Briefing

September2017

Reforming Scotland's Non-Domestic Rates System



The Barclay Review, published on 22 August 2017, considers the current rates system in Scotland and proposes 30 individual recommendations on how the rates system could be reformed, based on the following remit:

"To make recommendations that seek to enhance and reform the non-domestic rates (also sometimes referred to as business rates) system in Scotland to better support business growth and long term investment and reflect changing marketplaces, whilst still retaining the same level of income to deliver local services upon which businesses rely."

The Current System

Non-domestic rates is a tax based on property which is levied in order to help pay for the wide range of services that Councils deliver (such as education, social care, waste management etc). Non-domestic rates have been in place in the UK for generations, and the power to implement and set the rate of tax in Scotland has been fully devolved to the Scottish Parliament.

The calculation of rates depends on the 'rateable value' of the property, as assessed by the local independent Scottish Assessor. The rateable value of a property is generally based on its estimated open market rental value on a specific date. The current system has been criticized for imposing a tax burden which is excessive. Given the recent reduction in corporation tax, non-domestic rates now comprise the largest tax burden for many businesses. Furthermore, and this point being most relevant to charities, non-domestic rates have been criticized for permitting extensive reliefs and exemptions, meaning that businesses not eligible for relief are hit the hardest.

There are a number of different reliefs available in Scotland, including Charity/Not for Profit relief. This provides 80% mandatory relief for properties occupied by registered charities. Councils have discretion to top this relief up to 100% and award relief of up to 100% for those who operate properties on a not-for-profit basis.

The Review considers that the rates system can be improved, and that certain changes should be made which will stimulate economic development.

Recommendations

The Review makes clear at the outset that its remit was to provide recommendations which were fiscally neutral, and so it may come as a disappointment for many ratepayers that an overall reduction in the rates burden has not been proposed. The Review highlights that there is "no simple revenue neutral solution that would simultaneously maintain the same level of income and make all ratepayers content with the system."

Instead, the Review proposes a package of 30 individual recommendations to best deliver against its remit and the following identified key principles: fairness; consistency; transparency; simplicity and accountability.

This bulletin will focus on those recommendations which will have the biggest impact on the charities sector, which are predominately measures which are designed to increase fairness and ensure a level playing field.

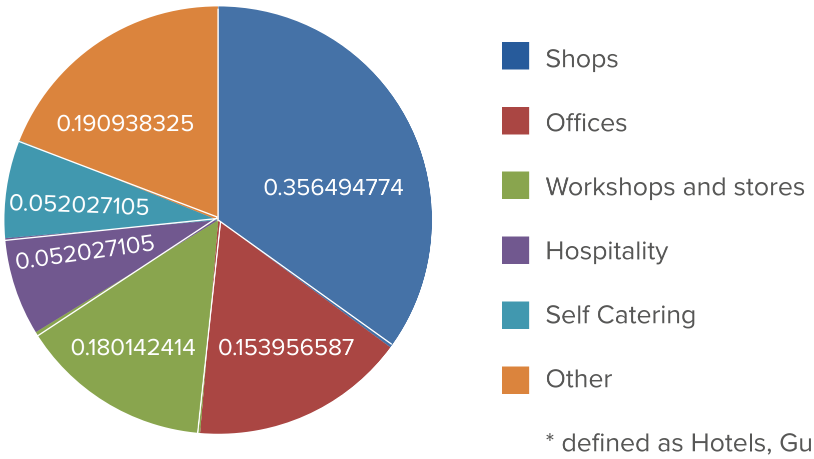
Review of Rates Relief

It has been noted that in a small number of occasions, charity relief had been awarded incorrectly, for example Councils awarding charity relief to some of the trading arms of a parent charity. Charity shops are eligible for relief where they are 'mainly or wholly' used for the sale of donated stock. However, trading subsidiaries of charities (and any shops run by them) are not eligible for mandatory relief.

The Review has recommended that where charity relief as been erroneously awarded, this should be corrected and Councils should be encouraged to audit current recipients of this relief.

Restricting Recipients of Charity Relief

Percentage of Small Business Bonus Scheme (in £) awarded by type of property (2015).



