United against a disproportionate tax

Simply reducing business rates may be unrealistic, but there are other options

ON RATING

Blake Penfold

The rating system has never been popular with ratepayers (what tax system is?), but the volume of adverse comment recently has been particularly great. The chief executive of Hammerson has described the increase in business rates as a "crazy situation" and called the system "outdated". Sir Philip Green of Arcadia has called for the system to be reviewed and Justin King of Sainsbury's has spoken of the need to "rebalance the tax burden". The Federation of Small Businesses agrees, calling the system "a blunt tool for maintaining the government's income" and asking for "a major overhaul". It is hard to think of anything else on which these different parties would agree so completely.

How did we get here...?

The problem stems from increasing business rates liability at a time of economic stagnation or even recession. Between 2008/9 and 2012/13 the net amount collected by local authorities from business rates in England increased from £19.1bn to more than £21.8bn, an increase in excess of 14%. During the same period, gross domestic product in the UK has fallen by 3.3%.

This disparity is exacerbated by the fact that an increasing proportion of the economy is not based in real property (which is what is taxed by the business rates system), but consists of e-commerce. The Office of National Statistics suggests that in the period 2008 (its first record) to 2013, the proportion of all retail sales made online rose from 2.8% to 9.7%.

The Local Government Finance Act 1988 allows government to increase the Uniform Business Rate (UBR) multiplier each year by no more than the Retail Prices Index (RPI) measured at the preceding September. The government says that not increasing by RPI (the maximum amount allowed) would represent a "loss" of income. This is an interesting use of the word loss, as it would actually only be an increase forgone.

...and how can we effect change?

Some commentators have suggested that a revaluation, such as the one postponed from 2015 to 2017, would solve the problems of the system. But at revaluation the legislation not merely allows, but requires, the government to take the same income out of the system after the revaluation as before, plus an increase by the amount of RPI growth. Any fall in aggregate rateable values will therefore be offset by a greater increase in the UBR. Yes, there will be a redistribution of the rates burden, but this will only be between different parts of the property sector. There will be no fundamental shift in liability from the sector as a whole.

Others have suggested an internet sales tax to part replace business rates. This feels like jumping out of the frying pan and into the fire. Most retailers now make a significant proportion of their sales online and such a tax would be damaging to their businesses. Lord Wolfson, chief executive of Next, summed it up neatly, describing the proposal as "simply shifting the burden" in a way that is "detrimental for consumers, jobs and investment". The Treasury seems to have come to the same conclusion, saying that it does "not favour a specific tax targeted at the online sector, although we aim to ensure that tax principles are developed which can be applied consistently across the economy".

> Exemptions and reliefs have no clear logical basis and little internal consistency

The realistic options

So what can ratepayers realistically seek from government that might help alleviate the problem of rising business rates at a time when the economy is stagnant and real property is a relatively declining proportion of the economy?

First would be a review by government of what is an economically sensible level of UBR, given other corporate and personal taxes. When the UBR was first introduced it was set at 34.8p. In that year (1990) the basic rate of income tax was 25%, higher rate income tax was 40% and the full rate of corporation tax was 34%. A UBR of approximately 35% made sense.

This year, the UBR is 46.2p, but it is enhanced by a number of supplements and reaches 49.5p for large properties in the City of London. The basic rate of income tax is 20%, higher rate income tax is 40% and the full rate of corporation tax is 23%. A UBR of more than 46% is out of proportion with other taxes.

Second is a review of whether an annual RPI increase is still appropriate. It is largely this which has caused the current problems. There is no logical reason why the rate of this tax should be treated differently to any other. Surely the level of business rates should be reviewed annually along with other tax rates? Businesses could be protected against unpredictable increases by legislation that required a notice period for any change in the rate of UBR.

Third is a review of exemptions and reliefs. These have grown up piecemeal over many years and have no clear logical basis and little internal consistency. I have identified at least 18 exemptions and 10 reliefs, plus another due to take effect from September this year. Sewers are exempt but sewage treatment works are not. Micro-generation plants are temporarily exempted but combined heat and power plants (of good quality) have a permanent exemption. Where is the economic logic in these differences?

Fourth is a review of the frequency of revaluations. While a revaluation will not shift the tax burden away from the real property sector, it will help to keep rateable values in touch with the real world. Technological advances have allowed annual revaluations in some countries and more frequent revaluations might reduce the incidence of appeals, thus reducing the costs of running the system rather than increasing them. A move to three-yearly revaluations with a valuation date one year ahead would mean that values would never be more than four years out of date.

It takes a powerful set of circumstances to unite landlords, tenants, and large and small businesses, as is the case with opposition to business rates. Given the state of public finances, it is unrealistic to expect an immediate reduction in business rates, but a review of these items would represent a reasonable start.

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