

TAX BRIEFING NOTE

BUSINESS RATES

DECEMBER 2017

What are they?

Non-domestic rates, commonly known as business rates, are a tax on the annual rental value of most non-domestic properties. Business rates, along with the community charge (or 'poll tax'), were established in 1990 to replace the rates system. Rates were set out in the Poor Law 1572 and General Rate Act 1967, but pre-existed those acts.

Properties are valued every five years (although the 2013 revaluation was delayed until 2015, meaning new valuations were applied in 2017 instead of 2015) and a rate, or 'multiplier', is set annually for England. The standard rate for 2017-18 is 47.9p, meaning that the liability for a property with a 'ratable value' of £10,000 would be £4,790.

What's the problem with them?

Business rates can be seen as fulfilling two tax functions. The first is to tax the value of the land on which business premises sit. The second is to tax the value of the buildings and any other improvements made to the land. The first leads to very little economic distortion and destruction. The second, by contrast, is highly destructive. The effect of the second dominates.

Taxing the unimproved value of business *land* is relatively unproblematic. Taxing the increase in the rental value of a premises caused by an improvement of nearby facilities or demand will do little to discourage such improvements. Introducing any tax harms incentives but, because owners are largely not responsible for demand or nearby facilities, taxing unimproved land value should not prompt much reduction in their provision.

By contrast, the tax on the value of improvements and buildings is highly problematic. It distorts property use away from commercial use in favour of residential use and other production inputs, because the consumption value of business property is taxed, like all other inputs, through VAT. Taxing its consumption through business rates prompts businesses to reduce their use of commercial property and prompts landowners to shift property away from double-taxed commercial use to relatively untaxed residential use.

To make tax neutral between commercial and non-commercial use, non-commercial use must be untaxed if the consumption goods and services it is used to produce are themselves taxed. The distortions caused by the arbitrary nature of business rates harm productivity and prosperity, leading to lower incomes and fewer jobs.

What should be done?

1. Rule out rises in business rates.
2. Reform business rates to exempt the value of buildings and improvements from the rating, resulting in 'business land rates' to replace business rates.