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Via Email to: OSTconsultation@hmtreasury.gov.uk

FSB Response to the consultation on Online Sales Tax: Assessing an option to help rebalance taxation of the retail sector

FSB is a non-profit making, grassroots and non-party political business organisation that represents 160,000 members in every community across the UK. Set up in 1974, we are the authoritative voice on policy issues affecting the UK's 5.5 million small businesses, micro businesses and the self-employed.

This consultation, on the potential introduction of an Online Sales Tax, has been linked by the Government to last year's review of the business rates system. FSB did welcome some of the changes which were announced in last year's review of Business Rates, but our view remains that the review did not go far enough. Business rates continue to represent a disproportionate tax burden on many small businesses, continuing to hold back the recovery of high streets. Therefore, we believe that Business Rates should continue to be reformed, in particular by expanding the Small Business Rates Relief threshold to £25k. Those further reforms to the business rates system should not be conditional on the decisions taken as a result of this consultation on an Online Sales Tax (OST).

The tax system is already highly complex and burdensome to small businesses, we strongly believe that the introduction of an OST would add to this burden without providing sufficient relief to those under the pressure of Business Rates. Small businesses are currently facing a cost crisis and an additional tax at this time is not a sensible approach. As it stands, the tax system is at its highest since the Second World War and small businesses continue to face pressures in their recovery from the pandemic. We strongly oppose the introduction of an additional tax in the form of the OST at this time. It is imperative that, if an OST is considered, a full small business exemption is implemented – small businesses will disproportionately feel the effects of the additional administrative burden and costs from this tax and it will affect their ability to compete online if left liable.

We also do not think this is the way in which to adequately 'rebalance' the tax system as many of the retail businesses set to benefit from a Business Rates relief from the income of the OST also began trading online during the lockdowns and as such may face that tax too. We are not in an economy where businesses trade *either* online or in store, but often, trade through both channels. Likewise, the proposed OST is only estimated to raise between £1-2bn – this is not enough of a return to offset the burdens placed by creating a new tax with all the administrative costs and complexities associated with its adoption.

One of the major issues of this consultation is the vagueness and uncertainty of the proposed OST. It is very difficult to fully establish the likely effects of this potential tax when so many elements are yet to be decided and by extension difficult for the FSB to support any measures given we cannot fully comprehend the implications of such policies for our members. Should the OST gain more traction, it is vital the Government consults again with more concrete propositions to be evaluated.

The above view represents FSB's headline position on the online sales tax. However, we have nonetheless sought to answer a number of the specific consultation questions, in particular to make the point that if an Online Sales Tax were to be introduced, it will be vital to exclude small businesses from its scope as far as possible. But none of the responses below should be read as contradicting our headline position that an Online Sales Tax should not be introduced at this time.

A.1 Chapter Two: Scope

Question 1: Would you favour a tax for all 'remote' sales or just a subset of 'online' sales?

Given the focus of the OST is to rebalance the tax system between traditional in-store retail and online, we believe that the tax should be restricted to just online sales. 'Remote' sales could create significant ambiguity for businesses in what is within scope and what isn't. 'Remote sales' implies anything that is not bought directly in person, therefore bringing into scope mail-orders or phone-orders of products, neither of which are the official target of the tax and both of which existed prior to online sales and therefore do not meet the criteria of 'rebalancing' the tax system.

As with any tax, small businesses rely on clarity. We found in our report *A Duty to Reform*, that 63 per cent of small businesses find the number of different taxes too confusing and only 31 per cent agreed that the UK's business tax system is broadly transparent.[1] It is imperative that if the OST is implemented, it has very clear guidance around scope and design – ambiguity in this area will create significant increases to the

[1] FSB, A Duty to Reform, October 2021, https://www.fsb.org.uk/resource-report/a-duty-to-reform.html#:~:text=FSB%20acknowledges%20that%20the%20Government,MTD%20should%20help%20with%20this.

administrative burden of tax for small businesses. It is good to see that this is recognised by HM Treasury, laid out in paragraph 2.4.[2]

Question 2: How should taxable sales be defined and what would the practical implications be?

Clarity around what is in scope is crucial as this will significantly impact the administrative burden and unintended consequences that accompany the tax. The more ambiguous the definition, the greater the chance of avoidance and the greater the administrative burden for small businesses in establishing whether it applies or not.

