DRD PARTNERSHIP

A TAX TO SAVE THE HIGH STREET?

WHAT TO EXPECT FROM THE GOVERNMENT'S PROPOSAL TO INTRODUCE AN ONLINE SALES TAX

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WHAT IS THE ONLINE SALES TAX?

- The Government is shortly publishing a consultation paper on an Online Sales Tax. This would be a hypothecated tax used to fund a reduction in business rates on bricks and mortar retailers.

WHAT CAN DRD OFFER?

- DRD provides strategic public affairs and campaign support which has a real-world impact on policy development and the passage of legislation.

EXECUTIVE SUMMARY

On 27 October 2021, Chancellor of the Exchequer, Rishi Sunak, unveiled his budget, announcing that the Government were set to publish a consultation paper setting out proposals for an Online Sales Tax (OST).

Since 2019, the Government has been debating the implementation of an OST. In the Budget, they have confirmed that this would be a hypothecated tax to be used to fund a reduction in business rates.

This report provides an introduction to the Government's thinking to date regarding an OST system. The report explores its practical implementation, the potential impact on online businesses, and the most up-to date-industry reactions.

Furthermore, the report considers the public policy balance of benefits regarding the business rates system. It illustrates that, while non-domestic rates may appear over-complicated, archaic and unfair to our High Street, they bring in a significant monetary benefit, that the Government will not be lightly willing to part with.

An OST would not replace business rates, but fund top-sliced reduction in their total yield. As things stand, there is little available published material regarding the OST. The very idea of taxing the sale of 'online goods' leaves many unanswered questions, and there is wide avenue of opportunity for interested parties to shape the direction of this policy area.

With the Budget, Sunak took a further step towards the introduction of the tax, yet the Treasury remains cautious given the potential divisive and complex nature of such a proposal, whatever form it may take.

Key issues to resolve include: the tax rate; how to prevent costs being passed on to consumers and fuelling inflation; the treatment of hybrid businesses, food delivery services, non-physical goods and 'click-and-collect' services; and the collection methodology.

POLICY TIMELINE

1990 – INTRODUCTION OF BUSINESS RATES

- National non-domestic rates in their current form were introduced in 1990, with the Local Government Finance Act 1988. In rating systems, a multiplier is applied to the rateable value of the property to determine the tax bill.
- While previously the local authorities had determined the rate of the tax, the new system was determined by a centrally set multiplier.
- Local authorities continued to collect the tax, but the revenue was passed to the Treasury and redistributed on a per capita and needs basis as part of the local government's external financial support from Whitehall.

JULY 2020 – BUSINESS RATES REVIEW

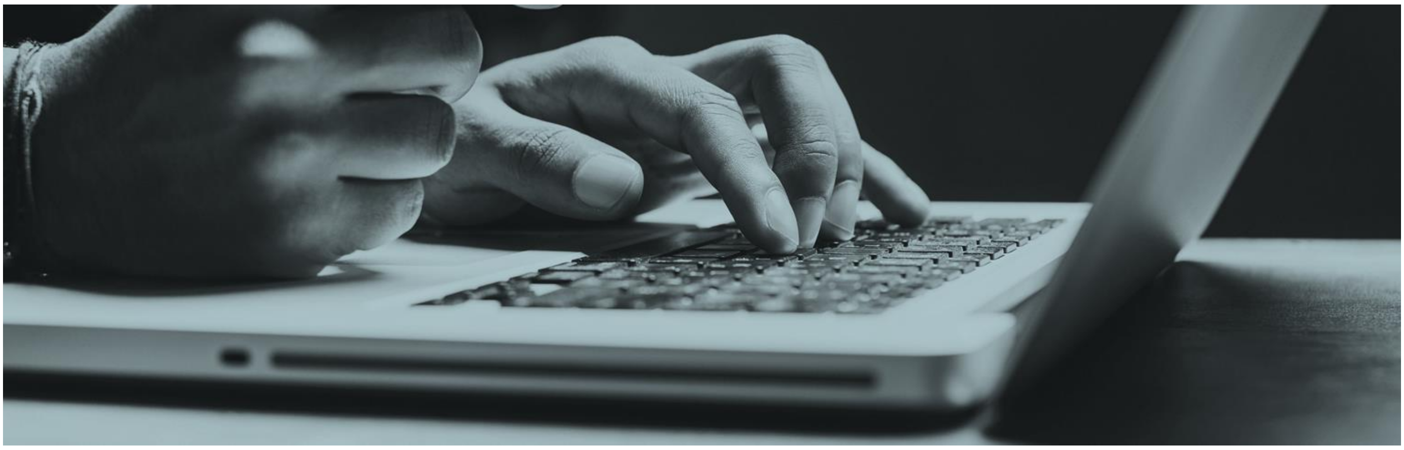
- In its Budget, the Government announced that it would conduct a fundamental review of the business rates system in England.
- It launched a review which examined the case for new taxes, including an OST. This review was set to end in Spring 2021.

