Business Rates Wales Review: Incentivising Growth

May 2012

Preface

On behalf of everyone on the Business Rates Review Task and Finish Group, I am pleased to present our report. The Group was set up to assess how the business rates regime in Wales could be used as a targeted policy intervention to encourage economic development and growth. The full terms of reference are set out in the report.

The Group would like to thank those people and organisations who kindly attended our meetings to share their expertise and to those who submitted written evidence. The evidence is set out on the Group's web page and includes the summary of responses to the call for evidence. We also express our gratitude to the Secretariat of the Review for their excellent work in helping us to complete our task. However, the Group accepts full responsibility for all errors of omission or commission involved in reaching our conclusions and recommendations.

We saw the main objective of the report as improving incentives for business growth and investment. To achieve this we have advocated measures that will introduce greater accountability for raising revenue and increasing the tax base by both local and national government in Wales. We are also recommending new ways of allocating the revenue from business rates as well as developing new approaches to investing in our town centres and rural communities. We believe that these measures taken together offer a consistent and coherent approach to business development. We hope they will strengthen Wales reputation as an attractive place in which to invest.

Taxation is rarely a hot topic but business rates seem to have become one. Rates are being extolled as a panacea for an ever widening range of economic problems. We feel we must warn against this elevation of business rates as a cure-all for low levels of economic activity. In the report we stress that there are strict limits to what can be achieved by variations and exemptions within this area of local taxation. Even so we are hopeful that our report offers a practical set of measures that will address some of the key issues we have been tasked to address.

Finally, I would personally like to extend my thanks to members of the Review team and the Secretariat for the professionalism, commitment and good humour they brought to our meetings and discussions. Without their enthusiasm for the task at hand we would not have been able to deal so comprehensively with the complex issues underlying the deceptively simple terms of reference of this Review.

Professor Brian Morgan, Chair – Business Rates Task and Finish Group

Executive Summary

Non-domestic rates, commonly known and in this report referred to as business rates are a major source of taxation bringing in almost £1 billion of revenue to fund local services in Wales. Although the operating system for calculating rates, essentially based on market rental value, is the same throughout the UK there are different public funding arrangements in Wales, Scotland, Northern Ireland and England. Rates in Scotland for example are fully devolved whereas Wales resources from rates are partly dependent on Barnett formula consequentials from the distribution of business rates in England.

The Group has also looked at issues which have emerged since our inception, including the growing impacts of the recession on Welsh town centres and the announcement of Enterprise Zones and Local Growth Zones. We met with representatives of the Holtham and Silk Commissions to discuss the non-devolved nature of business rates which limits their use as strategic policy levers by the Welsh Government.

Our over-riding philosophy was to favour simplicity and consistency of policy and to provide incentives to invest rather than increased costs or more regulation. There is a lack of research or evidence on the impact of rates but where changes are made the burden or benefits appear to be at least partly borne by landlords rather than occupiers. There are limits on what changes to rates can achieve. They were created as a means of taxation based on property values and not as an economic development tool. They cannot be a cure-all for the economic problems of Wales. Also, additional reliefs could only be funded out of existing Welsh Government resources and state aid policy severely restricts the amount each business can receive.

We recognise that many sectors of the economy are under huge pressure at the present time, particularly SMEs for whom business rates represent a larger proportion of total operating rates. The current UK wide Small Business Relief scheme is particularly important for Wales and we see it as crucial that the Welsh Government lobbies the UK Government as powerfully as it can to extend this scheme beyond its current end date of 2013.

We believe the abolition of Empty Property Relief in 2008 has had a significant negative impact on the Welsh economy and property market. We propose a variation of reliefs for empty property to encourage new development and property improvement and also to relieve hardship in appropriate cases. A large number of respondents raised questions over the equity of the current system of charitable reliefs and the inconsistent approach to social enterprises and we have recommended some limited changes in this area.

We examined in detail the current rating system and the concerns raised in evidence regarding the treatment of out of town stores. We have made some recommendations to address this issue. Another area of concern was the current approach to Material Changes in Circumstance applications and Hardship Relief applications. We discussed the adequacy of the current 5 year revaluation cycle in the light of the downturn in property values since the last antecedent valuation date of 2008. In general, we do not recommend fundamental changes to the current rating system as we feel the overall benefits would be short term and do not justify the additional resource and complexity involved. We have however made some lesser recommendations focussing on removing inconsistencies and increasing awareness of the system.

The current arrangements, whereby business rates are not devolved, limits the Welsh Government's ability to use business rates more strategically to promote economic growth. We see no reason why the calculation of the Welsh share of Business Rates should not be devolved. Council Tax is already devolved and Business Rates appears to be an anomaly which needs to be addressed. There would be both risks and rewards to this approach and the current system provides some protection from the downside volatility in rates yield. Ways to manage this volatility is something we feel the Silk Commission will need to look at closely. However, overall, we believe devolving rates would introduce both a hard budget constraint and a considerable incentive effect for Welsh Government and Local Authorities to widen the tax base. This is consistent with the overall incentive effect we wish to encourage.

We have looked at the arguments for offering additional rate reliefs in Welsh Enterprise Zones (EZs). Whilst ideally we would like to see the Welsh offer match that of English EZs, we accept that the consequential funding available to the Welsh Government for EZs is much more limited. As a principle, we believe that financial support provided on a project by project basis is a more effective tool for supporting economic growth than blanket rates relief. We have recommended a more targeted and focussed approach in Wales and suggested how Welsh Government can more effectively bring to bear the competitive advantage of Assisted Area status through other financial levers both in EZs and outside.

The challenges facing retailers and other businesses in our town centres as analysed at length in the recent *Portas Review*[1] and National Assembly for Wales (NAfW) Enterprise and Business Committee reports is of special concern. We have taken a considerable amount of evidence and investigated initiatives being taken forward both in Wales and elsewhere to address these concerns. This is a complex problem which cannot be solved by top down Government intervention alone. Whilst rates reductions could have some positive impact on business confidence, this has to be part of a much more strategic and integrated policy which utilises a range of levers including Business Improvement District (BIDs) type models, planning reform and new sources of funding. The key element we feel is that local business communities need to come together and demonstrate the willingness to invest and drive forward their own plans to increase

1 The Portas Review (2012) – An independent review into the future of our high streets

marketability and competitiveness. Welsh Government and Local Authorities (LAs) should respond by providing matched funding to encourage (but not direct) the development of these activities and support them where these initiatives already exist. We see a strong potential for the use of EU funding to support this approach.

Our terms of reference included addressing the potential to support renewable energy businesses through rates policy. We have recommended setting up a Welsh Renewable Energy Scheme including specific proposals for local community retention of some of the benefits created.

We believe there are strong arguments for greater local retention of rates by Local Authorities (LAs). We recognise it would be necessary for Non Domestic Rates to be devolved in Wales to do this. However as a principle we see merit in LAs being more accountable and responsible for raising more of the money they spend. At present there is little incentive for a Local Authority to increase its rates revenue through the creation of a stronger local economy. We have examined the workings of the current system in some detail and have suggested in outline a local retention mechanism which would create significant incentive to LAs to encourage economic growth whilst building in suitable safeguards to protect funding for local services in areas where growth potential was more limited.

Principal Recommendations

Recommendation 1

We recommend the Silk Commission consider the case for the devolving of business rates to Wales.

Recommendation 2

We recommend that the Welsh Government consider enabling Local Authorities to retain a proportion of the income they generate from business rates.

Recommendation 3

We recommend that the Welsh Government should strongly lobby Central Government to retain the current Small Business Rate relief scheme beyond March, 2013.

Recommendation 4

We recommend that the Welsh Government makes representations to the UK Government to seek a longer period of exemption from empty property rates in Assisted Areas.

Recommendation 5

We recommend that the Welsh Government increase the period of exemption from empty property rates for new development or significant refurbishment of existing property on a speculative basis in all areas of Wales.

Recommendation 6

We recommend that exemption from empty property rates be introduced for premises with a Rateable Value not exceeding £6,000 which are part of a composite property (property which comprises both residential and commercial elements).

Recommendation 7

We recommend deferring increases in rating assessment arising from property improvements for two years.

Recommendation 8

We recommend for partially occupied premises, extending the period before empty property rate applies to the unoccupied areas, especially in the case of new occupiers gradually taking up occupation.

Recommendation 9

We recommend that awareness be raised of the existing hardship provisions.

Recommendation 10

We recommend that the Welsh Government introduces a limited and targeted scheme of rate relief in Enterprise Zones in Wales.

Recommendation 11

We request that the Welsh Government promotes more clearly its ability to support projects within the Assisted Areas of Wales beyond the restricted limits available in Enterprise Zones in the rest of the UK.

Recommendation 12

We recommend that the Welsh Government monitor the progress of implementation of Tax Increment Financing in England and Scotland.

Recommendation 13

We recommend the Valuation Office introduces specific guidance to businesses who might be seeking a material change in circumstances reduction in rateable value.

Recommendation 14

We recommend a number of options to level the playing field between out-of-town developments and city centres in a sustainable way.

Recommendation 15

We recommend the Welsh and UK Government consult with the charitable and retail sectors to review the current rating provisions for charities and social enterprises.

Recommendation 16

We recommend that local retention of business rates should incentivise local authorities to properly enforce Empty Property Rates regulations.

Recommendation 17

We recommend that the Welsh Government makes available match funding to encourage the Business Improvement District approach where business communities commit to invest and develop strategies to improve their town centre commercial offer.

Recommendation 18

We recommend the Welsh European Funding Office examine additional ways to directly support town centres in the next EU funding round commencing in 2013.

Recommendation 19

We recommend that the Welsh Government establish a Welsh Renewable Energy Relief Scheme including provisions for local retention of rates generated by these projects.

1. Background

The Business Rates Review Task and Finish Group, (the Group), was set up in Autumn 2011 to assess how the business rates regime in Wales could be used as a targeted policy intervention to encourage economic development and growth.

The Review has been produced by the Group under the Chairmanship of Professor Brian Morgan, Professor of Entrepreneurship at Cardiff Metropolitan University.

