HM Treasury fundamental review of business rates: call for evidence – October 2020

1. New West End Company and London's West End

1.1 New West End Company is the Business Improvement District (BID) for London's core West End. We represent 600 retail, hospitality and property owner businesses in the largest of London's two International Centres, focused around the three main shopping streets of Bond Street, Oxford Street, Regent Street and also East Mayfair.

1.2 Over 150,000 people are employed in the retail and hospitality sectors within our district and annual turnover, pre-COVID-19 was around £10 billion.[1]

1.3 Retail and hospitality are key elements in the economic eco-system of the wider West End which includes theatre, culture, heritage and substantial office based commercial activity. Together they employ over 650,000 people (including 10% of all working Londoners) and produce a GVA of £53 billion, more than the City of London and as much as the whole of Wales. Before COVID-19, the West End was a major net contributor of tax to the Treasury.[2]

1.4 The West End is one of Britain's global strengths, attracting visitors, investors and talent from around the world. The unique eco-system of world class shopping, dining, hotels, theatre and other cultural assets has a direct impact on Britain's economy and is also a major contributor to the soft power pull of London and the wider UK.

1.5 The West End competes in a global market to attract retail, hospitality, entertainment and cultural occupiers. The West End has some of the highest occupancy costs in Europe and the greater reliance by Britain on property taxation makes it difficult to compete, particularly as we leave the EU.

1.6 Westminster City Council raised over £2.2 billion in business rates annually, accounting for 25% of the total raised in London. Around half of that is raised in the West End. For every pound raised in Westminster, 96p is retained by the Treasury for redistribution through the Government system of grants.[3]

1.7 This submission below builds on our response to Tranche One where we set out the position of our members of both rates relief and the multiplier as part of the Government's call for evidence.

https://www.newwestend.com/member-services/advocacy/business-campaigns/

2. Objectives

2.1 New West End Company's long-term objective is for the Government to ensure that business rates, and all business taxes, are fit for purpose and appropriate for an increasingly digital 21st Century.

2.2 We also want to ensure that the business rates system reflects more closely the economic performance of the taxpayer. As an example, between the revaluation dates of 2008 and 2015

[1] NWEC sales data
[2] Arup West End Good Growth Strategy
[3] Westminster City Council

(the latter implemented in 2017), business rates across the West End International Centre rose by an average of 80%. During the same period, sales rose by just 30% (from £6 billion in 2008 to £8 billion in 2015).[4]

2.3 Sales in the West End in 2020/2021 are predicted to be around £3 billion with little upside in 2021/22. Property values have undoubtedly plummeted as a consequence. In any revaluation this would see business rates in the West End tumble to far below the 2017 revaluation level and even below the 2008 level. No business can operate with the uncertainty that this brings. What is more, businesses cannot exist without immediate relief from what is now the intolerable burden of a failed system.

2.4 In the immediate term, as a result of the impact of COVID-19, we want to ensure that there are the short-term reliefs necessary to enable West End businesses to survive until sales start to return to their normal levels, so that the West End can continue to be a major net contributor to the Treasury.

3. <u>Current economic environment – COVID-19</u>

3.1 The COVID-19 pandemic has exacerbated an already overwhelming case for fundamental reform of the business rates system as high street businesses, who account for a disproportionately large element of the business rates, are struggling with the short term impact and the, as yet unknown, long term structural changes. Retail accounts for 6% of the UK's GDP but is responsible for raising 26% of all business rates. [5]

3.2 Already the business rates system was proving unfit for purpose, with its growing number of reliefs acting as short term fixes to cover distortions caused by the heavy reliance on a property-based tax system to raise funds from businesses to help finance local government services. The growth of online businesses, many competing with, and some complementing, high street businesses but using little and low value property, means that this form of taxation is not fit for purpose in an increasingly digital, 21st century economy.

3.3 In the short term, the dramatic decline in visitor numbers and the inability of certain elements of the West End economy (such as theatres and night life) to operate under social distancing rules is threatening to breakdown this eco-system and damage this valuable global asset, just as Britain leaves the EU and seeks an independent path in the world. It threatens the net tax take that the West End has consistently delivered.

3.4 Of particular importance to the UK economy is the West End's draw to international visitors. Almost half of the £10 billion annual spend in the West End is from overseas travellers. This is a direct £5 billion injection of foreign money into the economy, with all the tax and employment benefits that brings. This is now lost as the temporary suspension of international travel, particularly from high spending states, means that for at least 12 months there is little chance of it being restored.

