

CONFIDENTIAL

1. MR EDWARDS

FROM: R FELLGETT

2. CHANCELLOR

Date: 22 November 1988

I agree. DOE have also been toying with an alternative scheme whereby all gainers would reach their full gains by 1995 (say). For such a scheme to be self-financing, however, losers would likewise have to reach their new assessment by 1995, contrary to the undertakings which Mr Ridley has given.

cc: Chief Secretary  
 Financial Secretary  
 Paymaster General  
 Economic Secretary  
 Sir P Middleton  
 Mr Anson  
 Mr Monck  
 Mr Phillips  
 Mr Scholar  
 Mr Culpin  
 Mr Turnbull  
 Mr Potter  
 Mrs Holmans  
 Mr H Burns  
 Mrs Chaplin  
 Mr Tyrie  
 Mr Call

AJCE.  
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Not R M.

#### UNIFORM BUSINESS RATES AND REVALUATION: TRANSITIONAL ARRANGEMENTS

Mr Alex Allan's minute of 3 November reported your views on the transition to reformed rates bills after 1990, following my submission of 1 November. I subsequently met DOE officials and learnt that Mr Ridley's preliminary thinking was very close to your own.

2. I now attach a draft minute that Mr Ridley is being advised to send to the Prime Minister, proposing specific transitional arrangements. If you are content with all the details (and Mr Ridley is also) we will inform DOE before he writes, and prepare a draft minute you might send the Prime Minister to express your agreement a day or two after Mr Ridley has written.

Ch  
 Some points to be picked up / sorted out, but generally OK.  
 I'm nervous about publishing statistical study (para 12).

AA

The proposed scheme

3. The draft that DOE officials have prepared:

- i) recognises the overriding need for the scheme to be broadly self-financing, and for the cost of phasing for losers to be met by phasing gains.
- ii) proposes generally to phase increases in rate bills at 20% a year (before the annual change in the NNDR poundage, ie broadly in real terms), financed by phasing reductions for gainers at about 10-12% a year.
- iii) proposes quite an extensive special scheme for small businesses. Losers among small properties (defined by their new rateable value, with different thresholds in London and outside) would face increases of only 15% a year. Small premises, similarly defined, would receive gains in full immediately in 1990-91.
- iv) proposes to phase-in very small cash changes immediately, even if they represent large percentage changes, by making all changes for "properties" with a new rateable value of £100 or less immediately.

This general approach is consistent with your instructions to us, and one or two points reflect detailed suggestions we have made to DOE. I understand that the detailed proposals for losers are quite firm, but Mr Ridley may consider some variants on this precise approach for gainers.

Possible pressure points

4. It may be helpful to summarise the aspects of the scheme which are most likely to generate pressure for concessions.

5. The scheme envisages that small business losers will have slower phasing of increases in rates bills than large business; and all small business gainers will have immediate full reductions, whereas many large businesses gainers will not. The definition of small business by reference to its rateable value will generate anomalies, eg between a medium-sized shop and a chain of small ones. Large businesses may well complain. However, the total cost of the concessions to small business averages around £80 million a year (less in 1990-91, more towards 1994-95), and requires the percentage limit on gains for large business to be reduced by only about 1½ percentage points a year. It will be necessary to explain to the representatives of large business that the effect on their members is relatively small; but there is inevitably a danger that they will respond by saying that it could therefore easily be met by the Exchequer.

6. You will wish to consider whether the attractions of offering gains in full in 1990-91 to small business outweigh the chances of provoking a reaction from large business gainers, who will be subsidising both gainers and losers among small business. We would see merit in phasing gains similarly for large and small business; or, if some concession to small business gainers is necessary, having the same differential as for losers (eg 10% gains for big business and 15% for small). If you agree, we will let DOE know before Mr Ridley finalises his proposals.

7. The paper proposes to balance gains and losses over the five year period from 1990-91 to 1994-95 as a whole, not year by year. The arithmetic requires a deficit of £22-44m in the pool in 1990-91, which may have to be met by grant rather than Community Charge, and a surplus in most other years. It may prove difficult to claw back any extra RSG for 1990-91 in later years.

