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Dear Sirs,

Business Rates Review Terms of Reference and Discussion Paper - Response

Thank you for offering the opportunity to respond to this discussion paper. This letter is my response to the questions raised in the paper.

Blake Penfold is an independent consultancy specialising in business rates advice. I have more than 35 years' experience as a rating consultant in private practice and has been involved with rating appeals in respect of all types of property throughout the United Kingdom and in the Irish Republic, the Channel Islands, and the Isle of Man. As well as appeals before Valuation Tribunals and the Upper Tribunal (Lands Chamber), I have been involved with appeals to the Court of Appeal and House of Lords on matters of rating law. I have also appeared before Local Valuation Appeal Committees in Scotland and as an expert witness in the High Court, at County Court, and in Magistrates' Court proceedings in respect of business rates.

I began my career with H Brian Eve and Company (later Wilks Head & Eve) before joining Hillier Parker (now CBRE) and, most recently, headed the Business Rates team at GL Hearn for ten years. I am a former Chairman of the RICS Rating and Local Taxation Panel and represent RICS on the Valuation Tribunal for England Tribunal User Group and elsewhere, including giving evidence to the Parliamentary Scrutiny Committee on the Business Rates Supplements Bill. I am a past President of the Rating Surveyors' Association and a former member of the Valuation Standards Board of the Royal Institution of Chartered Surveyors.

I have expertise in all aspects of business rates from legislation to liability and all types of property. I also have experience from throughout the United Kingdom, and in respect of property tax systems elsewhere.

I preface my response to the questions in the discussion paper with some comments regarding the business rates system that I regard as relevant to the review, drawn from my experience and knowledge of the system.

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Background comments

Tax Rate

The current level of Uniform Business Rate (UBR) is too high. When the present system was introduced in 1990 the UBR was set at 34.8 pence – a tax rate of almost 35%. At that time Corporation Tax (full rate) was 35%, Income Tax basic rate was 25% and higher rate was 40%. The level of UBR made sense in relation to other taxes.

In 2015/16 the UBR is 48.0 pence with a supplement of 1.3 pence for larger properties – a tax rate of 48% or 49%. Corporation Tax (full rate) is 20%, Income Tax basic rate is 20% and higher rate is 40%.

The level of UBR no longer makes sense in relation to other taxes. I comment further below in my detailed response that property taxes in England are much higher than property taxes in other, competing, economies.

Complexity

The tax regime is too complex. In 1990, when the present system was introduced there were no rates supplements and three possible rates reliefs.

Now there are four possible rates supplements and at least thirteen possible rates reliefs, as well as potential Business Improvement District (BID) rates levies.

The reliefs and supplements have grown in a piecemeal fashion and sometimes conflict one with another, which I comment on in more detail below. Even experienced professionals at times struggle to understand the system.

Lack of Transparency

The business rates system is opaque to taxpayers. In part this is because of the complexity I have described above, but this is also due to the outdated valuation base on which the tax is levied. By the time the present rating list ends in 2017 the values on which it is based will be nine years out of date – an age in the modern economy.

Responses

I set out below my responses to the specific questions in the Discussion Paper:

1. What evidence and data can you provide to inform the government's assessment of the trends in use and occupation of non-domestic property?

The Valuation Office Agency publishes floor space statistics that will show trends in use of non-domestic property and some of this detail is referred to in the discussion paper but, in my view, it is more important to assess the significance of real property (which provides the vast majority of the tax base for business rates) as a proportion of the economy as a whole. Increasingly, economic activity in the UK is based less in real property and more in E-commerce.

According to ONS, E-commerce sales represented 20% of business turnover in 2013, up from 18% in 2012, and an increase of 6 percentage points from the 2008 estimate of 14%.
[http://www.ons.gov.uk/ons/rel/rdit2/ict-activity-of-uk-businesses/2013/stb-ecom-2013.html]
I have not yet seen any equivalent figures for 2014 but suspect the trend towards E-commerce is continuing.

Against this background it makes little sense to me to seek to maintain a set "real terms" yield from a tax on real property.

