DEMOS

TIME FOR CHANGE:

ABOLISH BUSINESS RATES AND INTRODUCE A LANDLORD LEVY

JAMES SWEETLAND
CHARLES SEAFORD
BEN GLOVER

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15 Whitehall, London, SW1A 2DD
T: 020 3878 3955
hello@demos.co.uk
www.demos.co.uk

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While the names of the businesses we interviewed are not included within the report, their contribution to this project has been considerable. The willingness of tax directors (and other senior professionals) from some of the largest businesses in the UK to spend time speaking with us has been vital to the research published here and in the project's first report, *Race to the Top*.

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James Sweetland
Charles Seaford
Ben Glover

EXECUTIVE SUMMARY

The UK faces a significant fiscal challenge in the near future, partly due to the costs of Covid-19 but also due to structural factors, such as our ageing population, that predate the pandemic. As part of a wider programme of work at Demos examining who should pay for this, we have investigated whether the UK government can raise more revenue from businesses, without causing economic or political problems.

In our previous report, *A People's Budget*, the public told us that any attempts to raise taxes on individuals must be accompanied by efforts to raise taxes on businesses too. If not, tax rises on the general population will be deemed unfair and illegitimate by the public.

Business rates currently raise over £30bn: a significant amount of revenue that we should at least look at the potential for increasing, given the UK's fiscal challenges. However, our research - drawing on 20 interviews with tax directors or equivalent at large businesses with UK operations - finds a number of legitimate issues exist with the current business rates regime. Only once these have been resolved can we begin to consider increasing the tax take in a way that would minimise the backlash from businesses.

But tinkering with the existing regime is not enough. This may make life a little better for some businesses, but it will not remove the blocks - primarily political in nature - which we identified to raising more revenue from commercial property. Only by abolishing the business rates system and replacing it with a new Landlord Levy can we unlock the scope for higher revenues while simultaneously delivering the practical fixes that the system needs.

While business rates are not the root of the problem for high streets, a shift to a Landlord Levy will also deliver a much-needed boost to brick-and-mortar retailers. Our proposed system would have several substantial benefits for retailers. It would shift the administrative burden of paying business rates from tenants to landlords, it would remove existing disincentives to invest in buildings and it would create a system of payments that better reflects changing market values and economic conditions.

We therefore propose that:

1. Commercial landlords become responsible for paying tax on commercial property - in place of tenants, who pay under the current system.
2. The tax base for commercial property is based on land values only, rather than the land value and the building value combined.
3. The level of tax payable by a commercial landlord is set and revalued regularly, with reference to rental values.

This proposal would benefit businesses by fixing fundamental flaws in the current system, and benefit taxpayers by unlocking the potential for higher revenues going forward. There are, inevitably, some administrative issues and practical concerns to address if this is to be implemented, but these are not deal breakers.

The need to raise more revenue as we emerge from Covid-19 shows that the time has come to abolish business rates and introduce the Landlord Levy.

INTRODUCTION

The UK faces significant medium to long-term fiscal challenges. In the long term, our ageing population will require significantly higher public spending as we move into the 2030s. In the medium term, particularly in light of Covid-19, there will be strong pressure to invest more in our public services. For example, a recent study by the London School of Economics and the Lancet estimates that spending on health and social care must increase by £102bn over the next decade to improve the UK's health.[1]

Given there is little public appetite for more austerity - particularly after the heroic efforts of public servants during the pandemic - tax rises are expected to fill the gap once the immediate economic crisis of the pandemic is over. Indeed, this is already the government's direction of travel, with this year's Budget delivering the biggest tax rises for 28 years.[2]

In light of this, Demos is investigating how taxes should be increased, as part of a wider programme of work. Last year, we examined how taxes should rise on individuals and made recommendations for personal tax increases.[3] During this research, the public repeatedly told us that any attempts to raise taxes on individuals must be accompanied by efforts to raise taxes on businesses too. Otherwise, tax rises on the general population will be deemed unfair and illegitimate by the public.

Given this, we have been investigating how higher taxes should be levied on businesses. In our recent report, *Race to the Top*, we laid out a strategy for raising additional revenue by increasing corporation tax rates, based on our conversations with leading UK businesses.[4] We also found that increasing revenue by raising Employers' National Insurance Contributions (ENICs) would be economically damaging and unpopular, so we ruled out proposals focused on this form of tax.

In this report, we address an alternative source of increased revenue: business rates. Business rates are a substantial form of tax for the Treasury, worth around £30bn per year.[5] In addition, they are relatively easy to collect and very difficult to avoid. In this context, we should at least look at the potential to increase business rates, given the need to raise revenue to pay for the costs of Covid-19 and the desire to avoid increases in less appropriate forms of tax, such as employer's national insurance and VAT.

