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THE PHASING OUT OF INDUSTRIAL DE-RATING IN NORTHERN IRELAND

Manufacturing rates were re-introduced in Northern Ireland in April 2005. Having previously been entitled to 100% relief, local manufacturing companies are now liable for rates charges. This paper outlines the background to industrial de-rating in the UK, the current situation in Northern Ireland, and identifies a number of future considerations

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1. Introduction

The re-introduction of manufacturing rates in April 2005 has created considerable public reaction. Having previously been entitled to 100% relief, local manufacturing firms are now liable for rates charges, as has been the case in England and Wales since 1963. To ease this transition, a phased system has been put in place, whereby full liability will occur in 2011. A campaign by the Northern Ireland Manufacturing Focus Group (NIMFG) argues that this de-phasing of relief will have serious detrimental effects for NI, including job losses and an exodus of resident companies. As a result of this campaign, and pending the recently announced rates review, industrial rates have been temporarily capped at 30%[1]. This paper outlines the course of events to date and potential considerations for the forthcoming review.

2. Background

Industrial de-rating was introduced in the UK as a whole in 1929, mainly in response to growing competition in manufactured goods from foreign countries. It also acknowledged the fact that traditional manufacturing was comparatively space intensive[2]. This relief was abolished in England and Wales in 1963 and phased out in Scotland by 1995[3].

However, in April 2003, 100% relief still applied to the 5,100 eligible manufacturing firms in Northern Ireland (NI), resulting in c£60 million of foregone rates revenue[4]. The decision to phase out industrial de-rating in NI was announced in April 2003, following a public consultation exercise on the Review of Rating Policy in May 2002.

3. Rationale for Reform

A number of factors, practical, financial and legal in nature, motivated the decision to review industrial de-rating, as follows:

3.1 Shortcomings of existing system

The rating review was motivated by the fact that the legislation dated back to the 1920s. The old system rendered business such as vehicle repair and print shops eligible for de-rating. Quarries also had relief entitlement. The applicability of industrial de-rating to these activities was considered to be debatable, highlighting the requirement for a more modern system.[5]

3.2 Revenue / Economic Implications

The main financial objectives of the phasing out of de-rating were[6]:

- To widen the tax base and therefore share the burden of local taxation in a more equitable way
- To raise additional rates revenue to enable borrowing under the Reinvestment and Reform Initiative (RRI) that in turn will fund essential infrastructure projects.

[1] As opposed to the 35% in the original schedule
[2] "Regulatory Impact Assessment", The Removal of Industrial Derating, August 2003 www.ratingreviewni.gov.uk/quarries.pdf
[3] http://archive.nics.gov.uk/dfp/040211ii-dfp.htm
[4] "Regulatory Impact Assessment", The Removal of Industrial Derating, August 2003 www.ratingreviewni.gov.uk/quarries.pdf
[5] "Regulatory Impact Assessment", The Removal of Industrial Derating, August 2003 www.ratingreviewni.gov.uk/quarries.pdf
[6] "Regulatory Impact Assessment", The Removal of Industrial Derating, August 2003 www.ratingreviewni.gov.uk/quarries.pdf

In June 2006, the then Finance Minister, David Hanson quantified the anticipated revenue implications:

"Industrial rates will contribute £18 million to our spending plans with a further £26 million next year. These amounts are already built into our plans for this year and next and will make a significant contribution to investment in services and infrastructure, which will benefit the entire community[7]"

In terms of the effect on the local business community, a study by a firm of economic consultants, DTZ Pieda, in 2002 concluded that any negative implications would be limited[8]:

> *"while there would be specific cases where the removal of industrial de-rating would lead to adverse effects, the overall effect on the level of economic activity in the medium term would be negligible."*

Further, the authors predicted long-term economic benefits:

> *"It is also arguable that the removal of de-rating would be beneficial in the long term to the process of economic restructuring – blanket tax allowances or subsidies which are unrelated to market failure distort the cost and price signals which firms face and thus distort economic decision making[9]."*

3.3 European Union (EU) State Aid regulations

Industrial de-rating operated in the UK prior to accession to the EU and accordingly was classified as an 'existing aid'. Such existing aids do not need to be notified, however there was always the possibility that the European Commission (EC) could challenge this. Although accepted in the past, it was considered unlikely that de-rating would be allowed to continue under EU State Aid regulations10. This was another factor in the decision to phase out industrial rate relief.

