# Business Rates Review: Discussion Paper

**Joint response from Charity Finance Group, Institute of Fundraising, NCVO, and Charity Tax Group**

**For more information, please contact Michael Birtwistle, Senior Policy Officer, NCVO (michael.birtwistle@ncvo.org.uk) or Andrew O'Brien, Head of Policy, Charity Finance Group (andrew.o'brien@cfg.org.uk)**

## Introduction

Charities play a vital role in improving our society and make a huge contribution to the UK economy. They employ over 800,000 people and support over 20m people to volunteer across the UK every year. The voluntary sector as a whole (mainly charities) has a gross value added of £12.1bn per year and we estimate the economic value of UK volunteering at over £23.9bn.

We want the best environment for the voluntary sector that enables them to support their communities and beneficiaries. We know that resilient communities are built upon the ownership of assets, and we want the business rates system to continue to complement government policy that aims to put assets under the control of communities, for the public benefit. It is important therefore that the reform of business rates does not adversely impact the charity sector.

Since the mid-19th Century, buildings used for public benefit have received the benefit of exemption from or reduction of taxation. The reasons for this principle are just as relevant today; charity assets can only be used for public benefit in pursuit of their charitable objectives, and in addition to the significant economic contribution detailed above, they add well documented social value above and beyond the primary focus of services they may provide.

This can include: job creation; volunteering opportunities; increasing community involvement and cohesion; addressing social isolation; generating apprenticeships and education pathways; facilitating neighbourhood improvement schemes; reducing environmental degradation; or fostering local economic growth[1].

**We urge the government to use this opportunity to restate its commitment to this principle** and to ensure that any reform to non-domestic property taxation does not undermine it.

This response outlines a number of challenges that the current system presents for charities, including:

- The lack of clarity surrounding discretionary rate relief
- The disadvantages for charities working in disadvantaged communities or multiple areas
- The disadvantages for charities working on a national or international basis
- The uncertainty around discretionary rate relief and implications for business planning
- The valuation process for charities

To resolve these issues, we propose that the funding for reliefs be met by central government, and the extension of mandatory rate relief to 100% for all charities, replacing the current provision for 20% discretionary rate relief. We recommend that the introduction of these changes should be tapered over five years.

We believe these changes would lead to a fairer, simpler and more efficient system for charities and government. Should they not prove feasible, we have a number of suggestions for reforming what is currently a complex local system that is costly to administer for all involved.

[1] NCVO's response to the Social Value Act Review highlights a number of specific examples.

Our response is based on our consultation with members over several years on business rate relief and charity tax policy more broadly.[2] Our analysis has also been informed by a small survey of 40 charities, specifically for this discussion paper, designed to better understand how business rates relief is working for the voluntary sector.

### Importance of business rate relief for charities

The business rate relief is one of the most important tax reliefs for the charity sector, and also the largest, worth around £1.5bn a year[3]. Rate relief enables many charities to deliver services that would otherwise be uneconomic to operate and ensures that resources are targeted at delivering public benefit by ensuring as much of their expenditure as possible can be used for charitable objectives.

The relief is particularly important for smaller charities. Around half of charities have an income of less than £10,000, and 83% have an income of under £100,000. Although there is no detailed government data on the size of organisations claiming business rate reliefs, the vast majority of organisations that benefit from the relief will be small and medium sized charities in these income bands.

Like the rest of our economy and society, charities have to operate in the midst of a tough financial environment. Sources of funding, for example income from central and local government, have come under significant pressure. This has made tax reliefs, such as business rate relief, even more important for the financial sustainability for many charities.

The reduction of rate relief or reforms to business rates that removed this relief would negatively impact small and medium sized charities the most. In some cases, loss of rate relief would force the closure of services or organisations which depend on the relief to make their operations economically feasible.

## Challenges of the current system

Our consultation with charities has highlighted a number of problems with the current business rate relief system including:

- The lack of clarity surrounding discretionary rate relief
- The difficulties for charities working in disadvantaged communities
- The disadvantages for charities working in multiple areas, on a national or international level
- The uncertainty around discretionary rate relief and implications for business planning
- The costly and bureaucratic valuation process for charities that operate museums and galleries

Our response details our concerns in each of these areas.