In this report we present a blueprint for doing this, one which involves abolishing the business rates system and introducing a new Landlord Levy on commercial premises. As with our previous work on tax, our aim is to present reforms which benefit the taxpayer and the Treasury, but also minimise the backlash from UK businesses.

We draw on research and interviews we undertook to understand the future of the business tax system. These primarily focused on corporation tax - to inform *Race to the Top* - but some of the interviews also involved discussion of business rates. Our full research base included:

- Desk-based research
- A roundtable with experts and businesses.
- 10 interviews with NGOs, independent experts and accountancy firms.
- 20 interviews with tax directors or equivalent at large businesses with UK operations. Interviews were carried out during March and April 2021.

Interviewees are kept anonymous in this report, with quotes attributed to industries alone, rather than to specific businesses. These industries are defined in broad terms to protect anonymity and are described as:

- Consumer Goods/Retail
- Services

1 Anderson, M. et al. The LSE-Lancet Commission on the Future of the NHS. The Lancet, 2021, Available at https://www.lse.ac.uk/healthpolicy/research/LSE-Lancet-Commission [accessed 19/05/2021]
2 Inman, P. and Jones, R. Rishi Sunak's £65bn budget tax increases are highest in 28 years. The Guardian, 2021. Available at https://www.theguardian.com/uk-news/2021/mar/03/rishi-sunak-budget-tax-increases [accessed 19/05/2021]
3 Glover, B. and Seaford, C. A People's Budget: How the Public Would Raise Taxes. Demos, 2020. Available at https://demos.co.uk/wpcontent/uploads/2020/09/A-Peoples-Budget-Sept-2020-v5.pdf [accessed 19/05/2021]
4 Sweetland, J. et al. Race to the Top: A New Corporate Tax Deal for the UK. Demos, 2021. Available at https://demos.co.uk/wp-content/uploads/2021/05/Race-to-the-Top.pdf [accessed 07/06/2021]
5 House of Commons: Treasury Committee. Impact of Business Rates on Business. 2019. Available at https://publications.parliament.uk/pa/cm201919/cmselect/cmtreasy/222/222.pdf [accessed 19/05/2021]

CHAPTER 1
WHAT'S WRONG WITH THE CURRENT SYSTEM?

The current business rates system has received considerable criticism, with repeated calls for reform. The loudest objections tend to be raised by retailers and businesses with physical stores on high streets across the UK. We identified four main objections to the current business rates system, reflecting the views of retailers and others. These objections are:

1. Business rates deter investment (especially green investment) in buildings.
2. Business rates are insensitive to economic conditions.
3. Business rates are too expensive, especially for high street businesses.
4. Business rates create an uneven playing field, which unfairly advantages online retailers over their brick-and-mortar competitors.

In this section, we evaluate whether these objections are reasonable: should they affect the practicalities of any new system or are they ultimately erroneous and/or unjustified?

OBJECTION 1: BUSINESS RATES DETER INVESTMENT (ESPECIALLY GREEN INVESTMENT) IN BUILDINGS.

It's often argued that business rates act as a significant disincentive to invest in commercial premises. This is because any investments made by a business in their property will increase the rentable value of the premises, which, in turn, will result in higher rates being charged from the next revaluation period onwards. Businesses commonly cite this as a major flaw in the current system:

> *"Some respondents, many from the retail sector, called for the removal of P&M [plants and machinery] from all assessments." (Business Rates Review, HM Treasury)* [6]

> *"We think that they should… remove some of these disincentives to invest, like removing plants & machinery from valuations." (Business Organisation)*

This objection is frequently linked to green investment decisions. Many businesses argue that the current system discourages spending on improvements to their properties that could improve energy efficiency or reduce carbon emissions:

> *"[The current business rates regime] was seen as a disincentive to green energy investment in property…" (Business Rates Review, HM Treasury)*

> *"If you want to put solar power on your factory, you're disincentivised to do so, because your business rates bill goes up as well." (Business Organisation)*

Is this a reasonable objection?

Yes, this is a reasonable objection to the current system. Improvements made by businesses to

6 HM Treasury. Business Rates Review: Interim Report. 2021. Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971681/Fundamental_Review_Interim_Report.pdf [accessed 19/05/2021]

the buildings they rent will result in higher rates being charged, which can be expected to create a disincentive to invest in premises. This is especially true at the margins, where concerns about the cost of business rate rises may deter investments which are less obviously cost effective.

