Reform and function

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There is widespread agreement that the business rates system needs to change ? but what are the options for fairer and more efficient commercial property taxation?

In recent months, the influential Commons Treasury Select Committee announced an inquiry into the impact of business rates on businesses. At around the same time, the Commons Housing, Communities & Local Government Committee said that, without rates reform, formerly thriving shopping areas ?are likely to become ghost towns and effectively close down altogether?.

So consensus is building in the retail sector that business rates need to change. However, reforming them may have knock-on effects for other parts of the economy and for public finances. In large part the current debate has been led by business occupiers and city-based think tanks. Property professionals have a major role to play in improving this situation.

Reforming business rates may have knock-on effects for other parts of the economy and for public finances

There is clearly considerable pressure on the business rate system, which has to be both fair and consistent with economic conditions. The system is also required to support growth and fair competition in all business sectors. More recently, in 2013, business rates were commandeered by central government to cover shortfalls in English local government funding through the retention system.

This means the local income from business rates has effectively replaced the previous revenue support grant and is worth almost ?30bn per year to local authorities; the business rate system is thus required in part to fund public services ranging from health and social care to libraries and parks. So it?s tempting to feel sorry for business rates. A simple property tax based on a periodical Treasury assessment of rateable value is being asked to perform an impossible contortion, with the result that it pleases no one.

Any change in favour of one interest has the potential to undermine all the others. 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 local public funding purposes. Meanwhile, the continued push to remove small ratepayers ? typically retail concerns ? from the business rate regime has helped to support the high street.

However, the consequence is that a larger rate burden is shouldered by an ever-decreasing number of businesses with larger floorplates. This is particularly acute for retail, office and manufacturing and engineering sectors, which operate from space-hungry premises, although it also affects smaller floorplates in prime areas.

The burden is less for smaller businesses that are taxed at a lower rate, which often benefit from rate relief or a tapered arrangement. To put this in context, following the 2000, 2005 and 2010 national revaluation exercises the business rate multiplier was reduced to 41.6p, 42.2p and 41.4p respectively. After the 2017 revaluation exercise, though, 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

Reform should not be led by the retail sector alone, which is currently beset by myriad structural, large- and small-scale concerns that together magnify business rate costs. Rates are also often relatively high for larger retailers because they have paid a premium for a central location.

Rather, the current situation should be assessed, and the various considerations and priorities identified that rely on or demand reform in both public and private sectors. This will then give an opportunity to work backwards in order to understand how a better-distributed system of property tax could be implemented.

These considerations and priorities include the following:

- responsiveness to economic conditions, and offering incentives to invest in property and business;
- sensitivity to the way work now favours leaner, hybrid business models that mix bricks and mortar with digital interfaces;
- the need to ensure transparency, legibility and simplicity;
- sympathy for the way business rates fall on various property sectors and locations, for example retail, leisure, office and industrial, all of which experience property tax differently;
- tackling the perversity inherent in empty property rates that at times reward vacancy more than occupation, creating a culture of devising techniques to avoid empty property rates;
- the demand for local government financing, which is only projected to increase as people live longer; and
- the need to collect the value created by public spending on local physical, social and knowledge infrastructure.

In facing up to the demand for business rate reform, there is interest in land value tax as an alternative arrangement. Unlike business rates this is based on location, and is levied on the value of land with or without property in situ. The central contention is that the value is defined by what is happening in the immediate location and wider region, and for this reason the tax is considered progressive because it collects value invested by society in a given location, echoing current calls for local wealth-building and inclusive growth.

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 to ready it for development, which suggests a complex system of equalisation between locations and grant funding will still be needed.

Similarly, reducing property tax will not help the high street if the demand for certain retail products simply no longer exists in conventional bricks and mortar formats. Neither is it clear how land value tax would deal with digital platforms that have no physical footprints, nor with the dynamic reality of commercial business that must increasingly switch between uses in quick succession. Perhaps the biggest obstacle will be political: a switch to land value tax would shine a light on the deeply engrained professional practice of wealthy property owners, who may not take kindly to disturbance.

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The eventual reform may be a very English compromise. For example, a semi-permanent transition that combines elements of land value, property and turnover-related tax would resemble the split-rate tax, where land is taxed at a higher rate than property, as seen prominently in the USA. But it would also include elements of business gain not easily collected from physical properties ? for example, a digital sales tax to collect value from firms that shift sales and profits between administrative jurisdictions.

While we should take the opportunity to reform business rates, it will be a very complex process. Property professionals have a key role because they see the daily play-out of the business rate system and the appeals process, as well as the growing relationship between public finances and property performance. Very few property professionals or organisations have contributed to government inquiries on business rate reform or the development of the business rate retention scheme, though, which represents a missed opportunity.

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Further information

- Related competencies include: Capital taxation , Valuation
- This feature has come from the RICS Property Journal (July/August 2019)
- Related categories: Finance and tax , Retail property