8. The scheme envisages that losers among large business will face increases at the rate of 20% a year, whereas reductions for gainers among large business will be around just half that - 10% a year. It should be no surprise that at present losers generally pay less rates than gainers, so in a self-balancing scheme

percentage increases will be larger than percentage reductions. But the gap will probably be wider than many people expected. Narrowing it would cost up to around £300 million a year, if it were closed completely.

9. No doubt these points, and perhaps others, will be made by business representatives when the scheme is announced. Apart from the possible reaction of large business to the small business scheme, however, we have no reason to expect that such pressure will be too severe to be dealt with; and DOE seem commendably robust in their defence of the requirement that the scheme be self-financing.

#### Handling and announcement

10. It has proved impossible to arrange another meeting of E(LF) before 22 December. Mr Ridley therefore hopes to clear the proposal in correspondence, although there remains a possibility that the Prime Minister or other colleagues may ask for a meeting.

11. The draft paper envisages that Mr Ridley will announce the scheme and the specific limits on losers as soon as possible. However, he will give only an estimate of the likely limit (or limits) on gains. More information will become available over the next few months, as the VO proceed with the rating revaluation and local authorities fix rate poundages for 1989-90. The calculation of the cap on gains can therefore be refined, to reduce the risk that it might not, after all, be self-financing. Regulations to implement the scheme would be taken through both Houses sometime between Easter and the summer Recess in 1989. We agree with this approach.

12. When the announcement is made, there will naturally be immediate questions about how the Government arrived at its decisions (or rather proposals, as business and local authorities will need to be given an opportunity to comment on them, and one cannot exclude minor revisions to the scheme as a result). We therefore envisage that a suitable version of the Inland Revenue

statistical study should be published on the date of announcement; indeed, Mr Ridley seems to have committed the Government to doing so. As he notes, this will need to be cleared with you and him. A draft is being prepared.

#### Wales

13. The paper assumes that very similar (although not identical) transitional arrangements will apply in Wales, although I understand Mr Walker has not yet considered the question himself. We will encourage the Welsh to keep as close as possible to the English scheme, but not (in view of your comment in Mr Allan's minute) to the extent of suggesting any transfers of grant from Wales to England to keep the two national NNDR and RSG totals in balance.

#### Other points

14. The DOE paper assumes that the transitional arrangements will be based on 1989-90 rates bills, whereas we are currently preparing advice on the option of basing them earlier to help meet the VO's shortage of professional valuers. We hope to forward final advice on this point very shortly. The paper also takes no account of the proposal in the Chief Secretary's letter of 21 November that the NNDR poundage should be calculated in 1990-91 to maintain the total amount of rates paid by private business, rather than allowing this element of the tax base to be eroded. (Your minute to the PM could usefully re-emphasise the importance of this point). If necessary, these points may need to be incorporated in the detailed figures to be published. But they should not affect them sufficiently to be relevant to the decisions that now need to be taken.

Conclusion

15. The DOE paper broadly reflects Mr Ridley's views, and is consistent with your own. We agree with the proposals for handling. I therefore recommend that you endorse the scheme in detail, subject to your views on the particular proposal for small business gainers (para 6 above). We will let DOE know your views, and that you expect to minute the Prime Minister supporting at least the general nature of the scheme.

Robin Fellgett

R FELLGETT

*1. Am sorry, until  
with Mr. R's scheme  
subject (a) to the  
write on Mr C's wife  
(b) to do with Mr F  
what you want by M-F  
explain why (with  
(c) to not publish to IR  
statistical study, which  
is a draft on transition  
and case, which of course  
is simple. Mr.*

CONFIDENTIAL

DRAFT MINUTE FROM THE SECRETARY OF STATE TO THE PRIME MINISTER

UNIFORM BUSINESS RATE AND REVALUATION : TRANSITIONAL ARRANGEMENTS

We last considered this subject in February (my minute of 20 February, and John Major's and your Private Secretary's letters of 29 February), and I subsequently announced our agreed proposals in outline to the House at Report Stage of the Local Government Finance Bill on 21 April. I am now seeking your and colleagues' approval to detailed proposals to be contained in regulations, and an early announcement of their outline.

