



## BUSINESS RATES REVIEW: CALL FOR EVIDENCE – TRANCHE ONE

Issued 18 September 2020

ICAEW welcomes the opportunity to comment on the **Business rates review: call for evidence** published by HM Treasury on 21 July. We will make a second submission on 31 October 2020.

Urgent action is needed before the business rates holiday for retail, hospitality and leisure ends in April 2021. In the current situation many businesses will fail when faced with inflexible rates bills. Those 2021 bills will be based on historical values that do not reflect economic conditions or the rapid shift to online we have seen since the lockdown started.

In the short-term **we believe there is a strong case for a significant reduction in the multiplier**. Currently at more than 50p for each £1 of rateable value, it's simply too high. The multiplier started at 34.8p in 1990 and it's now time to reverse the trend. Reducing the liability is a simple and relatively fair way that government can preserve the core revenue base, while giving time to properly consider further reform of business tax.

In our second response to be submitted at the end of October 2020, we will look at these possible reforms in more detail.

This response of **18 September 2020** has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business.

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## KEY POINTS

1. This is our first submission to the call for evidence. In our second submission we will consider longer-term reforms to business rates. In this submission we look specifically at short-term measures that could be taken to alleviate the problems that will arise in April 2021 when business rates are reintroduced for retail, leisure and hospitality businesses.
2. Fundamentally, we believe that the multiplier now is simply too high. At over 50p in every £1 of rateable value, the tax liability has reached unsustainable levels. Under current conditions we believe that **a significant reset of the multiplier to a lower level is unavoidable**. It is reasonable to expect this to help secure the tax base, albeit at a lower level, while a longer-term review of local government finance and business tax can be carried out. It will also be important to ensure that, in any reset of the multiplier, reliefs for smaller businesses are not impacted adversely.

## ANSWERS TO SPECIFIC QUESTIONS

### Section 3.1 Reliefs

***Question 1 How well do current reliefs and exemptions deliver their intended outcomes and satisfy the principles of good tax design? What changes would you suggest to the system?***

3. The government has responded to the current crisis with a significant and immediate extension to a recently introduced relief for retail, hospitality and leisure businesses. This was the right thing to do in the crisis. These businesses will continue to need support. But we appreciate that government will be seeking ways to reduce the level of support it offers and will wish to ensure that support is fairly distributed. To achieve this, we do not believe reliefs are the right vehicle. It is now time to simply consider a reduction in the multiplier.
4. Each of the current reliefs has been introduced for good policy reasons. Government may wish to sustain support to these businesses in some form, regardless of the outcome of the current review. It is understandable that government policy may wish to support communities through rates reductions, for example for rural communities or the high street.
5. Entrepreneurial small businesses are the lifeblood of the economy. Government has a key role to play in encouraging business formation and providing the conditions for businesses to grow and prosper. Reliefs for small businesses are therefore important and government should keep their effectiveness and targeting under review. We note that in some high rent locations such as central London, even the smallest businesses might not qualify for small business rate relief.
6. Nevertheless, while reliefs and exemptions have some success in delivering their assumed policy objectives, overall, they do not represent good tax design.
7. Typically, business investment could be expected where the incremental cash-flows generated exceed the cost of investment – by lowering costs, reliefs help tip the balance and could encourage investment where it may not otherwise be viable. The pertinent question here, however, is what viability means. In some cases, there could be good, productive business opportunities, but their potential variability mean investors cannot take on the significant fixed cost of business rates. Equally, reliefs might sometimes also support marginal activities that do not have the capacity to pay property taxes – there will often be good policy reasons for doing so, but it is for government to decide whether this is desirable.
8. Ultimately, business rates set at a lower level may need to have less reliance on reliefs.