This disincentive to invest is a significant problem, for several reasons. First, there are straightforward economic benefits to such investments: improvements to commercial premises may create new jobs and opportunities in the local economy. Secondly, investments can enhance existing shops and premises, potentially helping to revitalise high streets through the development of better quality, more attractive city centres for customers. Finally, green investments in commercial property - from solar panels to insulation - are of course a vital component of the UK's push to achieve its targets for net-zero.

Given this, any sensible reform of business rates should seek to amend this feature of the current regime.

OBJECTION 2: BUSINESS RATES ARE INSENSITIVE TO ECONOMIC CONDITIONS.

A second objection argues that business rates are insensitive to changing economic conditions, leaving ratepayers with tax burdens that are excessive when compared to the current business environment.

Business rates are determined during revaluations conducted by the Valuation Office Agency (VOA), with the level of rates remaining steady until the next revaluation takes place. The latest such revaluation for England and Wales took place in 2017, but was based upon property values from two years earlier, in April 2015.[7] This means that the level of business rates paid by tenants today is still notionally based on economic conditions from over six years ago.

The Chancellor's Covid-19 measures mean that rates have been reduced sharply in the current crisis, with businesses in the retail, hospitality and leisure sectors receiving a two-thirds cut in rates until the end of the current tax year.[8] But once these expire, businesses will once again be paying full rates, meaning that in 2022, rates will be based upon the economic conditions of 2015. This is exactly the kind of insensitivity cited by stakeholders as an issue:

> *"What we also hear quite a lot about it is, again, some of the challenges around aligning rates to the wider economic conditions. So, one of the things we've caught, for example, within the business rates review submissions, has been around creating a more flexible evaluation system, similar to what you see in Holland and I think the US as well." (Business Organisation)*

> *"Several stakeholders drew a link with the valuations process, noting that annual revaluations would help to more rapidly align the tax burden with economic conditions…" (Business Rates Review, HM Treasury)*

This problem has been exacerbated by extensions to previous revaluation cycles, meaning that rates reflect economic conditions from even longer ago:

> *"Many respondents referred to delays with previous revaluations and commented that this had resulted in payment liability being based upon outdated valuations." (Business Rates Review, HM Treasury)*

The Government's Business Rates Review also notes that stakeholders are supportive of shorter cycles, with revaluations perhaps taking place once every three years:

> *"A majority of respondents expressed a preference for more frequent revaluations. Of those who expressed a preference for increased frequency, the greatest number were in favour of 3 yearly revaluations." (Business Rates Review, HM Treasury)*

Is this a reasonable objection?

Yes, this is a reasonable objection to the current system. While rents themselves are fairly insensitive to changes in economic conditions (because rent reviews are infrequent), rates tend to be even more insensitive. This is because business rates are based upon an official assessment conducted by the VOA, which means that they cannot be negotiated in the same way that rents can - though of course appeals are possible.

Rate revaluations are, simply, too infrequent and too insensitive. When businesses in 2022 can expect to pay rates that reflect the economic conditions of 2015, it's clear there is a problem in the current approach.

7 HM Government. Business Rates: Revaluation. 2021. Available at https://www.gov.uk/introduction-to-business-rates/revaluation [accessed 19/05/2021]
8 HM Government. Business Rates Relief. 2021. Available at https://www.gov.uk/apply-for-business-rate-relief/retail-discount [accessed 07/06/2021]

To its credit, the government does recognise this. In the 2017 Autumn Budget, they pledged to "reform the revaluation cycle by increasing the frequency of valuations to every three years following the next revaluation"[9] - this is currently scheduled to take place in 2023. So, any new proposal to reform the rates system should either accept or go further than this pledge: rates must be made more flexible, reflecting the economic conditions that a business is actually facing.

OBJECTION 3: BUSINESS RATES ARE TOO EXPENSIVE, ESPECIALLY FOR HIGH STREET RETAILERS.

