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Executive Summary

Business rates are the method by which the occupiers of commercial properties contribute towards the cost of local public services. The current system of Uniform Business Rates (UBR) was introduced in 1990 against the backdrop of the 'rate-capping' of overspending authorities and the political struggle between central and local government. Today the revenue raised by rates totals in excess of £19 billion across the United Kingdom. While most of the debate around the future form of business rates has focused on balance of funding issues, there has been relatively little research on the actual operation and effectiveness of the UBR. Now, a generation after its inception, the SMF believes that it is time to examine the way business rates currently operate.

In their present form business rates constitute a broadly accepted and transparent method of raising taxation from business across the UK. Businesses and business groups emphasise the merits of having a predictable tax which is consistent between regions and authorities as well as easy to administer. Most of the criticisms centre on the system of rate reliefs and exemptions that has grown up around the UBR. This points towards the need to revise the UBR system while attempting to retain its obvious advantages. Central to this is whether the current system can be adapted to become a more market-based tool which provides more acute incentives for firms to meet future challenges.

Section 1 of this report examines the operation of the Uniform Business Rate and the current system of rate reliefs and exemptions. We ask whether the system is adaptable enough for today's economy. For example, since the introduction of the UBR in 1990 there have been significant changes in

commercial wealth-creation, most notably through new 'knowledge economy' enterprises which tend to be less property-intensive – potentially paying fewer rates. Questions of how the rates system follows macro-economic policy goals, such as encouraging competitiveness and high-productivity are also outlined.

The report also calls for a review of the current system of reliefs and exemptions. Reliefs and exemptions are the means by which the general tax revenue system can be used as an instrument to enable desirable policy aims to be achieved. In principle, the reduction or the removal of a requirement to pay tax can incentivise business to meet social, environmental, enterprise or regeneration challenges.

Since the introduction of the Uniform Business Rate there have been several key developments in rate relief, largely focused on relieving the burden of business rates in relation to the rural economy. On the one hand these may be seen as protective in nature, assisting 'community businesses' and commercial amenities, such as filling stations or post offices, in small towns and villages against economic adversity. On the other hand, they have been used as a catalyst for economic change, such as encouraging diversification away from farming. In limited cases other social, economic or environmental policy goals have been targeted. In Northern Ireland proposals for relief for environmental works in the quarry industry were proposed, and a relief to incentivise R&D was mooted in Scotland in 2005.

Outright exemptions exist for a range of historic reasons, some customary, others due to economic pressures and others still for public interest or community benefit reasons. Properties exempt from rates include agricultural land and buildings; fish farms; international headquarters; sewers; public parks; certain property used for disabled people; moorings; and listed properties. Recently, plant and machinery in industrial premises, including combined heat and power generators are been classified exempt. The report argues that over the years the exemptions have been extended to cover a wide variety of undertakings and activities and it is now time for a reappraisal of their justifications.

Furthermore, the coherence of rate reliefs and their alignment with wider policy goals needs to be fundamentally reexamined. A central contention of this report is that it is time for empty premises relief – costing £1.1 billion a year – to be reformed, re-targeted and phased out. In its current form it sits uneasily with other rate reliefs and critics have pointed to some unintended consequences in its operation. On one level it raises equity issues: while the occupiers of buildings have to pay business rates, the owners of empty premises pay halfor no rates at all. Despite this relief, owners of empty premises are still consumers of local services, such as police protection, the fire service or the local authority – meanwhile other businesses pay higher rates to cover the shortfall. Evidence has pointed out that the current system does not encourage empty properties to be filled quickly enough, thereby impacting on local regeneration.

In its place we suggest options for new reliefs and incentives to meet today's policy challenges.

Our first suggestion is for business rate reliefs and exemptions to be re-aligned with the new 'place-shaping' set out in the Lyons Review of local government. Consideration should be given to how rates can work in concert with the new strategic challenges facing local government. In particular, we ask whether a 'place-shaping' rate relief could work in the setting of Community Strategies or Local Area Agreements.

However, the principal recommendation of this report is the introduction of a 'Green Buildings Incentive' to stimulate firms to meet energy efficiency or carbon abatement goals. The rationale behind this proposal is threefold. First, despite the growth in regulation, 'green taxes' and fiscal incentives such as Enhanced Capital Allowances (ECAs), improving energy efficiency in commercial premises remains a policy challenge - it is estimated that around 40% of final energy consumption in the European Union emanates from commercial or industrial premises. While new planning policies can promote greener buildings in new developments, the problem of existing build remains. A focused, time-limited, rate relief for reducing carbon emissions could go some way to spur progress and innovation in this area, particularly for small and medium-sized businesses which public policy finds hard to reach.

Second, given that business rates are a tax upon property occupancy, there is a clear alignment with the policy aim to abate buildings' carbon emission. Currently the government

has set itself ambitious targets to promote microgeneration and combined heat and power plants as well as more broadly tackling carbon emissions. Taken together with the Climate Change Levy and Enhanced Capital Allowances, a business rate relief system for Green Buildings could spur a more immediate improvement in the environmental standards working in combination with regulation and government targets.

Finally, an exciting opportunity to align tax incentives with regulation presents itself with the introduction of the EU Energy Performance of Buildings Directive. The Directive requires all properties to be provided with Energy Performance Certificates when properties are constructed, sold or rented out. Under this scheme, properties will be given an energy efficiency rating from A to G. For non-domestic buildings, the main changes include a set of energy performance ratings – standards that new buildings must comply with. These include detailed design limits that help to control heat loss through the fabric of the building. The introduction of a time-limited 'Green Buildings' Incentive to work in concert with other incentives and regulations is worthy of further research and consideration.

It is therefore time to ask whether the system as it is currently formulated is suited to the British economy of today. As competitive pressures increase, and new business incentives are introduced it is becoming ever more apparent that reform of business rates and rate relief is due. The government must consider whether the Uniform Business Rate represents a fair and effective system and how it might be adapted to assist businesses in meeting enterprise, environmental and local regeneration goals.

Introduction

The levying of National Non-Domestic Rates (NNDR) more commonly called 'business rates', via the Uniform Business Rate (UBR) constitutes the method by which the occupiers of commercial properties contribute towards the cost of local public services. Business rates make up around a fifth (19%) of local government revenue, approximately £19 billion a year across the United Kingdom from 1.75 million valued properties (or "hereditaments"). [1]

In their current national form business rates constitute a broadly accepted and transparent method of raising taxation from business across the UK. Businesses and business groups emphasise the merits of having a predictable, buoyant and consistent tax. The rateable value of business property is also an important mechanism in several government policies, such as Business Improvement Districts (BIDs) and Local Authority Business Growth Incentives (LABGI). Moreover, the issuing of partial or full relief from business rates to certain businesses has proved a useful tool in protecting and promoting rural businesses and small firms.

The Uniform Business Rate was introduced in the midst of a recession in 1990 and is in many ways a manifestation of the political struggle between central and local government over expenditure and, ultimately, fiscal autonomy. Today, most of the debate around the UBR still focuses on the contentious issue of 'relocalising' business rates to local councils.

Since its inception, some reforms, such as transitional relief, have modified the business rates system to keep it true to its original purpose – a predictable, national rates system. Yet when all aspects of the current system - new, existing or old - are taken together a significant policy question arises over the extent to which business rates and the system of business rate

1 DCLG, *Commercial and Industrial Floorspace and Rateable Value Statistics 2005*, <www.odpm.gov.uk/index.asp?id_1163767> [13 May 2006].

reliefs and exemptions in particular are 'fit for the future.'

Published research in this area is largely limited to studies from the devolved administrations of Scotland, Wales and Northern Ireland. However, these have generally failed to touch on broader questions of how consistent the current system is with national public policy objectives. Nevertheless, a number of proposals extolling the need for modernisation of rates to meet today's challenges have been compiled, most recently by Greenpeace.[2]

Within this context the Social Market Foundation has examined the existing business rates system. Central to our analysis is whether rates can be adapted to become a more market-based instrument providing better signals or incentives for both large and small companies to invest and innovate to meet wider social or environmental challenges. In this report we argue that government should consider whether the UBR still represents a fair and effective system and how it might be 'future-proofed' to assist businesses and both local and national government in meeting enterprise, environmental and local regeneration goals.

- In Section 1 we examine the origins and workings of the Uniform Business Rate and analyse the effectiveness of the rate relief system.
- In Section 2 we look at the potential for business rate relief to be modernised to meet today's policy challenges, to encourage businesses to engage in 'place-shaping' and for a new 'Green Buildings' incentive to be implemented.
- Section 3 makes concluding remarks and recommendations for reform

2 Greenpeace, *Decentralising Power: an energy revolution for the 21st century* (Greenpeace International, 2005).

Section 1: The Uniform Business Rate and Property Taxes

With the exception of Sweden, commercial property taxes have historically been an important part of local taxation across Europe, and the United Kingdom is no different.[3] The main form of commercial property taxation is a company tax found in many European countries including Belgium, France, Italy, Germany, Luxembourg, Portugal and Spain. The basis for taxation varies considerably from country to country ranging from the taxation of profits (Germany, Italy, Luxembourg, Portugal); capital assets (France); or number of employees (Belgium, Spain). These may be combined with other determinants such as wages (France); power output (Spain); or class of business (Italy, Spain).[4] Bond and Brown[5] divide property taxes into three categories. The first, as found in the UK, Ireland, Italy, France and Belgium is based upon a tax on the rental value of the property paid by the occupiers of land. The second, operating in Denmark, Austria, Latvia and the Czech Republic is based upon the capital value of the property.

In other countries, notably Denmark and New Zealand, a version of land taxation has been attempted – a move supported by a small but longstanding lobby in the UK.[6] In its purest form, land taxation is a fixed annual tax on the market rental value of land, rather than land and property. Taxes are levied based on the assessed value of the land itself and not any property or development which has occurred on it. Proponents argue that this system aids regeneration in more deprived areas by assisting the freeing up of land, reducing land and property

3 NERA Economic Consulting, *Options for Reforming Local Government Funding* (NERA UK Limited, 2005).

4 John Loughlin and Steve Martin, *International Lessons on Balance of Funding Issues: initial paper* (Cardiff University, 2003).

5 Patrick Bond and Peter Brown, *Rating Valuation - Principles and Practice,* (2nd Edition, Estates Gazette Books, 2006).

6 *Land Value Tax Campaign, Options for Local Government Finance* (LVTC, 2004).

prices, and boosting construction, development and investment in deprived areas.[7]

Forms of land-value taxation combined with other forms of business taxation have been viewed as a possible remedy to the question of financing major public infrastructure development or replacing planning gain, in practice by shifting the tax burden from the developer to the landowner.[8] A pure land value tax has also been proposed by McLean to simplify existing taxes by abolishing council tax, business rates, stamp duty and even inheritance tax.[9] A more moderate set of proposals from Muellbauer proposes to shift half the basis for non-domestic rates from business assets to land above a set minimum value with a transitional payment window. [10] The Land Value Tax Campaign (LVTC) has also proposed a 'site value assessment', partially based upon land value taxation pilots in Pennsylvania, U.S.A. However, as some proponents admit, political will from mainstream parties to pilot a Land Value Tax is low and recent proposals to part-reform the UBR in this direction have failed to make much progress.

