2 April 2019

CBI SUBMISSION TO THE TREASURY SELECT COMMITTEE'S INQUIRY INTO THE IMPACT OF BUSINESS RATES ON BUSINESS

As the UK's leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

Business rates is a key priority for CBI members, who feel the system is broken and in need of urgent reform to ensure it is fair and sustainable to support growth and prosperity in the UK. We are therefore supportive of an inquiry into the impact of business rates on business and welcome the opportunity to provide evidence.

Executive Summary

Business needs certainty and predictability to be able to make decisions that shape their future growth. Business rates represent a significant cost for businesses, playing a role in key decisions such as investment, that are vital for the growth and prosperity of the UK economy.

- **The burden of business rates is high and increasing.** Business rates represent a significant tax burden to business: 14 pence in every pound of tax paid by business is in business rates. In 2017/18 business paid £27 billion in business rates, which is over half of what business paid in corporation tax and almost the equivalent of the defence budget that year. This burden has been increasing over time, outpacing growth in overall tax revenues, as well as other business taxes.
- **The UK relies more heavily on property taxation than the rest of the G7.** As a percentage of GDP, property taxes are the highest across the G7 and this has been increasing over the past decade, whilst over the same period countries such as the US and Japan have seen a decline. Consequently, this makes the UK less attractive to international investment, particularly when that investment includes the acquisition of commercial property.
- **The burden is disproportionate across sectors.** Although not designed to target specific sectors, the reliance of certain business models on commercial property results in a disproportionate amount of the tax burden falling onto consumer services, logistics and manufacturing firms.
- **Business rates do not flex with the economic situation.** The system does not allow the tax liability to move in line with the economic cycle (as is the case with other taxes), meaning it does not reflect a business' true ability to pay. Instead, the multiplier increases every year, increasing the business rates burden regardless of the economic situation. In addition, having revaluations only every 3-5 years accompanied by a 2-year gap between the valuation date and the impact on the business rates bill means than business' annual payments do not reflect actual property values.
- **Business rates impact investment decisions.** Business rates is a key factor when making decisions on both large capital investments where the return is realised over a longer period and smaller investments, such as improvements or upgrades to existing properties. The current level of business rates burden often means such investments are not economically viable.
- **The recent revaluation disproportionately affects regions across the UK.** While on average the rateable value of properties has increased by 9% over the most recent revaluation period, the regional disparities are significant. At one end of the spectrum, Hackney saw a 46% increase in its average rateable value, whereas Redcar and Cleveland saw a 20% fall and some areas such as Wyre saw no change. However, due to transitional arrangements a fall in the rateable value following revaluation does not immediately reduce the business rates bill. Businesses who see a fall in their rateable value tend to be in areas that have also seen a slower recovery in economic activity, further hampering the growth of those businesses.
- **Fiscal neutrality constrains policy makers.** The existence of transitional arrangements is a consequence of fiscal neutrality, meaning those who benefit from a lower rateable value following a revaluation are unable to benefit from the reduced rateable value immediately. Furthermore, when

seeking to make the system fairer, policymakers are constrained by fiscal neutrality rules, meaning small targeted reliefs are typically the changes announced during fiscal events which only support a small share of business rates payers.

- **Previous policy changes have not gone far enough.** Previous changes have been targeted at specific areas of the economy. Reliefs are most effective when there is a clear market failure that is disadvantaging one area of the economy over others. However, adding more reliefs only makes the system more complicated. The more sticking plasters are added, the greater is the signal that the system is broken and in need of a rethink.
- **The check challenge appeal system is not working**. Engaging with the new appeals system is challenging, which is adding to the administration burden associated with paying business rates. The new system does not provide transparency over a business' business rates assessment. Consequently, there is an increasing sense of unfairness within the system.

Recommendations

It is the view of the CBI and its members that the business rates system is urgently in need of significant reform to put business rates back on a sustainable path to supporting investment, economic growth and prosperity across the whole of the UK. A crucial step in achieving this is the following:

1. Conduct an independent review of the business rates system ahead of the next revaluation, with the objective of reducing the rates burden on individual businesses over time. This review should:
    - Consider the impact of business rates on business in the wider context of business taxation, as well as including an impact assessment on a range of alternative options that should subsequently go out to consultation.
    - Review how the distribution of business rates payers has changed over time, with a focus on the sectoral and regional distribution of these rates payers.
    - Review the scope of rateable plant and machinery to ensure it is better aligned to the modern economy and is consistent with other government initiatives.
    - Review the current suite of reliefs available to ensure they are correcting clear market failures and represent good value for money.
    - Move towards annual revaluations to ensure rateable values are in line with current market conditions.

