

Transitional relief, discretionary reliefs and the adjustment factor

1. Introduction

1.1 This paper discusses:

- How to treat transitional protection payments in the calculation of the adjustment factor (AF) in practice. The paper concludes that this could be done by not taking account of the transitional relief at the point of setting the AF.
- How in theory, the amount of transitional relief in the system could regardless of its treatment for the calculation of the AF continue to impact the amount of mandatory reliefs in the system and thereby growth. The paper concludes that if the AF was set for a fixed period of time, we could take out any impact that transitional relief may have on changes in the level of other reliefs over the fixed time period.
- How the alternative arrangements could be susceptible to 'gaming' due to changes in the level of discretionary relief between system set-up year and future years. Members of the Working Group are invited to think of potential solutions to the problem.

2. Treatment of transitional relief in the calculation of the adjustment factor

2.1 The System Design and Implementation Working Groups have previously discussed how certain aspects of the existing business rates retention system administration could be simplified under the alternative arrangements, including the incorporation of transitional relief protection payments into the calculation of 1st stage top-up and tariffs (i.e. the 'needs' calculation). Because tariffs and top-ups are adjusted each year to take account of changes to non-domestic rating income, they will automatically adjust for fluctuations in income resulting from the unwinding of the transitional arrangements. As such it will no longer be necessary to have a separate system of transitional protection payments.

2.2 It will, however, still be necessary to take account of the impact of the transitional arrangements when making the 2nd stage top-up and tariff calculations for growth. Otherwise, the 'growth' calculation could itself be distorted by arrangements which, arguably, do not reflect underlying rating liabilities.

2.3 The growth baseline and AFs will be set in 2021-22, coinciding with the next revaluation. Historically, the transitional arrangements in the first year of a revaluation have represented a net cost to authorities – i.e. they reduce business rates income. If therefore, the AF is set at the national level, taking account of the cost of the transitional arrangements would lead to a lower AF than would have been the case if the transitional arrangements were stripped out of the calculation (see Table 1).

2.4 If we were to set the AF at the level of individual authorities, the picture would be more mixed – some authorities would see a net gain to income from the transitional arrangements; others a loss. Accordingly, for some authorities the AF would be higher and for others lower, solely as a result of the impact of a temporary scheme put in place to insulate ratepayers from the full impact of the revaluation and which unwinds over time.

Table 1: System set-up	Parameters	Baseline figures with transitional relief not accounted for in the AF	Baseline figures with transitional relief accounted for in the AF*
Rateable Value (RV) (RV data by the VOA published on 1 April 2021)		148,000,000	148,000,000
Multiplier	0.5		
Gross Rates Payable (GRP) (RV*Multiplier)		74,000,000	74,000,000
Mandatory reliefs (Assumed as 5% of GRP)	0.05	-3,700,000	-3,700,000
Discretionary reliefs (Assumed as 1% of GRP)	0.01	-740,000	-740,000
Transitional relief (Assumed as 1% of GRP)	0.01	-740,000	-740,000
"Net Rates Payable (NRP)" (GRP-mandatory and discretionary reliefs) or (GRP-mandatory, discretionary and transitional relief)*		69,560,000	68,820,000
Adjustment factor (NRP/GRP)		0.94	0.93
Growth baseline in NRP terms (GRP*Adjustment Factor)		69,560,000	68,820,000
Baseline Funding Level (BFL) (Informed by the needs funding formula)		49,500,564	49,500,564
Local share	0.75		
Central share	0.25		