The introduction of the Uniform Business Rate

The current system of Uniform Business Rates was established as part of the Local Government Finance Act 1988 (LGFA 1988), against a backdrop of 'rate-capping', overspending local authorities and the political struggle between central and local government. The new 'Non-Domestic Rate', effective from 1990, was now set centrally but collected locally. Travers and Esposito argue: "Business rates were no longer a form of local tax, but had in effect become part of the central grant distribution to local authorities."[11]

The original rationale behind the system was twofold: on the grounds of economic efficiency and local accountability non-domestic rates were not a satisfactory local tax.[12] At the time the government believed that it was important to control local authority tax and spending on the basis that local authority control of business rates had led to high and diverging rates across the country, adversely affecting enterprise and where business chose to locate. Business premises with identical values faced differing rate bills purely because they were located in different local authorities. Research, although limited in scope,

7 Owen Connellan, *Land Value Taxation in Britain: Experience and Opportunities* (Lincoln Institute of Land Policy, 2004).

8 Nathaniel Lichfield and Owen Connellan, *Land Value and Community Betterment Taxation in Britain: Proposals for Legislation and Practice* (Lincoln Institute of Land Policy, 2000).

9 Iain Maclean, 'Politics of Land Tax Then and Now', in *Time for Land Tax?,* ed. by Dominic Maxwell and Anthony Vigor (IPPR, 2005).

10 John Muellbauer, 'Property Taxation and the Economy', in *Time for Land Tax?,* ed. by Dominic Maxwell and Anthony Vigor (IPPR, 2005).

11 Travers and Esposito (2003).

12 Department of the Environment, *Paying for Local Government,* Cm 9714 (HMSO, 1986).

suggested the impact of varying rates included higher prices charged to consumers, reduced investment and fewer jobs.[13] By restraining the variability of rates and wresting them from local authority control, the UBR attempted to tackle these problems.

Consequently, the debate over 'relocalisation' of business rates has dominated the discussion around the potential reform of local government finance and business rates themselves. The Lyons Inquiry took evidence from a strong lobby of local authorities and representative bodies who have called for the return of business rates to Town Hall control. Proponents argue that a return to locally set rates would restore the link between local government and business and enhance local freedoms by reducing the unfair 'gearing' mechanism on local government spending. A Cardiff University study commissioned for the Lyons review has noted that 'fiscal decentralisation' possesses further potential benefits, such as better local efficiency and targeting of resources; greater control over local policies and more local accountability.[14]

The Cardiff study also illustrates the disadvantages of relocalisation. Chief among these are the potential for greater complexity, loss of alignment with central government policies and the potential for economic distortions. On the latter point, it is argued that more decentralisation can lead to issues such as tax competition (or 'shopping').[15] NERA research has also noted that varying local rates can cause other distortions including negative impacts on employment or increased difficulties in taxing more mobile businesses. These concerns have been echoed during consultation with stakeholders. Meanwhile the Confederation of British Industry (CBI) and other business groups have set out a forceful defence of the national system of business rates.[16] The declared advantage of the Uniform Business Rate is that it gives a business both year-on-year and geographical certainty over its tax requirement. According to the Royal Institution of Chartered Surveyors (RICS) the UBR currently commands widespread support among business ratepayers, and a removal of equalisation and a return to locally-set rate poundage would result in the loss of the business benefits of stability and predictability.[17] RICS argues that if rates were locally set businesses with multiple sites across authorities would be disadvantaged. They also question whether relocali-

13 Paul Crawford, Stephen Fothergill and Sarah Monk, *The Effect of Rates on the Location of Employment* (University of Cambridge, 1985).

14 Lyons Inquiry into Local Government, Interim Report (Stationery Office, 2005).

15 Lyons Inquiry (2005).

16 Lyons Inquiry (2005).

17 Royal Institution of Chartered Surveyors, *Consultation Paper and Interim Report Response by the Royal Institution of Chartered Surveyors,* March 2006, <www.rics.org/NR/rdonlyres/73651D53-B163-470A-82BA-BEDF5AF7DADD/0/012LG2006LyonsInquiry.doc>, [07 May 2006].

sation would in fact lead to a re-engagement of business with local authorities, stating that "although property may be a local asset, the majority of the value represented by this asset is occupied by businesses that are competing in a national or global marketplace."[18] The CBI supports these assertions, arguing that the UBR currently achieves "protection, predictability and a fair distribution" and so meets many of the tests of a good tax.[19]

Today local rates form a small but highly visible tax on business. Research from the DETR (1995) pointed to an estimated business rate impact of 3% of turnover, 6% of overhead costs and 19% of operating profit.[20] However, it appears that the impact of rates varies across sectors. Between the 2000 and 2005 revaluations, for example, business rates on large retail properties are estimated to have risen by as much as 30%.[21] Below we chart the development of the current system since it came into effect in 1990 and analyse the system of rate relief and its effectiveness.

How the Uniform Business Rate works

Business rates are based upon the concept of 'rateable value', a professional assessment of the annual rent of a property assuming it was available to be let on the open market on a fixed valuation date. The statutory definition of rateable value is contained in the LGFA 1988, Schedule 6:

"The rateable value of a non-domestic hereditament shall be taken to be an amount equal to the rent at which it is estimated the hereditament might reasonably be expected to let from year to year if the tenant undertook to pay all usual tenant's rates and taxes and to bear the cost of the repairs and insurance and the other expenses (if any) necessary to maintain the hereditament in a state to command that rent."

The basis of liability is the beneficial occupation of real property, an assessment based upon the value of the land and the value of the properties on the land taken together. As Lichfield and Connellan have argued: (a) liability rests upon the occupiers and not the owners; (b) real property includes both the land and the buildings taken together; and (c) as the rent is based upon the assumed rental value of the tenancy with regard to

18 Royal Institution of Chartered Surveyors (2006).

19 Confederation of British Industry, *CBI Response to Consultation Paper: Modernising Local Government: Business Rates,* 2000, <http://www.cbi.org.uk/ndbs/positiondoc.nsf 1f08ec61711f29768025672a0055f7a8b2fa35b3d5887d3a8025673200551580/$FILE/br1.pdf>, [05 June 2006].

20 DETR, *The Impact of Business Rates on Businesses* (DETR, 1995).

21 Source: Andrew Smith, speaking at the SMF Seminar: *Is the Uniform Business Rate in Need of Reform?,* 9 May 2006.

improvements, valuation will be of the existing condition of the property without regard to the potential for improvement (the doctrine of rebus sic stantibus).[22]

All non-domestic properties are assessed, by statute, every five years with the last review effective as of 1 April 2005. The purpose of revaluations is not to change the national yield from rates in real terms, but to redistribute the effect according to changes in property prices from the previous revaluation.

The final rateable value of a property is based upon a number of factors including the value of the whole property and several other determinants, including the national 'multiplier' (or 'rate poundage') set by central government at a level which by law cannot rise from year to year by more than the annual increase in the Retail Price Index.

Examples of Rateable Values (2005 figures)

Harrods	**£20,000,000**
BBC Broadcasting House (2-22 Portland Place)	**£3,470,000**
Chelsea Football Ground	**£1,950,000**
The Ritz	**£1,690,000**
Royal Opera House, Covent Garden	**£1,210,000**
Eton College	**£1,045,000**
Camden Market	**£843,250**
Chester Zoo	**£742,500**
Symphony Hall, Birmingham	**£325,000**
Glyndebourne Opera House	**£110,000**
Blenheim Palace	**£50,000**
Castle Howard, North Yorkshire	**£14,500**
Hawk and Buckle Public House, Llannefydd	**£10,000**

Rateable values may increase or decrease between revaluations. However, the effect of the national multiplier acts as a check on this, making adjustments upwards or downwards to offset any overall rise in values – for 2006/7 the multiplier is set at 42.6 pence in the pound. In addition, a transitional relief operates to calm any significant rises in individual revaluations. The key object of transitional relief is to ensure that ratepayers are protected from significant and unpredictable increases in their bills and to provide consistency for the business community. As

22 Lichfield and Connellan (2000).

the Welsh Assembly report states: “NNDR is a unique tax in the UK in that it is required to raise the same yield in real terms without regard to changes in the tax or rental base upon which it is calculated.”[23]

The Rate Relief System

Reliefs and exemptions are the means by which the general tax revenue system can be used as an instrument to enable desirable policy aims to be achieved. In principle, the reduction or the removal of a requirement to pay tax can incentivise business to meet social, environmental, enterprise or regeneration challenges. Individual reliefs have a long history stretching back to the 19th century, but arguably began to be used as an active policy tool under the provisions of the Local Government Act 1929 which granted an outright rates exemption upon agriculture, and a 75% relief placed upon industrial property.[24] Today reliefs exist in a variety of forms, ranging from mandatory reforms to local authority discretionary and transitional relief schemes.

Under the present system a significant number of reliefs exist to protect or promote individual businesses or proscribed classes of business or other organisations. While most pre-date the 1988 legislation, the number of reliefs has increased since the LGFA came into force, most notably in relation to transitional relief for businesses, rural businesses and small businesses. Additional outright exemptions, which we turn to later, have historically been in place providing outright cover from business rates. The policy rationale for rate reliefs and exemptions is that the organisations or businesses entitled to relief are of special importance to the community or wider society. EU competition rules generally bar state subsidies to businesses and relief from taxes, including non-domestic rates, and relief and exemptions could potentially breach EU state aid rules. However, in addition to considerations as to whether rate relief affects inter-Community trade the quantum of many reliefs usually falls below the EU ‘de minimis rule’ of 100,000 and so can be granted. [25]

The provisions of the LGFA (ss.43-47) outline the statutory basis of business rate relief, including the power of local authorities to grant discretionary reliefs to certain types of premises of up to a full 100% of rates (s.47). The cost of meeting a mandatory relief is effectively borne by all ratepayers in the form of a higher business rate, while discretionary reliefs to a greater or lesser extent are met by council taxpayers. The fiscal impact of mandatory and discretionary rate relief across the UK is approximately 16% of the total rates receipt, with the former taking up the bulk. However, evidence from Wales suggests that the total growth of business rate reliefs has increased over time: the rise in yield from 1996/7 to 2003/4 was 32% for mandatory reliefs and 88% for discretionary, compared to a total rate yield growth of 23%.[26]

23 Welsh Assembly Government, *An evaluation of the effectives of the existing system of NNDR reliefs in Wales and consideration of the need for a small business rate relief scheme* (Welsh Assembly Government, 2005).

24 Travers and Esposito (2003).

25 Department for Communities and Local Government, *Non-domestic rates: guidance on rate reliefs for charities and other non-profit making organisations*, < http://www.local.odpm.gov.uk/finance/ >, [24 June 2006].