While a review is a necessary step to fundamental reform, conducting a thorough review of the business rates system will take time. As this review takes place, the challenge of the current business rates system will continue to impact business decision making, stifling investment and growth. To support businesses at the present time, we are calling on Government to adopt the following recommendations at Autumn Budget 2019:

2. Introduce a similar measure to Scotland's Business Growth Accelerator that enables new properties or improvements to existing properties to receive a 12-month holiday from business rates payments.
3. Introduce a strict set of guidelines setting out in what circumstances local authorities should grant partly-occupied relief. This should be revenue neutral to local authorities such that any relief granted should be reimbursed by central government.
4. Transitional arrangements should be removed for properties whose rateable value decreased because of the 2017 revaluation. The rates bill of these properties should reflect the 2017 rateable value, while upwards transitional relief should be maintained.
5. The check challenge appeal system should include a workable VOA portal and business rates valuations should be transparent, with the evidence upon which values are based being made available to rate payers.

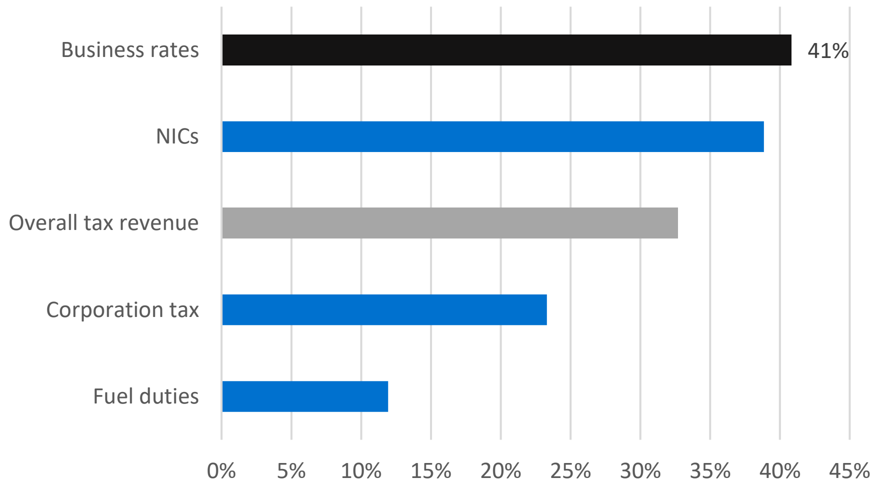
The ability of businesses to pay

Business rates place a significant burden on business

Business recognises the importance of business rates as a source of revenue for both central and local government, accounting for 4%[1] of total tax revenue and 16% of local government revenue.[2] However, business rates are a major sticking point for a lot of businesses who are finding the ever-increasing burden a major factor when making decisions critical to their future growth: a challenge for businesses of all sizes and across many sectors of the economy.

Business rates represent a significant tax burden to business: 14 pence in every pound of tax paid by business is in business rates.[3] In 2017/18 businesses paid £27 billion in business rates, which is over half of what business paid in corporation tax[4] and almost the equivalent of the defence budget that year.[5] Business rates is the third largest business tax after national insurance contributions and corporation tax. This burden has been increasing over time, outpacing growth in overall tax revenues, as well as other business taxes.

Exhibit 1: Growth in nominal tax revenues since the financial crisis (2007/08-2017/18)

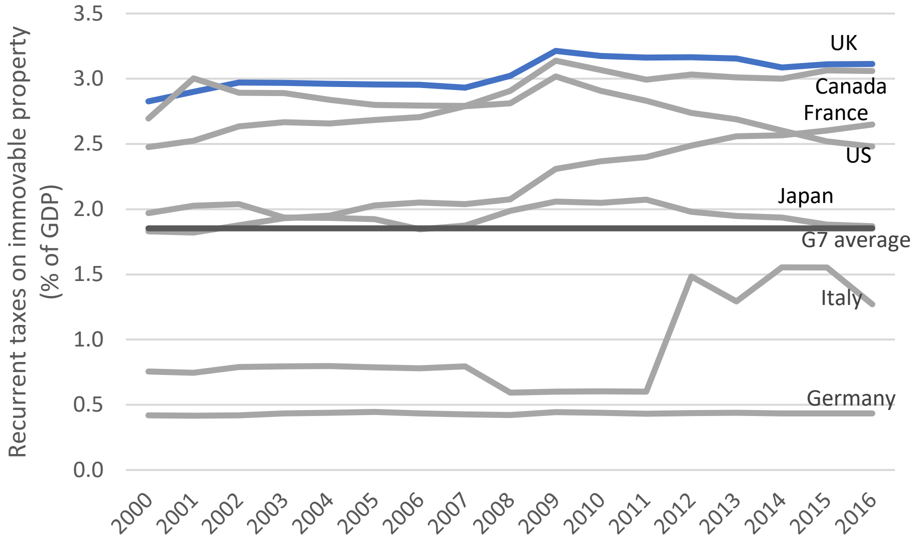


Source: CBI analysis of ONS receipts data for the years 2007/08 and 2017/18

Furthermore, the burden in the UK is significantly higher than its international counterparts. The UK relies more heavily on property taxes to fund public services. As a percentage of GDP, property taxes are the highest across the G7 and this has been increasing over the past decade, whilst over the same period countries such as the US and Japan have seen a decline. Consequently, this makes the UK less attractive to international investment, particularly when that investment includes the acquisition of commercial property.

