Transitional Protection Payments in 2020-21 and Beyond

Introduction

Under the current business rates retention system, "transitional protection payments" strip-out, as far as possible, the impact of the transitional arrangements put in place following the Revaluation.

We need to decide whether, following the changes to the business rates retention scheme in 2020-21, we adopt the same system of transitional protection payments, especially as:

i. the value of mandatory reliefs that are uncompensated via s.31 payments is likely to rise at 2020-21; and

ii. the frequency of Revaluations will increase from 2021-22 onwards, potentially complicating the transitional arrangements that will be put in place.

This paper looks at how transitional protection payments work under the current 50% scheme; considers how their impact on local authorities' income might change following the re-set of the system in 2020-21; and discusses the practicalities of changing the current arrangements.

This paper does not consider the extent to which transitional protection payments complicate the setting of business rates baselines for 2020-21, or how they should be dealt with as part of the baseline calculation. This will be the subject of a separate paper at a future meeting of IWG.

IWG is invited to consider and discuss the arrangements for transitional protection payments that should be put in place from 2020-21 onwards.

Background

1. At a Revaluation, the Government puts in place transitional arrangements that ensure that significant increases in ratepayers' bills, due to the Revaluation, are phased-in over five years. The aggregate cost of the scheme is met by similarly phasing-in significant reductions in bills. The details of the current transitional arrangements are set out in *The Non-Domestic Rating (Chargeable Amounts) (England) Regulations 2016 (SI 2016/1265)*.

2. Other things being equal, local authorities' income from business rates will increase, or decrease from year-to-year, solely as a consequence of the unwinding of the transitional arrangements.

3. Therefore, the business rates retention scheme provides for "transitional protection payments". In NNDR returns, billing authorities provide details of the amount by which, in any year, a ratepayer's rates liability is higher or lower than it would have been if there had been no transitional arrangements. The net cost, or gain, to authorities results in a corresponding transitional protection payment being made, or recovered from the authority. This ensures that, as far as possible, the impact of the transitional arrangements is stripped out of the rates retention scheme. Effectively, local authorities' non-domestic rating income under the scheme is measured as if there were no transitional arrangements and, therefore, "growth" is not artificially inflated, or deflated by the existence of the transitional arrangements.

4. At the operational level, transitional protection payments are included as part of the calculation of "non-domestic rating income", which is apportioned between billing and major precepting authorities (and central government).

5. The estimate in NNDRs is reconciled at NNDR3 and results in a payment to, or from the Department, which is credited or charged to the Collection Fund. Accordingly, in estimating the Collection Fund balance as part of the NNDR1, billing authorities are required to anticipate the amount they will include in NNDR3s.

<u>Calculating the cost of the transitional arrangements</u>

6. In working out the cost of, or gain from the transitional arrangements, authorities are required to make the calculation <u>before</u> applying mandatory, or discretionary reliefs. This is consistent with the "Chargeable Amounts" Regulations, which determine the gross chargeable amount.

7. A consequence of this, however, is that transitional protection payments do not perfectly strip out the net gain, or loss incurred as a result of the transitional arrangements. Transitional protection payments <u>perfectly</u> adjust for:

    i. any hereditament that is <u>not</u> in receipt of a mandatory or discretionary relief; or

    ii. any hereditament that is in receipt of a mandatory or discretionary relief for which the Government provides compensation through a s.31 grant.

8. But for a hereditament that is in receipt of a mandatory, or discretionary relief which is <u>not</u> compensated via a s.31 grant, the year-on year change caused by the transitional arrangements will have an impact on the non-domestic rating income available under the rates retention scheme. This can be simply illustrated:-

	counter-factual (no trans. arr)		trans. arr upward	trans. arr downward	
Rateable value	1000				
multiplier	0.5				
Gross rates payable (GRP)	**500**	**Ch.amount**	**400**	**600**	*determined by Regulations (eqivalent of GRP)*
relief (@ 80%)	-400		-320	-480	
net rates payable (NRP)	**100**		**80**	**120**	
		net trans arr	-100	100	*calc. as difference between GRP and Ch.amount*
		TPP	100	-100	*TPP "reverses the net cost of the trans. arr*
NDR Income	**100**		**180**	**20**	

9. Of course, the scale of the impact will diminish each year as the number of ratepayers in transition reduces and the chargeable amount determined by the transitional arrangements get closer to the “true” nets rates payable.

