**Introduction**

The UK has one of the most heavily centralised systems of policy-making, political control and public finance (Martin et al. 2015), In an era of austerity, Government is using fiscal decentralisation/federalism as a mechanism to increase territorial autonomy represented by growth based market reforms (Muldoon-Smith and Greenhalgh, 2015). Despite tax raised from local business rates being significantly higher than in any other OECD country, there has been little focus on the business rates tax since it was reformed in 1990 (Adam and Miller, 2015).

In the Local Growth White Paper: realising every place’s potential (HM Government, 2010), the Coalition Government announced that they would consider strengthening incentives to encourage and support local growth via local retention of business rates, giving greater financial autonomy to local authorities. In the 2014 Autumn Statement (HM Treasury, 2014), George Osborne committed the Government to undertake a fiscally neutral review of the business rates system (due 2017). A year later the Chancellor announced at the Conservative Party Conference that from 2020, Local Authorities in England would retain 100% of their Business Rates as the block grant is abolished (Osborne, 2015).

The BRRS was introduced on 1st April 2013, following an initial Government consultation in July 2012 (DCLG, 2012c), the intention of the scheme being to provide local authorities with an incentive to grow their economy however at the same time it transferred financial liability for backdated appeals to LAs which potentially undermines this. The LGA (2015) suggests that the volume of appeals being submitted against rateable value is so high that the VOA doesn’t have the resources to deliberate and deal with them efficiently; local authorities are paying the price of this delay the longer it takes for appeals to be resolved the more it costs them. A consequence of the scheme being relatively new, is that there has been little research into the impact of appeals liability on local authority business rates revenue under BRRS; a case study of Leeds is used to investigate the impact of appeals liability on one of the largest cities in the UK..

**Background and Literature**

Business rates, or National Non-Domestic Rates (NNDR) is a property tax charged on non-domestic properties, such as shops, offices and industrial premises; whilst the principles of NNDR are the same across the UK, regimes vary in their operation: Scotland and Northern Ireland function under comparable but separate legislation from England and Wales, which themselves operate slightly different systems. The focus of this research will be based on the English system only.

Business rates in England raise approximately £24 billion per annum from around 1.8 million non-domestic properties, calculated according to a property’s rateable value which is set by the Valuation Office Agency (VOA) for each non-domestic property (HM Treasury, 2016). The tax is levied on an assessment by the VOA of the annual rental value which a property (‘hereditament’) could have been let for from year to year (Kolinsky, 2015) at the date of valuation. An antecedent data of valuation (AVD) date is used for revaluation, which is two years prior to the new rating list coming into effect, in order to allow the VOA time to collect rental evidence, prepare valuations and consult with ratepayers. Currently in England, the rateable value of a property, following the 2010 revaluation, is based on a valuation date of 1 April 2008; the antecedent valuation date for the 2017 revaluation is 1 April 2015.

According to the VOA (2016a), rateable value represents the hypothetical annual rental value for a property let on the open market at the AVD, assuming that a tenant is responsible repairing and insuring the property (often referred to as Full Repairing and Insuring (FRI) equivalent. Rateable values are assessed by VOA staff, based on rental market data collected around the AVD, including survey data collected using ‘forms of return’ which asks business tenants about their passing rent and the lease or tenancy agreement. This rental evidence is analysed and adjusted to ensure that all the evidence is considered on the same basis, from which Valuation Officers determine the levels of values for different types of property. Each property is valued as it physically existed at the date the rating list is published, but on the basis of rental values prevailing in the market at the AVD (VOA, 2016a).

Establishing a rental value for retail, office and industrial property is relatively straightforward process, using the comparable method, with retail property being zoned and offices and industrial premises being valued on a ‘main space’ basis (VOA, 2016a). However, valuation can be highly complex for bespoke properties and rateable infrastructure such as steel plants, power stations, transport infrastructure and utilities.

Different non-domestic properties may require a different method of valuation, i.e: specialist properties with little or no rental comparable evidence, such as a Town Hall, may require a method such as the Contractors Method (see VOA 2016b Rating Manual Volume 4 Section 7 and Appendix 1), for which an estimate of what it would cost to build a replacement is calculated and a statutory percentage of this figure is taken as the equivalent rental value, this method is complex and is often viewed as a last resort by valuers (Hunter, 2014). Another alternative is the Receipts and Expenditure Method (see VOA 2016b Rating Manual Volume 4 Section 6) which is a ‘profits method’ basis of valuation where rental value is ascertained by reference to the receipts and expenditure, adjusted as necessary of an undertaking carried on within the premises (VOA, 2016b).

