Policy Paper

An Enterprising Welsh Tax Policy

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About FSB Wales

FSB Wales is the authoritative voice of businesses in Wales, with around 10,000 members. It campaigns for a better social, political and economic environment in which to work and do business. With a strong grassroots structure, a Wales Policy Unit and dedicated Welsh staff to deal with Welsh institutions, media and politicians, FSB Wales makes its members' voices heard at the heart of the decision-making process.

Throughout 2020 FSB Wales is speaking to businesses the length and breadth of Wales through our campaign *Our Business is Wales*. The conversation will be used to inform practical policy suggestions to improve the business environment for SMEs.

Introduction

A lot has changed during the last five years of Welsh politics. As we approached the 2016 National Assembly for Wales elections, FSB Wales was concerned with business rates as the key devolved tax lever that has an impact on businesses large and small across Wales. Five years later, as we approach the 2021 elections to the Senedd, we do so in the context of nearly £5bn in 'Welsh' taxes including taxes on income, land transaction as well as properties accounting for nearly 30% of Welsh Government's revenue on an annual basis.

We can now talk clearly about an articulated Welsh policy on taxation that impacts on individuals and businesses across Wales. There is a Welsh revenue agency – the Welsh Revenue Authority – that collects Welsh taxes for the first time in over 800 years. Decision on taxation have a meaningful impact on public spending, but also on the future of the Welsh economy. A tax system that helps nurture SMEs and encourages further investment could benefit us all through increased productivity, growth and revenues.

FSB Wales has been quick to engage in this agenda with our partnership with Bangor University to research tax collection arrangements in Wales titled *Funding Prosperity: Creating a New Tax System for Wales*. This paper takes the agenda further by setting out the key focus for the next Welsh Government in creating an enterprising Welsh tax policy.

How important is tax to the business environment?

In our UK-wide report *Taxing Times* FSB highlighted that on average a small business loses 3 working weeks a year to tax compliance, *with* well over half saying they don't feel informed about issues such as tax reliefs available. In particular, 47% of those who responded to our survey felt that business rates and corporation tax stifled their ability to grow. A third of businesses said tax had stopped them growing their business with a further third saying it had made growth harder to achieve. It is therefore clear that tax has an impact on the overall business environment. This provides an opportunity to Welsh Government particularly as it now has significant control over aspects of business related tax policy.

Background

Welsh Government currently controls five major taxes in Wales, they are; non-domestic rates (NDR), council tax, income tax, land transaction tax (LTT) and Landfill Tax. Furthermore, the present Welsh Government has proposals for four 'new' taxes; a social care levy, a plastic tax, a vacant land tax and a tourism tax. Whilst all are important, our focus here is on taxes directly affecting business. As such, this document takes each in turn and also includes some further suggestions that may require further devolution or action in partnership with UK Government.

Non-domestic Rates (Business Rates)

Business rates are incredibly important to SMEs across Wales. Around £1bn is raised from rates every year in Wales and this has increased significantly over the years. A common concern expressed by businesses is that rates increase without a commensurate increase in the quality of services the tax is aimed at funding. As far as business taxes go, it's often perceived as one of the most unfair and outdated. Businesses pay their rates before making any profit. Many online businesses are able to compete without having the same overheads as businesses on the high street and that has implications for the fabric of ours towns and cities. Investment in plant, machinery or new buildings often carries with it much higher rates bills. Every 5 years (or 7 in recent times) there is a revaluation with the tax base shifted between different sectors and areas of Wales.

The Welsh Government's permanent Small Business Rates Relief scheme does much to help those occupying the smallest properties, but ultimately this is a tax that creates winners and losers at almost every turn. While reliefs are helpful to many they are arguably a 'sticking plaster' for the correction of a much wider problem. However, reforming NDR is an almost impossible task. It gives government stable revenue and change in this area is easy to theorise but difficult to deliver as reports from the IFS and accounting bodies such as the ICAEW and several government reviews have recognised.[1] Additionally problematic is that reform brings with it the threat of bringing businesses into taxation that would previously have been exempt.

The general consensus is that the current system is unfit for purpose, but a complete abolition would cost too much. Abolition could also create a very imbalanced landscape across the UK. Options therefore focus on either replacing or reforming the current regime. Welsh Government has itself commissioned work from Bangor University into a Land Value Tax and has committed to reviewing both of those options in the medium term[2]. Similarly, in recent years small alterations have been made on a UK basis including moving from an RPI to CPI inflation measure, promising (although not yet delivering) more frequent revaluation and changes to the appeals process.

