Business rates reform

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Introduction

Business rates are widely seen by commercial enterprises, both large and small, as the tax on business that is the least fairly applied, poorly administered and most in need of reform.[1] The principle reasons for the unpopularity of business rates are:

- Their sheer scale in relation to rental values, rising from 34.8 per cent on introduction in 1990-91 to 49.3 per cent in 2018-19.

- As a general tax on business, it takes no account of the financial circumstances or performance of the business on which it is levied. Corporation tax, by contrast, is assessed on the profits of a business and therefore falls on those businesses that are in a position to pay it. Business rates make no such distinction. Being payable without relief – even during tough economic times – only adds to their unpopularity.

- Business rates are always assessed on an out of date measure, specifically the market rent of the business premises on which they are charged. Rental values are only assessed every five years and then only applied two years after the valuation date. Consequently the charge lags market conditions by between two and seven years at any given time.

This has two consequences. First, the increases in business rates are usually more substantial when they occur and are therefore more challenging for businesses to plan for and absorb. Second, when rental values are falling, businesses may for several years be paying higher business rates than the economic value of their premises justify.

Targeted relief

A general reduction of the multiplier (currently 49.3 per cent of rental value) at which business rates are applied would clearly be attractive to business in the short term. However, there is some consensus that occupiers in fact assesses the value and affordability of business premises on a combination of both the rent and business rates when making decisions. The implication cited by many economists[2] [3] is that if business rates are universally reduced, rental value will rise in the medium to long term, taking the combined cost back to or near that prevailing before the cut. This suggests that, over a period of perhaps five to seven years, the initial reduction in the cost of commercial premises would be diluted, as rents rose to restore the combined cost in line with economic value.

[1] British Retail Consortium, *Ensuring fundamental reform of business rates*, 2018, https://brc.org.uk/making-a-difference/priorities/business-rates, (accessed 28 November 2018).

[2] Johnson, P., *Abolishing business rates is not the answer to the high street's problems*, Institute for Fiscal Studies, 9 July 2018, https://www.ifs.org.uk/publications/13132, (accessed 23 November 2018).

[3] Bond, S., Gardiner, B., & Tyler, P., *The Impact of Tax Incentives on Local Real Estate Markets: the Question of Incidence*, 2011.

There is empirical evidence to support this proposition, meaning that any universal reduction in business rates will ultimately benefit the landowners rather than the business occupying the commercial property.[4] [5] That said, freezing the increase in business rates in the short term, say for two years, would provide some immediate relief on costs for business generally.

To target relief more precisely, it is necessary to analyze where business rates present the greatest burden and threat to business occupiers. The current plight of many retailers provides a good example of how the application of business rates fails to respond to changes in economic circumstances. Internet shopping and its effect on traditional retailers is well documented. In summary, online retailers operating on a lower cost base model have taken away turnover from and lowered the margins of high street retailers. Whilst some argue that the implementation of targeted digital taxes may in part redress this balance, the competitive advantage of online operations will remain. The unavoidable result is that the overall gross profit generated by traditional retailers will fall until an equilibrium is established reflecting the publics' shopping preferences.

The economic and rental value of retail locations reflects their ability to generate footfall from shoppers and the sales that generates. To the extent that generation of sales and profits is reduced by the growth of online shopping, rental values for retail locations will likely fall. There are numerous examples among household brands that illustrate this point, with some resorting to the extreme measure of company voluntary arrangements to force landlords to reduce rents on existing leases to survive. This adjustment in rental values is a normal and inevitable result of market changes. Rentals will adjust quickly for new leases, but lag for existing leases with fixed rent review periods (especially those with upwards only reviews).

The problem with business rates in this context is that they do not adjust to falling rents quickly enough. This could take up to seven years currently and still five years if and when triennial reviews are established. During the period that business rates do not reflect the lower level of prevailing rents, businesses are effectively over-taxed on the premises they occupy. The lag can be critical for businesses struggling with a change in market conditions yet suffering the overhead of excessive business rates.

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[4] HM Treasury, *Business rate supplements: a White Paper*, 2007.

[5] Bond, S., Denny, K., Hall, J., & McCluskey., W, *Who Pays Business Rates?*, Fiscal Studies, 1996.

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Proposal

The business rates legislation already allows appeals to the Valuations Office Agency and Tribunal if there is a 'material change of circumstances'. However, economic factors are not included in this categorization within the Local Government Finance Act 1988, even though their effect may be substantial.

The TaxPayers' Alliance is therefore proposing that a material fall in prevailing rental values, say exceeding 10 per cent, would henceforth be considered a material change in circumstances, allowing businesses to appeal and reduce their business rates assessment. This could bring immediate relief for businesses where rents are falling but business rates are not. Making such a change to the Act by statutory instrument would be administratively straightforward.

This change would only apply where rental values are falling, any adjustment for appreciating rents would be covered in the periodic revaluations.

This will benefit companies of all sizes adjusting to changing market conditions, while enduring excessive overheads from both business rates and rents that are too slow to adjust. The government is in a position to react to such situations and positively assist businesses as they adapt to changing market conditions. It is likely that the retail sector would be a significant beneficiary of this policy, as would regions adjusting to changes in their traditional manufacturing and commercial base.

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