Rates payable (usually by the building occupier) is determined by multiplying the Rateable Value (RV) by the Uniform Business Rate (UBR) before applying reliefs that the ratepayer may be eligible for (HM Treasury, 2016). Uniform Business Rate (UBR) is a pence in the pound multiplier of rateable value payable, set by Central Government each year adjusted in line with the September Retail Price Index (RPI)1, based on the previous year; this calculates the amount of business rates payable by the ratepayer. There are two UBR multipliers in England; if a property has a rateable value of below £18,000 (£25,000 for Greater London) this, is considered a small business and therefore the small business multiplier is used, for anything else the standard UBR multiplier is applied, these multipliers are 48.0p (0.480) and 49.3p (0.493) respectively (DCLG, 2015a 2015b) 2.

Rateable Values are set periodically on a five yearly basis at which point a review by the VOA of each individual non-domestic property in England is undertaken. The purpose of revaluation is to align rateable values with current market rental values. Revaluations do not raise any extra revenue, rather they aim to redistribute the amount businesses pay based on changes in rental markets, with the URB being adjusted to maintain revenue (HM Treasury, 2016).

The first revaluation took place in 1990, after which the five yearly cycles continued until 2010 when the Government took the decision to delay the revaluation 2015 by two years to 2017, it was argued, to provide greater stability for businesses during a period of economic difficulty (HM Treasury, 2016). Adam and Miller (2014) believe that the Government’s rationale to delay the revaluation was to avoid sharp changes in business rates bills for commercial property occupiers, particularly retailers in Greater London and wider south east. Although rental values and, consequently, rateable values have generally fallen since 2008, Minister Brandon Lewis (2012) stated in his press release about the delay, that should a revaluation take place in 2015, firms would be liable to pay a higher proportion of their rateable value due to increases in the multiplier as a consequence of inflation. He suggested analysis showed 800,000 premises would have experienced a real term increase in business rates at a 2015 revaluation in comparison to 300,000 seeing reductions (Lewis, 2012). The decision to delay the revaluation has been widely criticised by sector experts and commercial property occupiers with many suggesting this decision was taken to benefit southern parts of England to the detriment of other parts of the country.

**Business Rate Reform**

The last significant reform Business Rates was introduced 1st April 1990 by the Local Government Finance Act 1988 which effectively abolished the ability of local authorities to set their own business rate by introducing the UBR which is set by Central Government (Kolinsky, 2015). The reform meant that although business rates were collected locally they were pooled nationally and redistributed by central Government via a Formula Grant System. Craske (2014) suggests that when the link between the amount of rates revenue raised locally and the resultant income receivable to that local authority was broken, the incentive for local authorities to invest in growing their economy in order to produce a higher income from business rates revenue was lost. Since 1990, reallocation of business rates has been a needs basis, creating a “begging bowl” mentality among local authorities (DCLG, 2013a). On 1 April 2013, the Government introduced a new system of business rates retention in England, allowing Local Authorities to retain up to 50% of business rates collected in their area. In his Autumn Statement 2015, George Osborne, the Chancellor of the Exchequer, confirmed the Government’s intention to move to 100% business rates retention by 2020 (HM Treasury, 2016). HM Treasury (2016) has confirmed that any business rate retention scheme must be built upon a valuation system that is stable and predictable and has a high compliance rate.

In March 2016, HM Treasury (2016) published a discussion paper ‘Business Rates: delivering more frequent valuations’ which considers that merits and challenges of delivering more frequent revaluations u under the current valuation systems and explores alternative options, such as self-assessment and formula methods, that might facilitate more frequent revaluations The Treasury acknowledge that any proposals that change how frequently properties are revalued will need to consider the risks to local authorities of volatility in rates income but confirm that the intention is that any changes will be fiscally neutral (HM Treasury, 2016).

Empty Property Rates (EPR) are payable at 100% following the mandatory relief periods of three months for commercial or six months for industrial units on any property with a rateable value of more than £2,600 (HM Government 2016a; 2016b). Under the Local Government Finance Act 1988, businesses with charitable status benefit from a minimum of 80% mandatory rates relief, extending up to 100% at the councils discretion (HM Government, 2015). Prior to the introduction of BRRS in April 2013, mandatory relief was funded by central Government in its entirety with the discretionary element split 75% by the local authority and 25% by central Government. Post 2013, LAs are liable to fund 50% of this mandatory relief (CFG, 2015). EPR was introduced in England and Wales to encourage landlords to bring vacant properties back into use; but could not have come in at a worse time (1 April 2008), following on the tail of the Credit Crunch, at the start of the deepest recession in the UK since the Great Depression and based on historically high RVs. Perversely, LAs have now become dependent on medium term vacancy of large chunks of non-domestic property which guarantee them full EPR from landlords after the initial three or six months exemption.