SPRING 2021 – PLANS ARE DELAYED

- In February 2021, 18 retail and property organisations (including Tesco, B&Q, Waterstones, Asda and Morrisons) wrote to Rishi Sunak arguing that online retailers should pay more tax.
- Also in February 2021, Rishi Sunak announced a delay to the final report on the review of business rates arguing that he wanted fully to consider the case for an OST when the economic uncertainty caused by the pandemic had receded.
- In March 2021, Ministers released the Interim Report on Business Rates.

AUTUMN BUDGET 2021 – CONSULTATION TO BE PUBLISHED

- Stated that the Government would 'continue to explore the arguments for and against' an online sales tax and publish a consultation shortly.



WHY IS AN ONLINE SALES TAX BEING CONSIDERED?

The introduction of an OST was first floated by then Chancellor of the Exchequer Philip Hammond in 2018. [1] It was suggested in order to relieve the business rates burden placed on bricks-and-mortar enterprises, especially the hard-pressed high street retail sector.

This section of the report examines the business rates system, its significance for the Government and the roots of the potential introduction of an OST.

THE IMPORTANCE OF BUSINESS RATES

Business rates are a form of tax on property used for business purposes, ranging from warehouses to stores themselves. Business rates in their current form were introduced in 1990, via the Local Government Finance Act, and their revenue has risen faster than inflation, bringing in an important source of financial income for the Government. National non-domestic rates are one of the seven highest grossing taxes in the UK. In 2018-2019, the Office for Budget Responsibility estimated that £31 billion was being raised through business rates.[2]

There have been efforts to reform the system, and the 1990 changes had decoupled the incentives for local authorities to grow their taxable base by encouraging enterprises to locate within their boundaries. Since 2013, at least half of the business rates revenue is retained by the local government and used for adult social care and children's services.[3] However, other changes to the mix of local government's external revenue support make it hard to determine the true extent of this renewed link between the local tax base and resources available to fund local public services.

THE PROBLEMS WITH BUSINESS RATES

Despite the indispensability of the tax, many in the industry have been calling for its termination for a number of years. In 2019, the Treasury Committee report admitted that the tax had several shortcomings. The Committee consulted a number of businesses, including bricks-and-mortar stores, hybrid and online shops, as well as consultancies and academics. It determined that a major drawback of the business rates system is that it places a 'disproportionate burden… on bricks-and-mortar businesses.' [4]

Steve Rigby, the Group Property Director for Tesco highlighted that the issue was not only that the 'burden' is placed on bricks-and-mortar retailers and not on online ones, but also that the rates were continually rising in their tax take. Rigby exemplified this by outlining how Tesco's rate bill has almost doubled over the preceding ten years.[5] Since 1990, business rates' yield has increased by 210 per cent. If they had grown in line with inflation, they would have increased by just 75 per cent.[6] The Treasury Committee Report further highlights that, due to business rates being a property tax, they do not reflect the profitability or the revenue of a firm, which many believe to be unfair.[7]

