

C|B|I|



# Over-rated

Making the case for business rates reform

September 2020  
Tax and Regulation

In partnership with

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YOUNG**



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## AVISON YOUNG

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### About the partner

Avison Young creates real economic, social and environmental value as a global real estate advisor, powered by people.

As a private company, our clients collaborate with an empowered partner who is invested in their success. Our integrated talent realizes the full potential of real estate by using global intelligence platforms that provide clients with insights and advantage.

Together, we can create healthy, productive workplaces for employees, cities that are centres for prosperity for their citizens, and built spaces and places that create a net benefit to the economy, the environment and the community.

With Government devolution increasing divergence in business rates liability, appeal process and legislation across England, Wales, Scotland and Northern Ireland, our bespoke strategies and solutions have helped over 2,600 clients to achieve a combined £2.2 billion of business rates savings since 2010.

For further information, contact:

**David Jones**

E: [David.Jones@avisonyoung.com](mailto:David.Jones@avisonyoung.com)

W: [www.avisonyoung.com](http://www.avisonyoung.com)



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# Foreword CBI

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Business rates are an integral part of the UK's tax system, raising 4% of government revenue to fund our vital public services. But in their current form, the burden is at an unsustainable level, impacting investment by retailers, manufacturers, and distributors alike, at a time when business investment is already weak. And at the same time, through the very design of the system, we too often see business rates exacerbating regional inequalities.

At the CBI, we have long been campaigning for reform, drawing on our member's experiences to provide insight into how the current system affects business decision making, building the case to reduce the burden to spur investment and growth.

It is great to see the government taking the first critical steps towards reform in England. The announcement of a fundamental review into business rates is hugely supported by the business community. And the publication of the subsequent call for evidence reaffirms that this is a fundamental review, exploring many of the issues we hear businesses grappling with every day.

The Covid-19 pandemic has seen many businesses struggling with cashflow, highlighting the high burden of business rates when faced with a sudden loss of income. We may well now see an acceleration in the growth of online retail and home working, increasing the uncertainty of the future business rates tax base. It is therefore even more crucial that the government uses this review to achieve a fair and sustainable system that works for all businesses and supports long term growth and prosperity.

That is why we have collaborated with Avison Young. Together, we have delivered a set of evidence-based proposals that draws on both of our expertise and insight from the business community. We firmly believe that the recommendations in this paper contribute towards the government's objective of reducing the overall burden of business rates for business while promoting sustainable public finances.



**Annie Gascoyne**

Director of Economic Policy, CBI



# Foreword Avison Young

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The last major reform in the business rates system came in 1990 with the introduction of the Uniform Business Rate and regular revaluation periods. These changes delivered a tax base which offered business greater certainty and equity.

Over the past 30 years, the business rates system, unlike any other tax base, has provided government with levels of receipts guaranteed to rise every year. Conversely business has had to contend with the inexorable increase in the Uniform Business Rate, experiencing real term growth which has outstripped rental performance by 40%. Consequently, the tax has come under increasing scrutiny with calls intensifying for major reform of the business rates system for failing to keep pace with the speed of change across the commercial property sector.

The government has listened, and Avison Young's wide-ranging client base welcome the decision to consider reform. Avison Young believe that there remains a strong case for business rates to continue as part of a diverse tax base. We are conscious that a new replacement tax would create real uncertainty for businesses at a time when they need stability. However, the tax needs reform to ensure it remains both relevant and fair and can adapt to the very different economic landscape we find ourselves in today.

Avison Young has welcomed the opportunity to work with the CBI and to share our skills to deliver a set of well-reasoned proposals, which in this first paper of two, addresses the level of the Uniform Business Rate and considers changes to reliefs, principally around the theme of business equity.

We consider these proposed changes will prove good for business, and therefore the wider economy, and in doing so continue to offer the government the security of income needed to address the commitments made to deliver on public services.



**David Jones**

Principal and Managing Director,  
Business Rates, Avison Young





# Executive summary

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**Business rates are an important source of revenue in England, for both central government and local authorities.** Introduced as a local tax on commercial property, they are an integral part of the UK's tax system to fund our vital public services. As property is fixed, it is simple for a tax authority to identify the taxpayer making avoidance rates low relative to other taxes. It is therefore easy to see why a tax on commercial property is desirable for governments around the world.

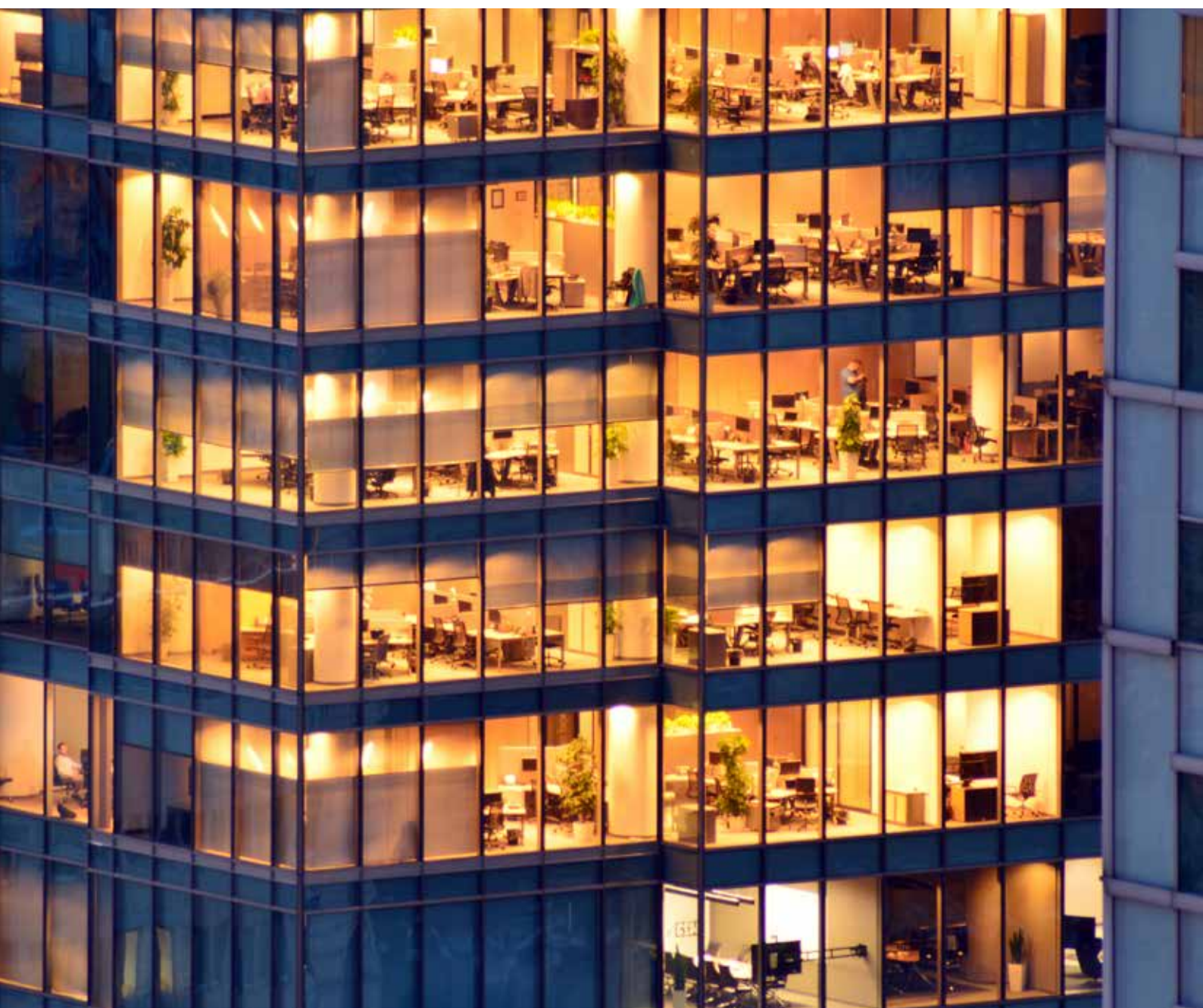
**But, the burden of business rates has now reached unsustainable levels, with the tax rate over 50% and increasing.** Since its inception in 1990, the rate of inflation (based on RPI until 2018) has significantly outstripped rental growth which means that despite an intention for revaluations to bring the UBR back down, in reality what has been observed is an upward trend. Analysis by Avison Young finds that if the government switched to uprating in line with CPI back in 2011, at the same time as other tax liabilities, this could have saved businesses £13 billion over nine years and the UBR should therefore arguably now be around 44p rather than 50p.

**This upward trend is expected to continue at the next revaluation, with the Uniform Business Rate (UBR)<sup>1</sup> estimated to reach the highest on record.** While the government's decision to postpone the next revaluation was the right one to capture the impact of the pandemic, analysis by Avison Young finds that the UBR will increase even further to 51.2p, costing business around £3.2 billion over three years. In reality, the rate may be even higher, as this assumes that Covid-19 does not have a material impact on rental values by April 2021 (the next revaluation date). However, the economic outlook remains highly uncertain with the Bank of England expecting the economy not to return to its pre-Covid-19 levels until the end of 2021.

**A further increase in the UBR would come with a high economic cost, dampening business investment at a time when business investment is already subdued and has been further hit by the pandemic.** Unlike many other business taxes, companies treat business rates as a fixed cost as it needs to be paid regardless of revenue or profits. CBI analysis finds that business rates represents an estimated 6% of firms' fixed costs across the economy. This means that any change in business rates has a direct impact on a firm's bottom line, affecting their decision-making on important areas such as future investment. At the same time, a higher business rates burden increases the associated cost of investing in buildings and plant and machinery, with business rates often being at the margin.

**As the government and business look to build back better there is an opportunity to re-think the future of the business rates system.** Reliefs are a crucial part of this, both to stimulate the economy but to also protect struggling firms. However, some reliefs need a re-think to ensure they meet their intended policy objective. The transitional relief scheme has cost affected businesses almost £1.8 billion, with most of this impact hitting businesses in regions with slower growth. Reforming the transitional relief arrangements therefore supports the government's ambition to level up the economy.

**Reducing the overall burden of business rates has the potential to realise wider economic benefits, increasing tax revenue elsewhere in the tax system.** The ultimate economic impact depends on how businesses respond to a reduction in their fixed costs, but if this is absorbed entirely as a cost saving, firm's profits will increase, boosting business investment and wider economic growth, which in turn leads to tax revenues elsewhere in the system.