For our part, we believe the next Welsh Government could go further in reforming the tax, while continuing to review options for future replacement. Whilst not addressing all the issues with NDR, we believe the following would help facilitate a more enterprising tax policy:

[1] See ICAEW. 2018. *Business Rates: maintain, demolish, rebuild or refurbish?;* IFS. 2019. *Submission to Treasury Committee Inquiry: The impact of business rates on business;* and Scottish Government. 2017. *Report of the external Barclay review into tax rates for non-domestic properties, with recommendations for rates system reform.*

[2] Ap Gwilym, R; Jones, E; & Rogers, H. 2019. *A technical assessment of the potential for a local land value tax in Wales*. Cardiff: Welsh Government, GSR report number 17/2020 [Online]. Available at: https://gov.wales/sites/default/files/statistics-and-research/2020-03/technical-assessment-of-the-potential-for-a-local-land-value-tax-in-wales.pdf (accessed 31st July 2020)

1) **Relieve the rates burden by introducing a Business Rate Freeze for the life of the next Senedd**

When calculating a business rates bill, two variables are at play; the value of the property and the multiplier rate: *Rateable Value X Multiplier = Rate Bill*. Property prices change over time so a revaluation occurs that alters the tax base. This also resets the multiplier rate to ensure the tax revenue is maintained. Then, for the years following that the multiplier increase by CPI until there's another revaluation. Historically, this was done by RPI which meant that for many years the increase on the tax was higher than other costs (with CPI being accepted as a better measure of inflation). For instance, the multiplier rate in 2013/14 was 46.4p whereas for 2020/21 it will be 53.5p.[3]

Over time, this has meant that business rates has increased as a cost faster than other taxes and general prices, making property and in particular property on the high street, less attractive. To rectify this, the next Welsh Government could introduce a business rates multiplier freeze. Over the life of the Senedd, this would mean increases in revenue would only come from tax base growth (i.e. increases in rateable value) as opposed to CPI linked increases in the tax. This would come at a cost of CPI inflation per year for Welsh Government in foregone revenue, which on a crude calculation of £1bn would equate between £9m per year (using May 2020 CPI rate of 0.9%) and £20m per year (assuming a 2% inflation target).[4]

The impact on individual businesses would not be large, but over time a freeze would rebalance the size of rates as a tax and make occupying property more viable, particularly in more valuable locations such as the high street.

2) **Move from a revaluation cycle to rates indexing**

As referenced previously, the revaluation process for business rates happens every five years at present and sees major winners and losers in terms of sectors and towns in Wales. It's a painful exercise and in recent years economic turbulence (following 2008 and the current crisis caused by Covid-19) have meant governments are unwilling to carry out revaluations. This is a concern because while it provides some degree of certainty, it creates much more significant winners and losers when revaluation eventually happens and allows unfairness to be maintained within the tax base. Revaluation has also posed challenges in that while NDR is a devolved tax the revaluation process is procedurally tied to the English system, reducing flexibility for policy innovation.

One solution to this is to introduce more frequent revaluations, with three years proposed often as ideal. However, we believe the next Welsh Government could go further by looking to introduce local property indices instead which would be regularly updated and maintained by the VOA in Wales and would remove the need for a revaluation process. This has been proposed by Prof Gerry Holtham in a paper done for us previously and more recently by the Institute for Fiscal Studies in their submission to the Westminster Treasury Committee's review on NDR.

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[3] Swansea Council. 2020. *Business Rates Basic Information* [Online]. Available at: https://www.swansea.gov.uk/businessratesinfo#:~:text=The%20multiplier%20in%20Wales%20for,15%2C000%20multiplied%20by%20%C2%A30.535 (accessed 31st July 2020)

[4] ONS. 2020. *Inflation Price Indices: May 2020* [Online]. Available at: https://www.ons.gov.uk/economy/inflationandpriceindices (accessed 31st July 2020).