4. Implementation of Rates

The Rates (Amendment) (Northern Ireland) Order 2004 removed industrial de-rating, but allowed for subsequent changes to be made to the phased percentage levels[11]. Phasing-out began on 1 April 2005; the original schedule was set as follows:

[7] "Industrial rates make an essential contribution to NI budgets", DFP website: www.dfpni.gov.uk/news-june-2006-industrial-rates
[8] Further details can be found at www.ratingreviewni.gov.uk/quarries.pdf
[9] "Regulatory Impact Assessment", The Removal of Industrial Derating www.ratingreviewni.gov.uk/quarries.pdf
[10] "Rating Reform in Northern Ireland: Key Issues", Public Finance Research Unit, 19 December 2006
[11] Paragraph 4 of Schedule 7 to the Order outlined the introduction of rates, sub-paragraph 4(5) allowed for percentage changes.

YEAR	% OF FULL Rate Liability	EXPECTED REGIONAL (£m)	EXPECTED TOTAL (£m)
2005-06	15	6.4	10.7
2006-07	25	10.8	18.2
2007-08	35*	15.2	26.1
2008-09	50	22	38.2
2009-10	75	33.5	58.7
2010-11	75	33.9	60.1
2011-onwards	100	45.7	82.1

* Subsequently pegged at 30% (2006).
Source: Rating Policy Division, Department of Finance and Personnel

Nominal rate liability is based on an assessment, by Land and Property Services (Valuation), of a property's Net Annual Value (NAV), including any buildings, yards, rateable plant and machinery. Only occupied properties are rateable. The product of the NAV and the non-domestic poundage rate determines full rate liability; the

relevant phasing percentage is then applied to establish *phased* liability in any given year, until 2011[12]. The average rates bill in 2006-07 for applicable properties was estimated at £3,990; upon implementation of 100% liability in 2011 the estimate rises to £19,890[13].

In terms of actual revenue created, in the first year (2005-06), the 15% proportional liability created some £10.9 million from 4300 businesses. In the subsequent year, a 10% increase in rate liability meant that revenue was in the region of £20 million[14].

5. Criticisms of Industrial Rating

- The Northern Ireland Manufacturing Focus Group (NIMFG) suggested that de-rating was poorly understood by government and that its phasing out was based on a "*fundamental misunderstanding*" of the role and value of de-rating[15]. The group claims that thousands of jobs will be lost and industrial rates will drive the "*biggest and best companies abroad*". They also contest that NI companies pay the highest energy charges and most expensive insurance costs[16]. Further, the group argue that the DTZ Pieda report, upon which the reform was (partially) based, was "flawed", over-estimating local manufacturing profits by around £1,000 million per year.

- In terms of projected economic implications, while unable to quantify the effect, the NIMFG refers to a Price Waterhouse Coopers (PWC) report which predicted the loss of 40,000 jobs if local investment collapses. The group also debates the robustness of the Government prediction that it will realise £80 million from industrial rates, suggesting that companies will scale down or relocate, reducing actual revenue.

- Evidence submitted by Moy Park and Wrightbus, to the Committee on the Preparation for Government, presented the negative impact of increasing rates on costs, investment decisions and R&D activity. Wrightbus highlighted

[12] Appendix 1 provides the explanatory leaflet for the phasing out of industrial de-rating
[13] Rating Reform in Northern Ireland: Key Issues", Public Finance Research Unit, 19 December 2006
[14] Rating Reform in Northern Ireland: Key Issues", Public Finance Research Unit, 19 December 2006
[15] "First Report on the Economic Challenges Facing NI", Committee on the Preparation for Government, Vol. 1, pp.27-28
[16] Rating Reform in Northern Ireland: Key Issues", Public Finance Research Unit, 19 December 2006

the space intensive nature of its business, and the arguably unfair implications of this upon rate burden.

- The CBI stated that the phasing out of de-rating would add to the already high cost base in NI, damaging the industrial sector. It also highlighted the withdrawal of EU state aid in relation to electricity prices, suggesting an urgent need for an industrial rates cap until at least 2012.

- The Ulster's Farmer Union also presented evidence to the sub-group, expressing concern that the financial burden of industrial rates would discourage farm diversification[17].

6. POST-IMPLEMENTATION DEVELOPMENTS

The NIMFG, which represents 300 manufacturing companies in NI, has been campaigning against the proposed schedule for phasing in industrial rates. Specifically, the group has been seeking a 'cap' of 25%. The sub-group on the Comprehensive Spending Review and Programme for Government; Rates Charges; and Water Reform ('the sub-group') has also recommended the freezing of rates, pending major review. This culminated in an Assembly debate on 6th June 2006 to consider the motion to freeze the liability at 25%. The motion was carried.