26 Welsh Assembly Government (2005).

Transitional, mandatory and discretionary reliefs (£Million)

	2002-03	2003-04	2004-05	2005-06	2006-07
Net Transitional Relief	**-243.3**	**-218.7**	**-44.9**	**430.2**	**339.6**
Mandatory Reliefs					
Small business				33.3	-91.9
Charity	587.2	615.7	625.2	678.4	724.3
Rural village shop	6.1	6	6.3	6.1	5.9
Former agricultural premises	0.3	0.6	1.2	1	0.9
Partly occupied	57.30	44.5	48.7	36.8	40.8
Empty premises	1118.5	1189.5	1243.8	1253.3	1333.1
Community amateur sports clubs			3.9	5.6	7.1
Total	**1769.4**	**1856.3**	**1929.1**	**2014.5**	**2020.2**
Discretionary Reliefs					
Charity	6.6	6.6	7.1	7.7	8.8
Non-profit making bodies	26.8	27.3	24.8	27.2	26.2
Rural Village shop	2	2	2	2.1	2
Other small rural business	1.1	1.2	1.3	1.2	1.2
Former agricultural premises	0.1	0.1	0.1	0.1	0.1
Hardship	2.6	1.5	0.9		
Charges on property	0	0	0		
Community amateur sports clubs			0.1	0.3	0.3
Total	**39.1**	**38.6**	**36.3**	**38.6**	**38.6**

The Royal Institute of Chartered Surveyors has questioned whether the growth in rate relief that has occurred since 1990 represents a coherent and consistent strategy and whether they are effectively aligned with government policy goals.[27]

The Effectiveness of Rate Reliefs

There is currently limited published research on the impact of business rates for enterprises, or the extent to which the relief system acts as an incentive for inward investment. Key studies from the devolved administrations tend to regard rate relief as a potentially welcome policy tool when used in conjunction with other policies, for example it is argued by the Welsh Assembly that rate relief could be used to encourage regeneration and as an environmental incentive.[28]

Below we analyse the effectiveness of several of the more significant rate reliefs, notably:

- Rural Rate Relief and Hardship Relief
- Small Business Rate Relief
- Transitional Relief
- Empty premises rate relief
- Historic exemptions

Impact of rate relief

Consultation by the Welsh Assembly in 2005 suggests that while direct economic benefits of rate relief may be more marginal, the availability of reliefs has strong stakeholder support from the business community. Other evidence suggests that business rates have a disproportionate impact on certain sectors, notably small businesses and property-intensive firms, such as large manufacturing or retail firms.

As a tool for inward investment, business rate relief has had a mixed impact. Devolved administration studies show that rate relief is a popular device among the business community, although not always the most effective policy tool. Industrial de-rating (outright exemption from business rates) in Northern Ireland, the only jurisdiction to continue de-rating past 1963, was not on its own seen as an incentive towards business decisions to invest.[29] Consultation with industry in Northern Ireland concluded that its non-targeted nature meant that it was a blunt policy instrument which benefited companies intent on setting up in Northern Ireland regardless of the exemption. During consultation a similar finding presented itself in Wales. However, the available evidence suggests that when used in concert with other initiatives – such as in Enterprise Zones or with rural rate relief – rates have proved both popular among stakeholders and relatively effective interventions.

27 RICS (2006).

28 Welsh Assembly Government (2005).

29 Northern Ireland Department of Finance and Personnel, *Regional Rates and Rating Policy Review* (2003) http://www.ratingreviewni.gov.uk/index/pub-2002-cons.htm

Relief for the rural economy

Since 1929 an outright exemption for agriculture has operated, most recently reaffirmed in Schedule 5 of the LGFA 1988, and variously interpreted by case law.[30] The need to tackle deprivation and isolation in rural communities has led to an emphasis on rate relief targeted at rural areas more generally, and in particular small or ‘community’ businesses. Mandatory rural rate relief of 50% now exists for certain types of business in towns and villages with a population below 3000. Other businesses with a rateable value of up to £12,000 may qualify for full relief if the local authority is satisfied that there is a legitimate community benefit. Moreover, certain types of prescribed businesses with a rateable value in excess of £12,000 (such as newsagents and convenience stores) are also subject to full discretionary relief.

Evidence from the devolved government studies reveals a number of issues thrown up by the operation of rural rate reliefs. In Wales, chief among these is the emergence of gaps in the system of reliefs in areas not classified as ‘rural’ for relief purposes because of high population, for example some ‘valley areas.’ In these areas a significant proportion of businesses are not eligible for rural rate relief. Small businesses in deprived urban areas have requested similar relief, and this argument has been used to promote the introduction of small business rate relief in Scotland, Wales and Northern Ireland.

Since the introduction of the Uniform Business Rate there have been several key developments in rate relief, largely focused on relieving the burden of business rates in relation to the rural economy. On the one hand these may be seen as protective in nature, assisting ‘community businesses’ and commercial amenities, such as filling stations or post offices, in small towns and villages against economic adversity. On the other hand, they have been used as a catalyst for economic change.

30 Christopher Lewsley, *Encyclopedia of Rating and Local Taxation* (Sweet & Maxwell, 1988).

Government policy has used time-limited reliefs to 'pump-prime' farm diversification into non-agricultural activities such as farm shops, storage light industry or leisure activities. Taken together, and in combination with other government incentives, business rates appear to have been a fairly significant and popular policy tool in protecting businesses in rural areas.

Hardship Relief

Subject to conditions, local authorities may grant discretionary relief to reduce bills faced by ratepayers suffering hardship. Hardship is not defined in law and guidance states that authorities must approach relief on a case-by-case basis. In practice it is not confined to pure financial hardship, other factors such as impact on local employment can be taken into account. In response to the Foot and Mouth crisis of 2001 the government introduced a modified hardship scheme for small businesses in rural areas. In that year alone the Valuation Office received around 74,000 rating appeals linked to Foot and Mouth, usually relating to farming or detriment to the tourist industry.

The application of hardship relief, however, appears to suffer from inconsistencies owing to differing priorities or policies between authorities. One potential explanation for this is where the cost of hardship relief rests. Government guidance states that 25% of hardship relief must be borne locally. As local authorities cannot spread the cost to other non-domestic ratepayers, the costs are ultimately borne by council taxpayers either in the form of reduced public services or increases in council tax. Therefore hardship relief is usually limited to individual businesses particularly important to the local community.

Beyond the special use of hardship relief to tackle the consequence of Foot and Mouth, hardship relief appears to be little used – totalling only £900,000 in 2004/05. Most discretionary reliefs are limited in scale although on occasion they can be very significant. Birmingham City Council, for example, offered to waive a £4 million rates bill for a three-year period to help secure 12,000 jobs at the Longbridge plant during abortive negotiations with Rover about the future of the site in 1999.[31] The extent to which business rates can be used as a more effective policy tool to protect local industries, subject to EU state aid and competition rules, is worthy of more detailed research

31 Financial Times, 17 March 1999.

as local authorities continue to develop local economic strategies and respond to the 'place-shaping' challenge set by the Lyons Review.

Charitable Rate Reliefs

For not-for profit organisations local authorities can also provide up to a 100% business rates waiver for premises used for philanthropic, educational, recreational or religious purposes, or for the promotion or study of science or literature. Local authorities are required by law to provide a mandatory relief of 80% of the rates bill to all ratepayers with charitable status. Councils also have the power to waive the remaining 20%, although 75% of this will be met by the local authority itself.

However, consultations have shown that there may be an area of confusion in the test of when mandatory rate relief should be granted to charity shops. Under the Local Government Finance Act 1988, charity shops are only entitled to rate relief if they are used 'wholly or mainly' for the sale of goods donated to a charity and the proceeds of the sale are applied for the purposes of a charity. This is a mandatory relief, but the local authority must decide whether or not any particular case is eligible for it. In deciding whether a charity shop 'wholly or mainly' sells donated goods, local authorities must consider: (a) the percentage of floor space occupied by donated goods; (b) the percentage of turnover and profit represented by the sale of donated goods; and (c) the percentage of individual items sold which are donated goods.[32] This is a time-consuming and complicated procedure, with room for error.

Furthermore, changes in the voluntary and community sector, as well as a new emphasis on the promotion of social enterprise, means that there needs to be a new approach to charity relief, its aims and consequences. Commentators such as the Forum of Private Business (FPB) argue that the emergence of professional charity shops with the buying power of major retailers are undercutting small businesses and should no longer benefit from tax breaks. They state that the transformation that charity shops have undergone, with their focus shifting to selling new goods, means that many charities are now competing directly with small businesses, and are receiving unfair relief. The FPB states that the definition of charity shops should be

32 Department for Transport, Local Government and the Regions, *Consultation paper on the revised guidance on rate relief for charities and other non-profit making organisations* (London: Department for Transport, Local Government and the Regions, 2002).

altered, with charities that sell new goods and employ professional staff paying full business rates.[33]

Empty premises relief

Chief among business rate reliefs, and perhaps the most controversial, is empty premises relief. Historically, liability for rates would only occur if the property was occupied, owing to the development of the rate as a beneficial charge on occupation (see above). However, after a number of well-publicised cases – most notably the allegation that Centre Point had purposefully been left vacant for tax reasons - charging for empty property was introduced as a discretionary charge through the provisions of the Local Government Act 1966 and the General Rate Act 1967. The aim of these acts was to ensure, in the words of the British Property Federation, "that property was brought into occupation as soon as it was completed and to minimise voids in lettings or occupation during its life."[34]

By 1990 this position was effectively reversed. The discretionary power to charge rates on empty property was, in line with the creation of the UBR, transformed into a national, mandatory relief on empty premises, subject to certain conditions.

Properties exempt from unoccupied property rates

- Newly built properties or those where structural alternations or major repairs have taken place (exempt for up to three months from completion of work)
- Properties formerly occupied for more than 6 weeks (exempt for three months)
- Industrial properties (i.e. where no part has been built or adapted for the purpose of retailing goods or services)
- Properties where occupation is prohibited by law
- Properties where occupation is prohibited by action taken by the Crown Court or any local or public authority
- Listed buildings (subject to a preservation notice under s.58 of the Town and Country Planning Act 1971). Ancient monuments (as scheduled under s.1 of the Ancient Monuments and Archaeological Areas Act 1979)
- Properties with a rateable value of less than £2200
- Unoccupied properties where the owner is entitled to possession only in their capacity as the personal representative of a deceased person
- Unoccupied properties where the owner is subject to a bankruptcy order or a winding-up order under the Insolvency Act 1986
- Unoccupied properties where the owner is entitled to possession only in their capacity as a trustee under a deed of arrangement or as a liquidator under the Insolvency Act 1986[35]

33 Bytestart, *Charity shops gaining unfair advantage over small businesses,* 08 March 2006, http://www.bytestart.co.uk/content/news/1_12/charity-shops-small-business.shtml,[03 May 2006].

34 British Property Federation, *Memorandum to House of Commons Environment Sub-Committee Inquiry into Local Government Finance: Empty Property Rates* (BPF, 1998).

In times of recession or downturn relief of this kind can undoubtedly assist businesses. The 1986 White Paper states:

"In a period of recession, rates upon empty property may place a particularly heavy burden on industry. On the one hand they encourage owners to bring empty properties back into full use, if necessary by selling or letting them. On the other hand, such encouragement serves no purpose if there is no market for a property, as for many industrial properties at present. Rates on empty property then represent an unavoidable and often excessive burden."

The BPF notes that prior to 1990 nearly half of local authorities in England and Wales used the relief, with some councils allowing time limited exemptions of up to a year, while others exempted new build altogether.

