CBI

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CBI submission to the Treasury's Business Rates Call for Evidence – Tranche 2

Introduction

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. We are pleased to be able to contribute our views and evidence to support the questions set out in the Treasury's business rates call for evidence document.

A fair and sustainable business rates system is critical to support business investment and growth, and ultimately UK prosperity. To achieve this requires a fundamental rethink to the functioning of the business rates system. We are therefore hugely supportive of the government's announcement to fundamentally review business rates. With the tax rate on an unsustainable path, the objective of reducing the overall burden of business rates on business is the right one.

The call for evidence covers a whole range of issues that businesses have been grappling with for many years, from transitional relief to plant and machinery (P&M). As business rates is such an important but complex area, the decision to consult in two tranches will provide businesses with the necessary time to contribute effectively towards the debate. Businesses are facing heightened uncertainty, both because of the continued economic impact caused by the pandemic, but also because they are looking ahead to the end of the transition period of the UK's departure from the European Union and future trading arrangements with the bloc. Despite this, business rates reform remains at the top of business' agenda. Getting this right is critical to supporting businesses as we look to rebuild the UK economy and build back better.

To achieve a fair and sustainable business rates system that promotes economic growth and prosperity, the CBI and its members believe fundamental reform is necessary, and this call for evidence presents a real opportunity to take the critical first steps towards this.

The Context of our Response

This review is an opportunity for the government to create a fair and sustainable business rates system

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 incentivising green investments in the stock of commercial property and privately-funded public infrastructure, as well as in ensuring these investments, and by extension growth, is distributed evenly across the country.

We believe there has never been a better time for government to reform an overly complex business rates system and ensure that it is incentivising the right behaviours, is conducive of business investment, and supportive of other government objectives such as green recovery.

Our tranche 1 response has already highlighted that a large business rates burden, along with the disconnect between the business rates bill incurred by businesses and the state of market demand and economic conditions, can hamper business investment and put a strain on economic activity at times of economic distress.

We have argued that, in order to achieve the principles of good tax policy-making, a reformed system should continue to be based on annual rental values but displaying the following six characteristics:

- ✓ **A fixed tax rate.** Indexing the multipliers to inflation has resulted in a standard multiplier that is now over 50%, significantly higher than the tax rate for other business taxes. Fixing the tax rate would not only align business rates with other taxes, but it would also increase the stability and predictability of the tax for businesses, enabling businesses to make more informed decisions.
- ✓ **A tax base that is frequently aligned to the economic cycle.** Business rates is the only business tax where the liability is out of kilter with the economic cycle due to the infrequent updating of the tax base and the requirement to ensure revenue stability. Allowing government revenues to fluctuate will ensure business rates bills reflect economic realities, increasing the predictability and certainty of a business' business rates liability.
- ✓ **A tax burden that enables business investment.** Reducing the overall tax burden on businesses will support investment in the stock of commercial property and public infrastructure funded by the private sector. In addition, the tax system could be used more effectively to incentivise investment in areas where the government has a clear policy objective, such as decarbonisation and delivering gigabit-capable digital infrastructure.
- ✓ **A tax liability that is transparent and simple to administer.** There is a lack of transparency in the system relating to how business rates valuations and bills are determined. At the same time, the system is complex due to the number of reliefs and the difference in application by local authorities of discretionary reliefs. A transparent and simple system would enable businesses to understand their properties' assessments and access the appropriate reliefs and provide stability to support wider business planning decisions.
- ✓ **An appeals process that is simple to navigate.** Engaging with the new appeals system is challenging, which is adding to the administrative burden associated with paying business rates. The lack of speed in this process often means that businesses are unclear on what level of refund they are entitled to and cannot factor this into their planning.
- ✓ **Fit for purpose with possible English devolution.** It would be inappropriate to devolve a tax that needs reform, but the CBI recognises that further devolution of business rates in England may be coming down the line. Therefore, any reform to the current system should consider the impact this would have on further devolution.

We re-iterate the importance of these characteristics, the first three of which were discussed in detail in our tranche 1 response. Our present response consolidates the views of our members on the link between business rates and business investment, highlighting the role that business rates can play in supporting the economic recovery by boosting investment and growth, as well as how the administrative processes for business rates could be reformed to increase its simplicity.

Business rates impact investment decisions at a time when business investment has a critical part to play in the economic recovery

Business rates are a key factor for businesses 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.

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. Capital investments in P&M made by the occupier may 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. A major retailer also stated that "stores that are overly burdened by business rates receive lower levels of investment".

Business investment is a key enabler of productivity improvements and, as a result, of future prosperity. In the UK, business investment is already weak due to Brexit uncertainty and other structural factors.[1] 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%.[2] 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.[3] 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.[4]

The high tax burden and the inclusion of some 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.[5]

Moreover, because business rates are a fixed cost, an increase in the burden (following an increase in the tax rate) 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.

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.

[1] See CBI (2018) Catching the Peloton for a detailed explanation of this
[2] ONS (2019) Business investment in the UK: April to June 2019 revised results
[3] ONS (2020) GDP first quarterly estimate, UK: April to June 2020
[4] CBI Services Sector Survey (Aug 2020), CBI Industrial Trends Survey (Jul 2020)
[5] ONS (2020) Gross fixed capital formation by sector and type of asset

Summary of recommendations

1. Working within the constraints highlighted above and appreciating that the ratepayer must play a role in facilitating this process, we would propose a phased approach towards more frequent revaluations to be implemented immediately. The government should set out a path to achieving annual revaluations by 2026, which should include the following interim steps:
    - At the 2023 revaluation reduce the Antecedent Valuation Date (AVD) gap to 18 months (as per our tranche 1 recommendation);
    - If annual revaluations following this are not achievable, then this could then be followed by a 2-yearly revaluation and a 12-month AVD gap;
    - Then move to annual revaluations in 2026.

2. 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.

3. It should also remove transitional arrangements for properties whose rateable value decrease 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.

4. While revaluations occur less frequently than annually, the government should consult on alternatives to transitional arrangements that support those businesses facing a sudden increase in their business rates bill, while allowing those facing a decrease to move to that new bill immediately. Moving to annual revaluations would subsequently negate the requirement for transitional arrangements.

5. Introduce a similar measure to Scotland's Business Growth Accelerator that enables improvements to existing properties to receive a 12-month exemption as the absolute minimum from increased business rates payments to encourage investment in the existing property stock.
6. Review the P&M regulations to ensure they are relevant for the 21st century, with a statutory commitment to keep this under regular review to ensure it keeps pace with a changing economy and advancements in technology.