We agree with The Organisation for Economic Co-operation and Development's (OECD) definition of an e-commerce transaction laid out in paragraph 2.10: *the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing orders*. We agree that the process of ordering is what should be within scope, not how the good or service is received as this is immaterial to the differences faced between in-store and online retail. Likewise, with the explosion of digital infrastructure, the scoping should include platforms such as purchases through phone applications as well as websites.

Question 3: Are there transactions that would be particularly difficult to classify as either online or remote? What are these, and how should these be addressed?

Question 4: Should click and collect be exempted? If so, how?

We do not believe that click and collect should be exempted from the online sales tax if implemented. The reason for this is that how an individual receives an item is somewhat immaterial to whether or not the purchase was made online or in-store. Creating carve outs like the above potentially risks creating a tax without much substance and significant loopholes which individuals could take advantage of. The more narrowly defined an 'online sale' is, the greater the possibility businesses can navigate around being subject to it, nullifying the purpose of the tax. As such, if the tax were to be introduced, click and collect should be viewed as an online transaction and thus included within scope.

However, within this scope, we do think there should be exemptions. Click and collect may also be interpreted as in-app or website purchases of food and drinks while sat at restaurants, bars, or pubs, i.e., you order your food and drink online and it's delivered to your table. We do not think this should be within scope of the OST as it would not be serving to rebalance the tax system, but rather just a modern way of table service

[2] HM Treasury, Online Sales Tax, February 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057267/OST_condoc.pdf

primarily implemented during covid. As such, we would expect in-store hospitality to be exempt from any click and collect online sales taxes – an individual should not be charged more for their food or drink from ordering through the venue's preferred platform.

However, the above highlights a significant issue with the OST. There are going to be many examples of where the tax should, in principle, apply (click and collect) but in practice have unintended consequences that should not be in scope of the tax. This also increases the administrative burden on businesses in establishing whether or not they are in scope. It is for this reason that we again raise the point that we are not in favour of the OST. We foresee significant unintended consequences and considerable burdens on small businesses that are not justifiable for the attempt to redistribute incomes and provide relief to Business Rates. We would be much more supportive of Business Rate reform that is independent of the success of another tax.

Question 5: Should an OST be applied to all goods? Are any exemptions necessary? If so, what are these and why?

Business Rates are paid irrespective of the goods sold, that being food, medicine, or other VAT zero-rated goods.[3] Should the OST be implemented, the scope needs to address the rebalancing issue and creating carve outs for certain goods is inconsistent with this policy objective. Likewise, exemptions on goods are likely to create significant administrative burdens for businesses. As such, the OST should in principle apply to all physical goods sold via online channels – digital products, however, should not fall within the scope of the OST. This is outlined in greater detail in Q7.

FSB strongly believes there must be a full small business exemption within any OST that is implemented. Small businesses do not have the resources to be able to easily deal with the increased administrative burden placed upon them from the tax. Our full reasoning and explanation to a small business exemption is detailed in Q26.

Question 6: How would a goods-only approach apply to takeaway food?

We do not believe that the OST scope should include takeaway food. The food delivery sub-sector provided a lifeline for many small businesses throughout the pandemic and including within it within the OST does serve the aim of rebalancing the tax system, but potentially damages a growing revenue stream for these businesses.

A Capital Economics report found that delivery services during the period between April and June 2020, peak pandemic lockdown, protected 100,000 restaurant jobs from

[3] HM Treasury, Online Sales Tax, February 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057267/OST_condoc.pdf p.13

being lost or furloughed.[4] Delivery services provide a valuable source of revenue for the hospitality sector when the sector was effectively mandated to close during lockdowns. We do not believe that the Government should be imposing an additional tax on this which may create an artificial barrier to adoption or reduce the trend of online delivery services. The Government ought to be encouraging expansion of business models to online to benefit from this relatively new trend of online ordering.

FSB strongly believes that any OST should be limited to a 'goods only' approach rather than any applying to services such as food delivery.

Question 7: Do you think that digital products should be included in an OST? How should a "digital product" be defined?

No, FSB would not support the scope extension of the OST to digital products. Digital products by their very nature cannot be sold in traditional in-store retail and therefore do not fall into the scope of rebalancing the tax system. Rather they are a new type of product to emerge from the evolution of technology.