Today, the amount of relief that can be received on an empty property depends on the type of property (also known as bulk class) and the amount of time the property is empty for. Owners of vacant properties pay no business rates for the first three months that the property is empty and, after that, an empty property rate of 50% of the normal bill. On empty industrial buildings (including empty buildings used for manufacturing, storage, working or processing minerals or the generation of electricity), listed buildings and small properties with rateable values of less than £2,200, there are no rates to pay even after the first three months. In all, empty premises relief totalled over £1.1 billion each year for the last 5 years – or approximately 8% of the total yield. In one year it is estimated that, on average, 3% of all commercial and industrial property in any authority is likely to be vacant for up to 3 months at any time.[36]

Recent studies have questioned the overall justification of

35 Newcastle City Council, *Business rates: reliefs and exemptions,* <http://www.newcastle.gov.uk/core.nsf/a/busraterelief?opendocument>, [05 June 2006].

36 ODPM, *Commercial and industrial property vacancy statistics 2002/03* (ODPM, 2004).

empty premises relief. On one level it raises the issue of taxation fairness between occupiers and owners. While the occupiers of buildings have to pay business rates, the owners of empty premises pay half- or no rates at all. Despite this relief, owners of empty premises are still potential consumers of local services, such as police protection, the fire service or the local authority – meanwhile other businesses pay higher rates to cover the shortfall. The BPF, while arguing that charging empty properties is unjust have in the past set out proposals for reform, including a review of exemptions and the extension of free relief to 12 months, after which the rate should be 25% (not 50%).

Empty property tax is also viewed by some as inherently economically inefficient and as a barrier to investment. Evidence from consultees in the Welsh Assembly research pointed out that the current system does not encourage empty properties to be filled quickly enough, thereby impacting on local regeneration. Similarly, proponents of a Land Value Tax suggest that empty premises relief acts as a disincentive for development by discouraging businesses from using their property productively.

Critics point to the inherent contradiction in assisting firms who vacate premises or reduce their floorspace by shedding staff, machinery or other costs while taxing firms who develop or expand their activity. It is also alleged that the rate relief creates unintended tax avoidance behaviours such as the soft-stripping of valuable rateable fixtures and fittings, "de-roofing" or "constructive vandalism" where properties are rendered unusable for tax avoidance purposes or otherwise delaying the full completion of buildings.[37] If an owner reopens their site they are penalised with business rates, Corporation Tax, National Insurance, PAYE, and VAT.[38] As a result empty property relief acts as a disincentive for companies to bring idle buildings and land into use and calls for its reform have been made from a variety of sources, including from business groups themselves.[39]

In addition, while empty property is not taken into account for the purposes of Small Business Rate Relief, as soon as an empty property becomes occupied then the property is taken into account and the ratepayer's eligibility for SBRR reassessed. Once again this may encourage ratepayers to leave property vacant to avoid paying full rates on all their properties.

Finally, as we shall see below in relation to Rural Rate

37 Land Value Tax Campaign, *Options for Local Government Finance* (LVTC, 2004).

38 Dave Wetzel, *Land tax needed to avoid wasted resources,* The Observer, 06 April 2003, <http://www.labourland.org/in_the_news/articles/land_tax.php>, [12 April 2006].

39 e.g. Federation of Small Businesses, *Think First, Think Business: A Business Manifesto for the Scottish Parliament from FSB Scotland* (FSB, 1999).

40 Northern Ireland Assembly, *Rating of Vacant Properties: New TSN Analysis,* <http://www.dfpni.gov.uk/pub-consult-rating-vacant-prop> [14 June 2006]

Relief, Small Business Rate Relief and relief in Enterprise Zones, there appears to be a historic inconsistency in the application of relief for empty properties and the use of rate relief as a spur to regeneration. Evidence from a Northern Ireland study on the impact of rating empty non-domestic premises notes a correlation between deprivation and a high number of empty properties. Moreover, it suggest that 'vacant rating' would have a beneficial impact on regeneration in deprived areas:

"The impact on deprived areas, particularly urban ones, with high numbers of vacant properties is then likely to be beneficial because the locality of the vacant property may benefit from environmental improvements through the regenerative effect of increased occupation and the possibly accelerated change of use or redevelopment."[40]

This poses a policy question – to what extent does the current rate relief system represent a coherent and joined-up tool to protect and promote enterprise - which we now turn to examine.

Other exemptions from rates

Under the LGFA 1988 and amending legislation, other types of property are exempt from business rates altogether. Exempt properties include agricultural land and buildings; fish farms; international headquarters; sewers; public parks; certain property used for disabled people; moorings; and certain listed properties. There are also some types of properties that are subject to valuation, but exempt from assessment. These include lighthouses and beacons; premises used for religious worship and police premises. More recently plant machinery in industrial premises has been exempted from rates, ostensibly to remove penalties on businesses investing in technological improvements. Similarly, an exemption applies to the rateable value of Combined Heat and Power Technology (CHP) plant machinery. However, taken as a whole it is difficult to ascertain the policy rationale behind many outright exemptions bar their association with charitable status over the years.

Properties exempt entirely from business rates

- Agricultural land and buildings (e.g. arable, meadow or pasture ground; buildings used in connection with agricultural operations on the land and with the keeping and breeding of livestock)
- Fish farms
- Fishing rights (where these are exercisable in a fishery which is regulated by specified legislation)
- Places of religious worship (where these belong to the Church of England or the Church of Wales. For other religions, the property concerned must be certified under the Places of Worship Registration Act 1855. This exemption includes church halls and similar buildings, provided they are used in connection with a place of public religious worship)
- Trinity House property (e.g. lighthouses, buoys and beacons)
- Sewers and accessories (e.g. drains, sewers, manholes, ventilating shafts and pumps. The exemption does not apply to sewage farms or sewage disposal works)
- Property of Drainage Authorities (e.g. structures used for controlling or regulating the flow of water into or out of a watercourse on a main river)
- Parks (provided they are under the management of a relevant authority and are available for free and unrestricted for use by members of the public)
- Property used for the disabled (e.g. properties providing facilities for the welfare and training of disabled persons)
- Air raid protection works (e.g. air raid shelters)
- Swinging Moorings (i.e. a buoy attached to an anchor which rests underwater)
- Road crossings over watercourses (e.g. bridges, viaducts or tunnels constructed to allow river crossings).
- Property in Enterprise Zones

It is unknown precisely how much revenue is offset from rate exemptions each year. Exemptions have not been reviewed for a considerable amount of time, with some based upon case law interpretations going back to the 1930s, leading RICS to argue for a re-evaluation of the exemption system.[41] The BPF have argued that the current list of exemptions can also impact of good business decision-making, for example, where listed properties are left exempt to offset the impact of rates. Changes in planning use classes have sometimes not been aligned with the relevant rating regulations.

41 RICS (2006).

42 The transition scheme, which was confirmed in December 2004, operates over a four year period. Every ratepayer will pay their true rates liability by the fifth year. Mybusinessrates, *The rates bill,* 2004, <http://www.mybusinessrates.gov.uk/rates/transitional_adjustment/index.html>, [14 June 2006].

43 Department for Transport, *Local Government and the Regions: Business Rates: A guide,* 17 December 2001, <http://www.local.dtlr.gov.uk/finance/busrats/guide/02.htm>, [4 May 2006].

Transitional Relief

As mentioned above, almost all non-domestic property has a rateable value which is based on the market rent it would be expected to command. A revaluation is carried out every five years so that the values in the rating list can be kept up to date. The total rates collected do not change except to reflect inflation, but the revaluation ensures that this is spread fairly between ratepayers. Some ratepayers, however, see quite dramatic changes in their rates bill. Transitional arrangements soften the impact of revaluation, preventing significant and unpredictable increases in bills, by phasing in the changes to the rates bill over a period of time. [42] There are limits on increases in bills and limits on reductions in bills, after a revaluation.

A business is protected by transitional limits if, in any year, the amount the business would have to pay is higher than the previous year's bill by more than the amounts shown below. If this is the case, the businesses bill will be increased by the stated amounts:

Year	Small property (rateable value of less than £12,000 or £18,000 in Greater London)	Large property (all others)
1	**5%**	**12.5%**
2	**7.5%**	**15%**
3	**7.5%**	**17.5%**
4	**7.5%**	**17.5%**
5	**7.5%**	**17.5%**

Reductions in bills are limited as well. Transitional limits apply if, in any year, the amount a business would have to pay is lower than the previous year's bill by more than the amounts stated below:

Year	Small property (rateable value of less than £12,000 or £18,000 in Greater London)	Large property (all others)
1	**5%**	**2.5%**
2	**5%**	**2.5%**
3	**10%**	**5%**
4	**12.5%**	**7.5%**
5	**25%**	**15%**[43]

Transitional relief was introduced in 1990 as a discretionary relief. The Local Government Act 2003 made transitional relief mandatory. Small businesses find it more difficult to adjust to changes in their rates bills. Therefore, transitional relief particularly provides greater protection for properties with lower rateable values.

The LGFA 1988 required transitional schemes to be self-financing, i.e. the amount of rate income lost in any year through phasing-in increases in bills had to be offset by the rate income gained from phasing in decreases. The Act was subsequently amended to allow the Exchequer to contribute to the cost of transition schemes. Under both the 1990 and 1995 schemes a net loss in rate income was revealed, subsequently made good by central government to ensure that local authorities did not lose out. However, the Local Government Act 2003 reversed this, requiring that any transitional arrangements be revenue neutral. In effect, the current system requires ratepayers to fund the protection of their peers from significant and unpredictable increases. As ODPM research states: “Transitional arrangements are, in effect, a redistribution from one set of individuals to another.”[44]

Small Business Rate Relief

Published research shows that business rates are an especially heavy burden for small businesses. They account for a significantly higher proportion of operating profits than is the case for larger businesses.[45] As a result the 2001 White Paper Strong Local Leadership – Quality Public Services proposed a reduction in the rate bills of small businesses, funded by a supplement on the bills of other ratepayers. This extra revenue is generated by all those businesses not classified as small businesses paying a higher business rate. As a result two multipliers exist, a business multiplier and a small business multiplier.[46] The business multiplier is set at a higher level than the small business multiplier, and the extra revenue generated funds a Small Business Rate Relief (SBRR), which came into effect on 1 April 2005.[47]

The ODPM also notes that for the purposes of SBRR, ‘small businesses’ are defined by reference to the rateable value of the hereditament, i.e. those with a rateable value below £15,000 (or £21,500 in London). No other distinction is made between different types of small business for the purposes of considering eligibility’.[48] This seems to be a rather arbitrary way of determining whether a business requires rate relief. A question therefore arises as to whether this is the best way of allocating relief. It is also worth questioning whether this money could be better used to further the government’s own goals on regeneration and community cohesion or to help enterprises respond to current and future competitive, environmental or social challenges.

