findings

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The operation of the non-domestic rate

The national non-domestic rate (NNDR) has operated effectively since its introduction in 1990, with a high rate of collection, according to a study by Rita Hale and Tony Travers. However, forecasting errors made at the start of the new system may have led to a reduction in the amount of rates paid over the last five years. The study found:

- **Local authorities collected 95% of the amount collectable in 1993-94 — in line with the Audit Commission's target collection rate.**
- **The fall in the distributable amount in the years 1993-95 suggests that the scale of losses on appeal was under-estimated and the growth in the non-domestic rateable value base over-estimated when the rate poundage for 1990 was set. Consequently, non-domestic ratepayers have probably paid some £2 billion less than they might have expected to pay since 1990.**
- **The recession has depressed the yield from the NNDR non-domestic rate. Over the past five years the Government has taken into account more than £4.8 billion in empty property relief when calculating the NNDR income available for distribution to local authorities.**
- **The overall burden of NNDR is likely to have been lower by some £4 to 7 billion in 1994-95 than it would have been under the locally-set system. The rules under which the NNDR operates limit increases to the tax rate so this lower level is likely to continue.**
- **Business organisations and the Government strongly favour keeping the NNDR, while local authorities would prefer a return to a locally-set tax.**
- **Returning non-domestic rates to local control is tied up with wider questions about local government funding and autonomy and would also require decisions about the link between non-domestic rates and council tax; councils' accountability to businesses; and the need for equalisation between local authorities.**

JR Joseph Rowntree Foundation

Local taxation and finance

The National Non-Domestic Rate (NNDR) was created by the Local Government Finance Act 1988 and introduced in 1990. Like the locally set non-domestic rate it replaced, NNDR is levied on virtually all properties not wholly used as dwellings. The rate poundage (or 'multiplier') is set by central government and by law cannot rise from year to year by more than the annual increase in the Retail Prices Index.

Nationalisation of the non-domestic rate increased the proportion of local authorities' revenue income determined from the centre to about 80 per cent - ie the NNDR and the Revenue Support Grant. Only council tax can be set locally.

The Local Government Finance Act, 1988, created two types of non-domestic rating list. The *central list* covers utilities such as gas and the railways, as well as all pipelines and telecommunications networks and a small number of large companies. The *local lists* include all non-domestic properties other than Crown properties and those on the central list. The rateable values are set by the Valuation Office Agency but each district and borough authority is responsible for billing and collecting the NNDR.

Changes since 1973

The 1990 revaluation was the first since 1973. Because of this long interval, large shifts in relative rateable value had occurred, both between types of non-domestic property and between regions.

Thus, whereas commercial rateable values made up 58 per cent of the total in the pre-1990 rating list, they rose to over 63 per cent after 1990. Leisure properties, though a far smaller proportion of the total, also increased significantly. On the other hand, industrial rateable values fell from 18 per cent to just over 16 per cent of the total. The rateable values for shops showed the biggest relative increases and factories the lowest.

Compared with an average national rise in rateable value of 8.1 times the 1973 figure, the South West saw the biggest rise (up 9.3 times), followed by the South East (excluding London) (up 9.2 times). The smallest rises were in the West Midlands (up 6.5 times) and the North West (up 7.2 times). Perhaps surprisingly, the average rise in Yorkshire and Humberside was slightly above the national average, while London was fractionally below.

The total non-domestic rateable value rose by 4 per cent between 1990 and 1994 with increases in the numbers of both commercial and industrial properties. However, the actual rateable values of industrial properties fell in this period.

Collection of the non-domestic rate

The Department of the Environment (DoE) publishes quarterly data about the amount of the NNDR collected by individual authorities expressed as a proportion of the amount expected to be collected and as a proportion of the amount collectable. DoE survey results show that local authorities collected 95% of the amount collectable in 1993-94 - in line with the Audit Commission's target.

A number of city authorities contain concentrations of non-domestic properties with high rateable values. Analysis of the DoE figures for the twenty authorities with the highest levels of non-domestic rateable value showed that the 1993-94 collection rates varied from 84.5 per cent (Hackney) to 110 per cent (the City of London).

If all the 'top 20' billing authorities had collected at least 95 per cent of the amount collectable, the national collection rate would have risen to 96 per cent. The amount contributed to the national pool of NNDR would also have increased. Clearly there would be benefits for the Government if authorities with very high rateable values consistently had high collection rates.

The yield

The total NNDR yield is paid into a pool and then distributed to local authorities in proportion to their populations as part of the annual Local Government Finance Settlement.

The distributable amount in 1990-91 was £10.4 billion. Although the non-domestic poundage has risen by almost 22 per cent since 1990, the distributable amount for 1994-95 is only 2.5 per cent higher than in 1990-91. (In real terms, the non-domestic rate poundage has risen by 2.5 per cent between 1990-91 and 1994-95, while the distributable amount has fallen by 13.6 per cent.)

The study suggests that the main reasons for this reduction are:

- the scale of relief for empty property; and
- the effect of successful appeals against the 1990 rateable values.

The report suggests that the value of empty property relief taken into account by the Government in calculating the NNDR yield exceeded £4.8 billion over the period 1990-91 to 1994-95. Successful appeals against the 1990 rateable values meant the Government also had to provide for almost £1.7 billion for prior years' adjustments in calculating the distributable amount for 1993-94, with a further provision of £875 million for 1994-95.