# Summary of recommendations

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To achieve a fair and sustainable business rates system that promotes economic growth and prosperity, the CBI and Avison Young have developed a policy package, that we urge the government to adopt at the upcoming Autumn Budget 2020. We believe that this package achieves the government's objective of reducing the overall burden of business rates while promoting sustainable public finances, and meeting the government's ambition to build back better from this crisis.

## **The UBR should be rebased to 44p by 2023 to realign it with growth in rental values**

1. For the remainder of the 2017 revaluation period (up to 2022/23), the government should freeze the UBR at 49.9p and therefore not continue to index it in line with CPI. This is estimated to cost around £0.8 billion in lost gross tax revenue.<sup>2</sup>
2. At the start of the 2023 revaluation, the government should freeze total gross receipts from business rates at £30 billion. Based on an estimated rateable value of £68.7 billion, this would equate to a revised UBR of 44p.
3. For future revaluations the government should continue to set the UBR at 44p so that any business rates revenue growth relates to rateable value growth.

## **The valuation period should be shortened to ensure business rates bills better reflect the economic situation**

4. The government should delay the valuation date until 1st October 2021 and shorten the period between the antecedent valuation date (AVD) and the start of the next revaluation period to ensure the tax more accurately reflects the economic situation.
5. It should also use the upcoming comprehensive spending review to increase the VOA's funding to ensure they have the necessary resource to shorten the valuation period to 18 months and to deal with the increase in challenges from Covid-19. As a starting point this should be at least £9 million to make up for the fall in revenue in 2018/19.



**Reliefs should continue to be targeted to support the most vulnerable businesses, but reform would ensure they also continue to serve their intended purpose**

6. The government should ensure all businesses in downwards transition from 1 April 2021 move onto their new liability following the 2017 revaluation, to reflect the postponement of the next revaluation and provide further support to the recovery.
7. It should also remove transitional arrangements for properties whose rateable value decreases following a revaluation, so the business rates bill of those properties reflects the true rateable value; while upwards transitional relief should be maintained to allow a smooth transition to a new higher business rates bill for those properties. This will cost government in the region of £1.5 to £2 billion.<sup>3</sup>
8. It should consult on alternatives to transitional arrangements that supports those businesses facing a sudden increase in their business rates bill, while allowing those facing a decrease to move to that new bill immediately.
9. Provide retail properties with a relief worth £1.3 billion over the next two years (from 2021/22 to 2022/23) to offset the estimated cost of postponing the 2021 revaluation.
10. Standardise discretionary reliefs across England so there is a consistency in approach.
11. 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 is reimbursed by central government.
12. Introduce a simple system, along the lines of that for council taxpayers, to allow businesses to challenge the mandatory and discretionary relief decisions of local authorities through the Valuation Tribunal.



# The current and future challenges of the business rates system

## Business rates was first introduced as a devolved tax to fund local services

Business rates is a tax on non-domestic property paid for by the occupier of the property; where a property is vacant, the owner is liable for the unoccupied rate. In the UK, business rates is a devolved policy, set by the respective governments in England, Wales, Scotland and Northern Ireland. This paper focuses on the English business rates system which is set by the central UK government.

Introduced in its current form in the 1990s as a way for local businesses to contribute towards local public services, business rates are an important source of revenue for both central and local governments, accounting for 4% of the UK's total tax revenue and 16% of local government revenue in England.<sup>4, 5</sup>

### How a business rates bill is calculated

A business rates bill is calculated for each property as follows:

$$\text{Business rates bill} = (\text{Rateable value} \times \text{Multiplier}) - \text{reliefs}$$

- **Rateable value (tax base):** This is determined by the Valuation Office Agency (VOA), an executive agency of HMRC, based on rental values at a specified point in time. Until 2010, properties have been revalued every five years.
- **Multiplier (tax rate):** There are two multipliers, determined by the government that reflect the rateable value of a property; the small business rates multiplier and the standard business rates multiplier. There are additional supplements applied in specific circumstances.

The applicable business rates for a property combines the rateable value with the relevant multiplier and nets off any reliefs.

As shown by the box above, a business rates bill depends on the multiplier and the property's rateable value, as well as any applicable reliefs. The business rates burden for an individual property or business is therefore impacted by the interaction of the multiplier and the rateable value.





Business rates multipliers are set annually and at every revaluation to maintain government revenue from business rates in real terms. Each year, the multiplier is indexed to inflation and then adjusted at each revaluation to reflect changes in the total rateable value of non-domestic properties in England.

As the tax base is immovable and therefore difficult to avoid, the collection and administration of business rates is relatively simple for government.<sup>6</sup> Avoidance rates are therefore low relative to other taxes (at 2%), making it a desirable tax for government.<sup>7</sup>



## **While business rates are an important source of government revenue, reform is crucial to minimise economic distortions**

As the economy evolves, this brings new challenges for a property-based tax. Over time, longer term structural changes, including the increased use of digital tools in the retail sector and increased automation in the manufacturing sector, mean the business rates system is now operating in a very different environment to the 1990s when it was last reformed. A combination of these changes, amongst others, has resulted in a shrinking tax base (as the total rateable value has not kept pace with the rate of inflation) and a tax rate that is now over 50%.

In 2019/20 businesses paid over £29 billion in business rates across the UK, which is over half the revenue raised from corporation tax in the same year.<sup>8</sup> The UK relies more heavily on property taxes to fund public services than its international counterparts, with property taxes as a share of GDP the highest in the UK across the G7; at 4% compared to 1% in Germany.<sup>9</sup>

These factors create several economic distortions by:

- **Exacerbating regional inequalities.** Revaluations typically penalise those businesses in areas of slower growth because transitional arrangements prevent these businesses from benefitting from a reduction in their rateable value immediately.<sup>10</sup> Research by Avison Young found that 66,000 businesses were affected by downward transition at the 2017 revaluation, with the scheme estimated to have cost businesses almost £823 million in the first year.<sup>11</sup> The hardest hit businesses tend to be in regions of slower growth; the North West and Yorkshire & Humber saw the biggest impact, while at the same time 2018 GDP growth in these regions lagged behind the UK as a whole.<sup>12</sup>
- **Restricting investment in the stock of property in the UK.** The high tax burden and the inclusion of some plant and machinery (P&M) in the rateable value prevent businesses, both national and global, from investing in buildings and some P&M across sectors and regions in England. Despite digitalisation, investment in buildings remains a significant part of business investment, accounting for 42% of the total.<sup>13</sup>
- **Hitting sectors most reliant on commercial property.** Although not designed to target specific sectors, the reliance of certain business models on commercial property results in a disproportionate incidence of the tax falling on retail, services, logistics and manufacturing firms. At the 2017 revaluation almost 75% of rateable properties consisted of what are defined as bulk classes – shops, offices, warehouses, and factories. As a result, businesses occupying these types of properties contribute a significant proportion to the total revenue raised from business rates.<sup>14</sup>

Together, these factors have implications for both the UK's competitiveness and productivity, and by extension the growth and prosperity of the UK economy.



**Covid-19 has created new challenges for the business rates system, as well as reinforcing the urgency for reform**

The coronavirus pandemic has undoubtedly had a dramatic impact on the economy. In the second quarter of 2020, the economy contracted by over 20%.<sup>15</sup> As a result, many businesses have seen a remarkable fall in demand and revenues. This has only reinforced the need for a fair business rates system that reflects economic fluctuations and business' ability to pay.

Accessing the necessary cash flow has been critical for businesses to stay afloat throughout the crisis. The business rates holiday announced by the government has been a welcome support for certain sectors with what is a significant proportion of their fixed costs. However, many small and medium sized firms in the middle of supply chains are still paying a business rates bill based on 2015 rental values which does not reflect the current economic conditions, nor the trends in economic activity seen since 2015.



This is partly because revaluations are not sufficiently frequent to allow a prompt adjustment to economic conditions. Historically, revaluations have occurred every 5 years, with the 2010 revaluation an exception due to the financial crisis. In 2017 the government announced that subsequent revaluations will take place every 3 years. In addition, commercial rents often respond slowly to an economic shock because tenants are generally locked into a lease arrangement. The average lease length for office and retail properties was approximately 6 years in early 2019.<sup>16</sup>

Despite signs of an economic recovery, there may be a long way to go before economic activity returns to pre-Covid-19 levels. Already, the crisis has left many businesses with higher debt levels, adding further challenge to businesses' ability to stay afloat once government schemes come to an end. A slower recovery, coupled with higher indebtedness will reduce the viability of many investment decisions, impacting business investment in buildings, and some P&M in the short to medium term, and in turn the business rates tax base.

The impact of the pandemic on business investment is already being observed in the data: in Q2 business investment fell by 31% over the quarter, reaching its lowest level since 1997.<sup>17</sup> This comes at a time where business investment is already subdued due to Brexit uncertainty.<sup>18</sup> Looking ahead, CBI surveys point to weak investment intentions, with both the services and manufacturing sectors expecting to cut back on investment in buildings and P&M next year.<sup>19</sup> To aid the economic recovery, it is therefore crucial that policy encourages rather than discourages businesses to invest.





There are also signs that structural changes in the commercial property market are likely to occur in the medium to longer term. However, there are several factors at play that mean both the extent and the timing of this change is still highly uncertain:

- **Working from home likely to become a more permanent feature of working practices.** Across all industries, around 51% of the workforce have been working remotely instead of at their place of work in late June 2020.<sup>20</sup> This differs by sector, with the share of those working from home highest in the education (86%) and information and communication (75%) sectors. This has prompted businesses to reassess their property portfolios, with anecdotal evidence suggesting these working patterns are likely to be retained to some degree in the future in some sectors.
- **Some sectors will continue to rely on commercial property.** Many job roles across the economy cannot be performed at home. For example, only 14% of workers in the accommodation and food services are working remotely.<sup>21</sup> Businesses in these sectors will therefore continue to rely on commercial property as part of their business model as the economy recovers.
- **Consumer behaviour could shift even further towards online retail.** Online retail spend has increased significantly since 2007, from 3% of total retail expenditure (excluding fuel) to 19%.<sup>22</sup> The pandemic is expected to accelerate this trend. The CBI's surveys show that, while trading conditions for the retail sector remain tough due to subdued consumer demand and declining household incomes, online retailers saw increased sales volumes month-on-month of more than 30% while retail sales volumes as a whole decreased by 49%.<sup>23</sup>
- **Long leases are likely to lead to a slow adjustment in demand.** In general demand and supply for commercial property can be slow to adjust to economic shocks. On the demand side, this can partly be explained by the structure of the UK's tenancy market, with new leases in the first half of 2019, lasting on average 6.3 years, and rent-weighted leases lasting 10.6 years.<sup>24</sup> This is likely to limit the ability for businesses renting commercial property to adjust their property portfolios in the short term.