## How BRRS works

The guiding principle of the Business Rates Retention Scheme is to incentivise economic growth by giving local authorities the potential to retain up to 100% of growth in business rates revenue from new assessments added to the rating list making it synonymous with the construction of new commercial property floor space. Under the scheme, business rates revenue, mandatory relief *and* liability for successful appeals is spilt 50/50 between central Government and local government share the rewards of growth and bear the risk of losses. Under the Formula Grant System, any financial risk is pooled and borne nationally by central Government, leaving local authorities unscathed by any reduction in business rates income.

Rates revenue is split into a “central share” and a “local share”. The “central share” although collected locally, is paid to central Government and redistributed to fund the local government sector via a revenue support grant which is used to finance expenditure on local services, following which a baseline funding level was calculated by the DCLG for the purpose of the business rates retention scheme (DCLG, 2012a).



Figure 1: Determination of individual local authority funding baseline (Authors’ own).

The complex calculations associated with the formula grant system are detailed in The Local Government Finance Report 2013-14 (DCLG 2013b), but for the purposes of the research, the baseline funding level is calculated by applying the formula grant process to the local share of the Estimated Business Rates Aggregation, leaving LAs with more or less what they would have received under the formula grant system (DCLG, 2012a)3.

### *Control Measures*

Some local authorities collect a significantly higher level of business rates than others and so in order to ensure balance, those who have more business rates than their baseline funding level must pay a tariff to central government equal to the difference between the individual local authority baseline and the baseline funding level. Equally, to ensure a local authority doesn’t receive a disproportionate decrease in their business rates revenue, if the individual local authority baseline is lower than the baseline funding level, that local authority will receive a top-up from central government equal to the difference between the two; tariff payments are used to fund top-up payments (DCLG, 2012a). Top ups and tariffs are built into the business rates retention scheme as part of the redistribution system, they are set for a fixed period of time; currently this is until the system resets in 2020 (CIPFA, 2013), after which they will be recalculated in line with the new baseline funding level. In addition to this, top-ups and tariffs will be made following the revaluation in 2017 in order to ensure business rates income doesn’t change as a result of this (Burkhalter, 2013). The allocation of top-up and tariff local authorities is illustrated in Figure 2.



Figure 2: Identification of top-up and tariff authorities (Authors’ own)

The scheme also contains a built in means of protection for local authority income via safety net, levy and transitional protection payments (CPIFA, 2013). The safety net guarantees that local authorities will be protected against significant reductions in their income as a result of the business rates retention scheme by ensuring no authority will see its business rates revenue fall below 7.5% of its baseline funding level (CIPFA, 2013). The safety net is funded by levy payments from those councils seeing an increase in their business rates revenue overtaking the increase in their funding level which is deemed as a disproportionate benefit and therefore a levy payment must be made on this. Councils who are eligible to pay the levy are often those that are able to make substantial gains from a comparatively small investment in further growth. In order to ensure that the economic incentive stays strong, the Government have capped the levy payment at 50p in every £1 of growth (LGA, 2015).

When the system ‘resets’ in 2020, a new baseline funding level will be calculated to ensure that disparity between high growth and low growth local authorities doesn’t grow too large (Sandford, M 2014). Whilst DCLG (2011) believe that fixing the components of the business rates retention scheme will enable local authorities to the stability they require when making long-term investment decisions to stimulate economic growth, the ‘reset’ will perversely act as a disincentive to LAs to grow, as any growth experienced close to the ‘reset’ point through development will be lost once the system has been recalculated. There is risk that local authorities and developers will delay projects until after the ‘reset’ date in order to reap the rewards associated with the additional construction of floor space a solution to which could be that the ‘reset’ point should be at the point of completion of a development to ensure that local authorities are rewarded correctly for their investment and growth under the business rates retention scheme.

*Business Rate Appeals*

Under BRRS, local authorities have inherited 50% of the liability for mandatory relief and 50% liability for all outstanding appeals against valuations from previous years in some cases stretching as far back as 2005 (LGA, 2013). The risks associated with this can include but aren’t limited to ratepayers successfully appealing to reduce their rateable value, or a charity eligible for up to 100% rates relief taking over a large property. Such risks are a new concept and challenge for local authorities to take on board as previously under the formula grant system they bore no such risk**.** As a result of the introduction of the BRRS, consequential fluctuations in business rates income due to these financial risks poses a new obstacle when it comes to financial forecasting and planning for the collectable amount (Craske, 2014).

Prior to the scheme going live, the Government recognised the potential volatility to income as a result of appeals liability, and made downwards adjustments to the EBRA to reflect the collective losses suffered against the rating list as a result of successful outstanding appeals to allow local authorities to make provisions for outstanding appeal, without squeezing their budgets in the early years (DCLG, 2012b).

The Local Government Association (2013) observe that had the government not made local authorities liable for backdated appeals predating 2013 the scheme would not have been in deficit to the tune £27m (without the safety net it would have been £200m more) and that many LAs were unprepared for the increased financial exposure compared to the old formula grant (LGA, 2015). Had central Government taken responsibility for appeals raised before April 2013, LGA (2015) estimate that the scheme would have completed its first year with a surplus of £236 million.