Shopify defines a digital product as:

"A digital product is an intangible asset or piece of media that can be sold and distributed repeatedly online without the need to replenish inventory. These products often come in the form of downloadable or streamable digital files, such as MP3s, PDFs, videos, plug-ins, and templates."[5]

We view this definition as comprehensive of a digital product and should be used as the basis of determining whether a good is digital or physical and thus whether it falls within scope of the OST. This definition also raises the point that streamable goods are digital products and these are items that do not have a comparable tangible equivalent e.g., streaming music is not equivalent to purchasing of CDs. Given these complexities, we urge the Government to exempt digital products entirely from the scope of the OST.

Question 8: How can the risk of value shifting from goods to services be reduced, for an OST that has services out of scope?

Question 9: Are there other ways you could foresee OST being avoided? How could this be defended against?

There is significant risk with an online sales tax that larger organisations with market power effectively avoid the tax through passing on the costs. This is precisely what

[4] Takeout Delivery Business, New study reveals role of food delivery in helping to protect 100,000 jobs in UK restaurants, October 2020, https://takeoutbusiness.co.uk/news/2020/10/28/new-study-reveals-role-of-delivery-services-in-helping-to-protect-100,000-jobs-in-uk-restaurants/

[5] Shopify, The Most Profitable Digital Products to Sell in 2021, February 2021, https://www.shopify.co.uk/blog/digital-products

occurred when the Digital Services Tax was introduced and meant the cost of the tax, even though not targeted at small businesses, was felt by small businesses. As an example, Amazon,[6] Apple and Google[7] passed the 2% tax directly onto sellers and advertisers which meant small businesses faced the fee increase indirectly despite not being the target.

There needs to be a concentrated effort by HMT to minimise the avenues through which this could be done. Small businesses are facing a cost crisis with mounting inflation, energy costs and debt repayments, an additional cost via this tax will be very detrimental.

There is significant risk in these types of taxes levied on organisations with sizable market power. We very much expect to see a similar result if the OST is levied in that small businesses will be the ones facing the brunt of this tax irrespective of whether they have a small business exemption or not and is again another reason why we are hesitant about this tax being introduced.

Question 10: Do you think some or all categories of services listed above (including any digital services) should be included in the scope of an OST? Would you add any additional services?

Question 11: To what extent do businesses currently distinguish between their sales of goods and services in business systems? On what basis do they currently make this distinction?

Question 12: Do you agree that an OST should be designed to exclude B2B sales?

FSB understands and appreciates the complexity of the B2B issue and how it may create a cascading price-transfer effect. Our headline position remains that an OST should not be introduced at all. However, if despite this Government does decide to nonetheless introduce an OST we believe that there is a case for B2B to be included within scope of the OST.

Although mentioned in the consultation document that including B2B sales in the OST would result in significant administrative burdens for businesses, the reverse is also true and likely to be worse. Purchases through a website are not identified as consumer or business in their transaction and the administrative burden placed onto small businesses that are then liable to pay the OST would increase significantly in terms of

[6] The Guardian, Amazon to escape UK digital services tax that will hit small traders, https://www.theguardian.com/technology/2020/oct/14/amazon-to-escape-uk-digital-services-tax-that-will-hit-smaller-traders

[7] Financial Times, Google to pass cost of digital services tax on to advertisers, September 2020, https://www.ft.com/content/fda648aa-bb52-4ab2-aa18-46b5023cb893

having to identify the out-of-scope transactions. Likewise, if consumers were to self-select at the point of sale as B2B or B2C to ease the administrative burden on the seller, this leaves the tax open to large-scale avoidance.

If B2B were to be excluded, we see two possible ways this could be done that reduces the administrative burden on both the seller and consumer. First is the issue of wholesale purchases. This could be easily solved by including an exemption of all businesses within the wholesale SIC code 45 and 46. Wholesalers do not typically sell directly to consumers as this would fall under SIC code 47, retail. Therefore, this exemption would exclude wholesale B2B from the OST and largely fix the issue of cascading price-transfers. Similar SIC code exemptions could be made for other areas of B2B. If HMT is keen on excluding B2B we would urge to explore this route.

The second option, although dismissed in the consultation is to introduce a reclaim expense system in the way VAT is done for businesses. This reclaiming process is well established and can only be done for B2B sales. Extending this to include OST seems like a very obvious avenue with minimal administrative burdens placed on both the Government and businesses as businesses will already be used to this process. We do not agree that just because the OST is more targeted it makes it inappropriate. Functionally, the OST acts like a second VAT rate for online sales and therefore should be quite easily assimilated into the VAT reclaim process. This also removes the sellers' need to identify sales as either B2B or B2C which will be a very administratively burdensome task.