2. Is there evidence to suggest that changing patterns in property usage are affecting some sectors more than others?

Given the evidence above, it seems very likely that those sectors where value added can also be derived from E-commerce, rather than only from real property, will be affected more than others. This would be likely to include particularly the retail sector and certain elements of the service sector, where the total amount of property usage may be affected.

But in other sectors, such as manufacturing and other parts of the service sector, the change in patterns of property usage is likely to be expressed in a change of the type of property required, rather than in the total amount of property usage.

3. What, in your view, does this evidence suggest about the fairness and sustainability of business rates as a tax based on property values?

The growth of E-commerce suggests a relative decline in importance of real property in the economy and, because of this, property taxes, if maintained at a high level (as at present) may adversely affect the competitiveness of those sectors heavily reliant on real property. The incidence of property taxes needs to be rebalanced and reduced to reflect the decline in relative importance of real property.

4. What evidence is there in favour of the government considering a move away from a property based business tax towards alternative tax bases? What are the potential drawbacks of such a move?

The level of business rates is very high in relation to other taxes and in relation to property taxes in competing markets (see response 5 below). This, together with the increasing importance of E-commerce, suggests that a re-balancing of business taxes would be sensible. This view is supported by the concerns currently expressed by the business community about business rates, which are greater than at any time during the period that I have been involved with the system.

The key potential drawback of such a move is that other business activities can be "offshored", whereas real property cannot. But the imbalance at present is so great (see the evidence throughout this response) that the present system of an ever-increasing tax rate for real property in an economy where real property is of relatively declining importance appears ultimately unsustainable.

The Lyons review in 2007 investigated alternatives in a thorough and comprehensive manner and concluded that a property based tax, if set at fair levels and administered correctly, represented an essential and integral part of a modern tax regime and I consider that this conclusion remains true today. The current difficulties with the business rates system are the result of an overly-high level of tax and an overly-complex system. They do not represent a systemic failure of property tax as a part of a balanced tax regime.

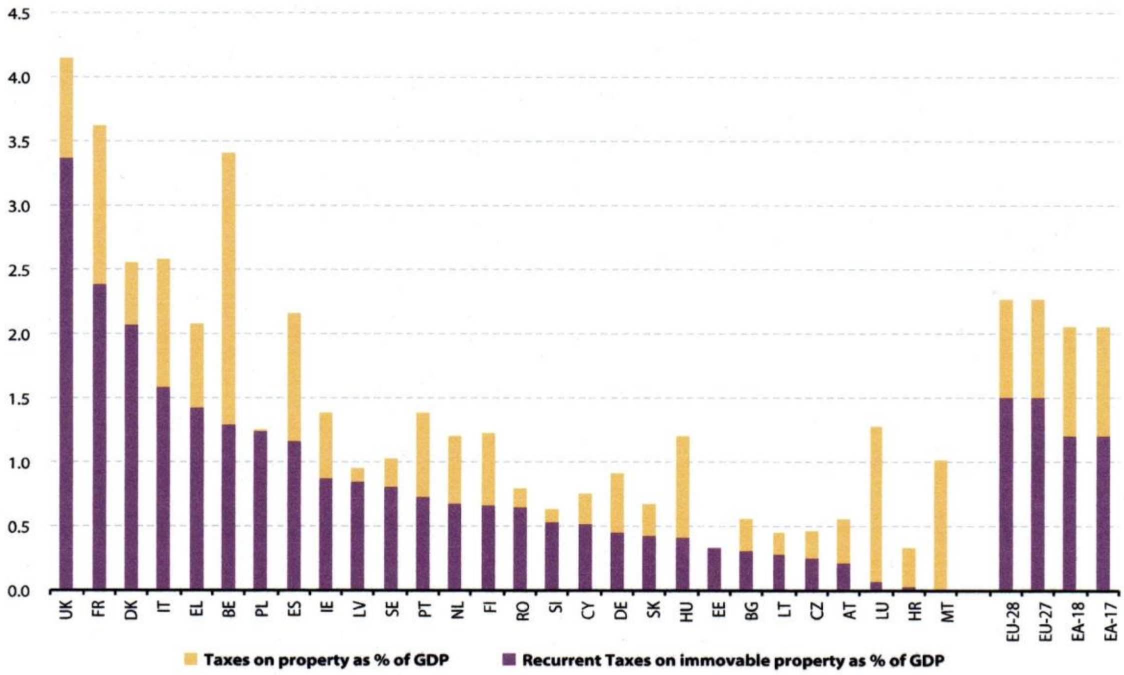
Developed economies all have a place for property taxes, and the current problems with business rates in England could be largely resolved by:

- Freezing and ultimately reducing the tax rate (UBR)
- Revaluing the tax base regularly and frequently
- Reviewing all exemptions and reliefs
- With a view to creating a simpler system at a lower level of tax
- But with less need for reliefs and exemptions

5. What examples from other jurisdictions and tax systems should the government consider as part of this review? What do you think are the main lessons for the business rates system in England?

The level of recurrent (annual) property taxes in the UK is much higher than in competing economies within the European Union. EU Commission data in 2012 shows the following:

Graph 24: Composition of property taxes by Member State, 2012
(% of GDP)



This suggests that annual property taxes in the UK are at more than twice the average for EU-27 or EU-28 members.

The picture appears to be the same if taking a wider range of international comparisons. OECD figures, also from 2012, show taxes on property as a % of GDP as follows:

- United Kingdom 4.2%
- Canada 3.3%
- USA 3.0%
- Israel 2.9%
- South Korea 2.8%
- Japan 2.7%
- Australia 2.3%
- New Zealand 2.1%

This suggests that UK property taxes are damaging the competitiveness of UK businesses, particularly those businesses that are dependent upon real property, and that a rebalancing with other taxes is required.

6. How can government use business rates to improve the incentive for local authorities to drive local growth?

Business rates retention was intended to have this effect, but it appears to have had little effect on local authorities' attitude to driving local growth. Instead, local authorities have focussed on increasing business rates income by identifying properties not presently included in rating lists and by restricting rate reliefs - as "quick wins" in increasing business rates income.

It would be sensible to review the outcomes from the existing, more limited, level of business rates retention and to try to see if there has indeed been any improvement in local growth as a result of business rates retention.

7. What impact will increased local retention of business rate revenue have on business growth? What will the impacts be on local authorities?

Experience suggests that there has been very little change in attitude to new development as a result of the current level of business rates retention. Instead, local authorities have looked to expand the rate base by identifying properties not presently included in rating lists and by restricting rate reliefs. It is difficult to say whether increased local retention will merely see more of those actions or will cause some more fundamental alteration in behaviours.

8. What other local incentives should the government consider to further incentivise business growth?

It would be worth considering reviewing business rates retention to ensure that it acts as an incentive to genuinely new development and economic growth, rather than simply encouraging the types of action identified in responses 6 and 7 above.

9. Should business rates be reformed to make them more closely reflective of wider economic conditions and if so, how?

Yes, business rates should be reformed to make them reflective of wider economic conditions; principally the relative shift in importance between economic activity based on real property (taxed by business rates) and economic activity based on E-commerce and other areas (not taxed by business rates).

To reflect this change over time would involve**:**

- Freezing and ultimately reducing the tax rate (UBR)
- Revaluing the tax base regularly and frequently
- Reviewing all exemptions and reliefs
- With a view to creating a simpler system at a lower level of tax
- But with less need for reliefs and exemptions

Setting a fixed, and realistic, level of UBR multiplier and allowing the yield to fluctuate with the total amount of rateable value would make the tax more reflective of wider economic conditions, provided the tax base is revalued frequently.

10. If business rates remain a property tax, how do you suggest business rates could take into account the individual circumstances of businesses such as their size or ability to pay rates?

More frequent revaluations would be a key means of ensuring that businesses are taxed on the up-to-date value of the property that they occupy.