7. Where property improvements result in an improvement in the property's EPC, those properties should benefit from an additional business rates exemption (in addition to the general exemption proposed earlier) to encourage businesses to reduce the carbon footprint of their buildings. For this to be effective, implementation of the 2020 Action Plan to reform EPCs must occur in parallel. To reflect the scale of the improvement, we propose a period of 6 months exemption for 1 band improvement, 12 months for 2 bands, and 2 years for 3 bands.

8. Exempt certain existing P&M and new technologies that directly link to the 'green' agenda (including solar PV and heat pumps) from the P&M regulations to help stimulate investment in the green economy.

9. 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.

10. Transition period for the implementation of a centralised billing system from the announcement to the date the business should start to be compliant with the new processes.

11. More lenient penalties in this transition period while businesses learn the new way of billing.

Valuation and transitional relief

10. What are your views on the frequency of revaluations and what changes should be made to support your preferred frequency?

As we have previously argued in our tranche 1 response, we would ideally like to arrive at annual revaluations; achieving this may take time, and we ask that the government sets out a path for how it will achieve this. We would argue that this will be hugely beneficial, as annual revaluations would remove many of the other problems within the system:

- Annual revaluations would negate the need for transitional relief;
- They would substantially reduce the number of appeals; and
- They would better align the business rates bill to changes in property values to better reflect economic conditions.

These effects will be discussed in greater detail in other parts of this response.

Business rates are the only business tax where the liability is out of kilter with the economic cycle due to the infrequent updating of the tax base and the requirement to ensure revenue stability. The system, as it currently stands, 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 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, and fail to allow businesses to make informed assessments when setting budgets and planning investment.

Revaluations can result in a significant change in a business' business rates liability and therefore most businesses will be impacted by a revaluation. Given the significant time frame that is considered in revaluations, more frequent changes in property values and market demand are often overlooked, and a businesses' rates bill is not responsive to these wider conditions. 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%.[6,7] Consequently, the revaluation period was not reflective of the true economic conditions and therefore business' ability to pay.

The government has shown their intention to increase the frequency of revaluations, for example through their Autumn Budget 2017 announcement of moving from 5 yearly, to 3 yearly revaluations and their subsequent decision in the Spring Statement of 2018 to bring forward the next revaluation

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

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

by one year to 2021. However, the coronavirus pandemic has created significant uncertainty and therefore pushed these changes further into the future.

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).[8] 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.

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 which are now massively out of date and not reflective of the market currently. 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.[9]

Meanwhile, 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. 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 once again reflects the fact that revaluations are not sufficiently frequent to allow a prompt adjustment to economic conditions. In addition, commercial rents often respond slowly to an economic shock because tenants are generally locked into a lease arrangement.

Moving to annual revaluations in the medium-term would address many of these problems and would go a long way towards improving the business rates system as a whole. We acknowledge the capacity constraints at the VOA and the overhang of appeals from previous revaluations which mean immediately moving to annual revaluations would be extremely difficult, particularly under the current staffing numbers. We understand that, in order 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 presently two years between the Antecedent Valuation Date (AVD) and the start of the new rating list. This therefore acts as a barrier to more frequent revaluations.

However, there is appetite amongst our members that more information is provided by ratepayers on a more frequent basis to support a move towards annual revaluations. Our recent poll with members showed nearly 70% of 21 participants were willing to support the VOA to reach more frequent revaluations by providing more timely information to a single point of contact. While there were mixed views amongst participants with respect to business self-assessment, there was a clear preference towards the ratepayer providing more information to the VOA.

There is wide agreement that some of the responsibility should fall on ratepayers to provide timely information as a standard procedure both on a regular basis, as well as when there is a change that would affect the valuation, rather than the VOA having to issue requests for information. However, the process should be streamlined and simplified as far as possible to minimise the administrative burden, particularly for businesses operating large sites. Moreover, the VOA must provide re-assurance around the treatment of sensitive information (such as turnover, profits, or commercial lease information), ensuring that confidential data is not shared outside of the VOA.

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[8] Finance Bill 2020-21 draft legislation and tax documents: Written statement – HCWS400
[9] Bank of England Monetary Policy Report, August 2020.

Recommendation:

1. Working within the constraints highlighted above and appreciating that the ratepayer must play a role in facilitating this process, we would propose a phased approach towards more frequent revaluations to be implemented immediately. The government should set out a path to achieve annual revaluations by 2026. This could include the following interim steps:
   - At the 2023 revaluation reduce the Antecedent Valuation Date (AVD) gap to 18 months (as per our tranche 1 recommendation);
   - If annual revaluations following this are not achievable, then this could then be followed by a 2-yearly revaluation and a 12-month AVD gap;
   - Then move to annual revaluations in 2026.

11. What are your views on a banded or zone-based valuations system and the trade off with valuation specificity?

The Government has consulted on this approach in the past and the responses show a clear rejection of these approaches. Ratepayers support an individualised approach to valuation to ensure fairness. They want to continue to receive an individual valuation for their property, on which their business rates bill is based. Ratepayers would not support a move away from this towards more 'broad brush' approaches such as those considered in the discussion document (e.g. 'banding' or 'zoning').

There is, however, potential scope for grouping categories of assets and rating them together for each individual business. Take, for example, the out of home advertising industry, where each ratepayer has tens of thousands of relatively low value assets (e.g. bus shelters) located across the country which are rated on an individual basis. It would be much more effective if there was scope to rate similar assets together. For example, cumulo rates are used in limited circumstances within the utility and transport sectors, and while this would not be appropriate for many circumstances it demonstrates there are precedents for alternative systems of valuations to reflect the particular nature of a business's assets.

12. What are your views on changing the valuation process or the information provided to the VOA, to enable more frequent revaluations?

We have a firm view that something needs to be done to enable annual revaluations in the medium-term, and businesses see this as a clear priority within a fundamental reform of the business rates system. There are wide-ranging views on how this should be achieved, such as around the extent to which ratepayers provide information to the VOA, or around some form of self-assessment. One extreme is full self-assessment such as is the case with other taxes; however, this would be difficult for businesses to do, especially small businesses, and would likely create inconsistencies. On the other end of the spectrum, businesses can declare more information about their property on a more regular basis to support the VOA carrying out more frequent revaluations. However, the amount of information that businesses would be able to provide also varies, with some concerns around how sensitive information is handled and the administrative burden for businesses operating large sites.

Self-assessment had previously been suggested as a solution 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.

A more achievable alternative to self-assessment, at least in the short-term, would be for ratepayers to provide more information to the VOA on a more frequent basis in order to assist with annual revaluations. As previously mentioned, our members are willing to provide timely information in order to enable a more responsive and accurate tax system, provided that the process is simple and

minimises the administrative burden (offering the option to submit an annual declaration that there have been no changes to the property), and that confidential information about the ratepayer is not shared outside of the VOA. A centralised, online system to support this would be critical to make it work for businesses; however, many businesses would be cautious about an open register.