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[2] **Charity Finance Group, Policy Briefing: Charities and business rate relief, April 2015**
[3] HMRC (2015): 'UK Charity Tax Relief Statistics 1990-91 to 2014-15

**Clarity and accessibility of discretionary rate relief policies**

Many charities are concerned about the clarity of discretionary rate relief policies by local authorities. The detail, application and publication of discretionary rate relief policies vary hugely between local authority areas. This lack of consistency causes problems for charities trying to claim discretionary relief: half of our survey respondents told us that they did not understand their local authority's eligibility criteria for discretionary rate relief.

**Different approaches by local authorities**

Some local authorities do not provide detailed information on criteria for discretionary rate relief. The London Borough of Barnet, for example, does not have criteria accessible on its website, and merely copies text from the gov.uk website on discretionary rate relief. This is not atypical and a number of local authorities do not publish easily accessible criteria or guidance.

**The London Borough of Camden**, by contrast, has detailed discretionary rate relief criteria available on its website as well as downloadable guidance for applicants.

A number of local authorities have requirements that organisations receiving business rate relief 'serve the residents' of the local authority area. However, in many cases, they do not clearly outline what 'serving' the residents means in practice or examples of the activities which would enable organisations to receive discretionary rate relief.

Whilst we appreciate that local authorities should have discretion in awarding business rate relief, this lack of clarity creates a barrier for charities that wish to claim discretionary rate relief and can waste valuable time and resources through applications that are unlikely to succeed. Moreover, the lack of accessible criteria for the award of discretionary rate relief means that local communities are not able to hold local authorities to account for the operation of business rate relief policies.

*Recommendation 1: Government should mandate that all local authorities have publicly accessible criteria for the award of discretionary rate relief.*

*Recommendation 2: The Department for Communities and Local Government should work with the Local Government Association and charity representatives to produce guidance for local authorities on best practice in designing discretionary rate relief policies.*

**Difficulties for charities working in disadvantaged communities**

As part of the Local Government Finance Act 2012, the government introduced the Business Rates Retention Scheme (BRRS), which came into force in April 2013 in England. The aim of the scheme was to encourage local authorities to champion economic development and enable local authorities to keep half of all business rates revenue raised locally and flexibility to pool revenue with other local authorities, as well as borrow money against future growth.

In order for 'risks and rewards to be shared', the scheme mandated that local authorities would have to fund 50% of any new reliefs granted, including charitable reliefs. This increased the cost of funding new discretionary rate relief granted to charities by over 300%.

Combined with the increased volatility of the new scheme, this has created significant problems for charities working in deprived communities.

This has been compounded by the changes in business rates income for local authorities. Whilst some local authorities, particularly in London, have seen significant increases in business rates income between 2009/10 and 2014/15, many authorities have seen falls in business rate income. For example, Southampton saw a fall in real terms per capita income from business rates of £134 over this period. Manchester saw a fall of £143 and Tower Hamlets saw a fall of £248[4]. This is placing significant pressures on local authority budgets. As a consequence, discretionary rate reliefs for charities has come under additional pressure and local authorities have consulted on reducing discretionary rate relief as a direct consequence of the Business Rates Retention Scheme and pressure on local authority budgets[5].

This is concerning as it means that charities working in deprived communities are less likely to receive discretionary rate relief than those working in affluent areas, increasing their costs and potentially making their services uneconomical.

Charities are important, not only for the economic benefits that they create but also for the social capital that they generate. This social capital is crucial for generating long term economic growth. Strong local communities underpin strong local economies and by making it more costly for charities in deprived areas to operate, the current discretionary rate relief arrangement is not supporting the interests of local communities.

**Disadvantages for charities working in multiple areas, at a national or international level**

A number of local authorities, in response to the cost pressures outlined above, have also outlined changes to discretionary rate relief that would restrict relief to charities that work at a local level.

**Different approaches by local authorities**

As a 'matter of principle' Wyre Forest District Council does not award discretionary rate relief for national charities.

The London Borough of Westminster does not 'normally' consider discretionary rate relief for 'national or international organisations with additional properties outside of the borough'. A number of local authorities also restrict rate relief for offices or buildings used mainly for offices or administration.

Many other local authorities have similar restrictions which disadvantage charities which operate in multiple areas or work at a national or international level.

[4] Hastings et al (2015) "Cost of the Cuts: The Impact on Local Government and Poorer Communities"
[5] http://www.calderdale.gov.uk/community/grants/voluntarygroups/drr-review-report.pdf

This has a negative impact for a number of reasons.