The other members of the Group are:

- John Gravelle, Carmarthenshire County Council
- Juliet Luporini, Swansea Business Improvement District
- Chris Sutton, Jones Lang LaSalle
- David Swallow, Eversheds

In addition, the Group had an advisory member to support its work:

- Helen Simpson, University of Bristol

Terms of Reference

The Minister for Business, Enterprise, Technology and Science gave the Group specific terms of reference to:-

- Consider current Welsh business rates policy and whether the policies meet the needs of business.
- Consider the relative importance of the non-domestic/business rates regime as a lever for supporting economic growth.
- Assess the implications of specific policies in relation to small business rate relief, empty property rate relief, and rate relief as a targeted policy intervention to encourage economic development (to include renewable energy businesses as well as assistance in disadvantaged areas).
- Make recommendations on the above, taking into account that non-domestic/business rates exist to raise funding for local services and recognising that non-domestic rates do not just apply to businesses but to all non-domestic properties.

The Group met regularly between November 2011 and April 2012 and took evidence at various locations around Wales.

Our Approach

Our remit is forward looking and our aim is to retain the simplicity and uniformity of the current rating system and to improve the way it operates in practice. Business rates, also known as Non Domestic Rates (NDR), are a major source of taxation bringing in almost £1billion in revenue to fund local services in Wales. In recommending changes to the current system we are conscious that we should not create differences for differences sake, – especially compared to the much larger neighbouring economy of England. Hence our approach is to create incentives within the current rating system rather than prescribe increased costs or more regulations.

We see the main objective of the report as encouraging business growth and investment. To achieve this we have advocated measures that will introduce greater accountability for raising revenue and also new ways of allocating the revenue that is raised from business rates. We believe these measures will provide incentives to increase the tax base by both local and national government in Wales.

We are also recommending a more targeted approach to business rates relief schemes and developing new approaches to investing in our town centres and rural communities. We believe that, taken together, these measures offer a consistent and coherent approach to business development. We hope they will strengthen Wales reputation as an attractive place in which to invest.

The investment decisions of business requires a stable and consistent policy framework with few surprises and therefore a key driver of our recommendations is that we should seek to create a business environment which is clearly understood, and, as far as possible, operates within a similar policy framework to that in England. However, within the constraints of achieving certain revenue targets for business rates, we want to introduce more flexibility into the system.

Ultimately, a Welsh economy that can offer an investment proposition that is 10% more attractive than elsewhere can then benefit from its long porous border with England to attract mobile investment. Hopefully, our recommendations on business rates will help create an attractive business environment that will support the growth of the Welsh economy.

Emerging Issues

Since the Group was established, a number of other issues have arisen that have been included in the final review:

- **Town Centres**

The report by the National Assembly for Wales Enterprise and Business Committee into the Regeneration of Town Centres was published in January 2012. The Committee looked at the numerous challenges facing Welsh high streets and how policy, planning and financial levers could be better co-ordinated.

The importance of business rates featured strongly and a specific recommendation was made on business rates:

> **Enterprise and Business Committee Recommendation:**
> We recommend that the Welsh Government's independent panel on business rates should consider changes in legislation and in the application of discretionary powers, with the aim of improving the mix and quality of the retail offer in town centres.

As a result of this, the Group undertook further work on town centres.

- **Enterprise and Local Growth Zones in Wales**

In 2011, the Minister for Business, Enterprise, Technology and Science announced the preferred locations of the seven Enterprise Zones (EZs) in Wales. An emphasis was placed on ensuring maximum value from limited UK Government consequential funding and the Group has considered the cost and impact of business rate reliefs in EZs.

The Minister has since established a Task and Finish group to explore the suitability of Local Growth Zones (LGZs) as a complementary approach to EZs and the Group has also considered business rates in this context.

- **Wider Welsh Government funding issues**

In 2010, the Holtham Report was published and proposed devolution of limited tax-varying and borrowing powers to Wales. The Group met with representatives from the Holtham Commission to discuss funding in regard to business rates.

In October 2011, the Secretary of State for Wales launched the Silk Commission on Devolution to review current financial and constitutional arrangements in Wales. The Group met with the Silk Commission to discuss their emerging findings in April 2012.

2. Limits to Using Business Rates

There is a lack of research evidence on the real effects of business rates. Much of the evidence that exists implies that changes in business rates are unlikely to have long-term effects on business start-up decisions or employment.

The primary reason for this is that much, or all, of the incidence of changes in business rates is likely to fall on landlords and be capitalized into rents and property values. The firm or individual who actually bears the incidence of business rates may be different to the firm or individual on whom business rates are formally levied.

The extent to which business rates are actually paid by landlords will be greater:

(i) the more sensitive demand is to changes in price; and

(ii) the less sensitive the supply of property is to changes in price.

Some evidence on Regional Selective Assistance (RSA) grants for the United Kingdom suggests that they are more effective in stimulating employment and investment in smaller firms than changes to business rates. (More detail in Annex 1).

In the light of the empirical evidence it is important that we first explain the limits of what rates policy can achieve and to point out that it can never be a cure-all for the complex economic problems facing Wales.

In undertaking our review and formulating our report we have been particularly aware of the reports by the National Assembly for Wales Committee and the *Portas Review* into the worsening impact of the current downturn on our town centres and the wider expectations that await the publication of our recommendations.

We received a large number of representations regarding the operation of the current rating system. It was not part of our remit to investigate or recommend changes to the fundamental UK rating system but in any event we do not believe this would be advisable. The current rating system has operated successfully for many years, is well established and widely understood. The system is asset based (it is difficult to avoid or go off-shore) and, whilst not directly profits related, forms part of a balanced taxation system.

As with any universal scheme it throws up shortcomings or anomalies. Nevertheless its primary function is to create a fair system for taxation based on property values, and it was never itself intended to be an economic tool. This is a very important aspect to note. Hence we recommend that where rates measures are implemented for economic reasons these are confined to the level of rates payable at a point in time, and do not involve revising the over-arching rating system.

- ## **The Cost of Reliefs**

Income from business rates in Wales totaled £982 million in 2011 and is a vital contributor to paying for the public services provided by Welsh Local Authorities (LAs) – whose budget for these services is already under major downward pressure. Therefore in these stretched financial times any rate reliefs we might recommend would impact directly on LA services.

As business rates are not devolved (on which we comment below) any new reliefs specific to Wales would have to be paid for out of the Welsh Government block funding from the UK Government. As a consequence, the benefit of any reliefs will have to be measured against the benefits foregone by diverting existing funding from other Welsh Government programmes.

Although existing research indicates that variations in business rates (upwards or downwards) have negligible impact on the wider economy, we recognise that some sectors of the economy are suffering at the present time and there are other factors to consider such as the wider effect of retail closures in Welsh high streets which have social as well as economic consequences.

We appreciate also that rates tend to form a higher proportion of total operating costs for smaller businesses. Evidence from some SME representative organisations indicates that the level of rates remain a major concern for SMEs.

Since a thriving SME sector is of fundamental importance to the economic health of Wales, we are very much in favour of the current Small Business Relief scheme being extended to 2015. Currently it is scheduled for being withdrawn in March 2013 and we would urge the UK Government to retain this relief. (More detail in Section 4).

- ## **State Aid**

It is important to recognise that as well as the wider affordability issue of rate reliefs, there are limits to the levels of relief achievable. Rates are considered by the European Union (EU) to be a normal cost of running a business and relief would be an operating aid for state aid purposes. The practical consequence is that any rate relief granted in Wales, which differed from what was generally available in the UK, would be considered to be state aid and incompatible with the EU treaty.

We specifically asked the Wales European Funding Office (WEFO) if EU funding in the period 2014 – 2020 could be used to introduce a two tier system for Business Rates in Wales – with business in the Assisted Areas paying less rates. Because rates are deemed to be an operating aid, this proposal was considered unlikely to be acceptable to the EU. More targeted intervention, such as funding support for introducing Business Improvement Districts (BIDs) or a more sectoral approach to reliefs, was regarded as potentially feasible. (See section 8 below on BIDs).

Any additional reliefs the Welsh Government may wish to introduce would most likely be declared *de minimis* aid and all support to individual businesses would not be allowed to exceed €200k in any three year period. All aid given to a business using the *de minimis* framework has to be recorded representing a significant administrative burden.

This is the basis upon which the current rate reliefs operate in English EZs, so that although up to five years relief from rates is available within EZs, this is limited to the *de minimis* allowance. Of course, for most SMEs in Wales, €200k over three years is substantially greater than their total rates bill.

We comment elsewhere on the potential for rates relief in Welsh EZs and in Assisted Areas. But it is important to point out that the level of compatible state aid for new investment and job creation in Assisted Areas in Wales, significantly exceeds the levels that could be made available as rates relief under the *de minimis* framework.

3. Devolving Business Rates

In the light of the evidence we received, and our consequent deliberations, we are keen for business rates in Wales to be used more strategically to promote economic growth. However, recommendations that involve changes to the business rates regime in Wales would be problematic without the full devolution of business rates to Wales. Therefore, we feel that if we are to use business rates more strategically in Wales to help achieve broader economic objectives, this will necessitate the devolution of business rates to Wales along the lines that they are currently devolved in Scotland.

At present, business rates in Wales contribute to the financing of the Welsh Block Grant (Departmental Expenditure Limit, or DEL) with the balance provided by the UK Government. The Welsh DEL is determined by Barnett Formula consequentials. In practice this arrangement means that as long as the Business Rates regime in Wales is the same as in England, the actual yield from Business Rates in Wales has no impact on DEL.

In Scotland, in contrast, the yield from Business Rates is outside DEL and, like Council Tax, is a distinct revenue stream.

Benefits of the Current System

We were informed of some of the benefits of retaining the current system in Wales. Firstly, Wales is insulated from volatility in the yield from business rates – year to year volatility in the yield is absorbed by HM Treasury. Wales is insulated if the yield of Welsh business rates rises less rapidly than consequentials from English local authority spend. To some extent, this arrangement is good for Wales when spending in England is rising rapidly. Conversely, if the consequentials from the local government spend in England are rising slowly – as will be the case between 2011-12 and 2014-15 – this could result in less resource for Wales. (See the graph below).

According to the Holtham Commission[2], current arrangements offer a degree of policy flexibility with little risk: "we see little case for moving to the Scottish system since that would result in additional budgetary volatility for little real enhancement of tax-varying power".

But to obtain these benefits the relief schemes for small businesses in Wales must match those in England. However, if the reliefs in Wales were made more generous and reduced the yield relative to England, then the Welsh DEL would be reduced accordingly.