[1] Reflects 2017/18 data, ONS receipts September 2018.
[2] Reflects 2017/18 budget data, Local authority revenue expenditure and financing England: 2018 to 2019 budget.
[3] CBI analysis on ONS receipts data published on 21st September 2018.
[4] ONS public sector current receipts, September 2018.
[5] Based on Departmental settlements set out at Spending review 2015.

Exhibit 2: Annual property taxes across the G7



Source: Recurrent taxes on immovable property, Global revenue Statistics Database, OECD

At the same time digitalisation is increasing, business models are changing, and Brexit uncertainty is looming. Inaction on business rates only adds to an increasingly challenging business environment, stifling growth and investment. With the gap between UK business investment and the rest of the G7 widening, the policy environment has a role to play in providing firms with the confidence to invest.

There is a real opportunity for Government to act and start thinking about what longer term reform looks like.

Recommendation 1: Conduct an independent review of the business rates system ahead of the next revaluation, with the objective of reducing the rates burden on individual businesses. This review should consider the impact of business rates on business in the wider context of business taxation, as well as including an impact assessment on a range of alternative options that should subsequently go out to consultation.

The increasing burden impacts some sectors more than others and discourages businesses to invest

Although not designed to target specific sectors, the reliance of certain business models on commercial property results in a disproportionate amount of the tax burden falling onto some sectors. Almost 70% of rateable properties are shops, offices, warehouses and factories[6] and therefore businesses using these types of properties will contribute a significant proportion to the total revenue raised from business rates.

The impact on the consumer services sector

It is widely acknowledged that the consumer services sector is undergoing a structural change, with advancements in technology and changing consumer habits leading to a shift away from traditional business models, based on bricks and mortar, towards online and digital retailing. As a result, footfall on high streets is much lower than it used to be. At the same time, subdued consumer spending, as a result of weak real wages, is softening demand growth.

The retail sector is facing significant challenges. Cost increases are hitting retailer margins and, in part, are being passed onto the consumer. The latest CBI surveys show that volumes are falling in the retail sector, which is driving a deterioration in optimism and investment in the sector.[7]

[6] CBI analysis on VOA compiled local rating lists 2017.
[7] CBI quarterly distributive Trades Survey, Q4 2018.

As a result, traditional retailers are changing and adapting, and are increasingly moving towards an omni-channel offering. But this comes with a need for higher investment in an already difficult trading environment. Online retailing involves different costs to those of traditional retailers, including marketing and technology that is required to drive traffic to their websites. The high burden of business rates on traditional retailers is exaggerating these structural changes. A large retailer has cited that their business rates bill in 2017/18 was more than double their corporate tax bill, almost half of total taxes borne by the company and 20% of their entire tax contribution in the UK.

Other consumer services sectors such as the hospitality sector are also feeling the pinch. There has been a significant shift in the type of premises seen on the high street and in retail parks. Consumer services shops such as hair and beauty salons, barbers, takeaways, coffee shops and restaurants, as well as charity shops have been replacing pubs, banks, clothes shops, newsagents and travel agents.[8] This could be partly explained by the shift towards online shopping and therefore a reduced footfall to the high street.

For the former group of businesses, it is likely to be more challenging to transition towards online retailing than the latter group, and in some cases impossible. What is important to take from this is that those in the first group are more likely to receive reliefs from business rates, e.g. charity shops, than shops in the second group, suggesting the tax base could be narrowing.[9]

At the same time, those businesses unable to transition online are facing an increasing burden which in some cases is leading to closures, further reducing the tax base. For example, in 2010 there were approximately 55,000 pubs and, by 2017, there were only 48,000. By the end of the revaluation period pub bills increased by over 17% or over £2,600 per pub.[10]

The impact on logistics business

Logistics businesses rely on warehouses to help manage supply chains by providing storage for goods. These warehouses and any rateable plant and machinery within the warehouse are subject to business rates. As warehouse space is typically used for multiple clients over a defined period, there can often be instances when all or part of a warehouse is unoccupied. In a scenario where the property is entirely vacant, businesses would be able to claim empty property relief for 3 months (or 6 months if an industrial building) and, in a scenario, where part of the warehouse is unoccupied are able to apply for partly occupied relief.