Question 13: Do you agree that an approach of removing all B2B transactions from scope would be preferable to applying the tax according to the individual transactions (e.g. according to the use of the item sold)?

We do not think B2B should be excluded from the OST if implemented as it does not serve to rebalance the tax system in doing so, which is the ultimate aim of the OST. It will also likely be extremely administratively burdensome for small businesses to comply with the OST and identify B2B sales if excluded from scope.

However, if B2B were to be exclude, we see two possible routes in which this could be done: a full exemption of wholesale sellers and a VAT-style reclaim scheme for the OST, see answer to Question 12 for more detail.

Question 14: What is your preference from the above or any alternative approaches to exclude B2B sales from an OST while limiting administrative burdens on business?

We do not think B2B should be excluded from the OST as, irrespective of method used, it is likely to incur significant administrative burdens on small businesses. The example *Inclusion by online seller*, where either all or none of the sales are included depending on what's dominant does imply a low administrative burden. However, the policy itself then becomes very blunt and indirect, which we again would not be supportive of.

Equally, self-declaration of whether one is a consumer or business leaves the tax open to significant avoidance. As rightly noted, it would be in the interest of the seller (and by extension the buyer) to identify as a business to minimise their costs. As noted in paragraph 2.3 "*a tax with fewer exemptions would generally be simpler for businesses and government to administer, reduce opportunities for avoidance, and raise greater revenue.*"[8]The whole issue of including B2B inherently increases the risk of tax avoidance, increases the administrative burden placed on businesses and reduces the potential incomes from the OST.

Question 15: How do you think a business should be defined for the purposes of an OST?

As outlined in detail in Question 26, we believe that small businesses should be exempted from the OST based on the 2006 Companies Act definition of a small business. Given this, a business for the purposes of the OST should be any that do not classify as small by that definition i.e., medium and large businesses.

Question 16: Are there other types of entities or transaction types which should be out of scope of an OST e.g. online sales by charities, public bodies or consumer to consumer transactions?

The question of whether any transaction types should be out of scope of the OST goes back to the same question on whether the OST should apply for all goods. If you introduce an exemption for charity sales, why would the exemption not be extended to VAT zero-rated products? As such, the OST should be a fundamental tax, encompassing the sale of all products via the internet, irrespective of how the product is received. However, digital products, as defined in Question 7 should be excluded. Thus, in the question's example, charity sales of physical goods should be included.

FSB does not believe that consumer to consumer transactions should be within scope of the OST. Going back to the point of the tax, it is to 'rebalance' the tax system between online and in-store retail. Consumers, under this definition, should fall out of scope as they do not have an 'in-store' equivalence, rather they are just utilising new technologies for their trading.

A.2 Chapter Three: Design

[8] HM Treasury, Online Sales Tax, February 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1057267/OST_condoc.pdf p.9

Question 17: Do you agree that an OST would be levied on vendors?

Yes. However, irrespective of whether the OST is levied on vendors or on the consumer it is very likely that consumers will face the brunt of this tax through transferring of the cost – this point on second-order effects needs to be remembered throughout the design process of this tax, if implemented.

Question 18: How should different intermediaries that sell online on behalf of other businesses be treated with respect to an OST i.e. online marketplaces, franchises, auctioneers, agents and commissionaires?

Question 19: Are there situations in which it is not possible to distinguish the vendor from the intermediary, or in which the intermediary plays a crucial role in the sale? How should these be treated?

Question 20: Are there circumstances in which it would be appropriate for an intermediary to be liable for an OST, rather than the underlying seller? What are these?

Question 21: How would an OST define UK customers?

The use of delivery addresses to identify UK-based customers appears sensible and keeps the administrative burden of identification minimal, FSB would be supportive of this approach.

The use of delivery address as identification also adds weight to the argument that digital products purchased online should be out of scope of this tax.

However, it is worth noting that this tax, if implemented, should not only apply to UK customers. If an international order was placed, i.e., a non-UK customer, and the tax was not applied to their order, that consumer would gain preferential pricing over UK domestic customers. Therefore the tax should apply to all orders placed on UK-based online sellers.

Question 22: Should UK-based intermediaries play a role in identifying taxable transactions or be made liable in some cases?

