Explanatory Memorandum to the Valuation for Rating (Prescribed Assumptions) (Wales) Regulations 2023

This Explanatory Memorandum has been prepared by the Local Government Finance Reform Division and is laid before Senedd Cymru in conjunction with the above subordinate legislation and in accordance with Standing Order 27.1.

Minister's Declaration

In my view, this Explanatory Memorandum gives a fair and reasonable view of the expected impact of the Valuation for Rating (Prescribed Assumptions) (Wales) Regulations 2023. I am satisfied that the benefits justify the likely costs.

Rebecca Evans MS
Minister for Finance and Local Government
7 March 2023

PART 1: EXPLANATORY MEMORANDUM

1. Description

Non-domestic rates ("NDR") are a local tax which raise revenue on properties that are used for non-domestic purposes, for example public buildings, shops, factories, offices, leisure facilities, schools and hospitals. In 2023-24, it is estimated that NDR in Wales will generate over £1.1 billion (net). All the revenue is distributed to local government to help fund local services in Wales.

Appeals may be made by ratepayers under the heading of Material Change of Circumstances ("MCC"), with a view to reducing the rateable value of their properties, and in turn their NDR liability. During the COVID-19 pandemic, increased volumes of MCC appeals were lodged on the basis that government measures and restrictions had the effect of reducing the rateable values of properties. This did not align with the policy intent of the existing legislation. To address this in relation to the 2017 rating list and specific circumstances of the COVID-19 pandemic, the *Valuation for Rating (Wales) (Coronavirus) Regulations 2021* were made, and then, to address the issue retrospectively, the *Rating (Coronavirus) and Directors Disqualification (Dissolved Companies) Act 2021* was passed.

This exemplified a broader risk of rating list exposure arising from a lack of clarity with respect to the intended scope of MCC provisions for updating property rateable values between revaluations. The *Valuation for Rating (Prescribed Assumptions) (Wales) Regulations 2023* ("the Regulations") clarify the assumptions that are to be made when determining the rateable value of a hereditament in accordance with paragraph 2 of Schedule 6 to the Local Government Finance Act 1988 ("the 1988 Act"). The Regulations apply to the 2023 rating lists onwards.

2. Matters of special interest to the Legislation, Justice and Constitution Committee

None.

3. Legislative background

Section 43 of the 1988 Act sets out how a ratepayer's liability for NDR on an occupied property is to be calculated. The basic NDR liability for a property is calculated by multiplying the rateable value of a property by the multiplier.

Section 56 of the 1988 Act introduces Schedule 6 of that Act. The Schedule sets out the provisions to be applied in determining the rateable value of non-domestic hereditaments.

Paragraph 2(8) of Schedule 6 to the 1988 Act contains the function of the Secretary of State to make regulations prescribing assumptions that are to be applied to a prescribed class of hereditament, in determining its rateable value.

The powers of the Secretary of State in paragraph 2(8) of Schedule 6 to the 1988 Act were transferred, in relation to Wales, to the National Assembly for Wales by the National Assembly for Wales (Transfer of Functions) Order 1999. The 1988 Act is an enactment referred to in Schedule 1 of, and transferred by Article 2 of, that Order. The functions of the National Assembly for Wales were subsequently transferred to the Welsh Ministers under section 162 of, and paragraph 30 of Schedule 11 to, the Government of Wales Act 2006.

The Regulations follow the negative procedure.

4. Purpose and intended effect of the legislation

The Valuation Office Agency ("VOA") is an executive agency of HM Revenue and Customs and is responsible for determining the rateable value of all non-domestic properties for the purpose of calculating their NDR liability. NDR revaluations ensure that rateable values are updated by the VOA on a periodic basis, to reflect changes in economic factors, market conditions or the general level of rents, for all properties in the tax-base at the same time.