While these reliefs allow for the business rates bill to be reduced in the short term in line with the economic use of the warehouse, sometimes the demand for space is not large enough to compensate for the associated increase in the business rates bill. As a result, the business rates system can in some instances disincentivise the productive use of space even when demand for the space exists. In addition, while empty property relief is guaranteed, the decision to grant partly occupied relief is at the discretion of the local authority and therefore there is a risk that if a portion of the space is occupied, the business could be liable to pay business rates on the whole property. As a result, in some cases it is financially more viable for part of the warehouse to not be rented out.

This has been the case for a leading logistics business in the UK who previously had 500,000 square foot of warehouse space vacant and are benefitting from empty property relief. Although there are multiple business requirements for a small percentage of the space, there is little incentive to utilise the space due to the risk of triggering the full business rates liability.

The impact on manufacturers

Manufacturing and other production industries such as utilities rely heavily on large buildings as well as plant and machinery, which are subject to business rates. Due to the nature of these sectors, there is typically a

[8] The Local Data company collects data on the retail and leisure industry.
[9] The Local Data Company analysed the top four categories of store closures since 2012 and assessed what happened to those units.
[10] Beer and Pub Association.

long lag between an investment decision being made and the investment becoming commercially viable and generating returns for the business. In addition, the size of the investment required up front as well as subsequent investments required to maintain assets are often significant, with returns only realised over several years. Consequently, investment decisions in these sectors are based on long-term assumptions about the tax and regulatory environment, of which business rates are a factor.

In addition, this sector is highly sensitive to short-term market changes and therefore long valuation periods are particularly distortive. This is further exacerbated by the two-year lag between the reference period and the valuation period, which often means this sector is exposed to significant risk.

For Storengy, an energy storage company in the UK, business rates have played a significant role in determining the profitability of the business, as well as their investment decisions. It took 6-7 years between the beginning of the construction of the facility and beginning of commercial operations. The initial investment decision was based on the rateable value for 2009 but the 2010 revaluation resulted in a five-fold increase in their rateable value, while at the same time, the drivers of storage value fell significantly. At the 2017 revaluation, the facility saw a decrease in their valuation but due to the transitional arrangements the business has not been able to reap any of the benefits: their rateable value decreased by 59% but their business rates bill reduced by only 1%. Furthermore, in 2017, business rates accounted for 45% of their total operating expenditure and 40% of revenues, meaning the business has yet to become profitable. This has directly impacted their ability to become a profitable business.

Recommendation 2: Review how the distribution of business rates payers has changed over time, with a focus on the sectoral and regional distribution of these rates payers.

The relationship between Business Rates and the behaviours it drives in business

The impact on investment

The burden of business rates not only impacts significant capital investments in production industries, it affects business investment across the economy. The disproportionately high tax rate disincentivises investors from developing commercial property, encouraging a shift towards the development of residential property. Between 2015/16 and 2016/17 alone, 35% more dwellings in England were converted into residential properties.[11]

As well as affecting investment decisions in new property, business rates also impact the decisions of property owners to further invest in their existing premises. Any capital investments in plant and machinery made by the occupier will increase their business rates bill, and sometimes this can be the deciding factor when evaluating an investment proposal. One business cited that it was more financially viable for them to deactivate a plant than to reinvest in upgrading the assets due to the associated business rates bill.

Business investment is a key enabler of productivity improvements and as a result future prosperity. However, business investment in the UK is falling behind its international peers, accounting for only 9% of GDP, compared to 13% across the rest of the G7.[12] The CBI's report, 'Catching the Peloton', found that this underperformance is only partly explained by a declining manufacturing base and uncertainty caused by Brexit, pointing to a deeper structural issue at play. Even though business has a key role in delivering investment, the Government must ensure the policy environment both promotes and encourages businesses to make investment decisions.

[11] Department for Communities and Local Government, Housing supply; net additional dwellings, England: 2016-17, November 2017.
[12] See the CBI's report "Catching the Peloton": http://www.cbi.org.uk/insight-and-analysis/catching-the-peloton/

The tax system is one lever the Government can use as an enabler of business investment. However, under the current business rates system investing in digital, new technologies and energy efficiency, e.g. fibre optic broadband or solar panels, increases the business rates bill and can therefore act as a barrier to investment.

The scope of plant and machinery was last reviewed in 1993.[13] Since then, there have been a lot of changes in the way businesses operate and the technologies they use meaning the current scope of plant and machinery is not reflective of the modern economy. For example, energy efficient investments will increase a properties rateable value and therefore the business rates bill, which could discourage that investment from taking place. This is inconsistent with the Government's initiatives on energy efficiency and climate change. Similarly, the Government has set out ambitious goals to improve UK digital connectivity, which is contrary to a rates system which raises rateable liability for full fibre networks in the long term. This short-term relief, as with many other temporary rate reliefs, is inadequate to address the structural problems with the business rates system.