A business is classed as a small business if:

- It has only one property in England on which it is liable (wholly or jointly) for the payment of non-domestic rates[49]
- The rateable value of the property is £14,999 or less at the start of the financial year and remains below £15,000 throughout the financial year
- The property is occupied and the business is not entitled to claim any other mandatory relief

In 2005/2006 the business multiplier was set at 42.2p in the pound, while the small business multiplier was 41.5p in the pound. Properties under £10,000 rateable value (RV) will get a further reduction as follows:

- RV £1 - £4,999 = £50% relief
- RV £5,000 - £9,999 = reducing relief from 50% to 0.01% (e.g. 1% for every £100 above £5,000)
- RV £10,000 - £14,999 = reduced multiplier only

However, while further research needs to be carried out, concern has been expressed over an apparent lack of awareness of the availability of Small Business Rate Relief and business rate relief in general. While SBRR is now in operation, in February 2004, before it had been launched, NOP Business conducted a piece of research for the ODPM which found that there was a low level of awareness of the forthcoming relief and a low level of experience of other rate reliefs amongst small businesses and their accountants.[50]

44 Frontier Economics, *Modelling Options for Transitional Arrangement: Local and Regional Government Research Programme*(ODPM, 2004).

45 Local Government Act 2003 (London: Stationery Office, 2003), Chapter 26.

46 In 2005/2006 the business multiplier was set at 42.2p in the pound, while the small business multiplier was 41.5p in the pound. In England a small business is one where the total rateable value is under £15,000 (under £21,500 in London).

47 Businesses with a rateable value (RV) of £8000 or less are eligible for SBRR. Relief is 50% for those businesses with a RV of up to £3000 and declines on a sliding scale as rateable value increases reaching no relief at £8,000 RV. To qualify for relief a business has to apply to the local authority declaring that it only occupies the one property for which it is claiming relief.

48 Local and Regional Government Research Programme, *Research Summary: Survey of Small Business and Rate Relief* (London: Office of the Deputy Prime Minister, 2004).

49 If the business pay rates on other assessments the rates will be disregarded if their rateable value is £2,199 or lower, provided that the total of all the business’ properties rateable values are £14,999 or less.

50 NOP Business, *Research Summary: Survey of Small Business and Rate Relief* (ODPM, 2004).

Business rates: emerging policy issues

The above analysis throws up a number of policy issues for further consideration. Chief among these is the extent to which rates and, in particular, rate reliefs and exemptions constitute a coherent system in their own right and how they interact with other policy goals.

1. *Internal consistency.* Despite several codifications of the business rates system and the substantial reforms undertaken in 1990, today's system of business rates, rate reliefs and exemptions are in need of more coherence. In particular, public policy makers should consider how consistent reliefs and exemptions are with one another
2. *Are business rates aligned with external public policy?* Research from the devolved administrations has suggested that business rate relief could be made a more effective policy tool if aligned with wider strategic priorities. While the justification for rural rate relief and small business relief fits within broader strategies to help rural enterprise and reduce the burdens on small business respectively it is currently unclear, for example, how the costly empty premises relief sits within wider social, economic or regeneration goals. Similar arguments can be made for a more fundamental review of other reliefs and outright exemptions and further consideration of the policy alignment of rates with relevant policy goals which have developed and been articulated since 1990.
3. *Do business rates help or hinder competitiveness?* As a business tax, further consideration needs to be given to the cost/benefit of rates and rate reliefs in the context of competitiveness. This issue has come to the fore when discussing economic policy responses to technological progress and globalisation. Increasingly policy makers are concentrating not just on how states respond to international competitive pressures, but regions, cities and local authorities. How well these areas perform depends on factors such as the ability to encourage, retain and grow business.[51] The extent to which business rates – as a local and as a national tax - encourage a high-productivity culture is therefore relevant.

51 Ivan Turok, *Local and National Competitiveness: Is Decentralisation Good for the Economy?* (University of Glasgow, 2005).

4. *Adaptability to changes in the economy.* Finally, we ask whether the current system of uniform business rates is adaptable enough for today's economy. Since the introduction of the UBR in 1990 there have been significant changes in commercial wealth-creation, most notably through new 'knowledge economy' enterprises which tend to be less property-intensive. The expansion of internet-based enterprise has been swift, with sales in one year alone (2004) totalling £71.1 billion. In addition, the advent of competition in sectors which were once public utilities, such as telecoms, water and energy all have posed challenges to the rating system as it is currently constructed, raising questions as to how forward-looking or adaptable the current business rates system is to change.

Recommendations

Recommendation 1:
The SMF calls for a fundamental review of the alignment of the current system of rate reliefs and exemptions in the UK with government policy objectives for promoting enterprise, regeneration and social policy.

Recommendation 2:
Specifically, the SMF calls for the examination of the effectiveness and relevance of Empty Premises Relief. We propose that the current relief should be phased out and resources retargeted at supporting public policy objectives.

Below we explore two proposals for reform of business rates and rate relief to meet modern policy challenges.

Section 2

Business rates: the case for reform

Since 1997 there has been a significant growth in the number of rate reliefs available to business across the UK, but it is questionable whether these have been aligned with changing policy goals. Over the past decade a number of important steps have been made promoting the sustainability agenda as a priority of government policy.[52] These have ranged from the promulgation of new regulations through to adjustments in tax policy and the creation of new incentives and voluntary agreements at a national and regional level. In addition, the government has striven to engage local authorities both as promoters of local economic growth and as environmental champions.

As a fiscal incentive a rate relief can play a role in promoting policy aims by sending appropriate market signals to effect changes in behaviour. As such it is important that reliefs work in concert to support specific policy aims, and do not promote contradictory policy outcomes. The analysis above reveals that the business rate relief system is founded on a variety of justifications and operates with a number of differing purposes. In particular, this research has argued that empty premises relief – the largest relief by far - can sit uneasily with other reliefs aimed at protecting small- or rural- businesses.

In the following sections it will be argued that rate reliefs and exemptions should keep in step with local authority governance reform. Local authorities, particularly in the most deprived areas, are expected to work strategically with other local public services and the business community to promote economic, social and environmental well-being. A modernised rate relief system could be used as a mechanism to meet challenges to the environment and local economic or regeneration goals. Potentially, this could ensure more consistency with a suite of

52 Department for Communities and Local Government, *Sustainable Communities: Building for the future* (London: Department for Communities and Local Government, 2003).

53 Lyons Inquiry into Local Government, *National prosperity, local choice and civic engagement: A new partnership between central and local government for the 21st century* (HM Treasury, 2006).

local, regional or national government incentives maximising the opportunity to meet policy goals.

The caveat to any proposed reform is how the current advantages of the business rate system might be affected. A rise in the number of reliefs, for example, would increase the general rate base for those not in receipt of the relief or, in the case of discretionary reliefs, reduce expenditure on public services. Furthermore, the extension of yet more reliefs, which has already been met with criticism from RICS, would risk further complicating a system which has simplicity as its main operation advantage. Any proposed reforms to rate relief either have to consider abolishing current reliefs and starting again from scratch or must weigh up the costs and benefits of reform.

Below we set out proposals to reform rate relief to meet regeneration and environmental challenges.

A 'Place-shaping' Relief

The concept of 'place-shaping' was mooted in the Interim report of the Lyons Inquiry in December 2005. It describes a wider, more strategic role for local authorities:

"…the ultimate purpose of local government should be to take responsibility for the well-being of an area and its communities, reflecting its distinctive identity, and promoting its interests and future prosperity. It involves a focus on developing the economic, social and environmental well-being of the local community and the local area. It therefore requires councils to take responsibility for influencing and affecting things beyond their more narrowly defined service responsibilities."[53]

In essence, 'place-shaping' goes beyond pure service delivery and promotes a more energetic connection between local authorities and strategic policy challenges, such as global competition, the changing nature of political engagement, growing consumer demand for bespoke services and climate change. It also recognises the key role that local government can play in meeting national objectives. The above analysis of the Uniform Business Rate and associated systems of exemptions and reliefs has noted the need for a realignment of the relief system to meet today's policy challenges, and argues for a further examination

of the case for reforming relief and exemptions.

The policy context for reform

Attempting to stimulate business and inward investment in deprived areas has a long history in UK public policy. The government's current approach to regeneration and urban renewal is set out in the Sustainable Communities Plan launched in February 2003.[54] The Plan established a programme of action for delivering sustainable communities in both urban and rural areas. Inter alia, it focuses on urban and rural neighbourhood renewal, planning, design, housing, environmental sustainability, brown- and green- belt development policy and regional economic development.

Promoting local economic, social and environmental well-being has also been a key government ambition and has become an increasingly important aspect of local government reform since 2000. Under section 2 of the Local Government Act 2000 councils have the power to promote the economic, social and environmental well-being of their areas ("the well-being power"), in order to respond to the needs of their local community. A plethora of strategies, mechanisms and policies currently exist to encourage or incentivise business to get involved in local regeneration. Chief among these has been the Neighbourhood Renewal Fund, an area-based incentive designed to assist local public services in meeting government Floor Targets for deprived areas. In addition, several new levers have emerged to promote greater engagement between the business community and local authorities in order to meet local regeneration challenges. These range from strong partnership arrangements through Local Area Agreements (LAAs) to new mechanisms such as Business Improvement Districts (BIDs) and Local Authority Business Growth Incentives (LABGI).

Business Improvement Districts are a key policy initiative to encourage greater business involvement in the locality. They are locally controlled partnerships set up to improve the economic performance of a local area or to meet local environmental and regeneration goals. BIDs are formed by groups of businesses to oversee and fund these improvements and the provision of a limited number of additional or enhanced local services.

54 Department for Communities and Local Government (2003).

55 GLE and oneLondon, *Policy Roundtable: Local Authority Business Growth Incentive Briefing Paper,* November 2003, <http://www.gle.co.uk/downloads/publications/OneLondon/LABGIBriefingPaper.pdf>, [26 May 2006].

BIDs are not in themselves directly associated with rate relief, but rather involve a rate levy or supplement based on the rateable value of property, subject to a majority vote by businesses within a defined area. Ultimately BIDs represent a relatively small levy on businesses and usually cover a small area, such as a town centre or a sub-ward area, thereby suggesting that the scope for major regeneration initiatives is rather limited. Furthermore, to date, relatively few BIDs have been established, with just over 20 set up nationwide. From initial evidence it appears that BIDs are more popular in areas that have good economic prospects, although initial opinion notes that the very process of formalising BIDs can lead to an improved partnership arrangement between the business community and local authorities.

Recognising the potential for business rates to empower local bodies and encourage economic development and growth also forms a cornerstone of the new LAGBI. The scheme allows local authorities to retain some of their business rate revenue if they can grow their tax base above a specified rate. Through LABGI the government hopes to encourage local government to take a greater interest in encouraging local economic growth and ultimately to reduce economic variations between and within regions. As a result the Treasury estimates that over £1 billion will be raised over three years.