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Question 23: Would either a revenue or a flat fee approach have a greater distortive impact on consumer behaviour? What are the scope and design considerations that would lead to distortion caused by both models?

A flat fee approach would undoubtedly have a greater impact on consumer behaviour than a revenue-based tax. As we outline in our tax report *A Duty to Reform*, all new taxes implemented should aim to be as neutral as possible. That is the Government should aim to raise revenue without distorting the decision that individuals and companies would make for purely economic reasons.[9] Introducing the flat fee would largely encourage bulk ordering as opposed to more organic purchases that consumers may otherwise make.

It is true that for both models the effective cost of the tax is likely to be transferred onto the price and price is a significant driver of consumer behaviour. As such, irrespective of either model, there is likely to be some element of consumers shifting away from online retail to in-store retail as a result of the tax.

However, FSB does view the revenue-based tax to be overall less distortive to consumer behaviour as it should not, in theory, create adverse incentives to bulk order or significantly shift behaviour in purchasing from online if rates are set at a reasonable level. A revenue-based tax is also more progressive than a flat-fee tax and also requires less Government administration over time; a flat-fee tax would need to be updated in line with inflation or otherwise lose it's efficacy to raise sufficient revenues over time.

Question 24: Would either approach be particularly preferable? If so, why? Are there any preferences around scope (i.e. different exclusions or exemptions) which would make one of the approaches more preferable?

Yes, FSB believes the revenue-based tax to be the better choice for the OST. We believe that it would be more aligned with the aims of the taxation without creating adverse incentives for consumers, is a more progressive tax and has a lower long-term administrative burden on Government..

However, we would not be in favour of a tiered approach as outlined in paragraph 3.30 for the reason stated. Thresholds are a common area for 'bunching' of economic activity, and we would envisage the same to occur if the OST brought tiers in i.e., businesses actively avoiding moving into the higher tax tier. We believe this is likely as in other areas of the tax system, namely VAT, small businesses often reduce or stop activity to avoid crossing that threshold, subduing economic growth.

We also agree that a revenue-based OST would need to be set in the range of 1-2% as outlined in paragraph 3.19. Anything greater than this would create significant issues for online retailers. Online retail, as a direct result of how competitive online stores can be, typically have smaller margins on sales. As such, setting the rate above this could

[9] FSB, A Duty to Reform, October 2021, https://www.fsb.org.uk/resource-report/a-duty-to-reform.html#:~:text=FSB%20acknowledges%20that%20the%20Government,MTD%20should%20help%20with%20this.

very well see many small businesses become unprofitable online, concentrating the online retail space in the hands of larger businesses if the cost of the tax was not fully passed onto consumers.

However, as stated in paragraph 1.16: *"It is worth noting that an OST levied at 1% or 2% would not raise sufficient revenue to replace in full the business rates levied on retailers"*. As stated throughout the consultation document, the tax seems likely to raise only between £1 billion to £2 billion, barely touching the £25 billion raised in Business Rates per year and thus highlighting how inefficient this tax would be in raising funds to provide a Business Rates relief. Given the scale of difference in funds, it raises the question of whether a distortive tax like the OST is worth implementing at all – FSB again urges the Government to reconsider this approach.

Question 25: Do you have experience to share of overseas' taxes on online sales using either model, or similar approaches not covered above?

Question 26: What factors should be taken into consideration in setting an allowance? How would this differ for revenue and flat-fee models of an OST?

FSB firmly believes that there should be a full small business exemption from the OST, irrespective of how the tax is levied. There is precedent in excluding small businesses from new taxes that would be very detrimental, the most recent example being IR35. We would urge the use of the same exemption criteria, namely excluding all small businesses so long as they satisfy two or more of the following requirements laid out by the 2006 Companies Act:

- It has an annual turnover not exceeding £10.2m;
- It has a balance sheet total not more than £5.1m; and
- It has an average of no more than 50 employees for the company's financial year.[10]

As with off-payroll rules, these exemption criteria apply to limited companies, LLPs, unregistered companies, and overseas companies,[11] thus aiding the question in what defines a business.