13. What are your views on the relative importance of the period between the AVD and compilation of the list vs. more frequent revaluations?

There are two elements of the business rates system that could be improved to better align business rates bills to the economic cycle: 1) the frequency of revaluations and 2) the time between the AVD and the new rating list. A combination of changes will be needed to both of these in parallel.

It is clear that the business rates system is slow to respond to changes in both the commercial property market and the economy. This is due to the length of time between the date commercial properties are valued for a revaluation, the AVD, and the start of the new rating list (when the updated rateable values and UBR are applied). Having revaluations only every 5 years accompanied by a 2-year gap between the valuation date and the impact on the business rates bill means that business' annual payments do not reflect actual property values. 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. This would also remove the need for transitional arrangements or one-off measures such as the Covid-19 business rates holiday that are difficult to target to those businesses who need it most.

The next revaluation in 2023 is expected to have an AVD of 1 April 2021 with the new rating list commencing on 1 April 2023, a period of two years. 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. The Scottish government have recognised this challenge by announcing a reduction of the AVD to 12 months for the 2023 revaluation in Scotland. The government should consider taking a similar approach to reduce the uncertainty surrounding rateable values.

However, delaying the AVD will mean shortening the period between the AVD and the start of the new rating list. To be able to do this will require more resource for the VOA, together with better supply of information to 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.[10, 11] 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.[12] 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. With some additional resource, we think it is realistic to expect the VOA to undertake the 2023 revaluation adopting an AVD at 1 October 2021, rather than 1 April 2021. Withing the current economic uncertainty and financial strain on businesses caused by Covid-19 and the many local lockdowns, we are concerned that the economy will not have recovered sufficiently by April 2021 for the rental transaction market to be sufficiently stable such that the VOA can determine reliable rating valuations.

To support the VOA with these changes, the government should increase its funding at their Comprehensive Spending Review (CSR) to, as a first step, offset the fall the VOA saw in its funding in 2018/19. This has formed a key part of our ask in tranche 1, as well as our CSR submission. Going forward, 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.

We therefore re-iterate that the government should ultimately aim to get to annual revaluations. Appreciating that this would be difficult to achieve immediately given the constraints discussed above,

[10] VOA (2009) Annual report and account 2008-09
[11] VOA (2019) Annual report and accounts 2018-19
[12] VOA (2019) Annual report and accounts 2018-19

we maintain our recommendation in Q10 and propose a phased approach to increasing the frequency of revaluations and reducing the AVD period.

14. What are your views on changing the definition of rents used in the valuation process? How could this be done in a way that most fairly reflects the value of the property?

Rental information is fundamental to the current valuation approach. The VOA analyses and adjusts all rental information from discrete locations for particular types of property, for example shops on a high street. Some ratepayers would like a system that is more directly based on the actual rent they pay. This would mean changing the definition of rent in the valuation process, from estimated open market annual rental values. Many properties are not rented, and so any valuation system will need a basis on which to value these properties.

However, this could have a detrimental effect for businesses more heavily dependent on physical space, such as warehouses and industrial plants, which have seen strong rental growth in recent years due to an accelerated shift in digitalisation and remote working as the knowledge-economy grows and technology enables new ways of working.

Fundamentally, we believe the business rates system should continue to seek to achieve fairness through a "tone of the list" whereby all properties in the same location and used for similar purposes are valued on the same basis, by a common yardstick (i.e. market rental value). This should not be changed.

15. If you have had concerns over the specific method of valuation applied to your property, what were these concerns and how could the process be improved?

We would re-iterate that a uniform basis of valuation should be adopted for each class of property. One of our members has quoted an example of the VOA seeking to change the valuation basis for certain properties within a class of property from 'Contractors' to 'Receipts' in order to maximise the valuation of the larger profitable occupations. The VOA is also seeking to use Contractors on the smaller unprofitable properties. In other words, changing the valuation basis within a class of property to maximise the rateable value. We believe this should not be allowed to happen.

16. What are your views on the design of the transitional relief scheme, and how transitional arrangements should be funded, given the requirement for revenue neutrality?

Transitional relief limits the amount by which business rates bills can change each year due to 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.

While, on average, the rateable value of properties[13] increased at the 2017 revaluation by 9%, the regional disparities were 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.[14]

Businesses located in areas where property prices have increased significantly have been supported by the introduction of transitional arrangements[15], enabling them to adjust to their new business rates bill gradually. However, as the transitional arrangements are also in place for those properties where their rateable value has decreased, businesses occupying these properties have taken on the burden of the overall value shift. As a result, businesses in areas where the rateable value fell were unable to benefit from a reduced business rates bill immediately. Not only are these businesses located in

[13] The total value of properties that forms the business rates tax base.
[14] 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.
[15] 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.

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.

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 and targeted reliefs are typically the changes announced during fiscal events which only support a small share of business rate payers.

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.[16] 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 over four years.[17]

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 recovery of those businesses.[18] Avison Young's research finds that the North West and Yorkshire & Humber saw the biggest impact from the transitional relief scheme as part of the 2017 revaluation, while at the same time 2018 GDP growth in both of these regions lagged behind the UK as a whole in both regions.[19] For businesses in these regions, there is therefore a double hit.

It is therefore clear that transitional relief has had a distortive effect on ratepayers. We have therefore long argued that downward relief should be removed. We also maintain that annual revaluations would remove the need for transitional arrangements in the first place. Until annual revaluations are achieved, the relief could be funded through a supplement outside of the business rates system; longer-term, however, the move to annual revaluations would eliminate this cost to Government altogether.

We would re-iterate the recommendations from our tranche 1 response:

2. 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.
3. It should also remove transitional arrangements for properties whose rateable value decrease 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 cost to government will vary depending on the outcome of the revaluation and the detail of the transitional scheme but based on previous schemes this could cost in the region of £1.5 to £2 billion.
4. While revaluations occur less frequently than annually, the government should consult on alternatives to transitional arrangements that support those businesses facing a sudden increase in their business rates bill, while allowing those facing a decrease to move to that

[16] Avison Young (2019), Win, lose or draw
[17] This is based on Avison Young (2019) Win, lose or draw but updated to reflect the business rates holiday.
[18] IPF (2013) The Role of Commercial Property in the UK Economy
[19] ONS (2020) regional economic activity by gross domestic product, UK

new bill immediately. Moving to annual revaluations would subsequently negate the requirement for transitional arrangements.

Plant and machinery and investment

17. What evidence is there that the business rates treatment of P&M and changes to property affects investment decisions?

