Summary findings
5th July 2018

Business Rates review study

Alexander Jan and Zach Wilcox, Arup
with
Professor Tony Travers, London School of Economics & Political Science
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Alexander Jan
Director, Chief Economist, Arup
alexander.jan@arup.com

Limitations
We have made a number of simplifying assumptions in order to complete our work. These assumptions have been necessary in order to build upon previous work denoting the size and structure of existing tax regimes. Ultimately, the design of any future tax will have implications on the tax rate, incidence, any exclusions or exceptions, and so forth.

We have not modelled the impact of any tax reforms on the full impact on businesses, property owners or consumers. This work should be carried out at a future date, in particular in response to proposals for any changes to taxing online retail in relation to the Government’s existing White Paper.

Ove Arup & Partners Limited, July 2018
Background and Introduction

• Arup’s City Economics practice was appointed with Professor Tony Travers of the LSE by New West End Company (NWEC) to review the strengths and weaknesses of the business rate system and assess options for change

• Focus has been on two questions:
  • How can the current system be improved in the short term?
  • What might an alternative solution look like?

• This summary report explores the potential for a goods and services turnover tax or sales tax to replace business rates
Issues with business rates have made headlines in past few years with significant challenges for businesses and councils alike.

**Financial Times**

Business rate pain targets London and Reading

Jump of 9% in the capital contrasts with 25% fall in Blackburn

Budget 2017: Small companies welcome business rates change

Switch from basing increases on CPI to RPI is brought forward by chancellor

Business rate rises do not happen often enough

What we really need is far-reaching reform and the introduction of a land value tax

Outrage in London over sharp rise in business rates

Telecoms groups and utilities also hit by first revaluation in 7 years

Business rates reform leaves north and south unhappy

Rebalancing cripples London traders and only cuts bills marginally outside capital

**IFs: Business rates relief is 'small beer'**

Business rates hike could lead to “tsunami” of high street closures

**EXpress**

Crippling business rates force closure of award-winning butcher's shop after 127 years

A CRPFS 45 per cent rise in business rates will see a family run butcher's shop close its doors for good today after 127 years.

Outrage in London over sharp rise in business rates

Telecoms groups and utilities also hit by first revaluation in 7 years

Business rates reform leaves north and south unhappy

Rebalancing cripples London traders and only cuts bills marginally outside capital

**CityAM**

Business rates to rise by £1bn in England due to rocketing inflation

Retailers braced for £280m rise in business rates as inflation climbs

**Independent**

Councils unleashing bailiffs on 41,000 companies for lack of payment

Two London boroughs - Hounslow and Lewisham - had the highest bailiff referrals
These issues have sparked much research on distributional impact of rates increase and how to improve the system.

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**Institute for Fiscal Studies**

The business rates revaluation, appeals and local revenue retention

Who pays business rates? Beyond Business Rates?

Business rates retention: latest IFS research and thoughts on the way ahead

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**Centre for Cities**

Beyond business rates
Incentivising cities to grow

What do the coming business rates changes mean for cities?
March 2017

3 reasons why business rates reform would help firms as well as cities
Changes are needed to make the system fairer and more transparent for businesses

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**IEA**

Change business rates regularly to avoid the shock of a huge rise

Localised business rates will encourage growth

Cuts in business rates will profit landlords

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**London Councils**

Item 4 - Business Rates Devolution and London Finance Commission (E13/9)

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**ARUP**
Why business rates are important...

Business rates account for 4% of total tax revenue (£28.8 billion) and 20% of local government’s local funding.

Sources of locally-funded council income, England 2015/16

- Council tax: 42%
- Sales, fees and charges: 20%
- Capital receipts: 4%
- External interest receipts: 2%
- Retained Income from Rate Retention Scheme: 20%
- Council rents: 12%

Sources of government revenue, 2016/17 forecasts (£bn, % of total receipt)

- Council tax: 5%
- Business Rates: 4%
- Corporation tax: 7%
- Other company taxes: 0%
- Capital taxes: 4%
- Other taxes: 16%
- VAT: 18%
- Nic: 19%
- Income tax: 27%

Sources:
- DCLG. 2017. Local government financial statistics England no. 27 2017. Data from Revenue Outturn (RO) returns and Capital Outturn Returns (COR), 2015-16
- Institute of Fiscal Studies, 2016
## 10 key points for taxpayers and local government

### For taxpayers (businesses)
- Tax liability shocks at revaluations
- Opaque tax system
- Not correlated to businesses’ ability to pay
- Unfair distribution of tax burden from business to business and place to place

