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FSB Northern Ireland response to Consultation on Reforming the Rating System

The Federation of Small Businesses is Northern Ireland's largest business organisation with approximately 6,000 members, from across all sectors of industry, and over 170,000 members throughout the UK. Our aim is to promote and protect the interests of small businesses and to that end, we work with decision-makers to create a better business environment.

Northern Ireland is a small business economy, and micro and small businesses form the bedrock. Northern Ireland has the highest concentration of SMEs of all the regions in the UK – here, 98% of all firms employ fewer than 20 people, while 95% employ fewer than 10. Northern Ireland SMEs provide 75% of all private sector jobs. Clearly, small businesses are the core of the local economy and have a vital role in contributing to employment opportunities.

We welcome this opportunity to respond to the Consultation on Reforming the Rating System, and we hope you find our response helpful.

It is unfortunate that the current proposals have not had the same level of pre-consultation and engagement which were so evident throughout the previous stages of the Review of Northern Ireland's Non-Domestic Rating System.

Throughout our engagement to date, we have made it clear that our main concern is that Non-Domestic Rates is a major barrier to business and has an unfair and disproportionate impact upon small businesses, and we believe that the current Small Business Rate Relief mitigates these adverse impacts. We are concerned that neither ending the current SBRR scheme nor the proposed new Retail and Hospitality Scheme appear to have been subject to regulatory or economic impact assessment to consider their the impact or likely effectiveness.

A recent survey of FSB members in Northern Ireland revealed that if the SBRR were to be removed, nearly two-thirds would cancel planned investment, downsize or amend their plans for growth. Over 40% would reduce staff hours or examine pay, and over one in ten would close their businesses.

Removing SBRR from small businesses would result in significantly dampening growth, employment and training activity across the small business community, and we are of the view that this negative effect would be more significant than any uplift that the proposed targeted Retail & Hospitality Industry scheme is intended to produce.

We would welcome further discussions with you prior to any decisions being taken, and we would also welcome any further Innovation Lab or 'policy hack' type events on the specific issue of small business rate relief.

Please do not hesitate to contact us if you have any queries in the meantime.

Kind regards

Wilfred Mitchell OBE
Northern Ireland Policy Chairman

FSB NORTHERN IRELAND RESPONSE TO THE DEPARTMENT OF FINANCE CONSULTATION ON 'REFORMING THE RATING SYSTEM'

FEBRUARY 2017

Introduction

FSB welcomes the opportunity to respond to the Department's Reforming the Rating System consultation paper. Our response addresses the proposals relating to non-domestic rates, with more substantive comments on the proposal to abandon the Small Business Rate Relief scheme (SBRR) and to replace it with an application-based sectorally targeted rate relief.

Previous Consultation and Engagement

FSB has contributed to and helped shape the Department of Finance's reviews of rating policy since proposing the Small Business Rate Relief scheme in a submission to the Minister for Finance and Personnel in 2008.We welcomed the introduction of the scheme in 2010 and its extensions in 2011 and 2012. We were active in inputting to NICEP's *Small Business Rate Relief Evaluation* in 2014, conducting a survey of our members as well as encouraging participation in the Perceptive Insight research, and of course, meeting with the researchers in NICEP and submitting a substantive response.

We subsequently participated in the Innovation Lab in 2015, and welcomed the inclusive nature of the Department's approach in encouraging discussion and open thinking. However, the Small Business Rate Relief scheme was not included in either the Innovation Lab discussions or the formal consultation on the Review of Northern Ireland's Non-Domestic Rating System in 2016.

We have not, therefore, had an opportunity to formally comment on the outcome of the Small Business Rate Relief Evaluation. The only consultation prior to the Finance Minister's current proposals, as set out in the Reforming the Rating System consultation document and announced in the Northern Ireland Assembly in November 2015, was the Discussion Paper on Alternatives to the Small Business Rate Relief Scheme published in March 2016. None of the tentative proposals included in that Discussion Paper appeared to be viable, and there was subsequently little to indicate the ongoing nature of a review. It is unfortunate that the current proposals have not had the same level of pre-consultation and engagement which was so evident throughout the Review of Northern Ireland's Non-Domestic Rating System. In submitting our response to the 'Alternatives' Discussion paper, we specifically stated that "*We would welcome further discussions with you prior to any decisions being taken, and we would also welcome any further Innovation Lab or 'policy hack' type events on the specific issue of small business rate relief*[1]." We are disappointed that no such discussions were undertaken. We repeat our willingness and invitation to meet in the covering letter to this response.