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.[20] The high tax burden and the inclusion of some P&M in the rateable value prevent businesses, both national and global, from investing in buildings, public infrastructure, 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.[21]

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. Including P&M within 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. 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.

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

Business investment is a key enabler of productivity improvements and as a result future prosperity. 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.

As business rates are a fixed cost, an increase in the burden (following an increase in the tax rate) 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.

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.[22] This comes

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[20] Department for Communities and Local Government, Housing supply; net additional dwellings, England: 2016-17, November 2017.
[21] ONS (2020) Gross fixed capital formation by sector and type of asset
[22] ONS (2020) GDP first quarterly estimate, UK: April to June 2020

at a time where business investment is already subdued due to Brexit uncertainty.[23] 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.[24]

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. To aid the economic recovery, it is therefore crucial that policy encourages rather than discourages businesses to invest.

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.

An example coming from a large manufacturing firm operating across multiple sites shows that the scale of the investment required to upgrade many of their legacy sites to simply bring them up to modern standards and maximise energy efficiency, ensuring that they are fit for purpose in relation to modern manufacturing techniques would far outweigh any return on investment. We believe there should additional relief or discount for this category of sites in order to incentivise upgrade.

Our recommendation from the TSC submission stands:

5. Review the P&M regulations to ensure they are relevant for the 21st century, with a statutory commitment to keep this under regular review to ensure it keeps pace with a changing economy and advancements in technology.

18. Are the current P&M principles and regulations still relevant? How could these be updated if necessary, and what would the effect of any proposed changes be?

P&M is the physical equipment in or on a non-domestic property, other than the structures or buildings themselves. Common examples include lighting systems, lifts and machines used on production lines. For business rates valuation purposes, all items of P&M are exempt unless the P&M regulations specifically list them as needing to be considered in valuations. Therefore, in a business rates context, P&M is confined to this defined list of items.

The Valuation for Rating (P&M) (England) Regulations 2000 set out a list of potentially rateable P&M under four classes:

Class 1*: 'power generation, storage and transmission etc.'*

Class 2*: 'services – heating, lighting, water supply, hazard protection etc.'*

Class 3*: 'infrastructure - telecommunications cables, wires, lifts, pipelines, railway tracks etc.' and*

Class 4*: 'named structures such as masts, bridges, dams, fixed cranes and tanks'.*

Many of the defined items are often referred to as 'service' P&M which allow the property to be used for its intended purpose. For example, heating and lighting are essential to use a building as a factory, so these are of value and are considered in a property's valuation. Conversely, other essential or integral features are treated as P&M. The steel and foundation works for certain advertising structures

[23] Ibid.
[24] CBI Quarterly Trends Surveys, Q3

(e.g. large digital billboards) have been treated as P&M, yet are clearly an integral part of the rateable asset, not additional apparatus used by the business to generate revenue.

However, the listed P&M is exempt from a property's valuation if it is used in connection with the occupier's specific activities. For example, if a factory is used to prepare food, the P&M used to control the temperature for hygiene purposes will be exempt. This is known as 'process' P&M and the exemption is often referred to as the 'tools of the trade' exemption. There are other anomalies. For example, CCTV is now deemed rateable, yet in most circumstances not only is it not a permanent fixed asset, it does not add any meaningful value to the physical assets subject to business rates.

The scope of P&M was last reviewed in 1993.[25] Since then, there have been a lot of changes in the way businesses operate and the technologies they use meaning the current scope of P&M 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. We, therefore, believe that including P&M within the rateable value is a tax on investment and goes against good tax policy making principles.

When making investments that improve an existing property, these investments can immediately increase the market rental value of the property and as a result the property's rateable value and its associated business rates liability. This means that when improving the specification or expanding part of an existing premise, the business rates liability can increase immediately after the scheme of works reaches practical completion, regardless of whether the improvements have started to deliver value for the business. In reality it takes time for businesses to get back to full operation following property improvements, which means that in the interim, businesses that improve their properties are hit by a potentially significant increase in their business rates bill.

Often, this can be the deciding factor when evaluating an investment proposal, as the increase in the rateable value of the property (and the resulting increase in the business rates burden) reduces the commercial viability of undertaking that investment. This effect can be particularly pertinent for foreign businesses deciding where to locate a business that requires the acquisition of property, and as a result could reduce the UK's international competitiveness.

While a notable proportion of the value relating to P&M is exempt from business rates[26], the current business rates P&M regulations[27] provides a list of P&M that is rateable for business rates purposes. Therefore, in some cases investment in certain P&M not only increases the rental value of the property, but can also increase the scope of the property that is rateable, resulting in a higher business rates liability. This list can therefore often act as a barrier to investment in improving energy efficiency.

Broadly, the regulations stipulate that where P&M forms part of the economic activity undertaken within the building, known as 'process P&M', it should be exempt from business rates (for example, a food manufacturer may use P&M to control the temperature for hygiene purposes). Under the regulations the Valuation Office Agency (VOA) should only have regard to P&M which increases the value of the building, known as 'service P&M', which allows the property to be used for its intended

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[25] 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

[26] This has been the case since the Rating and Valuation Act 1925 [the "1925 Act"]. Only the items contained within the Third Schedule to that Act were rateable [s.24(1)(a) of the 1925 Act]

[27] *Valuation for Rating (Plant & Machinery) Regulations,* 2000

purpose (e.g. heating or lighting).[28] The associated P&M regulatory list identifies named items which are specifically rateable. Within this list, many items that would enable a more productive use of a building, including some digital (e.g. fibre) and green technologies (such as renewable energy), are rateable.[29]

Therefore, if these P&M items are installed within a building, the property's rateable value and consequent business rates liability would increase. This higher business rates bill would apply from the date of completion of the works and therefore before any return on investment can be realised, which often reduces the investment's commercial viability. The increase in the property's rateable value act as a barrier to investing in certain P&M items for the landlord or owner-occupier, as well as holding back any potential cost savings and productivity gains these investments could realise for the occupier.

As evidenced, the business rates system can often discourage investments that should be financially viable from being realised. To address this, we recommend the introduction of a new business rates exemption scheme of at least 12 months for properties in England that have undergone improvement works. This means that, subject to the ratepayer notifying the VOA of any improvement works, for example through confirming the updated specification, the rateable value would not immediately increase to reflect these improvements, with the original rateable value maintained for the subsequent exemption period following completion. After this initial exemption, the rateable value would then increase to reflect the improvement works and the revised liability would be payable. To discourage poor behaviour, if the improvement works are not declared, the VOA would have the ability to retrospectively increase the property's rateable value from the date of practical completion of the works.

