The impact of Business Rates on business

2 April 2019
To: Treasury Select Committee

Introduction and background

1. The British Property Federation (BPF) represents the real estate sector – an industry with a market value of £900bn which contributed more than £60bn to the economy in 2016[i]. We promote the interests of those with a stake in the UK built environment, and our membership comprises a broad range of owners, managers and developers of real estate as well as those who support them. Their investments help drive the UK's economic success; provide essential infrastructure and create great places where people can live, work and relax.

2. Business rates were introduced in the 1990s but have failed to keep up with the times. As a result, successive governments have felt it necessary to introduce multiple reliefs– often complex and temporary in nature – to take the edge off a tax whose burden which has risen inexorably since its inception.

3. To make matters worse, revaluations have been postponed and the agency responsible for administering the system has seen large cuts in its resources, affecting its ability to support taxpayers. We think the business rates system needs reform to better support business and investment and therefore welcome this timely inquiry from the Treasury Select Committee.

4. We would be pleased to discuss our comments with you in more detail. Please do not hesitate to get in touch if you require further information.

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Executive summary

5. Business rates is one of the few taxes whose yield does not rise and fall with the economy, but instead increases annually by a measure of inflation. Until now the total burden has increased annually by the now widely discredited Retail Price Index (RPI). We welcome the government's decision to switch to the more appropriate Consumer Price Index (CPI), but the consequence of almost three decades of uplift using an inappropriate rate of inflation is that the business rates burden is now unsustainably high. From a tax rate of close to a third of rents in the 1990's, the business rates burden is now approximately 50% of rents, the highest rate of recurrent property tax in the OECD.

6. While there are certain fiscally neutral changes that we would recommend, we believe that it would not be possible to make satisfactory improvements to the business rates system without allowing the total burden to reduce. Furthermore, as the way we use property continues to evolve; the business rates system needs to adapt to ensure that it is not stifling business. Our recommendations are intended to make the business rates system more agile and responsive as our towns and cities adapt to changes in our economy and consumer preferences.

The impact of Business Rates on business

Key recommendations

1. **The total business rates burden should be reduced.**
It is not sustainable for the business rates yield to increase with inflation every year. Business rates were roughly a third of rents in the 1990s but are now over 50% of rents. This perpetual increase is not sustainable – and if it is not addressed, will continue to harm the economy of our towns and cities.

2. **The total tax yield should fluctuate in line with the economy.**
Instead of increasing every year by inflation, the tax yield should fluctuate with the economy – to ensure that business is paying tax which is reflective of the wider economic conditions.

3. **The suite of exemptions and allowances should be reviewed and streamlined.**
As the business rates burden has become increasingly unsustainable, consecutive governments have had to introduce a raft of reliefs and exemptions. This not only has consequences on those businesses and industries left bearing the burden, it creates a complex and incoherent system for business. Government should review the suite of reliefs and exemptions to ensure they are still in line with wider government policy objectives and represent good value for money.

4. **Revaluations should take place more frequently, ideally annually.**
While the business rates debate is currently focussed on high streets; the way we use real estate more broadly is evolving as we respond to structural shifts in our economy and changes in consumer preferences. The tax system must be agile enough to respond to these changes across all types of property, to avoid stifling business. To that end, revaluations should be conducted annually to ensure that the business rates burden is shared appropriately between property types and geographies – and businesses are paying a tax which is reflective of the true value of the space they are occupying.

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Scope of the inquiry

> **1. The impact of changes in Business Rates policy since 2017 on businesses, in particular:**
> **- The changes in reliefs and allowances**
> **- The ability of businesses to pay**
> **- The relationship between Business Rates and the behaviour it drives in business.**

7. The multiple reliefs that have been introduced by government are symptomatic of a tax burden on business which is unsustainably high. Moreover, tinkering with ad hoc reliefs does not address the fundamental issues with the business rates system – nor do these reliefs provide certainty to business because of their temporary nature.

> **2. How the current Business Rates system measures up against the following pillars of good tax policy:**
> **- Fair**
> **- Support growth and encourage competition**
> **- Provide certainty**
> **- Be coherent.**

8. Most economists would agree that a recurrent tax is generally less damaging for business and investment than transactional taxes. To that end, we would not advocate for completely removing business rates; but rather addressing the more deleterious aspects of the tax.

9. The table below sets out our recommendations to make the tax fairer and more supportive of growth:

Pillar	**Issues**	**Solutions**
Fairness	Transitional arrangements unfairly penalise those who should pay a lower burden immediately after a revaluation. Increasing the tax burden every year means businesses are paying tax which is out of kilter with the economy. The new Check, Challenge, Appeal (CCA) system is causing undue pressure on business.	Remove downward phasing. Reduce the burden and allow the tax yield to fluctuate with the economy going forward. CCA should be reviewed immediately.
Support growth and encourage competition	The burden is too high, which stifles investment and makes the UK less competitive globally.	Bring the burden down to a more reasonable level which is more in line with international peers. Review business rates in the context of business taxation in the round to ensure that the suite of business taxes is appropriate to capture value as generated in the modern economy.

