Stuart Adam, Institute for Fiscal Studies

Should the government introduce an online sales tax?

10 May 2022

IFS-CIOT debate

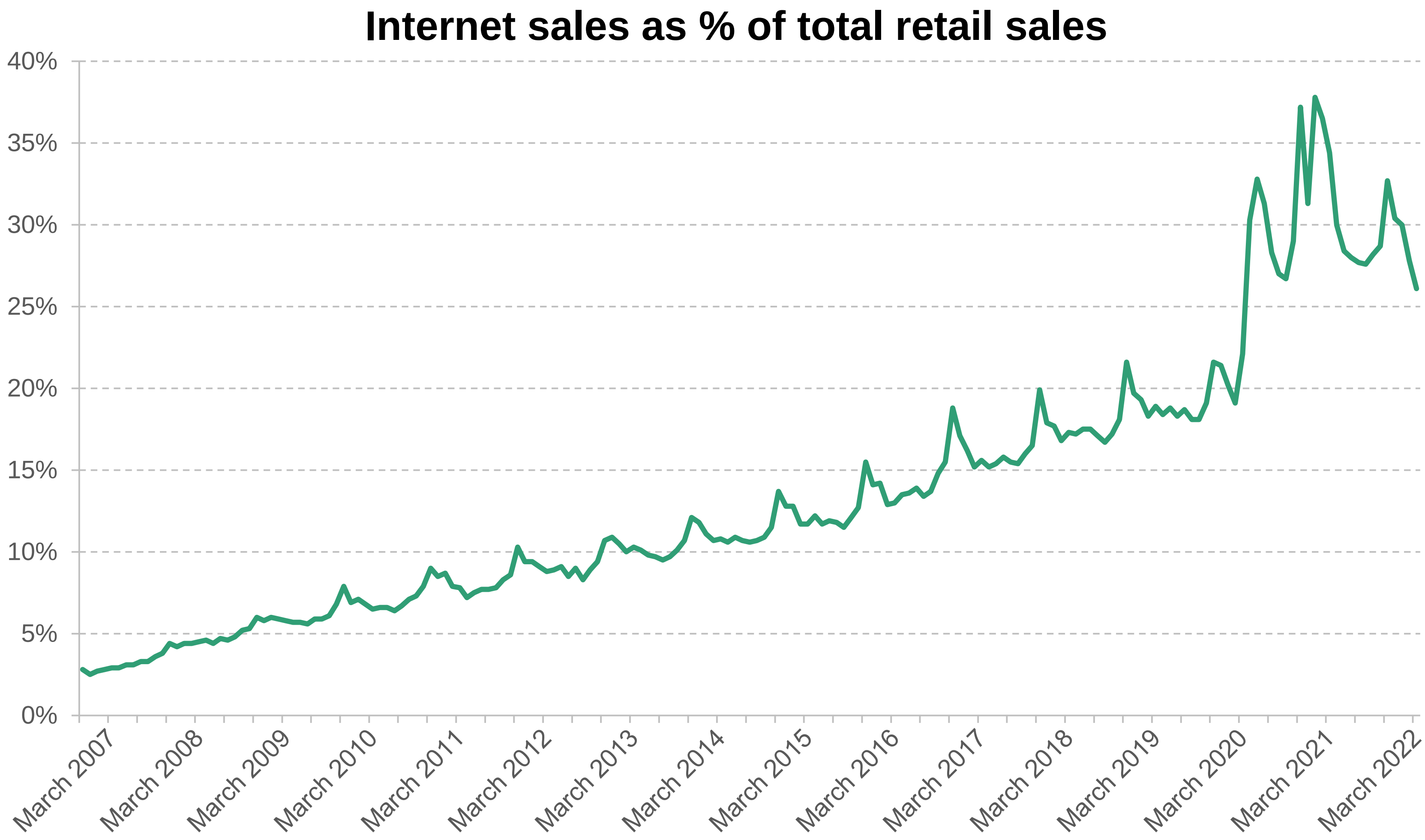
British Academy

London

@TheIFS

Economic and Social Research Council

The rise of online retail



Source: ONS Retail Sales Index, series J4MC

Key design issues

Scope of the tax

- Only goods, or services too?
  - Take-aways, digital downloads, accountancy, warranties,…
- What is an online sale?
  - Telephone, click-&-collect, in-store terminals, appointment bookings,…
- Taking B2B sales (most sales!) out of tax
  - Essential to take out, but problems: fraud and distortions

The tax schedule

- % of sales or flat £ tax per order/delivery/whatever?
- Size of tax-free allowance
- Tax rate

Revenue

Government's initial rough estimate:

- If only applied to retail sales of goods >£2m:
- 1% tax rate (or £1 tax per order) would raise about £1bn

For comparison:

- Business rates forecast to raise £35bn next year
  - Less than half is retail, mostly paid by the biggest 1% of retailers

Likely effects of an OST

- *'The government does not see the proposal as a measure to discourage consumers from shopping online.'* – para. 1.16

- But online retail would shrink
  - Business that is viable without OST would become unviable

Likely effects of an OST

- Widespread assumption that fully passed through to prices is too simple
  - Tax on one sector not the same as broad-based consumption tax
- Likely effects:
  - Prices rise for online goods (and, to a lesser extent, offline alternatives)
  - Wages fall at online retailers (and, to a lesser extent, offline alternatives)
  - Rents fall for warehouses etc. (and rise for high-street premises)
  - Profits squeezed for online retail (and, to a lesser extent, rise for offline)
- Size of effects depend on degree and nature of competition in markets
  - e.g. how easily can consumers, workers, investors and firms move away from online retail?
    - The ones who can move least easily will be hit hardest

Effect of cutting business rates

- Theory & evidence suggest main long-term effect would be higher rents
  - With largely fixed supply of property, rent + rates must be low enough to fill properties
  - Lower rates mean landlords can charge higher rent and still find tenants
- Cutting for retail specifically is slightly different
  - More use of property for retail, less for other purposes
  - Big rent rise for retail properties or smaller rise for all property, depending how easily use can be changed
- If introduce OST and reduce business rates, main beneficiaries would be landlords
  - OST and lower business rates both increase demand for retail property
- Some nuances:
  - Would help shops in the short run
  - More building and use of property for business purposes limits rent rise

Conclusions

- OST would need high rate and/or broad base to make a serious dent in business rates
- The tax would be complicated and distortionary
- Complex effects on prices, wages & rents in taxed & untaxed sectors
- But effect clearly to discourage online retail
- NOT levelling the playing field between bricks-and-mortar and online
  - Business rates tax property, not sales; main effect is to reduce rents
- Would mitigate decline of retail in high streets and shopping centres
  - Apparently not the government's intention
  - Is there a reason to prefer high-street locations to be used for retail?
  - Is an OST the best way to achieve that?

➢ OST desirable if it would be desirable even if business rates didn't exist