2 Fairness and accountability: a new funding settlement for Wales (2010)

Constraints

Therefore, the degree of policy flexibility under the present system is constrained because any change in business rates reliefs that result in a lower yield will be penalised through changes in the DEL. Of course, if business rates were devolved, Welsh policies that result in a lower yield will also result in reduced funding for the Welsh Government. But, after devolution of business rates, this would then become a Welsh Government policy decision. These decisions would simply become part of the budget constraint that any devolved government would need to take into account.

We noted that the additional budgetary volatility referred to by Holtham is likely to be much lower going forward e.g. it is unlikely that public expenditure in England over the next few years will rise at the rate it did between 2002 and 2010. Rather, we are more likely to see the small variations in funding levels through DEL that were experienced in 1998 – 2002. (See the chart below) i.e. the Welsh budget will have to be flexible enough to absorb changes in funding levels of around £10m; (i.e. the average in 1998-02), as opposed to the £200m differential experienced in 2004-08.

Devolution

We have come down in favour of devolving the Welsh share of business rates – currently calculated jointly for England and Wales. In other words, we recommend breaking the ties between Welsh and English-and-Welsh yields of business rates. This would make business rates a fully devolved tax and it would introduce a hard budget constraint into Welsh Government policymaking that is currently lacking. Given the legislative powers currently devolved to the National Assembly, and the fact that Council Tax in Wales is already devolved, the present arrangements on business rates look like an anomaly that needs to be addressed.

Also, devolving business rates to Wales along the lines of Scotland would not appear to be a difficult constitutional issue. Indeed, it might not require primary legislation. Local government finance is already a devolved matter as it is within Subject 12 of Schedule 7 to the Government of Wales Act 2006. Grants to local authorities and council tax (but not business rates) are already legislatively devolved under the Part 3 arrangements of devolution – i.e. before the wider legislative powers in Part 4 of the 2006 Act came into effect.

On that basis, the National Assembly for Wales already has the power to determine all aspects of business rates, including the rate, exemptions and reliefs, and the administrative arrangements for its calculation – including the current pooling arrangement with HM Treasury. Therefore, it would be open to the Assembly to pass legislation putting an end to those arrangements if it so wished.

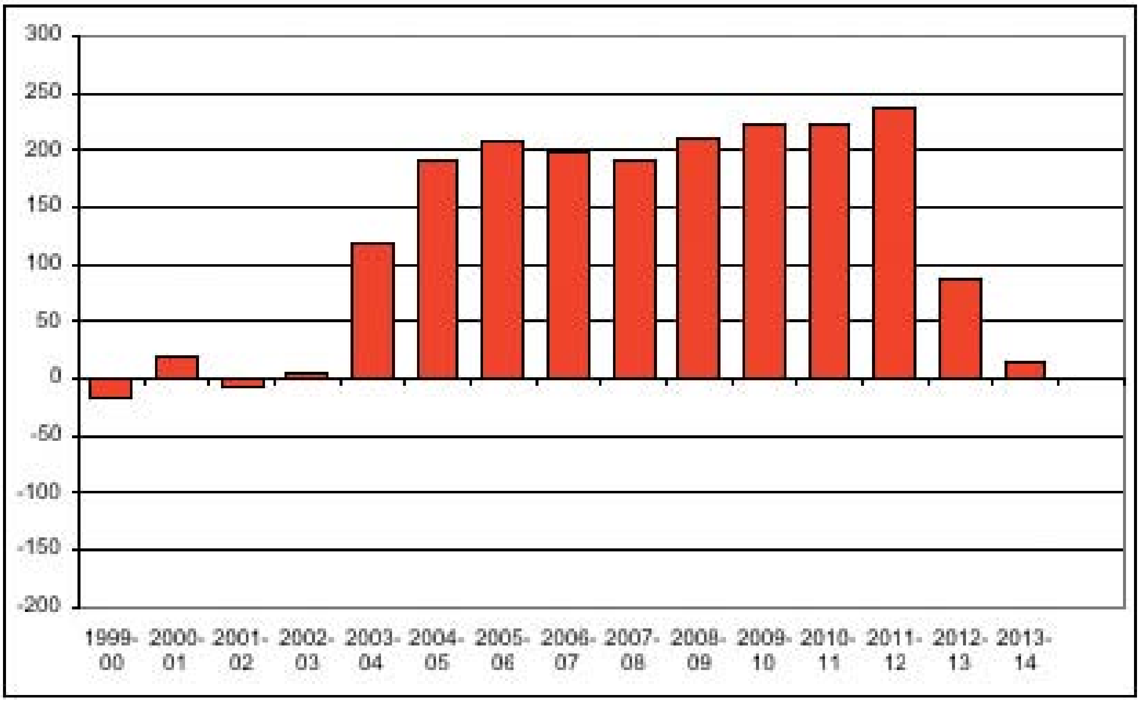
However, the National Assembly's powers to legislate so as to alter 'pre-commencement functions' of Ministers of the Crown (such as the business rates arrangements) are limited. It may do so only if the provision is incidental to the exercise of devolved powers, or if the Secretary of State consents. In practical terms, this means the Secretary of State's consent would be needed for the change – but primary legislation at Westminster would not be required.

Recommendation

In our opinion, with the possibility of additional tax devolution being recommended by the Silk Commission, we recommend that business rates be moved out of DEL and devolved to Wales. This would provide greater accountability and offer more opportunity to develop different policies on Business Rates for Wales.

However, some mechanism may be needed to manage the prospective volatility in yield from business rates, e.g. the yield from other sources of revenue as well as increased borrowing powers will need to be sufficient to cover this volatility. We feel that this is something that the Silk Commission will need to look at closely.

Figure 1: Impact on Welsh Funding Levels of Business Rates Being Inside DEL: Evidence Since 1999-00 (£ million)



Source: Welsh Government

4. Local Retention of Business Rates

As outlined above, control over Business Rates is only partly devolved to Wales. Although local authorities in Wales are responsible for collecting business rates, the total prospective yield is allocated to the pool which is then included in the block grant to Wales. The Welsh Government then re-distributes the income back to local councils according to a formula based on population and needs.

This creates problems at two levels:

(i) It constrains the ability of the Welsh Government to introduce changes in the Business Rates system different from that in operation in England.

(ii) It breaks the link between the revenue raised by each local authority in Wales and the amount of income it receives.

In section two we argue that this needs to change and that Business Rates should be fully devolved to Wales. In arguing our case we have emphasised the importance of accountability in devolving business rates to Wales.

A similar issue is involved when discussing local rate retention. This has been highlighted in the localising reforms being proposed in England which would see local authorities being able to retain a proportion of their business rates from April 2013. Similar changes to the system are being introduced in Scotland. We feel that the recommendation we are putting forward below for local retention in Wales is simpler than the proposed change in England and also more transparent.

- **Localising**

We see some merit in local authorities being responsible and accountable for raising more of the money they spend. The link between local taxation, local expenditure and delivery of services is important and needs to be highlighted so that rate payers can see the value of the services they get from paying business rates. This may require some powers to be devolved to local authorities in order to give them more control over business rates.

At present there is little incentive for a local authority to focus on increasing the revenue it raises from business rates through the creation of a stronger local economy – because any extra revenue is pooled. The total revenue is then re-distributed by the Welsh Government to all councils – independently of the revenue raised by each local authority. We recommend introducing a system that restores the link between economic growth and the revenue received from business rates. Although many local authorities already work closely with local businesses to encourage economic development, the proposed change can only incentivise further cooperation with business if the extra revenue generated from business rates is retained by the council.

During the consultation on this proposal we received only two responses from the 22 Local Authorities in Wales. The point was made that LAs already have a statutory duty to collect business rates and that therefore the system required no further incentives. We disagree and set out below our proposal for local rates retention.

We are aware that in the current economic climate, some LAs will be more able to generate economic growth than others, so any simplistic introduction of a system based solely on revenue growth will have both winners and losers. We have therefore looked at the total amount of revenue received from all external sources and made an adjustment that ensures that, although all of the business rate income will be returned to the council, the Revenue Support Grant (RSG) from the centre will be adjusted to ensure that no council is initially worse off. The following table highlights the main changes involved using recent allocations under the current system.

- **The Present System of Allocating Funds**

Local authorities receive a total funding package made up of an allocation from the Business Rates pool plus an allocation from RSG. The two together produce their total revenue referred to as Aggregate External Finance. This is reproduced in the third and sixth column of the table as 'Total Funds'. Other factors like Police funding complicate the totals but these are ignored for simplicity.

The table indicates that Anglesey currently receives £93.4m in Total Funds – made up of £16.3m from business rates and £77.1m from the Revenue Support Grant (RSG). Under the proposed new system Anglesey would continue to receive £93.4m in Total Funds but get only the £11.3m revenue it generates from business rates – plus an increased amount of £82.1m in RSG. Similarly Cardiff would continue to receive £395.3m in total funds but would get all of the income it generates from business rates – £143.8m – plus a lesser amount of £251.5m in RSG.

If this adjustment was introduced in 2013 then no authority would be worse off – all changes in income from business rates would be compensated for by changes in RSG. Total funds available would be unchanged. However, the total amount of business rates raised by each authority would be retained by them and they would therefore be directly responsible for raising a greater proportion of their income than they are at present.

Table 1: Current and Proposed Allocation of Total External Funds

	Current Allocation from Welsh Government*			Allocation with localised rates**		
Unitary Authority	Business Rates*	Revenue Support Grant RSG	Total Funds	Business Rates**	Revenue Support Grant RSG	Total Funds
	-1	-2	-3	-4	-5	-6
Isle of Anglesey	16,324	77,112	93,436	11,325	82,111	93,436
Gwynedd	28,327	139,700	168,026	28,463	139,563	168,026
Conwy	26,671	117,945	144,616	22,973	121,643	144,616
Denbighshire	22,950	113,588	136,538	15,738	120,800	136,538
Flintshire	35,203	149,753	184,956	45,724	139,232	184,956
Wrexham	31,361	129,778	161,139	29,335	131,804	161,139
Powys	31,412	148,025	179,438	20,910	158,528	179,438
Ceredigion	18,806	82,181	100,988	13,908	87,080	100,988
Pembrokeshire	27,561	132,368	159,929	33,719	126,210	159,929
Carmarthenshire	42,829	206,482	249,310	34,736	214,574	249,310
Swansea	55,556	242,743	298,299	55,395	242,904	298,299
Neath Port Talbot	32,519	164,063	196,582	29,727	166,855	196,582
Bridgend	31,522	147,197	178,719	32,145	146,574	178,719
Vale Of Glamorgan	28,951	121,681	150,632	30,319	120,313	150,632
Rhondda Cynon Taff	54,964	289,227	344,190	36,430	307,760	344,190
Merthyr Tydfil	12,942	73,320	86,262	11,777	74,485	86,262
Caerphilly	40,047	210,977	251,024	25,698	225,326	251,024
Blaenau Gwent	16,122	92,365	108,487	9,099	99,388	108,487
Torfaen	21,201	108,447	129,647	16,521	113,126	129,647
Monmouthshire	20,733	75,463	96,196	15,307	80,889	96,196
Newport	32,233	162,146	194,379	45,221	149,158	194,379
Cardiff	80,067	315,272	395,338	143,831	251,507	395,338
Total Unitary Authorities	708,300	3,299,832	4,008,132	708,300	3,299,832	4,008,132

- *Current system – Business rates re-allocated according to population and needs
- **Proposed system – Business rates income retained by the local authority

We feel that the present system is not transparent because it involves adjustments to both business rates revenue and RSG, with little explanation of the underlying criteria. It would be more transparent if business rates income were retained locally and the adjustment for population and need were to be achieved solely through the RSG.