There are several reasons as to why there must be a full small business exemption within the scope of the OST. One of the primary reasons is due to small businesses' ability to manage tax administration. Small businesses do not have the dedicated resources larger organisation do when it comes to tax compliance. We found in our report *A Duty to Reform,* that the average small business spends 52 hours per year on completing their tax liabilities at a cost of £4,100 – this is the cost of software and accountants, not the actual liability itself. The OST is likely to exacerbate this, placing

[10] BDO. Small companies' exemption – Off-payroll rules, June 2021, https://www.bdo.co.uk/en-gb/insights/tax/global-employer-services/off-payroll-rules-what-is-the-small-companies-exemption

[11] Ibid.

significant burdens on administration by the smallest businesses if they were to fall within scope of the OST. Depending on how complex the OST is to work out (click and collect, B2B etc.,) this could further amplify the administrative burden placed on small businesses.

FSB also has significant issues with the idea of a threshold for the OST. Thresholds significantly alter business' behaviour and cannot be categorised as being neutral. Many small businesses actively avoid crossing the £85,000 VAT threshold which subdues significant growth and economic development. We envisage a threshold placed on online sales creating the same sort of incentives. Even if the threshold were an allowance, crossing this may push many low-margin small businesses into unprofitability when selling online if they are unable to completely offset the tax through higher prices.

Another significant issue with thresholds in the context of an OST is due to how varied businesses selling online are. The consultation suggests a threshold of £1-2 million. There will be many small businesses that operate with the 'low margin, high volume' model and hence the £1-2 million threshold could very well mean that these small businesses are still in scope of the tax, potentially making their sales unprofitable. The fact this is a revenue-based tax ignores small businesses in this model and ignores whether or not they are profitable – a threshold like this will significantly incentivise these types of businesses to either change their model or to avoid crossing said threshold. And this highlights the issue at hand with a threshold approach; small businesses have varied business models and one threshold may be suitable to one form while being incredibly harmful to another which is why we cannot reasonably suggest a threshold for this tax. We strongly urge the Government to implement a full small business exemption if this OST is implemented.

Thresholds or allowances also require continuous monitoring and updating once implemented. If the threshold were to be set at £1-2 million, inflation slowly gnaws away at this, pushing more and more small business into the tax liability if not updated. At a time where inflation is expected to reach 10%[12] the threshold would need to be updated often and adequately to ensure that small businesses are not pushed into the tax for no other reason than exogenous economic conditions. Therefore, a threshold-based tax requires much greater Government administration than a full small business exemption.

Fundamentally, e-commerce is a growing trend that is not going to wane. It has been accelerated by covid and was the saviour for many small businesses throughout the sequential lockdowns when in-store retail shut down. The Government should not be placing artificial barriers in place that reduce the competitiveness of small businesses in this emerging sub-industry, if anything it should be encouraging innovation. Indeed, the launch of Help to Grow: Digital[13] shows that the Government is supportive of

[12] Bank of England, How high will inflation go?, May 2022, bankofengland.co.uk/knowledgebank/will-inflation-in-the-uk-keep-rising

[13] UK Government, Help to Grow: Digital UK, January 2022, https://www.gov.uk/business-finance-support/help-to-grow-digital-uk

digitalising the economy and highlights again that the OST is at odds with both economic development and the Government's own ambitions.

Question 27: What would be a reasonable OST threshold and allowance to set in order to protect small businesses while also making sure the OST generates sufficient tax revenues?

FSB does not believe such a threshold exists. As explained in Question 26, given that small businesses have significantly varied business models, no such threshold will satisfy both conditions. Low margin, high volume small businesses will suffer at too low of a threshold while revenues will suffer at too high of one, while also potentially exempting larger organisations. Likewise, any threshold level set would need continuous monitoring and updating so that inflation does not erode the share of small businesses exempted.

FSB strongly urges the Government to implement a full small business exemption as has been done for other taxes such as IR35.

Question 28: Do you agree that an OST threshold or allowance should apply once to all businesses under common control?

Yes, this negates incentives for businesses to decentralise and disaggregate their business when they otherwise wouldn't have chosen to do so.

Question 29: Do you agree the threshold or allowance would apply to individual businesses when they operate franchises or sell through online marketplaces?

Yes

Question 30: Do you consider there to be strong arguments either for or against quarterly or annual reporting? If this hinges on any of the design options laid out in this consultation, please specify which options and why.

FSB believes annual reporting and payment would be the optimal OST design. We found in our report *A Duty to Reform* that 72 per cent of small businesses struggle to accurately forecast their earnings for the year and that 53 percent view the current system for paying tax as too confusing. Given this, we agree that annualised accounts are likely to be the easiest route to identifying online sales and calculating their respective liabilities. We also agree that it makes sense to align the OST, if implemented, against an existing tax structure.