This proposed scheme would operate in a similar manner to the Business Growth Accelerator Relief introduced in Scotland in April 2018, with some adjustments to address the limitations of the Scottish scheme. Properties which undergo improvements as part of a change of use, and assessments which are split or merged yet also improved during this process, do not qualify for the Scottish Accelerator relief. The proposed English scheme would have a wider scope to encompass these scenarios, ensuring that all property improvements can be effectively incentivised.

Delaying the increase in a property's rateable value will allow the business to start realising the benefits of their investment before being hit with the additional cost of business rates, as well as providing adequate time to plan for an increase in their total liability the following year. This will enable businesses to put forward a more viable investment case to undertake improvements to their property or wider property portfolio. It will also promote self-certification by encouraging landlords and occupiers to provide the accurate property data to the VOA. Access to real-time information would assist the VOA in its duty to maintain an accurate ratings list, as well as reducing the workload for the billing authorities in undertaking inspections and background research to identify those properties undertaking works.

The evidence also demonstrates that part of the barrier to business investment is explained by the inclusion of certain P&M within the scope of a property's rateable value. While there is a rationale for many of the current components to remain as named items, the P&M regulations have not been reviewed since 2000 and are therefore lagging the speed of technological advancements of the modern economy. The current legislation refers to many historic practices from much before the 21st century and does not refer to many of the new technologies coming onto the market. The government therefore needs to consider whether the existing regulations remain appropriate and relevant twenty years later.

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[28] Regulation 2A [SI 2000 No 540] provides, by virtue of s.26(2) & (3) of the Climate Change and Sustainable Energy Act 2006, for the exemption from rates of microgeneration installations generating less than 50kW electricity or 45kW thermal energy for use on the property.

[29] Table 1, Page 5 - Valuation for Rating (Plant and Machinery) (England) Regulations 2000 [SI 2000 No 540]

A review of the P&M regulations should form part of the government's current fundamental review of business rates. The review should include consultation with business to determine what should and should not be included. Further to introducing updated P&M regulations, a statutory commitment to keep this list under regular review should be introduced to ensure it keeps pace with technological improvements. As part of this, the government should consider reviewing the P&M regulations at each revaluation. Modernising the P&M regulations on a regular basis will ensure they support the government's wider policy objectives and enable, rather than hinder, business investment in property and P&M that has wider economic and societal benefits.

Recommendations:

6. Introduce a similar measure to Scotland's Business Growth Accelerator that enables improvements to existing properties to receive a 12-month exemption as the absolute minimum from increased business rates payments to encourage investment in the existing property stock.

We also re-iterate recommendation 5 above.

19. What evidence is available on the potential benefits of exempting certain types of P&M on a permanent or time-limited basis?

Generally speaking, temporary reliefs are aimed to incentivise socially and environmentally beneficial behaviours, whereas permanent changes to the tax system are mostly about addressing inefficiencies in the tax system. There is an argument to exclude certain P&M temporarily as an incentive to change behaviour. This could, for example, be a mechanism to encourage investments that align to the government's strategy e.g. net-zero, rolling out full fibre etc.

We believe that including certain elements of P&M in business rates goes against good tax principles, and works against other objectives important to government, such as incentivising investment generally, and in particular green investments. While we recognise that exempting all P&M from business rates would be costly, we believe there is an opportunity to use this fundamental review to determine whether any elements of P&M should be excluded permanently.

20. What practical challenges would the implementation of wider exemptions for P&M pose, and how might those be addressed?

We recognise there are practical challenges with exempting certain P&M as sometimes this is implicit in rental values. However, the practicalities would depend on the P&M that is exempt. We generally feel that there should be no difficulties in implementing wider exemptions for any items of P&M that are not normally provided as part of the building demised by landlord to tenant, but are added subsequently to meet the specific needs of the occupier.

Where difficulties might arise is if one was to exclude P&M which is included in the property for which a rent is being paid that valuation difficulties can arise. Where there are issues, solutions to this could be: 1) applying a percentage reduction to account for the exemption, 2) increasing the information provided by ratepayers on upgrades etc.

21. How can business investment and growth best be supported through the business rates system, and how effective would business rates changes be compared to other available measures?

Investment is a key enabler of economic growth both now and in the future. Higher rates of business investment drive future productivity growth and higher standards of living. However, the UK underperforms relative to its international peers on levels of business investment, as our *Catching the*

Peloton report shows[30]. The UK has stood at the bottom of the G7 league table for close to four decades and the gap between the UK and the rest appears to have widened. In the UK, business investment accounts for 10% of GDP, compared to 13% across the G7.

The UK's comparatively weak business investment has also been attributed to the relative decline in its manufacturing sector over time: the notion being that manufacturers invest more in "physical" assets than services firms, so a shrinking manufacturing sector is directly linked to falling investment intensity. The importance of buildings and P&M to business investment (49% in Q2 2020, down from 67% twenty years earlier) is particularly pertinent, but this has been declining as intangible investments have increased in importance (44% in Q2 2020, up from 27% in Q2 2000).[31] But while the UK economy has undoubtedly undergone profound structural changes, these still do not explain the bulk of the UK's underperformance in business investment. Indeed, other advanced economies experienced similar changes over the same period without corresponding declines in their investment intensity. Supplementary evidence suggests this weakness in growth for buildings and P&M could be partly explained by the tax landscape. [32]

Firstly, the UK relies more heavily on property-based taxes than across the rest of the G7. OECD data shows that UK property taxes as a share of GDP are the highest across the G7, at 4% compared to 1% in Germany.[33] This reliance has been increasing over time while over the same period countries such as the US and Japan have seen a relative decline. This means the tax burden associated with operating a business in the UK that requires commercial property is higher than in other G7 countries, which makes the UK less attractive to international investment particularly when that investment requires the acquisition of commercial property.

Another contributing factor is that tax incentives on industrial buildings and P&M are less competitive in the UK relative to the rest of the G7. Analysis in the CBI's *Catching the Peloton* report finds that when purchasing an asset, the cost businesses can recover using capital allowances is the lowest in the G7, which was explained by: 1) the absence of capital allowances for industrial buildings and 2) one of the least competitive capital allowances regimes for P&M (second to last after Germany).[34]

The government has subsequently announced the structures and buildings allowance (SBA) at the 2018 Budget as a step to addressing this.[35] However, similar analysis conducted for 2019 finds that this has only moved the UK up one rank to sixth place when looking at the competitiveness of the overall capital allowances regime, with the UK now just slightly ahead of Japan.[36] The UK is still significantly lagging the top performer, France, because both the cost businesses can recover on P&M and buildings in the UK is well below that on offer in France.[37] It is clear therefore that the UK tax system could go further in encouraging businesses to invest in commercial property.