- **Future Growth in Business Rates**

Once the income from business rates has been reallocated in this way, we propose that, from 2015, (following two years operation and the new 2015 Rating List) each local authority should be allowed to retain 50% of any future increase in business rates revenue that they generate. The other 50% is reallocated to those authorities who have been less successful in generating economic growth. LAs would be allowed to keep this uplift for 5 years. However, at the next revaluation of property values in 2020 the new system would be evaluated on its performance and re-assessed to ensure a fair allocation of total funds to each authority going forward.

The ability to retain 50% of any increase in rate income will give councils more control over their revenue. It will provide an incentive for local authorities to introduce innovative local economic development strategies that encourage local businesses to invest and promote new business start-ups. It could also support the development of Tax Increment Financing (TIFs) – outlined in more detail in section 6. However, we categorically are not recommending that LAs be given the right to vary the Universal Business Rate (UBR) for their area.

Under our recommendation, LAs would have more incentive to evaluate business rates relief schemes in their areas to ensure that both revenue and growth are maximised. Raising more revenue directly from local businesses will increase local accountability and give LAs more autonomy in the application and policing of the business rates regime.

These changes will increase transparency and make LAs more responsive to local business needs. Linked to other recommendations in this report (such as improving the way in which the business rates system is communicated to local businesses), it could address some of the concerns of business over the way in which business rates are charged and the services provided. Overall, the system will incentivise councils to provide an attractive economic environment for future investment and to grow their rates base.

Recommendation

The current system of allocating back the income generated from business rates to the LAs which actually generated it, is needlessly opaque. We recommend a more transparent system whereby LAs are allowed to keep most of the business rates income and the Welsh Government adjusts total funding for 'need' by altering the revenue support grant (RSG). From 2015, LAs should be allowed to retain 50% of any increase in business rates revenue that they generate for a period of 5 years. The other 50% should be pooled and then re-allocated to other authorities to ensure that no LA is worse off.

5. The Current Scheme, Reliefs and Exemptions

- ## The 5 Yearly Rating List

The Valuation Office Agency (VOA) undertakes a revaluation of business and non-domestic premises every five years. Properties are valued as at the Antecedent Valuation Date (AVD), some two years prior to each new List.

In Wales (unlike England) there is no transitional relief scheme to gradually phase in increases arising from 5-yearly revaluations. The Group sees this as an advantage as the scheme is already complex and difficult to understand. Furthermore, the relief given to businesses faced with increases is funded by delaying the reductions for those businesses whose rateable values have fallen.

The 2010 Rating List has an AVD of 1 April 2008. We recognise this last review was carried out before the current economic downturn and the 2010 valuations reflect the relatively buoyant market of 2008. Consequently, values in most areas will be lower now than then.

There is no mechanism within the valuation process to adjust for macro-economic trends that have taken place after the AVD although property specific factors can trigger a valid appeal. We have been asked why we can't revalue now and then enjoy lower rates, however this is to ignore the fact that the overall yield must be constant so a revaluation simply shifts the burden from one sector to another. The rating system already re-balances the burden on a five yearly basis and it is already open to Welsh Government to provide further special allowances for markets or sectors which it may choose to support.

In the 2015 Rating List (with an AVD of April 2013) it can be expected that businesses will see an overall fall in RV. We recognise that this provides little comfort now for hard-pressed businesses and we have considered whether recommending a change to a 3 year review cycle could be beneficial.

Recommendation

Whilst the principle of reflecting changes in market value as quickly as possible is preferred, our recommendation proposes no change to the current quinquennial revaluation due to the following:

- There would be considerable additional resource requirements which the VOA has advised it could not readily meet
- Increased revaluations would increase the churn in appeals, raising processing costs for both taxpayer and collector
- Business requires a stable and consistent policy framework and this is well established

- **Charging for Appeals**

There is no charge levied on appellants for submitting appeals. Whilst we note a recent move towards this basis in the Republic of Ireland, we do not recommend a change. This would discourage applications and be out of step with other forms of local taxation – e.g. Council Tax. We also see no reason to limit the time to make appeals.

- **Valuation Changes & Material Changes in Circumstances**

Ratepayers have the right to appeal for a reduction in the rateable value (RV) where they believe the assessment is incorrect. Appeals can also be made where there has been a material change in circumstances affecting an individual property or a given area. We have seen evidence of wide-ranging RV reductions being granted e.g. due to a severe commercial impact such as an anchor department store leaving a High Street. There is however a lack of clarity over what is an area-based material change in circumstances.

We received mixed evidence as to the effectiveness of the appeals system. Some companies seldom pursue appeals for various reasons, but evidence suggests that appellants are generally satisfied that the VOA maintains its ‘duty to the list’.

Views have been expressed that there is a disincentive to improve premises as this can result in a reassessment and subsequent increase in rateable value, potentially backdated for a significant period. However, contrary views have also been expressed, suggesting that any deferral would unfairly disadvantage other businesses or landlords.

The current arrangement for business rates differs from the situation with Council Tax whereby any increase in valuation arising from improvements or extensions to dwellings are deferred until there is a change of ownership or a general revaluation.

Recommendation

(a) Introduce specific guidance to ratepayers on “material change in circumstances” in a way that businesses will understand the Valuation Office Agency’s approach to this issue

(b) Limiting the extent to which rateable values can be increased retrospectively to avoid unbudgeted liability for businesses

(c) Consideration should be given to deferring increases in assessment resulting from property improvements for two years, or the effective date of the next quinquennial re-valuation, whichever is sooner

There are a number of different business rate reliefs and exemptions in existence:

- **Small Business Relief (SBR) (See also section 3 above)**

A significant enhancement to the original SBR scheme was introduced from 1 October 2010. Initially to run for a period of 12 months, this has recently been extended by the UK Government to 31 March 2013.

Although there are minor variations (e.g. Post Offices receive slightly more generous relief), in general terms, premises with RV not exceeding £6,000 attract 100% relief. Above £6,000 RV the level of relief reduces on a sliding scale to an upper limit of £12,000 RV.

Relief is granted automatically with no requirement for the ratepayer to apply and with no restriction on the number of premises for which a single business can receive assistance. The system is easy to administer, simple to understand and, due to the RV profile in Wales, applies to a high percentage of ratepayers. It has naturally been welcomed by ratepayers and there is anecdotal evidence that some businesses have become reliant on this relief.

This UK scheme is funded by HM Treasury and we urge Welsh Government to strongly lobby for this to be continued beyond 2013. Its loss would be a greater blow to Wales because of our higher proportion of SMEs. If withdrawn, it is unlikely Welsh Government would be able to continue to fund the estimated cost of £75 million (for Wales). In this eventuality, we have outlined elsewhere how a reduced, Wales only scheme, might operate and be better targeted to maintain a lesser relief scheme.

Recommendation

Welsh Government to lobby UK Government to retain the SBR scheme beyond March 2013, at least until the 2015 Rating List, citing the larger impact withdrawal of the scheme would have on Wales (given the greater contribution small businesses make to Welsh GDP than elsewhere in the UK).

If the scheme is abolished in 2013, Welsh Government should investigate the affordability of introducing a reduced relief scheme, targeted to priority sectors and areas until 2015:

1. A more targeted approach based on the needs of the community.
2. Restricting national or multi-location companies from benefiting from SBR on numerous premises purely because they have smaller RVs.

Reviewing the current threshold, regarded by some contributors as too low to assist some retail businesses.

- ### Small Premises

The lowering of the empty property rate threshold to RV £2,600 has increased the number of small vacant premises now subject to the full 100% charge.

This has been criticised by a broad range of contributors. Reference has been made to the anomaly with SBR whereby occupied premises with an RV of less than £6,000 receive 100% relief but unoccupied premised with an RV over £2,600 will pay in full. It has also placed a burden on some retired ratepayers "living above the shop" that are liable to pay Empty Property Relief (EPR) but where it may not be viable to let or sell the business element of the property.

Recommendation
Make exempt from the existing empty property charge those premises with an RV not exceeding £6,000 and which are part of a composite property (property which comprises both residential and commercial elements) which is difficult to let or separately occupy from the residential accommodation.

- ### Charitable Relief

We understand the value of this retail fund to charities and acknowledge that a shop let to a charity is preferable to a vacant slot on our High Street. We also recognise the Welsh Government's commitment to supporting the charitable sector nevertheless we consider a review of current arrangements is appropriate.

Sine 1990 premises occupied by a charity enjoy 80% mandatory relief (50% relief was afforded under previous legislation when charity shops were also obliged to sell over 50% of donated goods.) Billing Authorities can also grant up to an additional 20% in discretionary relief.

This relief is easy to administer and seen as helpful if it prevents vacancies on the High Street. However, representations to our Call for Evidence raised the continuing trend of charity shops clustering on certain High Streets and benefitting from reduced overheads in competition with general retailers.

There has been evidence of organisations registered as charities occupying large vacant premises of a type not usually associated with charitable occupation. This has relieved the owners of the EPR liability and generated suspicions of rates avoidance tactics.