	As the economy changes and businesses use property differently, the 'fixed yield' nature of business rates means that fewer properties are left to support the same amount of tax. Charging rates on empty space discourages investment and penalises a landlord at the very point they have no rental income to pay a tax. Furthermore, it forces landlords to make short term decisions to let the property as soon as possible, rather than taking sufficient time to ensure the right mix of tenants in a given area. Property Owner Business Improvement Districts (POBIDs) are a powerful tool to help bring together property owners to adapt the high street but have thus far been limited to London. The business rates system disincentives growth as physical improvements to properties lead to immediate increases in rates bills	Review reliefs and allowances to ensure they are still appropriate. Allow the tax yield to fluctuate with the economy. Reintroduce Empty Property Rates at 25% of the normal rate – and extend the rate free period between tenants to 6 months. POBIDs should be extended to the rest of the UK. (More detail on POBIDs in the following section). Introduce the Scottish 'Business Growth Accelerator' to provide a break on rates when an occupier first leases a newly built or refurbished premises – which could be a useful tool to support high street adaptation.
Provide certainty	Infrequent revaluations create uncertainty for business around each revaluation and results in businesses paying rates which are not reflective of the economic environment. The valuation process is not transparent which leads to a greater number of appeals and general uncertainty. CCA has not helped provide transparency and has put undue pressure on business.	Revaluations should take place more frequently – ideally annually. Furthermore, the gap between the valuation date for revaluation assessments and their coming into effect should be reduced from two years to one year. Greater transparency in the valuation process – and review the effectiveness of CCA.
Be coherent	Ad hoc reliefs are symptomatic of an unsustainable burden and exacerbate complexity and uncertainty.	Review all reliefs and allowances to streamline and simplify the tax. Bring the rates burden down to a reasonable level which doesn't require so many reliefs.

3. The economic justification for a property-based business tax:
- The impact of Business Rates on rental prices
- The impact of Business Rates on property prices
- Alternatives to property-based business taxes, such as the proposed digital services tax
- The problems associated with property-based business taxes
- The impact of changes (proposed and actual) of Business Rates on Local Authorities and Councils, and the High Street.

10. ***Impact of business rates on rental and property prices:***

11. We would like to draw your attention to a report by Regeneris Consulting: "Business Rates: Who Pays and Why it Matters". This research sought to better understand the relationship between rents and rates and the implications for investment in real estate. The research drew on Valuation Office Data and rental data over a period of 24 years – which we understand is the longest time series study of this nature.

12. The research concluded that the economic incidence of business rates is shared between landlords and occupiers. On average, approximately 75% of a change in business rates – although initially borne by the occupier – was capitalised into rents over a period of 3 years. This relationship did vary across geographies and asset classes. The association was strongest in the retail sector and in regional markets – including Newcastle, Manchester, Birmingham and Liverpool – with London rentals appearing to be less responsive to changes in business rates.

13. However, the relationship between rents and rates appeared to break down after 2008. This is not wholly surprising given that when the research was conducted in 2015, the rateable values were still based on 2008, pre-recession values – over this time the financial crisis had a large impact on many businesses as well as property and rental values. There were also unprecedented changes to the use of real estate over that period, particularly in the retail sector. Therefore, the outcomes of this research are less helpful at present, particularly in the context of retail, given rateable values are so out of kilter with the true value of the space businesses are occupying.

14. However, the findings may still be helpful in understanding the interplay between rent and business rates in a more functional market. We can infer from these findings that if business rates increase, rental values and (as a result) property prices would decrease. Extrapolating further if the return on a given investment falls, the appetite to invest in that asset falls too, which in the long run would reduce the incentive to invest in modernising our towns and cities.

15. The report also considered the potential impact of rates on development activity on the assumption that the proportion of business rates that is capitalised into rents results in a net loss of reinvestment capital for the landlord or investor. The research calculations suggested that if the rates burden is 75% capitalised into rents over a 3-year period, then an increase in rates of £100m per annum over a three-year period would lead to a **£150m reduction in development capital** and a £150m loss in income for rental tenants, equating to approximately **1,000 jobs foregone**.

16. ***Problems associated with a property-based tax:***

17. As previously noted, most economists would agree that a recurrent tax on property is less damaging for business and investment than one-off transactional taxes, like SDLT or VAT. To that end, we would not

advocate for completely removing a recurrent property tax; but rather addressing the more deleterious aspects of the existing business rates system – most notably:

1. *The total business rates burden is unsustainably high –higher than most international peers.*
2. *The business rates burden increases every year and the tax yield does not fluctuate in line with the wider economy.*
3. *The infrequency of revaluations puts pressure on businesses who are paying rates which are out of kilter with the real value of the space they are occupying.*

18. The delay of the 2015 revaluation, coupled with the large burden has exacerbated the challenges faced by traditional retailers as it has delayed capturing the decline in value of some retail premises. Revaluations should be more frequent, ideally annual, to ensure businesses are paying rates which are as closely aligned as possible with the performance of the property they are occupying.