### For local government
- Little avoidance risk
- Revenue uncertainty from appeals, volatility at revaluations, and complex relief / transition schemes
- Does not capture uplift in value / quality of place
- Opaque system of retention
- Mismatch between tax base and local funding needs

### For others / the economy
- Distorts the commercial property market away from property-intensive activities

### How does business rates tax rate overall?

- [Collection](#)
- [Local services funding](#)
- [Ease of avoidance](#)
- [Equity](#)
- [Ability to pay](#)
- [Economic impact](#)
Eight measures to improve business rates

1. **Annual revaluations**
   - 3-years revaluations implemented from 2022 >> Annual

2. **Remove cap on national yield**
   - Allow total yield to increase faster than CPI; Reward net growth not relative growth

3. **Capture value growth**
   - Change formula base to include value uplift not only quantum growth

4. **Devolve Valuations Agencies**
   - Improve efficiency and accountability of valuations; enable more frequent valuations and value capture.

5. **Decouple London**
   - Prevent the capital’s robust property market from continuing to distort the operation of the national system

6. **Share risks and rewards**
   - Across functional economic areas

7. **Devolve decision making**
   - Local needs assessment, Local resets

8. **Reduce the equity gap**
   - Revise evaluation approach for online retailers
Prioritisation of eight measures to improve business rates

Implementation / impact matrix

1. Frequent Valuations
   - Enables
   - Maximises benefits

2. Capture value growth
   - Short-medium term
   - High impact

3. Remove cap on national yield
   - Short-medium term
   - High impact

4. Devolve Valuations Agencies
   - Short term/ low impact

5. Decoupling London
   - Long term
   - High impact / Long term

6. Share risks and rewards
   - Short-medium term
   - Low impact

7. Local needs assessment
   - Low impact / Long term
   - Decide local criteria
   - Set local rates
   - Decide resets locally

8. Set local rates
   - Low impact / Long term

Source: Arup
Longer term options

• With guidance from New West End Company, focus on two revenue-based tax options:
  • Turnover tax
  • Sales tax

• These options have been evaluated against criteria covering:
  • Ease of collection
  • Income generated
  • Collection rates
  • Equity
  • Ability to pay
  • Impact on the economy
Sales tax, turnover tax – both with similarities to VAT

Below, we consider three taxes: VAT, local sales tax and turnover tax. We define each below.

Turnover Tax

Turnover taxes do not have a universally consistent definition; they vary from country to country. Turnover tax in this report would be charged as a percentage of a company’s annual gross income, defined as total business sales less the cost of goods or services sold (including production inputs, but excluding operating expenses like salaries, property costs, and so forth). A turnover tax is similar to VAT. The main difference being that it is also incurred on intermediate and possibly capital goods. It is an indirect tax, and is typically charged based on the value of the goods or services being sold applicable to a production process or stage rather than final point of sale. This type of tax is not frequently used; governments are more likely to use the ad valorem tax concept, which can be applied more broadly.

Value Added Tax (VAT)

VAT in the UK is charged on the supply of all goods and services made in the course of a business by a taxable person, unless they are specifically exempt or zero rated. All businesses must register for VAT if their turnover of taxable goods and/or services is above a given threshold.

VAT is charged on the additional value of each transaction, and is collected at each stage of production and distribution. A business pays VAT on its purchases - known as input tax, and charges VAT on its sales - known as output tax, settling up with the tax jurisdiction for the difference between the two. Some goods and services are zero-rated, and some are VAT-exempt.

Local Sales Tax

For the purposes of this report, a local sales tax is similar to VAT, with the difference being that it is applied and collected only at the point of sale to the ‘final’ consumer and intermediary sales are exempt from collecting the tax.

2. Note: Turnover, as defined under the Companies Act, carries a different meaning. Under the Act, it is defined as the amount derived from the provisions of goods or services within the company’s ordinary activities after deduction of trade discounts, VAT and other relevant taxes (i.e., it is a measure of total turnover, not net of cost of goods sold). Profit is different from turnover, in that profit also deducts all other expenses, including operating expenses and tax.
3. Gross income = Total Revenues – Cost of Goods Sold. Profit also takes out other operating expenses and taxes.
4. VAT: the new 20% standard rate, House of Commons, Standard Note 2013, Anthony Seely
How do other places do it?