Recommendation

Welsh Government to consult with UK Government and charitable and retail sectors to discuss these issues. Consideration be given to:

(a) Limiting rate relief to 50% for larger charity shops trading in new goods

(b) Place an upper RV limit on the definition of retail premises eligible for charitable relief

(c) Introduce tighter qualifying criteria e.g. must be philanthropic, providing social or community benefit AND/OR must be actively using all the premises

Limit the number of retail units eligible for charitable relief in a given town centre OR limit relief to only one per charity in a given area

- **Social Enterprises**

Social enterprises are not-for- profit businesses that engage in trade in order to tackle social or environmental issues, although not afforded the same mandatory relief as charities. Whilst local authorities have discretion to grant relief to non-profit making organisations, including social enterprises, we understand that there are differing approaches by the various local authorities across Wales.

Recommendation

Consideration should be given to introducing a limited relief for social enterprises. In this respect, changes could be cost neutral with any increased liability for high street charity shops.

- **Section 44a Applications (Relief for Partly Occupied Premises)**

Section 44a, Local Government Finance Act 1988 is a means whereby Billing Authorities can use discretion and grant relief where, in the short term, premises are only partly occupied. This is generally applicable where the ratepayer is gradually occupying (or vacating) premises, or temporarily mothballing sections of the premises.

The relief is based on the RV attributable to the unoccupied/unused area as determined by the VOA. There is no cost to the Billing Authority and it is difficult to see situations where applications for this relief should be refused. However due to the current rules relating to empty property rates (i.e. limited rate free periods followed by 100% empty rate charge) , Section 44a relief can only be for a limited duration before the full charge is reinstated.

> **Recommendation**
> Consideration should be given to promoting assistance for new occupiers moving into larger premises by extending the period before empty property rate applies to the unoccupied areas to a maximum of 12 months, at the complete discretion of the local authority.

- **Hardship Relief**

Billing Authorities have discretionary powers to grant relief in cases of financial hardship. The Billing Authority may reduce, or remit in full, rates payable, although any relief granted must be "*… in the interest of the local Council Tax payers.*"

Since April 2012 Billing Authorities have additional discretionary power to reduce or remit business rates for whatever reason they see fit, which has given more flexibility. However, with 100% of the cost of such reductions falling on authorities with the current financial pressures we see little incentive for authorities to widely exercise this discretion.

> **Recommendation**
> Awareness of this relief should be raised in order that occupiers can discuss this option with their Billing Authority which is best placed to assess the merits/demerits of the application.

- **Empty Property Relief (EPR)**

Changes in regulations in April 2008 introduced an obligation for property owners and developers to pay full business rates on vacant property, after an initial three month void period for office and retail property and six months for industrial property. New builds are also subject to a 100% charge. Prior to that date vacant office and retail property was subject to only 50% charge and vacant industrial property was rate-free indefinitely.

In addition, the RV threshold under which premises are exempt has been significantly reduced and more small premises are subject to EPR.

This decision by the UK Government has increased holding costs for owners of vacant property. The increased tax liability remains unpopular within the property sector and is regarded by the Royal Institution of Chartered Surveyors (RICS) and CBI Wales as a disincentive towards speculative development. In addition, investors, whether pension funds or property companies, take this cost liability into account when deciding whether to acquire investment properties, particularly in secondary locations where property may take longer to re-let. A three or six month void period is not considered to be a realistic marketing period with many properties in Wales taking one to two years to be re-let.

The argument has been made that this liability to pay EPR might persuade property owners to take a more pro-active approach to re-letting. However, we have not come across any examples in Wales where property owners have intentionally left property vacant; indeed pressure from insurers and the risk of holding vacant property are ample enough incentive to re-let.

The abolition of EPR has had a wide-ranging impact, contributing to an overall tone of reduced rental and capital values. This may, subsequently, affect the balance sheets of business owners.

The UK Government's current indebtedness means that the wholesale removal of this little understood tax is now fairly remote. We recognise that the Welsh Government does not have the resources to completely withdraw EPR legislation and underwrite the loss to the Welsh budget. However, the negative impact upon the property market should be recognised and modifications considered where there is a limited financial impact upon the Welsh budget.

Recommendation

(a) Welsh Government should make representations to the UK Government to seek a longer period of exemption for secondary property markets, defined as top tier EU assisted areas (e.g. West Wales & the Valleys). This could be justified in terms of market evidence for longer periods for re-letting in these areas.

(b) We are aware of a growing rates-avoidance industry. Ratepayers should legitimately use the EPR relief to mitigate their outgoings, particularly where a property is subject to short term or seasonal lettings. However, our recommendations on local retention of business rates should incentivise local authorities to properly enforce these regulations.

- **Empty Property Rates and Speculative Development**

The obligation to pay EPR is considered to be a significant disincentive against speculative development. Where a developer puts together an appraisal, a void period of circa 24 months is usually assumed until a letting/rental income is achieved. Indeed, in parts of Wales, new-build units have been vacant for substantially longer than 2 years. The introduction of EPR after three or six months for office or industrial schemes adds cost to the appraisal and clearly reduces each scheme's viability.

Across Wales, the rate of speculative development of business space has slowed dramatically since the start of the economic downturn in August 2007 e.g. in the industrial market, just 25,000 sq ft of speculative floorspace was under construction in Wales in Q1 2012 compared to over 500,000 sq ft pa in the mid 2000s[3].

In the office market the general trend has again been sharply reduced speculative development, although there has been a small resurgence in Cardiff City Centre (based around one scheme at Capital Quarter).

The factors affecting new development are not restricted to the abolition of EPR. Other material considerations include the reduced availability of development funding, lack of occupier confidence, the general sentiment in the economy and the availability of other high yielding investment opportunities. The vision of a large scale return to speculative development in Wales may therefore be somewhat distant. However a longer period of rates exemption would make a positive statement about how the Welsh Government is working with business to encourage investment and employment.

Recommendation

(a) A longer period of exemption from empty property rates be introduced of two years for new speculative development.

(b) Consideration be given for a longer period of exemption for speculative development in EU top tier assisted areas (West Wales and the Valleys), of say, three years.

These measures would need to be clearly defined but could either fall away upon first occupation, or, preferably, when occupied could run at a reduced rate of 50% through to the end of the time limit – thereby encouraging the occupier to take up new floorspace, in order to further encourage investment and employment.

Measures such as these, offer the Welsh Government the opportunity to make a positive statement on how it can work with the property industry to encourage investment and employment.

- **Empty Property Rates and the Second-Hand Property Markets**

EPR has an impact upon the rate of refurbishment of second-hand buildings, with property companies by and large having left the market. This has impacted upon the refurbishment and sub-division of older stock, previously a major driver of regeneration and job creation.

3 Jones Lang LaSalle Floorspace Survey

This reduced demand has contributed to significant reductions in capital values which may put asset valuations under pressure, thereby affecting the capital base of Welsh companies' balance sheets. This is the secondary impact of the EPR changes.

Recommendation

To encourage investment in refurbishing secondhand stock we recommend a longer void period (where nil business rates are paid) for those investors/developers.

We propose consultation with the Construction Sector Panel with a view to introducing an increased void period, triggered by a clearly defined measure, such as a marked improvement in the carbon efficiency of the property. For example, an improvement of two grades in a property's Energy Performance Certificate (EPC) rating, subject to a minimum new floor rating of, say, Grade C. This would contribute to Welsh Government's sustainability targets and help the tackle creeping obsolescence of buildings. (See also section 9 below on micro-generation and renewable energy).

6. Enterprise Zones (EZs), Assisted Areas and Tax Increment Financing (TIF's)

- **Enterprise Zones (EZs)**

We have looked specifically at the arguments for offering business rates relief in the announced Enterprise Zones in Wales. To the business community, the most identifiable feature of EZs (historically) has been rate relief and therefore we perceive it would be a difficult sell to promote Welsh EZs that do not offer this feature. It is also important that any incentives offered are consistent with the approach to economic development across all areas of Wales.

Rates relief of up to five years (subject to the state aid *de minimis* limits of €200k over any three year period) is already available to companies in most of the English Enterprise Zones – although this is often at specific sites within the EZs rather than across their entire area. In our view, Welsh EZs should ideally match the English offer, i.e. new occupiers would benefit from exemption from rates up to five years (capped at state aid limits). But the Welsh Government might also offer extra pan-Wales incentives over and above English zones such as a longer period of exemption for new speculative development, e.g. a two year exemption for Empty Property Rates.

However the Welsh Government advised us that it believes offering similar rate free periods in the first five confirmed Welsh EZs would cost over £20 million over five years and it has only been awarded a consequential funding increase from Central Government of £10 million for the same period. Ways to address this financial imbalance might be to match the English offer on rate relief to a set fund (avoiding an open ended commitment through a fund limit similar to the Economic Growth Fund) and restricting rates relief to the target key sectors identified to each zone – or make relief available for occupiers from the target sector and discretionary for applicants from other sectors.

Our recommendation on reforming Empty Property Relief (section 4) could help encourage new speculative developments in the EZs or in the proposed Local Growth Zones. There is also the possibility of developing a sector focused BID to support supply chain development in the targeted sectors. (See section 6 on BIDs).

The main point is to avoid the perception that incentives for EZs in Wales are lower than in England. Investors must be made aware that greater financial assistance is potentially available in Wales in the Assisted Areas (only 2 Welsh EZs are not Assisted Areas). We believe it important therefore that these issues are made clear in the Welsh Government's promotional media and project support activities.

- **Financial Assistance v Business Rate Relief**

As a principle, we believe that financial assistance from the Welsh Government on a project by project basis (e.g. Welsh Government Business Finance) is a more effective tool for supporting economic growth and investment in Wales than non-discriminatory rates relief. By definition, these reliefs would be available to any qualifying occupier regardless of their specific contribution to the Welsh economy. Generally, any company seeking to locate or expand in Wales would incur new capital investment costs and create new jobs in delivering their project. Both these activities can be financially supported in Assisted Areas up to the applying state aid limits – which are far greater than the *de minimis* limit.

The whole of West Wales and the Valleys currently has top level Assisted Area status and, with the exception of Cornwall, is the only area of the UK to enjoy this status. This allows the Welsh Government to provide the highest level of financial support for companies, within state aid rules. Currently of the seven designated EZs, only St. Athan and Cardiff Central Business District, are outside of Assisted Areas.

In the case of the St. Athan EZ, aerospace operations by their nature require significant capital investment and priority should be given for making some form of capital allowances available. Also, runway availability is necessary for a large percentage of aerospace companies, either because they operate airside themselves or need to be close to customers who do. Key concerns for many aerospace companies are the cost of airside property – which generally command a premium value over other industrial property – and the cost and availability of runway access. Both these factors can represent a strong competitive advantage for the St. Athan EZ compared to other airfield locations in the UK and Europe.