The provisions obliging Local Authorities to bear financial responsibility for backdated appeals can be a determinant in whether they fall within the category of the safety net or the levy. Some authorities that would have been subject to *lev*y payments, due to good levels of business rates revenue, had such high appeals reduction bills that instead they received safety net payments. Conversely, for some large local authorities to enter the safety net, financial losses would be far beyond any provision they would be able to make for appeals. Central Government recognised this problem and allowed those local authorities who couldn’t pay off backdated appeals in the first year to spread payments over 5 years (LGA, 2013). Local authorities find themselves in a double bind, exposed to volatility in their rates income and paying the price for previous Government over-valuations of commercial property with the backlog and delay in appeals cases magnifying the level of income reduction the longer they take to resolve (LGA, 2015).

Under the Formula Grant System, the financial liability for successful appeals and mandatory relief was pooled and borne by central Government on a national level however under the reformed system, local authorities now require essential information from the VOA in order to make provision for reductions in rateable value, and consequently income, they now face as a result of successful appeals cases. Although LAs now have a financial interest in the appeals process and outcome, even under the new system they are unable to influence the rate at which appeals are determined, limiting local authority’s ability to counteract the financial risk they now face (Craske, 2014). Unlike Council Tax, there is no banding on business rates so any potential change in the rateable value, following a successful appeal, can be unpredictable and as such local authorities now have to endure and account for these unpredictable levels of additional cost liability (LGA, 2013).

Appeals tend to arise following a period of revaluation during which a number of commercial properties see their rateable value increase; consequently the amount of rates payable by commercial property occupiers will also increase. If an individual occupier believes their rateable value to be too high, they may appeal against it and dispute the valuation in an attempt to reduce their bill, however there are numerous other reasons to appeal against rateable value which add to the weight of appeals (LGA, 2015).

In an attempt to reduce the backlog, the Chancellor pledged in his 2013 Autumn Statement to clear 95% of appeals lodged before April 2013 by July 2015 (HM Government, 2014). The remaining 5% of appeals are typically those contentious, complex major value cases that are particularly time consuming, suggesting that the VOA may not have the time or the resources to deal with the volume of appeals (Neville, 2014).

The Autumn Statement 2014 heralded another change in legislation; that any alterations to rateable values as a result of appeals submitted after 31st March 2015 will to 1st April 2015 rather than 1st April 2010 (Ruthven, J 2014). The announcement provoked ratepayers, who believed their rateable value to be inaccurate, to take action before 31st March 2014 to ensure that five years’ backdating to 1st April 2010 would not be lost (Rock, 2015), creating a large influx of appeals. Simultaneously it was announced that VOA alterations to rateable value submitted after April 2016 would be backdated to this point rather than 1st April 2010; an iniquitous decision, according to Whelan (2014), given the Government’s previous decision to postpone revaluation by two years, condemning many commercial property occupiers to two further years of historically high rateable values.

The unpredictability of appeal timing, due to the backlog, makes it difficult for local authorities to accurately budget for the prospect of successful appeals, it is now vital that the VOA: is transparent and provide detailed data and information to allow councils to plan and budget realistically (LGA, 2013).

Our review of the English Business Rate system has demonstrated its complexity and revealed how recent reforms not only create opportunity for local authorities to retain increases in business rates from new commercial development but also expose them to greater financial risk through liability for backdated rating appeals. The next section describes the methodology used to investigate the impact of appeals liability in one of the largest cities in the UK, which is followed analysis of the data to identify measures that may be taken to mitigate some of the negative impacts of the business rate system in England.

**Methodology**

Muldoon-Smith and Greenhalgh (2015) called for a microanalysis approach into researching Local Government Finance, emphasising the importance of monitoring and reviewing both new tools of urban finance and changes to existing ones. A case study approach was adopted to reveal disparities in impact through detailed examination that obtained multiple perspectives on the subject area through a single embedded case study of the City of Leeds (see Gray, 2014; Yin, 2009, Eisenhardt, 1989). Leeds was chosen for three main reasons: firstly because the City of Leeds is at the forefront of the Open Data movement in England (see ODI Leeds and Leeds Data Mill [www.leedsdatamill.org](http://www.leedsdatamill.org)), secondly, the researchers have an established arms-length working relationship with the City of Leeds that facilitates data sharing and innovation (see Muldoon-Smith et al 2015) and thirdly, Leeds is one of the largest metropolitan areas in the U.K. with a mature, diverse and dynamic commercial property market.