Importantly, more frequent reporting significantly increases the tax administrative burden placed on businesses. Given the levels of tax administrative burdens small businesses face we urge the Government to choose the option that adds to this the least, even at the cost of more up-to-date data on tax.

Question 31: Can you provide insight into the overall burden to administer all systems and processes required to support an OST? Do systems currently allow you to identify the features listed above; if so, please provide further details on how this distinction can be made.

A.3 Chapter Four: Impacts

Question 32: On balance, what would the impact be of an OST with business rates reductions on the scale described above, including on retailers that operate both online and offline?

It is clear that an OST set at any reasonable rate is unlikely to be able to raise sufficient revenue to markedly offset some of the cost burden of Business Rates. Taking the 5% OST example as posed in paragraph 4.7 (a rate well above what FSB considers reasonable as outlined in Question 24), £2.5 billion could be raised. This will still only reduce the cost burden of those facing Business Rate by 10% if applied broadly and by one third if applied solely to in-store retailers.

FSB does not believe that the £1-2 billion raised by the OST is sufficient to offset the costs associated with businesses administering and adopting the tax. It will cause a significant increase the administrative burden on businesses through identifying sales and paying the new tax. The potential gains do not offset the potential costs.

One of the central issues with the OST is that, by design, it implicitly assumes retailers are either in-store or online, not both. Without a suitable exemption, small businesses that operate in-store and online are likely going to face a double tax; they will be paying Business Rates and the OST which will have significant ramifications for profitability, their competitiveness, and prices they set. This is again why we are urging for a full small business exemption rather than a somewhat arbitrary revenue threshold for the tax.

The other issue with this approach of creating a tax to help fund Business Rate relief is that many small businesses receive the small business rate relief (SBRR). Many small businesses are already in receipt of the SBRR and therefore are unlikely to benefit from any relief from the OST while being potentially liable to the OST if the small business exemption isn't adequate. Additionally, there are many small businesses that do not qualify for the SBRR and, without a suitable small business exemption, may be liable to the OST while also paying business rates. Under this scenario, these small businesses, may be worse off despite the small relief from the OST.

These are, of course, only indicative figures and we agree that if more traction is gained on implementing an OST a full cost benefit analysis needs to be conducted. In this analysis, it is vital that a wide scope is considered to fully assess the impact of the OST. We would expect both direct and indirect impacts to be included. That is, the impact on businesses selling online but also their supply chain and cost transmissions both up and down: up to their suppliers and down to their consumers. Likewise, behavioural responses need to be considered too; we do not agree that a low-rate OST would not have any consequences on consumer behaviour purchasing online – this is not an assumption that should be made at any modelling stage as consumers are very price sensitive, especially in times of uncertain economic conditions.

Question 33: Do the potential revenues from such a tax justify the additional administration that it would require of businesses, as well as the design complexities detailed in the previous sections?

No, small businesses are already overburdened by tax administration and tax compliance and the tax is also at odds with other Government objectives of helping businesses become more digital.

Question 34: To what extend do you think an OST would impact innovation, efficiency and productivity?

FSB thinks that's the OST would have a significant detrimental impact on efficiency, productivity, and innovation. Digitalisation, and online retail more specifically, is a very fast-growing trend of the twenty first century. Access to online platforms and online retailing was a huge benefit to many small businesses throughout the pandemic's sequential lockdowns, allowing businesses to innovate and continue trading.

The UK is amongst the top countries in the world for share of retail sales that are done online. The ONS estimates that 30.5% of all retail sales were done online in 2021 compared to just 19.2% in 2019,[14] and there are expectations that this will continue to

[14] ONS, Internet sales as a percentage of total retail sales (ratio) (%), March 2022, https://www.ons.gov.uk/businessindustryandtrade/retailindustry/timeseries/j4mc/drsi

grow, reaching 38% by 2026[15] - that is a doubling in its share in a space of just seven years.

Given this significant trend, the Government should be aiding and encouraging businesses to diversify and use technology to boost their growth opportunities. The Government's own *Help to Grow: Digital* scheme is evidence that this is an objective which means the OST is at odds with overarching Government aims. The Government should not be creating artificial barriers to entry for businesses wishing to expand through online platforms. The OST will directly reduce the ease and efficiency at which businesses expand to online markets.