In September 2006, the Secretary of State agreed to set up a working group to consider the various issues in advance of a formal policy review scheduled for April 2007. This was motivated by, and will be based on, the views of NIMFG and the trade union, Amicus. The findings of this group, whilst not considered conclusive, resulted in the acknowledgment that further work was required.

In response to the aforementioned developments, changes to the original phasing schedule have been introduced. David Hanson confirmed this on 30 January 2007, as follows:

> *"I announced on 23 November 2006 that the level of rate liability for manufacturers in 2007-08 would be 30% rather than 35%. I can now confirm that the legislation to bring this into operation from 1 April 2007 has been laid at Westminster"[18].*

On 12 June, it was confirmed that no further adjustments will be made pending results of the formal review. This will be conducted by the Economic Research Institute of Northern Ireland (ERINI) and *"will enable the returning Assembly to make an informed and balanced decision on the phased introduction of industrial rating within the wider context of the budget process"[19]*. The results of the review are expected in September 2007[20].

7. FUTURE CONSIDERATIONS / LINE OF QUESTIONING BRIEFING

The following issues might be worth considering in the context of the forthcoming review:

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[17] "First Report on the Economic Challenges Facing NI", Committee on the Preparation for Government, Vol. 1, pp.27-28

[18] "Legislation laid at Westminster for 30% industrial rating liability for 2007/2008", DFP website: www.dfpni.gov.uk/news-jan-2007-legislation-industrial-derating

[19] "Institute to review industrial derating", Irish News, 24 March 2007

[20] Hansard: Private Members Business: Industrial Rates, 12 June 2007
ERINI confirmed on 14/06/07 that they are scheduled to complete the report at the end of September 2007

- ***Financial Implications:***

  On 12 June 2007, Peter Robinson quantified the financial scale of amending the original phasing-out schedule as follows:

  "The cumulative cost of keeping this form of relief at its current rate of 30% liability — compared to the phasing schedule set out in the legislation — is estimated to be £144 million between now and 2011-12. Thereafter, it will be around £50 million a year[21]."

  Further, he considered the cost of restoring rate liability at 25%:

  "..the cumulative figure is just under £160 million: £19.1 million in 2008-09; £39.1 million in 2009-10; £40.1 million in 2010-11; and £61.5 million in 2011-12[22]"

- ***Legislative Restrictions:*** It is important to note that there is no provision in the current legislation to allow industrial rate liability to be capped / frozen indefinitely. The current legislation allows for changes to the annual increments, however this does not apply to the final year, 2011, which is fixed in the Order. Any interim reductions would therefore necessitate subsequent increases, in order to enable full liability in 2011.

- ***EU law:*** Furthermore, any capping or freezing might be 'notifiable' to the EU under State Aid rules. There could be compliance issues with anything other than a temporary cap, particularly in relation to larger businesses[23].

- ***ERINI Report*** The 'Cost of Doing Business' report is frequently cited as the basis of DFPs decision to phase out industrial rate relief[24]. The report concluded that NI is not at a comparative cost disadvantage in relation to Great Britain and the ROI. It has therefore been suggested that this report might be important in any capping decision. Further, it would be interesting to establish whether this report was considered by the Working Group (established in 2006 in response to, and to consider, the views of NIMFG and Amicus), and if so, the interpretation / conclusions that emerged.

- ***Sub-group Recommendation:*** The sub-group on the Comprehensive Spending Review and Programme for Government; Rates Charges; and Water Reform welcomed a proposal by NIMFG and Amicus for a surcharge of 5% on industrial rates to establish a private sector-led training trust to develop skills and help increase competitiveness and productivity. It recommended that this self-help approach be explored, along with the possibility of associated Government funding[25]. This might be considered in the context of the forthcoming review.

- **Impact on Small Firms:** The DTZ Pieda study concluded that "*the most adverse impacts would be likely to be on very small firms*". However, it countered, "*the very small firm is of limited economic performance*". This is reflected in the view of the CBI that "a substantive case has not been made with regards the provision of relief for small companies"[26]. The relative impact on small firms might be a noteworthy consideration for the review.