The impact of business rate appeals on City finances was explored through in-depth semi-structured interviews with business rate experts. Expert or elite interviews are not without methodological controversy; Harvey (2011), suggests that there is an ‘under theorization of the term elite’, within methodological discourses (for further details about elite interviewing see Harvey, 2011; Aberbach and Rockman, 2002). Our definition of elite refers to the status of interviewees within the overlapping domains of local government finance and business rates. Such a definition is purposely narrow as order to focus the empirical stage of research on targeted interviews with practitioners who work at the heart of the business rates system in Leeds.

Purposive sampling was used to identify experts based on their knowledge and expertise of the business rates retention scheme and appeals within the City of Leeds. Gray (2004) recognises the potential to inadvertently or subconsciously bias the sample; to reduce this potential, snowball sampling was used achieve a greater breadth and diversity of opinion (see Gray, 2014). Biernacki and Walkdorf (1981) recognise that when a study is particularly niche in nature, such participants are able to use their ‘insider knowledge’ to assist in locating further participants for the research. Ten potential participants working at Leeds City Council, the Valuation Office Agency, Central Government and private practice surveying consultants were approached in July 2015, five of whom responded positively; all interviewees were asked the same 12 carefully formulated, open-ended questions in semi structured face-to-face interviews conducted in August 2015. Due to the highly specialised nature of the topic and the requisite level of expertise required to submit to in depth analysis, the number of participants is limited.

Interview transcripts were analysed through the open coding method, by naming and categorising phenomena through the close examination of data (Strauss and Corbin 1988). The data was coded in accordance to the aims, objectives and questions of study along with an “other” category to record outlying issues with potential for further consideration and research.

**Data analysis and findings**

*Introduction of Business Rates Retention Scheme*

The LGA (2013) stated that the time between consultation and implementation was insufficient for local authorities to be able to make the appropriate provisions and adjustments, such as liability to fund 50% of the reductions in rateable value as a result of successful appeals cases, consequentially making their annual income volatile and subject to fluctuation, in time for the new scheme going live in April 2013. The primary concern of Leeds City Council was the potential fluctuation in business rates income associated with business rates income being dependent on market rental values:

*“There was a big concern that this represented a fundamental change in funding mechanisms from something that was based upon needs and requirements of a City”*

(Finance Officer)

Because ability to grow business rates income is now to be dependent on construction of additional floorspace, there is concern about disparities across England, with larger more buoyant authorities at an advantage in comparison to smaller authorities with little requirement or ability to grow economically (confirmed by Muldoon Smith and Greenhalgh – 2015). The nature and scale of the changes made it a particular challenge to anticipate and prepare for their implementation:

*“I thought it was very complicated, it took me a long time to get my head around it. It was all rushed through at a time when there were a lot of budget cuts and I don’t think the Council were prepared for it”*

(Private Practice Consultant)

*“We were not in favour of the scheme as it was brought in”*

(Finance Officer)

The VOA regarded the business rates retention scheme as an opportunity to build and improve relationships with the Council, to enable closer working. To smooth the transition, they appointed a specialist team, headed up by a Local Authority Relationship Manager, to liaise with the City Council and deal with any rates retention queries; a ‘Data User Group’ has also been established to enhance the quality and quantity of information that the VOA to provide to the Council. Despite these measures, Leeds City Council indicated that their experiences of BRRS had, on the whole, been challenging, attributable mainly to the inherited 50% liability for and backdating of successful appeals cases

Participants highlighted a perversity associated with the incidence of Empty Property Rates (EPR): because landlords are liable to pay 100% of the occupied rate for vacant premises, after 3 months void period, if a new business occupies a vacant property, the local authority experiences no income growth. Indeed, if the business is a SME or charity, and entitled to a reduced rate, the local authority’s revenue actually decreases. It is financially advantageous for local authorities to ‘sit on’ lots of vacant commercial property, on which 100% EPR is payable, than trying to promote more dynamic market conditions that could encourage indigenous business starts ups to occupy small suites and units. The perversity of inertia and stagnation generating greater financial reward than agility and innovation, may be addressed if the Government were to abolish EPR, or allow local authorities to spatially or sectorally vary EPR to incentivise the promotion of indigenous economic growth (see Muldoon-Smith and Greenhalgh 2015). As it stands, the only way for a local authority to grow its rates base is though new build:

*“The fundamental flaw for me is that there is a very weak link between economic wellbeing and growth and an increase in business rates revenue because they are predicated on new builds”*

(Finance Officer)

This is an acute problem for City of Leeds, which has an over-supply of office accommodation in the City Centre following the financial crisis and recession - several large, new build office buildings are vacant and generating 100% EPR. The only way for the Council to growth business rates income is to encourage and permit more new build accommodation, exacerbating the over-supply of office space in the city, with a consequent diminution in rental values.