The Government should conduct a review of the scope of rateable plants and machinery, which should examine the economic impact of excluding productivity-enhancing investments such as digital infrastructure from business rates.

Recommendation 3: Review the scope of rateable plant and machinery to ensure it is better aligned to the modern economy and is consistent with government initiatives.

Under the current system, businesses that occupy a building for non-domestic purposes are liable to pay business rates annually. The business rates bill is due regardless of whether the building is being used for commercial activities. Typically, there is a lag between the purchase of a commercial property and putting it to productive use, which is not reflected in the current business rates system. In addition, this lag can vary significantly by sector and by business model, placing some businesses at a disadvantage. In some cases, business rates can be the tipping point when deciding whether to invest in a new premise.

A similar situation arises when renovating or expanding part of an existing premise. The business rates bill increases immediately after the renovation is complete, regardless of whether the improvements have started to deliver value for the business. As with new buildings, it can take time for businesses to get back to full operation following facility improvements, but in the interim, businesses will be hit by a potentially significant increase in their business rates bill.

Providing an exemption from business rates for new properties and property improvements for a specified period will give business the necessary time to begin commercial activity before facing the cost of business rates. By reducing the immediate burden, investing in commercial property is more likely to be financially viable.

Recommendation 4: Introduce a similar measure to Scotland's Business Growth Accelerator that enables new properties or improvements to existing properties to receive a 12-month holiday from business rates payments.

Businesses renovating their property could also benefit from partly occupied relief under the current system. Businesses can apply for the relief and if granted, their business rates bill will be apportioned based on the use of the property.[14]

When this relief was first introduced, it worked well and was welcomed by business. However, subsequently empty property relief has been introduced which makes the relief more complex as it does not take into consideration partial occupation.

[13] Rating of plant and machinery: a report by the Wood Committee, 17 March 1993. Link: https://www.gov.uk/government/publications/rating-of-plant-and-machinery-a-report-by-the-wood-committee
[14] Section 44a as set out in the legislation.

However, the increased localisation of business rates means local authorities often do not have an incentive to grant the relief. Revenues from business rates represent a significant share of local funding needed for local infrastructure. One business cited being rejected for partly occupied relief on the basis that the low level of occupation was classified as normal business operations by the local authority.

Reviewing the interaction of partly occupied relief and empty property relief and the circumstances under which partly occupied relief is granted will help to encourage efficient use of space and the accompanying economic benefits. Setting out a strict set out guidelines for granting partly-occupied relief and reimbursing local authorities for any loss in revenue will ensure its effectiveness.

Recommendation 5: Introduce a strict set of guidelines setting out in what circumstances local authorities should grant partly-occupied relief. This should be revenue neutral to local authorities such that any relief granted should be reimbursed by central government.

The impact of previous policy changes

The impact of the 2017 revaluation

Revaluations can result in a significant change in a business' business rates liability and therefore most businesses will be impacted by a revaluation. However, the most recent 2017 revaluation was particularly significant because it spanned the aftermath of a financial crisis, a period of rising property prices.

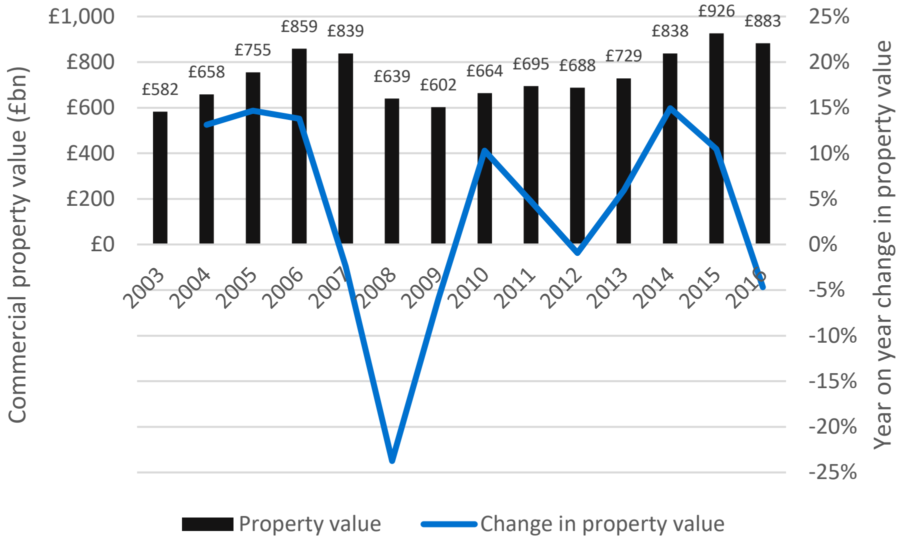
One challenge with the 2017 revaluation was that it covered a 7-year time period when businesses had expected a revaluation to occur after 5 years, but this was postponed. Another challenge was that while the 2017 revaluation was an update to the 2010 rateable values, the assessments were based on property rental values from 2015 and 2008 respectively. More specifically, the antecedent valuation date of 1/4/2008 was at the peak of the market and the economy subsequently went into recession and property prices fell significantly before starting to recover.