While it is too early to observe the full impact, the Office for Budget Responsibility (OBR) considers these effects in their latest coronavirus scenario. They assume commercial property prices fall by almost 14% in 2020/21 and rise slowly in subsequent years, while at the same time they expect commercial property transactions to fall by almost 24%.<sup>25</sup> This is estimated to leave purchase prices 5.5% lower than their forecast back in March, this emphasises the fact that the future UBR is likely to rise.

## Longer term, reforming the business rates system supports the government's ambition to build back better

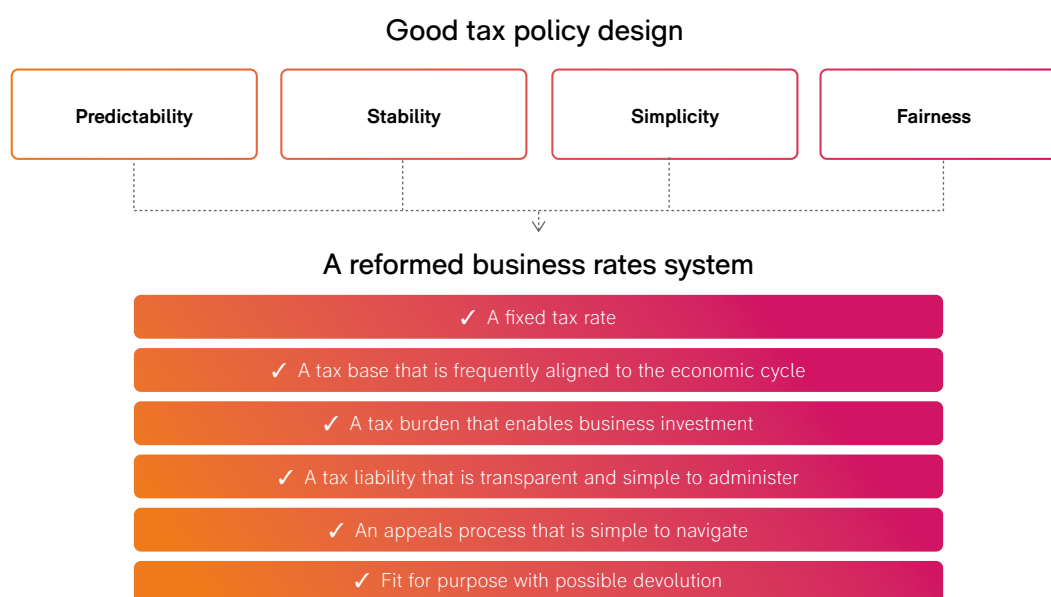
As the government and business look to build back better, there is an opportunity to re-think the future of the business rates system. Businesses need certainty to be able to make investment decisions that will deliver the economic growth needed to help rebuild the economy. Business rates reform has a part to play in both incentivising green investments in the stock of commercial property and in ensuring these investments, and by extension growth, is distributed evenly across the country.

To help achieve these policy objectives, business rates reform should focus on creating a fair and sustainable system in the long-term, which will require fundamental change from the status quo. Both the CBI and Avison Young believe the best way to achieve this is by reforming the existing system so that it not only works more effectively for businesses across the economy, but so that it also promotes sustainable public finances. Replacing business rates with another tax or introducing additional taxes would further complicate an already complex tax system in the UK and add to the cumulative burden of firms.

### **A reformed business rates system should be predictable, stable, simple, and fair to promote growth and prosperity**

As a key first step towards a reformed business rates system, any tax system should be based on the below four 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.
- **Fairness** – The incidence of the tax should be fairly distributed across the economy to minimise economic distortions.

**Exhibit 1** Characteristics of a reformed business rates system

To achieve the above principles of good tax policymaking, the CBI and Avison Young believe a reformed system should continue to be based on annual rental values but with the six characteristics set out in Exhibit 1.

The purpose of this policy paper is to examine the first three of these characteristics. Fixing the tax rate and aligning the tax base to the economic cycle will help to encourage business investment. The remainder of this paper brings together new evidence that builds the economic case for change.

A second research paper by the CBI and Avison Young will consider how the business rates system can better incentivise investment through rateable plant and machinery (P&M), as well as options for improving the administrative processes underlying the business rates system.





# The evolution of the business rates landscape in England

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## **The UBR was introduced in the 1990s to provide a consistent rate across the country**

The Uniform Business Rate (UBR) (or multiplier) is effectively the national poundage that is applied by Government to each commercial property's rateable value. This results in what is defined as the "gross business rates liability". The UBR is calculated at each revaluation, by taking the previous years' gross liability (before any reliefs are applied), adding inflation, and dividing it into the newly assessed pool of rateable values.

The UBR was introduced in 1990 as a replacement for the previous system where each Billing Authority could levy its own rate. This historic approach resulted in over 350 different rates, with significant variations between local authorities, ranging from as low as 122p in the Royal Borough of Kensington & Chelsea to as high as 400p in Sheffield City Council. It was therefore primarily introduced to remove significant variations between local authorities to allow for greater stability in business rates over time.

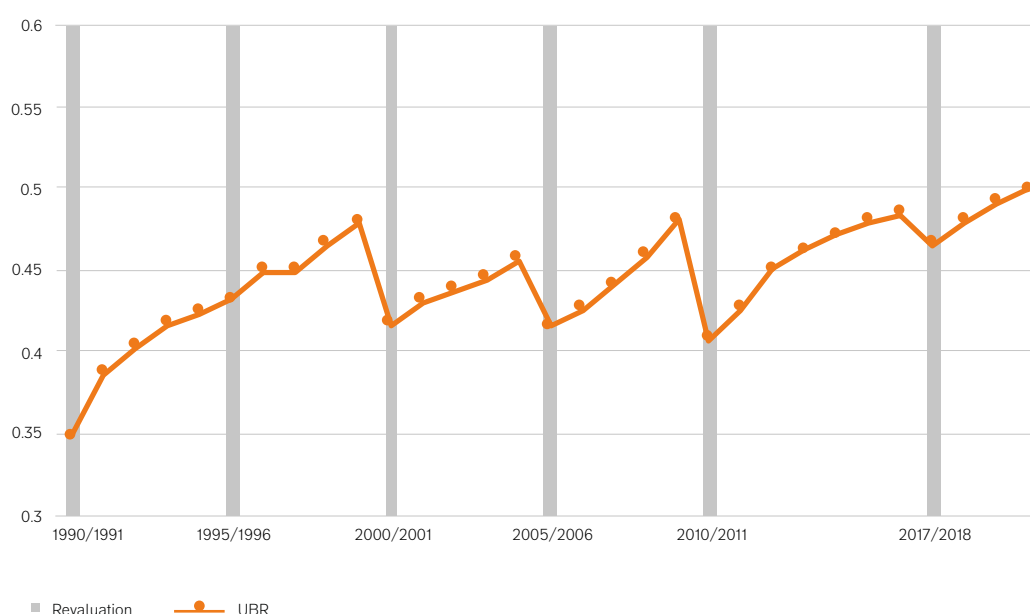
## **Since being introduced the UBR has increased by 44% (to 49.9p), rather than remaining at the intended rate of 34.8p**

On its inception the UBR was calculated and applied at 34.8p for every £1 of rateable value. This was then updated each year by the Retail Price Index (RPI) measure of inflation to maintain growth in government receipts in real terms. The UBR is therefore the lever by which the government annually increases the total amount collected each year in business rates. Unlike any other tax base, this provides a stable revenue source for government.

However, this comes at a cost to businesses who face a tax burden that does not accommodate demand fluctuations. Business rates are treated as a fixed cost rather than a conventional tax which can vary. For example, in 2019/20 corporation tax payments reduced by 10% in a single year following weaker economic activity (real GDP growth slowed in 2019/20 to 0.5% from 1.6% in 2018/19), whereas business rates payments increased by 3%.<sup>26, 27</sup>

The UBR is reset at each revaluation to account for changes in the total rateable value. In a strong market, this allows government to ensure the total bill does not increase above inflation as it can reduce the UBR to better reflect market conditions. The objective of this mechanism was to ensure the UBR would, on average, remain at the original rate of 34.8p, with every revaluation correcting for changes related to movements in the property market. However, as shown by Exhibit 2, the UBR has seen a steep increase in its first decade, and subsequent revaluations have resulted in a much higher UBR, an average of 45p.

**Exhibit 2** The UBR from 1990 to 2021



**Source:** Avison Young Research 2020

The UBR has now reached 49.9p, an increase of 44% over a thirty-year period. This is predominantly because the rate of inflation (which until 2018 was based on RPI inflation), has significantly outstripped rental (rateable value) growth. While Exhibit 2 demonstrates that the UBR does re-base at each revaluation as intended, it is clear that overall, the UBR has seen an upward trend.

### **Switching from RPI to CPI has helped slow this growth, but if changed earlier this could have saved business £13 billion over nine years**

Much of the growth seen above can be attributed to the choice of index used to account for inflation. The switch from the RPI to the CPI method of indexing in April 2018 came after considerable pressure from business due to the consistently higher RPI measure over-inflating the business rates bill.

At the 2010 Budget the government announced a switch from RPI to CPI for the indexation of benefits, tax credits and public service pensions to start in April 2011.<sup>28</sup> Between 2011/12 and 2018/19 RPI has been on average 1% higher than CPI.<sup>29</sup> This RPI-CPI wedge is driven by a 'formula effect' caused by using two different formulae to aggregate prices. If CPI inflation had been applied to business rates at the same time, gross receipts in 2019/20 would have been an estimated 12% lower, resulting in a much lower UBR of 44p.<sup>30</sup> This is estimated to have cost businesses in England £13 billion in additional gross business rates.

