B

CONFIDENTIAL

P 03357

From: R T J Wilson
6 February 1989

MR GRAY

NON-DOMESTIC RATING

You asked for advice on Mr Ridley's minute of 3 February to the Prime Minister.

2. Mr Ridley and Mr Major have had extended correspondence about technical details of the National Non-Domestic Rate (NNDR) which is to be introduced in England and Wales from 1 April 1990. Your letter of 12 December recorded the Prime Minister's wish that they should settle these issues bilaterally. They are now seeking formal endorsement of the outcome. There are three main issues.

Government contributions in lieu of rates

3. The occupiers of Crown properties do not pay rates directly. Instead the Government currently makes a contribution in lieu of rates to each local authority based on an assessment by the Rating of Government Property Department (RGPD) of the aggregate rateable value of all the Crown property in its area.

4. Under the NNDR, all that would be required to replace contributions in lieu of rates would be a single payment from the Government into the pool, based on a valuation of Crown property throughout England and the uniform national poundage.

5. The revaluation in 1990 is however expected to increase the valuation of Crown property, so the single payment would be larger than the current total of contributions in lieu of rates. This would add to central Government expenditure. To avoid that, the Chief Secretary proposed to Mr Ridley that contributions in lieu of rates should be abolished, and that the Government should make a once-and-for-all increase in Exchequer grant to compensate for this. By

CONFIDENTIAL

implication, this increase in grant would be based on the current total of contributions in lieu of rates, taking no account of the effects of revaluation. Mr Ridley felt that this would lay the Government open to serious criticism from local authorities, since the abolition of contributions in lieu of rates would be seen as a Government exemption from rates.

6. After discussion, Mr Ridley and the Chief Secretary have agreed:

i. to retain a contribution in lieu of rates into the NNDR pool, based on the new valuations; but

This sounds like a device to keep govt. rates constant

ii. to offset any change in the Government contribution by a corresponding change in the amount of Exchequer grant to local authorities. The total Government contribution would thus be held constant, whatever the results of the revaluation or subsequent changes.

7. This approach would achieve the Chief Secretary's objective without explicitly ending Government contributions in lieu of rates. But it could be controversial if it became public, either directly or simply from the evidence of the way in which the Government set and revised the figures for grant. Mr Rifkind may raise reservations along these lines. The Prime Minister will wish to consider whether to accept the solution proposed by Mr Ridley and Mr Major. An alternative would be to suggest a looser formulation, for example that any changes in Government contributions should be taken into account when the total of Exchequer grant is discussed.

Setting the business rate

8. A second issue is how the initial NNDR poundage should be set in 1990/91. The Government's commitment is to set it so that the overall revenue from "business rates" is the same in real terms as in 1989/90. But "business rates" could be interpreted in either of two ways:

i. as the total of all non-domestic rates. This would include rates paid by the Government and local authorities themselves, which are likely to rise more steeply than average as a result of the 1990 revaluation. Consequently the real burden of rates on private businesses and nationalised industries would fall. Since private businesses and nationalised industries will be the only sources of net revenue, community charges might have to be as much as £6 per adult higher to offset the loss of rate income from these sources; or

ii. as the total of rates paid by private businesses and nationalised industries. This would keep the real burden on these ratepayers constant, and consequently the revaluation would have no effect on community charge levels. But revenue from the NNDR as a whole, including public sector rates, would increase by more than inflation in 1990/91.

9. Commentators may have assumed that the Government intended to ring-fence the NNDR as a whole (8(i) above). But Mr Major and Mr Ridley now consider that the alternative approach (8(ii) above) is preferable because of the implications for the community charge; and that it is consistent with the Government's public commitments. Treasury officials say that the most detailed commitment is the one attached at Annex A to this minute, which does seem to support this claim. Provided the Prime Minister is satisfied on this point, the approach favoured by Mr Ridley and Mr Major may be the better of the two.

Decapitalisation rate

10. The decapitalisation rate is used to value certain specialist properties for which no rental evidence exists (eg steel, ship-building, oil and petrochemical installations, and many Crown properties like hospitals). It is applied to capital values to produce notional rental figures. The current decapitalisation rate in England and Wales is 5%. But there are lower rates for local authority premises (3.75%) and educational charities (2.5%). The Scottish rate is 7%.