During the financial crisis, property values declined (a fall of 24% in 2008 alone), before rebounding in subsequent years as the economy started to recover. However, the recovery in property values has outpaced that of the broader economy, an increase of 45% over the revaluation period compared to GDP growth of just 8%.[15,16] Consequently, the revaluation period was not reflective of the true economic conditions and therefore business' ability to pay.

[15] IPF The Size and Structure of the UK Property Market July 2017, Paul Michell estimates using VoA, Scottish Government and IPD data

[16] ONS Gross Domestic Product: chained value measures seasonally adjusted £m

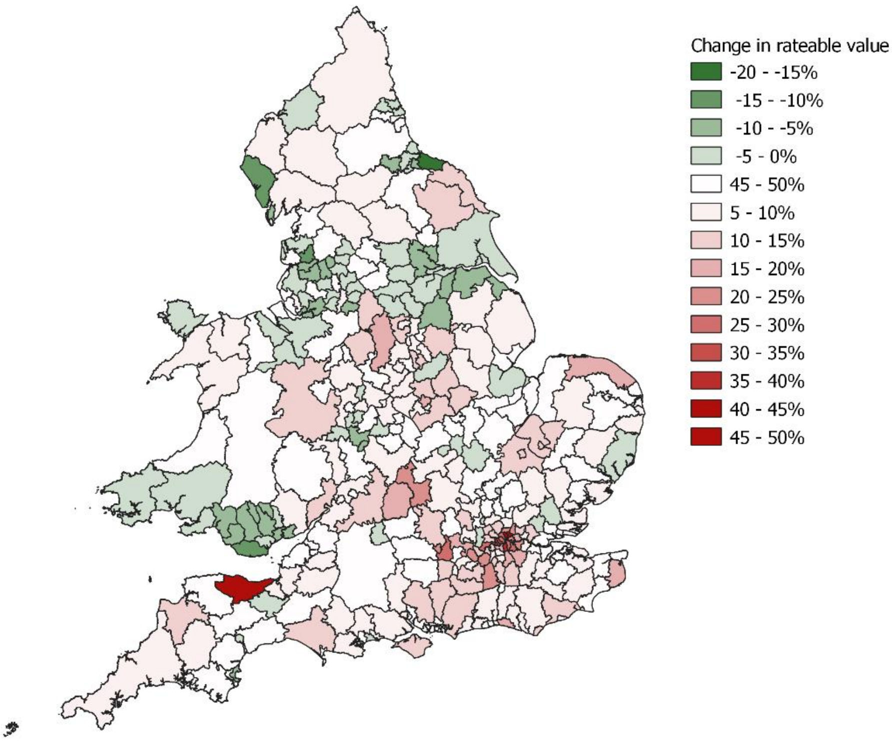
Exhibit 3: Aggregate value of UK commercial property (2003-2016)



Source: Paul Mitchell estimates using VOA, Socttish Government and IPD data.

While on average the rateable value of properties[17] has increased by 9% over the revaluation period, the regional disparities are significant. At one end of the spectrum, Hackney saw a 46% increase in its average rateable value, whereas Redcar and Cleveland saw a 20% fall and some areas saw no change.[18]

Exhibit 4: Change in average rateable value by Local Authority (2010 to 2017)



Source: CBI analysis on VOA administrative data as at 31 March 2017

Businesses located in areas where property prices have increased significantly have been supported by the introduction of transitional arrangements[19], enabling them to adjust to their new business rates bill gradually.

[17] The total value of properties that forms the business rates tax base.
[18] Total number of Rateable Properties, Total Rateable Value and Percentage change in Rateable Value by Administrative area, VoA Administrative Data as at 31 March 2017.

However, as the transitional arrangements are also in place for those properties where their rateable value has decreased, businesses owning these properties have taken on the burden of the overall price shift. As a result, businesses in areas where the rateable value fell are unable to benefit from a reduced business rates bill immediately. Not only are these businesses located in areas where the recovery in property values has been sluggish, these areas have also typically seen a slower recovery in economic activity, further hampering the growth or recovery of those businesses.

Annual revaluations would combat this issue as there will be no need for transitional arrangements. However, recognising that moving to annual revaluations should be a longer-term policy goal, transitional arrangements for those properties facing downward transition following the 2017 revaluation should be removed so businesses typically facing weaker economic growth can benefit from the lower cost immediately. Similarly, there should be no downward transition applied for the 2021 revaluation.

