Department of Finance and Personnel – Review of Northern Ireland's Non-Domestic Rating System

A Submission by:

The Chartered Institute of Public Finance and Accountancy

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CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

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1. Executive Summary

1.1 CIPFA's experience in the area of changes to funding local services and local taxation shows that substantive change is politically challenging. In order support changes to make a system of non-domestic rating fairer, any changes should be firmly based in and measured against a set of clear principles.

1.2 CIPFA believes that any tax measure should be set against CIPFA's taxation principles that include:

- Accountability;
- Fairness;
- Stability and Predictability;
- Buoyancy of the tax base;
- Ease of Understanding and transparency; and
- Ease of Collection including administration.

1.3 The current system of non-domestic rating based on property net annual values (NAV) has a number of merits, particularly in ease of collection and administration and the predictability of the tax base. However, there are a number of criticisms which necessitate review and potential reform.

1.4 CIPFA views the current system as inflexible and not progressive. There is also a need to consider a rebalancing of the system between business sectors and to differentiate between larger and smaller organisations to distribute the tax more effectively.

1.5 CIPFA's review of the available research would support the view that there is no one method of tax that will address all concerns and form the ideal system. We believe that there is merit in consideration of broadening the tax base to include other forms of taxation if proved feasible. These could include sales, income or payroll based methods of taxation.

1.6 Our understanding of Land Value taxation methods also point to potential for development in the longer term. We would advocate that further work is completed in order to fully explore the merits of developing local land value taxation in Northern Ireland.

1.7 We believe that stakeholders in this debate will have widely differing views and our overall objective in this submission is to inform this important policy debate in order to achieve a fair and sustainable funding system over the long-term.

2. Introduction and background

2.1 The current system of non-domestic rating in Northern Ireland is based on the rateable value of property. The basis of this valuation is that it represents the rental value the property could be let for on the assumption that the tenant is responsible for rates, repairs and insurance. This valuation basis is referred to as the Net Annual Value (NAV).[1]

2.2 Valuations have recently been updated in Northern Ireland through a valuation exercise completed as at the 1st April 2013. The resulting valuations are applied from April 2015 in non-domestic rate charges.[2] Prior to the April 2013 valuation, the last revaluation was based on 1st April 2001 valuations and implemented from April 2003.

2.3 The structure of Local Government services, and therefore the allocations of funding, in Northern Ireland is different to England, Wales and Scotland. A number of Local Government functions are administered and provided by Central Government in Northern Ireland, for example housing and education. The Non-Domestic rate in Northern Ireland is split between resources that fund district council services and those that fund regional services provided by Central Government bodies, (see table below).

2014/15 Domestic and Non-Domestic Rates in Northern Ireland

2014/15 £m	**District Income**	**Regional Income**	**Total**
Domestic	£261m	£319m	£580m
Non-Domestic	£254m	£339m	£592m
Total	£515m	£658m	**£1,172m**

2.4 The total revenue raised through both domestic and non-domestic rates in Northern Ireland is approximately £1.17bn, with around 50% of this being funded through non-domestic rating. Non-Domestic Rates make up approximately 31% of district council total income which includes domestic

[1] NI Business Info: How Business Rates are Calculated, https://www.nibusinessinfo.co.uk/content/how-business-rates-are-calculated

[2] Department of Finance and Personnel – information on Non-Domestic Rating, https://www.dfpni.gov.uk/topics/property-rating/non-domestic-rating

rates, income earned locally through fees and charges and other revenue grants.[3]

2.5 The setting of rates is a split responsibility between district councils, for district income above, and central government for regional income. Both set a poundage rate which is applied to the NAV in the case of non-domestic rates to arrive at the income figure. A key feature of the poundage rates set is that while district council poundage rates vary, the central government rate is one single rate that applies across all councils.[4] The system of non-domestic rates is supported by a fairly complex set of reliefs based on location and industry or business sector.

2.6 CIPFA's has worked with the Local Government Association in England to set up the Independent Commission on Local Government Finance. In relation to reform of business rates the Commission's report[5] recommended that multi-year funding settlements be in place for local government. This would enable effective long-term planning for local authorities. The Commission also recommended that there should be consultation on localisation of business rates reliefs.