10. The impact on an individual authority’s income or on the overall income under the rates retention scheme in any year is impossible to determine, without access to hereditament-level data. In general, however, the impact is likely to have been small under the current 50% scheme, because:

    i. Whilst unfunded reliefs in the first year of the scheme (2013-14) were c.£3bn – about 12% of gross rates payable;

    ii. Of those ratepayers in receipt of unfunded reliefs, not all will have been subject to the transitional arrangements;

    iii. 2013-14 was the third year (of five) of the transitional scheme and therefore, the gap between gross rates payable and the chargeable amount will have narrowed and many ratepayers will have fallen out of transition; and

    iv. ratepayers in upward and downward transition have opposite effects on income under the rates retention scheme. To some extent, therefore, the impact of those in upward transition will have been cancelled out by those in downward transition and vice versa. The net cost of the transitional arrangement in 2013-14 was about £33m – less than 0.2% of that year’s net rates payable.

11. Potentially however, there are reasons why the impact following the reset in 2020-21 might be more significant:

i. At the reset, it is probable that Government will remove the need for s.31 payments by building the current level of reliefs into business rates baselines. Changes to the small business rates relief scheme since 2013, in particular, mean that an additional c.£1.3 billion of relief, that is currently compensated through s.31 payments, will instead be uncompensated – a c.40% increase in the amount of unfunded relief. This is likely to increase the impact of transitional protection payments on local authorities' non-domestic rating income.

ii. The Revaluation in 2021-22 is likely to herald the beginning of a three year Revaluation cycle. It is currently unclear what impact this will have on the design of transitional payments, but it is at least possible, that future transition schemes will not have fully unwound by the time of the next Revaluation. If three yearly Revaluations result in future transition schemes that base the first year's "chargeable amount" on the previous year's "transitional" bill – so-called "transition on transition" – it is possible that, for any year, the gap between the "real" gross rates payable and the chargeable amount will be wider.

Possible solutions

12. If it is currently unclear how big an impact unfunded reliefs have on authorities' non-domestic rating income, it is even less clear how that impact could be reduced or eliminated.

13. In theory, measuring the cost of the transitional arrangements net of reliefs would remove the problem. But it is not clear whether this is practically possible; it would almost certainly require, possibly costly, changes to local authorities' IT systems.

14. Moreover, any change in the data collected by NNDR1s would need to be consistent with secondary legislation. Without more work, we cannot be certain that it would be possible to design and legislate for transitional arrangements that measured transitional payments based on the net rates liability. If it were not possible, one option – albeit, one that further complicates the rates retention scheme – would be to de-link the calculation of the cost of the transitional arrangements, form the calculation of transitional protection payments. This would almost certainly require authorities to report two figures in NNDRs. One for the cost of transitional arrangements, which would be used for the purpose of billing ratepayers and reporting the cost of

the transitional arrangements and reliefs in NDDRs; and one for working out the transitional protection payments due.

Next Steps

15. We need:

    i. To consider how best to investigate/model the current impact on authorities' non-domestic rating income of unfunded reliefs;

    ii. Model the potential future impact of ending s.31 grants at a reset.

16. Once we have the results of modelling, and depending on our objective for the rates retention scheme – ie the extent to which we want the arrangements to deliver simplicity and/or fairness and/or transparency – we may conclude that we should simply continue with the existing arrangements, or consider whether;

    i. there are alternatives to the way in which transitional arrangements are currently defined in legislation; or

    ii. there is a practical way of breaking the link between the calculation of the amounts due under transitional arrangements and the determination of transitional protection payments.