribed but we should prescribe what information was required in an application.

The date for making applications up to 6 months after the end of the financial year for which the business is eligible was accepted by the majority of respondents. However, many felt that the one-month deadline for applications following an alteration to the rateable value was insufficient and should be extended to six months.

Action as a result of the consultation

In the light of these comments, the Government has given further consideration to how the criteria for eligibility might be extended to address these concerns, while at the same time ensuring that the scheme is still targeted at genuine small businesses and does not raise the cost excessively.

In considering the conditions for eligibility the following issues were taken into account:

- the costs of the scheme should not increase significantly;
- there should not be an undue additional burden on those administering the scheme;
- the scheme should be clearly understandable for both applicants and local authorities;
- it should not prompt legal challenges on the grounds of unreasonableness; and
- it should not lead to an increase in appeals to the Valuation Office Agency.

The Government has therefore decided to amend the scheme so that all properties with a rateable value below £2,200 will be excluded from being considered as second properties, provided the total rateable value of all the ratepayer's hereditaments remains within the overall threshold that applies to single properties. The buffer zone is also being extended to include businesses in London with a rateable value up to £21,500. In addition, the time limit is being extended, from one month to six months, for a ratepayer to apply for relief after an alteration to the rateable value. Some further changes are also being made to the draft Regulations proposed in the consultation paper in the interests of clarity and consistency.

Benefits of final recommendation

Economic

It is estimated that the scheme as amended will provide relief to about 520,000 small businesses. The introduction of a buffer zone means that a further 80,000 businesses will not have to pay the additional supplement. About 250,000 ratepayers will see their rate bills halve. Small businesses stand to benefit from the scheme to the tune of around £350 million.

Environmental

None.

Social

The benefit that small businesses receive from such relief will have wider implications for consumers and local communities. The 1999 report of the Urban Task Force, *Towards an Urban Renaissance*, suggested that rate relief was needed for shops in deprived urban areas to encourage regeneration. These shops will receive relief through this scheme (so long as they meet the qualifying tests) without the added complexity of defining deprived areas.

Costs of final recommendation

Economic

Amending the scheme as proposed is not expected to increase costs significantly for the estimated 1.1 million ratepayers that would pay for the scheme, as the relief will still be limited to one property per ratepayer. Also, the additional property or properties below the £2,200 threshold would be subject to the higher multiplier. Allowing for the additional uptake that is likely to be triggered by the amendments proposed, it is estimated that the supplement could rise to around 0.71p and to 0.718p by extending the Buffer Zone in London to £21,500.

Although many small businesses own their own property, it is possible that - for those who don't - the benefit of SBRR will diminish over time due to offsetting increases in rent. As research - *The Relationship Between Rates and Rents* - published by the Department of the Environment in 1995 shows, landlords can increase rents when rates fall. Small business rate relief will therefore be monitored to ensure that it remains beneficial to small businesses over time.

Environmental

None.

Social

None.

Equity and Fairness

The policy is based on the fact that the impact of business rates is greater for smaller than larger businesses. However, any benefit to small business must be balanced against the cost to larger businesses of paying for it. The scheme strives to maintain this balance by protecting small businesses while not imposing an unreasonable burden on larger businesses.

The scheme applies equally to small businesses in urban and rural areas and will be particularly useful for those businesses in rural communities. The only difference is that the Buffer Zone threshold in London is higher than for the rest of the country to reflect the generally higher overall rateable value of businesses in the capital.

There are no health or race equality issues raised by the proposed scheme.

The proposal to allow ratepayers to apply for the relief over a much longer period is in line with approaches to other aspects of the rating system.

Consultation with Small Business: The Small Firms Impact Test

The scheme is designed to protect small firms that occupy small or low-value properties. There has been extensive consultation with small business bodies over the last few years, including the Small Business Service. Many of these bodies have pressed for a more generous scheme and a wider definition of small business to include small firms occupying high-value premises.

As explained above, a more generous scheme would have to be paid for by other ratepayers. The scheme aims to strike the right balance between relieving some of the existing rates burden on small businesses and not imposing unreasonable costs on larger businesses.

The Small Business Service has been consulted on this RIA and is content with the assessment.

Competition Assessment

The competition assessment was introduced jointly by the Office of Fair Trading and the Cabinet Office to ensure that new legislation will not introduce change to the competitive environment which could lead to a negative effect on the working of the markets. We do not believe any market sector will be disproportionately affected by these measures.

While small businesses will receive relief from their rates and large businesses will be paying slightly more, the change to actual rate bills for larger businesses will be minimal. Small firms occupying low-value premises will benefit substantially from this proposal. However, these measures will apply evenly to all small businesses that meet the criteria.