One common objection is that business rates are simply too burdensome. This argument suggests that - even if the disincentives and inflexibilities built into the current system were removed - business rates would still impose far too high a cost upon businesses, especially for high streets:

> *"A large number of respondents expressed the view that the extensive reliefs regime is made necessary by the high overall burden of business rates." (Business Rates Review, HM Treasury)*

> *"So pre-Covid, if you took a mailbag test of the biggest issues facing our members, business rates would be at the top. And that's not just tax, it's across all business type issues... So probably it would[n't] surprise you that our rules or approach is to lower the overall burden on the businesses from rates." (Business Organisation)*

This point was highlighted by many high street retailers during our interviews. They noted both the overall burden of business rates, but also the significance of this cost when compared to other forms of corporate taxation:

> *"It's a huge expense for us. Maybe £300 million a year. It is a huge number for us." (Consumer Goods/Retail)*

> *"We're a hybrid business, but we're a massive bricks and mortar business and paying a shedload of business rates, so it's the biggest single tax cost in our business." (Consumer Goods/Retail)*

> *"It's the biggest tax we pay… from a business rates perspective not many of the countries we operate in have a similar thing." (Consumer Goods/Retail)*

> *"Rates put up the cost of having that physical presence, and businesses have to work out whether the rents they can generate from their business are sufficient to cover those. Yes or no, isn't it? And there seems to be a lot of people saying, it's no at the moment…" (Services)*

Is this a reasonable objection?

This objection is largely unreasonable. The economic theory suggests that the burden of business rates and commercial rents on high street businesses is relatively fixed in the long run. This is because any cut in rates leads to an increase in demand for commercial space, as it becomes more attractive and affordable to retailers. In the long-term, this higher demand means that commercial landlords are able to charge higher prices for this commercial space - i.e. an increase in rents. As a result, the long-term effect of any cut in rates is negligible for tenants, as landlords raise rents in response to any reduction in the burden of business rates.

Crucially, the theory appears to be borne out in reality too. For example, Bond et al examined the impact of changes to business rates on 3000 commercial premises in the UK. This research found that: "increases in non-domestic rates put downward pressure on rents, whilst decreases in non-domestic rates put upward pressure on rents."[10] In other words, the cut in business rates led to higher demand for commercial premises, meaning that landlords raised the prices (i.e. rents) paid by tenants. The empirical evidence appears to match the theory.

So, the objection raised is almost correct. It is true that the combined burden of rates and rents can be too high for commercial tenants. But it is not the level of rates that creates this problem: as the evidence shows, if rates are reduced then tenants will simply pay more in rents, eventually. The real source of the problem relates to the economics of prime retail space: these are expensive premises which may simply be too costly for many businesses to rent.

However, while business rates are not the primary driver of pressures on the high street, some elements of how they currently operate do harm businesses. The inflexibility of the rates system and the investment disincentives built into the current regime - see Objections 1 and 2 - are problematic. These smaller issues need to be addressed in any new system.

9 HM Government. Business Rates: Delivering More Frequent Revaluations - Summary of Responses. 2018. Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/689236/Business_rates_revaluations.pdf [accessed 19/05/2021]

10 Bond, S. et al. Who Pays Business Rates? Institute for Fiscal Studies. 1996. Available at https://ifs.org.uk/fs/articles/fsbondetal.pdf. [accessed 07/06/2021]

But it remains the case that, even if business rates aren't really the main threat to the high street, they are often seen as the issue by retailers.

And this perception is a significant problem for the government. In fact, the prevalence of this objection is one of the defining flaws in the current business rates system. It ensures that it is politically toxic to defend rates and, more importantly, it is politically impossible to even suggest that they might be a source of additional tax revenues. Our proposal seeks to remove this long-standing political obstacle, in an attempt to help identify where business taxes could be increased to address the UK's fiscal challenges.

OBJECTION 4: BUSINESS RATES CREATE AN UNEVEN PLAYING FIELD, WHICH UNFAIRLY ADVANTAGES ONLINE RETAILERS.

The final objection we identified is that business rates unfairly burden brick-and-mortar retailers, by creating an uneven playing field that benefits online competitors against their physical counterparts. Some businesses we interviewed were often concerned by this perceived issue:

> *"[We will] do the right thing as a corporate citizen, but we also want a level playing field, and we're back to anything you mentioned there that doesn't impact an online sales business, it disadvantages us." (Consumer Goods/Retail)*

> *"So, you've got a lot of online businesses such as Amazon, who are operating from distribution centres and pay a very, very small fraction of the business rates that we would pay." (Consumer Goods/Retail)*

This issue is only heightened by the impact of the pandemic and the increased rise of towards online retailing:

> *"So why should you have... traditional retailers paying 10 times the multiple of someone like Amazon, whose business is rapidly developing through Covid for example." (Consumer Goods/ Retail)*

> *"The review that's going on at the moment around business rates, actually has become more urgent, in the pandemic, so you're seeing a lot of businesses who are bricks and mortar essentially, being hit harder than maybe digital type firms." (Business Organisation)*

Given this, some businesses are supportive of new taxes for online retailers. This is often perceived as helping to balance out the burden of business rates on physical retailers:

> *"Some respondents argued that an online sales tax would be an opportunity to 'level the playing field' so that online retailers pay a tax on doing business where benefit is derived..." (Business Rates Review, HM Treasury)*[11]

Is this a reasonable objection?