The Cardiff Central Business District EZ is focused around financial and professional services. Such investments do not usually involve major capital investment but there are significant property (usually rental not capital) and training costs. In these cases the supply of good quality property on competitive rental terms and availability of support to raise skill levels of indigenous employees is extremely important. The Welsh Government may therefore wish to consider additional measures to support property development (through site *pari passu* investment rather than grant support) and the provision of training aid.

Recommendation

We recognise matching the level of rate relief offered in English EZs is unlikely to be affordable in Wales. We recommend therefore that the Welsh Government considers the introduction of a more limited but better targeted scheme in Wales, based on a capped fund with preference being given to projects within the EZs and Welsh Government's priority sectors.

We also recommend that Welsh Government, as a priority, should make clear in its inward investment marketing strategy, that it has the ability to provide total financial support to suitable projects within the Assisted Areas of Wales beyond the restricted limits available in English EZs.

- **Tax Increment Financing (TIF)**

With respect to TIF, this can only be implemented when suitable primary legislation is forthcoming. The principle of TIF is that a public body is able to raise loan finance to support development and use the resultant business rates to repay the loan over time. We have received some representation from local authorities supporting the introduction of TIFs in Wales but it necessarily implies the local retention of rates.

The main issue for TIF in Wales may ultimately be one of financial viability, i.e. whether the costs of development and the resultant loan interest required can be defrayed from the expected rentals achieved given that the costs of development in many areas of Wales currently significantly exceed the market value of the property created.

Recommendation

We recommend the Welsh Government monitor the progress of implementation of TIF in England and Scotland, recognising it would be necessary to introduce some form of local rates retention scheme for it to come into effect. However, whilst the TIF approach may make available a further route to raising capital funding for development schemes, it is unlikely to redress the viability issues which currently makes speculative development in large areas of Wales uneconomic.

7. The Retail Sector and Business Improvement Districts (BIDs)

A significant proportion of the response to our Call for Evidence related to the retail sector. It is clear that the retail landscape in Wales remains very challenging as the High Street contends with reduced consumer spend, increased competition from out of town developments as well as the internet. This has been evidenced by an increased failure rate.

Evidence provided by Jones Lang LaSalle indicates that, across the UK, up to 50% of existing High street and shopping centre leases are likely to expire or break by 2015 – thereby providing a catalyst for change on our High Streets.

The above factors illustrate that the retail sector is dynamic and subject to continued evolution and change. However, although business rates are a significant issue for many retailers, the fundamental factors affecting trading and profitability may lie elsewhere. Notwithstanding this, variations to business rates may have a significant role to play in protecting our town and city centres.

The Welsh economy has a heavy reliance on small businesses and therefore arguably more support should be available for this sector. However, further rates reductions over and above the current reliefs would be costly, and there is little empirical evidence on how much impact a rates reduction would have on the local economy.

On the other hand, short term measures of support for SMEs during the current economic climate would be very well received by the business sector and politically. Additionally, rates reductions could have an impact on business confidence and investment which could address some of the issues that have led to the decline of our high streets. Certainly, the *Portas Review* highlighted rates as a factor in the regeneration of town centres, along with other support measures.

As highlighted above, the timing of the 2010 Rating List (which assumed a valuation date in April 2008, the height of the boom) was not kind to the retail sector. However, the 2015 Rating List will re-balance and may potentially lead to reduced rate liabilities for the retail sector. In the meantime it is worth highlighting that the Welsh Government has the ability to provide a special relief for the retail sector, or indeed any other sector, if it so chooses. However it would need to fund this concession from other income and consider state aid issues.

The crux of the question seems to be that without any hard empirical evidence on the effectiveness of rate reductions in improving town centres – independently of other issues such as planning – it is difficult to project a significant impact on the regeneration of the local economy. This is particularly the case if a costly rates reduction is unlikely to be sustainable into the future.

Therefore, for longer term impact, any change to business rate reliefs will need to be introduced in conjunction with other economic levers – such as BIDs and reforms to the planning regime. The use of the BIDs model (discussed below) could provide greater impact in terms of regeneration as it formally engages with affected businesses in town centres.

Out of town retail developments

The nature of larger out of town retail developments means that retail floor space in these developments often command a lower rate per sq.ft. than city centre units. As a consequence, rateable values are lower, leading to a more competitive rent/rates package for retailers. Retailers in town centres have expressed concern over the availability of free car parking for out of town developments, which contrasts with increased congestion and parking fees in central shopping districts. The Valuation Office Agency advises that the availability of free car parking is a valuation consideration which is taken into account when assessing the rateable value of out of town units.

Recommendations

We recommend looking at a number of options that could level the playing field between out-of-town developments and city centres in a sustainable way. Local Authorities should consider planning actions and strategies which restrict further out-of-town development where there is a direct impact upon the town centre.

There should be consultation on this issue with the planning community and relevant business groups to ensure that the cost of shopping in out of town centres matches the cost in city centres. A related option could be to require the Valuation Office Agency to assume a specific valuation factor for such parking when assessing the rateable values of out of town retail units.

Other more positive measures for driving footfall back into town centres would include the Local authority and businesses working together to develop and implement a BID delivery mechanism that offered parking initiatives and other proposals to attract shoppers. (Discussed in more detail below).

The Portas Review

This was an independent review into the future of the UK High Street with the aim of revitalising town centres by making them destinations for socialising, culture, well being, creativity and learning …. not just shopping. Under this premise, high streets would become the hub of the community and places that will develop and sustain new and existing markets and businesses. The report culminated in 28 recommendations.

In essence, the recommendations focus on supporting high street and retail business activity by encouraging greater communication between the stakeholders involved i.e. landlords, the local authority and the business community. The empowerment of local businesses to recognise the needs of their economic environment and work towards the common goal of regeneration and economic upturn is seen by us as being best achieved through the development of BIDs.

BIDs provide a clear mechanism for communication between the interested parties as well as assisting in the vision and strategic direction of town centres backed by a financially sustainable model. Specifically, where rates are concerned, the report suggests that Governments should consider how business rates could better support small and independent businesses; this could include reviewing the use of the RPI and changing it to the CPI. Portas also suggests that local authorities should use their discretionary powers to give business rate concessions to new local businesses.

For example, in Rotherham, a package of measures has been implemented that provides financial contributions towards both rental and capital improvement costs. e.g. 50% is offered towards Rental Costs in year 1, 25% towards Rental Costs in year 2 and 75% of the cost of shop Improvements up to a maximum contribution of £7,500.

Regeneration of Town Centres in Wales

The *Portas* recommendations were supported in January 2012 with the publication of the *Regeneration of Town Centres in Wales* report. Of particular note within the 21 recommendations were numbers 16, 18 and 19:

- The Panel on Business Rates to consider changes in legislation and in the application of discretionary powers, with the aim of improving the mix and quality of the retail offer in town centres.
- The Welsh Government to ensure that the new Regulations for EU Structural Funds 2014-20 are sufficiently flexible to enable the funds to be used to support town centre regeneration activities.
- An assessment of the effectiveness of the Swansea Business Improvement District and consult with a broad range of stakeholders to inform further BID development in Wales.

The BID model

We are of the opinion that BIDs deliver a sustainable financial model for a defined geographical area. They are a direct response to ideas of local businesses on improving their trading environment and enhancing their profitability. Generally, they plan to drive foot-flow and sales through improved car parking, cleansing, safety, security and marketing to support current businesses and attract new businesses. BID projects aim to directly deliver investment into town centres, into sectors, into villages etc by unlocking further consumer spending. In addition they aim to respond to the current trading climate by reducing business trading costs, allowing them to improve the bottom line.

Wales has one BID, which serves the needs of 850 businesses in Swansea, making it the largest BID in the UK. However, Scotland and England have been more proactive in the use of this model as a regeneration vehicle and are now looking at super BIDs and sector specific BIDs for tourism etc. Whilst examining the use of rates as an economic lever, the evidence presented has suggested on numerous occasions the use of the BID model as a lever for regeneration, hence we recommend support for the creation of more BIDs.

The BID model can be customised for a wide number of business situations. Experience in Scotland provides evidence that BIDs can be introduced on Business Parks and Industrial Estates, where they seek to improve services and reduce crime and vandalism. Additionally, rural community BIDs may focus on better access, sustainable transport or renewable energy. In order to finance projects in a small rural area, the BID could partner with another area to deliver a sustainable financial model.

Similarly, single sector BIDs can focus on a particular sector rather than a district e.g. a Tourism BID, which develops a sustainable financial model to provide additional resources to assist tourism and visitor businesses, to improve tourism.

Recommendation

The Welsh Government should follow the lead from Scotland by funding an amount, say £30,000, to fund the initial basic setup costs of each BID to reflect the potential tangible benefits in terms of high street regeneration. This could be funded by the Welsh Government applying to the WEFO to set up a BID Development Fund. Potential BID consortia could then apply to this fund for support – both in terms of setup costs and running costs. This approach would possibly be a cheaper and more effective option for regenerating town centres than blanket business rates reductions.

The imminent approach of a new EU funding regime in 2013 offers the opportunity to develop new approaches to economic development that include town centres as a priority area. These new models will need to engage businesses and encourage cooperation with all stakeholders if they are to achieve meaningful change and lasting economic impact. There is an opportunity now for the Welsh Government to embrace and support the use of BIDs across Wales and to assist in the development of Local Growth Zones as well as other regeneration opportunities.

Related Issues

- **Large Retailer Levy**

We are aware of the proposals by the Scottish and Northern Irish Governments to levy additional rates on large retail establishments; – popularly known as a 'Tesco tax'. The arguments in favour of such a tax are in some ways attractive, as superstores are perceived to be the winners in recent years, as well as a cause of decline in the High Street. Such a tax has the potential to generate significant additional revenue.

However we are concerned about the impact of this tax on the wider economy because such a levy is at odds with the aim of incentivising business growth and attracting mobile investment. Such a levy sends a negative message about the approach by Wales to larger corporate investors and the short term benefit of any levy could be outweighed by undermining business confidence.

In addition, the geography of Wales means our economy is more inter-connected with England than other devolved administrations. The threat of displacement of retail activity is therefore a real possibility if such a levy is introduced. Therefore, for wider economic reasons, we caution against such a levy.