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[1] FSB covering letter, Response to Discussion Paper on Alternatives to the Small Business Rate Relief System. 13 May 2016

Disproportionate Impact of Rates on Small Businesses

Throughout our engagement to date, we have made it clear that our main concern is that Non-Domestic Rates is one of the main barriers to business, and has an unfair and disproportionate impact upon small businesses. Business rates are a major obstacle to business success, as evidenced by the results of research conducted for FSB by the Ulster University Business School in June 2015[2], which found that 43% of respondents cited rates as a barrier. Moreover, when asked what would help their business grow, and what the government should address to support business growth, a reduction in business rates was one of their top three calls.

FSB has made many previous submissions and responses in which we have explained and described how non-domestic rates have a disproportionate and adverse impact on small businesses, constituting more than three times the proportion of turnover and more than twice the proportion of overheads than for large businesses, and are typically the third largest expenditure after wages and rent for a business with a turnover of less than £100,000. We have supported this information with evidence from government policy papers and established research.[3, 4, 5]

In 2008, FSB called for the establishment of the SBRR scheme as a means of recognising the importance and contribution of the small business sector in Northern Ireland, to provide equity with SMEs in England, Scotland and Wales, and to address the fundamental unfairness of this tax.

In 2010, the then Minister for Finance and Personnel announced the introduction of the Scheme as "part of the Executive's response to the economic downturn" to help "small businesses deal with the challenges they face."[6]The economic downturn of 2010 became a recession from which Northern Ireland was just beginning to recover before the outcome of the EU Referendum created further uncertainty. Research conducted by the Ulster University's Business School[7] in 2015 revealed that SME's top barrier to business is **still** cash flow. Given that the average cash flow timescale for small businesses is 8 – 10 weeks, this creates serious problems. It may be useful for the Department to commission some research into the challenges caused by cash flow turnaround issues, and the benefit of mitigating these as a business support measure.

The issue that the SBRR was intended to address still exists, and it seems illogical to remove the scheme. As one member put it, the relief Scheme

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[2]Ulster University SME Centre, *The Contribution of Small Businesses to Northern Ireland*, 2015
[3]*Modernising Local Government Finance: A Green Paper*, 2000
[4]*Evaluation of the Small Business Rates Relief Scheme*, DTZ Pieda, 2004
[5] ERINI, *Investigation into a Small Business Rate Relief (SBRR) Scheme in Northern Ireland*, 2008
[6] Nigel Dodds, Minister for Finance and Personnel, 1 April 2010
[7]*The Contribution of SMEs to Northern Ireland*, 2015

needs to continue to have *"the primary objective of small business having reduced overheads and bureaucracy."*

SBRR Evaluation Report

The Northern Ireland Centre for Economic Policy (NICEP) (now the Ulster University Economic Policy Centre, or UUEPC) Evaluation Report[8] noted that the Executive introduced the SBRR scheme as a "political measure" rather than as a "value for money" project; therefore "no specific economic targets, such as increasing employment, investment, productivity or output", were set for the scheme.[9]

Asking UUEPC to evaluate the SBRR scheme on its "economic impact and effectiveness as a policy intervention"[10] was flawed because it imposed as a form of measurement outcomes from the Scheme that were never the intended purpose.

The small business rate relief system in England will be extended from April 2017 to provide 100% relief to all non-domestic properties up to an RV of £12,000 and a tapered relief above that. Scotland and Wales already have schemes that provide 100% relief to their smallest businesses, and the move in England means that Northern Ireland is the only part of the UK now that does not have any form of 100% relief for small businesses.

FSB recommends protecting and retaining the current Small Business Rates Relief (SBRR) scheme in the short to medium term, at least until after the UK has left the European Union and greater political and economic stability[11]is restored both at home and more widely. We are also of the view that any further proposals to remove SBRR, and any proposed replacement scheme(s) must be fully researched and subject to adequate appraisal and evidence gathering before being taken forward.