*Estimated Business Rates Aggregation - Provision Settings and Volatility*

Previously, there was little fluctuation in local authority Formula Grant funding due to the outcome of successful rating appeals; following introduction of BRRS and backdated appeals liability, the volatility of business rates income has increased and losses experienced from appeals liability may outweigh growth under BRRS.

*“For every £1 we lose in rateable value in a year, we need to have 6 times that value coming back in in a new build each year to break even. However buoyant your economy you’re never going to get that, that is why we are continuing to lose money very rapidly now”*

(Finance Officer)

In the first year of BRRS, Leeds City Council estimated that they would need to allocate £20m for outstanding appeals, which reduced EBRA was designed to mitigate however

*“the 7.9% (EBRA) adjustment is proving to be inadequate…it’s very complicated and is something Government will hide behind by saying they made an allowance for appeals at the start of the scheme, no doubt if you look across the country it balances out but a lot of authorities have been hit hard”*

(Finance Officer)

Prior to the scheme, adjustments to EBRA were made to reflect appeals liability on a national scale, consequently Leeds and other local authorities have suffered huge losses to their business rates revenue due to appeals liability, consistent with an LGA (2013) survey of local authorities in which one third indicated losses in excess of 5%. Government’s attempt to mitigate the problem, by allowing local authorities to spread appeals liability over a period of 5 years, has made the system even more complex according to a Business Rates Officer.

A further ‘quirk’ of the system is the potential for local authorities that receive lower than expected income, to be able to write-off their outstanding appeals liability in the schemes’ first year by making a big enough provision to push them into the safety net, by breaching the 7.5% threshold below funding baseline beyond which they are protected against any further losses (CPIFA, 2013).

In 2013/14 Leeds benefited from the opening of Trinity Shopping Centre and the Leeds Arena, but even taking those large assessments into account, over the 20 months since the scheme was introduced the total rateable value for Leeds has grown 0.7% (Gray, A, 2014). Indeed, despite the addition of 1 million square feet of new retail floorspace to the city centre, without which the City may well have exceeded the safety net threshold, the ‘Trinity windfall’ has been almost completely eroded by backdated successful appeals. The Deputy Chief Executive of the City of Leeds, reported on 25 February 2015, that Leeds had seen some business growth during 2014/15 but this has not resulted in a net increase in business rates due to the impact of appeals, deletions from the rating list and the adverse effect of Valuation Office reviews. The City forecast that by the end of 2014/15, there would be an overall deficit on business rates of £13.1m (Gray, A. 2015).

Furthermore, the Trinity Centre, comprising 110 new retail and leisure units, has displaced retailers elsewhere in Leeds City centre, reducing market demand and rental values in these other locations. Retailers in such locations may submit appeals against their historic rateable value, on the ground that the fall in rents in secondary retail pitches is a material change in circumstance. If occupiers demonstrate that their turnover has fallen due to Trinity, then the VOA or Valuation Tribunal may agree a reduction in rateable value, setting a precedent for other city centre retail premises. The VOA acknowledge the potential knock-on-effect from material change in circumstance appeals and recognise that whilst individual reduction may not be significant, collectively they could have an impact.

The Victoria Gate shopping centre which includes a new 260,000 sq. ft. John Lewis department store, is due for completion in 2016, is likely to have further detrimental impact on city centre retail rents, such as House of Fraser, Debenhams and Harvey Nichols, who may lodge appeals against their rateable values, any reduction in which would have a significant impact due to the size and value of these heraditaments.

Prior to BRRS there was little need for local authorities to be involved with the appeals process and outcomes; now the VOA need to provide local authorities with clarity regarding ongoing appeals in order for them to be able to set their appeals provision a year ahead. The VOA is a department of HMRC and is bound by strict confidentiality rules and regulations under the Commissions for Revenue and Customs Act (Great Britain, 2005). A VOA participant observed:

*“We can’t provide any information which will identify a person or individual except in limited circumstances… We work within disclosure legislation to provide information where we are permitted to in order to support local authority finance teams in making their appeals provision”*

(VOA)

The VOA aim to provide Local Authorities with as much information as they can under the legal restrictions they face, however in practice, indication of the magnitude of reduction that a local authority may face, following a successful appeal, is often only available near the settlement date, which is too late for setting provision. Surprisingly, private practice consultants are not bound by the same confidentiality rules as the VOA and are at liberty to discuss and disclose information about possible risks to business rates income to councils. It is up to the consultant and their clients, whether they choose to disclose this information and, although it does not shed light on the timing of decision, it may give an earlier indication about the level of reduction the Council are facing to assist in setting their provision. Private practice consultants indicated that, in principle, they would be happy to speak to the Council regarding risks associated with the appeals process and potential reductions; whilst this is uncommon in practice it is a strategy that local authorities could pursue to improve their intelligence surrounding appeals, for better inform their provision forecasting.