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[21] This figure assumes the retention of the 30% cap beyond 2011-12
[22] Hansard, Private Members Business: Industrial Rates, 12 June 2007
[23] "Rating Reform in Northern Ireland: Key Issues", Public Finance Research Unit, 19 December 2006
[24] ERINI (2005) Measurement and Benchmarking of Competitiveness – The Cost of Doing business in Northern Ireland, December 2005.
[25] "Report on CSR and Programme for Government; Rates Charges; and Water Reform", Committee on the Programme for Government, Vol. 1, pp.4-5
[26] "Regulatory Impact Assessment", The Removal of Industrial Derating, August 2003 www.ratingreviewni.gov.uk/quarries.pdf

APPENDIX 1[27]

EXPLANATORY LEAFLET: PHASING OUT OF INDUSTRIAL DE-RATING

What is this leaflet about?

The decision to phase out industrial derating was announced in April 2003 following a public consultation exercise on the Review of Rating Policy in May 2002. The draft legislation was published in October 2003. Details of the consultation process, policy paper and legislation can be obtained from the Review of Rating Policy website: www.ratingreviewni.gov.uk/
The phasing out of industrial de-rating began on 1 April 2005 but full rates on industrial property will not become due until 1 April 2011.

How does the phasing out affect me?

If your property was occupied and used for industrial purposes on 1 April 2005, you became liable for rates at 15% of your full rate liability at this date.
The percentage amount of your full rate liability payable from 1 April 2006 will be as follows:

YEAR % OF FULL RATE LIABILITY
1 April 2006 – 31 March 2007 25%
1 April 2007 – 31 March 2008 30%
1 April 2008 – 31 March 2009 50%
1 April 2009 – 31 March 2010 75%
1 April 2010 – 31 March 2011 75%
1 April 2011 - onwards 100%

What is my full rate liability based on?

Your full rate liability is based on an assessment by Land & Property Services (Valuation) of the rental value of your property including any buildings, yards and any rateable plant and machinery.
This assessment is commonly referred to as your property's Net Annual Value (NAV). Rateable plant and machinery is normally confined to power generation and distribution equipment and specified structures and containers. This would have the greatest impact on heavy engineering businesses. As a general rule, if any plant and machinery is assessed, the amount attributable to these items is usually a small fraction of the total NAV.

How can I find out the current NAV of my property?

To find out the current NAV of your property, you can contact your district LPS office. Addresses can be found on
http://www.lpsni.gov.uk/

If I do not agree with this assessment, can I challenge it?

In the first instance, you can make an application for review to the District Valuer. If you are dissatisfied with the outcome of this review, you can appeal to the Commissioner of Valuation. You also have a further right of appeal, if you remain dissatisfied, to the Lands Tribunal for Northern Ireland. There is no fee for making an application for a review or for an appeal to the Commissioner.
You should be aware that if your property has been improved in recent years and was not reassessed at the time the improvements were made, your NAV could be

[27] http://www.lpsni.gov.uk/index/search.jsp/search.lsim?sr=0&nh=10&cs=iso-8859-1&sc=&sm=0&mt=1&ha=lps-cms&qt=+industrial+de+rating:

increased. Before submitting an application for review, it is a good idea to contact your district LPS office first and discuss the matter with a valuer.

Should I seek independent advice about the NAV?

During any discussion with the LPS about your property's NAV, you do not need to have independent representation. However, if you or your company, wish to be represented or seek independent advice, you should be aware that members of the Royal Institution of Chartered Surveyors (RICS) (www.ricsfirms.co.uk) and the Institute of Revenues Rating and Valuation (IRRV) (www.irrv.org.uk) are qualified and regulated by rules of professional conduct. Before employing a rating adviser, you should check that they have the necessary knowledge and expertise as well as appropriate indemnity insurance. You should be careful about paying monies to consultants up front either for their services or for them to lodge appeals on your behalf. If necessary, you should seek further guidance from the RICS or IRRV before entering into any contract.

How can I work out what my actual rate bill will be from 1 April 2006?

Your rate bill will be calculated by multiplying the NAV of your property by the non-domestic rate poundage for the relevant year and then applying the relevant percentage for that year, as shown in this leaflet.
Rate poundages are set annually and therefore it is not possible at this stage to work out exactly how much you will have to pay.

What if my property is vacant?

The phasing out arrangements only apply when your property is occupied.
If your property is vacant, it is assessed for rates under the unoccupied rating legislation, which came into operation on 1 April 2004. Certain vacant industrial properties, such as vacant mines and quarries, are exempt from this new rate. Factories may also be entitled to exemption, however this entitlement will be assessed on a case-by-case basis. There is also an initial three-month exemption period for those not entitled to a full exemption.

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