# Non-domestic rates: decapitalisation rates for the 2023 revaluation

## Business and Regulatory Impact Assessment

June 2022

Scottish Government
Riaghaltas na h-Alba
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# Business and Regulatory Impact Assessment

## Title of Proposal

Non-domestic rates: decapitalisation rates for the 2023 revaluation

## Purpose and intended effect

Background

Non-domestic rates, sometimes referred to as business rates, are a property tax based on the rateable value (RV) of a property. RVs are derived from net annual values (NAV), which are based on the annual rental value that a property would attract in an open market if vacant and to let. Rating valuations are carried out by independent Scottish assessors and RVs are periodically updated at revaluations taking into account changes to general market conditions. The most recent valuation was on 1 April 2017 based on rental values (‘tone date’) as at 1 April 2015. The next revaluation is on 1 April 2023 with a tone date of 1 April 2022. Assessors will be required to publish a draft valuation roll on 30 November 2022.

While most RVs are based on estimated annual rent, around 9% of subjects, accounting for 22% of total RV are derived using the Contractor’s method of valuation (Table 1). One of the inputs used in this method of valuation is the decapitalisation rate: the NAV and RV is calculated by multiplying this rate by the estimated capital value of a property.

Prior to 1990, valuation offices across the UK set their own decapitalisation rate(s) but there were difficulties in determining how the decapitalisation rate(s) should be derived and at what level it/they should be set. This created uncertainty as to the rates liability of those whose properties were valued using the Contractor’s method, and ultimately also to non-domestic rates income.

Since 1990, the decapitalisation rates have been prescribed using regulation-making powers contained in the Valuation and Rating (Scotland) Act 1956. For the 2017 revaluation, the standard rate was set at 4.6% and the lower rate at 2.9% for educational establishments and church and healthcare properties under the Valuation for Rating (Decapitalisation Rate) (Scotland) Regulations 2016.

Objective

The objective is to confirm the policy around the decapitalisation rates for the 2023 revaluation.

Rationale for Government intervention

The rationale for confirming this is to provide certainty to stakeholders, in particular Scottish assessors who require to apply these rates in non-domestic property valuations carried out using the Contractor’s method.

As mentioned previously, the Government has prescribed the decapitalisation rates to be used in the Contractor's method in legislation since 1990.

Draft valuations for the 2023 revaluation are due to be published on 30 November 2022. Confirmation of the decapitalisation rates for this revaluation is required to allow assessors to apply the appropriate rates in the draft valuations which use the Contractor's method.

**Consultation**

Within Government

The following government agencies and departments have been consulted :

- Directorate for Legal Services
- Directorate for Local Government and Housing

Officials within the Scottish Government's Non-Domestic Rates Team are in regular contact with their counterparts in the UK Government and other devolved administrations.

Public Consultation

The Scottish Government has traditionally consulted on decapitalisation rates at each revaluation. The consultation on the 2023 decapitalisation rates[1] ran from 20 December 2021 to 13 March 2022, receiving 13 responses.

The consultation asked for views on four questions:

1. Should the Scottish Government continue to prescribe decapitalisation rates to be used for the contractor's basis method of valuation at the 2023 revaluation?
2. Should the Scottish Government continue to prescribe two decapitalisation rates?
3. If prescribing two decapitalisation rates, should the Scottish Government continue to maintain the current groupings of properties in each rate?
4. Do you have any further views on the decapitalisation rates for the 2023 revaluation?

In summary, respondents reported they would welcome the continued prescription of decapitalisation rates by the Scottish Government for the 2023 revaluation, and all respondents either supported or had no objection to there being two decapitalisation rates (standard and lower).

Five of the thirteen respondents felt that there should be no change to the current groupings for the two rates, or had no strong views on the matter. Some respondents suggested there should be standardisation across the UK, while one respondent suggested that Scottish Water be included in the grouping for the lower decapitalisation rate. One response cautioned that any change to groupings should be carefully considered so that commercial organisations do not inadvertently benefit

[1] Non-domestic rates: decapitalisation rates for the 2023 revaluation - Scottish Government - Citizen Space (consult.gov.scot)

from the lower rate while another suggested that the groupings for each rate should be defined more generally than they currently are.

