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SECRETARY OF STATE FOR THE ENVIRONMENT

PRIME MINISTER

UNIFORM BUSINESS RATE AND REVALUATION: TRANSITIONAL ARRANGEMENTS

In February I announced with colleagues' agreement (my minute to you of 29 November, your private secretary's reply of 12 December, the Chancellor's letter to me of 7 December and my reply of 23 December) our proposals for phasing in the effect of the uniform business rate and of the revaluation of non-domestic property and invited views. Having considered the responses and discussed the issues with the main bodies representing business, I have concluded that we need to amend the proposals in some respects.

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THE ORIGINAL PROPOSALS

We have undertaken to fix the uniform rate so as to raise in 1990/91 broadly the same amount from business and nationalised industries in real terms as in 1989/90. Although the uniform rate and the revaluation will not increase the aggregate rate burden on business therefore, they lead to a major redistribution of that burden. Broadly, retailers will face increases, along with all businesses in some low-rated inner London boroughs: manufacturers, especially in the North and Midlands, are likely to gain. There is likely to be a very wide distribution round the average.

Against this background we had proposed that no property should face an increase in rates of more than 20% in real terms in 1990/91 and of 15% where the rateable value of the property in the new list was less than £7,500 in London and £5,000 elsewhere. These limits on increases would apply in each year up to 1994/95 by which time most properties would have reached their full rate bills. We left open the possibility that protection would be continued after 1995 for properties whose full increases had still not been phased in. These arrangements would apply only to existing properties.

In order to finance this protection for losers and to ensure that the effect of the transition on the yield from business rates was neutral, we proposed also to phase in reductions in bills for existing properties. The maximum reduction was to be about 10% a year in real terms and 15% for small properties (defined as above), the actual figures to be fixed later, when better information about the effects of revaluation was available, so as to balance the pool.

RESPONSE TO CONSULTATION

We have had a heavy response to these proposals. Although generally welcoming the decision to phase in the effect of the new system, business predictably complained that the caps on rate increases were too high and would cause many firms, especially retailers, financial difficulties. A majority of those responding said that the threshold which we proposed to define small properties was too low. There was a strong reaction from potential gainers that it was inequitable that they should be made to pay for the protection for losers and they argued that this protection should be funded by the Exchequer or, failing that, through a premium on the poundage. Significantly the Association of British Chambers of Commerce, which is more representative of business as a whole than any other body, argued for a premium. There was some pressure to extend the transition to new as well as existing properties, in order to avoid market distortions. Local authorities were concerned about their ability to implement such complex proposals and the associations, together with the professional institutions, also pressed for a premium on the poundage.

REVISED PROPOSALS

<u>**Treatment of Losers**</u>

I do not see any scope for ameliorating the effects on loser within a self-financing transitional scheme. Rate increases of this magnitude could have a severe effect on retailer whose profitability is marginal, especially coming on top of the down-turn in retail sales. But for most retailers rents are a far more significant cost than rates and they have coped with rapidly rising rents for most of the 1980s. In view of the paramount need to ensure that gainers receive their gains at a reasonable rate, I propose that we retain the caps on losses of 20% and 15%.

However, the small business lobby has made a convincing case for raising the threshold used to define small properties. Our concern had been to avoid setting the threshold so high that multiple retailers, banks and building societies with many small outlets would benefit. But the evidence is that our proposed figures would exclude also many of the small shops in secondary locations and small industrial units which we would want to protect. So I propose that we should double the thresholds to £15,000 RV in London and £10,000 elsewhere in England. This is not as high as small business representatives wanted, but it should go some way to meeting their concerns. 78% of properties are estimated to fall below these thresholds, but these represent only 16% of aggregate rateable value in the new list and, under our existing proposals for phasing rate reductions, this more generous threshold would not affect the proposed limits on gains.

I am not convinced by arguments for extending transitional protection to new buildings. The purpose of this protection is to help existing occupiers facing increased bills. Occupiers of new buildings will know about their potential rate liabilities in advance. Indeed, I now propose that protection should lapse where there is a change of occupier of an existing building.

Treatment of Gainers

I am convinced, however, that we must enable businesses which can expect reduced rate bills to enjoy more of their gains earlier. Many manufacturers in the North who have long suffered from high rate poundages would see very substantial reductions in bills but for the transition - over 50% in many cases. Yet with inflation at present levels, in cash terms their bills are likely to fall by a mere 2% or so next April under our existing proposals. That is causing a lot of resentment and is alienating the very people who should support the policy, including the ABCC. And it means that the wider economic benefits of redistributing the rate burden will be very slow to come through.

I therefore propose that we do as many of the respondents to the consultation urged and pay for the protection for losers, in part at least, by a premium on the poundage. We considered and rejected this early last year, but at that stage it was not apparent that the reductions in bills in cash terms which gainers would receive under a self-financing scheme which phased both losses and gains would be so small. And, of course, we had not consulted publicly at that stage. The other benefit of a premium is that it makes the administrative task of local authorities simple, an important consideration given the many other burdens which our policies are placing on them at the moment.

In order to balance the pool in each year of the transition, a very high premium of about 9 pence in the pound - around 25% - would be needed in the first year, falling to 1 penny in year 5. The effect is exemplified in the figures prepared by the Inland Revenue at Annex A. Only 24% of properties gain in the first year on this approach, with 71% losing (compared with 40% and 53% respectively under our original proposals), though the number of gainers grows through the transitional period.