### **Reliefs are a crucial part of the business rates system to promote growth, but an increase in their generosity has not offset the cost of a higher UBR**

A key variable in the business rates bill is the business rates relief, which can come in many forms and act to offset some of the liability for business. While reliefs inevitably reduce receipts for Government, the benefits clearly offset the costs by:

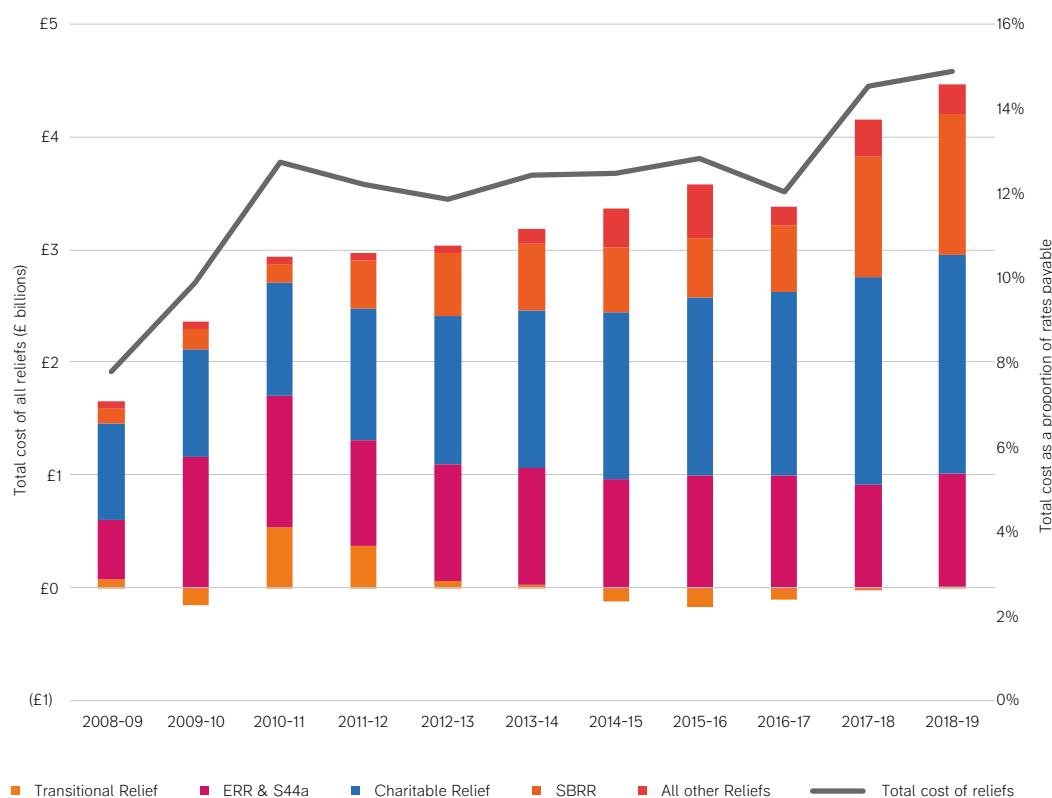
- **Stimulating growth in the UK economy.** Examples include the Government's decision to remove a third of all commercial properties from business rates through Small Business Rate Relief and the 100% business rates exemption granted in Enterprise Zones to encourage inward investment to more deprived areas.
- **Supporting struggling business sectors.** In response to the pandemic, the government provided a business rates holiday to the retail, hospitality, and leisure sectors at a cost of around £10 billion to support some of those most impacted. Similarly, the government has offered targeted help to traditional high street retailers through the Business Rates Retail Discount scheme.
- **Subsidising sectors that make wider social contributions.** An example of this is charitable rates relief that provides a mandatory 80% exemption from business rates to ensure that valuable societal contributions can be made by increasing the sector's viability.
- **Smoothing the impact of significant increases in business rates between revaluations.** Transitional relief enables businesses facing a significant increase in their business rates bill following a revaluation to adjust to the new higher bill gradually over time.

In England, there are currently 26 forms of business rates reliefs (that can be mandatory or discretionary) and 14 classes of exemption. Since 2010 the number of available reliefs has increased more rapidly, from 17 to the current 26 reliefs, but until the 2017 revaluation the proportion of relief granted has stayed broadly the same at around 12.4% of local authority rates receipts. Subsequently, the generosity of reliefs has increased, with reliefs granted averaging around 14.7% since 2017.<sup>31</sup> This increase has broadly resulted from more reliefs being granted to small businesses and through greater help for high street retail.



While reliefs have become more generous, this increase has only gone part of the way to offsetting the cumulative increase observed in the UBR. For example, in 2018/2019, the net business rates receipts (after reliefs) were 27% higher than those in 2010/2011, whilst gross receipts were 30% higher.

**Exhibit 3** Total reliefs and total cost of reliefs as a % of total rates payable



**Source:** NNDR3 reports compiled by MHCLG from Local Authority Returns

The CBI and Avison Young recognise the benefits to Government of using business rates reliefs and exemptions to both promote and provide targeted help to business. It is therefore clear there is an economic rationale to maintain reliefs as part of the business rates system. However, evidence shows that some reliefs are not as effective at achieving the four objectives set out above as others.

**While the 2017 transitional relief scheme helped smooth significant increases, it is estimated to have cost affected businesses £1.8 billion**

Transitional relief limits the amount business rates bills can change each year because of a revaluation, with the aim of phasing businesses to their new business rates bill over time. In England, businesses receive transitional phasing when their business rates bill increases (upward transition) or decreases (downward transition) by a certain amount depending on their rateable value.

This supports businesses located in areas where rental values have increased significantly, enabling them to adjust to their new business rates bill gradually. However, as transitional relief is also in place for those properties with a lower rateable value following a revaluation, businesses occupying these properties take on the burden of the overall price shift as they are unable to benefit from a reduced business rates bill immediately.

Avison Young's research paper, 'Win, Lose or Draw' found that over 66,000 businesses were affected by downward transition at the 2017 revaluation (with a combined rateable value of £6.6 billion in 2017), at an estimated cost of almost £823 million over its first year.<sup>32</sup> And by 2020/2021, almost 10,000 businesses remain affected, and in a scenario with a 2021 revaluation, these businesses would never have paid their true business rates bill from the 2017 revaluation. Overall, by the end of the original four-year 2017 rating period, it is estimated that downward transition will have cost affected businesses almost £1.8 billion.<sup>33</sup>



The burden of that cost is estimated to be disproportionately distributed due to differences in changes in rental values across sectors. Retail is estimated to have fronted almost 38% of this cost (at £688 million), and the industrial sector 15% (£281 million). These sectors are also those that were most severely affected in 2020 by the pandemic, and are therefore paying a fixed cost that does not accurately reflect their true ability to pay.

Transitional relief also has a disparate regional impact because an area with low rental growth is also likely to be an area of slower growth in economic activity, further hampering the growth or recovery of those businesses.<sup>34</sup> Avison Young's research finds that the North West and Yorkshire & Humber saw the biggest impact from the transitional relief scheme, while at the same time 2018 GDP growth in both of these regions lagged behind the UK as a whole.<sup>35</sup> For businesses in these regions, there is therefore a double hit.

### **Discretionary reliefs can create economic distortions if applied inconsistently across England**

A selection of reliefs is available at the discretion of the local authorities. The discretionary element of these reliefs can lead to two unintended consequences:

- **In many cases reliefs are interpreted differently by local authorities.** This can lead to an inconsistency in approach across England, creating distortions between regions. This has been observed during the pandemic, with some more ambiguous business uses being awarded the business rates holiday by one local authority but not by another.
- **There is a financial disincentive to grant reliefs as local authorities' income is reliant on business rates.** The increased localisation of business rates also 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. The partly occupied relief apportions a business rates bill based on the use of the property. When it 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. Partly occupied relief is an important relief as it allows businesses who are not fully occupying their space to receive a discount. This can support businesses when they are not utilising 100% of their space, either because they are facing a fall in revenue or because they are making improvements to their property. In both of these cases, if the relief was granted, this would meet the objectives of reliefs to stimulate the economy and support struggling businesses.



# The impact of future revaluations

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## **While postponing the next revaluation is important, business rates will continue to be out of kilter with the economy**

To account for the impact of the pandemic at the next revaluation, the government announced in July the postponement of the revaluation to 2023 based on rental values at 1 April 2021 (originally set for 2021 based on 1 April 2019 rental values).<sup>36</sup> This means that, under the rules of the current system, the UBR for the financial year 2021/22 will be increased in line with CPI from 1 April 2021 until the next revaluation in 2023, where the UBR should fall to reflect growth in rental values.

As a result, individual rate payers will see an increase in the UBR for two more years, while the tax base this is applied to (the rateable value of their property) will remain as it did at the 2017 revaluation, based on 2015 rental values. Continuing to uprate the UBR by CPI for the next two years could result in a UBR of 50.1p and 50.9p in 2021/22 and 2022/23 respectively.<sup>37</sup>

This will increase the average business rates bill, and in turn firms' costs, at a time when many firms are still expected to be in a recovery phase, and are facing the financial pressures of higher levels of debt. Forecasters including the Bank of England (BoE) expect the recovery to ease from Q3 due to the longer-lasting impacts of Covid-19 such as increased unemployment and lower investment, and therefore do not expect the economy to return to its pre-Covid-19 levels until the end of 2021.<sup>38</sup>

## **Basing the next revaluation on 2021 rental values could result in the highest multiplier ever seen, costing businesses around £3.2 billion**

This will also have implications for the 2023 revaluation as this will be based on rental values on 1 April 2021. To understand this impact, Avison Young have undertaken a comparable assessment of a 2023 revaluation to that they had originally undertaken for a 2021 revaluation, before it was postponed to 2023.<sup>39</sup> As shown by Exhibit 4, the rateable value is estimated to marginally increase at a 2023 revaluation, whereas a 2021 revaluation would have seen a much larger increase in the rateable value. Postponing the revaluation to 2023 means the UBR will increase by CPI for two more years, and the resulting UBR is estimated to be higher (at 51.2p) in 2023 rather than to fall (as it would have in 2021). This would represent the highest UBR on record.

