A plain English guide to business rates retention

The business rates retention scheme is changing (Only applies to England)

Business premises and business rates

Why are we changing the system?

The government wants to give councils more freedoms and flexibilities. This is because we want to reduce Whitehall interference and give more power to local people. We also want to give councils stronger incentives to create and support local jobs and local firms.

The local government finance system is one of the most centralised in the world with councils getting more than half of their income from a central government grant. Under the existing system all businesses - shops, offices, warehouses and factories - pay a tax to their local council (called business rates). Although the local council collects the bills, it doesn't keep the money. It goes into a Treasury pot and is then redistributed back to local authorities, via an extremely complex formula.

There are a number of problems with the current scheme. It fails to reward local authorities for increasing new business in their area. No matter how many new businesses start up in their locality, councils don't get a penny extra. They could even lose out by having to provide additional services to new companies. Instead of encouraging businesses, the system encourages a 'begging bowl' mentality, with councils looking to be rewarded for being worse off. It's a system in need of reform.

Government's proposals will shift more financial power from Whitehall to the town hall, allowing councils far greater influence over the money they earn. Overall, councils will now get to keep 50% of business rate growth giving them a real incentive to go for growth and encourage enterprise and job creation. It has been estimated that these reforms could boost economic growth by around £10 billion over the next 7 years. If economic activity increases, the total amount of money raised from business rates will grow too. This means there will be more money 'in the pot' both for prosperous councils and to support less well-off areas.

They will also have much greater flexibility to pool their business rates to encourage growth across their areas. The scheme also enables councils to borrow money against future business rate growth to fund infrastructure projects in their area. Meanwhile, councils that struggle to increase their business will have protection for basic services. And all councils will now have much greater certainty about their budgets over a longer period of time - allowing them to plan ahead.

How will the new scheme work in practice?

Instead of business rates going straight into the Treasury coffers, town halls will now get to keep a proportion of their growth in business rates.

But the reality is that some wealthier local authorities earn more in business rates than they used to receive from the current formula grant and there are other local authorities who earn much less. So government is levelling the playing field through a mixture of 'top-ups' and 'tariffs'.

In the first instance, government will calculate a funding level for every local authority for 2013 to 2014. Should a local authority receive more in business rates than its funding level then government will pocket the difference (the 'tariff'). This will be used entirely to 'top up' local authorities who receive less than their funding level. Government intends that this will be fixed for 7 years.

Once underway the scheme allows local authorities to keep 50% of business rates income including growth. But without adjustment the scheme would be weighted towards richer local authorities. This is because, for a comparatively small investment in growth, local authorities with a large amount of business property can gain large increases in their revenue. In comparison, local authorities with a small amount of business property who put a lot in, may get comparatively little out.

For example, in a local authority with business rates income of £100 million and funding level of £50 million, a 5% increase in business rates income produces a 10% increase in income compared to its funding level. A local authority with a different rate base (£10 million) and the same funding level (£50 million), would find the same 5% increase in rates income only produces a 1% increase in income compared to its funding level.

To make the rewards of growth more proportionate for different local authorities, where local authorities have greater business rates income than their funding level, the government will take some of their business rates growth as a levy. The levy will be calculated for each individual local authority and will be based on their original business rates income and their funding level. It is designed so that a 1% increase in business rates income will provide no more than a 1% increase in funding, except where this would impose a levy rate of more than 50p in the pound. In these cases the levy will be set so the authority keeps at least 50p in each pound of growth in its business rate income. This means that, even after the government's 50% central share, at least 25p in each extra pound of business rates generated locally, will be retained locally.

The money government takes as a levy will still be ploughed back into local authorities. In this case it will be used as a shock absorber to protect other authorities that see their business rates income drop by more than 7.5%, for example, as a result of a big local business in their local area closing.

What do these proposals mean for you?

Local residents should see greater investment in local services as local authorities see their business rates income increasing. Equally, spending is protected even if it suffers a significant decrease in its business rates income.

Businesses will see no change in the way their business rate bills are calculated. But they will have more influence on local authorities' decisions, including their budget as the local authorities' income is directly linked to the success of businesses in its area.

Charities and voluntary groups which currently receive tax relief on their bills will see no change, as such relief will continue. Local authorities will have much greater incentive to grow businesses in their areas and much greater certainty about their future funding - allowing them to plan ahead, manage risk, budget for the long term and plan for worst case scenarios.

Developers will find a more encouraging atmosphere with local authorities actively seeking to encourage appropriately-sited and well-planned non-residential development. This is especially true of new renewable energy projects that start paying business rates from year 1.

The police authority will not be affected by fluctuations in business rates in their area.

All fire and rescue authorities (that are not part of a local authority) will be funded through a 2% share of each district or borough council's business rates income. They will receive a top-up to bring their funding up to their funding level.

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