The Housing, Communities and Local Government Committee reported that Amazon's UK business rates amounted to approximately 0.7 per cent of its UK turnover in 2017. Comparatively, high street retailers' business rates as a proportion of turnover, were between 1.5 per cent and 6.5 per cent, illustrating the distinctive tax difference between online shops and

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[1] Conway, Sky News, 2018
[2] Page 7, Treasury Committee, 2019
[3] Page 28, Housing Communities and Local Government Committee, 2019
[4] Page 13, Treasury Committee, 2019
[5] Page 42, Treasury Committee, 2019
[6] Page 11, Treasury Committee, 2019
[7] Page 13, Treasury Committee, 2019

bricks-and-mortar stores.[8] Since spring 2020, the pandemic crisis has only exacerbated this imbalance, with many shoppers shifting their purchasing habits to online marketplaces.[9] This is an issue that, as many retailers and institutions argue, illustrates the unjust nature of business rates, emphasising that business rates fail to take the success of a business into consideration.

HAVE BUSINESS RATES LED TO THE 'DECLINE' OF THE HIGH STREET?

Additional arguments against business rates include the understanding that they have contributed to the 'decline' of the British High Street.[10] This is a popular refrain among retailers with a pronounced physical presence. Mike Ashley, Chief Executive Officer of the Frasers Group, owner of Sports Direct, lamented that the '*web has killed the high street*.'[11] This is mirrored by Gary Grant, owner of The Entertainer, who suggested that only by supporting physical stores through tax measures, can we 'make sure high streets are vibrant'.[12] However, writing for the Institute for Fiscal Studies Johnson suggests while this argument is popular, it lacks substance.[13] He argues that the level of business rates on high street properties in comparison to non-high street properties are unlikely to be a significant cause of closures because business rates have not increased overall, rather they have increased relative to location. He further suggests that cutting business rates would not 'save' the high street because it would almost certainly be replaced by higher rents.

INITIAL PROPOSAL FOR THE TAX

The then Chancellor of the Exchequer, Philip Hammond, floated the tax in an interview in 2018.[14] He didn't offer specifics, but he did suggest that the current sales landscape was unfair and that the introduction of an online retail tax would help to 'rebalance the playing field.' A General Election intervened, and Steve Rigby, the Group Property Director for Tesco, re-proposed to the Treasury Committee in 2019. Rigby gave evidence detailing a potential Online Sales Levy against physical goods sold online which would be used to reduce the multiplier for retailers' business rates.[15] He suggested that it should be a 2 per cent levy on the online sale of physical goods which would increase revenues from online sales by £1.5bn. This would be used to fund a 20 per cent cut in business rates for all retailers, but small businesses should be exempt.

However, in the same inquiry others gave evidence against the introduction of a tax of this calibre. Chis Harris, Group Property and Development Director for John Lewis pointed to the intertwined nature of John Lewis' business model, with people being able to shop in person if an item is not available online and vice versa.[16] In the round, he illustrated how a customer's decision to shop online or in person is driven by a variety of factors. Some are motivated to shop online if a product is not available in store and vice versa. The Treasury Committee Report concluded that the Treasury Committee should prepare a consultation identifying potential alternatives to business rates with detailed evaluations of the options.[17]

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[8] Page 4, Housing Communities and Local Government Committee, 2019
[9] Page 6, Treasury Committee, 2021
[10] Institute for Fiscal Studies, 2021
[11] Page 11, Housing Communities and Local Government Committee, 2019
[12] Butler and Wood, 2021
[13] Johnson, Institute for Fiscal Studies, 2018
[14] Conway, Sky News, 2018
[15] Page 42, Treasury Committee, 2019
[16] Page 43, Treasury Committee, 2019
[17] Page 4, Treasury Committee, 2019

WHAT WOULD THE TAX LOOK LIKE?