However, capacity constraints at the VOA mean annual revaluations would be extremely difficult, particularly under the current staffing numbers. Self-assessment has been suggested as a solution to this and the Government has previously consulted on this. However, self-assessment was not welcomed by the business community on the basis that it would result in a large compliance burden for businesses who would be required to ascertain the evidence and commission a valuation from a rating expert. If there was an open land registry, so that ratepayers could access every rental transaction, then there may be a role for self-assessment for property taxation.

Recommendation 6: In the longer term move towards annual revaluations to ensure rateable values are in line with current market conditions. In the interim, remove transitional arrangements for properties whose rateable value decreased because of the 2017 revaluation. The rates bill of these properties should reflect the 2017 rateable value, while upwards transitional relief should be maintained.

In addition, the new system does not provide transparency over a business' business rates assessment. Consequently, there is an increasing sense of unfairness and grievance within the system. In some other jurisdictions all information is available online so rates payers can see exactly how their valuation was determined. As a result, the appeals rate is much lower. The VOA should be required to justify its valuations to ratepayers, rather than deny them the relevant evidence and impose an onus on businesses to prove the assessment to be inaccurate.

Recommendation 7: The check challenge appeal system should include a workable VOA portal and business rates valuations should be transparent, with the evidence upon which values are based being made available to rate payers.

Previous policy changes have not gone far enough

The business community recognises subsequent budgets have sought to increase the fairness of the 2017 revaluation through policy changes. For instance, bringing forward the switch from RPI to CPI at Autumn Budget 2017 helped to mitigate some of the impact of the revaluation. However, while this has helped in the short-term, it has only slowed down the speed at which the multiplier is increasing over the longer term. The burden of business rates is still increasing, just at a slightly slower pace.

In addition, several reliefs have been announced that are targeted at those businesses the Government feels have been hit the hardest by business rates. For instance, at the 2018 Autumn Budget, the Government announced a third off the business rates bill for smaller retailers to support the pressures of the high street. This was welcome news for smaller retailers, but the challenge is much broader than this. Businesses of all shapes and sizes across a range of sectors face the burden of business rates.

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[19] Transitional relief was introduced to limit the amount a business rates bill can change as a result of revaluation. Businesses are eligible for transitional relief if the property is in England and their bill goes up or down by a certain amount.

It is often thought that larger retailers can combine the profits and losses from various stores to manage their risk. However, for large retailers, the performance of a store is considered on an individual basis regardless of the profitability of other stores across the country. As a result, business rates play a key role in determining whether a store is commercially viable and can often be the tipping point when taking a decision to close a store. For example, one large retailer has indicated that their decision to close a store in Covent Garden was taken in response to a 40% rise in the business rates bill on that property following the last revaluation.

While the policy response to the 2017 revaluation was relatively more significant given the controversy surrounding it, policy announcements prior to this should also be considered. Most notably is the 2016 Budget where the Government announced a £6.7 billion package following the comprehensive business rates review (announced at the 2015 Budget). While this review was welcomed, it was constrained by the rule of fiscal neutrality, which sets boundaries for policymakers and resulted in only short-term fixes being implemented, rather than sustainable structural reform.

The switch in indexation from RPI to CPI was one of the significant announcements following this review. However, any further action that supported all business rates payers was limited, with other policy announcements being predominantly targeted reliefs for smaller businesses in specific sectors. This has been a theme of many past fiscal events, which means that when looking at business rates payers in aggregate, the changes that have an accompanying fiscal cost have had little, if any, impact on reducing the overall business rates burden.

Reliefs are the most effective when there is a clear market failure that is disadvantaging one area of the economy over others. However, adding more reliefs only makes the system more complicated. The more sticking plasters are added, the greater is the signal that the system is broken. Instead, the solution is for the business rates system to undergo fundamental reform so that adding more reliefs is no longer necessary. A step towards this is an independent review of the system which is not constrained by fiscal neutrality.

Recommendation 8: Review the current suite of reliefs available to ensure they are correcting clear market failures and represent good value for money.

Assessment against pillars of good tax policy

Based on the evidence set out above, the current business rates policy struggles to stand up to the principles of good tax policy making.

Fair

- **Business rates do not adjust with the economy:** The structure of the system does not allow the tax liability to move in line with the economic cycle, which means it does not fully reflect a business' ability to pay. An increase in the multiplier every year increases the business rates burden, regardless of the economic situation. In addition, revaluations every 3-5 years accompanied by a 2-year gap between the valuation date and revaluation results in a business rates bill that is not reflective of current economic conditions.
- **Fiscal neutrality limits the ability of policymakers to create a fair tax:** The existence of transitional arrangements means those who benefit from a lower rateable value following a revaluation are unable to benefit from the reduced rateable value immediately. Furthermore, when seeking to make the system fairer, fiscal neutrality often means only small targeted reliefs are announced which only support a small share of rates payers.
- **The check challenge appeal system is not working:** Engaging with the new appeals system is challenging, which is adding to the administration burden associated with paying business rates.