A proper system of empty property rate reliefs would offer relief to those businesses that, because of contractual or other reasons, have property that they can derive no benefit from.

These changes would increase the transparency of the system. If they were allied with other changes identified in this report the problems of an overly high tax rate and an overly complex system would also be addressed.

11. How does the proportion of total operating costs accounted for by business rates vary by the sector and size of a business?

Earlier evidence (from 1995 research *"The Impact of Rates on Businesses"* commissioned by ODPM) suggests that business rates represent a higher proportion of turnover for smaller businesses than they do for larger businesses. However the research underlying this evidence predates recent changes to small business rate relief.

To answer this question now would require research in the light of the current small business rate relief regime, and also should also be looked at in the light of the complete "basket" of taxes. So, whilst business rates may represent a higher proportion of turnover for smaller businesses than they do for larger businesses, the reverse may be true for employers' National Insurance contributions, for example, or for other taxes. I recommend a researched answer to this question that make proper comparison with other taxes and takes account of the current business rates regime for small businesses.

12. What is the impact of the business rates system on the competitiveness of UK businesses? Are there any particular impacts on SMEs?

The evidence set out above (in response 5) from the EU Commission and from OECD shows that the level of recurrent property taxes in the UK is amongst the highest (and may actually be the highest) of all developed economies. The high level of property taxes in the UK damages the competitiveness of UK businesses. There is also evidence that the EU State Aid rules are restricting reliefs that would otherwise assist business through difficult circumstances.

13. How could the government better target support for SMEs given that the size of a company may not be reflected in the rateable value of a property it uses?

As the size of a company may not be reflected in the rateable value of a property it uses the business rates regime is not a good one to use to support SMEs. Instead, it would be better to provide that support by other means and to reduce the burden of business rates on all businesses by setting the tax at a level that properly represents the significance of real property to the economy as a whole.

14. Should investment in plant and machinery, energy efficiency improvements or other similar property improvements be treated differently by the business rates system? If so what changes could be made?

The whole question of rating of plant and machinery requires review. The last review was by the second Wood Committee in 1995 and this recommended regular reviews of the classes of plant and machinery that are, and are not rateable, so as to coincide with rating revaluations.

There has been no further review since 1995 other than the introduction of two piecemeal reliefs – one of these gives a complete (and permanent) exemption from rates for "good quality" combined heat and power plant, and the other gives a temporary (for a period varying from one day to seven years depending upon the date of installation) exemption for certain micro-generation plant. These reliefs seem inconsistent one with another and wholly piecemeal and unrelated to wider government objectives on sustainability.

There should be a full review of rateability of plant and machinery to include consideration of sustainable energy sources and the effect of carbon reduction commitment and other controls.

15. What evidence and analysis should the government take into account when evaluating the impact of and any changes to the range of reliefs and exemptions present in the business rates system?

As I commented in my introductory remarks, the tax regime is too complex. In 1990, when the present system was introduced there were no rates supplements and three possible rates reliefs.

Now there are four possible rates supplements and at least thirteen possible rates relief, as well potential Business Improvement District rates levies. There are also at least nineteen different exemptions from business rates.

The reliefs and supplements have grown in a piecemeal fashion and sometimes conflict one with another. An example of this is the conflict between Small Business Rate Relief (SBRR) and Rural Rate Relief (RRR). The legislation requires RRR to be applied first and does not allow SBRR to be applied to properties benefitting from RRR. The result of this is that, since the level of SBRR for properties below Rateable Value £6,000 was doubled to 100%, properties to which RRR applies cannot benefit from that doubling of the SBRR and are worse off than they would be if RRR did not apply to them. This seems absurd.

There should be a full review of exemptions and reliefs, including empty property rate relief which currently acts to inhibit regeneration and redevelopments.

If the tax was to be set at a more sustainable level reliefs and even exemptions would take on a lesser significance and this might offer the opportunity to extend the tax base without causing damage to business and to the economy.

I confirm that I have no objection to this consultation response being made public. I am happy to amplify or explain anything contained in this response.

Yours faithfully

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