- **VAT**
- **Retail sales tax**
- **Mix of VAT and retail sales tax**
- **No general turnover tax**

Map source: Arup, data from *Overview of General Turnover Taxes and Tax Rates, January 2012*
Property tax in the UK compared to European countries

UK is very reliant on property tax for local tax revenue

Reliance on property tax on immovable recurrent property

Defined as the revenues from recurrent tax on immovable property as a percentage of all tax revenues in the country by percentile groups of the countries reported as levying such a tax in IMF 2010. Low below 25th percentile, High above 75th percentile.

Source: UN Habitat

Source: GFS 2010, computations by author.
Comparative findings

Business Rates in the UK

Collection  Local services funding  Ease of avoidance  Equity  Ability to pay  Economic impact

Local sales tax in the US

Collection  Local services funding  Ease of avoidance  Equity  Ability to pay  Economic impact

Regional Turnover Tax in Argentina

Collection  Local services funding  Ease of avoidance  Equity  Ability to pay  Economic impact
## Comparative findings from taxes in other countries

<table>
<thead>
<tr>
<th>Criteria</th>
<th>Business Rates (current system)</th>
<th>Local Sales Tax (US case study)</th>
<th>Turnover Tax (Argentina “Gross Income Tax” case study)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Collection</strong> - ease of collection</td>
<td>Poor transparency for businesses, complex to administer and forecast for local government, especially in relation to re-basing and re-setting years. High rates of appeals, volatility at revaluations, and complex relief / transition schemes.</td>
<td>One point of collection in production chain split at payment between recipient governments.</td>
<td>Tax collected at all levels of production chain.</td>
</tr>
<tr>
<td><strong>Income generated</strong> – level of tax collected to spend on local services</td>
<td>No correlation between monies collected locally and expenditure needs of local services. Stable and reliable for local government revenue for 5-7 years.</td>
<td>Tax base (rates and exemptions) change locally to reflect local expenditure needs and policy direction. Represents between 10-60% of state tax revenues.</td>
<td>Tax base (rates and exemptions) change locally to reflect regional expenditure needs and policy direction. Represents 70% of regional tax revenues.</td>
</tr>
<tr>
<td><strong>Collection rates</strong> – level of collection and ease of avoidance</td>
<td>Immobile tax base; Difficult to avoid for businesses; revenue risk for local government from appeals and discounts.</td>
<td>Risk of evasion relies wholly on final seller tax payments; audit trail can be obscure; preferential geographic decision for customers and businesses.</td>
<td>Easier to administer. Avoidance by under-reporting or vertical integration.</td>
</tr>
<tr>
<td><strong>Equity</strong> – the spread of the tax across local businesses</td>
<td>Economic activity unnaturally skewed away from property development and property-intensive production activities.</td>
<td>Performance pressure on retailer only; localised rates can impact cross-border competitiveness</td>
<td>Distributional impact is indeterminate.</td>
</tr>
<tr>
<td><strong>Ability to pay</strong> – the relationship between taxation and ability to pay</td>
<td>Little correlation between a business’s ability to pay and ‘properties’ rateable value or multiplier used.</td>
<td>Direct correlation between tax collected and due, no impact on profits (ability to pay).</td>
<td>High turnover does not automatically imply high profits (ability to pay). *Note: turnover tax could include cost of inputs to better align to ability to pay.</td>
</tr>
<tr>
<td><strong>Impact on the economy</strong> – how a different basis for local business taxation would affect the local and national economy</td>
<td>Risk on investment and development decisions close to resetting period.</td>
<td>Localised rates can impact competitiveness.</td>
<td>Economically most distorting form of revenue-based tax considered.</td>
</tr>
</tbody>
</table>
Who ends up paying?

**Business Rates**
- **paid by**: Businesses (renters)
- **Redistributed through rents**
- **Consumers %**
- **Land owners 10-65%**

**Sales tax / VAT**
- **paid by**: Consumers
- **Redistributed through prices / demand**
- **Businesses 0 – 40%**
- **Consumers 60-100%**
## What could an alternative tax look like in the UK?