**Question 2 How can reliefs be targeted more effectively? How can reliefs and their administration be simplified?**

9. Reliefs are a symptom of a system that is not effective in creating the right incentives to encourage productive business activity. This would be alleviated if rates were lower. Longer-term, reform should be targeted at making the system more flexible, to enable it to better reflect economic conditions and support enterprise. Unless changes are made now, it is likely that further and deeper reliefs will be necessary – as we have seen in the current crisis.
10. Properties are exempt from rates if incapable of occupation. This may provide an incentive to delay repair and refurbishment or even for the property to be made unoccupiable. Further evidence would be needed about whether this causes a problem in practice.

**Question 3 What evidence is there on the capitalisation of business rates and business rates reliefs into rents over time? What does any evidence mean for the design of rates reliefs and business rates more broadly?**

11. We do not have any evidence on this point but intuitively, changes to business rates are likely to bear a reasonably close correlation to rental values. Government should consider commissioning quantitative research in order to have a better understanding of this correlation. However, as noted above, the issue is that the economic system should encourage productive business activity; at present business rates act as a potential brake on activity because of their inflexibility. This should be tackled by reforming rates to be more responsive and transparent.
12. When a business decision is made about operating from a premises it will be on the basis of the marginal 'contribution' or cash-flows that can be earned. Those cash-flows are after taking account of the costs of operating from that premises, a significant portion of which is rent and rates. So, if a business has to pay more (or less) in either rent or rates it will affect the viability of operating from that location. There is no perfect correlation, but overall market rents will reflect the local economy and the return that businesses can make by operating there.
13. In theory rates are based on the same factors, but in practice they will be slower to adjust. While rents are also fixed for a period of time, in practice there will sometimes be scope for them to be adjusted to reflect economic conditions – either directly through renegotiation or in some cases the lease may even provide for rents to be linked directly to trading conditions. That means that when conditions change, rents might be expected to adjust more quickly. Of course, this is not a perfect mechanism and sometimes businesses will fail or withdraw from a location because they cannot afford the rent and rates.

**Question 4 What role should local authorities have in determining business rates reliefs and exemptions? Should reliefs and exemptions be set by central government or set locally?**

14. Local authorities should be able to act to promote productive activity, regeneration and development in their areas. Local communities profit from this in many ways and encouraging productive business activities should also be expected to boost funding for local public services. To some extent, this is what happens now. But the design of the business rates system can act as an impediment.
15. The setting of a high multiplier but with many reliefs such as the small business rates relief and lower multiplier, is likely to lead to distort decision making and incentives. There are clear incentives for local authorities in planning to favour large business developments as these are more likely to maximise the business rates charged. This is, therefore, in direct conflict with the Government's wish to encourage the growth and establishment of small

businesses. We need a planning and rates system that do not result in distortions in decision making and/or favour different sizes of businesses.

16. Local Authorities are constrained somewhat by the funding arrangements from central Government. Since the reform to Local Authorities' funding arrangements in 2013 with the introduction of rates retention, Local Authorities are now partially responsible for losses in the rates system, which increases their risk because where rates appeals are resolved (and which are sometimes backdated many years), this can have a significant impact on cashflow. As a result, we understand that Local Authorities consider they are restricted in the amount of local financial assistance they can give. They are also restricted by State Aid limits and can only use locally targeted reliefs up to the State Aid de minimis limits.
17. Local authorities should be able to know how much they will benefit from business, regeneration and development decisions – there should be a clear and meaningful incentive. We understand this is not always the case at present – the system of tariffs and top-ups means that the benefit to local authorities may be difficult to quantify and often less than expected. The national system of reliefs does not flex to reflect local conditions and will be a significant issue for local authorities with a large concentration of exempt activities in their area, often for reasons of historical or geographical coincidence. All of these factors increase uncertainty and hamper good decision making.
18. A complex and potentially opaque local system of exemptions and reliefs, while welcome by those businesses that benefit from them, is unlikely to be helpful overall. Businesses may end up with even less visibility or ability to forecast rates bills, which will be magnified by those operating nationally. They already face the prospect of further divergence within the UK nations. Any local flexibility needs to be coupled with transparency.