The difficulty of setting an accurate provision is evidenced by the losses incurred by City of Leeds due to appeals between April and July 2015:

*“In the period from April through to June this year (2015) we lost £9m to backdated appeals, and in the month of July we lost a further £9m. We have lost £18m so far this financial year and the provision we set was £17m for the whole year, so already by the end of July we have used all our provision. To make things worse, when we look at appeals still outstanding we have to make a provision of £26 million for next year – this is an enormous problem”*

(Finance Officer)

The continual build-up of appeals is placing a huge burden on local authorities in terms of the level of provision that has to be made. Accurate provision setting is critical during a period when cuts are being experienced in other areas and demand for services is increasing – striking a balance between optimistic and pessimistic financial liability forecasts is difficult:

*“If we are pessimistic and set too big a provision, we would have to make cuts elsewhere that we don’t have to make…but if at the end of the year we are sat here with a big surplus, we would be equally as unpopular”*

(Business Rates Officer and Finance Officer)

*Forecasting Backdated Appeal Provision*

The VOA provides councils with historic appeal outcomes back to April 2005. Whilst, in theory, such evidence offers some indication of possible appeals outcomes, in practice, due to inconsistency in levels of reduction, it is little help; hedonic valuation methods are not much help at forecasting rating appeal outcomes.

*“Historically we know the level of successful appeals and that the average reduction is 11.5%, however in the last 4 months the average level of reduction has been 18.5% and that makes a big difference…recently the levels of reduction have been higher than we have ever seen and there is no way of knowing if this will be a continuing trend”*

(Business Rates Officer)

*Growing the list – under the radar*

The ability for local authorities under BRRS to retain growth (50% currently; proposed to increase to 100% by 2020) in business rates, which they can use to offset against increasing appeals liability, encourages councils to add new assessments to their rating list. The VOA and local authorities are actively looking for additional assessments that can be allocated a rateable value to generate additional income, for example ATM machines are now regarded separate assessments, backdated to 2010; whether local authorities will be able to continue to employ trained and qualified people to do this job when frontline services are threatened with cuts is uncertain.

A private consultant observed:

*“We come across all kinds of property that is under assessed or that should be on the rating list, I guess it would be useful for the Council to identify these properties and boost their revenue”*

(Private Practice Consultant)

Whilst from a consultant’s perspective, it is not in their client’s interest to identify such assessments to the council or the VOA, they may advise their clients to declare them to the VOA if there is a risk of their assessment being backdated if it is discovered.

*“There is a lot of information out there, when you look at the planning website all the applications are there – this information is in the public domain. I think the main problem is there have been a lot of cuts and it is difficult for the Council and particularly the VOA to keep on top of new assessments, the revaluation and the backlog of appeals”.*

(Private Practice Consultant)

*Mitigating measures*

HM Treasury’s (2015) Business Rates Review and the Betts’ inquiry into Business Rates (DCLG 2015b), offer the Government a timely opportunity to comprehensively improve the operation of the business rates system in England. We identify five ways in which the Government could do this:

### Removal of Backdated Appeals Liability

Backdated appeals liability is negatively impacting on the ability local authorities to manage their budgets from year to year. Removal of liability for appeals lodged before the introduction of the scheme would help local authorities benefit from BRRS, one suggestion being to create a central fund to deal with all appeals prior to (say) 2013

*“Leeds didn’t benefit from anything over-valued prior to April 2013….. that money went straight into the national pool….. (but) we have to fund half the cost of properties eligible for reductions before that date”*

(Business Rates Officer)

Revenues from business rates are at their highest immediately after introduction of a new rating list, following which there is an erosion in revenue as appeals are deliberated and resolved and reductions awarded. BRRS was introduced mid-cycle, such that councils are funding the reductions from the peak (2010-2012) without having benefitted from it – local authorities were unable to retain any business rates growth prior to 2013 but are liable for reductions on properties that were overvalued as far back as 2005 - which is patently inequitable.

1. Strength the link between economic growth and business rates growth by abolishing Empty Property Rates

The abolition of EPR for landlords would have a positive effect on growth in BRRS by strengthening the link between economic activity and business rates growth.

*“Gone are the days where a large corporate firm would come in to a city and employ a couple of hundred people and take a mass of floor space. Now requirements are to split up units and take less space, which means less business rates income for us”*

(Business Rates Officer)

Failure to include empty property rates in recent announcements on Business Rates reform is a missed opportunity. If Government abolished Empty Property Rates, or if local authorities had the power to alter the rate, this would incentivise local authorities to promote indigenous economic growth by rewarding them for creating conditions whereby vacant space is reoccupied, rather than the current situation where they get penalised. This would provide a welcome boost to small businesses and the managed work space sector that supports this new economy (Muldoon-Smith and Greenhalgh 2016)

1. More Frequent Revaluations

The frequency of revaluations could be increased from five yearly three yearly; many businesses (particularly in outside Greater London) and local authorities are feeling the adverse effects of a seven yearly revaluations cycle, as a consequence of the of historically high rateable values prevailing since 2010 (based on peak rental values in 2008). More frequent revaluations would reduce the number of years that appeals could be backdated *and* ensure that rateable values are more accurate and representative of prevailing market rents, which in turn reducing the number of appeals.