Value of SBRR to small businesses

A recent survey[12] of FSB members in Northern Ireland revealed that 56% are receiving a discount as a result of the SBRR. They reported that they were most likely to have used the saving to ease cash flow or offset other cost increases (reported by 66% of recipients), while 47% used the saving

[8]UUEPC, *Small Business Rate Relief Evaluation*, 2014
[9]UUEPC, *Small Business Rate Relief Evaluation*, 2014, p.8
[10]UUEPC, *Small Business Rate Relief Evaluation*, 2014, Terms of Reference, p.75
[11]SMEs' greatest future concerns, *Contribution of Small Businesses to Northern Ireland*, 2015
[12]January / February 2017

from the lower bill to invest in their business, and 24% have invested in their staff.

> *"Rate Relief has been very needed extra cash to put into business"*

> *"Rate relief has given us a chance to up staff numbers an improve service"*

If the SBRR were to be removed, nearly two-thirds would cancel planned investment, downsize or amend their plans for growth. Over 40% would reduce staff hours or examine pay, and over one in ten would close their businesses.

> *"A reduction in discretionary spend e.g. staff training, marketing would be necessary"*

> *"We are a low pay sector and the loss of the SBRR would mean that wage increases above NMW would suffer alongside investment in the business"*

Removing SBRR from small businesses would result in depressing activity, growth, employment and training in the small business community, which constitutes 99% of the private sector and provides 75% of all private sector jobs. It is our contention that this negative effect would be more significant than any uplift that the proposed targeted Retail & Hospitality Industry scheme is intended to produce.

> *"While this proposed change does not personally affect me, the proposed change would be disastrous to the small business community and must be stridently opposed"*

SME views on Targeting

We asked respondents to our survey on what criteria they thought a future revised small business rate relief should be based. Nearly 40% said it should continue to be based on property value, for all types of business, as now, and that this should not change.

However, a third (32%) thought it should be based on geographical location. When given the opportunity to expand on their choice through free text comments, it is evident that the majority of these respondents believe relief should be given to businesses in rural areas.

> *"Rural villages are quickly being decimated with businesses closing on account of increased running costs."*

> *"Many shops and business will have to close altogether, if rates are not reduced especially in rural areas"*

Nearly a quarter thought a future rate relief should be awarded for business growth, including many who thought rates should be based on turnover or profit, while one-fifth felt that business or industry sector was appropriate.

> *"Some small businesses particularly in rural areas need to carry a lot of stock which in turn requires storage. The turnover on this stock can be slow compared to large towns so rates should be based on turnover/area"*
>
> *"Start up and small business should be exempt for 5 years provided they employ locally"*
>
> *"No charge should be made for business with a turnover under £1million"*
>
> *"Rates should be based on turnover and net profit. Properties of equivalent size and location shouldn't have to pay the same rate just because of square footage and shop front size."*

In addition to the support for a business growth relief, there was some support for a start-up relief, though respondents' comments suggest stronger support than the quantitative data indicate. It may be that this category overlapped with the 'business growth' option.

> *"So many costs are incurred when starting up a business so some relief for the first few years should be given to help you on your way to success."*
>
> *"25% rates for first year and 25% increase each year up to 75%"*
>
> *"No rates due for first three years from start-up"*

As stated above, however, the strongest support was for any available small business rate relief to be based on property value (NAV) -"*Keep the current system"* - and to be available to *"all sections of SME -Retailers solicitors hairdresser etc."*

Proposed Retail and Hospitality Industries Relief

FSB does not accept the Department's rationale for scrapping Small Business Rates Relief, and replacing it with a Retail and Hospitality Industries Relief. Many other sectors of the economy are also facing barriers and have seen decline recently, including the wholesale sector, business administration and support services, transport and storage businesses and the construction industry.

We fully support the principle of regenerating town centres and high streets and boosting tourism, and we believe that appropriate and relevant strategies need to be developed and implemented to ensure their growth and prosperity. However, the Executive's economic ambition, as set out in the draft Programme for Government[13], is for new high-waged, skilled jobs, coupled with significant export growth, and an entrepreneurial environment that sees start-ups flourish. Rather than contributing to this outcome, this proposed new R&HI scheme will limit a key business support to largely low-waged, importing sectors. It focuses on a few chosen winners, and may in fact damage the very sector it aims to assist.