3.5 The West End depends on international travellers and roughly 50% of its sales are from international visitors. Until there is a return of international visitors West End retail, hospitality and leisure will find it impossible to generate revenue and therefore investment into their physical assets, people and services.

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[4] New West End Company sales figures
[5] British Retail Consortium

3.6 This dramatic loss of income is exacerbated by the halt of most domestic tourism and the low number of office workers returning. In London, office worker return is around 30% compared with over 80% in Paris and Berlin. In the West End only 10%-15% of office workers have returned. The passenger capacity on the tube is only around 30% of normal, way below the level that the West End needs to function properly.

3.7 Footfall in the West End has plateaued at around 45% of its former levels, compared with around 75% across the UK. The average transaction value has plummeted as high net worth individuals are not yet travelling to the UK. In some cases, three-month advance hotel reservations levels, usually at 80% at this time of year, are now as low as 7%.

3.8 As a result, we are predicting a fall in annual turnover of West End retail and hospitality of between 70%-80%, with sales of just £2-3 billion in the 12 months from March 2020. We expect around one third of West End retail jobs to be lost (around 50,000 jobs) by the end of the year. There could be many more in the hospitality and cultural sectors that also depend on tourism and business hospitality to thrive or indeed to survive.

3.9 In the short term, this necessitates continued business support as we proposed in our response to Tranche One of this consultation. This should be more targeted to city centre businesses with a high tourist consumer base. What is more, there is an emerging view that this will lead to a new pattern of working with home working at least part of the week becoming the norm for many. If this is so, the West End will not see the footfall and sales it has previously experienced and obviously this will affect businesses ability to pay the level of business rates that it has until now.

3.10 Professor Tony Travers of LSE has pointed out that business rates in the West End (as elsewhere in the country) are based on 2015 economic conditions when it is likely that West End retailers will be operating at between 10%-20% of that level and hotels at between 0%-10%.

3.11 As many tenants have renegotiated leases and rents with their landlords, business rate levels now have absolutely no link either to economic performance or to rental values in the West End and are now one of businesses' highest costs.

3.12 It also puts into question how a revaluation in 2021 or even 2022 could be undertaken, given the collapse in rents and the lack of transactions taking place, yet an adjustment to the level of business rates in the West End is needed now.

3.13 If HM Treasury were to continue to aim for a revenue neutral revaluation, then the relative decline in rateable values in central London would result in a huge shift of the rates burden to businesses outside London and the South East. In addition, if the Treasury aimed for a fiscally neutral revaluation, any national fall in rateable value would be balanced by a rise in the multiplier, so erasing much of the benefit gained through reductions in rateable value.

3.14 In short, the arguments for business rates, namely the certainty and the ease of collection are now no longer true for retail in particular. The change to on-line is accelerating and town centres are bleeding as businesses fail. This is the time for a fundamental reform both to keep physical stores alive and keep the Treasury income buoyant.

4. Local or national tax?

4.1 The notion that business rates are a tax on local businesses to pay for services provided by their local authorities is clearly a myth. In truth, it is a national tax, collected locally with a redistribution by central Government on a needs-based formula to local Authorities. The highly complex business rates retention scheme has made little difference to the overall dynamic here, especially with Westminster retaining such a small percentage of the business rates it collects.

4.2 Therefore, there is no reason that this should not be part of a wider review of Business taxation with a formula-based distribution of taxation to meet local authorities' requirements.

5. Options for change – our five key points

5.1 We note that HM Treasury is seeking evidence on a limited range of options that maintain a property element with the possibility of a further contribution from an online sales tax. Before responding to some of the questions asked in the call for evidence, we would make four key points.

Key Point One - COVID-19 has exposed the flaws of a tax system that is not fit for purpose

5.2 There are fundamental flaws in the business rate system which distort business performance and undermines the tax when judged against the six principles of good taxation. In particular, while it has the benefit of being difficult to avoid, it fails when judged on equity and ability to pay. The COVID-19 pandemic has exposed these flaws and it is difficult to see how it can be restored in its current state. It is not fit for purpose. The flaws in the system are often addressed by an increasing number of business reliefs, e.g. small business relief. A substantial cut in the Uniform Business Rate, which we called for in our Tranche One response, would reduce the need for some of the reliefs that have been added to the rating system in recent years. Any reliefs that are considered to be still necessary and fit for purpose should be funded by Government, not by larger payers.