- **Charitable Relief**

We recognise the Welsh Government's commitment to supporting the charitable sector. However, during our Call for Evidence, we were made aware of issues arising from the continuing trend of charity shops (subsidised through rates reliefs) to cluster in certain High Streets and to compete with other retailers. Our recommendations with respect to the charitable and social enterprise sectors are highlighted in Chapter 4 above.

- **Communication and education**

Evidence suggests that despite communications from the VOA about five yearly revaluation changes, the rating system would benefit from greater consultation with business rates payers, particularly where businesses are likely to face an upward revaluation. This would allow businesses to plan for rates increases and it would improve the relationship between all parties.

We are aware of the efforts already made by the public sector to explain the rating system however this is a continuous process and further work needs to be done to help businesses understand more clearly the rates they are paying, how they are calculated and what the money is spent on. Local authorities need to communicate more carefully the rating procedures, as well as how to apply for hardship relief and other short term reliefs such as material change of circumstances.

8. Sustainability and Renewables

Our terms of reference requested an assessment as to whether specific policies relating to renewable energy could be introduced to encourage economic development. In this context, we recognise the Welsh Government's commitment to sustainability and the low carbon agenda and have focused on the following areas.

- **Micro-generation**

A key criticism of the current rating system is that periodic revaluations based upon rateable values (essentially rental values) will automatically increase when improvements are made to the property and therefore penalise such investment.

The Welsh Government introduced measures in 2010 which means that ratepayers who implement energy saving measures will not face an increase in the rateable value of their property until the next five yearly revaluation.

RICS Wales noted at the time their concern that "…the exemption only extends to defined "micro generation" plant. It would not therefore provide any relief for [other] plant …" Their suggestions were not adopted, as the Welsh Government would have to fund changes that are more generous than those being made in England, and any additional changes would be complex to introduce.

Recommendation

We welcome the recently introduced legislation. Whilst we see that an extension of this benefit would provide a further incentive to invest in micro-generation it would require Wales to fund those changes that are more generous than in England.

Our recommendation is for the Welsh Government to lobby Westminster for a more generous scheme. Should business rates in Wales be devolved in the future then an analysis should be carried out on the cost and benefits in extending this scheme on a Wales-only basis.

- **The Scottish Model – Renewable Energy Relief Scheme**

Relief on renewable energy commenced in Scotland on 1 April 2010. This offers discounts of up to 100% to support the central role of renewable energy producers in the climate change agenda and to promote the further expansion of this sector. A wide range of renewable technologies are eligible for support.

Renewable Energy Relief is granted as *de minimis* aid for state aid purposes, providing relief as follows:

Threshold by rateable value	Relief (%)
Up to £145k	100
Up to £430k	50
Between £430k and £860k	25
Between £860k and £4m	10
Greater than £4m	2.5

Recommendation

Establish a Welsh Renewable Energy Relief Scheme – with a similar schedule of specified reliefs – which apply to smaller scale projects under *de minimus* rules. This would need to relate to stand-alone facilities which do not form part of a larger assessment. The Scottish model has been estimated to have cost £4m per annum in 2010/2011.

The financial implications for Wales would clearly need to be assessed, although our understanding is that the renewable industry in Scotland is substantially larger than in Wales. The definition of renewables would need to be consulted and agreed with the Energy Sector Panel, but we see a graduated stepped relief structure such as that outlined in the Scottish model as a realistic target.

- **The English Model – Local Retention Scheme for Renewables**

In England, the Department for Communities and Local Government issued a consultation paper in 2011 to consider the issue of rates retention for business rates arising from renewable energy. This would allow communities that host renewable energy projects to keep the additional business rates they generate.

Furthermore: "We propose that at least the greater proportion of this funding should go to the level of the local planning authority to maximise the community benefit."

The UK Government has concluded that allowing local authorities to retain a greater proportion of business rates revenue raised locally would give local authorities an incentive to encourage sustainable growth through investment and also reward that growth with greater revenue. In addition, it intends that local authorities would have the ability to borrow money against future increases in revenue. The intention is that local authorities would be able to retain the whole of any rates revenue from renewable energy projects.

We would support this approach and recommend that the revenue retained at the local authority level is devolved down to the local community council level to ensure that the maximum benefit is retained by communities that support the development of renewable technologies.

Recommendation

We see merit in the proposals from UK Government for the English local retention model for renewable energy projects, as it engages with the local community and provides a material reward for those communities which accept new technology.

However the structure of local retention for renewables would need to be carefully considered because business rates for specific industries and utilities are often collected through a central list directly by the Welsh Government.

Again we would recommend that business rates arising from larger schemes, not exempt under the proposed renewable scheme above, be directed towards the local community council level to encourage sustainability in ways that would provide tangible economic benefit to local communities. At present, many local community councillors are returned unopposed at local elections because the ability to make a difference at this level is constrained by lack of resources. This recommendation may therefore also promote local democracy.

9. Conclusions

We recognise that the business rate regime in Wales has to be seen as part of the bigger picture of improving economic development opportunities. The Welsh Government will want to consider these recommendations in parallel with other equally significant policy initiatives. We have also highlighted in the report that variations in business rates should not be seen as a panacea for the economic problems facing the Welsh economy at this difficult time in the economic cycle – and there is little empirical evidence of how business rates reliefs can be used as a targeted economic intervention.

This Section draws together the Group's ideas on restructuring the business rates regime in Wales to introduce greater accountability, within a more streamlined system including a more consistent set of reliefs. Here we highlight which of our recommendations we feel are the most significant and which offer the greatest opportunity to improve the economic well being of Wales.

The first two topics considered in the report focused on the issues involved in devolving business rates to Wales and local retention of the revenue from these rates. We stressed that the recommendations are aimed at increasing the accountability for raising revenue – at both the national and local level – and introducing new ways of allocating the revenue from business rates so as to provide more incentives for LAs to widen the tax base. We feel that these recommendations are essential pre-requisites for using the business rates system as a lever of economic policy. They fit well with our overall objective of introducing more incentives into the system to encourage business growth and investment. However, these ideas will need to be discussed in relation to the forthcoming report from the Silk Commission[4].

In Sections 4-7 we set out our views for improving the investment climate in our town centres and rural communities. Rate reliefs and the local retention of rates have a significant part to play but there is also scope to encourage local businesses to collaborate together to address some of the key issues in the decline of our town centres by creating and developing Business Improvement Districts. We believe that these measures taken together offer a consistent and coherent approach to business development and we hope that they will strengthen Wales' reputation as an attractive place in which to invest.

The Group spent much time debating the case for devolving business rates to Wales and for LAs to retain a greater share of the rates revenue locally. The underlying themes can be linked with our views on renewables where we believe there is a great opportunity to grow the renewables sector and to compensate local communities for the disruption that may be involved. These proposals are not without risks but we believe they combine a fair funding package for LAs with enhanced accountability and more incentives to grow their tax base. They also offer support for the creation of investment vehicles such as TIFs.

4 The Commission on Devolution in Wales

Since the first meeting of the Group the outlook for the Welsh economy has become more uncertain with the Welsh Government and LAs having to consider the uncertain prospects of higher inflation and higher unemployment. The likely impact of spending cuts on LAs income and expenditure is uncertain and will make it more difficult to prepare expenditure budgets. The significant changes to spending plans – particularly in the area of capital spend – will make forecasting revenue more difficult. However, we feel the more control LAs have over the income they generate from rates, the better they will be placed to make the required adjustments.

This does however throw up the issue of managerial capacity. Our main recommendations on devolving rates, retaining them locally, using them to support TIFs and to assist in the formation of BIDs will undoubtedly put pressure on LA resources. In the current system the relationship between income and expenditure in the public sector has been largely determined by the accounting and audit departments of these organisations because they have had few incentives to maximise revenue. Therefore, significant changes in skills may be needed if our recommendations are to be implemented effectively. In this respect, some preparatory work will be needed between now and 2015, as well as discussions with HM Treasury, in order to reduce the implementation costs of these recommendations.

However, the changes recommended in the report should not be exaggerated. Transferring business rates to Wales would not fundamentally alter the existing devolution settlement as most of local government finance is already devolved. Also the amount of money raised through business rates, although significant, will still only represent about 8% of the block grant. Therefore, the majority of the Welsh Government's resources would still be allocated from the centre and devolving business rates would not significantly widen the Assembly's remit. Hence we do not believe that primary legislation will be needed – only Secretary of State approval.

Similarly in the area of local rate retention, we feel that the current allocation of business rates amongst the 22 LAs is essentially arbitrary. So even if business rates is not devolved (or before it is devolved) we feel that the Welsh Government should certainly begin to implement this recommendation because the benefits, in terms of greater accountability, incentivisation and transparency, far outweigh the likely costs. This reform can only be opposed if LAs can demonstrate that it will raise insurmountable problems. But this is unlikely to be the case if the Revenue Support Grant is used judiciously to retain fairness in the system between the faster and slower growing regions of Wales.

In terms of the reliefs available under the current rating system, the evidence we received provided the Group with a wide range of suggestions on how the system can be improved and streamlined. Of course there were different views on many of these issues. For us the most important recommendation is to extend current Small Business Rate relief scheme beyond March, 2013 to at least 2015. Failing that extension, then a targeted version of the current scheme may remain a possibility in Wales and should be considered.

In terms of changing and streamlining the current system, the main area of concern was empty property rates. Because of the distortions flagged up in the report we recommend a longer period of exemption from empty property rates – particularly in Assisted Areas and for new developments or significant refurbishments. Also, we recommend responding to the anomaly between the point at which empty property rates are payable and the rate at which Small Business Rate relief becomes available. These should be harmonised by raising the former to £6,000 for targeted properties. A similar recommendation simplifies the response to property improvements – any increased rates should be deferred for two years.

We discussed a number of options to level the playing field between out-of-town developments and city centres in a sustainable way. But rather than introduce rate reliefs in town centres we feel the most appropriate response would be for the Welsh Government to make available match fundin to encourage the creation of Business Improvement Districts. The introduction of BIDs would introduce greater collaboration amongst the main stakeholders to improve their town centre through a sustainable financial model which could be further supported by a dedicated WEFO fund for BIDs. Town centres could also be improved through a consultation process which involves the charitable and retail sectors to review the current rating provisions for charities and social enterprises.

Finally, for Enterprise Zones in Wales we recommend a targeted scheme of rate relief but highlight the ability of the Welsh Government to provide additional support to projects within the Assisted Areas. A related area of relief is our recommendation to establish a Welsh Renewable Energy Relief Scheme including provisions for local retention of rates generated by these projects.