* defined as Hotels, Guest Houses, Pubs, Cafes and Restaurants

Source: 2015 Billing System Snapshot (provided by councils to the Scottish Government).

The rate of charity relief has increased over the current revaluation cycle [, as shown on the chart]. There are concerns that some Councils award a significant amount of relief to Arm's Length External Organisations (ALEOs) which the Councils themselves have created to deliver services which Councils previously provided directly. ALEOs have charitable status which entitles them to receive relief. The Review highlights that this creates unfair competition between the public and private sectors, where for instance private gyms and leisure facilities will compete with ALEO facilities that do not pay rates. The Review is critical of this practice by Councils and suggests that this is a method of tax avoidance which should cease.

The Review also highlights the equivalent position in respect of independent and state schools. Independent schools benefit from reduced or zero rates bills, whereas state schools do not qualify and generally will pay rates. The Review proposes that whilst independent schools should still retain charitable status and the other benefits which flow from that, eligibility for charity rates relief should be removed to end the inequality between the two categories of schools.

As regards universities, the Review recommends that they should be able to continue claiming charity rates relief as their core functions of education and research and development support economic growth through education of the workforce and supporting innovation. That being said, the Review considers that university residential properties, whilst not being occupied by students during term time, should be subject to rates where they are being rented commercially and competing directly with the private sector.

Observations

There is a notable inequity in the Review's approach to education as between schools and universities. Given the similarities of their remit to promote economic growth through education, it is interesting to note the Review's disparity of opinion in respect of eligibility for business rates relief.

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Should these specific recommendations relating to independent schools be approved, the cost of non-domestic rates will inevitably be passed on to parents. This could indeed lead to the end of private schooling, if the already expensive cost for parents sending their children to private school becomes unaffordable.

As regards ALEOs, these organisations provide a range of community facilities, from libraries and museums to community pools and gyms, which for the most part do not compete directly with the private sector. Many users do not have the resources to access private facilities, and therefore there is a risk that imposing business rates on these ALEOs will have an impact on their work with local authorities and the NHS to promote healthy living in Scotland.

The recommendations will not have any impact on the current 2017 revaluations, but will be considered and scrutinised by the Scottish Parliament during this parliamentary session.

If you feel these recommendations may have an impact on your organisation, please contact our Charities team or speak to your normal Shepherd and Wedderburn contact.

Our Charities Team

Our charities team is well known for providing bespoke, high quality advice to our clients. With an understanding of the specific challenges faced and the different regulatory regimes under which they work, we draw on experience and expertise from across the business to create a multidisciplinary team which provides quality, rounded and incisive legal advice.

In our regular bulletins, we aim to provide key information about issues affecting the charity sector, as well as commentary and guidance on new and existing legislation.

If you would like further guidance please contact our Charities team or speak to your normal Shepherd and Wedderburn contact.

Chris McGill
Partner
Charities, Constitution and Governance
T +44 (0)131 473 5262
M +44 (0)791 206 9063
E chris.mcgill@shepwedd.com

Katie Russell
Partner
Charities and Employment
T +44 (0)131 473 5266
M +44 (0)787 269 9897
E katie.russell@shepwedd.com

Malcolm Rust
Partner
Charities, Constitution and Governance
T +44 (0)131 473 5284
M +44 (0)779 560 0460
E malcolm.rust@shepwedd.com

David Dunsire
Consultant
Charities, Corporate and Governance
T +44 (0)131 473 5256
M +44 (0)781 466 8378
E david.dunsire@shepwedd.com

Rhona Harper
Partner
Charities, Property and Infrastructure
T +44 (0)141 566 8547
M +44 (0)775 387 1606
E rhona.harper@shepwedd.com

Joanna Boag-Thomson
Partner
Charities, Information Technology and Intellectual Property
T +44 (0)141 566 8570
M +44 (0)775 387 1607
E joanna.bt@shepwedd.com

Euan Murray
Senior Associate
Charities, Property and Infrastructure
T +44 (0)131 473 5679
M +44 (0)791 240 6039
E euan.murray@shepwedd.com

Stuart Greenwood
Associate
Charities, Property and Governance
T +44 (0)131 473 5455
M +44 (0)759 509 2287
E stuart.greenwood@shepwedd.com