The current Small Business Rate Relief scheme provides benefits for the economy as a whole by mitigating a consistently identified barrier to business establishment and growth. Just as importantly, the SBRR scheme communicates a strong message of support and recognition to our vital small business foundation. Replacing the scheme with one that arbitrarily focuses on selected sectors will also send a strong but negative message to business in Northern Ireland – a message that disparages micro and small non-retail and non-hospitality businesses here.

> *"Granting Retail and Hospitality small business rates relief seems arbitrary"*

The consultation document notes that the current SBRR scheme did not include any outcome-based measures, yet it does not include any measurable outcomes for the alternative R&HI scheme that it proposes. We maintain that SBRR is effective in that it mitigates a disproportionate impact and an established barrier. If a replacement relief is to be developed that is intended to deliver well-defined and evidence-based outcomes than the current proposal, we are of the view that the rate relief should be available to <u>all</u> businesses which can meet the set criteria, in any sector of the economy.

No evidence has been presented that would suggest that such a targeted relief would have the desired impact of regenerating our towns and cities, nor that it would encourage investment to any greater degree than the current Small Business Rate Relief. In fact, requirements for businesses to apply and to "demonstrate specific investment in e.g. new equipment, staff training or the employment of additional staff", may result in many small retailers and hospitality businesses currently in receipt of SBRR losing it, if their proposals for 'investment' are not appropriate or the application process creates more red tape for businesses.

> *"[I] do not agree with proposal- appears open to abuse and hard to administer and unfair as aimed at hospitality businesses"*

Additionally, the Department does not appear to have taken account of the UUEPC's substantial warning that *"[t]here are considerable risks associated with sectoral or location specific incentives...They may result in moving economic activity (displacement) and thus damaging other locations or*

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[13] December 2016

missing out key businesses in need if a broad sectoral classification is used."[14]

The Report is also critical of the economic benefit of targeting retail, due to its dependence on consumer expenditure, strongly suggesting that focusing economic growth on a consumer driven sector is therefore unlikely to increase output in this sector:

> *The main beneficiaries...are retailers and wholesalers who are dependent on consumption expenditure. Whilst the relief will have helped with cash flow...it is unlikely to help boost demand for their products.*[15]

The key to assisting the retail sector in Northern Ireland is to improve consumer spending, which is dependent on the performance of all businesses and employers across the economy to provide jobs and income, not just the retail sector. Policy levers must help the economy as a whole, rather than trying to pick winners.

> *"The decline in the retail sector is due to the move towards e-commerce so I don't agree with the underlying arguments made in the proposals to support the retail sector."*

Requirement to Apply

Businesses occupying property with an eligible NAV will be required to apply to LPS for the proposed R&HI rate relief. FSB is of the view that the automatic nature of the current SBRR system is one of its best features, keeping costs low for both LPS and small businesses. The proposed scheme, aside from significantly reducing the level of beneficiaries by restricting the scheme to only two selected sectors, would impose a rate relief application process which will have the effect of reducing the number of businesses likely to benefit, as fewer than are eligible will undertake the application process. In England, when businesses had to apply to receive a small business relief, FSB surveyed 240 billing authorities across England and found that the average take-up of relief was only 49% of eligible businesses.

While nearly four-fifths of respondents to FSB's most recent survey on rates said they would be likely or very likely to apply in order to obtain a relief, fewer (46%) were willing to complete and submit a form; only 11% would provide details of how they planned to spend the value of the relief, and only 7% would provide invoices or receipts of expenditure. One-fifth said they would not submit any of the proposed elements of an application.

Members' comments illustrate their response to the proposal for an application based scheme:

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[14] *Small Business Rate Relief Evaluation*, 2014, p. 6
[15] *Small Business Rate Relief Evaluation*, 2014, p.11

"In principle I don't agree with the move to have to apply for SBRR but would do so if necessary"

"Sounds like a lot of work; also, how would accuracy/honesty be assessed? Would government investigate and claw back if promises unfulfilled?"

"If it became more than a 10 minute task, I will probably not bother and look at downsizing"

"As a small business owner I don't have the time to start filling in yet more forms"

"More red tape and time taken from running the business"

It is worth noting here that SMEs' top barriers to business growth, as revealed in the *Contribution of SMEs to Northern Ireland,* included "bureaucracy and regulation" as a major obstacle and the number one priority for government action to support business growth.