Two respondents expressed concern over using property yield information to determine the decapitalisation rates (method 3 in the consultation document) while some others acknowledged that this method had been favoured by Scottish case law prior to prescription of decapitalisation rates.

Six out of thirteen respondents noted the relevant decapitalisation rates used in other UK administrations and suggested that these rates be used as benchmarks when considering the appropriate rates for Scotland.

Seven respondents asked that the Scottish Government provide a clear and transparent reasoning and analysis when setting the decapitalisation rates.

**Business**

As outlined above, the Scottish Government launched a public consultation and a number of businesses and their representative groups took the opportunity to provide their views on the 2023 decapitalisation rates.

**Options**

Based on the most common methodologies set out in the literature to calculate appropriate ranges for decapitalisation rates and available data, a broad range of policy decisions on the precise decapitalisation rate(s) for the 2023-26 cycle could be supported. For instance, the method that considers the use of borrowing to fund the replacement cost of a property provides a range between 1.0% and 7.5% for the private sector and between 1.0% and 4.5% for the public sector.

The Scottish Government gave consideration to the following options:

1. <u>Do nothing.</u>

The decapitalisation rates would remain at 4.6% and 2.9% with no change to the categories as the Valuation for Rating (Decapitalisation Rate) (Scotland) Regulations 2016 came into force on 1 April 2017 and do not have an expiry date.

<u>2. Decrease the rates.</u>

This option sets the decapitalisation rates at 4.4% and 2.6% (matching those in England).

<u>3. Increase the rates.</u>

This option is illustrative and sets the upper rate at 4.8% and the lower rate to 3.1% (mirroring Option 2 in the sense of delivering a change of a similar magnitude in terms of rateable value effect, but in the opposite direction to Option 2 relative to the current rates).

4. Do not prescribe statutory decapitalisation rates.

Scottish assessors would determine the rate(s) to apply in the valuation of properties using the Contractor's method.

5. Change the number of categories with different rates and/or their make-up

Many different designs would be possible.

**Sectors and groups affected**

The sectors affected will be the non-domestic properties valued using the Contractor's method. From an administrative point of view, the Scottish assessors will be affected insofar as they apply the statutory rates when rating a non-domestic property using the Contractor's method.

The costs and benefits of different decapitalisation rates for different cohorts of ratepayer can only be illustrated on an 'all else equal' basis. Ultimately, the cost or benefit to an individual ratepayer depends on changes in capital value (for properties under the Contractor's method)/nominal rental values (for properties under the other methods), valuation practice, other NDR policies at revaluation, including the property rates (poundage, etc.) and reliefs. These are announced at budget for the next financial year. To note, the decapitalisation rates set may influence these decisions, for instance if government's choice of the tax rate is based on a target NDR income for 2023-24.

**Cost and Benefits**

Options 1 – 3

If the setting of decapitalisation rates causes the RV of properties valued using the Contractor's method to increase in aggregate relative to those valued using other methods (in other words the share of Contractor's method RV increasing relative to non-Contractor's method RV), for a given poundage, this means the gross tax (before the value of reliefs are taken into account) burden on Contractor's method properties will increase – and therefore that the gross tax burden on non-Contractors' method properties will decrease (benefitting them in aggregate).

Conversely, if this causes the RV of properties valued using the Contractor's method to decrease in aggregate relative to those valued using other methods (in other words the share of Contractor's method RV decreasing relative to non-Contractor's method RV), for a given poundage, this means the gross tax burden on Contractor's method properties will decrease (benefitting them in aggregate) – and therefore that the gross tax burden on non-Contractors' method properties will increase.

Option 4 – Do not prescribe the rates in statute

As noted previously, if all else were equal, properties that see their RV decrease as a result of this would benefit and those that see it increase would incur a cost.

All respondents to the consultation supported the proposal that the Scottish Government should continue to prescribe the decapitalisation rates. Eleven respondents noted that this practice would provide certainty for assessors and ratepayers, and should provide a greater degree of certainty in financial planning for taxpayers.

Respondents to the consultation expressed that if two rates were not prescribed, this would lead to appeals that could take considerable time and expense to resolve.

Option 5 - Change the number of categories with different rates and/or their make-up

As noted previously, if all else were equal, properties that see their RV decrease as a result of this would benefit and those that see it increase would incur a cost.