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3) **Minimise the cost of appeals**

One benefit of more frequent revaluations or indexing is that it could lower the frequency of appeals. The present system generates a large number of appeals to the revaluation process and is often a cause of difficulties for businesses who often fall victim to unscrupulous agencies purporting to help with the appeals process. Furthermore, Wales should not introduce further costs for the appeals process as has happened in England through the *Check, Challenge, Appeal* process. Instead, where possible we should look to make the appeals system simpler and the overall process of rating and revaluations more approachable for SMEs.

4) **Increase the role of the Welsh Revenue Authority on Rates**

The creation of the Welsh Revenue Authority has created new possibilities for tax administration in Wales. The experience and approach to date has been positive for Welsh taxpayers with an emphasis on compliance held above enforcement in the existing devolved taxes. FSB Wales would like to see the current system of 22 local authority billing authorities removed and the responsibility placed instead with the Welsh Revenue Authority.

This would allow for ease of contact for businesses, consistency across Wales in terms of billing processes and would remove the link between NDR and local authorities that often leads to local authorities being criticised for a tax over which they have no control. Furthermore, if a move to an indexing system was considered, the Welsh Revenue Authority could take over these responsibilities providing greater alignment than is currently seen with the Valuation Office Agency. Such a move would should be purely administrative and should not preclude business rates policies being used to inform regional policies such as city and growth deals or consideration of local retention of rates in the future.

5) **Introduce a new Investment Relief**

One of the largest issues around NDR is its disincentive to investment. Currently, new properties and elements of plant and machinery are included in the rating process and bring with them an increased bill. For instance, if a business builds an extension to a building, introduces renewable energy to the property or makes a material change by introducing air conditioning or lifts then they are liable for a rates bill increase. Indeed, the Westminster Treasury Committee recently noted that investment in certain types of assets are dis-incentivised by the system and that the system is currently based on definitions made in 1993, but actually relate to the 1960s.[5] They concluded:

"*The [UK] Government should look at where case law currently stands on what assets are included in rateable values and should consider whether legislation is required to ensure the categories are fit for the modern economy. If it is the Government's stated aim to incentivise the transition to a green economy, it should be proactive in ensuring that businesses that invest in green assets such as solar panels or energy efficient machinery are not subjected to higher business rates as a result.*"

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[5] House of Commons Treasury Committee. 2020. *Impact of Business Rates on Business* [Online]. Available at: https://publications.parliament.uk/pa/cm201919/cmselect/cmtreasy/222/222.pdf (accessed 31st July 2020).

The Scottish Government has introduced a Business Growth Accelerator Relief to deal with these issues, leaving new build and improvements a 12 month period before rates liability applies. We think the next Welsh Government could match this and go further by removing certain types of new investments from the rating process completely by introducing an Investment Relief for improvements that accord with government ambitions on productivity and decarbonisation – for instance new plant and machinery and new energy efficiency investments. It would also need to work with landlords, who often hold responsibility for investment in property but are not necessarily the rate payer.

Crucially, this relief would apply over a longer period, recognising that investment pay-offs are typically 15-20 years for these sorts of investments. For new property, this could be capped at one year as is the case in Scotland. The cost to the Welsh Treasury would be foregone revenue in future years, which would need to be factored in to future budgeting rounds.

Over the longer term, Welsh Government could include further work on whether all plant and machinery should be removed from the rating lists to further incentivise the use of productive assets.

6) **Review existing reliefs**

It is important that any reliefs introduced through the business rates system are subject to regular reviews in order to ensure they are effective in their stated aims and achieving good value for businesses and the taxpayer. In particular, we are aware of inconsistencies in schemes such as the High Street Relief scheme that treats some businesses such as retail on the high street as within scope whilst excluding others such as estate agents and medical services. Reviewing such reliefs would ensure they keep pace with the agenda around revitalising high streets and towns more generally.

Income Tax

The most significant tax devolved to the Welsh Government is Income Tax. For the 2020/21 tax year the Welsh Rates of Income Tax (WRIT) is estimated to bring in £2.2bn to the Welsh exchequer making it a key area of tax policy for the Welsh economy.[6] Strictly speaking, income tax is a personal tax and not a business tax. In principle, the level of income tax applies after salaries are paid by employers, therefore it has no impact directly on business costs.

It is worth noting however, for those that are self-employed income tax is essentially a business tax. Similarly, tax rates have an impact on behaviour, particularly at higher levels of the tax base where individuals are more mobile and have the ability to choose where they locate themselves. A Welsh tax system that makes take home pay lower than locations elsewhere will therefore have an impact on the ability of companies to recruit at certain levels of the labour market.