The proposal for the tax mentioned in the Business Rates Review, is that it will be a 2 per cent levy on all goods bought online, in addition to the regular VAT rate of 20 per cent.[18] The Government estimates that the income generated from this would be between £1bn and £3bn, and therefore would ideally fund a 20 per cent reduction in business rates. However, Ministers have been slow to opine on the finer details of the tax.

WHO WOULD BE SUBJECT TO THE TAX?

There is general agreement among retailers that small and-medium sized enterprises (SMEs) and small retailers should not come within the scope of an OST.[19]

Considering the Government's commitment to supporting small businesses, including in the 'Supporting Small Business Scheme' from 2022 to 2023, it is unlikely that they would impose this new tax on small businesses.[20]

While, on big marketplaces, the majority of UK transactions are made by mid or small retailers, thousands of sellers fall below the UK VAT registration threshold (£85,000) which many believe will make it difficult to enforce an online sales tax.[21]

In the Housing Communities and Local Government Committee's 2019 report, some suggested internet retailers should be subject to an online sales tax if they generate more than 80 per cent of their turnover online.[22] At the other end of the scale, Mike Ashley, Chief Executive Officer of the Frasers Group, suggested a 20 per cent tax on retailers that made more than 20 per cent of their sales online. [23]

WHAT COUNTS AS AN 'ONLINE' SALE?

Furthermore, it is unclear what definition of an online sale the Government would be using. It was initially suggested as a tax on internet retailers, although many have argued that Ministers might extent this to any online sale that could have been made on the high street, including – for example - travel, accommodation, and software.[24] This is important because, while an average of £100bn is spent with internet retailers per annum, the value of all online sales is £700bn. [25]

The Government has so far not offered a clear definition of an 'online sale.' In the course of Parliamentary inquiries, those that gave evidence questioned whether it would include click and collect and/or food delivery services. Chris Harris highlighted the hybridity of theirs, and many other stores', models.[26] Additionally, The British Retail Consortium pointed out that eight of the top ten online retailers were also on the high street; and of the £1 in £5 spent online, more than half was spent with retailers that have physical shops as well. [27]

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[18] Morales, Bloomberg, 2021
[19] Page 27, Treasury Committee, 2021.
[20] Page 2, HM Treasury, 2021
[21] Jangid, 2019.
[22] Page 29, Housing Communities and Local Government Committee, 2019
[23] Page 29, Housing Communities and Local Government Committee, 2019
[24] Aldrick, The Times, 2021.
[25] Aldrick, The Times, 2021.
[26] Page 43, Treasury Committee, 2019
[27] Page 21, British Retail Consortium, 2021

WOULD THE MOST VULNERABLE SHOULDER THE BURDEN?

While it might initially appear that it is the online businesses who would face 'the burden' of the tax, it is important to consider the issue of tax incidence and the risk of burden-shifting to other stakeholders.

There are suspicions among journalists, and certain stores, that the tax would be passed on to the consumer and will likely result in an increase in the cost of goods purchased online.[28] This was a view shared by the British Retail Consortium, the country's leading retail lobbying body, who noted that the tax would '*ultimately hit consumer spending through higher prices*'.[29] Some went further, to suggest it was not just people who would face the burden, but vulnerable individuals as well. Frances Ryan, a journalist for The Guardian called the OST a 'tax on disability' due to the frequent inaccessibility of many bricks-and-mortar stores to disabled people. Moreover, she made the point that the pandemic had forced many vulnerable individuals to stay at home.[30]

THE IMPACT ON SMALL VS. LARGER BUSINESSES

Others suggested that an OST would hit retailers such as Amazon the hardest, with tax experts estimating it would pay about £380 million on its UK sales of £19 billion (including the reduction of business rates in the calculation).[31]

Despite general consensus amongst businesses that smaller online retailers should not face an OST, there is concern that SMEs could be hit hard if exemptions were to fall away.[32]