***Question 5 Are you aware of ratepayers misusing tax reliefs or other means to avoid paying their full business rates liability? What could be done to tackle this?***

19. As noted above, business rates are a major burden on businesses and it is inevitable that businesses will seek to identify legitimate ways to reduce the burden. No doubt there are also some misuses of the system, but we have no evidence on how widespread it might be. That said, and as noted in the call for evidence, business rates are inherently hard to avoid. Therefore, we would not expect this to be a major problem. The issue is that lack of transparency, flexibility and responsiveness within the system means that businesses lack visibility into their rates liabilities and find it difficult to correct them when they are wrong.

### **Section 3.2 The business rates multiplier**

***Question 6 What are your views on how the business rates multiplier is set annually and at revaluations?***

20. International comparisons show that business property taxes in the UK are high. Given the many concerns raised about the level of business rates on businesses in the UK, this would suggest that the multiplier is now set at too high a level. We note, for example, that in 1990 it was set at 34.8p but the current small business multiplier is now 49.9p, see Chart 1.

Chart 1: The multiplier has increased over time



21. We appreciate that a feature of the multiplier is that it allows government and local authorities to have a stable level of income, rising each year by inflation. This is understandably attractive, but other taxes do not work like that – normally tax revenues track the economy and business activities. Business rates already track the economy both in terms of the number of hereditaments and rateable values, which have both risen consistently over time. But the inflation link for the multiplier has resulted in a long-term trend of a proportionally bigger and bigger tax, as Chart 1 illustrates. We do not believe it is productive for business to bear the cost of producing a stable, consistent and steadily rising revenue stream for government. Property tax revenues will naturally be relatively stable anyway and have high collection rates.
22. More longer-term, it should be noted that the annual multiplier is another symptom of a sub-optimal system. It is necessary because valuations cannot be done annually, so a fixed multiplier is used to enable local authorities to capture growth between valuations (albeit at an overall inflated level, as illustrated above). Although we appreciate the difficulties highlighted in the call for evidence on the time needed by the VOA to prepare the revaluations, we believe that modern technology and system capabilities should help to design a more transparent system that tracks rents closer to real time.

**Question 7 How could the multiplier be set in future to ensure the sustainability of public finances and support growth and productivity? What would the impact of any proposed changes be on the level of the multiplier and revenue from business rates over time?**

23. We do not believe that a multiplier at current levels will prove sustainable in April 2021. To protect the core tax base, we suggest it is now time to reset the multiplier to a lower level. Given the issues with business rates and the rapid shift to online, it may be necessary to accept a permanent reduction in the multiplier. That will alleviate pressures. As government seeks to recover revenues, we believe that a fundamental review of local government finance and business taxes to support that will then be necessary.

***Question 8 How should the multiplier and any supplements relate to business rates reliefs? Should these be discrete, or should supplements fund specific reliefs?***

24. In the crisis the government turned to the reliefs system to rapidly exempt all retail, hospitality and leisure businesses from rates. We do not believe reliefs will be the right vehicle for the recovery, partly because it will be more difficult to achieve a fair outcome. We suggest a reduction in the multiplier will be a simpler and fairer way to support business.

***Question 9 What are your views on introducing additional multipliers that vary by geography, property value, or property type?***

25. This sounds like a complicated solution, although it may have a place in targeting government support to where it is most needed. Currently the annual uprating of the multiplier provides a mechanism to capture growth between revaluations, but it could be used to enable local or national government to address geographical or sector factors. Clearly, reducing rates could help encourage activity in locations/sectors benefiting from reductions. But tax would presumably end up being recouped elsewhere.
26. Overall, we believe that across the economy the multiplier is now simply too high and should be reset. Longer-term government could consider rebalancing taxes to reduce reliance on business property, as well as reforming rates to make them less problematic for businesses. As noted above, one of the key problem areas is that rates do not respond quickly to changes in business conditions – the system needs to be reformed to make rates more transparent and responsive. We will explore this further in our second submission.