Support growth and encourage competition

- **Business rates represent a significant burden, which is increasing:** Business rates are a significant cost for many businesses, and this burden is increasing over time. The switch from RPI to CPI supported this but it only helped to slow down the rate of increase. An increasing cost base has consequences for decision making and ultimately growth.
- **Business rates creates economic distortions:** The shrinking reliance of businesses on property results in fewer businesses paying the tax, and the increasing number of reliefs only exacerbates this. As a result, the burden of the tax is falling on a few key sectors in the economy.
- **The current system discourages investment:** Including plant and machinery in the scope of business rates means that business rates is a contributing factor when determining the viability of an investment. Often business rates can be the tipping point when deciding whether to go ahead with an investment.

Provide certainty

- **Infrequency of revaluations:** Having revaluations every 3-5 years limits a business's ability to estimate its future business rates bill and to therefore plan. This is particularly true for longer term investments requiring an in-depth business case – significant variability around the expected business rates bill could result in these investments being deemed commercially unviable.
- **Lack of transparency of the check challenge appeal system:** The new system does not provide transparency over a business' business rates assessment, which is consequently leading to more appeals.

Be coherent

- **Business rates does not support other government initiatives:** The current system discourages investment in several areas of focus for the government such as energy efficiency and fibre optic broadband.
- **The number of reliefs introduced are a sign of a broken system:** Adding more reliefs to the system only reduces the tax base further, increasing the burden on other rates payers.
- **Business rates are inconsistent with other business taxes:** Other business taxes such as corporation tax adjust in line with changes in the economy, are a tax on success rather than operating cost, are not constrained by the rule of fiscal neutrality and do not have an increasing tax rate each year. The way business rates operate is significantly different to other business taxes. The UBR should be fixed with the tax take fluctuating directly in line with changing property values.

What are the alternative options?

Increasingly, alternatives to business rates are being posited. The most straightforward option would be to continue with the status quo, introducing targeted reliefs to support those businesses that are hit the hardest under the current system. However, as has been demonstrated above, the current way the business rates system operates is unfair and unsustainable, and therefore needs to be fundamentally reformed. Business believes that reform to the business rates system is crucial to ensure fairness across business models and sectors within the economy and to provide the right environment to enable businesses to invest and grow.

At one end of the spectrum, the existing system could be fundamentally reformed and at the other end, the Government could replace the system with a completely different system, such as a land value tax. There are also some interesting ideas, particularly in the retail space relating to how to combat the changing nature of retail. Some have advocated for a sales or turnover tax or an online sales tax more specifically, while others have suggested a transactions tax in the place of a property tax. However, adding more taxes is not necessarily the answer. New taxes such as the diverted profits tax, the digital services tax and insurance tax premium have already added complexity to the tax system and adding another tax will only increase this further. Whilst all new taxes have had their reasoning, more taxes create a complex landscape of tax law for businesses to navigate which increases the cost of compliance, increases the risk of errors and opportunities for evasion and ultimately damages UK competitiveness.

Research indicates that well designed taxes on immovable property are less distortive than other taxes. As the supply of property is not very responsive to its price, it is difficult to avoid and easy for the tax authority to identify the tax payer.[20] However, the approach to taxing property can be complex and as the economy modernises and becomes more digitalised, the tax system also needs to evolve. A more digitalised economy brings additional distortions from the business rates system. As property values increase and the burden of business rates rises, some businesses are more sheltered as they can move their trading online, while others that continue to rely on commercial property are more exposed.

Longer-term reform should be considered in the context of the whole suite of taxes borne by businesses. Businesses contributed almost 30% to tax revenues in 2017/18. While the traditional large taxes of corporation tax, NICs and business rates are still the main drivers of this contribution, the list of “other” taxes has been increasing over time, more than doubling since 2009/10.[21] Reviewing taxes independently is likely to discount the interaction between different elements of the tax system and its impact on the effective tax rate, the rate that businesses base their decisions on.

The CBI and its members have yet to develop a clear view on what an alternative system to business rates should look like but are in the process of developing recommendations for the 2019 Autumn Budget.

As a key first step, any tax system should be based on the following principles of good tax policy making:

- **Predictable** – Businesses need to be able to plan when making decisions for the future, and tax law will be one of the deciding factors.
- **Stable** – Stability in the tax rate, the tax base and the tax administration are important in encouraging businesses to make investment decisions effectively.
- **Simple** – Businesses need to be able to navigate the tax system to reduce the risk of error and minimise the cost of compliance.

[20] Tax principles stipulated by the OECD, the IFS and others.
[21] CBI analysis of ONS receipts data