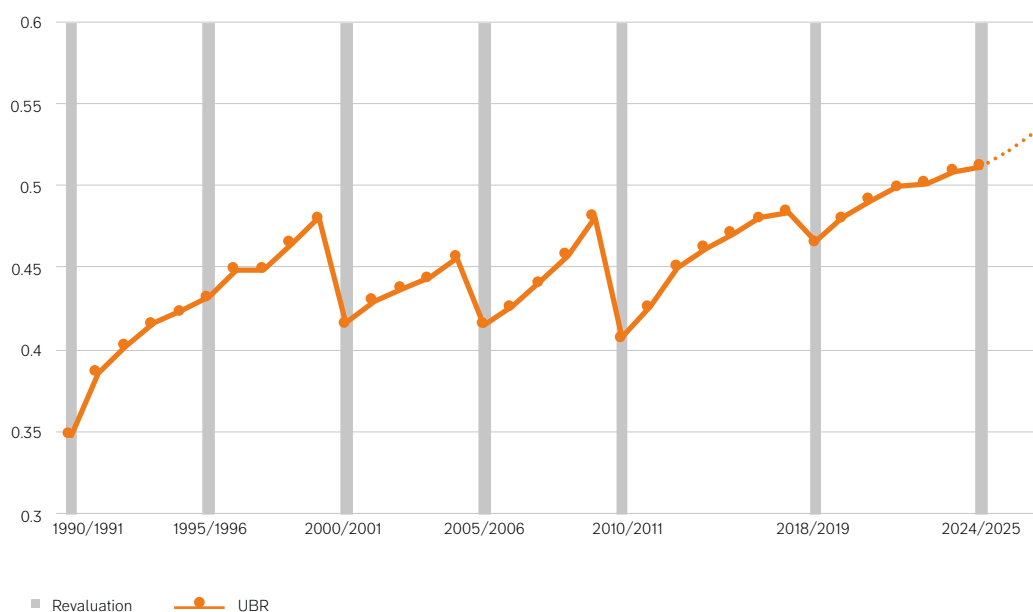
**Exhibit 4** Rateable value and UBR at 2017, 2021 and 2023 revaluation

	2017 (actual)	2021 (estimated)	2023 (estimated)
Rateable value	£68.5 billion	£72.7 billion	£68.7 billion
UBR	49.9p	47.7p	51.2p

Source: Avison Young Research 2020

If the Government continues to collect an ever-increasing amount in business rates each year, the UBR as a percentage of rent will continue to grow. As shown in Exhibit 5, Avison Young analysis finds that in 2023/2024 (in the absence of any reforms to the UBR or the wider business rates system) the UBR will not be rebased as intended at revaluations, and will instead continue on an upward trajectory. Across the board, this will result in the tax take increasing, costing businesses £3.2 billion in additional liability over three years.

Assuming a three-year revaluation period, by 2025/2026 the UBR could be in excess of 53p, before supplements such as small business rate relief and cross rail (London) are added, taking the potential multipliers for large London businesses to over 56.5p.

**Exhibit 5** Estimated UBR at a 2023 revaluation

Source: Avison Young Research 2020

This research is based on two key assumptions underlining the rental market in April 2021:

1. There will be no material impact of Covid-19; and
2. The market will not have returned to pre Covid-19 levels; however, in line with the sentiment of forecasters and Avison Young's agency and research, there will be an improvement in the market in 2021.

These assumptions imply general growth across England from the April 2015 valuation date to February 2020, followed by a significant downturn through to the new April 2021 valuation date. Based on current market sentiment, it is not expected that the resulting UBR would be lower than the estimated 51.2p, rather this is likely to be a conservative estimate.

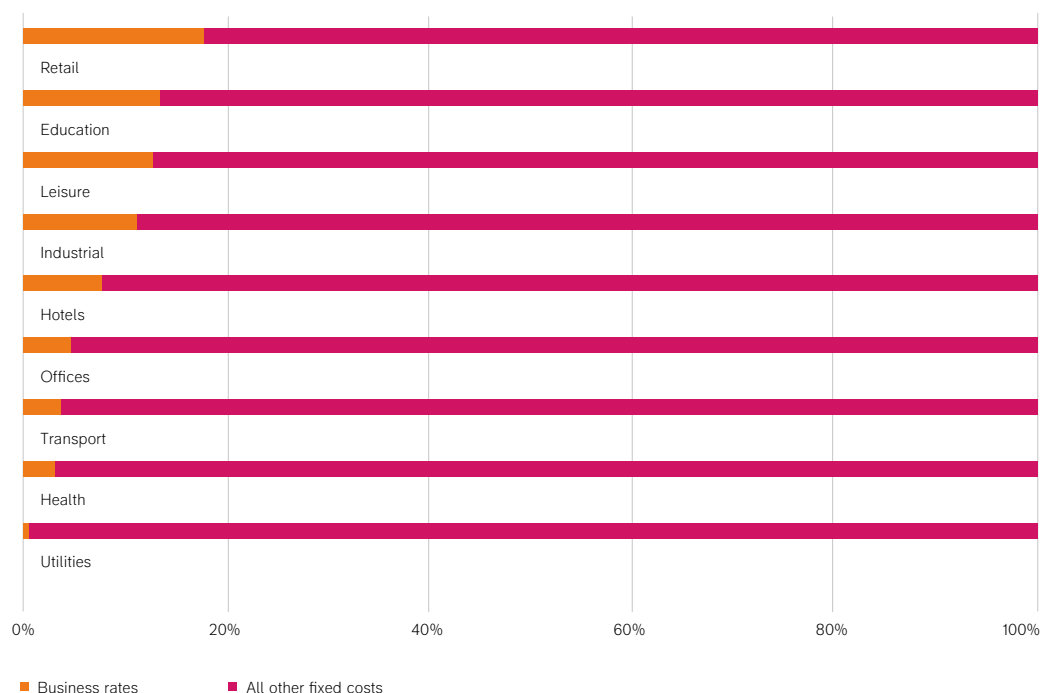
While there is huge uncertainty surrounding the value of the rental market in 2021, as previously highlighted, it is likely that the short-term impacts of Covid-19 will endure for some time, and that longer-term structural changes could start to filter through into rental values in 2021. Therefore, if Covid-19 continues to disrupt the rental market and does not recover to some extent, the resulting UBR could be higher. Nonetheless, this analysis clearly demonstrates that continuing to set the multiplier through the current approach only exacerbates some of the challenges inherent within the system.

### **A further increase in the UBR would come at a cost to business investment, at a time when this is already weak**

For most businesses, their business rates bill is absorbed as a fixed cost of doing business alongside other fixed costs such as rent, utilities and insurance, hitting balance sheets before a profit has been made. This is dissimilar to other business taxes which are typically a tax on success. For example, the higher the profits a business makes, the higher corporation tax they pay.

Of those sectors paying business rates, CBI analysis finds that it represents an estimated 6% of total fixed costs across the economy, where the remainder includes other fixed costs such as rents.<sup>40</sup> As shown by Exhibit 7, this varies by sector due to differences in business models between sectors. The share is estimated to be the largest for businesses in the retail sector, at 18%. But even the lowest share of 1% in the utilities sector is still significant given a large proportion of this sector's total costs are made up of fixed costs: 75% compared to 33% across the economy.<sup>41</sup> This is significant since business rates are purely a cost that is absorbed, whereas other fixed costs, such as rent, are a key input for businesses to be able produce.



**Exhibit 6** Business fixed costs by sector

**Source:** CBI analysis based on ONS (2016) Input-output tables

The significance of property costs to businesses has been highlighted by the pandemic, as fixed costs need to be paid regardless of market demand. For many firms, business rates have therefore had a significant impact on their cash flow. While some sectors have benefited from the business rates holiday, the support has not been applied across the board. At the same time, sectors out of scope have been unable to use HMRC's time to pay scheme for business rates.

Because business rates are a fixed cost, an increase in the burden (following an increase in the UBR) would impact business investment by increasing the average cost of production and therefore reducing the incentive for businesses to invest. A higher tax rate will also reduce the viability of investment in buildings and some P&M. This effect can be particularly pertinent for foreign businesses deciding where to locate, and as a result could reduce the UK's international competitiveness.

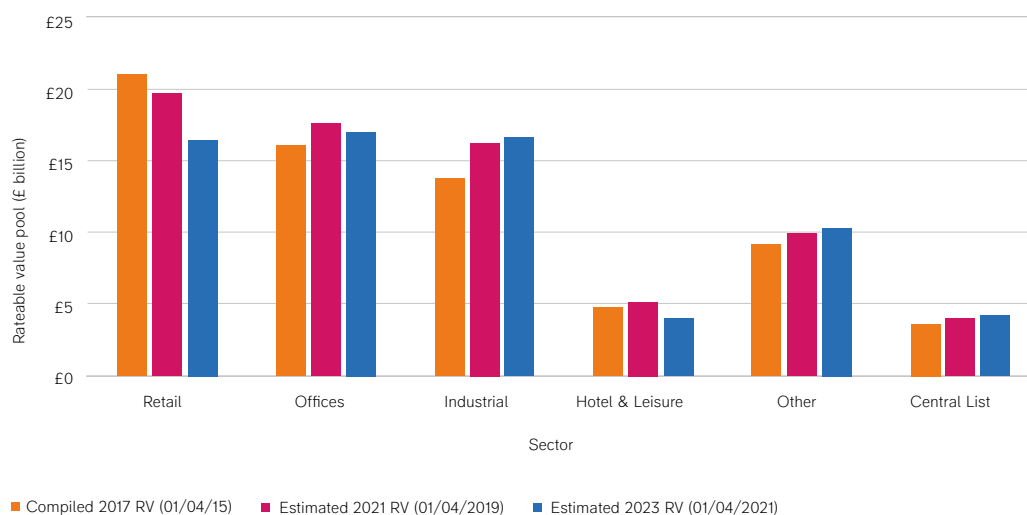
In the UK, business investment is already weak due to Brexit uncertainty and other structural factors.<sup>42</sup> UK fixed investment grew by 2.8% between the first quarter of 2016 and the second quarter of 2019, compared with the G7 average of 7.6%.<sup>43</sup> This has been further hampered by the impact of the pandemic, as business investment tends to move in line with the economic cycle. This is already being observed in the data: in Q2 business investment fell by 31% over the quarter, reaching its lowest level since 1997.<sup>44</sup> Looking ahead, CBI surveys point to weak investment intentions, with both the services and manufacturing sectors expecting to cut back on investment in buildings and P&M next year.<sup>45</sup>

### The postponement of the 2021 revaluation is estimated to cost retailers £1.3 billion as rental values are expected to fall significantly

Revaluations can create winners and losers as they can lead to a significant change in a business' business rates liability, with huge disparities observed across sectors and regions. It is likely that the next revaluation will see a similar impact to the 2017 revaluation, but to a greater extent given the economic environment and the structural changes that have occurred since 2017.

As demonstrated by Exhibit 8, the retail sector is estimated to be significantly hit by the postponement to a 2023 revaluation, at an estimated cost of £1.3 billion in additional business rates during the next two years. At the 2017 revaluation, the retail sector accounted for almost a third of the total rateable value of business rates, a similar share to the 2010 revaluation.<sup>46</sup> Analysis by Avison Young estimates this to fall to 24% at the 2023 revaluation, with the loss in rateable value partly offset by rental growth in the industrial (more specifically logistics) sector.