Enforcement and Sanctions

The supplement on the multiplier to fund the scheme has been set by the Secretary of State at 0.7p and will be used by local authorities when calculating rate bills. Local authorities will, as now, be responsible for collecting the rates, and they have well-established powers to enforce payment through the Magistrates' Courts.

Monitoring and Review

When responding to the Green Paper, valuation professionals argued that gains from rate relief would often be short-lived because the majority of business premises are rented, and landlords would take account of any reduction in rates when setting the rent.

However, the property market is more complex than this analysis suggests. Landlords would take into account the ability of their tenants to pay the rent when negotiating an increase. To address this concern, SBRR will be monitored through a long-term evaluation of rate reliefs to ensure that it benefits small businesses and not landlords. A number of years will need to elapse before the impact of the scheme on rent levels is known. The research into the take-up of the SBRR included some benchmarking which will be used in the longer-term evaluation of the effectiveness of the scheme.

Consultation

The Green Paper, *Modernising Local Government Finance* (September 2000), consulted on the idea of a small business rates relief scheme. It was widely welcomed by small business groups, although some business groups were less enthusiastic.

The Green Paper set out various different means of targeting relief at small businesses. This included taking account of turnover, employers' National Insurance contributions, and excluding types of property clearly not occupied by small firms, such as telecommunications masts. It was agreed that this would involve a great deal of effort by the ratepayer and the billing authorities to prove that the criteria had been met. It was also thought that neither turnover nor National Insurance contributions could guarantee an accurate measure of the size of a business.

Nevertheless, both businesses and local authorities agreed that the relief did need to be targeted to make sure it benefited small businesses, not small properties. As a result, it was decided that any business should be able to apply for relief provided they declared to the local authority that they occupied only the one property for which they were claiming relief.

The draft Local Government Bill was the subject of consultation in the summer of 2002. Since enactment of the Local Government Act 2003 in September 2003, small business bodies have continued to express their views on the proposals.

These were incorporated into the proposal that was published in the consultation paper in August 2004. The consultation exercise involved a wide range of interests, including local authorities, rating professionals and organisations representing small businesses. Responses to the consultation paper are summarised above.

Summary and recommendation

The Government's preferred option is to retain the single property criterion, but to exempt all properties with a rateable value below £2,200 from being considered as second properties, provided the aggregate value of all properties occupied remains below the overall small business rate relief threshold. The Government also proposes to extend the Buffer Zone to include businesses in London with a rateable value up to £21,500, and to extend the time limit for applying for relief following revaluation of a hereditament.

This approach addresses concerns raised in response to the August 2004 consultation paper and is expected to cover most situations where there is a second small value property without significantly increasing the costs of the scheme. It strikes a reasonable balance between supporting small businesses while not imposing an unreasonable burden on larger businesses. Compared with the 2001 White Paper proposal, this gives businesses the benefit of increased thresholds that more than compensate for the average effect of revaluation, and add a buffer zone which was not part of the original proposal. It also brings the buffer zone threshold for small businesses in London in line with that which applies under the transitional relief scheme. The arrangements for claiming relief are also relaxed by allowing an element of retrospection and giving ratepayers longer to apply following a revaluation of their property.

The scheme is therefore significantly more generous to small businesses than the previous White Paper proposal. Despite this, the scheme can be achieved while keeping the supplement to around 1.6%, which is well below the 2.5% maximum bill increase promised in the White Paper.

Guidance

Details of the small business rate relief scheme and how it should be administered are being sent to billing authorities by means of a Business Rates Information Letter from ODPM.

Businesses were informed about the introduction of a small business rate relief scheme through a leaflet prepared by the ODPM and distributed by billing authorities with rate bills for 2004/05. A further leaflet is being prepared by ODPM explaining the effects of the revaluation of business rates that is due to take effect from 1 April 2005. This will be finalised in time to send to businesses with their rates bill for 2005/06 and will include information about the small business rate relief scheme and other reliefs that businesses may be entitled to. The Council Tax and Non-Domestic Rating (Demand Notices) (England) (Amendment) Regulations 2004 also require billing authorities to include on the rate bill (the demand notice) information about the small business rate relief scheme.

Separately, the ODPM is updating its existing booklet 'Business Rate - A Guide' which will include information about the small business rate relief scheme. It explains how the business rates system operates and is used primarily to send to businesses and others that raise queries with billing authorities.

Information about the small business rate relief scheme will also be available on the joint ODPM / Valuation Office Agency website mybusinessrates.gov.uk.

Ministerial signature

I have read the Regulatory Impact Assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister

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Date.....

Contact point: Rob John, Office of the Deputy Prime Minister, Local Government Finance Division 4, Zone 5/H2 Eland House, Bressenden Place, London SW1E 5DU; telephone 020 7944 4223; e-mail Rob.John@odpm.gsi.gov.uk.