3. Evaluating the current system

3.1 The current system has both positive aspects and a number of criticisms that need to be addressed. The system has advantages in that rating based on property is easy to understand and determine. The tax base on property is immobile, evasion is relatively difficult and it is simple to allocate the tax base to individual local councils.[6]

3.2 Criticism arises in a number of areas when rating is linked to property values:

- While there are a range of reliefs and exemptions, there is not a link between the charge and the resources to pay, limiting its fairness in that it is insensitive to the circumstances of individual businesses. There is also merit in looking at where relief can be targeted towards providing incentives for businesses to develop.

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[3] Based on figures from the Northern Ireland Audit Office report: Local Government Auditor's Report 2015, June 2015

[4] Department of Finance and Personnel – Rate Poundages 2015-16, https://www.dfpni.gov.uk/articles/poundages-2015-2016

[5] Independent Commission on Local Government Finance, Final Report, Feb 2014 - http://www.localfinancecommission.org/documents/iclgf-final-report

[6] Findings from the report: Options for Business Rate Reform, June 1995 published by the Institute of Fiscal Studies, supported by the Joseph Roundtree Foundation

- As a significant proportion of the non-domestic rating is based on a central government poundage set at one rate across all councils, the charge is not fully reflective of services provided within the local district. The regional rate element is pooled to fund regionally administered services.

- The current system of non-domestic rates taxes only a single input to the business process (property), therefore any property intensive businesses face a greater burden.

- The development of e-commerce and online retailing is changing the nature of the way business is conducted. The Centre for Retail Research in the UK has reported that online sales growth in the UK has risen by 15.8% in 2014 and 16.2% in 2015.[7] Ofcom also report that in Northern Ireland 60% of those with internet access purchase goods and services online.[8] Its impact on rating is that property based organisations such as high-street retailers feel unfairly disadvantaged by the current rating system when compared to on-line counterparts.

3.3 Research provided by the Northern Ireland Assembly's Public Finance Scrutiny Unit[9] supports the last point above. The research notes in its conclusions that the proliferation of internet use and associated rise in online retail transactions has contributed to the transformation of the retail sector in Northern Ireland. Further it concludes that the system for charging non-domestic rates in Northern Ireland appears to favour the online retailer at the expense of their bricks and mortar counterparts.

3.4 Online retailers can avail of two distinct areas of advantage over their bricks and mortar counterparts. These are firstly that they can locate their centre of operations in an area of lower property values and also lower non-domestic rate poundage. Secondly they can employ business processes that limit or negate completely the need to hold significant stock levels, and therefore space requirements, through just in time or drop and ship supply chain management. Both of these have the potential to lower the non-domestic rates burden for these operations when compared to regular retailing through stores.

3.5 We recognise that the Assembly makes a number of policy interventions to mitigate the impact of Non-Domestic rates on businesses. Most of which

[7] Centre for Retail Research: Online Retailing: Britain, Europe, US and Canada 2015, http://www.retailresearch.org/onlineretailing.php
[8] Ofcom: Communications Market Report Northern Ireland Research Document, August 2013
[9] Research and Information Service Briefing Paper 61/15: Rating Online Retailers in Northern Ireland: preliminary considerations, May 2015

relate to support for particular sectors, such as industrial de-rating or exemptions to charities. There is also support for smaller businesses through the small business rates relief scheme. However as the rating system is based around property which is generally capital employed in a business, this does not take account other inputs to a business and provide a fairer basis for linking to resources to pay.

3.6 The mitigation measures the assembly currently makes available cost £221m based on 2015/16 estimates.[10] This represents over a third of the potential non-domestic rate income (district and regional) being lost. While mitigation is required, we would suggest that consideration be given to reviewing areas where there is opportunity to improve the targeting of reliefs.

3.7 For example, charities that operate as social enterprises usually operate along commercial lines and generate profits. The difference between private companies and social enterprises is primarily how the profits are distributed. Social enterprises re-investing those profits in either charitable ventures or the enterprise itself as opposed to a private business where profits would be available for distribution to its shareholders. There should be a case to treat all profit generating enterprises in a similar manner and to assess the profiling of charitable organisations to determine if there is a reasonable case to consider some form of rates contribution.

3.8 The mitigation of hardship is expected to cost £0.003m in 2015/16 out of the £221m lost revenue. In order to provide for a fairer system that doesn’t just de-rate by sector or industry, there is a case to assess providing more to alleviate hardship, as opposed to outright sector de-rating, and to have a revised formal system and process to avail of hardship relief. While de-rating sectors is administratively simple, it does not take account of business that are trading profitably in a sector compared to others that are on the margin of survival. In this case the burden of non-domestic rates on a net basis is significantly higher than a profitable business as the business rates cost cannot be set against corporation tax liabilities where no profits arise.