I do not believe that so large a premium in the early years is acceptable because it would mean increased bills for so many businesses which could otherwise expect to gain. Annex B therefore exemplifies the effect of a premium of 4p in year 1 falling to 1 penny in year 5. In order to eliminate the large deficit in the pool which would occur in the first year, a 20% limit in real terms on gains would be needed in that year only. Under this option 32% of properties would gain in the first year and 61% would lose, but the proportion of gainers would grow over time. The effect is that big gainers, most of them in manufacturing, get much more of their gains in the early years. Businesses which could expect small reductions or increases but for the transition will pay more at first, but the biggest losers - those whose increases are limited by the caps on losses, pay no more until the year in which they reach their full liability and at that stage the premium may have declined.

This latter scheme as exemplified produces small imbalances in the pool in each year, but these could be minimised by fixing the premium when we have more precise information to one place of decimals. It takes account of my proposal above to raise the threshold defining small properties for the purposes of protecting losers.

I propose that we should adopt a scheme on the lines of that in annex B. I believe that a premium at this modest level produces an acceptable distribution of losers and gainers in the early years. If you and other colleagues disagree, I see little alternative but to accept that part of the cost of protecting losers should be met by the Exchequer, because I do not think that our original proposals for phasing in gains are sustainable.

NEXT STEPS

If you and other colleagues agree these proposals I would aim to announce them in July, probably to coincide with the tabling of amendments to the Local Government and Housing Bill necessary to give them effect. Meanwhile the Inland Revenue are preparing a updated survey of the effects of the revaluation, based partly on a sample of actual revaluations rather than estimates. I should want to consider whether these proposals need fine-tuning in the light of the survey results, in consultation with Nigel Lawson. I would hope that we could publish those results at the time of my announcement.

SECRETARY OF STATE FOR THE ENVIRONMENT

CONCLUSION

I should be grateful for your and colleagues' agreement:

i. to retain limits on rate bill increases of 20% a year in real terms on large properties and 15% on small ones;

ii. to increase the threshold for defining small properties to £15,000 RV in London and £10,000 elsewhere;

iii. to limit protection to existing occupiers;

iv. to finance this protection by a premium on the poundage, together with a 20% limit on rate reductions in real terms in 1990/91: the premium would be fixed in the light of the new survey being carried out by the Inland Revenue;

and for my announcing these conclusions in July when the necessary amendments to the Local Government and Housing Bill are ready.

I am sending copies to members of E(LF), to John Wakeham, David Waddington and to Sir Robin Butler.

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(Approved by the Secretary of State
and Signed in his Absence)

7 June 1989

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ANNEX A

Scheme A - England

Premiums are 9p, 4p, 2.5p, 1.5p, 1p. RV threshold is £15000 in London, £10000 elsewhere.

1. First Year Change

Numbers of properties (000)

Gainers	Small Properties	Large Properties	All Properties
50% or more	40	5	45
25% to 49%	125	30	155
5% to 24%	130	45	175
Total	295 (24.0%)	80 (23.5%)	375 (24.0%)
Little change	60 (5.0%)	15 (4.5%)	75 (5.0%)
Losers			
5% to 10%	50	10	60
11% to 20%	810	230	1040
Total	860 (71.0%)	245 (72.0%)	1100 (71.0%)
Overall Total	1215	340	1555

2. Five Year Changes

Numbers: thousands; Rate bills: £m

	Gainers		Little Change		Losers		Shortfall(-)/ Windfall(+)
	Numbers	Rate Bill	Numbers	Rate Bill	Numbers	Rate Bill	£m
1990-91	375	2100	75	500	1100	5590	-20
1991-92	495	2610	100	590	960	4980	-30
1992-93	540	2750	105	680	905	4800	+40
1993-94	575	2830	120	760	865	4630	+20
1994-95	590	2890	115	750	850	4580	+10

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ANNEX B

Scheme B - England

Premiums are 4p, 4p, 3p, 1p and 1p. RV threshold is £15000 in London, £10000 elsewhere. Caps on gainers of 20% apply in 1990-91.

1. First Year Change

Numbers of properties (000)

Gainers	Small Properties	Large Properties	All Properties
50% or more	0	0	0
21% to 49%	0	0	0
5% to 20%	385	105	490
Total	385 (32.0%)	105 (31.0%)	490 (31.0%)
Little change	80 (7.0%)	25 (7.0%)	105 (7.0%)
Losers			
5% to 10%	55	15	70
11% to 20%	690	200	890
Total	745 (61.0%)	210 (62.0%)	960 (62.0%)
Overall Total	1215	340	1555

2. Five Year Changes

Numbers: thousands; Rate bills: £m

	Gainers		Little Change		Losers		Shortfall(-)/ Windfall(+)
	Numbers	Rate Bill	Numbers	Rate Bill	Numbers	Rate Bill	£m
1990-91	490	3130	105	590	960	4470	-10
1991-92	495	2610	105	590	960	4980	-30
1992-93	525	2670	105	700	925	4970	+130
1993-94	590	2890	115	750	850	4470	-90
1994-95	590	2890	115	750	850	4580	+10

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Rates