The background is that the revaluation and uniform rate in 1990 will cause major shifts in the rate burden for many businesses. Broadly, retailers are likely to face increases, along with all businesses in some low-rated inner London boroughs; manufacturers, especially in the North and Midlands, are likely to gain.

During the passage of the Bill, the retailers' and small businesses' organisations and some of our backbenchers pressed for a transitional package including:

- a 10% per year ceiling on increases, with the biggest increases spread over an indefinite period;
- increases in the uniform rate to be held below the RPI;
- a standard abatement of rateable value for small businesses;
- protection for losers to be financed by the Exchequer rather than by gainers.

We successfully resisted this. Instead, we announced a package consisting of;

- an unspecified percentage ceiling on increases for the first five years, with power to extend it beyond 1995 if required;

- power to set a lower ceiling for small businesses (more accurately, small premises);
- protection for losers to be financed by phasing benefits for gainers in corresponding fashion.

In resisting pressure to announce a figure for a ceiling on increases, we referred to an Inland Revenue survey of the forecast effects of revaluation, to be available in the autumn. We now have that survey; selected key tables are at ~~Annex A~~ <sup>annexed</sup>. Broadly, it confirms our expectations of the likely pattern of gains and losses by area and type of business. In one major respect, it contains good news. The increase in total rateable values from the old 1973 list is forecast to be a multiple of 7.5, higher than expected; the proportionate reduction in the new uniform poundage from the present average will be correspondingly greater. This means that individual businessmen who have forecast their own RV fairly accurately, but have relied on published forecasts of the poundage, will pay less than they have been expecting.

The less good news is that changes in rateable value, and hence rate bills, are even more widely dispersed than we had expected, with a significant proportion of properties facing very large increases (4% in excess of 200%). No doubt when we publish an edited version of the survey as we have promised, these cases will hit the headlines, although the businesses concerned will be protected by the transitional arrangements for at least five years.

The key findings of the survey are set out in Tables 1-3 at annex A. Table 1 shows the numbers of properties gaining and losing by specified percentages. Table 2 shows the effect on rate burdens by region, with the North and Midlands gaining some £900m after transition, around half of it paid for by businesses in the City and Westminster. Table 3 shows the effect by property type by region. (This last table uses small samples and some figures may be unreliable).

#### Proposed Transitional Arrangements

The survey goes on to analyse the cost of various possible transitional arrangements, in terms of the limit on gains that corresponds to specified levels of protection for losers in order to make the package self-financing and therefore neutral in its effect on local authority income. Table 4 shows



that limits on increases of 15%, 20% and 25% would mean respectively, limits on gains of 9%, 12% and 14% averaged out over the 5-year period; it also shows the numbers of properties with increases and reductions still to come after five years under each scheme and that a 5% lower limit on losses for small businesses would make very little difference to the overall "cost" of the package.

My proposals are set against the background of these figures, the expectations generated during passage of the Bill, and the overriding need to make the pool broadly self-financing. On the one hand, businesses, especially small shopkeepers, are very worried about the effect of revaluation on their businesses, and have strong support on our backbenches. They are pressing for a 10% ceiling, and I think looking realistically for 15%. On the other hand we also have an obligation to the manufacturers and others in the North and Midlands who stand to gain from our reforms; it will be particularly difficult to justify deferring these gains once it is on the public record what they "ought" to pay in rates.

I propose an annual percentage ceiling on increases of 20% for businesses at large, with a reduced ceiling of 15% for small businesses. The latter would be defined as properties with a new rateable value below £7500 in London and £5000 elsewhere; this includes the vast majority of corner shops, plus small workshops and other one-and two-man businesses. The ceiling works on a compound basis, with the result that for large businesses increases of up to 149% will come through in full by the fifth year; for small businesses the figure is 101%.

The cost of this in terms of the limit on gains, if spread over all gaining businesses, and averaged over five years as I propose, would be an 11½% limit on gains. This means deferring rate reductions exceeding 46% to beyond the fifth year. However, the survey also reveals that it would be possible to discriminate in favour of small business gainers as well as losers, at relatively little cost to the big business gainers. This has advantages of administrative simplicity besides appearing more generous at modest cost. I therefore propose that small businesses (defined as before) should receive their full gains immediately. This means setting the limit for larger gainers at 10%, and deferring their gains over 41% beyond the fifth year.