The DoE expects a further 460,000 appeals will be heard during 1994-95. The impact of these appeals cannot be estimated. As a result, it is impossible to be definitive about the underlying yield of the NNDR in any year from 1990-91 to 1994-95.

Although no data are available on the aggregate of reductions in rateable values resulting from appeals, the fall in the distributable amount in the years 1993-95 suggests that Ministers either under-estimated the scale of losses on appeal or over-estimated the growth in the non-domestic rateable value base after 1990. In effect, Ministers over-estimated the effective rateable value for 1990-91 and thus appear to have set the non-domestic rate poundage at a level lower than that necessary to maintain the yield at the same level in real terms as that for 1989-90, the last year of the old system.

A conservative estimate suggests that a more realistic poundage would have been 36p for 1990-91, instead of the 34.8p set, and that non-domestic ratepayers have paid some £2 billion less in total in rates over the five-year period than they might otherwise have expected to pay. The non-domestic rate poundage will be depressed for the foreseeable future because of the way the legislation is drafted.

Transitional arrangements

Because of the interaction of changes in rateable values and rate poundages in 1990-91, many businesses faced large changes in their rate bills. Transitional arrangements were introduced to smooth out the biggest gains and losses.

Originally the arrangements were designed to limit increases in 1990-91 rate bills to 20 per cent plus inflation (for larger businesses) and 15 per cent plus inflation (for smaller businesses). Maximum reductions were originally set at 10 per cent in real terms (large businesses) and 15 per cent in real terms (small businesses). Protection for ‘losers’ would be paid for by the limits on gains for those whose bills were to fall.

The transitional arrangements were changed for 1992-93, 1993-94 and 1994-95, to give greater protection to ‘losers’ and to allow ‘gainers’ to benefit more quickly than originally intended. As a result, the Treasury had to finance the transitional arrangements in each of these years at a cost of £400 million, £520 million and £464 million respectively.

Weaknesses were exposed in the transitional arrangements. On the one hand, some ratepayers found that the loss of transitional relief wiped out the gains from a successful appeal against revaluation. On the other hand, a number were able to exploit a loophole that allowed them to keep transitional relief despite having had their rateable values reduced. This did not reduce the amount of the NNDR distributed to local authorities because the cost was met by the Exchequer. New regulations have now been issued to remove these problems.

The impact on businesses

Those interviewed for the study generally agreed that the rates paid by the non-domestic sector since 1990 had been less than they would have been under the previous system. Linking year-on-year changes in the poundage to the Retail Prices Index ensured relatively modest changes in the overall tax burden.

Analysis suggests that had the Government retained the pre-1990 rating system - coupled with grant reductions on the scale of those made during the 1980s - the overall burden of non-domestic rates might have been £4 to 7 billion higher in 1994-95 than was, in fact, the case.

Interviews also suggested that the NNDR had been something of a success but revealed differences in attitudes between:

- the business organisations - the CBI and the Association of British Chambers of Commerce - which strongly favour retaining NNDR;
- the local authority associations and the Institute of Revenues Rating and Valuation (IRRV) - which favour returning control to local government; and
- the Government - which remains committed to the NNDR in its present form, although the DoE is seeking to introduce incentives for local authorities to gain from increases in their rateable value base.

Non-domestic rates as a local tax

The study examines a number of key arguments for and against non-domestic rates as a local tax. Many of the key criticisms exist whether they are set locally or centrally:

- they are not related to the services received by industry and commerce;
- they distort accountability;
- they distort industrial location;
- they do not vary with profitability;
- they require large amounts of equalisation

between authorities by central government;

- they are erratic and make planning difficult.

The key arguments in favour of locally-set rates are:

- they could reduce the 'gearing' of local domestic taxation;
- they could make authorities more financially independent of central government;
- they give authorities an incentive to build up their rate base;
- they restore the link between non-domestic ratepayers and local government.

Restoring local control

Ministers would have to consider several issues before deciding to return the non-domestic rate to local control. The four key questions are:

- what would be the relationship between the yield from the council tax and that from the locally-set non-domestic rate?
- would responsibility for *all* non-domestic properties be returned to local control?
- how would local authorities be accountable to non-domestic ratepayers?
- would differences in the non-domestic tax base be fully compensated through the Revenue Support Grant system?

The decision will in the end be political: the future of non-domestic rates is tied up with the longer-term shape of local government in Britain. Non-domestic rates may not be an ideal tax for either local or central government but they can potentially allow local authorities more autonomy. This study shows how robust non-domestic rates and local government administration proved during the reforms of 1990.

About the study

The study involved: the analysis of data on non-domestic rateable values, tax levels, central government grants to local authorities and local authority spending levels; interviews; and case studies.

Further information

The full results of the study are published by Cipfa and Rita Hale and Associates Ltd in A National or a Local Tax? A study of the non-domestic rate. The report is available from the Cipfa Publications Unit, 3 Robert Street, London WC2N 6BH, price £35 including p&p.

A discussion paper which explores the issues raised by the study is available free from Rita Hale and Associates Ltd, Suite 327, Chancery House, 53-64 Chancery Lane London WC24 1QX.

Related *Findings*

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