Key to LABGI is an analysis of rateable value and relative growth. The scheme works by setting a baseline for each local authority against which an assessment will be made of future performance in encouraging business growth and development. However, LAGBI is still in its early stages and the extent to which it will have a noticeable influence on the way councils act towards the local business sector is open to debate. For example, the maximum annual take for local authorities will be 1% of the annual government grant, posing a question over the ultimate strength of this incentive. Furthermore, the scheme has been criticised as being overly complex and having high administrative costs.[55]

Business rates and rate relief, as currently structured, are not closely aligned with these new policy instruments. While a number of other policy vehicles have been created to incentivise business, including Community Development Finance

Institutions and the Phoenix Fund, rates and rate relief make little contribution to strategic goals. Moreover, where they do (in the case of rural and small business relief schemes) the application of these reliefs may create gaps in benefit, for example, regeneration in between urban and rural areas. Rates should therefore be aligned with a wider regeneration policy or emerging regional or local authority economic development strategies to fully channel their potential impact. As the Welsh Assembly Government study argues, if the system of business rate relief is used in a more targeted way or integrated with other economic and social justice policies "there is the possibility that it could make a contribution to developing these themes and visions."[56] One such example, worthy of further investigation, is a new rate relief for R&D intensive companies, proposed by Scottish Minister Tom McCabe MSP, to provide a "positive locational signal" and combat the historic underinvestment in research and development in Scottish industry.[57]

Use of business rates for regeneration

Business rates constitute the key tax upon land. However, as the Fabian Society's Commission on Taxation and Citizenship argues, business rates set at the same rate across the country do not in practice provide significant help to deprived areas in need of regeneration.[58] The use of rates for regeneration purposes is not a new concept. During the 1980s and 1990s business rates were used as part of a policy package to encourage private sector investment in Enterprise Zones (EZs). EZs provided a number of benefits to developers, investors and occupiers of industrial and commercial properties, including 100% tax allowances for capital expenditure on construction and improvement to commercial or industrial buildings and, significantly, exemption from Business Rates for industrial and commercial premises. Other benefits included simplified planning procedures, exemption from industrial training levies and a reduction in government monitoring.[59]

Proponents have forcefully argued that the use of relief and exemptions has netted significant regeneration benefits.[60] A 1995 analysis of the first two waves of EZs found that there were over 5,000 companies in the twenty-two Zones by 1990, employing nearly 126,000 people. After allowing for deadweight and displacement, it is estimated that about 58,000 jobs were created in addition to those that would have been available in the local areas. Moreover, extra employment was found to be highest in the manufacturing industry and lowest for retailing and distribution activity.

56 Welsh Assembly Government (2005) p.68.

57 Scottish Minister Tom McCabe MSP, speaking on 5 October 2005.

58 The Fabian Society, *Paying for Progress: A New Politics of Tax for Public Spending* (Fabian Society, 2000).

59 Office of the Deputy Prime Minister, *Transferable lessons from the Enterprise Zones* (ODPM, 2003).

60 ODPM (2003).

The operation of Enterprise Zones did not escape criticism. Research suggests that the full 100% rate relief encouraged higher rents. Rents inside the zones were found to be significantly higher than those in areas immediately outside, mirroring operational criticisms of rate relief in other areas.[61] Detractors question the public expense of EZs: the cost per job in UK Enterprise Zones varied between £21,000 and £41,000.[62] In comparison with other initiatives, research implies that overall a lower level of investment activity occurs in Enterprise Zones, suggesting their focus on fiscal measures is less effective in stimulating the flow of private finance – a reason for their eventual phasing out in 2006.[63]

From our analysis the fit of business rates and business rate relief within the government's overall regeneration and sustainable communities polices is unclear, particularly following the demise of Enterprise Zones in 2006. While the forthcoming Lyons Review promises to further change the relationship between business and local government, the extent to which business rate reform will aim to incentivise local business appears limited to the use of reliefs to encourage small businesses and support businesses in rural areas.

Recently, a number of new levers have been introduced to help encourage enterprise and greater partnership between public and private sectors. Local Strategic Partnerships (LSPs) and Local Area Agreements (LAAs) were established to deliver services and have formalised strategic discussion between sectors in the eighty-eight recognised areas of deprivation across England. LSPs provide a more formal setting for local authorities and businesses to plan local development strategies (or 'Community Strategies') by bringing together local stakeholders from the public, private and voluntary sectors to improve the economic, environmental and social well-being of local areas. LSPs have become a key part of the institutional arrangements of local government.[64]

61 ODPM (2003).

62 Scottish Enterprise, *Lanarkshire leads Britain as the country's top Enterprise Zone,* 30 January 2006, <http://www.scottish-enterprise.com/sedotcom_home/news-se/news-fullarticle.htm?articleid=145808>, [26 May 2006].

63 Joseph Rowntree Foundation, *Attracting private finance into urban regeneration* (York: Joseph Rowntree Foundation, 1998). Although EZs still exist at present the initiative is due to finish by the end of 2006.

64 Warwick Business School, *Research Summary – Local Strategic Partnerships: Formative Evaluation and Action Research Programme 2002-2005* (ODPM, 2006).

Yet, despite this it is unclear to what extent current community planning has considered discretionary rate relief to encourage, protect or promote local enterprise or regeneration. A further consideration for LSPs in developing their statutory well-being power could be to review and re-target the use of existing discretionary rate relief for local firms, or businesses meeting local strategic priorities. To mitigate the impact on local taxpayers HM Treasury could consider a partial disregard for agreed cases, classes or geographical areas to free business rates to act in concert with agreed local initiatives, for example in Local Area Agreements.

The case for 'Place-Shaping' Relief

It is essential that rate reform keeps in step with other changes in local authority reform. Rates should be used as a mechanism to meet challenges to the environment and local economic or regeneration goals. This will ensure consistency with other incentives thereby maximising the potential for suites of incentives and exemptions to work in concert.

Section 1 has illustrated the predominant use of business rates for local regeneration in rural- or small- business settings, although rate relief was a factor in the Enterprise Zone strategy of the 1990s. However, the current national structure of ratings impedes the development of more innovative financing schemes. As such, rating appears at arms length from other government regeneration initiatives. In the 2006 Budget a range of new measures to capture development gain from planning were introduced, including Real Estate Investment Trusts (REITs), Planning Gain Supplement (PGS) and Stamp Duty reforms. There has also been a strong lobby for the use of business rates for major infrastructure projects or regeneration initiatives, although this will usually be in the form of a business rate supplement.[65] Flexibility to invest property tax revenues in designated urban areas, as with Chicago's Tax Increment Finance scheme (TIF), has been one suggestion.[66] The TIF is estimated to have raised in excess of $7 billion since 1992, and was mooted as a possible model by Lord Rogers' Urban Taskforce (1999). However, as with other such rates schemes the success of a UK TIF would largely depend on the retention of rates revenue by devolved, regional or local government – in effect a

65 Lord Rogers, Towards an urban renaissance (Urban Task Force, 1999) and Tom Startup and Ann Rossiter, *The Role of Property in Financing Infrastructure* (SMF, 2004).

66 Chartered Institute of Building, *Urban renaissance held back by funding obstacles* (CIB, 2004).

form of 'de-nationalisation' of rates.

Much of the debate around reform of business rates for local economic regeneration will be predicated on the outcome of discussions around the potential for fiscal decentralisation during the Lyons Review. However, reforming non-domestic rate reliefs for 'place-shaping' does present policy makers with an opportunity to align revenues collected from local businesses with locally agreed priorities.

Yet, in order to avoid further complexity any additional reliefs should be offset by the reform or abolition of existing reliefs or exemptions. The analysis (above) of empty premises relief suggests that there is considerable scope for reform to align the impact of this relief with the development of more active regeneration policies since 1990. We therefore believe that empty premises relief should eventually be phased out, and resources redirected towards regeneration and environmental incentives.

Considering the growth of business engagement in LAAs, LSPs and Community Strategies, aligning business rate reliefs with agreed local regeneration initiatives may be one option for consideration, however care would need to be taken to ensure that the relief was for regeneration work which represented 'added value' to the local area, i.e. above and beyond the economic footprint of the business in its own right. Moreover, a 'place-shaping' relief would have to be tightly defined in order to bring targeted benefits to deal with the criticism of rural and small business rate relief being too 'blanket' in their approach.

Following the demise of business rates working in concert with other enterprise initiatives in Enterprise Zones, the use of rate relief as a specifically targeted incentive to promote diversification from 'old' to new economy industries could be considered. In particular exploring how business rates could be used as an incentive to increase investment in research and development – as was mooted in 2005 in Scotland – is worthy of further exploration.

Time for a 'Green Buildings' / Carbon Abatement incentive

A second, more fertile, potential area for reform is the introduction of new business rate relief incentives for businesses to raise the energy efficiency of buildings. As a tax on property and the

occupation of land it is suggested that the introduction of rate reliefs for abating the carbon footprint of buildings may be appropriate.

The following analysis considers the fit of business rate relief with meeting climate change or energy efficiency goals. In particular, we ask whether programmes such as the installation of Combined Heat and Power (CHP), micro-generation or other measures could be incentivised further to compliment existing incentives such as Enhanced Capital Allowances (ECA) or to encourage compliance with new environmental regulations such as the EU Energy Performance of Buildings Directive.

The policy setting

Tackling climate change and cutting carbon emission has become a stated objective of energy policy across the industrialised world. During the late 1990s the United Kingdom embarked on a wide-ranging programme to tackle climate change and greenhouse gas emissions. These included various regulatory, fiscal and voluntary instruments such as the Kyoto Protocol and the UK Sustainable Development Strategy. It is now recognised on both a national and European level that a reduction in the energy consumption of buildings will help reduce carbon emissions.[67] The UK is committed to a 60% CO2 reduction 'aspiration' by the middle of the century and to the Kyoto targets to cut greenhouse gas emissions. However, serious doubts have already arisen as to whether it will be possible for the UK to meet the first stage targets (2008-2012) in the Kyoto timeframe. Taken together these problems represent major challenges which will require significant changes to the way people live and do business.

While industry's share of energy use in the United Kingdom has declined sharply over the last 35 years, a growing body of research points to the need to improve energy efficiency of existing commercial and industrial buildings. It is estimated that around 40% of final energy consumption in the European Union emanates from commercial or industrial premises.[68] Recent research by the Carbon Trust estimates that 8 million tonnes of carbon dioxide – the equivalent of the annual carbon emission of Birmingham – was released by commercial premises

67 Department for Communities and Local Government (2003).

68 Lord Marshall, *Economic instruments and the business use of energy* (HM Treasury, 1998).

69 Carbon Trust, *Carbon set to cost UK businesses £570 million this summer,* 15 June 2006, http://www.carbontrust.co.uk/about/presscentre/061506_campaign.htm, [18 June 2006].