No, this is not a reasonable objection. In part, this is because of the argument made in response to Objection 3. A decision to reduce - or even to abolish - business rates would not protect the high street. Instead, reducing rates would increase demand for commercial space, leading to higher rents for landlords but a lower tax take. In other words, the costs facing high streets reflect the economics of the market for commercial space, rather than being a consequence of a tax system which is simply too punitive.

In addition, the assumption that online retailing has extremely high margins (in contrast to offline shopping) is unconvincing. Several businesses we interviewed emphasised that online retailing often operates on fairly slim margins, reflecting the cost of delivery, the ease of online price comparisons, and competition from other firms, which occurs online as much as it does offline. There is, perhaps, an unhelpful conflation of online retail, which is often low margin, with the selling of particular high margin goods produced by major technology firms, such as Apple.

This is not to ignore other issues facing the high street and the tax system - around corporation tax or the Treasury's need to effectively raise revenue from global technology firms - which we addressed in our recent report, *Race to the Top.*[12] However, those issues are separate from calls to reform the business rates system, the focus of this paper.

11 HM Treasury. Business Rates Review: Interim Report. 2021. Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971681/Fundamental_Review_Interim_Report.pdf [accessed 19/05/2021]
12 Sweetland, J., Seaford, C. and Glover, B. Race to the Top: A New Corporate Tax Deal for the UK. Demos, 2021. Available at https://demos.co.uk/wp-content/uploads/2021/05/Race-to-the-Top.pdf [accessed 07/06/2021]

CHAPTER 2
FIXING THE SYSTEM

The objections raised in Chapter 1, coupled with the need to increase the business tax take to address the UK's fiscal challenges, demonstrates that the existing system of business rates is unsustainable. In response, we propose an overhaul which will address the reasonable concerns cited by business - around insensitivity, investment disincentives, and the high street - while opening the door for an increase in revenue from this important source of tax.

Our goal is to deliver a politically plausible solution. So, while this proposal will indeed aid the Treasury, by unlocking the possibility of higher revenues through raising rates, it also offers businesses a 'deal' in return. Our proposal would create a new commercial land tax regime, which is more flexible, removes the investment disincentives built into the current system and reduces some of the pressure on high streets. By offering something to businesses and to the government in order to reach a compromise which can prove mutually beneficial, our proposal seeks to build consensus.

OUR PROPOSAL

Under our proposal for a Landlord Levy:

- Commercial landlords become responsible for paying tax on commercial property - in place of tenants, who pay under the current system.
- The tax base for commercial property is based on land values only, rather than the land value and the building value combined.
- The level of tax payable by a commercial land is set and revalued regularly, with reference to rental values.

Who pays?

Under the current system, rates are charged to tenants directly. They are responsible for paying rates, appealing revaluations (where appropriate) and applying for various kinds of relief. This is burdensome and time-consuming, especially so for smaller businesses, who may lack the expertise needed to navigate an often highly complicated system.

This also creates a political problem: as rates are levied on tenants, it appears to many that retailers are struggling because of the rates system itself. This is not actually the case. As we have noted, the total value of rates and rents is relatively fixed over time, meaning that a reduction in rates can be expected to lead to an increase in rents, eventually. This is why cutting rates, as sometimes proposed, would not benefit retailers and would instead offer a windfall gain to commercial landlords. However, because tenants pay rates, it appears that rates are the problem. This makes any call for an increase in business rates politically untenable, as it is perceived as an attack on the high street.

Our proposal would help resolve this. We would place the responsibility for paying rates on landlords, rather than tenants. This would reduce complexity and the administrative burden facing retailers - benefiting smaller businesses in particular. But most importantly, it would align the payment of rates with the incidence of rates - i.e. on the landlord. This will reduce the political price of calling for higher rates, given that commercial landlords lack the popular support that high street retailers enjoy. This opens up the possibility that rates could be increased, to help address the UK's fiscal challenges.

What are rates charged on?

The current business system is flawed, in part because it charges rates on the value of both buildings and land. The problem this creates, as outlined in Chapter 1, is simple. If an increase in the building's value leads to higher rates for a tenant, then there is a strong disincentive to invest in improvements to premises.

Our proposal deals with this problem by levying rates solely on the value of land, rather than the value of buildings and land combined. Identifying the land value can be achieved by comparing the rental value of a plot of land and the buildings on it with the rental value of very similar land and buildings in the cheapest area.