<table>
<thead>
<tr>
<th>Concept</th>
<th>Local turnover tax*</th>
<th>Local sales tax* (operated as VAT supplement on final sales)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Concept</strong></td>
<td>Levy a percentage of local businesses’ annual turnover</td>
<td>Additional levy in the form of VAT on sales and services.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Indicative Rates</th>
<th>On annual turnover <strong>Blanket rates for fiscal neutrality, not taking into account different designs of the tax</strong></th>
<th>On sales prices <strong>Blanket rates for fiscal neutrality, not taking into account different designs of the tax. The tax would need to be levied on all existing rates payers.</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rates</strong></td>
<td>1-2%**</td>
<td>5%**</td>
</tr>
</tbody>
</table>

| Collection                             | Self-assessment, piggy-back on Annual Accounts reporting | Based on current VAT collection and refund system |

<table>
<thead>
<tr>
<th>Some benefits to consider</th>
<th>Benefits small businesses in high value locations</th>
<th>Ability to pay</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Local tax revenue raised proportional to levels of economic activity</td>
<td>Rebalance unfair tax distribution between online and high-street retailers compared to business rates</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Some issues to consider</th>
<th>Major equalisation needed</th>
<th>Equalisation required</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Potentially distortive (turnover vs value tax)</td>
<td>Tax evasion risks</td>
</tr>
<tr>
<td></td>
<td>Turnover not closely correlated to ability to pay</td>
<td>Duplicating administrative burden on businesses / consider potential change in tax burden on retailers</td>
</tr>
<tr>
<td></td>
<td>Windfall gains (short term) for property owners</td>
<td>Windfall gains (short term) for property owners</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revenue location different (where good are bought) from local services needs (where good are produced / sent)</td>
</tr>
</tbody>
</table>

*See page 11 for definitions of these tax types
Priority considerations for further investigation

- Compliance and administration
  - Transition mechanics
  - International issues
  - Central-local fiscal harmony

- Political response key driver
  - Brexit
  - New opportunities outside EU

- Managing long-term funding and finance arrangements
  - TIF
  - BIDs

- Financial vs economic incidence
  - Perceived and real incidence
Immediate focus: improving the tax system of online business

Reducing the inequity between high street and online retailers could radically improve the existing business rates system. However, this recommendation should be considered alongside the proposals for full-scale reform.

Business rates tend to strengthen the competitive advantage of online retailers as well as the historical cost base of high street shops. The typical London shop is facing a 14 per cent rise in rates, and the average shop across the country a 8.5 percent rise, while online retailers operating from out-of-town warehouses will only pay an extra 2 per cent.

Certain sectors—like retailers and restaurants—have particularly high business rates burdens compared to their total output. Retail contributes £7 billion business rates annually, more than any other sector.

A new tax system that improves the tax burden between brick-and-mortar and online businesses will need to balance the burden on those businesses which are a hybrid. Many retailers and online service providers occupy high street shops and offices alongside their major—and growing—online presence.

It is imperative to design tax for the 21st century—a system that properly reflects the value of online sales and high street sales, alongside the changing nature of localising taxes to fund local government.

In the 2018 Spring Statement, Government set out proposals for corporate tax and the digital economy. The proposals are set out in the following slides and should be considered alongside any proposals for taxes for online business.
User participation is an important aspect of value creation for some, but not all, digital business models.

User participation = the process by which users can create value for certain types of business through their engagement and active contribution, e.g. by generating content or contributing to a brand.

2. The Government’s preferred solution is reform of the international tax framework to reflect the value of user participation. The Government has committed to pursuing long term reform through the OECD.

3. In the absence of such reform, the Government will consider interim measures such as revenue-based taxes. See below.

There are three potential approaches to defining which businesses are in scope of any revenue-based taxes:

Define the **channels** through which user participation generates value, then tax the revenues of businesses for whom these channels are most relevant.

For example:
- Generation of content
- Contribution to brand
- Improving the quality of a service through participation in a network

Define the **categories of businesses** that derive most value from user, then tax the revenues of those businesses.

See next slide.

Define the **revenue streams** that those categories of businesses generate, then tax any business in relation to such revenues.

For example:
- Online advertising
- Commissions for facilitating third-party transactions
What categories of business are there in the digital economy?

- **Social networks**: Platforms that facilitate the interaction of users that create their own content.
- **Search engines**: Platforms that provide a matching service which connects users with other content creators or information.
- **Intermediation platforms**: Platforms that provide content online, either through acquiring rights to distribute content created by third parties/other users or delivering self-developed content.
- **Online content providers**: Platforms that match two pools of users, e.g., appstores.
- **E-retailers**: Businesses that sell acquired products on an online platform.
- **Digital software/hardware**: Businesses that design, develop and deliver digital solutions, e.g., cloud computing.

User participation less relevant to value creation

Adapted from HM Treasury, Corporate tax and the digital economy: position paper update (2018)
Question or comments, please contact

Alexander Jan
Chief Economist, Arup
alexander.jan@arup.com
07545 742 003