While the proposal 'envisages' that the application process will consist of a 'single page' online form, this has clearly not been developed yet. The proposed criteria for the relief are also somewhat vague. Small businesses would need more information about the type of information required, as well as clarity regarding the purpose for which it would be used, before they could properly assess their willingness to apply. FSB's view is that it would be difficult to maintain simplicity and minimum time input while still obtaining sufficient information to ensure due diligence.

Living Wage Criterion

One of the proposed criteria for qualifying for the new R&HI Relief is a business's accreditation with the Living Wage Foundation, on the basis that*"[t]ying rate relief to 'pay improvement' would help create the conditions to encourage employers to invest in employment and secure productivity gains in the process."*[16]

FSB believes this is unlikely to be effective.

A hospitality business would have to employ fewer than three people for the rates relief benefit to counterbalance the increase in wages costs they would face if they had to accredit with the Living Wage Foundation to qualify. A retail sector business would have to employ fewer than four; and both of these calculations assume that each business is already paying the sectoral median wage, meaning that the uplift to LWF is of the smallest order. The reality is that the uplift might well be greater, depending on the age and

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[16]Department of Finance, *Reforming the Rating System consultation* document, p10

current staff wages.[17] It therefore seems unlikely that this scheme would incentivise higher wages within the retail and hospitality sectors.

[17] See Annex I for details of calculations

Other Proposals

Small Business Empowerment Zones

While FSB supports the use of measures to regenerate areas of disadvantage, we would have some concerns in relation to the proposed pilot Small Business Empowerment Zones, particularly the blanket approach to including all non-domestic properties in the pilot zones, as well as the potential unfairness to adjacent business properties.

The areas identified for the pilots in West and East Belfast include a number of large businesses, such as a multinational hotel, a department store, several large public houses and a solicitor's offices, which will receive large amounts of rate relief while the majority of the recipients will receive relatively small awards. This makes the economic potential of the scheme relatively similar to the current SBRR scheme, which the Department states does not encourage economic growth.

The scheme also holds the potential to unfairly disadvantage adjacently located businesses. For example there are two butchers' shops in Castle Street, which is included in the proposed Lower Falls zone, one just inside the proposed area of the scheme and one just outside it. These shops operate in the same conditions, with the same opportunities and barriers as each other; however, under the proposed scheme one will receive over £8,000 in rate relief, while the other will receive nothing.

Castle Street, Belfast

____indicates extent of proposed Empowerment Zone

Butcher's shops

We are also unclear as to why Castle Street is included in the proposed pilot area, as it could reasonably be described as being part of Belfast City

Centre, and although it has experienced some vacancies in recent years, this is probably not higher than the vacancy level in, for example, Castle Lane.

Additionally Divis Street, in the proposed Lower Falls zone, holds only one commercial building, a small newsagent, with the majority of the property in that stretch of road being residential. The bulk of the commercial property in the area is actually in Northumberland Street, which is not included in the zone. If one of the aims of the scheme is to encourage Northumberland Street businesses to relocate to Divis Street, then this should be stated, and we would also expect to see a feasibility study which sought the views of targeted businesses.

As mentioned above (p.8), UUEPC warned that *"[t]here are considerable risks associated with sectoral or location specific incentives...They may result in moving economic activity (displacement) and thus damaging other locations or missing out key businesses in need."* If the Department is to progress with this pilot, consideration needs to be given to the effects and implications of these potential impacts, not just inside the zones but on adjacent areas of commercial activity.

FSB recommends that before any action is taken or measures put in place, research into the economic barriers in disadvantaged communities and feasibility studies should be commissioned, and a cross-departmental approach taken in light of those studies.

Revitalising our High Streets

FSB Northern Ireland supports the "Living over the Shops" (LOTS) scheme and would like to see it extended. In principle, encouraging greater residential use of town centres will increase the number of people and footfall in those areas and therefore encourage use of local retail and service facilities, providing a boost in demand for both residential and commercial property.

However, as stated earlier, addressing town centre vacancy and the decline of our high streets should involve not just the retail sector, but needs to take a holistic approach. Before any decision is made, FSB would be interested in seeing an assessment and evaluation of the impact of the LOTS scheme to date, with a view to informing the future of the scheme.

Charity Shops

We agree with the proposals to require charity shops to pay a contribution to rates revenue following the principle that "everyone should pay something", and that there should be an upper threshold for relief.