70 DEFRA, *EU Directive on the Energy Performance of Buildings* (DEFRA, 2003).

71 HM Treasury, *Statement of Intent on Environmental Taxation* (HM Treasury, 1997).

72 Greenpeace (2005).

73 HM Treasury, *Tax and the environment: using economic instruments* (HM Treasury, 2002).

74 Andrew Wordsworth and Michael Grubb, *Quantifying the UK's incentives for low carbon investment,* 2003, Climate Policy, <http://www.econ.cam.ac.uk/faculty/grubb/publications/J35.pdf>, [13 May 2006].

during the summer of 2006.[69] Most of this energy is used on heating, hot water, cooling and lighting. The EU has indicated that by significantly improving the energy efficiency of buildings, emissions could be reduced by up to 22%.[70]

At the centre of this drive to reduce carbon emissions is the Climate Change Programme which aims to encourage greater investment in 'low carbon' technologies with the aim of being a 'low carbon economy.' Traditionally controlling pollution and environmental damage had been subject to voluntary encouragement or government regulation, as opposed to taxes or incentives. However, since 1997 it has been the government's intention to use environmental taxes as a policy mechanism for meeting environmental challenges, providing they meet the principle of good taxation.[71] Concurrently, pressure has mounted from a variety of sources to use new and existing tax reliefs to incentivise businesses to encourage environmental improvements. Recently focus has shifted to look at how the tax system can work in concert with regulation. Greenpeace, for example, have called for an 'energy revolution' consisting of a variety of measures ranging from tougher EU regulation through to reduced business rates for properties capable of generating their own electricity.[72]

The Government has developed a range of measures to prevent market failure causing environmental damage. The 2002 HM Treasury study Tax and the environment: using economic instruments argues that market failures exist "where the costs of environmental damage are not reflected in the prices of goods and services; where environmental improvements can only be achieved by society acting collectively rather than individually; or where decision-makers do not have clear information about how best to reduce their costs."[73] As a result the government has introduced a variety of measures, ranging from new taxes such as the aggregates levy and the Climate Change Levy, as well as changes to existing taxes – such as the Landfill Levy and changes to the Fuel Duty. The total value of these interventions was estimated in 2002 (before renewable obligation certificates) to be approximately £1.3 billion a year of which 80% is judged to be from indirect expenditures or foregone tax revenues.[74] Other initiatives have included government investment in R&D grants and innovative steps such as the emissions trading

scheme and allowances against mainstream taxation – including the 100% first year Enhanced Capital Allowances (ECAs) scheme for firms making energy efficiency saving investments – although the scope for incentives within the existing system is thought to be broad.[75]

Using Business rate relief as an environmental incentive

The use of incentives to encourage business to meet environmental challenges is a relatively new policy tool. The advantage of using an incentive, in this case a business rate relief, for green buildings is twofold. First, unlike uniform regulatory standards firms have flexibility in choosing a response to the measure according to what suits their business best. Second, the availability of an incentive is usually continuous and therefore assists in promoting innovation, helping to spur technological improvements and efficiency.

The use of business rates to incentivise better environmental standards is not without precedent. The Energy Saving Trust, for example, has urged the government to review the fiscal incentives to energy efficiency. The Northern Ireland review cites an intention by the government to introduce a rate relief scheme to promote environmental good practice in the quarry industry thereby aligning it with incentives on the Aggregates Levy to comply with industry good practice. Meanwhile a successful council 'tax back' pilot in 2004 between British Gas and Braintree Borough Council was extended to sixteen other local authorities across Britain in March 2006 offering domestic householders council tax rebates of up to £100 following the installation of energy efficiency measures. DEFRA estimates this could result in an annual carbon saving of around 193,000 tonnes in these authorities. While the scheme is currently being funded by 'energy credits' from British Gas, the Chancellor's budget statement promised a further £20 million nationally to promote such initiatives.[76] Arguably the relative success of this scheme is partly due to its association with the highly visible council tax. Business rates have a lower, but still relatively high perceptibility, raising the possibility of creating an immediately appealing relief.[77]

There have been specific calls for the use of business rates to be reformed for environmental purposes. In 2005 Greenpeace called for a more imaginative use of business rates

75 ICCEPT and Fabian Society, *Innovation and the Environment: Challenges and Policy Options for the UK* (ICCEPT, 2001).

76 A further forty councils are now believed to be in discussion with British Gas plc about proposals to fund similar schemes across Britain.

77 Tony Travers, *International Comparisons of Local Government Finance: Propositions and Analysis* (London School of Economic and Political Science).

as part of its proposals to decentralise energy. In addition, the Energy Systems Trade Association, in their submission to the Energy Review argued that linkage of the UBR and energy efficiency would provide a strong incentive for businesses to be more efficient, affecting the asset value of buildings as well as their operational costs. This would bring the issue into focus for financial managers rather than energy managers and hence have a far bigger impact on businesses than energy prices.[78]

Although environmental taxes have been widely used in Europe a literature review reveals that a 'Green Buildings' incentive on property tax does not appear to have an equivalent in other EU countries.[79] However, environmental rate relief is briefly considered in the Welsh Assembly research when considering the possibility to encourage best practice.[80] Given that business rates are a tax upon property occupancy it makes sense to use business rate relief to encourage a reduction in the carbon emissions of buildings. A change in policy to allow business rate relief for environmental incentives must be seen in the context of other policy levers available to tackle the harm being caused. The aim of any new relief should be to assist and not counteract existing incentives, such as Enhanced Capital Allowances (ECAs).

Options for 'Green Buildings' incentive

Policy considerations

Below we chart two proposals for a 'Green Buildings' incentive. Both options are based upon the premise that despite new regulation in the form of the Energy Performance of Buildings Directive, changes in planning requirements and government targets and initiatives, there is a residual policy problem with energy efficiency/carbon footprint in existing build. As noted above, a key policy challenge is now how to incentivise firms to improve their efficiency/ carbon footprint.

The issue of whether this is revenue or regulation neutral is also a pertinent policy consideration. Furthermore, one of the key advantages of the present UBR system for businesses is its consistency and predictability. Adding more complexity to the system by way of extra rate reliefs may make the present system more inefficient or more difficult to administer creating further

78 Source: Energy Systems Trade Association

79 Agnieszka Laskowska and Frank Scrimgeour, *Environmental Taxation: the European Experience,* <http://wms-soros.mngt.waikato.ac.nz/NR/exeres/E33CCD10-4841-47AE-8A1A-C66E1B01E9FD.htm>, [3 June 2006].

80 Welsh Assembly Government (2005) p.69.

burdens on business. Alternatively, if not carefully targeted it could create unintended consequences or perverse outcomes.

Despite these reservations, the SMF thinks that both of these options are worthy of further research and consideration by public policy makers.

Option 1: Time limited alignment of business rate relief with government targets

Taken together with the Climate Change Levy and ECAs, a business rate relief system for green buildings could spur a more immediate improvement in the environmental standards working in combination with regulation and government targets. A relief of this kind would be focused on energy efficiency in existing build outlined above.

While a range of government targets could be used, Combined Heat and Power or micro-generation incentives are used here as indicative incentives to illustrate how a rate relief for energy efficiency measures could work.

Microgeneration is defined in section 82 of the Energy Act 2004 as the small-scale production of heat and/or electricity from a low carbon source. The technologies included in this definition are: solar photovoltaics (PV), micro-wind, micro-hydro, heat pumps, biomass, micro combined heat and power (micro CHP) and small –scale fuel cells.

This table shows the range of microgeneration technologies available and the number of installations in the UK.

Technology	No. Installations
Micro-wind	650
Micro-hydro	90
Ground source heat pumps	546
Biomass boilers (pellets)	150
Solar water heating	78,470
Solar PV	1,301
MicroCHP	990
Fuel Cells	5
Total	**82,202**

Chart A. Source: DTI Microgeneration Strategy 2006

The three goals of government energy policy are sustainability, diversity and security of supply. It is for these reasons that the government is becoming increasingly keen on microgeneration. If every building could generate some or all of its own electricity, through micro-renewable energy or CHP, this would meet all these government goals.

First and most importantly microgeneration installation will help to reduce carbon emissions due to the fact that it is low in carbon production. It is a sustainable source of power, offered by a range of different technologies suitable for different homes and businesses. In addition to being sustainable and diverse, microgeneration is also secure, which is becoming increasingly important in the potentially unstable energy market. The UK is no longer a net exporter of oil and shortly will lose that status in respect to gas. Therefore the UK will be reliant on external energy supplies for meeting future energy demands. If the UK could apply microgeneration technologies in a cost-effective way it would reduce import dependence. A recent report by the Sustainable Consumption Roundtable suggests that the "qualitative impacts of microgeneration technology can be substantial, presenting a living breathing and emotionally engaging face to energy consumption." The report goes on to state that some of their sample were "only producing very modest levels of energy through their microgeneration technology, yet the behaviour impacts in terms of energy awareness and efficiency were often still considerable". [81]

The DTI's 'Microgeneration Strategy' published in March 2006, states that the government's objective is to "create conditions under which microgeneration becomes a realistic alternative or supplementary energy generation source for the householder, for the community and for small business." A study commissioned by the DTI by the Energy Saving Trust (EST) suggested that by 2050, microgeneration could provide 30-40% of the UK's electricity needs. However, in 2004 there were only 82,000 microgeneration installations in the UK, so there is clearly a long way to go.

Combined Heat and Power

Combined Heat and Power (CHP) is an important element in the government's new energy policy, as set down in the Energy

81 DTI Microgeneration strategy, *The need for a microgeneration strategy,* <http://www.dti.gov.uk/files/file27577.pdf> [3 June 2006].

White Paper and its aim to achieving a 60% reduction in carbon dioxide emissions by 2050. CHP is a fuel-efficient energy technology that, unlike conventional forms of power generation, puts to use the by-product heat that is normally wasted to the environment. It is estimated that CHP can increase the overall efficiency of fuel use to more than 75%, compared with around 50% from conventional electricity generation. Furthermore, because it often supplies electricity locally, CHP can also reduce transmission and distribution losses. In 2000 the government set a new target to achieve at least 10,000 MWe of installed 'Good Quality' CHP capacity by 2010. To encourage CHP the rating system was reformed so that new CHP plant or machinery is to be exempted for the purposes of business rates – although this applies to the machinery and not the property as a whole.

A range of reliefs currently exist for CHP which a 'Green Buildings' incentive could supplement. Under the Climate Change Levy (CCL) exemptions exist for Good Quality CHP fuel inputs and electricity outputs used on site or (from April 2003) sold via licensed suppliers. In addition, Enhanced Capital Allowances (ECAs), introduced as part of the CCL package in 2001, included a 100% first-year capital allowances on investments in certain energy saving equipment. Under this scheme businesses are able to write-off the whole cost of their energy saving equipment (including Good Quality CHP) against taxable profits during the period of investment.[82] However, the impact of the ECA scheme is hard to measure, although the Inland Revenue estimates that take-up amounted to £100 million a year. The Environmental Industries Commission noted that the financial advantage represented for most companies a "relatively modest incentive", and recommended that the allowance be increased to 150 percent of the capital cost. The Carbon Trust also notes that for smaller companies, particularly those making little or no profit, the value of the ECA was insufficient to tip the balance in favour of energy efficient equipment.[83] Instead, it proposes that ECA should work with a range of other measures including the introduction of "differentiated Local Authority rates based on building energy performance."[84]

If microgeneration and combined heat and power technology is seen as an effective public policy measure for cutting

82 DEFRA, *Sustainable energy: Combined Heat and Power,* 28 March 2006, <http://www.defra.gov.uk/environment/energy/chp/index.ht>, [17 May 2006].

83 Select Committee on Science and Technology, *Second Report,* 05 July 2005, <http://www.parliament.the-stationery-office.co.uk/pa/ld200506/ldselect/ldsctech/21/2108.htm>, [16 May 2006].

84 Memorandum by the Carbon Trust to House of Lords Select Committee on Science and Technology , 05 July 2005, <http://www.publications.parliament.uk/pa/ld200506/ldselect/ldsctech/21/4111005.htm>, [16 May 2006].

emissions or saving energy then further consideration should be given to providing relief for business properties that invest in this technology. Those businesses that invest in this could receive some relief (possibly linked to the amount a business has to invest to set up this technology).

