

FEDERATION OF SMALL BUSINESSES
PRESS AND PARLIMENTARY OFFICE

2 CATHERINE PLACE
WESTMINSTER
LONDON SW1E 6HF

TELEPHONE 020 7592 8100 FACSIMILE 020 7233 7899
E-MAIL london.policy@fsb.org.uk WEBSITE <http://www.fsb.org.uk>



Lyons Inquiry into Local Government Funding
Room 3.12
1 Horse Guards Road
London
SW1A 2HQ

L16193

9 May 2005

Dear Sir Michael,

INQUIRY INTO THE BALANCE OF LOCAL GOVERNMENT FUNDING

The Federation of Small Businesses (FSB) welcomes the opportunity of responding to the inquiry on behalf of its 187,000 members.

Please find our comments in the document attached, which you will also receive shortly as a hard copy by post.

We trust that you will find our comments helpful and that they will be taken into consideration. The FSB is willing for this submission to be placed in the public domain. We would appreciate a copy of the synopsis of responses and of being kept apprised of further developments on this issue.

Yours sincerely

Roger Culcheth
Chairman, Local Government Affairs



**RESPONSE FROM THE
FEDERATION OF SMALL BUSINESSES (FSB)
TO THE
*INQUIRY INTO THE BALANCE OF LOCAL
GOVERNMENT FUNDING***

1. The Federation of Small Businesses is the UK's leading non-party political lobbying group for UK small businesses existing to promote and protect the interests of all who own and/or manage their own businesses. With over 187,000 members, the FSB is also the largest organisation representing small and medium sized businesses in the UK.

Balance of funding and the disproportionate burden of business rates

2. Almost uniquely in the world, the balance of funding required by local authorities in addition to Exchequer grants, including redistributed non-domestic rates revenue, is provided almost completely by council tax. Australia is one of the few countries with a similar situation. In Scandinavia balance of funding revenue is raised from local income tax and charges, whilst in many other European countries property taxes play a less significant role.
3. Council tax contributes on average 25% of local authorities total revenue with redistributed business rates contributing at least a further 20%. Consequently, Britain has some of the highest property taxes in the world. Business rates plus council tax at 4.4% of GDP, are nearly two and a half times higher than the average for rest of Western Europe.
4. Expressed another way, business rates contribute more than 3.8% of the Government's total tax revenues, over seven times more than Germany. These levels place an unfair burden on the competitiveness of all business compared with our major trading partners.
5. The rates bill is often the third largest item of expenditure. For small businesses the burden is even greater. As a proportion of turnover they pay some three times more than medium sized companies and some seven times more very large businesses. This burden is especially hard on start up businesses.
6. The fact is that British businesses face very high property costs. The combined costs of high rents, which are some of the highest in the world, and high rates, put a very unfair burden on British business.

Relocalisation

7. The FSB broadly supports the existing balance of funding that exists within local government. We consider that relocalisation of business rates would harm business and not achieve the desired aims of those advocating this change. Prior to 1990 such a system was in place and business found that locally set business rates did not work. This is largely because the 400 different business rates created vastly differing rate poundages. Some larger businesses avoided locations with high poundages, but most small businesses do not have the same degree of flexibility with regard to where they are located. Much time and effort was also spent consulting with local councils but often the results showed no discernible benefits leading to business and local authorities having strained relationships. Many small businesses felt it created a

democratic deficit. They could be heavily taxed to subsidise lower domestic rates without the benefit of having a business vote.