As charity shops increase in number and visibility in high streets, our members have expressed concern that the rates exemption provides them with an unfair competitive advantage over private sector retailers, particularly since there is a perception that charity shops are increasingly offering new as well as previously-used goods and services. Service providers, too, feel that the situation is unfair. As one member who runs a children's day nursery told FSB:

> *"[Rates] has an impact on my sector's viability especially since charitable activities compete with the private sector along with other child care facilities that attract charitable status and are zero rated for rates. A very strong commercial edge over our sector."*

In the interests of spreading the burden of taxation, addressing unfairness and taking account of the ability to pay, we are of the view that charities, particularly those with a large income or which occupy high-NAV properties, should make at least a nominal contribution to the business taxation take, by including rates as one of their essential expenses along with rent, heating, lighting, and wages.

Empty Property Relief

FSB welcomes the proposed changes to vacant property rating. We support measures to encourage occupation of vacant premises. However we would urge consideration of incentivising property occupation in addition to discouraging property vacancy. The existing 'Back in Business' initiative addresses this and we believe it would be useful to evaluate its impacts to date, with a view to expanding it. In addition FSB would encourage the Department to consider extending the relief to other types of non-domestic property rather than just retail units.

Experts in Business

Annex I

Impact of Living Wage Foundation Rates of Pay

Hospitality Sector

	Wage	Hours Worked[18]	Weekly Wage	Yearly Wage	Difference with LWF
Under 18 (National Minimum Wage)	£4.00	26.9	£107.60	£5,595.20	-£6,257.13
18-20 (National Minimum Wage)	£5.55	26.9	£149.30	£7,763.34	-£4,088.99
21-24 (National Minimum Wage)	£6.95	26.9	£186.96	£9,721.66	-£2,130.67
National Living Wage	£7.20	26.9	£193.68	£10,071.36	-£1,780.97
Median Wage	£7.20[19]	26.9	£193.68	£10,099.03	-£1,753.30
Living Wage Foundation	£8.45	26.9	£227.31	£11,852.33	

[18] Department of the Economy, *Annual Survey of Hours and Earnings*, October 2016
[19] Ibid.

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Retail Sector

	Wage	Hours Worked[20]	Weekly Wage	Yearly Wage	Difference with LWF
Under 18 (National Minimum Wage)	£4.00	28.2	£112.80	£5,865.60	-£6,559.52
18-20 (National Minimum Wage)	£5.55	28.2	£156.51	£8,138.52	-£4,286.60
21-24 (National Minimum Wage)	£6.95	28.2	£195.99	£10,191.48	-£2,233.64
National Living Wage	£7.20	28.2	£203.04	£10,558.08	-£1,867.04
Median Wage	£7.50[21]	28.2	£211.50	£11,028.21	-£1,396.91
Living Wage Foundation	£8.45	28.2	£238.29	£12,425.12	

Largest Award

To illustrate the potential effects of the proposed R&HI relief, the largest possible award would be for a £25,000 NAV property.

Calculated on the basis of current wage scales, as noted, and the rate poundage in, for example, the Derry and Strabane Council area, this would give a maximum relief of £4,558.58. (£25,000 x 0.607811; = £15,195.28 x 30% relief = £4,558.58)

A hospitality business would have to employ fewer than three people for the rates relief benefit to counterbalance the increase in wages costs they

[20] Ibid.
[21] Ibid.

would face if they had to accredit with the Living Wage Foundation to qualify. A retail sector business would have to employ fewer than four; and both of these calculations assume that each business is already paying the sectoral median wage, meaning that the uplift to LWF is of the smallest order. The reality is that the uplift might well be greater.

This is calculated as follows:

Hospitality = £4,558.58 (The rate relief) /£1,753.30 (the margin between the current sector median and the Living Wage Foundation scale) = 2.60 members of staff

Retail = £4,558.58 (The rate relief) /£1,396.91 (the margin between the current sector median wage and the LWF scale) = 3.26 members of staff

It is also worth noting that neither of these calculations makes provision for other additional employer costs that would accrue, such as increased National Insurance Contributions, Auto Enrolment Pension Contributions etc.

The calculations are simply included to illustrate the impact that a requirement to accredit to the LWF would have on value of the proposed R&HI relief.