While the extent to which CHP relief is taken up is unknown, incentivising businesses with existing properties to invest in new technologies may also require the use of time-limited relief. In 2001 the government introduced a time-limited (five year) relief for all new small non-agricultural enterprises on farms – small scale tourism, shops, offices, workshops or similar enterprises, to encourage industries to diversify or meet more competitive challenges. The advantage of this system would be that it would be extremely focused, simple and clear without expensive additional administration costs. Aligning business rate relief within the specific policy context of improving take-up of combined heat and power by 2010 could provide an added option to meet the environmental challenge.

Option 2: alignment with local authority climate change goals
Within the context of the relocalisation of rates debate, making rate relief available for local authorities to bestow on businesses for meeting local climate change challenges might could also considered. Lyons has noted the need for local government 'place shapers' to meet climate change and sustainable development. Local government has an important role to play in contributing local solutions to meeting national objectives. Local government's proximity to citizens also enables it to influence attitudes and behaviour, and to encourage them to take an active part in providing solutions." However, as of yet few local authorities have developed climate change programmes.

Option 3: Rate relief in concert with the introduction of EU Energy Performance of Buildings Directive
A potential opportunity to align tax incentives with regulation is afforded by the introduction of the Energy Performance of Buildings Directive. This requires all properties to be provided with Energy Performance Certificates when properties are constructed, sold or rented out. Under this scheme, properties will be given an energy efficiency rating from A to G. For non-

domestic buildings, the main changes include a set of energy performance ratings – standards that new buildings must comply with. These include detailed design limits that help to control heat loss through the fabric of the building. It also includes procedures for calculating the Target Emissions Rate (TER) of carbon dioxide for each building, depending on the particular size and characteristics of the design plans - the predicted rate of carbon dioxide must not be greater than the TER. For non-domestic buildings, an emissions target reduction of 25% less than the calculated standard will be applied. In addition a new requirement stipulates that work on existing buildings will trigger the need to make energy efficiency improvements to the building being extended or worked on and not just the extension. It is important to note that the ratings assigned under the certification process merely act as a benchmark and as a way of encouraging improved energy efficiency standards, especially in existing buildings.

However, the Directive does not impose any requirements in terms of penalties or incentives for building owners. The impact of the new regulations appears to be potentially significant and sets in motion future consideration of a proportionate incentive scheme. The policy could, for example, be shifted to consider introducing financial incentives or disincentives with regard to energy efficiency. Under a new 'Green Buildings' incentive businesses could be offered rate reductions for energy-efficient buildings, with the grading being based on a calculation of the energy use per square meter of floor area and the environmental impact based upon carbon dioxide (CO_2) emissions. These rate reductions would be offered to businesses resident in new and old buildings that improve their energy efficiency. Time-limited rate relief would be offered to all businesses that improved the energy efficiency of their property to a certain level.

Taken together with the Climate Change Levy of companies and ECAs, a business rate relief system could spur gradual improvement in environmental standards over time working in combination with existing regulations. Taken as a whole, the SMF considers the introduction of new green taxes, regulations and incentives to provide an ideal opportunity for fresh thinking around business rates and business rate relief.

Conclusion

The Uniform Business Rate was introduced in 1990 in the midst of recession and in the political climate of a struggle between central and local government. It is now time to ask whether the system as it is currently formulated is suited to the British economy of today. As competitive pressures increase, and new business incentives are introduced it is becoming ever more apparent that reform of business rates and rate relief is due. The government must consider whether the Uniform Business Rate represents a fair and effective system and how it might be adapted to assist businesses in meeting enterprise, environmental and local regeneration goals.

In their current form business rates constitute a broadly accepted and transparent method of raising taxation from business across the UK. Business community groups emphasise consistency between regions and authorities as well as ease of collection as key advantages of the present system. However, mapping some of the criticisms, particularly in terms of rate relief, bring a number of issues to light which point towards reform or revision of business rates while attempting to retain its advantages. These issues centre on whether the current system can be adapted to become a more market-based instrument providing better signals or incentives for both large and small companies to invest and innovate to meet competitive, social or environmental challenges.

This paper has attempted to provide an account surrounding some of the key issues effecting the operation of the Uniform Business Rate and make recommendations for reform. Our thesis is that it is timely for business rates to be looked at and made more consistent with new aspects of government policy. While the current system has its advantages - rates are seen as relatively simple to collect and administer; the system

is transparent; and rates are uniform to businesses across the country, making the system and administer, it is also accompanied by an ever increasing variety of reliefs and exemptions - approximately 16% of the total.

The use of relief from rates payments as an instrument of policy has a long history and over the years reliefs and exemptions have been extended to cover a wide variety of undertakings. Outright exemptions exist for a range of historic reasons, some due to custom, others due to economic reasons and others still for public interest or community benefit. Yet some new reliefs are already used in a forward-looking way. Examples include encouraging farm diversification – moving from traditional farming to reliefs on new workshops or mail-order premises and in Scotland a relief for research and development is currently being considered.

The Lyons review's focus on 'place-shaping' presents a real opportunity to look at how rate relief could align itself to sustainability goals – and we believe that business rates are an underexploited resource in this context. Even if business rates remain nationally set, the introduction of environmental relief has the potential to give councils a greater degree of financial autonomy and control over the 'place-shaping' agenda. Local Authorities would have a key role to play in relation to granting planning permission for the installation of environmental technologies. Using reliefs to directly encourage regeneration is, however, limited, as a number of studies have shown and there seems to be a prima facie case for exploring the use of rates to incentivise environmental behaviour first.

If old reliefs are reformed and the money used to incentivise businesses to invest in 'place-shaping' or shared environmental challenges, this could ultimately encourage more innovation among businesses, grant local government greater autonomy and build common bridges between the local community and local authorities committed to these goals.

Since 1990 business rates have arguably become a national business tax for local public spending. The reforms we suggest could help make business rates not only relevant for today's national policy challenges, but provide a greater business contribution to the transformation of the local environment.

Ultimately, many of the proposed reforms to business rates

the SMF suggests for further consideration and research will rest upon political decisions - in particular the need to align and reform the current system of rate relief and exemptions. Travers observes that because local government taxation has relatively visible the chances of significant reform carry with them a higher political risk – although this is more the case with reform of council tax than business rates. Carefully aligning business rates with wider policy goals while reforming contradictory or some of the unintended consequences present in the current system may bring about enough potential for change in this area to warrant further investigation.

Appendix A: The origins of business rates

The administration of local property rates is generally understood to have begun with the 1601 Poor Law, but this was preceded by similar enactments in the previous quarter century.[85] Rates were intended to provide for the poor, and were considered to be an accurate reflection of personal wealth. They were administered at the parish level by Overseers of the Poor and were consequently characterised by little uniformity.[86]

Industrial development in the eighteenth and nineteenth centuries led to an increased dependency on rates to finance responses to urban poverty and challenges associated with a growing urban population, such as law and order, and sanitation.[87] Rates were still administered locally, but attempts were made to encourage a degree of uniformity. The Municipal Corporations Act of 1835, which replaced the system of old corporations with directly elected corporate boroughs, established a series of bodies responsible for different aspects of public provision, each levying their own rates.[88] Later in the century attempts were made to rationalise this: the Union Assessment Act of 1862 gave responsibility of valuation to assessment committees which operated within unions of parishes, and rates were gradually merged through the Local Government Act of 1888 and later reforms of 1894 and 1899 (in association with the evolution of local government structures). The concern of central government to achieve uniformity of the system inspired the Local Government Act of 1948, by which valuation was given to the Inland Revenue, and local authorities were left with only the ability to vary the rate poundage.[89]

The assessment of rates has similarly undergone considerable change and review since its inception. The 1601 Law ambiguously decreed that sums were to be raised by "taxation of every inhabitant, parson, vicar and other, and of every occupier of lands, house tithes impropriate, propriations of tithes, coal-mines, or saleable underwoods in the said parish."[90] In practice, all personal property, stock-in-trade, and movables and immovables came to be rateable. But in 1840 movable property was decreed exempt by the Poor Rate Exemption Act. The 1925 Rating and Valuation Act formalised the rating of plant and machinery, although the earliest case to decide that "certain items of plant and machinery that [made the premises on which they were situated] fit for the purpose for which they were used were rateable as part of the property" dates from 1783.[91] The 1925 Act devised a list of plant and machinery, and decreed that tools and stock-in-trade were not rateable. The list was intended for regular review, but this did not occur until 1957 when it was ordered by the Ristson Committee.

Certain types of properties came to be granted exemptions: parks and buildings used for religious worship have been exempt since the eighteenth century, a custom formalised later – e.g. parks in 1897 and 1961 - and reviewed continually ever since concerning particular cases. The gradual 'de-rating' of agricultural land and buildings began at the end of the nineteenth century, with both being entirely de-rated in 1929. The 1920s also saw the 75% de-rating of industrial property in the hope of discouraging foreign competition, though a government White Paper of 1957 proposed to raise the rateable value of industry back to 50%, and in 1963 the de-rating of industrial assets was abolished.

During the 19th century, complaints over the inequity of rates proliferated: property rates were criticised for no longer being an accurate indicator of wealth, and by the 1920s the burden of rate payments was also falling increasingly on the 'working classes' as opposed to capital. The Goschen Report of 1870 considered such complaints, as well as attempting to address tensions arising between the manufacturing and agricultural sectors concerning the equity of the rates system. The Report proposed the establishment of an Assigned Revenue System, by which local authorities were assigned excise duties and probate revenues from a central pot, but this was gradually phased

85 Bond and Brown (2006).

86 For the text see: Peter Higginbotham, *The 1601 Act for the Relief of the Poor* <http://users.ox.ac.uk/~peter/workhouse/poorlaws/1601frames.html> [25 June 2006].

87 Tony Travers and Lorena Esposito, *The Decline and Fall of Local Democracy: A History of Local Government Finance* (Policy Exchange, 2003).

88 Travers and Esposito (2003).

89 Bond and Brown (2006); Travers and Esposito (2003).

90 Peter Higginbotham, *The 1601 Act for the Relief of the Poor* <http://users.ox.ac.uk/~peter/workhouse/poorlaws/1601frames.html> [25 June 2006].

91 Bond and Brown (2006).

out and finally abolished in 1929.[92] Revaluations continued to prompt complaints over rates bills, and the raising of poundages by local authorities in the 1950s and 1960s provoked a series of 'crises'.

Nevertheless several reviews of local government finance failed to abolish rates, their resilience being testament to their simplicity as a form of taxation – namely, their predictability for budget forecasting, and their concordance with administrative boundaries (unlike sales taxation). This was also the conclusion reached by the 1966 Green Paper, despite its admission that rates were regressive. On the other hand, the Layfield Royal Commission of 1976 recommended that the rating system should be retained, but that domestic premises should be assessed on capital values in place of annual or letting values. It further recommended that agricultural land and buildings should be rated, and that a local income tax should be levied as an additional source of finance. The White Paper of 1983 proposed the abolition of rates altogether, although the final Rates Act of 1984 settled instead for the introduction of rate capping of council budgets.[93] It was finally in response to the rating crisis in Scotland (1985) following a dramatic revaluation that legislation began to be drafted, according to which the levying of rates was removed entirely from local government authority.

92 Travers and Esposito (2003).

93 The act did not directly cap local rates bills, but instead gave the Secretary of State the power to cap any council budget which was deemed to be excessive. See Bond, pp.52-3.