There is one further small refinement. Included in the figures are a number of very small properties, such as AA phone boxes, which are not really businesses at all. Again for the sake of simplicity, I propose that properties with a new RV below ~~£100~~ should be outside transition entirely. Below that level one can be confident that a property is not supporting even a one-man business. ~~Table 5 at Annex A~~ shows the detailed effects of all these proposals in combination.

The figures quoted above are all in real terms. There is a case for rolling up the annual RPI-linked increase in the uniform rate, making an assumption about inflation, and specifying the limits in cash. 20% and 15% limits on gains might thus become 25% and 20%, and a 10% limit on losses would become 6%. This would be simpler to explain and administer. On the other hand, it makes the increases look larger, and involves going public with what would be seen as an inflation forecast for longer ahead than is our practice. On balance, I therefore propose to specify the limits in regulations in real terms, with the actual annual RPI increase to be added year by year.

I propose to maintain our previous line of giving no commitment to extending the arrangements beyond the fifth year, and, if pressed on behalf of the few very big losers, to say that we shall consider their position when we can forecast the results of the 1995 revaluation. By that time they may have benefited from some reduction in rents as the cost of the rate increases are passed on in part to landlords.

Taken as a whole, I believe my proposals strike the right balance between giving businesses in the North and Midlands their long overdue benefits, and checking the drift of economic activity to the South-East; and on the other hand giving small retailers the protection they are entitled to expect and ensuring that the horror stories from their organisations of widespread bankruptcies will not materialise. It is worth noting that rates are typically 1-4% of business turnover, and very rarely exceed 10%. A 15% annual increase will therefore commonly be less than ½% of turnover, and 2% at the very most.

The arrangements in Wales would be subject to the same structure, but it would be open to Peter Walker to adopt different figures if he thought fit. In practice, I understand through officials that he is content to have the same

limits for losers, but plans to calculate a different limit for gainers to balance the separate Welsh pool. The position in Scotland is different, with no uniform rate in 1990 and much less turbulence likely to result from revaluation because of the shorter interval since the last one. It is for Malcolm Rifkind to decide whether to use his powers to phase the effects of the revaluation.

I do not need to make the regulations until next summer. I undertook during passage of the Bill, however, to make an announcement this autumn when the Inland Revenue survey was complete. Subject to colleagues' agreement, therefore, I propose to make a statement in the House shortly containing a firm commitment on the protection for losers, and a provisional indication of what this will mean for the limit on gains. Leaving the latter open will give time to refine the figures and consult colleagues on matters not considered here including how, if at all, the arrangements are to apply to Crown property. Before the announcement, Nigel Lawson and I will also need to clear for publication an edited version of the Inland Revenue survey. I should be grateful for your and colleagues' agreement to my proposals for the transitional arrangements, and to my making an announcement on the lines I have described.

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

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TABLE 1  
Distribution of gainers and losers nationally (England)

	No of properties '000	%	1989-90 rate bills £m*	1990-91 burden £m	Real change in rates burden £m	% change in rates burden
<u>Change in rates burden</u>						
Reduction of 50% or over	131	8	1097	431	-666	-61
" 25% but less than 50%	281	18	2480	1576	-904	-36
" 5% " " " 25%	262	16	2013	1725	-288	-14
" of 0.5% " " 5%	53	3	420	409	- 10	- 3
Change of less than +/- 0.5%	13	1	60	60	---	---
Increase of 0.5% but less than 5%	46	3	351	360	9	3
" of 5% but less than 10%	50	3	347	371	24	7
" " 10% " " " 15%	57	4	367	411	43	12
" " 15% " " " 20%	59	4	352	411	59	17
" " 20% " " " 25%	54	3	287	350	62	22
" " 25% " " " 50%	196	12	1138	1541	402	35
" " 50% " " " 75%	115	7	499	808	308	62
" " 75% " " " 100%	74	5	337	634	297	88
" " 100% " " " 200%	131	8	263	626	362	137
" " 200% " " " 300%	35	2	30	104	74	242
" " 300% " " " 500%	22	1	22	109	86	381
" " 500% or more	7	--	20	158	137	669
 SUMMARY						
All Gainers	728	46	6012	4143	-1869	-31
No gain/no loss	13	1	60	60	--	--
All Losers	852	53	4019	5888	1869	47
Overall Totals	1593		10091	10091	--	--

\* In 1990-91 Prices

TABLE 2

Changes by region in rates burden: estimated 1990-91 burdens after revaluation and the introduction of NNDR compared with indexed 1989-90 burdens.