3.9 The issue of relief for non-domestic vacant property rating cost £43m but does not necessarily provide any incentive for the owners to develop the vacant property and bring it back into viable use. Currently relief is provided at a level of 50% on vacant property in Northern Ireland. In Scotland for example relief is reduced to 10% after three months.[11] This

[10] Department of Finance figures providing an approximate figure reflective of 2015/16 actuals. Represent the combined revenue lost to both district and regional rate tax bases.
[11] Scottish Government: Business Rates Reliefs, https://www.mygov.scot/business-rates-relief/empty-buildings-reliefs/

issue of incentives within the relief schemes should also be considered. In the case of vacant property this might be time limited, i.e. relief is only available for a certain period of time or only after the property is vacant for an extended period.

4. Reform and broadening the tax base

4.1 CIPFA supports the view that consideration should be given to broadening the tax base. The purpose of broadening the tax base is to move away from a tax base dependant on one single factor of business production and operations, i.e. capital invested in property. If the tax base is widened to include other elements of the business, such as labour, turnover or profits it should lead to a business rate more responsive to economic conditions, including changes to particular sectors within the economy.[6]

4.2 Evidence of what is referred to as a multi base business tax system can be seen in France and Germany where for example the 'taxe professionelle' in France taxes a variety of inputs including property, machinery and payroll. Similarly, in Germany, the local business tax has a broader base than non-domestic rates in Northern Ireland.[12]

4.3 In its simplest form, a multi base business tax could include a mix of two elements, for example property based and payroll based charges. An advantage of using payroll is that a considerable amount of information is already collected by HMRC and could be used to local tax purposes. This includes information on business level payroll and the business locations. A second advantage is that it captures additional elements of demand made on local services by the non-domestic sector through the number of employees as well as the organisations property assets.

4.4 Any consideration of a multi base business tax would however need to consider the basis and the costs of implementation carefully. For example, if an element of the multi base was sales or profits, there would need to be an administrative system in place to both capture the data and potentially provide a system of rebates. Rebates might be required where profitability is below a certain level, meaning that the tax operates similar to domestic rates where there are rebates on the ability to pay. The setting up of any new administrative systems to support a multi base business tax could prove expensive and would require consideration of feasibility.

[12] Slack, E. and R. Bird (January 2014), "The Political Economy of Property Tax Reform", *OECD Working Papers on Fiscal Federalism*, No. 18, OECD Publishing.

4.5 Changes to the nature and make-up of business rates would require a full assessment of the impact of any distribution changes resulting from a new tax base. If a simple multi base tax as outlined in 4.3 above were implemented, districts with a greater concentration of employment would likely benefit in terms of tax raised. Assuming no change in the overall tax take, a system of redistribution would be required to ensure that districts where the tax take is reduced as the employment base is much lower are not significantly disadvantaged.

4.6 The question also arises over whether the tax base should be set locally or regionally. If under a multi based business tax system all the tax levels were set locally, this would improve local accountability for costs and services delivered. However, it may have the potential to create geographical distortions in business decisions over where to locate operations due to favourable business tax rates.

5. Assessment of a Land Value Tax (LVT)

5.1 There has been growing interest among academics and political parties on the application of a LVT. This includes work by the Institute of Fiscal Studies,[13] the Scottish Green Party,[14] and NICVA's Centre for Economic Empowerment.[15] Glasgow City Council also completed an assessment and pilot of Land Value Tax in 2009.[16] The following paragraphs draw on this research and information and assess LVT against CIPFA's principles of taxation

Accountability

5.2 LVT is a tax levied on the unimproved value of land, or the site value in its highest and best current use. This form of tax has a number of advantages in that it is through the work of the local authority in granting planning and enabling local development that adds to the value of the land. This is through both development and infrastructure being put in place nearby or on the land or, through enabling the landowner to develop the land for use. An issue in accountability may arise depending on whether the tax is set locally or regionally/nationally as can be the case.