The policy environment created by government plays an important role in giving firms the confidence to invest and try out new approaches to running their business. The government has a range of policy tools it can use to affect the environment for business investment, for example through investment in infrastructure and skills, or through improving access to finance. But tax policy is one of the few ways in which the government can directly stimulate demand for business investment.

The role of tax in businesses investment decisions is often oversimplified, with a large weighting being placed on the headline rate that businesses pay on their annual profits. However, when businesses

[30] CBI - *CATCHING THE PELOTON THE BUSINESS INVESTMENT RACE AND HOW THE TAX SYSTEM CAN HELP THE UK TO CATCH-UP, August 2018*
[31] ONS, Business Investment by Asset, September 2020
[32] Industrial Strategy: UK Sectoral Analysis", BIS Economic Paper no.18, September 2012
[33] OECD Revenue Statistics, 2019
[34] CBI – *Catching the Peloton*, August 2018
[35] SBA is a capital allowances regime for certain of the costs of constructing or acquiring new structures and buildings, incurred on or after 29 October 2018. The allowance is at a headline rate of 2% per annum on qualifying expenditure to 31 March 2020 and 3% per annum on qualifying expenditure thereafter.
[36] Capital Cost Recovery across the OECD, 2019
[37] Ibid.

are considering an investment decision, the headline rate is only one factor among many. While low tax rates can help to encourage investment at the margin, the infrastructure underpinning the tax system is just as important. Stability, predictability and level playing fields are some of the factors that will impact businesses' decisions. Where the rules and their application are not transparent, too complex, or unpredictable, this increases the cost of the investment and adds to uncertainty over profitability.

One area of tax policy often cited by business as a barrier to investment is business rates. As stipulated in the CBI's response to the Treasury Select Committee's inquiry, business rates are a key factor for business when making investment decisions relating to commercial property.[38] Whether that investment is the acquisition of a property or an improvement to an existing property, business rates matter because an investment in a property results in a revised business rates liability.

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

A manufacturer recently reported that *"business rates are considered as contributing to the increasing cost of doing business in the UK, particularly in comparison to other European sites, and represent a drag on productivity at a time of economic uncertainty"*. Within the context of delivering greater operational efficiencies and cost savings for the business, business rates reportedly have an impact on the business cases associated with investment in P&M. They also posit that, as the Industrial Buildings Allowances (IBAs) was phased out from 2008/09, having no tax relief for industrial buildings fails to incentivise investment across the manufacturing sector in the UK.

Recent work commissioned by Tesco[39] also finds that business rates also reduce and damage investment in the areas most in need of levelling up, and that shops face a rates burden of 8% of economic contribution - double the next closest sector.

As evidenced, the business rates system can often discourage investments that should be financially viable from being realised. The business rates exemption scheme proposed above should go some way towards addressing this.

22. How could the business rates system support the decarbonisation of buildings? What would the likely impact of any changes be compared to other measures, including other taxes, spending or regulatory changes?

The built environment contributes around 40% of the UK's total carbon footprint. Within this, commercial buildings account for 14% of emissions from the UK's building stock.[40] While the carbon footprint of the built environment has reduced since 1990, the Committee on Climate Change's (CCC) most recent advice to Parliament highlights limited progress in reducing emissions from buildings over the last decade (a 13% reduction from 2008-18).[41] By comparison, the power sector saw a 67% fall in emissions during 2008-19, achieved through a "well-designed, coherent and effective package of policies to encourage low-carbon investment", according to the CCC.[42]

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[38] https://www.cbi.org.uk/articles/cbi-submits-evidence-to-inquiry-into-the-impact-of-business-rates/
[39] https://wpi-strategy.com/case_study/tesco-open-for-business/
[40] House of Commons Business, Energy and Industrial Strategy Select Committee, *Energy efficiency: building towards net-zero*, July 2019 https://publications.parliament.uk/pa/cm201719/cmselect/cmbeis/1730/1730.pdf
[41] Committee on Climate Change, *Reducing UK emissions, Progress report to Parliament*, June 2020
[42] Ibid

Reducing energy demand, as well as encouraging more efficient energy use will play an important role in making further progress. Improving the carbon footprint of commercial property is a clear area where progress can be made with the right regulatory and policy frameworks, as well as sufficient access to information and finance. Commercial buildings are also prime candidates for onsite renewable power generation and low carbon heating and cooling solutions, due to the availability of space and the financial benefit of reduced energy costs that can be delivered from deploying clean technologies.

While some green technologies are considered rateable, the regulations do explicitly specify the exemption of microgeneration on the property in order to support the objectives in the Climate Change and Sustainable Energy Act 2006.[43] Furthermore, providing the ratepayer has a Climate Change Levy certificate, combined heat and power plants are also not rateable. There are, therefore, clearly inconsistencies in how P&M which can improve a building's energy efficiency is treated within the current regulations.

Moreover, technology has advanced significantly since this these regulations came into force, rendering the list of exemptions obsolete and leaving many new, and more efficient, technologies that meet the same objectives within the scope for rating. Examples of these newer technologies include: Electric Vehicle (EV) infrastructure; energy storage systems (including batteries); hydrogen 'ready' boilers; heat networks; more efficient heat pumps, biomass boilers, hydro power, or solar photovoltaics (PV); other self-generated renewable energy; and energy to grid services (e.g. flex, smart and vehicle-to-grid).

While such technologies would notably increase a property's energy efficiency and reduce a property's carbon footprint (behaviours the government is looking to encourage), business rates often act as a barrier to the roll-out of these technologies. Business rates in its current form therefore works against the government's wider objectives to tackle climate change and reach net-zero by 2050.

the scale of the challenge to retrofit the existing stock of commercial property is significant. While newly constructed buildings are more energy efficient, 80% of domestic and non-domestic buildings in 2050 will have already been built.[44] This scale represents a huge opportunity: if the government raises the minimum Energy Performance Certificate (EPC) level to a B rating by 2030, this would result in 85% of the existing building stock requiring an upgrade, delivering energy bill savings estimated to be in the region of £1 billion to businesses, whilst creating a trajectory worth £6.1 billion (NPV) to the UK economy.[45] Landlords would also benefit from these energy efficiency improvements through higher rental values and lower operational costs during periods when a property is vacant.

The road to net-zero buildings will require a shift in the way the existing stock of property is improved and upgraded. As the government and regional authorities have signalled, building standards and regulations (such as the Minimum Energy Efficiency Standard, or MEES) are set to tighten over time to 2050. Landlords and occupiers will therefore be mandated to either follow the national regulations or, where planning requires, follow tighter local and regional planning requirements at an accelerated pace for larger projects and new developments. However, at the same time, the business rates system acts as a barrier to investment in decarbonising commercial property.