Key Point Two – We need to create a business tax regime that is fit for purpose in an increasingly digital 21st century economy

5.3 We believe that the Government should review the whole business tax regime, not just business rates, to ensure that business taxes reflect the increasingly digital nature of the UK economy. Pre COVID-19, round 20% of the UK economy was digitally based. For certain parts of the economy, such as retail, that level has risen, for some up to 70% as a result of COVID-19 and is unlikely to fall.

5.4 The traditional suite of business taxes (specifically business rates, National Insurance, Corporation Tax, VAT) are not always appropriate for digital businesses, many of which do not operate from expensive premises, do not retain employees in the traditional methods, do not record high levels of profit and do not pay UK sales taxes. This means that, over time, the tax base is shrinking with the burden of tax falling on a declining proportion of the economy's businesses while the growing portion of digital businesses escape paying their fair share of the total business taxes.

5.5 This is not the fault of digital companies, who generally pay the taxes they owe under the current system. It is the fault of the business tax system that was not designed for a digital economy and has not adapted to respond to the growth in online businesses.

5.6 We believe, therefore, that the Government should review all business taxes, not just business rates, or focusing on one narrow aspect of the digital economy (a potential online sales tax), to create a tax system that captures its share of the value created by all businesses, digital and non-digital. Addressing just one business tax alone may have unintended consequences on other taxes.

<u>Key Point Three – business taxes need to be linked to, and respond to, the real time economy</u>

5.7 With the current business rates system, the link has broken between tax levels and real time business performance. With seven years between the implementation of the last two revaluations, for many years rates bills did not reflect economic performance, based on historic rental values. Indeed, the whole principle of notional rents being a substitute for economic performance is increasingly strained, particularly in areas like central London where there is an international property market.

5.8 COVID-19 has exposed even further this weakness with businesses paying the country's highest business rates trading at around 20% of their normal rate. The business rates system has been unable to respond to this other than by an expensive, blanket business rates holiday.

<u>Key Point Four - business rates should be used to support policy priorities</u>

5.9 Business rates are a major tax for many businesses, particularly in high streets and town and city centres. This means that, as well as being a way of collecting tax revenue, they could be a vehicle for promoting policy priorities through targeted changes to the multiplier to promote positive behaviour change, in particular:

- businesses being encouraged to improve their environmental impact and path to zero carbon by for example reductions in the multiplier for those that meet certain standards i.e. energy rating from 'E to A' on Energy Performance Certificates or as an example a surcharge on diesel powered delivery vehicles;
- businesses being encouraged to invest in improvements in local public realm and transport by reductions in their multiplier;
- town and city centre revival being promoted by local reductions in the multiplier for certain business categories.

<u>Key Point Five – many of the issues with business rates would diminish if the level of tax take is reduced and the need and for fiscal neutrality is removed</u>

5.10 Many of the problems that businesses perceive with the business rate system arise because of the level of the tax. When first introduced in 1990, the standard multiplier was 34.8p. It has now risen to 51.2p, an increase of 47%. The gross tax revenue from business rates has risen from around £9 billion in 1990 to over £30 billion in 2019.

5.11 This has led to HMT having to introduce a variety of reliefs for certain business sectors to reduce the increasing cost burden.

5.12 It follows that many of the problems with the business rate system would be alleviated if the multiplier was set and pegged at the original 35p level rather than taking an increasing proportion of notional rental values.

5.13 To achieve this, the Government would need to remove the need for revaluations to be fiscally neutral. The revaluation would result in increased or decreased tax revenue, depending on the state of the market and economy. In that way it would operate similarly to all other national taxes.

6. Answers to Questions

Chapter 4 - Valuations and transitional relief

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

We believe that revaluations should be undertaken annually, to reflect more effectively any changes in the market and to reflect the current business environment.

The annual revaluations should be undertaken and implemented without political interference in the timetable through postponement. The 2015 revaluation was implemented in 2017, seven years after the 2008 revaluation was implemented in 2010, partly due to political decisions to delay.

That seven-year period between the two revaluation implementations was far too long and resulted in large changes in rateable values. This led to a transitional relief scheme that pleased neither those facing large rises nor those expecting falls in their rates bills.