Firstly, it undermines the principle that charities should be equally treated regardless of their charitable objectives or activities. We do not believe that charities should be denied access to reliefs because they carry out certain activities. No other charitable relief is awarded on this criteria and it enables it means certain activities may be unfairly disadvantaged by local authority policy. This politicises charities and undermines the ability of charities to work on unpopular causes.

Secondly, these criteria act as a barrier for charities that wish to work across local authority boundaries. Need does not stop at local authority boundaries, but the discretionary rates system encourages narrow thinking, as local authorities which benefit from services that are delivered by charities outside of their area do not have to bear the cost of business rate relief. The government said during the election that it wanted to use the 'talent and energy of charities to help people turn their lives around', and the current business rate relief rules are a direct barrier to this talent and energy being used.

Thirdly, discretionary rate relief policies focused on exclusive local area provision also inhibit efforts by charities to diversify their services and income. The policy encourages fragility by hampering the ability of charities to expand into new areas and develop new income streams.

Fourthly, excluding claims for discretionary rate relief from charities that use buildings for offices or administration ignores the impact that this has on the effectiveness of charities. All charitable funding must be used to deliver public benefit. Administration is not optional, it is essential to the achievement of charitable objectives. Excluding claims for discretionary rate relief from charities that use buildings for offices reduces the amount of resources that can be used towards achieving charitable objectives.

A similar issue concerns discrimination within the system of certain types of activities such as charity shops. Business rate relief is critical for supporting a wide variety of voluntary sector activity, yet distinctions between different types of activity are also common with no apparent justification for such distinctions.

For example, only a small minority (around 5%) of mandatory charitable rate relief is for charity shops[6] and the cost of discretionary rate relief for charity shops is even lower. The Charity Retail Association and Demos research[7] indicates that they have had a stabilising influence on footfall in high streets during a difficult economic climate, while generating £300m a year for good causes. It is possible that these types of distinctions by activity are made on the belief that income from, for example, charity shops may not be reinvested locally.

Again, this type of criteria means that reliefs are not being used to maximise the impact of voluntary organisations across the country as a whole, and also ignores the evidence that even commercially-focused charitable activities generate considerable social value for their local communities[8]. Moreover, this ignores the fact that all money generated by a charity *must be used for public benefit*. As referenced above, although the end receiver of the resources may change depending on the scope of the charity, all funding is being used for

[6] Measuring the Social Value of Charity Shops pg. 92-93
[7] See full report above.
[8] See full report above.

the public benefit and it is inherently unfair that certain types of activity should be disadvantaged in the receipt of discretionary rate relief.

Finally, this system also increases the cost of delivery of services for central government in certain areas, if charities there do not have access to business rate relief. Whilst some local authorities provide rate relief to charities that deliver local services in order to reduce the costs of provision for local residents, many local authorities do not have similar rules for central government services. This artificially increases the costs of central government services, without a clear rationale.

We believe that the points outlined above demonstrate the flaws and inefficiencies of the current regime and the need for reform, to ensure that certain kinds of charity or activities are not disadvantaged, with negative consequences for different causes and communities.

**Uncertainty of discretionary rate relief and implications for business planning**

Charities are operating in a volatile funding environment, and proposals for deficit reductions mean that this volatility is likely to remain over the next five years. Like any organisation, in planning for the future, charities want certainty on their income and the cost of delivering services.

We have heard from a number of charities that have indicated that the current regime does not provide them certainty around the continued receipt of relief. Funding pressures for local authorities have meant that some organisations do not feel confident one year to the next on whether they will still receive discretionary rate relief. This makes it hard to plan for future delivery and may lead to charities reducing or ending services in order to reduce risk. This is not in the interests of beneficiaries. No other charitable tax relief has the same level of instability as discretionary rate relief.

Some local authorities issue warnings that they may have to reduce or remove discretionary rate relief a year before they do so, however, this is often not confirmed until shortly before the end of the financial year. This does not enable effective forward planning and can create financial difficulties for charities.

Good communication is critical and whilst we support local authorities informing charities about reviews of discretionary rate relief, we do not believe that informing charities about a ‘review’ of discretionary rate relief should be considered the same as giving advanced warning of the loss of discretionary rate relief.

*Recommendation 3: The Department for Communities and Local Government should advise all local authorities to give at least one financial year’s notice on the reduction or withdrawal of discretionary rate relief to charities.*

**The valuation process**

Charities have raised concerns about the valuation process in recent years, particularly museums and galleries. A number of charities operate trading subsidiaries to carry out non-primary purpose trading which is in line with Charity Commission guidance. The revenues and costs from the sales of goods are then channelled through the subsidiary and any profits are then gifted to the charity.

