Explanatory Memorandum to The Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2016

This Explanatory Memorandum has been prepared by Local Government Finance Policy Division and is laid before the National Assembly for Wales 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 Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2016. I am satisfied that the benefits outweigh any costs.

Edwina Hart
Minister for Economy, Science and Transport
15 January 2016

Description

1. The Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2016 ('the 2016 Order') amends section 66(2BB) of the Local Government Finance Act 1988 ("the 1988 Act"), which defines domestic property for the purposes of Part III (non-domestic rating) of that Act.

2. Section 66(2BB), as inserted by the Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2010 ("the 2010 Order"), provides that from 1 April 2010 for a furnished property to be listed for non-domestic rates as opposed to council tax, it must meet the following conditions:

   a) in the 12 months following the assessment the ratepayer must intend for the property to be available for commercial letting to the public for periods which amount, in the aggregate, to not less than 140 days;

   b) on the day of assessment the ratepayer's interest in the property enables the ratepayer to let the property for the periods set out in (a) above;

   c) for the 12 months prior to assessment the property must have been available for commercial letting to the public for periods which amount, in the aggregate, to not less than 140 days;

   d) the periods for which it is so let amounted in the aggregate to at least 70 days.

3. The 2016 Order amends the definition so that where a building, or self-contained part of a building, is let for less than 70 days over the previous year as part of a business which lets a number of such buildings or self-contained parts of a building at the same location or within very close proximity of each other, it may nevertheless in some circumstances not be classified as domestic property. These circumstances are where the average number of days in which each of the buildings or self-contained parts of buildings at the same location or within a very close proximity of each other is let over the previous year is at least 70. If this condition is met, along with the conditions already contained in section 66(2BB)(a) to (c) (see above), each building or self-contained part of a building is not domestic property.

Matters of special interest to the Constitutional and Legislative Affairs Committee

4. None.

Legislative background

5. Section 66(9) of the 1988 Act provides the Secretary of State with the power to amend, by order, the definition of domestic property for the purposes of section 66.

6. This power was transferred, in relation to Wales, to the National Assembly for Wales by the National Assembly for Wales (Transfer of Functions) Order 1999, and subsequently transferred to the Welsh Ministers by virtue of paragraph 30 of Schedule 11 to the Government of Wales Act 2006.

7. This instrument will follow the negative resolution procedure.

Purpose and intended effect of the legislation

8. Section 66 of the Local Government Finance Act 1988 ("the 1988 Act") defines domestic property for the purposes of Part 3 of that Act (non-domestic rating). It specifies a number of circumstances where a property is to be treated as non-domestic. One such circumstance is where a property is commercially let as self-catering accommodation and section 66(2BB) specifies minimum requirements which must be met for a property to be considered non-domestic. Properties that do not meet the minimum requirements for commercial letting (and thus make a limited contribution to the local economy) are deemed domestic (unless the property falls within any other category of non-domestic property) and will be liable for council tax rather than non-domestic rates (subject to any exemptions or council tax reductions). Section 66(2BB) of the 1988 Act was originally inserted by the Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2010 ("the 2010 Order") and was intended to ensure that only properties being let as part of genuine businesses were considered non-domestic and therefore subject to non-domestic rates. This meant that properties not being genuinely let as part of a business would be liable to council tax payable to Local Authorities.

9. Where a building or self-contained part of a building is let for at least 70 days during the previous year and the remainder of section 66(2BB)(a) to (c) of the 1988 Act has been complied with, the building or self-contained part of a building will continue not to be domestic property.

10. The 2016 Order extends the scope of section 66(2BB) of the 1988 Act. The new condition inserted by the 2016 Order will provide that where a building or self-contained part of a building is let for less than 70 days over the previous year as part of a business which lets a number of such buildings or self-contained parts of a building at the same location or within very close proximity of each other, it may nevertheless in some circumstances not be domestic property. Where the average number of days in which each of the buildings or self-contained parts of buildings at the same location or within a very close proximity of each other is let over the previous year is at least 70, each building or self-contained part of a building is not to be domestic property.

11. However, a building or self-contained part of a building may only be included in one calculation in the relevant year. For example, buildings A, B and C, are let at the same location (and the conditions in section 66(2BB)(a) to (c) of the 1988 Act have been complied with). Building A is let for 95 days and buildings B and C are let for 45 days each. Building A may be included in a calculation under the new condition inserted by article 2 of the 2016 Order with either building B or C. The combined days let of buildings A and B, or A and C is 140 days, resulting in an average of 70 days, meaning that in either case, both buildings are not domestic property. The remaining building (not included in the calculation) does not fulfil the conditions and is therefore domestic property. If building A is included in a calculation with building B, building A cannot then be included in a calculation with building C.