11. Mr Ridley minuted the Prime Minister on 5 October 1988 proposing a common rate of 6% for England, Wales and Scotland, with a lower 4% rate applying only to educational institutions. Most colleagues accepted this package. But the Chief Secretary was concerned about the implications for public expenditure of a large increase in rates paid on Crown properties. To meet this concern, Mr Ridley has agreed to extend the 4% rate to hospitals and other health related premises and to specialist defence installations of types found only in the public sector. He proposes to consult on this basis.

12. These proposals would keep down measured public expenditure on education, health and defence. They would also benefit private schools and hospitals. They may however be presented by local authorities as an attempt by the Government to reduce Crown rate bills. Mr Rifkind may suggest that a lower rate for defence properties would be particularly difficult to justify. Nevertheless the Prime Minister may feel that the lower rates can be justified, particularly for educational health premises, and should form the basis for consultation.

Publication of likely effects of revaluation

13. Mr Major has now agreed to the publication of a summary of the results of the Inland Revenue survey of the likely effects of the 1990 revaluation, which is necessary to fulfil commitments given by Ministers.

Conclusions

14. To summarise:

i. on contributions in lieu of rates the Prime Minister may wish to accept what is proposed, provided she is happy with the agreement to offset any changes in the Government's contribution against Exchequer grant. If she is not content, she might want to suggest a looser formulation, eg that changes in the contribution should be taken into account when the total of grant is considered;

ii. on ring-fencing business rates, the Prime Minister may wish to agree with what is proposed, provided she is content that Government commitments will bear this interpretation;

iii. on the decapitalisation rate the Prime Minister will probably wish to accept what is proposed as the basis for consultation.

RTJW.

R T J WILSON

ANNEX A.

Cutting from hansard dated 14.3.88
Vol 129
NO 114

Rating Reform

Dr. Cunningham: To ask the Chancellor of the Exchequer when and in what form he plans to make announcements about future levels of the national non-domestic rate; and when he proposes to exercise his power, or indicate that he will not exercise his power, to set the national non-domestic rate multiplier under the proposed amendments to the Local Government Finance Bill.

Mr. Major *[holding answer 10 March 1988]*: Under provisions of the Local Government Finance Bill now before Parliament, the Government will, in 1990, set NNDR multipliers in England and Wales so as to produce the same yield of business rates in each country as if the rate poundages set by local authorities in 1989 had been indexed to the retail prices index and there had been no revaluation. In subsequent years, the presumption will be that indexation of the NNDR multipliers to the RPI provided for in the Bill will take place. Equivalent provisions are already in the Abolition of Domestic Rates Etc. (Scotland) Act. If, however, I decide to use powers in the proposed amendments to increase the NNDR multipliers by less than the RPI in any year, an announcement would be made before the RSG reports for that year had been approved by Parliament.

ccPU.

SECRETARY OF STATE FOR THE ENVIRONMENT

Prime Minister

NON-DOMESTIC RATING

cat flap (PT 11)

Your Private Secretary's letter of 12 December recording your agreement to my proposals for transition to the new non-domestic rating system invited John Major and me to settle bilaterally the related issues raised in John's letters of 21 November and 9 December and mine of 29 November. We have done so. This minute seeks your approval and that of colleagues - Malcolm Rifkind and Peter Walker in particular - for our agreement.

We have agreed on the following package:

(i) that a Government contribution in lieu of rates on Crown property will be paid into the National Non-Domestic Rate pool under the new system, based in 1990-91 on an updated assessment of the value of the Government Estate, akin to the revaluation of private sector property now underway;

(ii) that any change in the Government contribution resulting from the reform of business rates in 1990 will be off-set by a corresponding change in the amount of Revenue Support Grant in order to hold constant the total Exchequer finance for local authorities; and we intend to treat any similar change in future years in the same way;

(iii) that our commitment to hold the real yield of business rates constant in 1990 (apart from the natural buoyancy in the tax base) should be interpreted as applying to the private sector and nationalised industries rather than including also the rates paid by the Government and local authorities out of other tax revenues. Thus, for example, any increase in rates paid by local authorities will be recycled through the NNDR pool rather than adding to the