At present, where there are shops or cafes operating on the same site (e.g. museums, art galleries, homeless charities with outreach canteens), they are separately assessed for business rates and they do not receive relief. In some cases shops or cafes are integral parts of the building and cannot be removed or they are operated by the charity rather than through a subsidiary. However, the Valuation Office is currently arguing that shops and cafes should always be separated out for rate evaluation, even if a trading subsidiary does not occupy the property.

This significantly increases the rates liabilities for some charities and threatens their financial sustainability. We urge the government to use this exercise to clarify the rules and make clear that where a charity occupies a café or shop; or it is not occupied by a trading subsidiary that it is not separated for business rates valuation.

*Recommendation 4: The Government should clarify the rules to make clear that where a charity occupies a café or shop as part of its charitable objectives or where it is not occupied by a trading subsidiary that it is not separately valued for business rates.*

## Raising of mandatory rate relief to 100% - a proposal for reform

We believe that there are a number of flaws with the current business rates regime for charities. There is an opportunity through this exercise to improve the operation of the regime for charities and government. We believe that the operation of the business rates relief system should be in line with the following principles:

- **Fairness** – we believe that it should treat all charities equally, regardless of location and activity. This in keeping with the principle that providing charities meeting the legal criteria to be a charity that they should have equal access to charitable reliefs.
- **Simplicity** – we believe that the system should be as simple as possible both for charities and for the government to implement.
- **Consistency** - we believe that the rules should be consistently applied across all charities to give certainty and enable effective business planning.

We believe that the best way to achieve this would be to **raise the mandatory business rate relief for charities to 100%, replacing the existing provision for 20% discretionary rate relief.** We recommend that the cost of business rate relief should be met by central government, and that the change should be tapered over five years to reduce the immediate financial impact.

This proposal would be fairer as it would mean that all registered charities were treated equally and fairly. It would also mean that charities were not disadvantaged for working in certain local areas or a national or international level. We believe that this extended rate relief should cover charity shops which are important sources of revenue for the charities of all sizes.

It would also be simple, avoiding the need for local authorities to develop and operate discretionary rate relief policies. This would free up their time and reduce the cost of administration. This proposal would also promote consistency in the application of business rate relief and would support charities in business planning.

This proposal would generate a number of additional benefits. It would reduce the costs of delivering services or public benefit for charities and enable more resources to be focused on delivering charitable objectives. This will particularly help small and medium sized charities, and support charities working in disadvantaged communities. Charities are important builders of social capital, so reductions in the costs of operating will have significant benefits for charities and for small and medium sized charities it is likely that this additional resource will be recycled through local communities having a positive multiplier effect.

By shifting the cost from local to central government, we believe that this proposal would not disadvantage charities which are working in poorer areas. The Centre for Social Justice in *Something's Got to Give – The state of Britain's voluntary and community sector* highlighted concerns around 'charity cold spots'.[9] We believe that this proposal could address this concern and ensure that no area lacks the positive impact that charities can bring.

It would also reduce the costs of the delivery of central government services through charitable organisations and ensure that central government costs are not higher than local government costs when working with charities.

The change could be achieved by modifying section 43(6) and 47(2) of the Local Government Finance Act 1988.

The removal of discretionary rate relief would also remove uncertainty and avoid the need for additional guidance to be given to local authorities on the operation of business rate relief.

**Summary of additional recommendations**

Should the government decide to maintain the current system of business rate relief, we urge the government to take the following actions to support charities:

*Recommendation 1: Government should mandate that all local authorities have publicly accessible criteria for the award of discretionary rate relief.*

*Recommendation 2: The Department for Communities and Local Government should work the Local Government Association and charity representatives to produce guidance for local authorities on best practice in designing discretionary rate relief policies.*

*Recommendation 3: The Department for Communities and Local Government should advise all local authorities to give at least one financial year's notice on the reduction or withdrawal of discretionary rate relief to charities.*

*Recommendation 4: The Government should clarify the rules to make clear that where a charity occupies a café or shop as part of its charitable objectives or where it is not occupied by a trading subsidiary that it is not separately valued for business rates.*

[9] Centre for Social Justice (2013) "Something's Gove to Give – the state of Britain's voluntary and community sector"