#### Exhibit 7 Actual and estimated rateable value by sector – 2017, 2021 and 2023



Source: Avison Young Analysis 2019 & 2020

It is widely acknowledged that the retail 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 to high streets is much lower than it used to be (down 10% between 2012 and 2019).<sup>47</sup>

Furthermore, it is difficult to predict to what extent the impact of Covid-19 will be felt beyond 2020 and whether this has accelerated a trend towards online retailing (footfall so far has only recovered to 70% in August relative to the same month in 2019).<sup>48</sup>

The sector is also facing higher costs and lower sales, squeezing margins. This is demonstrated by the large number of Company Voluntary Agreements (CVAs), many of which have resulted in store closures and/or rent reductions, and several insolvencies. In the first half of 2019 alone, Britain lost over a thousand stores from the top 500 high streets, the highest in 5 years, while 43% of those who remained open after a CVA have renegotiated lower rents.<sup>49, 50</sup> In the 12 months ending Q2 2020, the wholesale and retail trade industry saw over 2,000 insolvencies.<sup>51</sup>

The pandemic has accelerated several of these effects, as well as creating an environment of weak consumer confidence and business investment. A CBI survey found that retail sales in August were, 27% lower than in 'normal' conditions, and that investment intentions for the year ahead remain negative.<sup>52</sup> An increase in the burden of business rates on traditional retailers would therefore further aggravate these effects.





# The economic case for change

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## **The UBR should be rebased to 44p to ensure the business rates bill grows in line with rental values**

It is clear from the evidence that the current trajectory for business rates growth is unsustainable as it is growing out of sync with rental growth, as well as the economic cycle. At its current rate of 49.9p, the burden is already significantly higher than other taxes; with the burden estimated to continue on this upward trend, it is crucial that the government uses the Budget in the Autumn to rebase the UBR back to a sustainable level.

The UBR has increased at a much faster pace than initially expected, an increase of 44% over a thirty-year period, resulting in a UBR of 49.9p in 2020/21. Delaying the switch from RPI to CPI has been a large contributor. As demonstrated by the analysis in this paper, if the switch occurred in 2011 alongside other policies the UBR would now be at 44p, at a cost to businesses of £13 billion over the nine-year period.

To offset this cost and support investment and growth, the government should rebase the UBR to 44p by the next revaluation in April 2023 so growth in business rates receipts is determined by rental growth and not by inflation. To achieve this, gross receipts from business rates would have to fall by 14% equating to around £30 billion (a level last seen in 2017/2018), based on an estimated 2023 rateable value for England of £68.7 billion.

Rebasing the UBR to 44p involves three steps at an estimated cost of £18.5 billion over the next 5 years:

1. For the remainder of the 2017 revaluation period (up to 2022/23), the government should freeze the UBR at 49.9p and therefore not continue to index it in line with CPI. This is estimated to cost around £0.8 billion in lost gross tax revenue over the next two years.<sup>53</sup>
2. At the start of the 2023 revaluation, the government should freeze total gross receipts from business rates at £30 billion. Based on an estimated rateable value of £68.7 billion, this would equate to a revised UBR of 44p and cost £17.7 bn over 3 years.
3. For future revaluations, the government should continue to set the UBR at 44p so that any business rates revenue growth derived from growth in rental values.



### **Rebasing the UBR to 44p has the potential to boost business investment and fuel economic growth**

By reducing the burden of business rates on individual businesses, the government could reduce a firm's fixed costs allowing the saving to be spent elsewhere in the economy. A UBR of 44p for example, would reduce the overall business rates liability in the order of £5 billion per annum (before reliefs), an average reduction of 14% per property. This new burden would lead to a reduction in the share of business rates of fixed costs from 6% to 5% on average.<sup>54</sup>

The economic impact of this depends on how firms respond to changes in the business rates liability, and necessarily relies on a set of assumptions such as firms having full information about prices, which is often not the case. In practice, there are several factors that would affect how businesses change their behaviour in response to a reduction in their fixed costs in both the short and the long term. The magnitude of each of these effects will determine where the cost saving falls in the economy and the extent of the economic benefit that could be realised as a result:

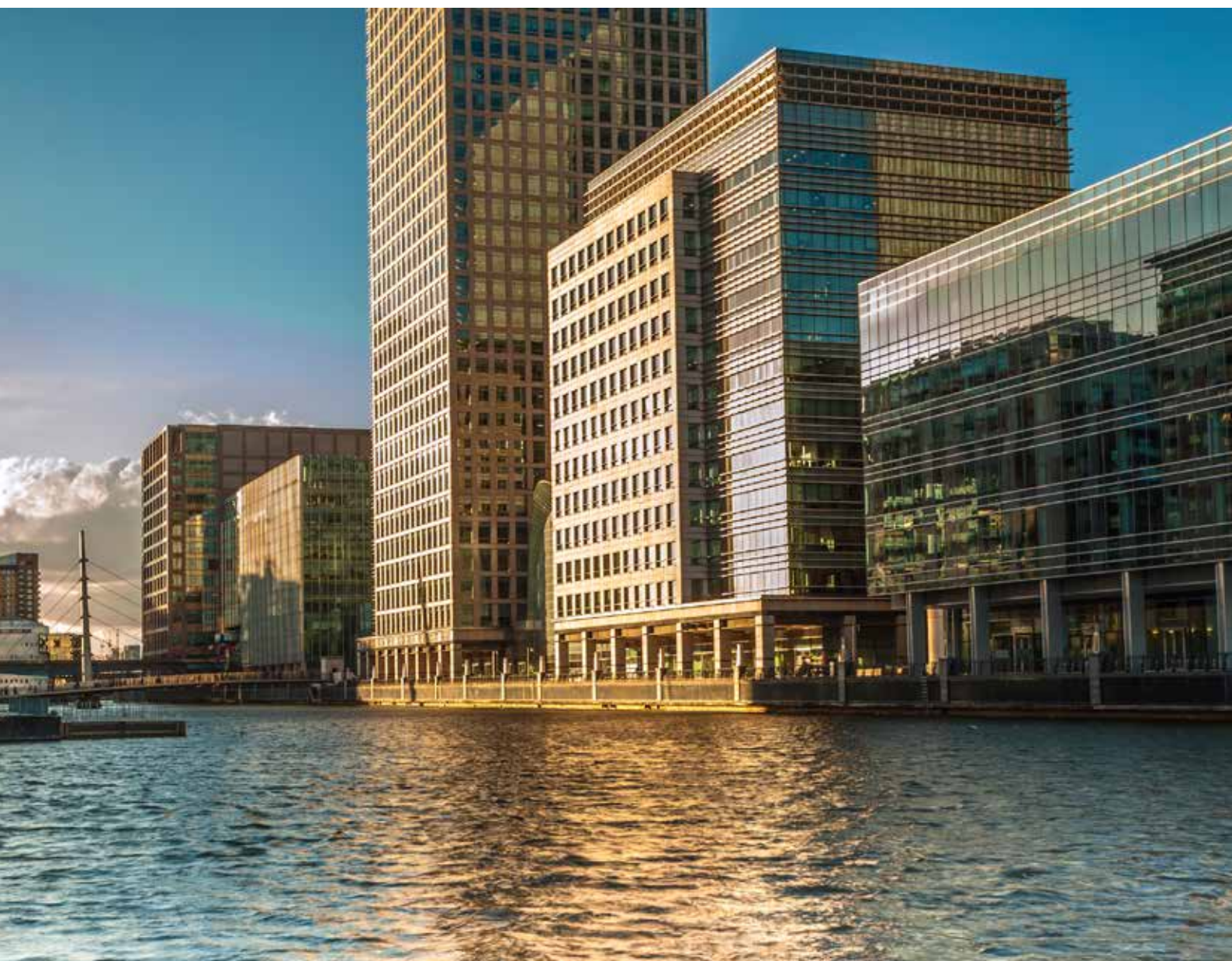
- **Absorbing the total cost saving.** Some businesses may decide to fully absorb the cost saving, which will then be passed through directly as additional profits. In this case a £5 billion reduction in business rates would translate directly into an equal increase in profits across the economy. With investments currently at 36% of profits, this suggests the increase in profits could translate into an £1.9 billion increase in investment, effectively doubling the growth seen between 2018 and 2019.<sup>55</sup>

- **The pass-through onto consumers as lower prices.** When business' costs reduce, they will pass on part, or all, of this saving onto consumers in the form of lower prices. There is limited evidence on the pass-through rate following a change in business rates, but by way of indication for the purpose of price reviews in energy regulation, it is assumed that 100% would be passed onto consumers.<sup>56</sup> There is however evidence underlining the extent to which firms respond to factors that affect the price of their products. The literature finds that the additional cost associated with changing prices can often be a barrier to firms adjusting their prices, and that when firms do respond they are more likely to change their prices in response to an increase in their costs rather than a decrease.<sup>57, 58</sup>
- **Impact of a price change on other costs.** Price effects may lead to a change in production levels and as a result a change in the level of inputs required for production. Firms typically use a combination of labour, capital, and raw materials to produce a given level of output. If a firm decides to increase its output in response to a reduction in its price (due to lower business rates), this will affect the inputs it uses. Firms may increase their demand for raw materials from other firms through their supply chains, which has wider economic benefits for those industries. It may also increase the number of employees, and as this impact would be across the economy as a whole rather than isolated to a sub-set of the economy, this could lead to increased employment levels on aggregate.
- **The relationship between business rates and rents.** Some existing criticism to a change in the business rates bill, is that economic theory shows any reduction in rates is reflected in an increase in rent charged to tenants in the long run, and as a result there would only be a short-term benefit.<sup>59</sup> This is based on the principle that tenants tend to consider total occupancy costs (rent and business rates) when negotiating their lease terms, so if business rates fall they may be prepared to pay higher rent. However, in practice, many of the assumptions underpinning this theoretical view - such as the presence of a perfectly competitive market - often do not hold. Firstly, business rates are paid by the occupier of the property, which in many cases is the tenant rather than the landlord thus separating the costs out. Secondly, many commercial properties are owner-occupied and therefore businesses will mechanically benefit from a reduction in rates since this landlord-tenant relationship does not exist. Finally, commercial landlords typically prefer cash flow certainty over fluctuations in rents which means tenancy agreements tend to be over a longer period. The lease length will therefore impact the ability of landlords to adjust their rents in response to a change in business rates. Over the long-term it is plausible that some of the reduction in business rates costs will be captured by changes in rental growth, however, given the imperfect nature of the market it is unlikely to cover the entirety of the savings cost.