8. Conversely, the present Uniform Business Rate (UBR) system offers several advantages. The nationally set multiplier together with RPI indexation allows business to plan its future expenditure with confidence. The single poundage rate provides a fairer distribution of the rate liability.
9. Of equal importance, the present system distributes the revenue obtained from non-domestic rates back to local authorities on a fair per capita basis. For example, the income received from Westminster City Council, which is about 6% of the total business rates revenue, is distributed to the more disadvantaged local authorities.
10. With relocalisation, many local authorities could be worse off and would only maintain their present levels of revenue by substantially increasing their business rate or council tax or both. Thus, it would not be long before the previously large variations between local councils would be seen again.
11. Additionally, it is likely that the annual increases set by local authorities would be above the rate of inflation. Since 1990 the average annual increase in council tax has been higher than the RPI. There is no reason to suppose that similar increases would not be applied to the business rate. Such a situation would add significantly to the costs of business and could deter business investment.
12. Overall, we see no merit in the relocalisation of business rates. The benefits to business obtained from the present system were recognised in the Local Government White Paper and give a solid economic case for not returning responsibility of business rates to local councils.

Simplicity and Transparency

13. To the owners of small businesses, the administration of business rates, the calculation of rateable values and the various rate relief schemes appears complex and disjointed. For example, many fail to understand that rateable values are directly related to rental values.
14. Then no fewer than three bodies are involved. The Valuation Office Agency is responsible for setting rateable values and hearing appeals. The ODPM sets the rate poundage, the multiplier. And local authorities send out the rates bills and collect the revenue.
15. Now that all summary assessments are available on the VOA website, ratepayers can compare the rateable values of similar properties within the same locality. They are surprised to find that for apparently similar accommodation the rate per square metre can vary from property to property.
16. Another area of concern is that parking areas at out-of-town supermarkets are rated at a lower level than high street parking where the smaller retailer is often located. Also, the absence of windows means that the interior shopping areas of these supermarkets

attract a lower rating than the front area of the average retail shop. These apparent anomalies militate against small businesses.

17. The FSB believes that this fragmentation and complexity causes the small businessman and woman to view business rates with suspicion and hence to lose faith in the system.
18. Although we realise that these matters are not directly part of the inquiry's work, we do ask the inquiry to consider in its deliberations recommending greater simplicity and transparency in the administration of business rates.

Conclusion

19. The FSB recognises that business rates make a significant contribution to the Exchequer. Furthermore, they are easy to collect, administratively cost effective and allow for a fair distribution to local authorities. And the revenue obtained can be predicted with confidence.
20. Business rates are one of the few taxes not related to the ability to pay. They have to be paid irrespective of whether a business is making a profit or not. And, as stated previously, small businesses are hit particularly hard. Also, it has to be recognised that utilities and non-business ratepayers contribute a substantial proportion of business rates revenue.
21. Many wish to see the payment of business rates related to the ability to pay. Others for the complete abolition of business rates and the revenue lost raised from other sources. To achieve these objectives other taxes, such as corporation tax or VAT, would have to be increased significantly to compensate for the lost revenue. Whilst initially attractive we consider that neither option is acceptable.
22. Accounting for nearly half of their funding, local authorities rely heavily on business rates and council tax, neither of which is based on the ability to pay. This dependence on property taxes, together with fund raising restrictions placed on local councils, would appear to leave little room for manoeuvre. Ideas for reform could be placed in a straight jacket.
23. The FSB believes, however, that other ways of funding the non-Exchequer portion of local council spending should be explored and, if possible, introduced. Recent initiatives like the Local Authority Business Growth Incentives Scheme could be extended to allow councils to retain a larger portion of the increased business rates attributable to business growth and enterprise. Likewise, Business Improvement Districts could provide real localised benefits, provided the levies charged are reasonable and the concerns of smaller businesses are taken into account. Continuously raising property taxes, in the case of council tax often beyond the rate of inflation, cannot be sustained forever.
24. Whilst we welcome the recent initiatives to ease the burden on the owners of small businesses, we believe that action needs to be taken to decrease the overall burden and to spread the balance of funding from a wider range of sources.

25. We therefore put forward two proposals designed to reduce the burden of business rates, which we believe are worthy of the inquiry's consideration
- First, to help small businesses even further, improve the new small business rate relief scheme to include properties with a rateable value of up to £20,000.
- Secondly, place a moratorium on the annual RPI increase in the multiplier. Over time this would produce in real terms a reduction in the burden of business rates to all businesses.