THE DIGITAL SERVICES TAX AND THE DIGITAL MARKETS UNIT

It is worth noting here two other initiatives designed to address policy concerns about 'Big Tech'. The UK implemented a Digital Services Tax, in 2020, which was set as a 2 per cent tax on gross revenues of large, predominately US multinational internet platforms, search engines, social media services and online marketplaces, which derive value from UK users. However, the tax was discontinued in October 2021, after the US threatened to implement trade tariffs against five European countries, including the UK, as part of a deal to force them to scrap their own digital services taxes in return for the OECD-inspired move to introduce a global minimum corporate tax rate.[33] The US' official stance was that the global agreement makes it easier to level the 'corporate tax playing field.'[34] However, all these major marketplaces and search engines are American, and a tax paid abroad means less tax for the US, which might suggest an alternative explanation why the US lobbied so fervently against individual digital services tax.[35] While it is not the same as an OST, it does suggest a geopolitical sensitivity to online taxes, largely due to the international nature of online sales.

Like the short-lived Digital Services Tax, the OST, which is also known as the 'Amazon tax,' runs a risk of being perceived as anti-American, by its taxing of a number of large American tech companies and by its taking potential revenue away from

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[28] Page 26, Treasury Committee, 2021.
[29] Partington, The Guardian
[30] Ryan, The Guardian
[31] Aldrick, The Times, 2021.
[32] Page 43, Treasury Committee, 2019
[33] Reuters, 2021
[34] Agyemang, Financial Times, 2021
[35] Page iii, Office of the US Trade Representative, 2021

the US. Similarly, the Competition and Markets Authority's new Digital Markets Unit, with its significant new 'ex ante' powers, could also be perceived as being anti-American.[36]

INTERACTION WITH EU STATE AID RULES AND SUBSIDY CONTROL

EU State aid rules prohibit the use of state resources to grant a selective advantage to businesses which affects trade between the EU's Member States. While in post-Brexit Britain this might not directly impact the UK (which is introducing its own 'subsidy control' legislation), EU State aid rules continue to apply to some degree in Northern Ireland.[37] The Online Sales Tax will arguably selectively favour the High Street at the expense of "Cloud Street". If the new tax applies across all the Home Countries, it will also affect trade between Northern Ireland and the Republic of Ireland. Fears that the tax might fall foul of State aid rules caused the Treasury to dismiss the tax in 2019 – when EU State aid rules still had their full effect in the UK –, which begs the question whether this will become another point of contention as the EU and the UK seek to renegotiate the Northern Ireland Protocol.[38]

[36] Gov.UK, 2021
[37] Article 10, Northern Ireland Protocol, 2020
[38] Ellson, The Times, 2019

INDUSTRY REACTIONS

The reactions to the tax are quite polarised. Many feel it would not do much to relieve the burden of business rates due to the hybrid operation of many businesses. Others argue that the unjust nature of the business rates system would only be relieved with the introduction of an online sales tax.

HYBRID BUSINESSES

Consensus amongst stores that operate based on a more hybrid model tends to be mixed. Larger, more successful department stores, such as Next, John Lewis and Marks and Spencer, are generally against the tax. However, supermarkets, as well as stores that sell sector specific goods, such as Sports Direct and The Entertainer, tend to support the introduction of the Online Sales Tax.

ONLINE STORES

Unsurprisingly, the online retailers, who provided comment on the issue, were all against the tax. Many pointed to the lack of fairness in taxing a business because of the way it operates, although this opinion seems ill thought-through when considering the existence of the business rates system, which punishes physical operations. Many suggested that it would ultimately be a tax on consumers as it would lead to increased prices for goods.

BRICKS-AND-MORTAR RETAILERS

Many stores with no online presence, such as Aldi, Primark or B&M Bargains were all notably silent on the matter. Those with an interest in physical retail, such as the CEO of Unibail-Rodamco-Westfied Malls and the representative for the Unions of Supermarkets, USDAW, were also for the introduction of the tax.

NEXT STEPS: WHAT CAN DRD OFFER?