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

We do not consider that banded or zone-based valuation systems would be appropriate. The concept of banding has been considered in previous recent reviews and rejected by ratepayers and Government. We believe that this approach would introduce considerable unfairness into the system by facilitating equal liabilities on ratepayers with differing property values.

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

No views

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

We regard both more frequent revaluations and a shortening of the period between the Antecedent Valuation Date and list compilation date as fundamentally important reforms. A recurring problem with the current system is that the two-year gap between AVD and compilation can often lead to assessments being out of date and substantially different compared with market values at the point of compilation. We would support a move to annual revaluations with a one-year AVD gap.

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?

No views

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?

No views

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?

Annual revaluations would do away with the need for a transitional relief scheme which is largely necessary as a result of significant changes due to the interval between revaluations. In the event of there needing to be transitional relief schemes, we propose that these should be funded centrally, not by delaying lower payments by those businesses whose rateable values are reduced.

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?

No views

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?

No views

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

No views

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

No views

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?

No views

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

We believe that the multiplier should be used to encourage businesses to adopt policy priorities, e.g. on measures to enhancing the local environment.

Valuation transparency and appeals

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

The business rate appeals system introduced following the 2017 rating revaluation, known as "check, challenge, appeal", is proving very difficult for ratepayers and their advisers to navigate. It is acting as an impediment against ratepayers being able to understand the evidence on which their rateable values were based at the revaluation, and an impediment to any challenge to those rateable values. We would therefore like to see a change to the CCA system to allow for a more transparent and fairer exchange of information.

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?

We believe that there should be greater provision of information to the VOA and the VOA should be obliged to provide details of the evidence upon which their valuations are based at the check stage, rather than after the submission of a complete Challenge. This will allow the ratepayer to review the basis upon which their tax is based and then make an informed decision as to whether or not a challenge is appropriate. We believe that this change would restore ratepayers' faith in the system and result in substantially fewer challenges and appeals.

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?

No views

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 Q24 above.

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

No views

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?

No views

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?

No views

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?

No views

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?

No views

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

No views

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?

The Call for Evidence makes clear that the Government plans to retain an element of a property tax in any fundamental review of the business rates. It is exploring options which include retaining the current business rates system; retaining the current business rates system with amendments to its operations; and replacing business rates with a Capital Values Tax.

We believe that the property element of this tax will ultimately become part of the total occupier cost. Transferring the property element of the tax from occupier to land or property owners is likely to result in rents being raised to reflect the additional cost for those owners.

Given that, in the long term, the property element of the tax will end up being paid by occupiers, it does not seem worth the short-term disruption and practical difficulties of the transition from business rates to a Capital Values Tax.

The practical difficulties include:

- The difficulty in tracing and billing some property and landowners, particularly those from overseas;
- The difficulty in undertaking revaluations, given the relatively few transactions of property assets compared with lease transactions;
- The difficulty of targeting specific sectors for reliefs (e.g. a Capital Value Tax would have made it difficult for HM Treasury to provide the current COVID-19 business rates holiday for retail, hospitality and entertainment sectors);
- Not all current leases would allow for the instant transfer of this tax back to occupiers. If CVT rests with owners then, to achieve the same tax take it will reduce the yield from properties by up to 50% overnight with a resulting reduction in property value. Many property loans would be instantly unsound. So, while rents and leases would adjust over time to compensate, the initial impact would be devastating;
- The absence of a complete register of property ownership in England. We understand that the Land Registry has an ambition to complete this project by 2030 which therefore becomes the earliest date for implementation of CVT. Fundamental reform to business rates is required now and cannot wait until 2030 at the earliest.

While there would be the opportunity for tenants to negotiate their rent levels with landlords (occupiers cannot negotiate the level of their taxes), we do not believe that there are sufficient benefits to make a change from a tax on occupiers to a tax on owners.

More importantly this proposal still fails to deal with the fundamental changes between physical and on-line businesses. Unless the Treasury harvests tax from on-line sales through low cost premises the result will be a continuation of the same issues for town centres and communities.

34 What evidence is there of the benefits that replacing business rates with a CVT would have in practice, for example, on business investment and growth?

No views

35 How can land and property be valued fairly and efficiently under a CVT in England? What evidence is available to do this?

No views

36 How would replacing business rates with a CVT affect the distribution of taxation?

No views

37 What are the likely implications of moving the liability for tax from tenant to landowner or property owner? How could the government ensure effective collection from and compliance by these taxpayers?