One often hears that delivering such a system of land valuations is impossible. We reject this claim, for two reasons. First, cogent and detailed blueprints for delivering land valuations already exist. A notable example is the full methodology laid out by Dixon et al. in their proposal for a Commercial Landowner Levy.[13] Their model bases valuations on a combination of VOA and HMRC data, publicly available information on commercial rents and purchases, and prices for vacant plots. Second, there are many land value taxes in operation in other countries around the world - for example in Denmark, Estonia and throughout Australia.[14]

A more UK-focused objection relates to the Land Registry, the government database of property ownership in England and Wales which would help deliver any land value calculation. Critics of proposals like ours often claim that the Land Registry is simply not complete enough to meet this task. This may be a reasonable problem at present, but there is no reason this cannot be addressed through additional resources. Indeed, the Land Registry already has coverage of the vast majority of land in England and Wales: around 87% in total, as of 2019.[15] Enhancing and updating the Land Registry to reach this final 13% is important - but it is clearly not an insurmountable barrier to change.

A final question relates to how business rates should be levied on empty properties. Today, landlords are generally liable to pay rates on their premises when no tenant is in place. However, there is an initial three-month relief period, in which landlords are exempt from paying rates after a tenant has left the property empty. This relief comes at substantial cost, with taxpayers losing out on around £1bn per year in total.[16]

This relief also increases the bargaining strength of landlords against their tenants, as the incentive to keep a tenant in place is far lower than if full rates were payable once a property became vacant. This makes it easier for landlords to charge higher rents, harming high street retailers, but also provides landlords with a short-term subsidy for holding empty premises. Therefore, our proposal calls for these reliefs to be abolished, to benefit tenants and to play a small part in revitalising the high street, by reducing the incentive for landlords to hold empty shops.

When are rates assessed?

The infrequency of rate revaluation is widely acknowledged as an issue with the current system. The government, to its credit, has responded to this and is moving towards a three-year revaluation cycle from 2023 onwards. This is a valuable development, one which would ensure that rates paid match current economic conditions more closely.

However, our proposal goes further by calling for annual revaluations. Under the government's plan for a three-year cycle, rates will continue to diverge substantially from economic conditions. This is because revaluations are based on market values from two years prior - e.g. the 2017 revelation was based on 2015 rateable values. This means that, even under a three-year cycle, rates quickly become out-of-date.

By contrast, annual revaluations will guarantee rates are flexible, responding much more quickly to changes in market conditions - if the past year has shown anything, it is that a great deal can change in 12 months. This change will, of course, place a higher burden on the Valuation Office Agency (VOA), meaning that more resources will be required to deliver annual revaluations. But it remains a wise investment.

In summary, our proposal delivers the following changes:

13 Commercial Landowner Levy (Corlett, Dixon, Humphrey, von Thun). Available at https://www.libdems.org.uk/taxingland-notinvestment
14 Commercial Landowner Levy (Corlett, Dixon, Humphrey, von Thun).
15 HM Land Registry. Why HM Land Registry wants to achieve comprehensive registration. 2018 [updated in 2019]. Available at https://hmlandregistry.blog.gov.uk/2018/04/27/why-hm-land-registry-wants-to-achieve-comprehensive-registration/ [accessed 07/06/2021]
16 Khoo, A. Empty Business Rates Relief 'costs £1bn'. BBC News, 2020. Available at https://www.bbc.co.uk/news/uk-england-48854450 [accessed 19/05/2021]

	WHO PAYS?	WHAT ARE RATES CHARGED ON?	WHEN ARE RATES ASSESSED?	WHAT ABOUT EMPTY PROPERTIES?
OUR PROPOSAL	Landlords	Land only	Annually	Exemptions for empty properties are scrapped
CURRENT SYSTEM	Tenants	Building value and land value (combined)	Every five years currently. Every three-years from 2023	Landlords receive 100% exemption from paying rents for three months

HOW DOES OUR PROPOSAL BENEFIT HIGH STREETS?

As we noted in Chapter 1, the major challenges facing the high street are largely unrelated to business rates, reflecting changes in consumer preferences and the high rental prices that prime commercial retail space commands. Thus, even though our proposal does not recommend a cut in rates (for the reasons laid out in response to Objection 3 earlier), it still offers significant advantages for high street retailers.