As the Treasury continues to develop the OST consultation, there is a variety of services DRD can offer in preparation for this and beyond as part of a sustained legislative strategy.

CASE-MAKING

DRD can support the development of evidence-based responses to the consultation paper, working closely with the client team to deploy research as part of an ongoing dialogue with policymakers in Whitehall and Westminster.

DRD can develop messaging for client needs based on a wide amount of research and internal messaging development so issues can be articulated to stakeholders effectively.

DRD regularly works with think tanks and economic institutes to develop research on behalf of our clients and their areas of concern. This research has been reported on in the national press and can push the national conversation on, should it stall.

AUDIENCE MAPPING AND ENGAGEMENT

DRD can develop and deploy stakeholder mapping, engagement and mobilisation in support of the client's case.

DRD has previous experience building alliances across sectors to ensure that issues are addressed by stakeholders and are heard on behalf of the broader business community rather than a lone voice.

CHANNEL STRATEGY

DRD can provide a detailed case-by-case plan for issues that clients may face and how to address them based on previous messaging that has been developed.

DRD can also provide support on how to engage with stakeholders and the press, should any issues come to light.

CAMPAIGN EXECUTION

Before, during and after the proposals' legislative passage, we provide services designed to mobilise, execute and follow through on legislative campaigns, including close quarters interaction with the legislative process itself, as well as the critical stages that lie beyond enactment, including coming into force and the applications of second legislation.

APPENDIX ONE: KEY QUOTES

HYBRID BUSINESSES

Clayton Hirst, Head of Corporate Affairs at John Lewis: '*Our high streets need successful retailers with both a physical and online presence to meet consumer demand*.' [39]

Chris Harris, Group Property & Development Director at John Lewis: '*We have an online and a bricks and mortar business. It is completely combined, and customers do not choose necessarily to go into a shop or online in an explicit way… Taking one element of our business and saying, "Let's apply a tax over there" seems like not the right way forward.*' [40]

Steve Rigby, Group Property Director at Tesco UK: '*The system can be repaired, but it actually needs fundamental rebalancing, because in the retail industry now, 20 percent of the sales are online*.' [41]

Steve Rowe, CEO of Marks and Spencer: '*An OST has too narrow a focus and would once again leave retail overburdened. We must not… constrain bricks-and-mortar retailers from embracing digital and competing with ecommerce.*' [42]

Mike Ashley, CEO of the Frasers Group, the owner of Sports Direct: '*The biggest thing that has killed the high street is not the high street itself but the web. Be absolutely crystal clear: the web has killed the high street*.' [43]

ONLINE STORES

Tim Steiner, CEO of Ocado: '*I don't think it's appropriate for anyone to put a sales tax on a retailer because they operate from a different type of premises or they're a more efficient operator*.' [44]