Region	Indexed 1990-91 burden		1990-91 burden after revaluation and introduction of NNDR		Change in rate burden relative to indexed 1989-90 burden	
	£m	% of National total	£m	% of National total	£m	% change
England:-						
North	596	6	517	5	-79	-13
Yorkshire & Humberside	928	9	733	7	-195	-21
East Midlands	731	7	575	6	-155	-21
East Anglia	325	3	375	4	49	15
Inner London	1809	18	2311	23	501	28
Outer London	881	9	947	9	65	7
Rest of South East	1963	19	2214	22	251	13
South West	692	7	836	8	144	21
West Midlands	948	9	727	7	-221	-23
North West	1212	12	852	8	-360	-30
England	10091	100	10091	100	--	--

Note : All figures in assumed 1990/91 prices

TABLE 3

ANALYSIS OF BURDEN CHANGES BY PROPERTY TYPE WITHIN REGIONS  
COMPARISON OF 1990-91 BURDEN (BEFORE TRANSITIONAL ARRANGEMENTS)  
WITH INDEXED 1989-90 BURDEN

Region	PROPERTY TYPE						All Properties Burden Change (%)
	Shops with living accommodation	Shops without living accommodation	Offices	Warehouses	Factories	Other + Properties	
	Burden Change (%)	Burden Change (%)	Burden Change (%)	Burden Change (%)	Burden Change (%)	Burden Change (%)	
Northern	-3	-15	-36	-47	4*	-15	-13
Yorkshire & Humberside	21	-15	-14	-32	-36	-14	-21
East Midlands	-3	-10	-26	-21	-40	-14	-21
East Anglia	34	36	10	2	-10	24	15
Inner London	69	61	20	3	-30	43	28
Outer London	32	30	0	-9	-24	25	7
Rest of South East	15	27	28	4	-8	17	13
South West	38	39	21	11	-4	25	21
West Midlands	-10	-13	-19	-35	-50	-4	-23
North West	-15	-28	-32	-38	-44	-19	-30
<u>England</u>	17	12	12	-14	-26	7	0

\*The result for this category is suspected of being inaccurate

+ Includes Crown, local authority, public utilities, pubs and hotels, sport, entertainment and miscellaneous.

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TABLE 4

## EFFECTS BY FINANCIAL YEAR OF VARIOUS REVENUE NEUTRAL TRANSITIONAL SCHEMES

	Increase in burdens met by losers before transition	Effect of transitional scheme for losers		Restriction on gains to finance scheme		
		£m	number benefiting '000	Cost £m	Cap on gainers %	Number affected '000
UNIFORM CEILINGS FOR ALL LOSERS						
15% CAP ON ALL LOSERS						
1990-91	1869	696	1367	9	617	1384
1991-92	1944	521	1005	10	497	1008
1992-93	2022	382	738	9	410	747
1993-94	2102	285	537	9	330	537
1994-95	2186	204	394	8	266	398
20% CAP ON ALL LOSERS						
1990-91	1869	639	1233	12	584	1240
1991-92	1944	428	811	12	442	827
1992-93	2022	293	533	12	336	527
1993-94	2102	190	356	10	254	357
1994-95	2186	115	256	9	201	261
25% CAP ON ALL LOSERS						
1990-91	1869	584	1114	15	542	1103
1991-92	1944	361	663	14	394	668
1992-93	2022	220	391	13	279	398
1993-94	2102	124	255	11	202	255
1994-95	2186	70	182	8	159	185
LOWER 'SMALL BUSINESS' CEILING						
15% CAP WHERE 1990 LIST VALUES LESS THAN £7500 IN LONDON, £5000 ELSEWHERE; OTHERWISE 20%						
1990-91	1869	674	1242	12	584	1240
1991-92	1944	478	825	12	442	827
1992-93	2022	346	548	11	344	551
1993-94	2102	245	370	10	264	374
1994-95	2186	170	269	8	208	274

Note : Cash figures in this table are assumed current prices in each year, derived by a uniform 4% pa uplift on 1988/9 prices.