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[43] Defined in the P&M Regs at Reg 2A(3) as: *'In this regulation "microgeneration capacity" means the capacity of plant or machinery to be used for the generation of electricity or the production of heat - (a) which, in generating electricity or (as the case may be) producing heat, relies wholly or mainly on a source of energy or a technology mentioned in section 26(2) (interpretation) of the Climate Change and Sustainable Energy Act 2006; and (b) the capacity of which to generate electricity or (as the case may be) to produce heat does not exceed the capacity mentioned in section 26(3) of that Act'.*

[44] Committee on Climate Change, *UK housing: Fit for the future?*, February 2019

[45] BEIS Consultation (2019), The Non-Domestic Private Rented Sector Minimum Energy Efficiency Standards (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/839362/future-trajectory-non-dom-prs-regulations-consultation.pdf)

The need for financial incentivisation towards installing energy efficiency measures was highlighted in the Call for Evidence on the Government's "Energy efficiency scheme for small and medium sized businesses" in 2019. This included linking business rates with energy efficient premises, suggesting that "landlords would be incentivised to improve [the energy efficiency of their buildings] to appeal to businesses attracted by the prospect of lower business rates".[46] There was also a suggestion that building standards regulations (including EPCs) should also apply to non-domestic owner-occupiers. Currently this can only be achieved by building owner-occupiers obtaining voluntary EPCs, which although useful in helping understand a building's fabric and energy efficiency to a degree, are not enforceable through MEES regulations with no onus on the building owner to improve the energy efficiency of the building.

A 'business as usual' approach to encouraging operational efficiency improvements, or simply ensuring that properties are compliant with building regulations, will therefore not be sufficient to achieve the goal of net-zero carbon emissions.

Encouraging green investments that decarbonise buildings will require addressing the barriers to investment occurring in the first place, including the barrier of business rates. In the context of an economic recovery from Covid-19, any savings that can arise for businesses from improved energy efficiency would be welcomed. While business rates is not the only barrier, addressing this barrier will go some way to supporting the net-zero agenda. But achieving this in practice will require collaboration between owners and occupiers, with a shared understanding of the costs and benefits involved.

In the context of an economic recovery from Covid-19, any savings that can arise for businesses from improved energy efficiency would be welcomed. Combining this with the government's policy objective to 'build back better' and the UK's long-standing target around net-zero carbon emissions, it is a critical time to implement schemes that encourage building improvements, in particular those that improve the energy efficiency of commercial property.

However, the initial exemption set out in recommendation 1 may not be sufficient to incentivise businesses to undertake these types of investments due to a longer rate of return before savings can be realised. Therefore, the CBI and Avison Young recommend extending the exemption scheme for investments that improve the energy performance of a property, to provide businesses with the incentive to make these investments now. This will both aid a sustainable economic recovery and contribute towards the government's net-zero agenda.

Enhancing the property's energy performance should be defined through energy efficiency improvements using the level of improvement in the EPC of a property as a measure to determine the additional period of exemption awarded as demonstrated by Exhibit 7. To determine eligibility, the ratepayer would be required to provide certification in the form of a new improved EPC rating. These exemptions would run with the property, rather than a single ratepayer. Even though the ratepayer could initially be the landlord, this exemption would then pass to the occupier (and any subsequent occupiers) to ensure that the benefits and incentives for making the building improvements are shared.

Recommendations:

7. Where property improvements result in an improvement in the property's EPC, those properties should benefit from an additional business rates exemption (in addition to the general exemption proposed earlier) to encourage businesses to reduce the carbon footprint of their buildings. For this to be effective, implementation of the 2020 Action Plan to reform

[46]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/891955/sbees-summary-of-responses.pdf

EPCs must occur in parallel. To reflect the scale of the improvement, we propose a period of 6 months exemption for 1 band improvement, 12 months for 2 bands, and 2 years for 3 bands.

8. Exempt certain existing P&M and new technologies that directly link to the ‘green’ agenda (including solar PV and heat pumps) from the P&M regulations to help stimulate investment in the green economy.

Valuation transparency and appeals

23. What further changes would you like to see made to the (a) Check, (b) Challenge and (c) Appeal stages?

We have previously argued that 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. One example demonstrates that the CCA process is particularly poor for industries that pay rates on thousands of relatively low value assets. It would be more efficient if there was scope for certain industries, like the out of home advertising sector, to be able to group multiple assets under a single appeal. This would be beneficial both for ratepayers and the VOA.

It is essential, for confidence in the business rates system, that there is an effective right of appeal that is simple to use, understandable, and that changes incorrect rating assessments speedily. Currently, when a rating assessment is incorrect, it takes too long to correct it. Urgent and wide-ranging changes are needed to restore ratepayer confidence in the CCA system.

In some other jurisdictions all information is available online so ratepayers 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 without them having to first initiate a Challenge, rather than deny them the relevant evidence and impose an onus on businesses to prove the assessment to be inaccurate.

The general view amongst our members is that the CCA system would work if more information were to be provided by businesses and if, similarly, the VOA were to share the evidence based on which valuations have been made, allowing the ratepayer the chance to understand the VOA’s reasoning for its valuation without first having to challenge the assessment. Once we reach annual valuations with the VOA justifying its assessments, then a system akin to CCA with the ratepayer having to explain in detail why the assessment is incorrect would be acceptable. This way a ratepayer could do straight to ‘challenge’ as the ‘check’ will have been undertaken as part of the process which leads to the VOA providing the rental evidence.

We re-iterate our previous recommendation from our submission to TSC:

9. 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.

24. What are your views on sharing information, such as rental/lease details, with the VOA? What are your views on the risks and benefits of this information being shared with other ratepayers, public sector organisations or more broadly?

Both owners and occupiers recognise that more frequent revaluations are needed and the only way to achieve this is for there to be a requirement for notification of lease events to the VOA and for the VOA to use that data in a sensitive way. Commercially sensitive information (e.g. rental/lease details) should not be shared publicly or with ratepayers other than those whose properties have been valued having regard to a particular piece of rental evidence.

25. What are your views on who can currently use the CCA system and become party to a challenge or appeal? What are your views on who can use the system, when and on what grounds?

We are not supportive of any change in the current position.

Maintaining the accuracy of ratings lists

26. What are your views on introducing a requirement to provide the VOA with rental information, either routinely or where changes to a lease occur?

See our answer above. We generally consider this would be an acceptable development if ratepayers could see the benefit through a more accurate rating list and more frequent revaluations with transparency from the VOA. However, we once again highlight that this must be as simple as possible and minimise the compliance burden on business, and ensure that confidential information is treated with sensitivity and not shared outside of the VOA.