Importantly, this tax also appears to be a penalty to those who have adapted and innovated to successfully trade during the pandemic and take advantage of this emerging sub-market. As explained earlier, online retailers, given the additional level of competition, typically have smaller margins and thus this OST has high potential to push businesses trading online into unprofitable sales if the cost of the tax is not transferred to consumers– this is an area that would need a full assessment within any further developments of the OST.

Question 35: To what extend do you believe that an OST would impact consumers' behaviour in favour of in-store retail?

We anticipate that irrespective of the level of OST, a significant share of the cost of the tax will be transferred onto final prices and thus the extent to which consumer behaviour changes is largely dependent on the scale of price increases. However, even at low rates we anticipate that this will, especially for more expensive goods, cause some shift towards in-store retail.

It is worth noting that this is also dependent on consumers' price sensitivity i.e., the more price sensitive they are, the greater the change is likely to be. In a recent report, it was found that 59% of consumers are now more price sensitive than compared to the start of the pandemic,[16] and so it can be expected that the OST will have a significant effect on online retail consumption as the cost-of-living crisis continues.

The assumption throughout the consultation is that the OST is unlikely to have any impact on consumer's shopping preferences is too strong. We do not think this is a realistic assumption, especially now during a cost-of-living crisis. Any subsequent modelling that is done for the OST must not exclude consumers behavioural response to the tax and subsequent price changes i.e., dynamic rather than static modelling.

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[15] Internet Retailing, UK retail sales set to be 38% by 2026: study, December 2021, https://internetretailing.net/industry/industry/uk-retail-sales-set-to-be-38-online-by-2026-study-24132#:~:text=Some%2032%25%20of%20UK%20sales,up%20from%2021%25%20in%202019.

[16] Retail Times, The price is right: pandemic drives price sensitivity among grocery shoppers, Pricer's data reveals, October 2021, https://www.retailtimes.co.uk/the-price-is-right-pandemic-drives-price-sensitivity-among-grocery-shoppers-pricers-data-reveals/

Question 36: How do you expect online retail to evolve in the coming decade and how should an OST take account of these?

Online retail is a very fast-growing sub-industry of retail and grew by 87% between 2017 and 2021.[17] It is likely to continue this rapid growth trajectory until it plateaus at a stable, long-term trend with levels expected around 40% of all sales.[18] It is for this reason that we do not think an OST is a sensible policy position. The Government ought to be encouraging businesses take advantage of this opportunity as opposed to erecting artificial barriers to entry.

Question 37: What is the evidence for the degree of pass-through of the cost of an OST to consumers? To what extent will this vary depending on the type and value of the goods sold?

The OST is reminiscent of the Digital Services Tax (DST) and is likely to be passed on in just the same way that was. Both Amazon and Google announced in response to the DST that they would be passing on the effective cost; Amazon onto sellers,[19] and Google onto advertisers.[20]

It is highly likely that following an introduction of an OST the cost of the tax will be passed on to consumers through higher prices rather than simply being absorbed by businesses.

Question 38: Do you have any data which would support the Government in making an assessment of the incidence of the tax or its distributional impacts?

Question 39: In your assessment, what would be the distributional impact of an OST? Are there particular groups who are likely to be worse affected than others? How would this change if an OST were applied as a flat-fee per transaction (or some other similar metric) versus a percentage of firms' revenue from online sales?

[17] ONS, Internet sales as a percentage of total retail sales (ratio) (%), March 2022, https://www.ons.gov.uk/businessindustryandtrade/retailindustry/timeseries/j4mc/drsi

[18] Internet Retailing, UK retail sales set to be 38% by 2026: study, December 2021, https://internetretailing.net/industry/industry/uk-retail-sales-set-to-be-38-online-by-2026-study-24132#:~:text=Some%2032%25%20of%20UK%20sales,up%20from%2021%25%20in%202019.

[19] Amazon, Fee changes in the UK following the introduction of the Digital Services Tax, https://sellercentral.amazon.co.uk/gp/help/external/366DPWD5P5QFDJP

[20] Financial Times, Google to pass cost of digital services tax on to advertisers, September 2020, https://www.ft.com/content/fda648aa-bb52-4ab2-aa18-46b5023cb893

Question 40: What environmental impact might an OST have? How would its design affect an OST's environmental impact?

We trust that you will find our comments helpful and that they will be taken into consideration.

Yours sincerely,

Paul Wilson, Policy Director

Federation of Small Businesses