4.Confidentiality, transparency and data sharing

Amend primary legislation to permit greater disclosure by VOA and other agencies to enhance transparency about pending appeals and improve the accuracy of business rate appeals provision setting.

5. Monitoring of Provision

Provision for appeals is set for the next financial year - due to the unpredictability of timing and level of reduction of successful appeals, provision setting on an annual basis is inevitably inaccurate. Adjusting provision on a monthly or bi-monthly basis would improve accuracy and if provision would be operated over a longer periods then flexibility would be enhanced.

**Conclusions**

The business rate system operating in England is complex and arcane; even those directly involved with the system struggle to fully comprehend and navigate the principles and procedures by which it operates. Changes to the system, such as BRRS, have been introduced prematurely and with little planning and forethought -there was little more than 9 months between initial consultation and BRRS going live, at a time when local authorities were experiencing deep cuts in funding.

Local authorities’ income is more volatile as a consequence of both the rates retention and appeals liability aspects of BRRS. The unpredictability of reduction levels, backdating and timing of successful appeal outcomes means that local authorities may be hit with are large reduction in their business rates income at such short notice that accurate provision is near impossible. Such volatility impairs the ability of local authorities to invest in growing their economy and providing front line services over the medium term – precisely the opposite of what BRRS is intended to do. A potential flaw of the system is its incentivising of construction of new floorspace, to add to the rating list which, without requisite demand, risks overbuilding and exacerbating oversupply in some markets. Another flaw in the system is the way in which EPR rewards inertia – local authorities are, perversely, better off having lots of vacant property generating 100% EPR, than encouraging dynamic market conditions that might result in some of the vacant space being taken up by new business start-ups which pay lower business rates and which may come and go, thus generating 3 month income voids. If EPR were abolished, local authorities would be incentivised to pursue local economic development policies and programmes that promoted the absorption of vacant commercial property as they would then retain 100% of the income generated.

Our in depth case study analysis reveals that even Leeds, which has a buoyant economy driven by retail and service sector growth, the introduction of BRRS has been detrimental, with the backdating of appeals outweighing any uplift in business rates income. BRRS is not a ‘one size fits all’ model – it results in winners and losers – a condition that will be exacerbated if, as announced by the Chancellor in 2015, the Formula Grant is abolished by 2020 after which local authorities will get to keep 100% of their business rates. Because of the risk of huge and punitive disparities between different local authorities, we believe that the tariff and top up and safety net mechanisms will be retained to ameliorate the worst excesses of the model. Quite how the latter will be funded and what impact the 2017 revaluation and 2020 reset will have remain the subject of some conjecture.

**Footnotes**

1. From 2020, rate bills will be indexed by CPI, the Government’s preferred measure of inflation, rather than RPI (see Department of Communities and Local Government, 2016)

2. In the Spring Budget 2016, the Chancellor of the Exchequer announced that from 2017/18:

1. Small Business Rate Relief (SBBR) will be permanently doubled from 50% to 100%;
2. The £6k and £12k thresholds will be increased to £12k and £15k respectively (this effectively means that businesses occupying properties with rateable values of less than £12k; that the meet the eligibility criteria, will pay no business rates);
3. There will be tapered relief between £12k and £15k
4. The threshold for the Standard Business Rate multiplier will increase from £18k (£25.5k in London) to £51k

(see Department of Communities and Local Government, 2016)

3. Calculating Local Authority baseline funding - the amount of local government funding is calculated by Government via a series of complex calculations previously known as the Start-Up Funding Assessment (SUFA), from 2014/2015 known as Settlement Funding Assessment (SFA). Central Government initially calculates the Estimated Business Rates Aggregate (EBRA), which translates to the total business rates income that will be collected by English local authorities in 2013-14. Central and local share percentages are applied to the EBRA, which is then multiplied by each individual local authority’s proportionate share to determine the local authority funding baseline. The proportionate share is based on the average historic business rates collection over a number of years for each individual authority (DCLG, 2012a; DCLG 2012b). defined by the DCLG (2012a p.7) as ‘*The ‘formula grant’ distribution of the proportion of ‘start-up funding’ within the rates retention scheme*.’; the baseline is adjusted on a yearly basis to take into account inflation but Council’s do not benefit from annual growth in business rates in line with RPI as this is deducted from the revenue support grant (DCLG, 2013a;. LGA, 2013).

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