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EXPERT COMMENT: Business rates: how reform can benefit both business and public services

Kevin Muldoon-Smith, Lecturer in Built Environment Adaptation and Investment at Northumbria University discusses the possible consequences and potential in regards to reforming the business rates system.

Business rates – originally a simple property tax based on a periodical Treasury assessment of rateable value – is being asked by government policymakers to face in multiple directions at once. Business rates are required to be fair, consistent with economic conditions, and to support growth and fair competition. More recently, in 2013, Business rates were also commandeered by Central Government to fund shortfalls in local government funding through the Business Rate Retention System. Local income from business rates has affectively replaced the previous Revenue Support Grant. Business rates are worth almost £30bn per year to the Treasury and are being used to counter the impacts of austerity.

This impossible contortion has resulted in a complex system that is very difficult to follow. Businesses face various multipliers, reliefs and exemption thresholds. In the economic sense, the incidence of the tax also falls negatively on both tenant (in the short term) and property owner (in the long term). While the local government Business Rate Retention Scheme relies on a convoluted web of tariffs, top-ups, safety nets, and levies. It also remains the case that the existing system only rewards business rate growth generated from new property development. Growth derived from existing property is stripped out during the national revaluation exercise – ignoring the value created by local regeneration. This balancing act creates a sense of pity for the business rate system: by asking it to serve so many agendas, it serves none.

Any change in favour of one interest has the knock on impact of undermining the other. For example, the decision by Central Government to maintain a consistent or increasing Business Rate Multiplier following national property revaluation has helped retain more business rates for public spending purposes. Concurrently the call for small businesses to be removed from the business rate system all together has resulted in lower tax rates, rate relief, or a tapered arrangement. However, the consequence is that this higher business rate burden is shouldered by an ever-decreasing number of businesses with larger floorplates. To put this in context, following the 2000, 2005, and 2010 national revaluation exercises, the Business Rate Multiplier was reduced to between 41.6p and 42.2p in the Pound. Following the 2017 revaluation exercise, the multiplier was only reduced to 47.9p and quickly increased to 49.3p in 2018 – one of the highest levels on record.

Business rate reform

A lot of the press attention for business rate reform falls upon the retail sector. However, although clearly an important consideration for retailers, Business rates are not necessarily the cause of market disruption in this sector. Business rates are often relatively high for retailers because they have paid a premium for centrality of location. Rather, the sector is currently beset by myriad structural, macro and micro concerns, which magnify the cost of business rates.

Consequently, business rate reform should not be led by one agenda. Instead, the opportunity should be taken to unite the various considerations and priorities that are reliant upon or demand a reformed commercial property tax in England. This will then provide the opportunity to work backwards to understand how a new system of property tax could be implemented. These considerations and priorities include:

- Being responsive to economic conditions and incentivising investment in property and business;
- Being sensitive to the new world of work that favours hybrid and online business models;
- The need for transparency, legibility and simplicity;
- Sympathy for how business rates fall on various property sectors and locations – for example retail, leisure, office and industrial, all of which experience property tax in different ways and locations;
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Tackling the perversity inherent in empty property rates that at times rewards vacancy more than occupation and has driven a sub-industry in Empty Property Rate avoidance techniques;

- The demand for local government financing which is only projected to increase as society lives longer;
- The need to capture the value created by public spending on physical, social and knowledge infrastructure in local areas.

In facing up to the demand for reform, there is a concurrent interest in Land Value Tax as an alternative arrangement. In contrast to business rates, Land Value Tax is based on location and is levied upon the value of land (with or without in situ property). The central contention is that the value of land is defined by what is happening in the immediate location and wider region. For this reason, Land Value Tax is considered progressive because it captures value invested by society in a given location and potentially aids current calls for local wealth building and inclusive growth. This certainly remedies one of the central concerns with the Business Rate Retention Scheme, that any value increase due to local investment is stripped out during the periodical national revaluation exercise – known as the 'wash through.'

However, England should be wary of viewing Land Value Tax as a panacea for concerns with business rates. A great deal of land simply has no value and demands a certain degree of investment for development readiness. In addition, any reduction in tax may capitalise into higher rents as property owners price in the change. Concurrently, it is not clear how Land Value Tax would deal with the new world of digital platforms that do not have physical footprints, nor the dynamic reality of commercial business that increasingly must switch between use in quick succession – necessitating repeated valuation.

A very English compromise

The economic and ethical argument for Land Value Tax is relatively well made. However, the practicality of moving to this system is not straightforward. It would require massive change to the English institutions of tax, another national revaluation exercise (for residential and commercial land) using a new method of site appraisal (although other countries use automated methods) and the development of a new valuation skill base. Perhaps the biggest obstacle will be political. A switch to Land Value Tax would shine a light on the deeply ingrained practice of wealthy property owners who may not take kindly to disturbance.

The eventual reality may be a compromise. For example, a semi-permanent transition that combines elements of land value, property, and turnover related tax. This balancing act would be similar to the split-rate tax (where land is taxed at a higher rate than property) seen prominently in North America but also include elements of business gain not easily captured in bricks and mortar – for example a Digital Sales Tax. The Digital Sales Tax, announced by Philip Hammond in the 2018 Budget aims to capture value from firms that shift sales and profits between administrative jurisdictions.

The situation is multi-faceted and therefore calls for a partnership based solution that brings together business, property owners, the various tiers of government, and those administering tax. The situation must not be distilled into respective political agendas or departmental budget silos. Nor should it be examined through simplifying principles of economic supply and demand or reduced to cash flow, expenditure ,and finance settlements. Rather cross party consensus must be found that views land and property based tax through a dual prism of business profitability and the payment of local public services.

Any solution must capture the value held in the new world of work and recover the investment put into National and Industrial Strategies and the bottom-up civic efforts of local communities, towns and cities. Such a system reaches into the institutional fabric and identity of local government and how, as a nation, we support, reward and recapture investment in business and economic development.

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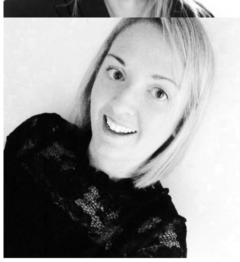

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