12. Detailed guidance has also been produced which provides ratepayers with advice regarding the non-domestic rating system and the legislative requirements used to determine how self-catering properties are rated for taxation purposes.

Part 2 Regulatory Impact Assessment (RIA)

Options

Option 1 – Do nothing

Section 66(2BB) of the 1988 Act, which provides for the 70-day letting criteria, could be left without any amendments.

Whilst the 2010 Order, which inserted section 66(2BB) of the 1988 Act, sought to close a tax loophole, in certain circumstances it has resulted in adverse consequences for some genuine business owners. As the short-term holiday letting industry makes an important contribution to the Welsh economy, it is recognised additional safeguards needed to be considered to ensure that policy arrangements are flexible enough to support local businesses.

Retaining the conditions in section 66(2BB) of the 1988 Act would ensure that the tax loophole remains closed. However, to take no further action would not seek to address some of the issues that have arisen since the implementation of the amendments to section 66 of the 1988 Act contained in the 2010 Order. Issues have included as follows:

- Difficulties in meeting the 70-day letting criterion due to unforeseen circumstances;
- Self-catering properties within close proximity being let by a ratepayer being treated differently for tax purposes due to some meeting the 70-day criterion and others not;
- Assistance where adverse circumstances such as poor weather cause problems in meeting the 70-day criterion
- Property owners fraudulently seeking to satisfy conditions for their property to be deemed non-domestic;
- Lack of engagement and communication regarding the introduction of the 70-day criterion.

This option is not recommended as it would not address any of the issues highlighted above, which have been brought to our attention by ratepayers and stakeholders.

Option 2 – Amend section 66(2BB) so as to remove the conditions inserted by the Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2010 and re-insert the conditions applicable prior to 1 April 2010

The 2010 Order amended section 66 of the 1988 Act so that from 1 April 2010 for a property wholly used for the purposes of living accommodation to be listed for non-domestic rates as opposed to council tax certain conditions must be met. The new conditions inserted by the 2010 Order provide that for a property to be non-domestic, it must have been commercially let for at least 70 days in the previous 12 months, as well as having been available to let commercially for 140 days during that time. It also requires that the ratepayer intends (and is able to arrange) for the property to be available for commercial lets for 140 days in the following 12 months.

The amendments to section 66 of the 1988 Act, as inserted by the 2010 Order, closes a potential loophole whereby owners of properties that are predominately unoccupied, used as second homes, or occupied for most of the time by the owner, can effectively reduce the tax liability on their properties by becoming liable to pay non-domestic rates instead of council tax. Prior to 1 April 2010, this could happen by the owner declaring that a property was available for let for short periods totalling at least 140 days in a year, but making little or no realistic effort to actually make it available, by, for example, not actively marketing the property, asking for unrealistic rents, or restricting the dates that the property was actually available for let.

To amend section 66 of the 1988 Act so as to remove the conditions inserted by the 2010 Order would result in the removal of the 70-day criteria and re-expose the tax loophole which was being exploited by some second home owners prior to the implementation of the 2010 Order.

This option is not recommended.

Option 3 – Further amend section 66(2BB) of the Local Government Finance Act 1988 by introduction of the amendments laid out in the Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2016

Further amendments could be made via the 2016 Order to provide for some additional flexibility in meeting the criteria to be classified as non-domestic.

An amendment to introduce a new provision is proposed which essentially will allow businesses consisting of several self-catering properties at the same location or within very close proximity to have the option to average the number of letting days of the properties to meet the 70-day criterion where they are let by the same or connected businesses.

Detailed guidance has also been produced which provides ratepayers with advice regarding the non-domestic rating system and the legislative requirements used to determine how self-catering properties are assessed for taxation purposes.

This is the recommended option as it addresses concerns that have been raised since the implementation of the amendments to section 66 of the 1988 Act made by the 2010 Order. Officials will continue to monitor this area once the new Order has been implemented to ensure that it is having the desired impact.

Costs and benefits

Option 1 – Do nothing

Costs

Section 66(2BB) of the 1988 Act ensures that the tax loophole would remain closed therefore ensuring that the criteria which prevents second home owners from exploiting a tax loophole still applies. This measure would ensure that the tax-base would remain protected and limits the loss of income to Local Authorities if properties were to be subject to non-domestic rates rather than council tax.

Benefits

Other than no amending legislation being required, the benefits of doing nothing are very limited.