The removal of buildings from the calculation of rateable value removes the disincentive to invest, in turn encouraging high street shops to improve their premises and attract customers. The shift to annual revaluations creates a more responsive system, replacing the current model where brick-and-mortar retailers can be charged far in excess of what current market conditions might suggest is reasonable. Rates will also be paid by landlords directly, minimising the administrative burden facing tenants, especially small businesses. Finally, our proposal to scale back reliefs for landlords on empty properties will benefit high street retailers too, by strengthening their hand when negotiating rents with landlords, who will now have a far greater desire to retain their tenants.

HOW DOES IT ALIGN WITH WHAT OTHERS HAVE ARGUED FOR?

Our proposal would represent a major reform to the current business rates regime. It would change who pays rates, by shifting the burden from tenants to landlords. It would change what rates are levied on, evaluating land values only, rather than buildings and land combined. And it would change how frequently rates are calculated, by moving to annual revaluations.

But, while this is a significant shift, our proposal has a long political heritage. Ideas like ours reflect a broad base of support for efforts to abolish business rates and tax commercial land values instead. Crucially, this support extends across the political spectrum.

In 2018, the Liberal Democrats called for a Commercial Landowner Levy to replace business rates; this work in particular has shaped our proposal.[17] In recent times, the Green Party has also called for a land value tax.[18] The Labour Party's 2019 manifesto also pledged to "... review the option of a land value tax on commercial landlords as an alternative."[19]

17 Commercial Landowner Levy (Corlett, Dixon, Humphrey, von Thun). Available at https://www.libdems.org.uk/taxingland-notinvestment
18 Green Party. If Not Now, When? 2019. Available at https://www.greenparty.org.uk/assets/files/Elections/Green%20Party%20Manifesto%202019.pdf [accessed 19/05/2021]
19 Labour Party. It's Time for Real Change. 2019. Available at https://labour.org.uk/wp-content/uploads/2019/11/Real-Change-Labour-Manifesto-2019.pdf [accessed 19/05/2021]

At the time, the Labour Party's proposal was met with criticism from the Conservatives and in parts of the media, and was labelled a 'garden tax'.[20] But calls for a tax on land values are not exclusive to the political centre or left. In fact, much of the support for this change comes from independent and right-leaning think tanks and organisations.

The independent Institute for Fiscal Studies has long promoted a land value tax as a superior alternative to the business rates regime - first endorsing it in the Mirrlees Review in 2011, but repeating their endorsement in 2019, for example.[21] On the right, the Adam Smith Institute has advocated for this policy - noting in particular "the confusion that the current system produces" in public discussion.[22] The Centre for Policy Studies has also endorsed a new approach in line with our plan, describing business rates as "outdated and inefficient" and calling for land values (rather than buildings) to determine taxes paid.[23] The same argument has been made by the centre-right think-tank Bright Blue, in recent years.[24]

The point is not simply that there is consensus around the problems with the business rates system - though broadly speaking, there is. What this shows is that there is appetite from across the political spectrum for similar solutions too.

WHY NOW?

It's clear that there is a long history of support for ideas like ours and that this support comes from across the political spectrum. But why is this the time for change?

From the perspective of the government, the major difference is the context of Covid-19. The UK already faced fiscal challenges pre-pandemic - around our ageing population and other structural issues - but the pandemic has added a new urgency to these issues. Paying for the cost of Covid-19 will require raising more revenue from business taxation and, as our research shows, corporation tax - as we argued in *Race to the Top* - and business rates, if reformed along the lines set out in this paper, appear the least damaging sources of new revenue.

But other events also make this an opportune moment. The Treasury is currently conducting its Business Rates Review, looking at the flaws in the current system and consulting with a wide range of businesses across different industries. The Chancellor has introduced new, time-limited reliefs, designed to minimise the burden of business rates throughout the pandemic. As the review ends and as these reliefs expire, we face a natural breakpoint for the government to announce a programme of reform.

Finally, the wider impact of Covid-19 has brought greater focus to longstanding issues facing bricks-and-mortar retailers. The surge of online shopping and home delivery over the past year has revived discussion about the decline of the high street, especially if these pandemic trends are here to stay. A proposal like ours, which aims to incentivise investment in physical shops and create a far more flexible commercial land tax system, would give the government something to offer high street retailers who are struggling in the current economic climate.