7) **Commit to no income tax rises above England during the next Senedd**

For this reason, FSB Wales believes that the next Welsh Government should make a commitment to at the very least maintain the same tax rates as currently exist in England. By doing this,

[6] Wales Fiscal Analysis. 2019. Government Expenditure and Revenue Wales 2019. [Online]. Available at: https://www.cardiff.ac.uk/__data/assets/pdf_file/0004/1540498/Government-Expenditure-and-Revenue-Wales-2019.pdf (accessed 31st July 2020) p.66

revenues will be maintained that can be used to fund public services and investment in infrastructure whilst businesses will not be at a competitive disadvantage to their counterparts in England in recruiting their workforce. Instead, it is our view that Welsh Government should focus on growing the Welsh economy and growing the Welsh tax base as a result.

Land Transaction Tax

The Welsh Government budget for 2018/19 set out the first rates and bands for the Land Transaction Tax. In relation to non-residential transactions the Welsh Government reduced the rate between £150,000 and £250,000 from 2 per cent (as currently applies in England) to 1 per cent.[7] This essentially halves the cost of tax on transactions between these values.

8) **The next Welsh Government should maintain the 1 per cent lower band for the Land Transaction Tax between £150,000 and £250,000.**

Furthermore, the knock-on impact of the cut in this band leads to a reduction in tax liable for property purchases up to a value of £1.1m. This has led to the tax becoming more progressive when compared to its English and Northern Irish counterpart, Stamp Duty Land Tax. FSB Wales believes a significant proportion of our members have benefited from this change. We therefore believe it should be maintained in the short-term and the impact reviewed at a later date to ascertain the impact on the number of transactions.

Corporation Tax

Corporation tax has a significant impact on the attractiveness of Wales not only as a location for foreign direct investment but on the profitability of domestic businesses. While corporation tax is not devolved to Wales, FSB Wales believes there is merit in revisiting the issue to understand how it could be used as a lever for economic development in Wales. This is particularly true given our departure from the European Union that previously provided a block on regional differentiation through the Azores Judgement.

9) **Revisit the proposals of the Holtham Commission on GVA weighted Corporation Tax reductions**

The Holtham Commission which undertook its work between 2008 and 2010 recommended that the then Welsh Government should explore the feasibility of corporation tax devolution. However, it did not favour a blanket devolution; rather it called for the ability to vary corporation tax in Wales in line with Wales' relative GVA performance. Whilst this recommendation has not come to pass, we believe it warrants further consideration.

For instance, rather than a Wales-wide reduction of corporation tax, this lever could instead be linked to the emerging regional policy that replaces European Funding. During our research in Brexit, one key finding from our surveys of SMEs was that they wanted more regional funding to be used to give tax reliefs – a lever that was previously ineligible under EU regulations. Under a new regime, a GVA weighted reduction in corporation tax could be linked to regional policy in Wales to allow for those less-developed regions to develop and attract businesses in their region.

[7] Welsh Government. 2018. *Welsh Tax Policy Report* [Online]. Available at: https://beta.gov.wales/sites/default/files/publications/2018-06/welsh-tax-policy-report.pdf (accessed 11th September 2018). P.51

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This would require further examination and we would welcome the next Welsh Government giving consideration to this by using the Holtham Commission proposals as its starting point.

New Taxes

10) **Introduce an SME test for any new Wales specific taxes**

The Welsh Parliament now has capacity to introduce new Welsh specific taxes in Wales through a consenting process through the UK Parliament. FSB Wales is not currently convinced of the need for new taxes at this moment in time, but should a future Welsh Government decide to pursue this route then an SME test should be introduced in order to ensure it does not disproportionately impact on SMEs. Such a test would involve ensuring new taxes do not provide barriers to entrepreneurship, innovation and business growth, is not unduly punitive on certain types of businesses and is not merely aimed at raising revenue without a reasonable justification for doing so.

Conclusion

The first election to the Welsh Parliament should provide an opportunity to think differently and requires all parties to rise to that challenge. We now have significant levels of tax devolution in Wales and the ability to craft an enterprising Welsh tax policy that helps the Welsh economy grow. We hope the proposals in this document are considered by all parties in the lead up to the 2021 elections and that they form the basis for the next step in Wales' tax journey for the next Welsh Government.

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