The short-term holiday letting industry makes an important contribution to the Welsh economy, and these businesses premises will continue to be assessed for non-domestic rates, and qualify for relief on the same basis as other businesses. The legislation as it stands is closely aligned to the Income Tax (Trading and Other Income) Act 2005 and Corporation Tax Act 2009 which define furnished holiday accommodation for income and corporation taxation purposes. Section 66(2BB) should not therefore adversely affect the taxation liability of genuine businesses, while closing a potential tax avoidance loophole.

However to simply leave section 66(2BB) as it stands does not address the issues that have been raised by ratepayers and key stakeholders.

Option 2 - Amend section 66(2BB) so as to remove the conditions inserted by the Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2010 and re-insert to the conditions applicable prior to 1 April 2010

Costs

This option would involve removing the 70-day criteria which would mean that self-catering properties would only have to evidence 140 days of available lettings as was the case prior to 1 April 2010. This would re-expose the tax loophole whereby second home owners could seek to reduce their tax liability by having their property assessed as non-domestic. This would be financially advantageous to the ratepayer as liability for Council Tax would be replaced with a liability for Non-Domestic Rates. The resulting bill is often lower than the equivalent Council Tax for a property, particularly if the business letting the property is eligible for Small Business Rates Relief.

The criteria in section 66(2BB) as inserted by the 2010 Order was initially implemented following concerns from Local Authorities regarding loss of income from properties being assessed as non-domestic rather than domestic. To amend section 66 so as to remove the conditions inserted by the 2010 Order and re-insert the previous requirement of the property simply being available for commercial lets for

140 days during the next 12 months would have an obvious impact on the tax-base which funds essential local services.

In addition to the loss of income from taxation, properties that are unoccupied for much of the year can adversely affect the sustainability of local communities as they do not have occupants to use and pay for local goods and services, and can exacerbate housing shortages.

Benefits

There are few perceived benefits in amending section 66(2BB) of the 1988 to revert to the position prior to 1 April 2010 as the realised benefits of closing the tax loophole would be lost, resulting in loss of income for Local Authorities. This would also fail to address the issue of properties that were in fact domestic being unfairly classified as non-domestic for the purposes of rating which was therefore resulting in a lower tax liability and not accurately reflecting the use of the property.

Section 66(2BB) of the 1988 Act as it currently stands means that properties that are not actually let for 70 days in a 12 month period will be assessed as domestic properties and therefore liable to pay council tax to the local authority. It closes the potential loophole whereby owners of what are effectively second homes can be assessed to pay non-domestic rates, and so pay a reduced amount of local taxation, but it does not affect the local tax liability of properties that are genuinely used for commercial letting for at least 70 days in a 12 month period.

To amend section 66(2BB) of the 1988 Act so as to revert to the position prior to 1 April 2010 would exacerbate concerns that have been raised by Local Authorities regarding loss of income from properties being assessed as non-domestic rather than domestic. The issue of some second home owners who are not genuinely commercially letting self-catering accommodation but still seek to be assessed as businesses in order to reduce their tax liability would again become prevalent. This may increase further in light of the forthcoming introduction of Council Tax premiums on second homes, which will increase the financial incentive for owners to have their property rated as non-domestic. It will be important to ensure robust requirements are in place.

Option 3 - Further amend section 66(2BB) of the Local Government Finance Act 1988 by introduction of the amendments laid out in the Non-Domestic Rating (Definition of Domestic Property) (Wales) Order 2016

Costs

The amendments made by the 2016 Order will introduce a new condition which will allow businesses consisting of several self-catering properties at the same location or within very close proximity to have the option to average the number of letting days of the properties to meet the 70-day criterion where they are let by the same or connected businesses. As with the 70-day criterion, this new option will only be available where the existing conditions in section 66(2BB)(a) to (c) are also satisfied.

The amendments made by the 2016 Order would therefore provide additional flexibility in meeting the criteria to be classified as non-domestic which would assist genuine self-catering businesses.

The difference between non-domestic rates and Council Tax on a property can be several hundreds of pounds depending on the rateable value of the property and the available reliefs. While the Regulations are expected to benefit businesses, there is a corresponding loss of tax revenue to Local Authorities.

Detailed guidance will also accompany the amendments being made by the 2016 Order which provides ratepayers with advice regarding the non-domestic rating system and the legislative requirements used to determine how self-catering properties are rated for taxation purposes.

This is the preferred option as it addresses issues raised by virtue of the Order.

Benefits

The 2016 Order makes amendments to section 66(2BB) of the 1988 Act to provide additional flexibility for ratepayers in meeting the criteria by allowing businesses consisting of several self-catering properties at the same location or within very close proximity to have the option to average the number of letting days of the properties to meet the 70-day criterion where they are let by the same or connected businesses.