There were mixed views expressed in the consultation responses about the benefits of changing the categories. One respondent for instance suggested that as their borrowing is at a similar rate to that provided to other public sector providers within health, education, etc. rather than the commercial rate, their properties should be valued using the lower decapitalisation rate, while another noted that they “would prefer to see the properties subject to one rate or the other defined for generically. In our opinion not-for-profit institutions and those which rely on public or private charitable funding should benefit from the lower decapitalisation rate, and ‘commercial’ operations pay the higher rate. Each ratepayer would then be able to claim the benefit of the lower rate if they fulfil the stated criteria.”

**Scottish Firms Impact Test**

Table 1 shows the premises valued under the Contractor's method as at April 2022. Half of the RV valued under this method is attributable to public sector properties, and half to the private sector.

**Table 1: Premises Valued under the Contractor's Method as at April 2022**

| Property Classification | Number of Premises | Approximate RV (£m) |
|---|---|---|
| Education and Training | | |
| School | 2,687 | 379 |
| University | 100 | 88 |
| College | 139 | 45 |
| Other | 161 | 21 |
| Public Service Subjects | | |
| Waste Water Treatment | 983 | 39 |
| Military Facility | 197 | 51 |
| Airfield | 49 | 29 |
| Prison | 21 | 15 |
| Police Station | 200 | 14 |
| Fire Station | 315 | 12 |
| Other | 6,414 | 127 |
| Health and Medical | | |
| Hospital | 208 | 153 |
| Clinic | 337 | 18 |
| Surgery | 131 | 3 |
| Other | 148 | 14 |
| Industry (including factories, warehouses and stores) | 534 | 141 |
| Care Facilities | 2,107 | 102 |
| Day Nursery | 278 | 5 |
| Petrochemical | 116 | 107 |
| Leisure, Entertainment, Caravans and Holiday Sites | 1,092 | 88 |
| Religious | 5,743 | 53 |
| Cultural | 562 | 34 |
| Statutory Undertaking | 95 | 36 |
| Other | 1,231 | 34 |
| **All** | **23,848** | **1,607** |

*Estimates are exclusive of a small amount of RV that is valued under hybrid methods, where part of the RV is valued under the Contractor's Basis and part using another method.

Table 2 shows the estimated impact, based on preliminary data provided by Scottish assessors on expected changes in the capital values of properties valued using the Contractor's method.

**Table 2: Illustrative options for 2023 revaluation decapitalisation rates**

| | 2022 | 2023 Option 1 | | 2023 Option 2 | | 2023 Option 3 | |
|---|---|---|---|---|---|---|---|
| **Discount Rate** | **2.90%** | **2.90%** | | **3.10%** | | **2.60%** | |
| | **Actual RV (£m)** | **Estimated RV (£m)** | **change** | **Estimated RV (£m)** | **change** | **Estimated RV (£m)** | **change** |
| Education - total | 533 | 533 | 0% | 570 | 7% | 478 | -10% |
| School | 379 | 378 | 0% | 404 | 7% | 339 | -11% |
| University | 88 | 89 | 0% | 95 | 7% | 80 | -10% |
| College | 45 | 46 | 2% | 50 | 9% | 42 | -9% |
| Other | 21 | 21 | -1% | 22 | 6% | 18 | -11% |
| Healthcare - total | 187 | 180 | -4% | 192 | 2% | 161 | -14% |
| Hospital | 153 | 145 | -5% | 155 | 1% | 130 | -15% |
| Clinic | 18 | 18 | 0% | 19 | 7% | 16 | -10% |
| Surgery | 3 | 3 | 0% | 3 | 7% | 3 | -10% |
| Other | 14 | 14 | 0% | 15 | 7% | 12 | -10% |
| Day Nursery | 5 | 5 | 0% | 5 | 7% | 5 | -10% |
| Care facilities | 102 | 102 | 0% | 109 | 7% | 92 | -10% |
| Religious | 53 | 50 | -5% | 54 | 1% | 45 | -15% |
| **Headline Rate** | **4.60%** | **4.60%** | | **4.80%** | | **4.40%** | |
| | **RV (£m)** | **Estimated RV (£m)** | **change** | **Estimated RV (£m)** | **change** | **Estimated RV (£m)** | **change** |
| Public - total | 236 | 243 | 3% | 253 | 7% | 232 | -2% |
| Waste Water | 39 | 46 | 20% | 48 | 25% | 44 | 15% |
| Airfield | 29 | 29 | 0% | 30 | 4% | 28 | -4% |
| Prison | 15 | 15 | -5% | 15 | -1% | 14 | -9% |
| Police station | 14 | 13 | -5% | 14 | -1% | 13 | -9% |
| Fire station | 12 | 12 | -5% | 12 | -1% | 11 | -9% |
| Other | 127 | 128 | 1% | 134 | 5% | 123 | -4% |
| Military Facility | 51 | 48 | -6% | 50 | -2% | 46 | -10% |
| Industrial Subjects | 141 | 157 | 11% | 163 | 16% | 150 | 6% |
| Petrochemical | 107 | 123 | 15% | 129 | 20% | 118 | 10% |
| Leisure etc. | 88 | 88 | 0% | 91 | 4% | 84 | -4% |
| Cultural | 34 | 34 | 0% | 35 | 4% | 32 | -4% |
| Statutory Undertaking* | 36 | 36 | 1% | 38 | 6% | 34 | -3% |
| Other* | 34 | 35 | 1% | 36 | 6% | 33 | -3% |
| **TOTAL** | **1,607** | **1,633** | **1.6%** | **1,726** | **7.4%** | **1,510** | **-6.1%** |