We believe that the property element of this tax will ultimately become part of the total occupier cost. Transferring the property element of the tax from occupier to land or property owners is likely to result in rents being raised to reflect the additional cost for those owners.

Given that, in the long term, the property element of the tax will end up being paid by occupiers, it does not seem worth the short-term disruption and practical difficulties of the transition from business rates to a Capital Values Tax.

38 What lessons can be learned from other countries experiences with CVTs?

No views

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

In 2018, New West End Company commissioned Arup and Professor Tony Travers to produce a review of the business rate system. You can see the summary of finding at

https://www.newwestend.com/wp-content/uploads/2018/07/20180705_NWEC_Tax_Reform_Summary_Report-ZW.pdf

A copy of the full report is available at. https://www.newwestend.com/wp-content/uploads/2018/07/Rates-Report-Full.pdf

The report examined the reliance of European countries on property taxes for local tax revenue. It found that the UK and Ireland far more reliant on property taxes than any other country (pp 12-13).

The report also compared business rates with the local sales tax used by most US states and the turnover tax used in Argentina to judge the alternative systems against the six principles of good taxation (pp 14-15).

<u>Online sales tax</u>

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

An online sales tax is one possible way of widening the tax base to take account of the increasing digitalisation of the economy, as we suggested needed to be done in section 5.2-5.5.

41 Which services and products do stakeholders think should be subject to an online sales tax and what evidence is there to support this?

Any online sales tax should not focus on just online retail sales. These account for around £100 billion of online sales. But the wider value of UK online sales (excluding financial services) is over £700 million.[6] These sales include travel, accommodation and software, previously many of these sales would have taken place in high street businesses e.g. travel agents. A 2% online retail tax would raise £2 billion but a 2% tax on all online sales could raise up to £14 billion.

[6] Statistica quotes ONS ecommerce sales, 2018, as £688.4 bn
https://www.statista.com/topics/2333/e-commerce-in-the-united-kingdom/#:~:text=According%20to%20the%20most%20recent,increase%20on%20the%20year%20prior.

We accept that there are practical difficulties of taxing some online sales, but we do not believe that online retail should be singled out for taxation while the majority of online sales are not.

The Arup/Travers Report examines the different types of digital businesses based on HM Treasury's position paper "Corporation tax and the digital economy (pp 19-21).

If the Government choses to introduce an online sales tax for retail only, and restricts it to supporting business rates, then any reduction in business rates via the multiplier should be restricted to retail businesses of all sizes.

We are aware that an increasing number of high street retailers have a growing level of digital sales and these should not be hit with the double whammy of business rates and online retail sales tax. Any online tax should at least result in a corresponding decrease in the amount of business rates payable.

We believe that using different VAT levels for online and non-online sales would be the most effective and efficient way to collect an online sales tax (i.e. increase VAT on online sales to 22%).

If online sales are click and collect, then any online sales tax should not apply, which may encourage people back into town centres.

42 What evidence is there for the effects of an online sales tax, for example, on changes in consumer behaviour, or prices?

We have no data about the impact on behaviour change likely to be caused by increasing the cost of online sales (e.g. by having a higher VAT rate for online businesses). Some online businesses often offer goods and services cheaper than high streets stores, partly because their costs are lower, including taxes paid. Goods and services being sold cheaper online is clearly one reason why consumers buy online. We assume then that a slight increase in tax will have some impact on consumer behaviour, in favour of high street businesses.

43 How could an online sales tax affect the distribution of taxation?

The introduction of an online sales tax should be part of a broader review of all business taxes, not just business rates. It should be used to ensure that all businesses active in the economy make equally fair contributions through taxes that are appropriate to their method of operating.

We appreciate the difficulties in taxing global online businesses and are conscious of the Government's efforts to reach worldwide agreement to ensure taxes are paid where sales were made or delivered, rather than in a nominated, low tax country.

Conclusion: It is welcomed that the Government is seeking to review the Business Rates system in the UK that is long overdue and supports this Government's manifesto commitment to fundamental reform. In both Tranche One and Tranche Two 'calls for evidence,' we have provided evidence and views from our 600 businesses that mirror similar concerns from the industry and local authorities throughout the Country. The main point to make is this is a fundamentally flawed system, not fit for 21st century global Britain and although some changes outlined in this document if implemented would assist on the margins, unless full reform of the broad tax system is made, we will back in this position in a few years-time with a shrinking share of UK businesses able to pay and reduced tax income for the Government.

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