3. Relationship between transitional relief, mandatory reliefs and growth

- 3.1 In a previous meeting of the Implementation Working Group (IWG), it was discussed how because of the order in which reliefs are calculated the system automatically impacts the level of mandatory reliefs in the system even when there has not necessarily been any change in the number of businesses claiming mandatory relief or in the wider government policy in relation to mandatory reliefs. Papers provided to the IWG demonstrated that the impact of mandatory relief totals was not necessarily compensated for by the Transitional Protection Payment. However, we were never able to determine from the available data whether the impact was significant or not.
- 3.2 The existing relationship between transitional relief and mandatory reliefs would continue to exist under the alternative arrangements even when transitional relief is disregarded from the way in which the AF is set, and therefore to some extent, growth under the alternative arrangements would continue to be indirectly effected by the amount of transitional relief in the system.
- 3.3 The technical paper 'Alternative Model: Update on Adjustment Factors and reliefs' (from Working Group meeting of 24 October) demonstrates with past NNDR data how at aggregate level variation in reliefs has not been significant since the current business rates retention was set up in 2013/14, however, variation at individual authority level can be more significant. This suggest that if we set the AF at individual authority level, and particularly if we let it 'float' year-on-year, the impact of such changes would impact on authorities' 'growth'. If on the other hand, we fix the AF at the national level and for a set period of time, authorities' 'growth' will be unaffected by changes to reliefs caused by the unwinding of the transitional arrangements.

4. Discretionary reliefs

- 4.1 Authorities themselves have the option to award discretionary reliefs to ratepayers. Because the amount of discretionary relief awarded is small, its impact on the AF would be marginal. However, if we set a national AF, and especially if it were for a period of time, authorities could, in theory, 'game' the system by awarding significantly increased discretionary relief knowing that it would not affect their 'growth'. This scenario is illustrated in Tables 4 and 5 below.
- 4.2 In Tables 4 and 5, we assume the baseline scenario presented in Table 1. The adjustment factor of 0.94 and the growth baseline of £69,560,000 (in "NRP" terms) have been set for a fixed period of time with the mandatory reliefs and discretionary reliefs factored in. When the authority increases the level of discretionary relief in Year Y, we can see that the authority is compensated to the reduction in its income at stage 1 of the top-up/tariff calculation. In Year Z, the authority maintains the high level of discretionary relief whilst also experiencing some growth. As in Year Y, the authority continues to be compensated for the reduction in its income through the stage 1 calculation. The increased level of discretionary relief has no impact on its growth.

Table 4: NNDR reporting in - Discretionary relief example	Baseline	NNDR (year y)	NNDR (year z)
RV	148,000,000	148,000,000	150,000,000
GRP	74,000,000	74,000,000	75,000,000
(less) Transitional Relief	-740,000	-740,000	-740,000
(less) Mandatory Reliefs	-3,700,000	-3,700,000	-3,750,000
(less) Discretionary Reliefs	-740,000	-6,000,000	-6,000,000
NRP	68,820,000	63,560,000	64,510,000
(less) Bad Debt Allowance	-450,000	-450,000	-450,000
(less) Provision	-5,000,000	-5,000,000	-5,000,000
(less) Disregarded Amounts	-67,493	-67,493	-67,493
Non-domestic Rating Income	63,302,507	58,042,507	58,992,507
Central Share 25%	15,825,627	14,510,627	14,748,127
Local Share 75%	47,476,880	43,531,880	44,244,380

Table 5: Top-up/tariff calculations - Discretionary relief example	Baseline	Year y	Year z
Stage 1 'need' (BFL - NNDR local share)	2,023,684	5,968,684	5,256,184
Stage 2 'growth' (NNDR GRP * Adjustment Factor 0.94 - NRP growth baseline) * 75% Local Share	0	0	705,000
Year 1 total top-up or tariff* Stage 1 'need' + Stage 2 'growth'	2,023,684	5,968,684	5,961,184
Local Share 75% (NNDR)	47,476,880	43,531,880	44,244,380
Retained Income (Total top-up or tariff + NNDR Local Share)	49,500,564	49,500,564	50,205,564
<i>*Negative figures represent tariffs, positive figures represent top-ups.</i>			

4.3 In principle, a potential solution could be to ignore discretionary relief in the setting of the AF and to adjust the tariff/top-up calculation £ to £ to the exact amount that the discretionary relief was awarded for as a way of eliminating 'gaming' potential. Subject to views of the System Design and Implementation Working Groups, we would need to explore the mechanics of this at a future technical paper.