27. What are your views on making a register of commercial lease information publicly available?

See above. Most of our members are against this.

28. What are your views on introducing a requirement to notify the VOA or billing authority of changes to a property that could impact the business rates liability?

As argued above, while this would support the VOA in reaching annual revaluations, we believe that annual declarations of changes to the property with pre-defined, standard questions and established timeframes for responding, would be a more efficient and acceptable approach. This would reduce the administrative burden for businesses where there are no changes to declare and making it clear for smaller businesses what changes and when to notify. Most property changes require either planning or building control consent and there should be an avenue whereby these can be shared with the VOA. The annual declaration would identify if the consent had been implemented – or the VOA could ask the question specifically having learned of the existence of planning or building consent.

The Billing process

29. How can the current billing process be improved? What changes would provide the most significant benefits to ratepayers through for example, cost or time savings?

Most of our members believe that the current billing process should be digitalised, to reduce administrative costs to ratepayers. Business would welcome a centralised online system, provided it allows the ratepayer to view and challenge their bills across different sites and different local authorities. Multi-site occupiers seek consistency from the 300+ billing authorities in England. For businesses that have thousands of assets, the current system means several sheets of paper are sent in relation to each asset. Not only is this inefficient and costly to the public purse, but it is also harmful to the environment, therefore a digital platform to engage with billing would be welcomed. Ideally, businesses (and their advisers) should be able to access a central portal where it is possible to see all their properties and the liabilities, discharging bills in one go with one monthly payment rather than to each authority. They should be able to query and challenge bills through the same portal. We do recognise that building this sort of system is likely to take some time, therefore in the meantime there is merit in considering whether short-term improvements could be introduced, for example, a centralised billing template to ensure consistency between local authorities.

30. What are your views on a centralised online system linked to other business taxes, enabling more joined-up data and management of billing across different locations? How could this best support ratepayers and billing authorities?

See our points in Q29 above. There is a clear case for streamlining and digitalising the billing system, particularly for businesses who operate across multiple sites and local authorities. We are generally in favour of changes which better allow effective and timely business planning and improves a business's ability to understand and challenge their bills. Extending the M*aking Tax Digital* approach for VAT payments to include business rates would therefore be welcomed.

However, we expect that any significant changes to billing processes will likely require new systems and training to be able to comply with these new processes. We therefore feel it will be crucial to provide businesses sufficient time to transition to this.

Recommendation:

10. Transition period for the implementation of a centralised billing system from the announcement to the date the business should start to be compliant with the new processes
11. More lenient penalties in this transition period while businesses learn the new way of billing.

31. What sort of support would businesses and agents expect to receive when moving to a centralised online process, and from where would you expect to receive it?

There are no member views which we can share on this matter.

32. What, if any, criteria should be applied in exempting certain ratepayers from online billing?

We would be in favour of learning from the experience of *Making Tax Digital* and borrowing the criteria used in its application, which starts with larger businesses before moving onto smaller businesses. We believe this would be a fair approach as larger businesses are more likely to be able to make a smoother transition, whereas a lot of smaller businesses still do their tax filings on paper.

Exploring alternatives to business rates

33. What are the likely benefits and costs of implementing a CVT? What are the practical implications of implementing a CVT?

Our TSC submission has previously discussed alternatives to business rates. 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, the current way the business rates system operates is unfair and unsustainable, and therefore needs to be fundamentally reformed. Businesses believe 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 them to invest and grow.

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.[47] 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 and knowledge-based 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 shift operations online and remote-working becomes the new-normal

[47] Tax principles stipulated by the OECD, the IFS and others.

for some industries, while others that continue to rely on commercial property (whether industrial, retail, or office) are more exposed.

Longer-term reform should be considered in the context of the whole suite of taxes borne by businesses. Businesses contributed almost 32% to tax revenues in 2019/20. 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.[48] 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 Capital Values Tax (CVT) remains a possible alternative to a fundamental reform of the business rates system that has been considered historically. Our members are not supportive of this option, and there is a general preference towards reforming the business rates system rather than replacing it altogether. Our members believe that the practical issues with implementing a CVT would outweigh those involved in reforming business rates, and the benefits of this change are not clear. Furthermore, the CVT implementation is currently restricted by the availability of a complete register of Freehold ownership within the country, which the Land Registry is aspiring to complete by 2030. We also believe that, while the CVT works in countries where it is well-established, in order for the system to work in the UK, it would require a re-basing of the tax rate to significantly lower levels, as business rates are much higher than comparable recurrent property taxes in the EU and OECD countries.

Fundamentally, we believe rental values are not currently reflected in the business rates system in real time, and the administrative task involved in the valuation for the purpose of implementing a CVT would not overcome this issue, particularly as data on capital transactions is even less easily accessible than rental value data. This would add to the difficulty of establishing a fair value and, therefore, a fair tax liability for the ratepayer.

Moreover, the transition of the business rates bill from the occupier to the property owner or landlord could prove challenging and disruptive. Replacing the business rates system with a CVT would mean a complete overhaul of the system, which cannot be achieved overnight, and does not guarantee additional long-term benefits to warrant this approach relative to an immediate reform of the current system.

Our members feel that, if the government is to consider this approach, it should run a comprehensive consultation with both ratepayers and property owners to understand the impact of the change in the burden distribution. It should also ensure a gradual transition to the new system to ensure that the same challenges within the current business rates system are not carried over into a new system. However, given the long-time frame involved in implementing this change, we strongly feel it is critical that in the short to medium term, the government focuses on reforming the existing business rates system.

39. What other international alternative approaches to the taxation of non-residential land and property merit consideration for England?

As mentioned earlier, the UK relies more heavily on property-based taxes than across the rest of the G7 and this reliance has been increasing over time while over the same period countries such as the US and Japan have seen a relative decline. This would make alternative taxation approaches significantly more difficult to implement in the UK, as the main criticism for the current system is that the tax rate is too high and unstainable.

40. What would be the benefits and risks of introducing an online sales tax?

Given the broadness of the CBI’s membership, it is difficult for the CBI to arrive at a consensus on the implementation of an Online Sales Tax. While some members have clear views on the matter,

[48] CBI analysis of ONS receipts data

amongst those, there is a clear division on the way forward. The CBI are therefore unable to provide a firm view on this topic, and instead will leave it to the individual members to make their representations. Members do however agree that the Government should continue to listen to the views of various businesses on this issue.

As previously stated, there is wide agreement amongst our membership on an immediate need to reform the business rates system as in its current form the burden is unsustainable. Businesses believe 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 them to invest and grow.