[13] Institute for Fiscal Studies: Tax by Design – Report from the Mirrlees Review, Chapter 16, 2011
[14] A Land Value Tax for Scotland - Fair, Efficient, Sustainable: A report prepared by Andy Wightman for the Green MSPs in the Scottish Parliament
[15] NICVA – Centre for Economic Empowerment: A Land Value Tax for Northern Ireland, 2015
[16] Glasgow City Council: Local Taxation Working Group 2009 Report, Consideration and assessment of Local Taxation Model – Land Value Tax
http://scottishpropertytaxreform.org/docs/LTWG_Glasgow_Overview_Report.pdf

5.3 If set regionally; this would override any local accountability for the level of tax by locally elected representatives. There may also be an issue if the tax is set locally and how any regional government equalization would interact with an LVT in terms of LVT generating other economic benefits such as enabling un-developed land to be brought back into use, therefore providing increased non-domestic revenues that are centrally redistributed.

Fairness

5.4 LVT can be seen as a progressive and fair tax. LVT should be raised on all land and therefore also provides some wider economic benefits to the area.

5.5 LVT is progressive and fair in that is reflects the investment in the local area completed by both the local authority and the landowner. As land is essentially a finite resource there naturally and not man made, increases in value are shared with the community rather than the wealth created being transferred to private ownership. An example of this is the Jubilee line extension in London where the public investment of £3.5bn resulted in land values increasing between £13.5bn and £9.75bn depending on the study referred to.[17]

5.6 LVT can provide wider economic benefits such as:

- Bringing under-developed land back into use. If LVT is raised on all land, the benefit of land banking for capital appreciation is eroded by the liability to pay LVT and;

- Additional sources of local taxation would be available from land that is currently not subject to tax, such as Forestry and Agriculture, or on homes where there is currently council tax discount or exemption. However, some of this will need to take account of the impact on businesses and non-domestic rates.

5.7 It should also be considered that the impact of LVT could, at least in the short-term, reduce land values. This will impact the land owner in terms of capital value and further impact the land owner through the liability to pay future LVT.

5.8 Land valuations are readily available and relatively easy to complete. It would be a straight forward process to perform regular revaluation in order to keep the tax base up to date and further promote the fairness of the tax.

[17] Don Riley, Taken for a Ride – Centre for Policy Studies (2001) (£13.5bn) or Mitchel and Vickers (2003) (£9.75bn)

Stability and Predictability

5.9 LVT has a constant tax base and can help with incentives to obtain the best use of land and avoid land banking for capital gain. There is also the opportunity to link more closely local investment and the funding for that investment delivered from the subsequent increases in land values. This makes LVT a relatively stable and predictable tax base.

5.10 LVT could potentially be raised in different ways. One being as a rate against the capital value of the land, another methodology would be to apply it against the rental values of the land. This exact methodology would need to be assessed fully.

5.11 The availability and completeness of land records and land sales would need to be reviewed to ensure that there is data available to underpin any future LVT system.

Buoyancy of Tax Base

5.12 LVT provides a buoyant tax base as land is not volatile and is in finite supply. This would be a strength of LVT compared to other forms of local tax as outlined above.

5.13 A report for the Green Party MSPs in 2010 made an attempt to assess the potential levels of LVT in Scotland. The report identified land values of £120bn across Scotland and that setting a LVT of 3.16p would yield £3.8bn. This would have the capacity to replace Council Tax (£1.9bn) and provide a further £1.9bn to reducing or eliminating other taxes or charges.[18]

Ease of Understanding and Transparency

5.14 The pilot study in Glasgow[19] concluded that there would be difficulty in explaining LVT to taxpayers, so there would need to be an effective campaign of communication to ensure the tax is understood and supported before implementation.

Ease of Collection and Administration

5.15 If landowners simply passed the tax onto their tenants, there would need to be consideration on the impact of this and any need to support tenants and provide protection from significant increases in rents.

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[18] 'A Land Value Tax for Scotland' - a Report by Andy Wightman for the Green MSPs in the Scottish Parliament. 2010

[19] Glasgow City Council - Local Taxation Working Group Overall Findings report, 2009

5.16 We noted in 5.11 above that records to identify land and land ownership will need to be reviewed. Any lack of records will present problems to implementing an LVT system and provide difficulties in billing and collection. However, these problems should not be seen an insurmountable.

5.17 We believe that in the longer-term there is merit in consideration of LVT as a basis for local taxation in Northern Ireland. We would advocate that further work is completed to assess its feasibility and application in Northern Ireland.