Detailed guidance has also been produced which provides ratepayers advice regarding the non-domestic rating system and the legislative requirements used to determine how self-catering properties are rated for taxation purposes. The guidance will also ensure ratepayers are fully aware of the proposed changes and offer ongoing advice and support to ratepayers in understanding the rating system.

Delaying the coming into force of the amendments made by the 2016 Order until 1 April 2016 will allow preparation time for the development of communication material to ensure appropriate information is available and communicated to relevant representative groups and businesses. It will also afford ratepayers almost six months notice to ensure they are able to prepare, including time to gather the necessary evidence to demonstrate the criteria are met.

Consultation

In 2013 Ministers commissioned an independent review of the effects of the amendments to section 66 of the 1988 Act made by the 2010 Order. This work was undertaken by the Institute of Revenues, Rating and Valuation (IRRV). Its report commented on the unintended effects which the legislation was having and suggested potential adjustments to section 66 of the 1988 Act.

The Welsh Government launched an initial consultation on IRRV's report in 5 February 2014: this closed on 19 March 2014. 15 responses were received. All interested parties (including organisations in the tourism industry) were asked to contribute their thoughts. Individuals who had previously written to the Welsh Government about the effects of the legislation were also contacted.

The results of the consultation are briefly summarised below:

- Only seven of the responses commented on the actual IRRV report and its contents;
- The remaining eight responses were more general in nature and commented on individual experiences after the implementation of the amendments made by the 2010 Order to section 66 of the 1988 Act;
- Of the seven respondents who commented on the IRRV report, five found the report and some of the recommendations favourable whilst the remainder thought the remit was too narrow or the options for consideration too limited;
- Of the eight responses who did not specifically refer to the IRRV report, three did not think any further amendment was needed to section 66 of the 1988 Act. The remaining respondents either cited their negative experiences as a result of the amendments made by the 2010 Order or commented on the potential unfairness of the legislation.

In addition, the IRRV recommended making the requirements in respect of commerciality clear to owners of self-catering properties. Some owners of properties have complained about a lack of awareness of the new rules so any further requirements or changes would need to be set out clearly and communicated to all members and representatives of the industry.

Following policy considerations and the drafting of the 2016 Order a further technical consultation ran for a six-week period from 3 August 2015 until 14 September 2015. The purpose of this consultation was to ensure that the proposed 2016 Order raises no practical issues in its implementation and does not create any unintended loopholes or unforeseen circumstances. Its intention was also to help to raise awareness of the proposals amongst ratepayers, local authorities and key stakeholders so they are adequately prepared for its implementation. A total of 12 responses were received in reply to the consultation.

A number of points arising from the technical consultation have been identified and considered. The main points are summarised below:

- Most respondents concurred with the intention of the 70/140 day criteria as a measure to close the tax avoidance loophole;
- Some responses suggested that the 70/140 day letting criteria should be raised to 105/210 days in line with HMRC's criteria for Furnished Holiday Lettings;
- A number of concerns that the 70-day benchmark is too high with ratepayers struggling to meet it due to unforeseen or exceptional circumstances and no provision in the 2016 Order to assist ratepayers in these circumstances;
- A suggestion was put forward that ratepayers should be required to obtain permission from Local Authorities before changing the use of a property from domestic to non-domestic which could be reviewed on an annual basis;
- Emphasising the requirement for a clear stance on tax avoidance;
- There should be a requirement for ratepayers to submit letting evidence to Valuation Office Agency on an annual basis;
- Two respondents queried 'the default position' referred to in the guidance which stated that if ratepayers do not meet the non-domestic rates criteria,

they will revert to the default position of being rated as a domestic dwelling. It was queried where this is specifically mentioned under statute and if it was ever consulted upon;
- Concerns regarding when a property is sold it will automatically revert to being rated for council tax;
- The option to average out should apply to all properties owned by a ratepayer, not just where they reside within one curtailment; and
- There is no provision for properties which have been specifically converted to be used as a self-catering property and which do not have permission to be used as a domestic dwelling.

Duties

13. In drafting the 2016 Order consideration has been given to the Welsh Ministers' duty to promote equality and eliminate discrimination.

14. Local Authorities are under general duties to comply with Welsh Language and Sustainable Development duties.

Competition Assessment

15. This Order has been scored against the competition filter test which indicated that there will be no detrimental effect on competition.

Post implementation review

16. The Regulations will be kept under review to ensure they are having the desired impact.