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P 02655

PRIME MINISTER

National Non-Domestic Rate: Starting Poundage and Transition
[E(LF)(87)10]

DECISIONS

The Committee is asked to decide:

i. the level of the starting national non-domestic rate (NNDR) poundage in 1990;

ii. the transitional arrangements to protect businesses facing large increases in rate bills arising from the combined effect of the revaluation of rateable values and the introduction of the NNDR;

(iii) the arrangements for uprating the initial NNDR poundage.

Mr Ridley's paper is concerned with England. Similar problems arise for Wales, but not immediately for Scotland, where the pattern of non-domestic rate poundages is being frozen in 1989/90.

BACKGROUND

2. The Committee agreed last November to proceed with the introduction of a uniform NNDR in England and separately in Wales (E(LF)(86) 6th Meeting). A revaluation of the non-domestic sector is also due to take effect from 1 April 1990, and the orders providing for this have now been laid before Parliament. Since the two changes will come into effect at the same time, it makes sense to consider transitional arrangements designed to limit their combined effect: that is the change which businesses will actually perceive in 1990 if there are no special arrangements.

3. The range of potential changes in rate bills is very large. The NNDR will cut rates in areas with high spending local authorities (eg Manchester) and increase them in areas with low spending authorities (eg West Sussex) and particularly in some low-spending London boroughs which also benefit from the London resource discount under the present RSG system. The revaluation is likely to cut rates in the North and Midlands and increase them elswhere; and to cut rates for factories and offices but increase them for prime shops. At the extremes the combined effect could cut rates on factories in Liverpool by 70 per cent and increase rates on prime shops in Kensington and Chelsea by 270 per cent. The great majority of changes would fall within a much narrower range.

Mr Ridley's proposals to ease the transition

4. Mr Ridley suggests a package of measures which could ease the transition to the NNDR and new rateable values:

i. a reduction in the starting NNDR poundage to perhaps 10 per cent below the prevailing average figure. This would cost £800m, which he suggests (without any specific proposals) should be recouped by increases in other business taxes;

ii. an upper limit on increases in rateable values in the revaluation. This would mean that part of the largest increases would be held over to the next revaluation;

iii. phasing the introduction of the largest increases and reductions in rate bills over 5 years, by limiting annual changes to a fixed percentage figure. Phasing for gainers would pay for the benefit to losers.

5. If this package were adopted, Mr Ridley estimates that increases in rate bills could be limited to a maximum of 15-20 per cent per annum, in addition to any general uprating. As a quid pro quo for a lower starting NNDR poundage he suggests dropping the flexibility for the Chancellor to increase the NNDR poundage

between years by <u>less</u> than the increase in the RPI, a proposal which E(LF) agreed in November (E(LF)(86) 6th Meeting). Mr Ridley does not propose a firm decision on these items now, but he does suggest that he should take the necessary powers, and bring detailed proposals back to the Committee in due course.

ISSUES

<u>Lower starting NNDR poundage</u>

6. The proposal to cut 10 per cent off the starting NNDR poundage would change the balance of gains and losses for businesses. Gainers from the introduction of the NNDR <u>taken alone</u> would outnumber losers by 3:1. But the effects would not of course be seen by themselves: they would be substantially obscured by the revaluation. This would reduce the presentational advantages of the move, which would in any case do little to ameliorate the worst losses.

7. The cost of the proposal is also very high (£800m). You will want the Chancellor of the Exchequer's views on this, and on the proposal that other business taxes should be increased to compensate. I imagine that he will be very strongly opposed to what is in effect a major fiscal proposal which requires much more careful consideration than the cursory presentation in this paper.

<u>Upper limit on increase in rateable values</u>

8. The proposal to limit very large increases in rateable values at the revaluation could help to reduce the burden on the other transitional arrangements. But Mr Ridley does not say what sort of limit he has in mind. If it were too tight, it might distort the overall pattern of rateable values, and prevent businesses whose premises are currently over valued benefitting in full from the revaluation. But some limit on the more extreme increases seems sensible.

Phasing the largest increases and reductions over 5 years

9. Mr Ridley proposes a form of phasing which would allow all changes up to a fixed percentage of 15-20 per cent to come through immediately. Larger changes would come through in 15-20 per cent tranches until they were fully effective. This would be after 5 years in the worst cases. There would be increases due to the indexation of the NNDR poundage on top of this. The phasing of losses would be balanced by the phasing of the largest gains.

10. Phasing of this sort will still allow very substantial increases each year. But that could only be avoided with a much longer transition, which itself is unattractive. The balancing of gains and losses will also be controversial. Businesses with large potential cuts in their rate bills will complain bitterly about the delay. Since they will be those whose premises are overvalued at present and/or in areas with high spending authorities, they will be able to mount an effective case. You may want to ask Mr Ridley to consider alternative options for meeting the cost of transition for the heaviest losers: for example, a rather higher starting NNDR poundage, which would mean that all other non-domestic ratepayers would contribute to transitional protection, rather than just those with the biggest potential gains.

Uprating Arrangements

11. Mr Ridley proposes (paragraphs 15 and 16) that the Committee should reverse its earlier decision to take a power to index the NNDR by less than the increase in the RPI. There seems no good reason for this; indeed the rest of Mr Ridley's paper points in the direction of retaining that measure of discretion. You may recall also that last November E(LF) was concerned that automatic indexing would give local government access to a very bouyant tax, because of the gradual increase in overall rateable values.

Timing

12. There is no need to take decisions on the details of transitional arrangements at this stage. You may simply want to agree whether a general line is needed which can be used in public to deflect criticism of the NNDR proposals - a decision that the largest losses whould be phased over 5 years might suffice for that. Mr Ridley could then be asked to develop his detailed proposals further, together with arrangements for running the NNDR pool to which he refers at the end of his paper.

HANDLING

13. You will wish to ask the Environment Secretary to introduce his paper. The Welsh Secretary, the Chancellor of the Exchequer and other Ministers will also wish to contribute.

J B UNWIN

29 April 1987
Cabinet Office