There remains much to be done on communicating the major elements of the current rating system to the business community. The system should be summarised, including the recommendations in this report, on one sheet and made available to all property agents and prospective tenants – especially new start-ups – to highlight the liability of business rates and also how the various reliefs can be applied for. In particular, information on existing hardship provisions should be made more easily available along with information on how to apply for relief in relation to material change in circumstances.

This report is likely to be the beginning of a journey and our recommendations set out what needs to be achieved in the short term, with a view to these being carried forward over the medium to long term. Ultimately, the aim of this report is to make Wales a more attractive investment proposition. Hopefully, our recommendations on business rates will help create an attractive business environment that will support the growth of the Welsh economy.

Annex 1 – Empirical Evidence on Varying Business Rates

This section examines evidence on the effective incidence of business rates – who really pays – and, given this, how changes in business rates might affect business decisions. There is a lack of research evidence on the real effects of business rates. However the evidence that does exist does not imply that changes in business rates are very likely to have long-term effects on business start-up decisions or employment.

The primary reason for this is that, at least in the longer-term, much, or all, of the incidence of changes in business rates is likely to fall on landlords and be capitalized into rents and property values. In the shorter term, until rents adjust, the available evidence suggests that changes in business rates could have effects on employment. Other, related evidence on locally varying business incentives examines the effects of Enterprise Zones and Regional Selective Assistance (RSA) grants. Recently available evidence on RSA grants for the United Kingdom suggests that these are more effective in stimulating employment and investment in smaller firms.

- **Evidence on the incidence of business rates**

To evaluate the effects of business rates on, for example, employment growth, a first consideration is who actually pays business rates. Understanding the effective incidence is important for assessing who might gain or lose from a change to the system, and how this might affect business decisions.

The firm or individual who actually bears the incidence of business rates may be different to the firm or individual on whom business rates are formally levied. As an example, the costs of renting a property can be treated as the total of rental costs plus business rates. If business rates increase by £1, the question of tax incidence equates to whether the total costs of occupying the property go up by £1, in which case the occupiers bear the full incidence, or whether the total costs increase by less than £1, in which case the landlord bears part, or all of the incidence.

Which group bears the tax incidence is determined by how sensitive the demand for and supply of properties are to changes in price. The extent to which business rates are actually paid by landlords will be greater:

(i) the more sensitive demand is to changes in price – i.e. landlords will be unable to shift an increase in business rates onto occupiers; and

(ii) the less sensitive the supply of property is to changes in price.

The incidence of the tax may also differ in the short and longer term, depending on how quickly rental costs can change in response to a change in business rates – for example, for properties which are already occupied, whether landlords and occupiers have long term contracts, and whether within these contracts, rents can be re-negotiated both upwards and downwards.

Evidence suggests that business rates are at least partially borne by landlords, (if not wholly in the longer term), in the form of lower rental income than they would have received in the absence of the tax. This is demonstrated in an empirical study which examines the effects of the 1990 introduction of uniform national business rates on rents[5]. The replacement of locally-varying rates by the uniform business rates meant that some areas saw an increase in business rates and others a decrease. The study finds that properties which experienced an increase in business rates had smaller increases (or larger decreases) in rents compared to properties that experienced decreases – that is some of the increase in business rates was passed on to landlords in the form of lower rents.

The study assesses the magnitude of the effects of changes in business rates on rents and how quickly rents adjust. It finds that after two years a £1 per square foot increase in business rates is associated with a 45p to 85p reduction in estimated rental values. It also finds that the longer-term effects, in terms of the proportion of a business rates increase passed on to landlords, are greater. This difference in short and long term effects is explained by the presence of contractual, upwards only, five-year rent reviews.

In summary the findings imply that in the short term tenants are likely to bear some of the incidence of an increase in business rates, or conversely benefit from a reduction. In the longer term the results suggest that the benefits of a reduction would be passed on to current landlords. Hence, in the short term this suggests that changes in business rates might affect business decisions. It also raises the issue of the extent to which landlords and occupiers are in practice the same entity, since changes in business rates might have different effects on property owner-occupier businesses.

- **Evidence on the effects of business rates on employment and business location decisions**

There is a lack of systematic evidence on the effects of business rates. One study examines the effect of changes in business rates on employment and business entry[6]. The research uses data for England during the period leading up to the introduction of the uniform business rate, when business rates varied across local authorities. In order to take account of differences in local area economic conditions that will affect business decisions, it compares business behaviour either side of a local authority boundaries, where the local authority areas on either side were subject to differential changes in business rates over time.

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5 Bond et al. (1996) "Who pays business rates?" Fiscal Studies. This study focussed on institutionally-owned large properties, and those used in the analysis were predominantly in the retail sector.

6 Duranton et al. (2011) "Assessing the effects of local taxation using microgeographic data", *The Economic Journal*. This study only considers manufacturing establishments.

The study finds a negative effect of business rates on (manufacturing) employment. The results suggest that a 1% increase in business rates (as measured by the local authority rate poundage) leads to a 1% decrease in employment (as measured by establishment employment). The study rationalises this finding as due to contractual rigidities in rent setting. That is, increases or decreases in business rates are not immediately capitalized into rents, meaning that occupiers bear some of the incidence at least in the short-term. In addition, a fall in employment resulting from an increase in business rates may come about by inhibiting firms' employment growth or by inducing exit, or re-location to other areas. The study also notes that if growth entailed a property expansion which would lead to a re-valuation then in principle this could magnify the above effect. The study finds no effect of business rates on new entry[7].

- **Other related evidence**

There is also some international evidence on the effects of locally varying business taxes, some of which highlights displacement effects across areas with different tax levels. For example, evidence for France suggests a weak relationship between lower local business taxes and higher business entry, potentially to the detriment of neighbouring higher tax areas[8]. A study which looks at the effects of US-State varying R&D tax incentives finds that such tax subsidies are effective in increasing R&D within States, but that nearly all of this is due to displacement of R&D from other US states[9].

Some international studies of enterprise zones have looked at effects on employment. A recent study investigates the effects of French enterprise zones on unemployment and finds small short-run positive effects on the likelihood that unemployed individuals find a job[10]. A study of enterprise zones in California finds no effects on employment[11] [12]. However, general conclusions should not be drawn from these results without knowing the precise nature of the incentives involved.

7 If anything the results point towards higher entry in locations with higher business rates. The empirical approach taken should have dealt with the fact that higher business rates and higher entry rates might be positively correlated due to other characteristics of the area. The study therefore explains this finding as the result of exits and re-locations freeing up sites for new entry, where those exiting might be more sensitive to business rates.

8 Rathelot and Sillard (2008) "The importance of local corporate taxes in business location decisions: evidence from French micro data." *The Economic Journal.*

9 Wilson, (2009) "Beggar thy neighbour? The In-State, Out-of-State and Aggregate Effects of R&D tax credits" *Review of Economics and Statistics.*

10 Gobillion et al. (2011) "Do unemployed workers benefit from enterprise zones? The French experience." CEPR working paper 8084.

11 Gobillion et al. (2011) "Do unemployed workers benefit from enterprise zones? The French experience." CEPR working paper 8084.

12 A recent report by the Work Foundation on enterprise zones contains a summary of evidence on effects. http://www.theworkfoundation.com/assets/docs/publications/283_Enterprise%20Zones_24%20Feb_FINAL.PDF

Evidence also suggests that the effects of tax differentials between areas can be dampened by other characteristics of locations or of industries[13] – for example, the existence of agglomeration economies (that is benefits from locating in areas with a higher density of economic activity or location specific benefits accruing to firms in industries that are geographically concentrated). This same argument might apply to other characteristics such as local infrastructure or labour market conditions. This highlights that the effects of any tax changes might vary according to other economic characteristics of the area, and according to the factors that shape location decisions in different industries.

Finally, recently available evidence on Regional Selective Assistance grants[14] suggests that these targeted subsidies have a positive effect on employment and investment at the firm level, and also on net business entry and employment at the local area level. The study finds that these effects are only present for smaller firms and not larger firms (with greater than 150 employees). The research also finds that the increase in (manufacturing) employment in eligible areas does come about through a reduction in unemployment, and not through a reduction in employment in non-grant recipient firms in the same areas or in firms in neighbouring, non-eligible areas.

13 Brulhart et al. (2011) "Do agglomeration economies reduce the sensitivity of firm location to tax differentials?" The Economic Journal forthcoming, use data for Switzerland and find that higher local corporate taxes are associated with lower firm entry, but to a lesser degree in industries that are geographically concentrated. Evidence on Regional Selective Assistance grants suggests that grants are more effective in inducing firms to areas with higher existing activity in that sector. Devereux et al. (2007) "Firm location decisions, regional grants and agglomeration externalities," *Journal of Public Economics*.

14 Criscuolo et al. (2012) "The causal effects of an industrial policy" Spatial Economics Research Centre discussion paper 98.

Annex 2 – The Rates Multiplier

The Rates Multiplier in Wales compared to the rest of the UK.

	Multiplier 2012/3
Wales	All: **45.2p**
Scotland	Small: **45.0p** Large (RV over £35k: **45.8p** Supermarkets: **54.1p**
England	Small: **45.0p** Large: **45.8p**
Northern Ireland	Regional: **31.4p** Plus District Rates (ranging from **16.7p** and **30.3p**)

As it stands, Welsh small businesses are marginally worse off while larger businesses are better off than those in England for comparable RVs.

Large businesses in Wales are better off than those in Scotland and NI (though a differend system) in regards to the Multiplier.

Large supermarkets in Wales are significantly better off than in Scotland and NI.

RV (£s)	**Wales**	**England**	**Scotland**
6,000	2,712	2,700	2,700
12,000	5,424	5,400	5,400
35,000	15820	16,030	16,030
500,000	226000	229000	229000
Supermarket (£500,000)	226000	229000	270500
Large Supermarket (e.g. £3,760,000)	1,699,520	1,722,080	2,034,160

Supermarket

Wales has the lowest business rates for large supermarkets, and is considerably lower than Scotland.

For example, a large supermarket in Wales (e.g. Tesco Western Avenue, Cardiff) will expect to pay £22,560 less rates in Wales compared with a store with the same RV in England. This rises to a considerable £334,640 saving in Wales compared with Scotland. This is a result of the multiplier difference across the UK.

Even a small supermarket in Wales will benefit to the tune of £3,000 a year under the Welsh multiplier compared with England, and a considerable £44,500 in comparison with Scotland.