TABLE 5

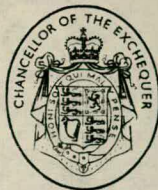
## EFFECTS OF TRANSITION IN ENGLAND BY FINANCIAL YEAR

MAXIMUM INCREASE IN REAL TERMS RATE BILLS SET TO 20% GENERALLY, 15% FOR SMALL BUSINESSES  
ALTERNATIVE 10% AND 10.5% REAL TERMS CAP ON BIG BUSINESS GAINERS ONLY

	1990/91	1991/92	1992/93	1993/94	1994/95
COST OF NET FOR LOSERS	£1242m	£825m	£548m	£370m	£269m
YIELD OF 10% CAP ON GAINERS	£1220m	£883m	£623m	£423m	£284m
POOL IMBALANCE	£-22m	£+58m	£+75m	£+53m	£+15m
YIELD OF 10.5% CAP ON GAINERS	£1198m	£851m	£588m	£391m	£259m
POOL IMBALANCE	£-44m	£+26m	£+40m	£+21m	£-10m
NUMBERS AFFECTED (000's)					
a) PROTECTED LOSERS	674	478	346	245	170
b) GAINERS CAPPED AT 10%	232	187	147	108	78
c) GAINERS CAPPED AT 10.5%	230	183	141	103	73

- NOTES: 1. In outturn prices assuming 4% per annum inflation from 1988/89.
2. Small businesses are those with an RV of below £7,500 in London, £5,000 elsewhere, on the 1990 list.
3. No allowance made for a de-minimis rule excluding the smallest hereditaments from transition.
4. The caps and nets were calculated in nominal terms. Hence a 20% real net is 24% in cash, (a 10% cap on gains is 6%), since inflation is assumed to be 4%.



FROM: A C S ALLAN *ACS*

DATE: 28 November 1988

MR FELLGETT

cc PS/Chief Secretary  
PS/Financial Secretary  
PS/Paymaster General  
PS/Economic Secretary  
Sir P Middleton  
Mr Anson  
Mr Monck  
Mr Phillips  
Mr Scholar  
Mr Culpin  
Mr A J C Edwards  
Mr Turnbull  
Mr Potter  
Mrs Holmans  
Mr H Burns  
Mrs Chaplin  
Mr Tyrie  
Mr Call

**UNIFORM BUSINESS RATES AND REVALUATION: TRANSITIONAL ARRANGEMENTS**

The Chancellor was grateful for your minute of 22 November, and for Mrs Chaplin's comments in her minute of 23 November.

2. He is broadly content with Mr Ridley's scheme, subject to:

- (i) he agrees with your proposal in paragraph 6 that if some concession to small business gainers is necessary, the best would be to have the same differential as for losers (eg 10 per cent gains for big business and 15 per cent for small). But he thinks we shall need to explain fully why this would be preferable;
- (ii) he would not wish to publish the IR statistical study, which was designed to enable us to decide on transitional arrangements, and which - if published - would cause immense aggravation to no benefit.



3. On Mrs Chaplin's minute, he agreed with the points in her paragraphs 2-4, that there is little to be gained by the Secretary of State for the Environment maintaining his line that he can give no commitment to extend the relief beyond the fifth year. He also agreed with the point in her paragraph 7 that we must look carefully at the suggestion that the gains and losses will balance over the five year period rather than from year to year. On her paragraphs 5-6, expressing scepticism about the value of a different level of phasing for small and large businesses, he feels that for political reasons there has to be some special treatment for small businesses; but for the reasons Mrs Chaplin gives it should be more limited than Mr Ridley seems to envisage.

ACSAT

A C S ALLAN