In practice a combination of these effects will take place. Economic theory explains that a change in a firm's fixed costs does not affect prices in the short run, and by extension production levels. Therefore, in the short term a reduction in cost will simply result in an increase in a firm's profitability. This short-term gain will lead to longer term benefits by incentivising investment, which has wider economic benefits by increasing the productive capacity of the economy.

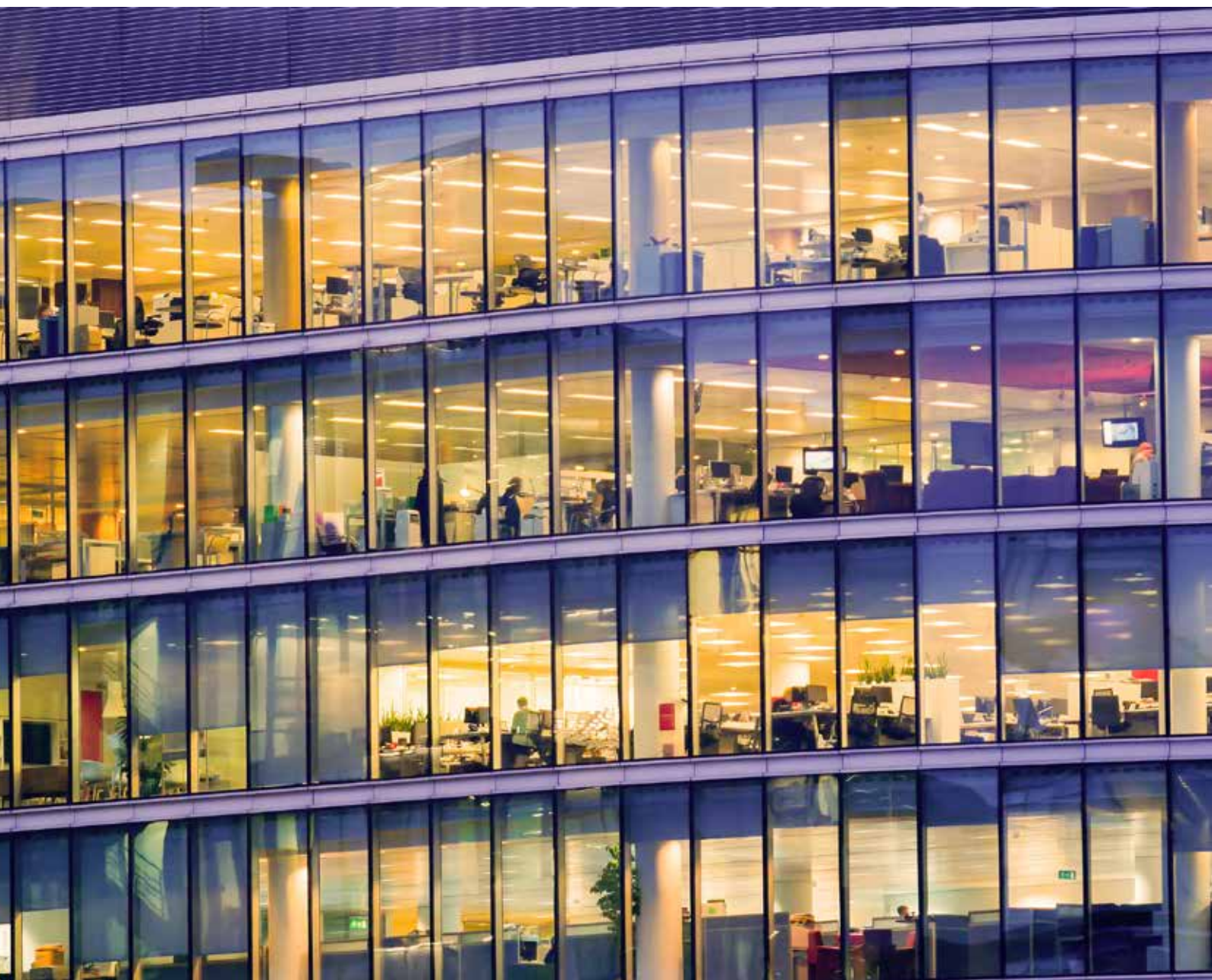
The extent to which profitability translates into increased investment depends to a great extent on the costs of property and plant and machinery. However, a reduction in business rates could be expected to increase investment. For example, previous Computable General Equilibrium modelling work carried out by HM Revenues & Customs<sup>60</sup> suggests a reduction in Corporation Tax from 28% to 20% has the effect of increasing business investment by 2.5% to 4.5% in the long term (equivalent to £3.6bn - £6.2bn). On the other hand, research shows that businesses' propensity to invest following increased profits has significantly deteriorated amongst high-income economies over the past couple of decades, including in the UK.<sup>61</sup>





At the same time, EY's most recent Attractiveness Survey suggests that cost competitiveness remains a top factor in business' location decisions in relation to inward investment.<sup>62</sup> Reducing the burden of business rates could therefore also impact international investment into the UK, particularly where that investment requires buildings and/or P&M. When making investment location decisions, firms consider several factors, one of which is the tax environment. Research suggests that taxation plays a significant role in the international allocation of investments, as profit-maximising firms are highly sensitive to differences in the tax rate when making their location decision.

Finally, we could expect greater efficiency in the commercial property market, reflected in rental values and/or longer tenancies, to further encourage landlord investment. When rental growth is constrained by higher business rates costs this can translate into lower property investment by landlords putting a strain on the availability of employee space and thus the supply side of the commercial property market.



### **Wider economic impacts raise additional revenues elsewhere in the tax system that can help to partly offset the cost**

While a reduction in the UBR to 44p is estimated to cost the government £5 billion in the first year of implementation (and a further cost in subsequent years), each of the effects described above would have wider economic benefits to government tax revenues elsewhere in the tax system.

As discussed, if the £5 billion reduction in the business rates bill translates into an increase in profits; this would result in a direct increase in Gross Value Added (GVA) by the same amount which, in turn, can support increases in employment, capital investment, and purchases through supply chains. Ultimately, this would act to raise economic output directly and through supply chain and spend effects (defined as a multiplier effect). Higher profits, output, employment, and spending on inputs would lead to an increase in production and income taxes (such as corporation tax, income tax, NICs and VAT receipts), which together currently contribute 65% to total tax receipts.<sup>63</sup>

By way of illustration:

- An increase in profits will lead to higher tax revenues from corporation tax. A reduction in the UBR to 44p could increase profits by £5 billion, which could lead to a direct £333 million increase in Corporation tax receipts.<sup>64</sup>
- Increased employment means higher income tax where this is not displacing other employment. Currently, wages and salaries amount to 45% of GVA; therefore, a £5 billion increase in GVA could result in a £2.3 billion increase in total wages and salaries, raising £588 million in income tax (gross of tax credits) for government.<sup>65</sup>
- An increase in raw materials, or the consumption of inputs, not only raises output directly, but also supports more business through supply chain spend. This means that, to the extent that the £5 billion increase in profits and GVA translates into increased supply chain spend, output should rise through a multiplier effect, according to the profile of that spend. The GVA multiplier ranges between 1 for services of households, to 3.4 for the electricity & gas sector meaning that, for example, every £1 million spent in the electricity & gas sector could generate a total increase of £3.4 million in output. Using an average GVA multiplier of 1.7 and an average employment multiplier of 1.8, the £333 million direct increase in Corporation Tax receipts could rise to £568 million, and the Income Tax collection could rise to £1.1 billion in a year.<sup>66</sup>



Note that the scenarios above are considered in isolation for illustrative purposes; a modelling exercise evaluating these changes simultaneously identify overlaps in the effects. One could assess the impact of changes in taxation rates through a Computable General Equilibrium (CGE) approach and simultaneously model the change in investment, profits, productivity, and output with respect to changes in the tax rate; it could also model changes in consumption arising from reduced prices if some of the cost savings are passed down to consumers. This could then feed into a Cost Benefit Analysis in accordance with the HM Treasury Green Book methodology to provide greater insight into how the benefits of a reduced business rates bill would weigh up against the costs to government in terms of overall tax receipts.

However, this exercise is more difficult to achieve in the present context given that business rates is a change in fixed costs that is not directly linked to performance measures such as profits, making it difficult to disentangle the effect of the change in rates from other factors affecting business decisions. Therefore, this exercise has not been undertaken for this report.

Nevertheless, while it would be complex to estimate the exact behavioural response and as a result the associated change in the government's overall tax take, it is clear from the above examples that the cost of a business rates reduction could be partly offset by the wider economic activity it would generate.



### **The valuation period should be shortened to ensure business rates bills better reflect the economic situation**

Another reason the business rates system is slow to respond to changes in both the commercial property market and the economy, is the length of time between the date commercial properties are valued for a revaluation, the antecedent valuation date (AVD), and the start of the new rating list (when the updated rateable values and UBR are applied). The best-case scenario would be for a revaluation to occur on an annual basis, so the tax base is updated regularly to reflect the economic situation. However, to conduct a revaluation of each commercial property in England, the VOA needs to compile a significant amount of data and information, which means there are two years between the AVD and the start of the new rating list. This therefore acts as a barrier to more frequent revaluations.

The latest revaluation has been postponed until 2023, with an AVD of 1 April 2021 and the new rating list commencing on 1 April 2023. While it is important to postpone the revaluation to reflect the impact of Covid-19, there is a risk the economy will have had insufficient time to recover by April 2021, increasing the difficulty of valuing the market at this time. To provide a greater chance of the economy returning to pre-Covid-19 levels by the AVD, the government should delay the AVD to 1 October 2021, while maintaining the start of the new rating list at 1 April 2023.

This delay, however, will mean shortening the period between the AVD and the start of the new rating list to 18 months as opposed to the standard two years. To be able to do this will require more resource for the VOA. Between 2008/09 and 2018/19 the VOA has almost halved the number of offices in Britain from 83 to 43 and lost 680 full time staff.<sup>67, 68</sup> Funding has fallen by 11% in nominal terms over 10 years and in 2018/19 alone had dropped by £9 million on the previous year.<sup>69</sup> At the same time, the VOA has had to deal with an increase in challenges as a result of the pandemic, which is putting further pressure on their resource.