*Specific estimates of movement in capital values for these property types were unavailable, the analysis assumes movements would be in line with the average movement in other Contractor properties.

It is estimated that Option 1 would lead to an increase in the RV of properties valued using the Contractor's method of 1.6% at the next revaluation, Option 2 would lead to an estimated increase of 7.4%; and Option 3 to a decrease of 6.1% instead.

**Competition Assessment**

Will the measure directly or indirectly limit the number or range of suppliers?

No – this will not impact the number or range of suppliers.

Will the measure limit the ability of suppliers to compete?

No – this will not influence sales or suppliers.

Will the measure limit suppliers' incentives to compete vigorously?

No – there is no impact on incentives to compete.

Will the measure limit the choices and information available to consumers?

No – there is no impact on the choices and information available to consumers.

**Consumer Assessment**

Does the policy affect the quality, availability or price of any goods or services in a market?

There will be no effect on the quality, availability or price of goods or services.

Does the policy affect the essential services market, such as energy or water?

There will be no effect on essential services.

Does the policy involve storage or increased use of consumer data?

It does not involve any change in processes or operations.

Does the policy increase opportunities for unscrupulous suppliers to target consumers?

No.

Does the policy impact the information available to consumers on either goods or services, or their rights in relation to these?

No – this policy will not impact on any information available.

Does the policy affect routes for consumers to seek advice or raise complaints on consumer issues?

No.

**Test run of business forms**

No new forms will be introduced as a result of this policy

**Digital Impact Test**

No digital impact test is required. This policy does not change current practice.

**Legal Aid Impact Test**

The policy has no impact on the legal aid fund.

**Enforcement, sanctions and monitoring**

Scottish assessors are statutorily responsible for non-domestic property valuation for rating purposes. All RVs are publicly available on the valuation roll.

**Implementation and delivery plan**

The policy will be taken into account by Scottish assessors to set rateable values for properties valued using the Contractor's method for the 2023 revaluation.

**Summary and recommendation**

The Scottish Government will continue to prescribe the decapitalisation rate for the next revaluation.

The two current rates and categories will be maintained at 4.6% for the standard rate and 2.9% for the lower (Option 1).

**Declaration and publication**
Sign-off for BRIAs:
I have read the Business and Regulatory Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options. I am satisfied that business impact has been assessed with the support of businesses in Scotland.

**Signed**

**Date: 20 June 2022**

**Ministers name: Tom Arthur**
**Minister's title: Minister for Public Finance, Planning and Community Wealth**

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The Scottish Government
St Andrew's House
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ISBN: 978-1-80435-606-7 (web only)

Published by The Scottish Government, June 2022

Produced for The Scottish Government by APS Group Scotland, 21 Tennant Street, Edinburgh EH6 5NA
PPDAS1102622 (06/22)