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The Rt Hon John Major MP  
Chief Secretary  
HM Treasury  
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29 November 1988

CH/EXCHEQUER	
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*Dear John*

NON-DOMESTIC RATING

Thank you for your letter of 21 November about harmonisation of rating valuation and related issues.

I have to say that I do not agree at all with your general approach, which will be seen as what it is - an attempt to shift some of the tax burden from public property onto business ratepayers at the outset of the new system.

Taking first your proposal that we should ring-fence the yield from the private sector (in which I assume you include public corporations), rather than non-domestic rates as a whole, that is consistent with our public statements only because we have not been pressed to give that degree of detail. We have repeatedly referred to, for example, "holding the yield of non-domestic rates constant in real terms", and all our published exemplifications have assumed a constant yield from non-domestic rates as a whole. There has been no doubt what we meant, and it will be seen as casuistic to argue otherwise.

The effect of your proposal would be to increase the business rate by some 2%, and increase the proportion of losers from around 54% to 56%. On its own this may not seem much, but there are other factors pulling in the same direction, for example, the cost of the concession to charities, the treatment of mixed hereditaments and any margin we include in the first year's poundage to avoid a deficit in the pool resulting from successful appeals. There is also the threat of increases in the average poundage in 1989/90 as authorities try to build up balances ahead of the new system. Against this background, we cannot justify any further increase in business rates. We will have enough difficulty with business rates as it is, without being accused of concealing a switch from the public to the private sector of 2% as well.

We need not form a final view on this point until we come to forecast the distributable amount of NNDR when we consult on the grant settlement next summer. Meanwhile I suggest we go on working on the same assumptions as in the past, that is with total yield to the pool held constant, and in particular that any exemplifications we publish when I announce the transitional arrangements should be on that basis, as previous ones have been.

Second, although final decisions on the amount of revenue support grant are also for a later stage, I do not accept that there is or should be any automatic trade-off between increases in the "rates" paid by central and local government and the total of RSG. The main argument for paying rates on Crown and local authority property is that public sector occupiers should pay the same marginal costs for occupying accommodation as the private sector. We would not reduce RSG now if the Crown's rate bill increased as a result, for example, of a change of control at Westminster City Council. I see revaluation as no different in principle.

You express concern about the increase in local authority expenditure and community charges resulting from any rise in the decapitalisation rate. The effect of your proposals, however, is to transfer this cost from community charge payers, who can exert downward pressure on local authority expenditure, onto business ratepayers who cannot.

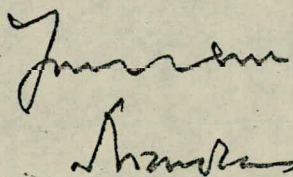
Turning to the decapitalisation rate itself, I do not accept your arguments for a uniform reduced rate for the public sector. This would in effect provide a continued subsidy for the public sector and would distort investment decisions. It would look perverse and inconsistent with our other policies if, when for example an office block was transferred from local authority to private occupation along with a contracted out service, the effect was to increase the rates bill by 20%. I believe you also underestimate the difficulties of principle associated with what you call the small technical amendment required. The rating system operates by reference to the value of the property, not its cost or value to the individual occupier. Moreover, the contractor's method is meant to give a proxy for rental value; and the Government is not able to negotiate significantly lower rents than other major occupiers, so it is unclear why it should pay less for property valued by other means. One merit of my proposal for a lower rate for schools, which other colleagues with an interest have agreed, is that school buildings are physically distinct and rarely put to other uses.

In relation to your comments on educational charities, I think it is worth noting that it was common ground among those who spoke in the House of Lords that the purpose of the concession we gave was to benefit, broadly, social welfare charities, especially those raising funds through charity shops, and that the benefit to the public schools was adventitious and not necessarily welcome. I accept, however, that if we were to adopt your approach to the main rates, we would probably have to concede a 4% rate for educational charities.

Finally, on the main decapitalisation rate, I question whether we should canvass options above 6%. I do not think it likely that in the outcome we shall adopt any rate above that level, and the effect of airing higher figures may be to shift the balance of opinion in the industries concerned against prescription on the basis that they would hope to do better through the normal appeal machinery.

It would, I think, be helpful if we were to discuss the decapitalisation rate and the wider issues you raise on grant, with a view to subsequent discussion at E(LF) if necessary. Meanwhile I trust you can agree that I should exemplify the transitional arrangements on the basis we have always assumed.

I am sending copies of this letter to the Prime Minister and members of E(LF) and to Sir Robin Butler.



NICHOLAS RIDLEY