20 Hall, M. Labour's garden tax to cost homeowners £2,700 every year 'hardworking people hit the most'. Daily Express, 2019. Available at https://www.express.co.uk/news/politics/1215999/labour-garden-tax-council-tax-Jeremy-corbyn [accessed 19/05/2021]

21 IFS. Chapter 16: The Taxation of Land and Property (Mirrlees Review). 2011. Available at https://www.ifs.org.uk/uploads/mirrleesreview/design/ch16.pdf [accessed 19/05/2021]; Adam, S. Submission to Treasury Committee inquiry: The impact of business rates on business. IFS, 2019. Available at https://www.ifs.org.uk/publications/14100 [accessed 19/05/2021]

22 Worstall, T. Retail Landlords Should Be Paying Much of the Business Rates Bill. Adam Smith Institute, 2020. Available at https://www.adamsmith.org/blog/retail-landlords-should-be-paying-much-of-the-business-rates-bill [accessed 19/05/2021]

23 Clougherty, T. et al. A Framework for the Future: Reforming the UK Tax System. Tax Foundation, 2020. Available at https://files.taxfoundation.org/20201023134831/A-Framework-for-the-Future-Reforming-the-UK-Tax-System-PDF.pdf [accessed 19/05/2021]

24 Bright Blue. Liberal Democrat manifesto exhaustive, but not economically liberal. 2019. Available at https://www.brightblue.org.uk/bright-blue-liberal-democrat-manifesto-exhaustive-but-not-economically-liberal/ [accessed 19/05/2021]

RECOMMENDATIONS

The UK faces an extraordinary fiscal challenge in the near future, partly due to the costs of Covid-19 but also due to structural factors, such as our ageing population, that predate the pandemic. As we have argued in our other report looking at corporation tax, Race to the Top, while the government needs to raise additional revenue to pay for these fiscal challenges, it should aim to do so in a way that minimises the backlash from businesses.[25] In other words, we need a new 'deal' across the business tax system: this should include business rates too.

Rates currently raise over £30bn: a significant amount of revenue that we should at least look at the potential for increasing, given the UK's current and long-term fiscal challenges. Our research finds, however, that a number of political and economic issues exist with the current business rates regime. Only once these have been resolved can we increase the tax take. To achieve this requires business rates to be abolished and replaced with a new Landlord Levy:

A tax on commercial land values, paid by landlords, with the level of tax revalued on an annual basis

This would be different from the existing rates regime in three main ways:

1. Rates would shift from being paid by tenants to being paid by landlords

Landlords would become responsible for paying rates, applying for reliefs, and appealing revaluations, if necessary. By shifting the burden from retailers to landlords, our proposal helps tackle the political toxicity of business rates, which are so often presented as 'killing the high street'. Instead, by charging landlords, our proposal could unlock the scope for rates to be increased in future, to help address the UK's fiscal challenges.

2. Rates would be charged on commercial land values only, rather than the value of land and buildings combined

Under the current system, rates are levied on commercial land values and the value of premises combined. If businesses decide to improve their properties - to attract customers, cut costs or make green investments - then the value of their building rises, meaning that they are met with a higher rates burden at the next revaluation.

This deters businesses from making investments which could benefit themselves and the wider economy, through creating new jobs and opportunities. It also hampers progress on sustainability: businesses are clear that this disincentive to invest prevents them from spending on projects aligned with commitments to net-zero. Our proposal removes this problem, by levying rates solely on land values, to ensure that investments and improvements made by business are no longer punished with higher rates.

3. Rates would be set annually, rather than operating through a five or three-year revaluation cycle

Our proposal would see the level of rates set annually, in contrast to the current system, where they are assessed through a five-year revaluation cycle (dropping to three years from 2023). This will ensure that rates are much more flexible and are more closely tied to the current economic conditions facing businesses, rather than reflecting land values from several years ago.

This will place a higher burden on the Valuation Office Agency (VOA), meaning that more resources will be required. It will also mean more investment to complete and update the Land Registry. But together, this is a shrewd investment to make, as it resolves one of the key issues which businesses have identified with the current rates system.

25 Sweetland, J., Seaford, C. and Glover, B. Race to the Top: A New Corporate Tax Deal for the UK. Demos, 2021. Available at https://demos.co.uk/wp-content/uploads/2021/05/Race-to-the-Top.pdf [accessed 07/06/2021]

We also recommend:

Eliminating the business rates' relief which landlords can claim for empty premises

Currently, landlords are fully exempt from paying business rates for the first three months that a property stands vacant. By eliminating this relief, we would strongly incentivise landlords to retain their tenants, perhaps by cutting rents.

This will strengthen the hand of tenants in negotiations with landlords and will reduce the chance of high street premises remaining empty. It will also yield its own financial benefits, given that this relief costs the taxpayer around £1bn per year at present.

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15 WHITEHALL, LONDON, SW1A 2DD
T: 020 3878 3955
HELLO@DEMOS.CO.UK
WWW.DEMOS.CO.UK