To support the VOA with this, the government should increase its funding at the upcoming comprehensive spending review (CSR) to, as a first step, offset the fall the VOA saw in its funding in 2018/19. Going forwards, the government should freeze any further cuts to the VOA's funding or staffing during this period, unless driven by technological improvements that support the VOA's capacity.

At the Autumn Budget the government should:

4. Delay the valuation date until 1st October 2021 and shorten the period between the antecedent valuation date (AVD) and the start of the next revaluation period to ensure the tax more accurately reflects the economic situation.
5. Use the upcoming comprehensive spending review to increase the VOA's funding to ensure they have the necessary resource to shorten the valuation period to 18 months and to deal with the increase in challenges from Covid-19. As a starting point this should be at least £9 million to make up for the fall in revenue in 2018/19.

### **Reliefs should continue to support the businesses most vulnerable, but reform would ensure they also continue to serve their intended purpose**

Another challenge of the business rates system is the gap between qualifying for a relief and moving onto the main rate, which is acting as a barrier to growth and diversification. As a principle, the system should encourage a transition between qualifying for reliefs and moving to the higher UBR. While reducing the UBR will help with this by reducing the gap, the government should also consider how the business rates system can help to encourage growth through, for example, tapered relief.

The evidence clearly demonstrates the importance of reliefs in ensuring an equitable tax system and in promoting economic growth. But to achieve this, it is important that reliefs are appropriately targeted and reviewed frequently to ensure they continue to meet their original objectives and represent value for money. Reliefs are the most effective when there is a clear market failure that is disadvantaging one area of the economy over another.

The CBI and Avison Young believe there are certain reliefs in the business rates system that could be reformed to increase their effectiveness. Firstly, while transitional relief achieves the objective of smoothing significant increases in business rates bills between revaluations, this comes at a cost to other businesses who have seen a reduction in their business rates bill, but are unable to benefit immediately. These businesses are typically in areas of lower growth, and this is therefore a double impact.

More frequent revaluations would minimise the requirement for transitional relief as the change in a business rates liability will be lower the more regularly rateable values are updated. If the government does reduce revaluations to every three years, there may therefore be less of a requirement for transitional relief. In this case, there should be a duty on the VOA to advise businesses on the expected change in their business rates liability at an earlier date so businesses can incorporate this into their financial planning.



There is already precedent in the tax system to do this. For example, for the carbon price floor HMRC set a tax rate each year for two years forward and provide indicative rates for the subsequent two years to support business decision making.<sup>70</sup> While this is a very different tax, a similar approach could be taken for business rates.

At the Autumn Budget government should:

6. Ensure all businesses in downwards transition from 1 April 2021 move onto their new liability following the 2017 revaluation to reflect the postponement of the next revaluation and provide further support to the recovery.
7. Remove transitional arrangements for properties whose rateable value decrease following a revaluation, so the business rates bill of those properties reflects the rateable value; while upwards transitional relief should be maintained to allow a smooth transition to a new higher business rates bill for those properties. This will cost government in the region of £1.5 to £2 billion.<sup>71</sup>
8. Consult on alternatives to transitional arrangements that supports those businesses facing a sudden increase in their business rates bill, while allowing those facing a decrease to move to that new bill immediately.



Secondly, the analysis by Avison Young finds that retail is estimated to be significantly impacted by the postponement of the 2021 revaluation. There is therefore a strong case for the retail sector to receive further assistance through business rates relief to offset this cost.

At the Autumn Budget, the government should:

9. Provide retail properties with a relief worth £1.3 billion over the next two years (from 2021/22 to 2022/23) to offset the estimated cost of postponing the 2021 revaluation.<sup>72</sup>

Finally, discretionary reliefs can often create perverse incentives for local authorities whose income is heavily reliant on business rates revenue, which often means the interpretation of reliefs differs across England.

To address this, at the Autumn Budget, the government should:

10. Standardise discretionary reliefs across England so there is a consistency in approach.
11. 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 is reimbursed by central government.
12. Introduce a simple system, along the lines of that for council taxpayers, to allow businesses to challenge the mandatory and discretionary relief decisions of local authorities through the Valuation Tribunal.





# References

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1. The Uniform Business Rate (UBR) (or multiplier) is effectively the national poundage that is applied by Government to each commercial property's rateable value. This results in what is defined as the "gross business rates liability". The UBR is calculated at each revaluation, by taking the previous years' gross liability (before any reliefs are applied), adding inflation, and dividing it into the newly assessed pool of rateable values.
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3. This is based on the cost of the transitional scheme for 2017 but in practice this would fluctuate and could therefore be higher or lower than this estimate.
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5. Local authority revenue expenditure and financing England: 2020 to 2021 budget – MHCLG, July 2020.
6. Tax principles stipulated by the OECD, the IFS and others
7. MHCLG "Collection rates and receipts of council tax and non-domestic rates in England 2019-20 (updated)" 12th August 2020.
8. Public sector current receipts – ONS, August 2020.
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13. ONS (2020) Gross fixed capital formation by sector and type of asset
14. 2017 RV using Revised Rating List Data from Analyse as at 10/07/2019.
15. ONS (2020) GDP first quarterly estimate, UK: April to June 2020
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23. CBI Quarterly Trends Surveys, Q3
24. MSCI (2019) UK Lease Events Review 2019
25. Office for Budget Responsibility, Fiscal Sustainability Report, July 2020.
26. ONS (2020) Public sector current receipts
27. OBR (2020) Fiscal sustainability report
28. HM Treasury (2010) Budget 2010
29. Based on Avison Young analysis
30. This estimate includes both the local and central ratings lists.

31. Reflects 17/18 & 18/19 – later data not yet published.
32. Avison Young (2019), Win, lose or draw
33. This is based on Avison Young (2019) Win, lose or draw but updated to reflect the business rates holiday.
34. IPF (2013) The Role of Commercial Property in the UK Economy
35. ONS (2020) regional economic activity by gross domestic product, UK
36. Finance Bill 2020-21 draft legislation and tax documents: Written statement – HCWS400
37. Forecast for CPI inflation is based on OBR (2020) Fiscal Sustainability Report taking the previous year's annual CPI inflation as business rates is indexed based on inflation from the previous September.
38. Bank of England Monetary Policy Report, August 2020.
39. Avison Young (2019), Win, lose or draw
40. This is based on CBI analysis using Input-Output supply and use tables and adjusted to 2018 figures.
41. This is based on the sum of estimated fixed and variable costs from intermediate consumption, and therefore does not include capital expenditure and spending on employees.
42. See CBI (2018) Catching the Peloton for a detailed explanation of this.
43. ONS (2019) Business investment in the UK: April to June 2019 revised results
44. ONS (2020) GDP first quarterly estimate, UK: April to June 2020
45. CBI Services Sector Survey (Aug 2020), CBI Industrial Trends Survey (Jul 2020)
46. Avison Young Research 2019 & 2020
47. British Retail Consortium & Springboard – UK Retail Footfall, October 2019
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49. PwC (2019) Store openings and closures: January – June 2019
50. PwC (2019) CVAs in focus: who is impacted?
51. The Insolvency Service Quarterly Statistics Q2 2020
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56. Ofgem (2017) Guide to RIOO-ED1 electricity distribution price control
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60. HM Revenues & Customs – Analysis of the Dynamic Effects of Corporation Tax Reductions (December 2013)
61. Durand & Gueuder (2018) – The Profit-Investment Nexus in an Era of Financialisation, Globalisation and Monopolisation: A Profit-Centred Perspective

62. EY (2020) Attractiveness survey
63. CBI analysis based on ONS Public Sector Finances, August 2020
64. CBI analysis based on ONS Public Sector Finances and UK Input-Output Analytical Tables
65. CBI analysis based on ONS Public Sector Finances and UK Input-Output Analytical Tables
66. CBI analysis based on ONS Public Sector Finances and UK Input-Output Analytical Tables
67. VOA (2009) Annual report and account 2008-09
68. VOA (2019) Annual report and accounts 2018-19
69. VOA (2019) Annual report and accounts 2018-19
70. House of Commons library (2018) Carbon Price Floor (CPF) and the price support mechanism
71. This is based on the cost of the transitional scheme for 2017 but in practice this would fluctuate and could therefore be higher or lower than this estimate.
72. By way of indication the 100% relief scheme for retail properties under £51,000 is estimated to cost £1 billion and therefore a 50% business rates discount as was originally planned for 2020/21 could cost around £0.5 billion





# About the CBI

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Founded by Royal Charter in 1965, the CBI is a non-profit business organisation that speaks on behalf of 190,000 UK businesses of all sizes and from across all sectors, employing nearly 7 million people between them. That's about one third of the private workforce. This number is made up of both direct members and our trade association members. We do this because we are a confederation and both classes of membership are equally important to us.

The CBI's mission is to promote the conditions in which businesses of all sizes and sectors in the UK can compete and prosper for the benefit of all. With offices around the UK (including in Scotland, Wales and Northern Ireland) and representation in Brussels, Washington, Beijing and Delhi, the CBI communicates the British business voice around the world.

## **Our mandate comes from our members who have a direct say in what we do and how we do it**

The CBI receives its formal mandate from 9 Regional Councils, 3 National Councils from Scotland, Wales and Northern Ireland plus 16 sector based Standing Committees. These bodies are made up of members in that region, nation or sector who serve a term of office. The chair of each Standing Committee and Regional and National Council sit on the CBI's Chairs' Committee which is ultimately responsible for setting and steering CBI policy positions.

Each quarter this formal engagement process across the CBI Council reaches over 1,000 senior business leaders across 700 of our members who have a direct say in what the CBI do and how they do it, from refreshing their workplan to discussing the key business issues of the day and re-calibrating its influence. Over 80% of the businesses represented on the CBI Council are outside of the FTSE350 as the CBI represents a wide range of sizes and sectors from the UK business community. This formal governance process is supported by a wide range of working groups, roundtables, member meeting and events that makes the CBI unparalleled at listening to and representing British business.

## CBI Council in numbers

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1000+

Committee and Council representatives



28+

Regional and National Council and sector based  
Standing Committees



50%

Representatives of the CBI Council at C-Suite level



80%

Of the CBI Council from non-FITSE 350 businesses



To share your views on this topic or ask us a question, contact:



**Megan Bulford**  
Head of Economic Analysis, CBI  
[megan.bulford@cbi.org.uk](mailto:megan.bulford@cbi.org.uk)



**David Jones**  
Principal and Managing Director,  
Business Rates, Avison Young  
[David.Jones@avisonyoung.com](mailto:David.Jones@avisonyoung.com)