19. ***Alternatives to a property-based business tax:***

20. A wholesale change to a new tax, such as a Land Value Tax, would put unprecedented pressure on businesses and government alike. We would instead advocate making the necessary improvements to the existing business rates system before considering such drastic wholesale change.

21. However, we firmly believe that the total business rates burden must decrease in order to avoid stifling businesses any further. It is clear that the economy is changing, and the use of real estate is no longer as accurate a proxy for where value is generated in the economy as it once was.

22. To that end, we recommend that an independent review of business rates is carried out, in the context of wider business taxation (including business rates, corporation tax, VAT and employer NICs) to ensure that the government is capturing a fair and sustainable element of the value generated by the modern economy.

23. In addition to ensuring that the suite of business taxes adequately captures value from the economy, the government should consider whether existing property taxes and reliefs are fit for purpose and support growth. To that end, the recommendations of the Mirrlees review of 2011 are still relevant and worthy of reconsideration; in particular:

- The recurrent tax on residential property has historically been much lighter than the equivalent tax on commercial property. To that end, the council tax bands could be reassessed with higher bands added to help fund a reduction in the business rates burden.

- The Mirrlees review also questioned the value of the capital gains tax relief on primary residences, which is estimated to have cost the government £27bn in 2017/18. The review recommended that the primary residence relief could be taken away in exchange for abolishing SDLT. Stamp duty on the acquisition of a property is generally considered to be far more damaging for the economy than a capital gains tax, which is at least only paid when a profit has been made. The SDLT tax yield (£14bn in 2017/18) is significantly less than the cost to government of the private residence relief, so this change would be affordable for government, whilst still leaving money left over to help ease the business rates burden

24. ***High streets and town centres***

25. While business rates are not the cause of the structural shift impacting high streets and town centres; they have exacerbated challenges faced by many traditional retailers. A well-functioning business rates system

should be agile enough to respond to changing values of property across asset classes and geographies. However, the current system has failed to achieve this in the last decade, leaving traditional retailers facing crippling business rates burdens and, in some cases, unable to pay anything in rent.

26. Recently introduced business rates reliefs and allowances have generally been targeted at small businesses, but large 'anchor' businesses are also struggling. There is a symbiotic relationship between small and large retailers on the high street, with traditionally large anchor businesses helping to generate footfall for all retailers. Only mitigating the burden for smaller retailers will not address the challenges of the high street.

27. However, it is important to reiterate that it is not just a retail property issue; the way we work, live and shop is evolving, and this has implications for the way we use all sorts of property. For instance, businesses use less office space than they used to, and the needs of logistics operators are changing too. Therefore, while the pressures on the high streets are at the forefront of policymakers' minds, it is important that any changes to the business rates system reflects the changing use of property more broadly.

28. Instead, the business rates system needs to be flexible enough to reflect changing property values and uses – to avoid putting undue pressure on our high streets and town centres as they adapt for the future. This reinforces the need for a reduction in the total rates burden; more frequent revaluations; and an ability for the business rates yield to fluctuate with the economy.

29. However, even if the government were to implement our recommendations today, it would take time for the business rates system to accurately reflect current values of retail premises. In the meantime, the government should be providing whatever support it can to high streets and town centres to help them adapt. The £675m Future High Streets Fund announced at last year's Budget is a good start, but more is needed, particularly to boost local authority planning teams' capacity to process the work needed to keep their town centres relevant.

30. Another tool we have advocated for in the past is **Property Owner Business Improvement Districts (POBIDs)**.

31. Legislation provides for Business Improvement Districts that are funded and voted on by property owners. Unfortunately, because this was an amendment to the Business Rate Supplement Act 2009, provision for landlord BIDs can only take place in areas where there is already a Business Rate Supplement, which has so far been limited to London. There is significant appetite for POBIDs from other cities; most notably Newcastle and Birmingham. The Local Government Finance Bill 2016/17 included provisions to extend POBIDs to other areas by decoupling the link to a Business Rate Supplement. Unfortunately, this legislation was never passed because of the 2017 General Election.

32. The recent report by the HCLG Select Committee on High Streets stressed that POBIDs "*could play an important role in bringing landlords into local discussions about high street and town centre transformation."* It further recommended that *"the Government revives the legislation needed to create such a body at the earliest opportunity".* We strongly agree and would support the Committee's recommendation on this matter.

[i] Property Data Report 2017, Property Industry Alliance