Ratepayers may make an appeal to the VOA if they believe the rateable value of their property is incorrect. One basis for appeal is on the ground of an MCC. Historically, MCC appeals have been linked to localised one-off events, such as flooding or roadworks, rather than changes in market-wide conditions. The scope of MCCs should not be so wide as to capture changes in economic factors, market conditions or the general level of rents, as that would amount to real-time revaluations, be impracticable and undermine the role of the regular revaluations. Appeals submitted during the COVID-19 pandemic, citing the impact of government restrictions, were not compatible with the policy intent and exposed a lack of clarity in the relevant provisions.

Changes are necessary to ensure the law is clearly and fairly calibrated, and that all stakeholders are aware of what should be reflected at revaluations and what should be reflected as MCCs. The primary purpose of the Regulations is to clarify matters which should not be considered in determining rateable values between revaluations. These matters are: legislation of any country or territory; provision made under and given effect by legislation of any country or territory; advice or guidance given by a public authority of any country or territory; anything done or not done by a person with a view to compliance with these matters, but only insofar as they concern:

a. the physical enjoyment of the hereditament,
b. the mode or category of occupation of the hereditament,
c. matters which, though not affecting the physical state of the locality are, nonetheless, physically manifest there, and
d. the use or occupation of other premises in the locality.

Applying legal boundaries to the scope of MCC provisions will not mean that rateable values will never change to reflect major events. It will, however, ensure their impacts are reflected across the whole tax-base at the same time, at revaluations. This is intended to restore the scope of MCCs to its originally intended extent and future-proof the system against other major and unforeseen events.

It is not possible to estimate the financial risks that may occur if the Regulations were not in place, as it would depend on the nature of future events. For appeals on a similar basis during COVID-19, the revenue risk was estimated to be between £70m and £100m. As well as presenting a risk to public finances and the funding available for local services, appeals arising from wider market and economic conditions would present administrative challenges to the VOA and the Valuation Tribunal for Wales ("VTW") and create unfairness for ratepayers.

5. Consultation

A public consultation sought views on the policy behind the Regulations as one of a series of questions on the reform of the non-domestic rating system in Wales. The twelve-week consultation was launched on 21 September 2022 and closed on 14 December 2022. The consultation was published on the Welsh Government website, circulated to key stakeholders and promoted on social media. It received 73 responses, from representative bodies for sectors of the tax-base, members of the public who may also be individual ratepayers for a business, individual businesses, local government, and professional rating or taxation representatives.

Question 13 of the consultation sought specific views on a proposal to address the matters which are the subject of the Regulations. Views were mixed, with a slightly higher proportion of responses against making legislative changes. The views provided in opposition to the proposal were not considered to undermine the rationale and need for the approach. A summary of responses to the consultation was published on 9 February 2023.

PART 2: REGULATORY IMPACT ASSESSMENT

Options

Option 1 – Do nothing

No legislative changes would be made.

This would enable ratepayers to continue lodging appeals on the grounds of an MCC relating to relevant measures taken by a government or public body. A successful appeal results in a transfer payment from public funds to the ratepayer.

Option 2 – Make the Regulations

Regulations would clarify the circumstances under which an MCC appeal could not be made and would disregard matters relating to relevant measures taken by a government or public body.

This approach would prevent MCC appeals relating to relevant measures taken by a government or public body from being considered by the VOA.

Costs and benefits

Option 1 – Do nothing

<u>Costs</u>

This is the baseline option and, as such, there are no additional costs or benefits associated with this option.

Under this option, any successful MCC appeals relating to measures taken by a government or public body would continue to have a negative impact on Welsh public finances. The scale of potential appeals on this basis is unknown, due to uncertainty around future economic circumstances and possible interventions. As such, it is not possible to estimate the scale of the risk, however if appeals continue to be allowed, the risk to public finances would remain. As noted in the Explanatory Memorandum, the revenue risk during the Covid-19 pandemic was estimated to be between £70 million and £100 million. These figures are provided purely as an illustration of the potential scale of risk. The actual scale of risk from one year to the next will depend on future circumstances.