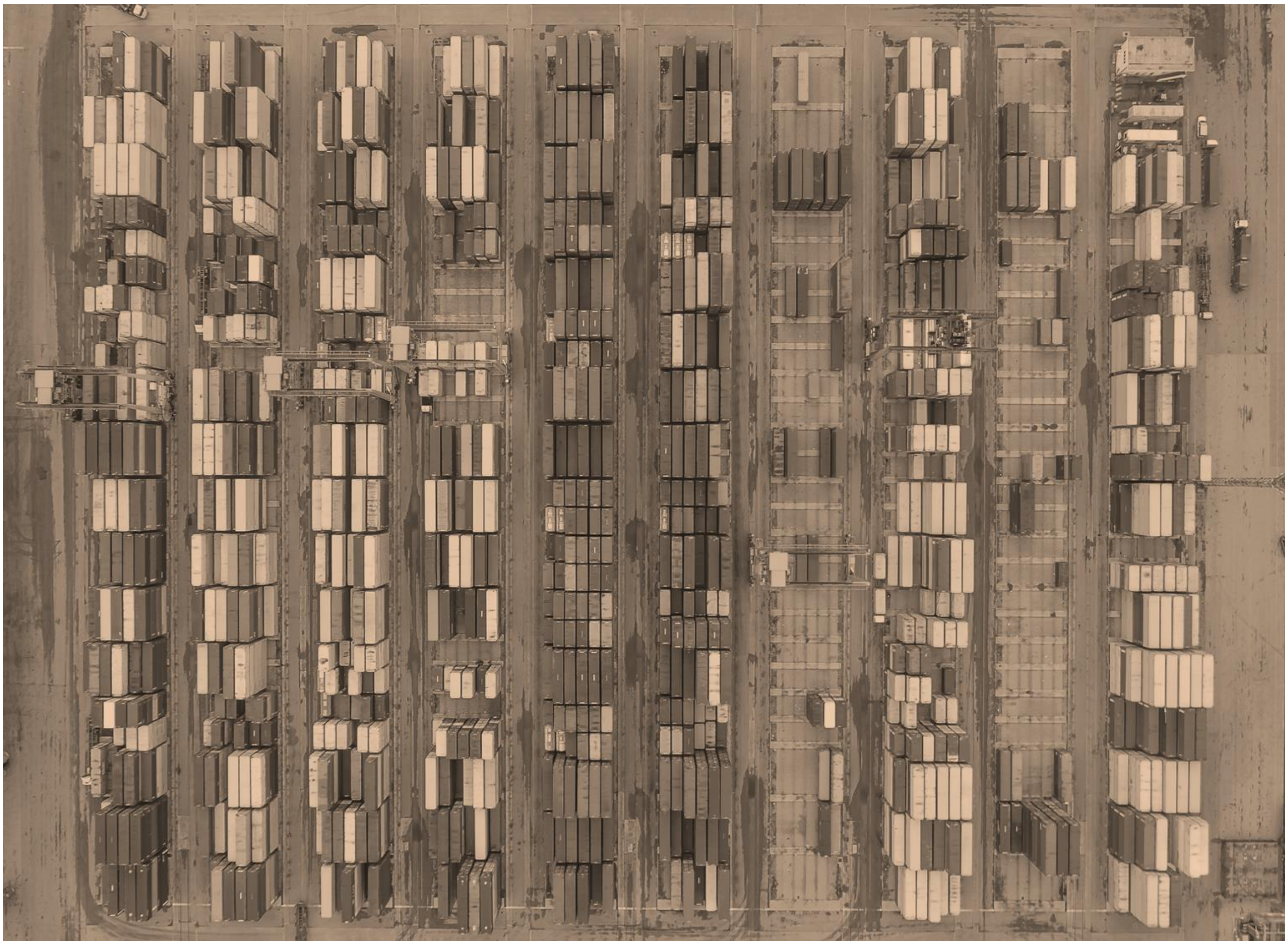
Nick Beighton, CEO of Asos: '*We actually think that will be self-defeating for the government as online sales [charges] will end up being packed on to consumers.*' [45]

BRICKS-AND-MORTAR RETAILERS

Paddy Lillis, General Secretary of USDAW (The Union of Shop, Distributive and Allied Workers): '*An online sales levy set at 1 per cent would raise around £1.5 billion, which could fund a cut in retail business rates of around 20 per cent.*' [46]

Scott Parsons, CEO of Unibail-Rodamco-Westfield Malls: '*The decision by the chancellor to continue to avoid imposing any kind of tax on the ecommerce sector is another blow, as bricks and mortar retailers continue to operate on an uneven playing field*.' [47]

[39] Page 43, Treasury Committee, 2019
[40] Page 43, Treasury Committee, 2019
[41] Page 42, Treasury Committee, 2019
[42] Rowe, Financial Times, 2021
[43] Page 11, Housing Communities and Local Government Committee, 2019
[44] Reuters Staff, 2021
[45] Fish, Drapers, 2021
[46] Usdaw, 2021
[47] Sheppard, 2021



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BUILDING AND PROTECTING REPUTATIONS

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