NDR provides a crucial revenue stream for the Welsh Government and, in turn, local government in Wales. If the Regulations are not in place, there is an ongoing risk that public funding will be significantly reduced as a result of future appeals. There is also potential long-term budgetary uncertainty due to the lengthy process of determining appeals.

There would be costs arising from the administration of MCC appeals relating to measures taken by a government or public body, particularly for the VOA and VTW.

Benefits

The circumstances in which ratepayers may submit MCC appeals would remain unchanged. The appeals process is an integral part of the NDR system and helps to maintain public confidence in the system.

Option 2 – Make the Regulations

Costs

There are no direct costs associated with this option. There is a potential cost for ratepayers who, in the absence of these Regulations, might otherwise have submitted an MCC appeal relating to measures taken by a government or public body. This impact will, however, be minimal as the Regulations will come into force at the start of the new rating list on 1 April 2023 and in advance of any future events which may otherwise give rise to MCC appeals.

Benefits

The Regulations prevent the risk of future revenue loss due to MCC appeals relating to measures taken by a government or public body. This maintains the funding available for public services in Wales and provides greater certainty for both Welsh Government and local government budget management. The scale of this benefit will be equivalent to the cost to the ratepayer (it is a transfer payment).

Preventing MCC appeals relating to measures taken by a government or public body would also enable the VOA and VTW to process existing appeals in a timelier manner, whilst removing administrative costs of processing any future appeals relating to measures taken by a government or public body (as a consequence of COVID-19 or otherwise). As an illustrative example, each appeal handled by the VTW costs an estimated £74.50. The VOA would remain able to focus resources on delivering more frequent revaluations in the future.

This will also provide fairness for ratepayers, by ensuring that economic factors and market conditions affecting the general level of rents are taken into account for all properties in the tax-base at the same time, as part of regular revaluations.

Option selection

The benefits of Option 2, particularly in protecting public finances and ensuring fairness for ratepayers, are considered to outweigh the benefits of Option 1. The approach described by Option 2 was announced by the Welsh Government on 9 February 2023, following consultation. Option 2 is, therefore, the Welsh Government’s preferred option.

Analysis of other effects and impacts

Promoting Economic Opportunity for All (Tackling Poverty)
Ensuring wider economic impacts are factored into the revaluation process helps to ensure that rates liability is distributed equitably between ratepayers. Limiting the potential impact of future appeals ensures that revenue for local government services is maintained. Many local services help to tackle poverty and the effects of poverty in our communities.

UNCRC
No particular impact on the rights of children has been identified.

Welsh language
No effect on the opportunities to use the Welsh language or the equal treatment of the language has been identified.

Equalities
No specific impacts, positive or negative, on persons who share a protected characteristic (as determined by the Equality Act 2010) have been identified.

Well-being of Future Generations (Wales) Act 2015
Maintaining the NDR tax-base contributes towards the wellbeing goals of a prosperous Wales and a more equal Wales and also to long-term, integrated economic growth.

Impact on the voluntary sector
No specific impacts on the voluntary sector have been identified.

Competition Assessment
In drafting the Regulations, we have applied the competition filter test. The purpose of the appeals system is to address valuation errors that may affect a ratepayer's liability for NDR. Market-wide conditions, including measures taken by a government or public body, are considered to fall outside the scope of MCC appeals. These conditions will be considered as part of the revaluation process. The Regulations will affect ratepayers across different sectors in a consistent way, and no competition impacts have been identified.

Justice
The Welsh Government have considered the impact of the Regulations on the justice system. The Regulations are intended to prevent potential future spikes in volumes of appeals which do not reflect the policy intent of legislative provisions for MCC appeals. There are no direct impacts on the handling of appeals, the role of the VTW or other aspects of the justice system. On this basis, impacts are considered to be negligible.

Post-implementation review
The Welsh Government will continue to monitor the impact of measures taken by a government or public body on ratepayers and will consider ongoing support as necessary.