Councils and e-commerce

The why, what and how of a Local E-Commerce Levy

Guide

Contents

Acknowledgements
This report has been prepared by WPI Economics for the Local Government Association.

Executive summary

The digital revolution is now decades old, but digital business is still rapidly changing our world. And we may still only be in the early stages of the transformation. Despite growing by 326 per cent between 2008 and 2017, e-commerce still only accounts for less than a fifth of all retail spending.

This transformation brings a range of issues for policymakers. Prominent among these issues is whether the current system of business rates is fair to those businesses with physical high street premises compared to those operating with a predominantly digital footprint.

The Local Government Association (LGA) has therefore asked WPI Economics to consider:

- the case for a Local E-Commerce Levy as part of a future tax system
- what a Local E-Commerce Levy would look like
- how a Local E-Commerce Levy could be implemented.

This report is intended to inform and promote the debate on a Local E-Commerce Levy and does not represent LGA policy.

E-commerce, business rates and the high street

E-commerce has been growing at a significantly faster rate than all retail. Over the decade from 2008 online sales grew by 326 per cent whilst store sales grew by only 13 per cent. As a proportion of all retailing, money spent online has increased from an average of 4.9 per cent in 2008 to an average of 16.3 per cent in 2017.

This structural change in the economy has affected the high street. For a number of years, more bricks and mortar stores have closed than opened, and this trend has been accelerating recently. Many of the categories of retailer with net store closures are associated with activities that can move online (eg banking, estate agents, fashion and clothing retail). Many of the categories with high net store openings are associated with experiences or activities (eg barbers, restaurants and cafés, beauty and nail salons and health clubs) that do not face strong competition from online retail.

There is a commonly expressed view amongst businesses that the business rates system is unfair, and as such could be causing high street decline. As businesses are the ones who pay the business rate tax bill, this view is understandable. However, economic insight and evidence suggests that the level of business rates on high street properties in comparison to non-high street properties is unlikely to be a significant cause of high street store closures.

Indeed, the Centre for Cities rejects the 'level playing field' argument:

> "We need to be wary of penalising companies that choose a different business model and succeed without the need for expensive city centre property."

Others argue that high streets and town centres need to innovate and adapt if they are to be maintained in the community.

The case for a Local E-Commerce Levy

We have identified two arguments in favour of imposing a levy on e-commerce:

1. To attempt to reduce the disparity in tax paid by bricks and mortar businesses in comparison to predominantly digital businesses. This is often referred to as 'levelling the playing field'.
2. To raise funds that support local authorities attempts to transform high streets.

We conclude that the first argument is weak. The evidence indicates that the level of business rates is unlikely to be the main cause of closures of bricks and mortar stores. And alternative approaches such as online sales taxes are likely to be limited in their effectiveness to halt the shift to online sales because many businesses sell through both physical and digital channels. A range of groups (such as the British Retail Consortium, the Federation of Small Businesses and The Countryside Alliance) have called for a broad review of business taxation, that considers business rates alongside other taxes that businesses face. Our work suggests that such a review would be required in order to identify reforms that could assist bricks and mortar retail in any substantial way.

The second argument is stronger. There is logic in saying that e-commerce – which is driving a structural change to our economy – is creating a need for expensive interventions to maintain the relevance of our high streets. Therefore, e-commerce should help fund the interventions. Recognising that the need for interventions does exist, the Government has already created the Future High Streets Fund of £675 million. However, whilst the Housing, Communities and Local Government Committee recently supported this approach, it also concluded that the level of available funding should be increased. Revenues from a levy on e-commerce could provide this increase.

The case for an e-commerce levy to be local are the same as the broader arguments for local authorities to have more freedom to tax and spend at a local level. These arguments include:

- **Financial freedoms for local government will mean that resources are better allocated.** There is a fundamental belief that decisions are, 'best taken as close to the citizen as possible'.
- **Financial freedoms for local government can have a positive impact on accountability.** Bringing tax and spending decisions closer to the people allows there to be a clearer link between local politicians and their performance.
- **Financial freedoms for local government would support innovation in policy.** With more control and responsibility over funds, local government would be able to try new policy approaches.

There is growing precedent for more localised financial freedoms, with Scottish devolution being the most obvious recent example.

Designing a Local E-Commerce Levy

There are different options for introducing a Local E-commerce Levy. Each option has economic, political and implementation issues that need to be considered:

1. **Economic issues.** As far as is possible, a Local E-Commerce Levy should meet the principles of good tax design (such as being low cost to administer, transparent and fair).
2. **Political issues.** Some taxes are more palatable to the public than others (and are therefore easier to implement).
3. **Implementation issues.** For example – how would a new tax be collected?

With these issues in mind, three options for a Local E-Commerce Levy were identified:

- embedding a Local E-Commerce Levy in the business rates system
- introducing a standalone Local E-Commerce Levy on e-commerce sales
- assigning the VAT revenue arising from e-commerce to local areas.

There are common factors that need to be discussed for all of the above options for a Local E-Commerce Levy; these are not insurmountable issues but do add complexity:

- **Collection and administration.** New tax collection and administration infrastructure would need to be built for any form of an e-commerce levy. First and foremost, there would need to be a decision made about where Local E-Commerce Levy revenues are attributable. For example, are they attributable to the local area where the goods and services are purchased? Or the local area where the business selling goods and services is based? Or – if a business operating over a wide geography – where the goods and services are distributed from? The answers to these questions will affect how revenues from a Local E-Commerce Levy are distributed across the country. The US rules on applying a sales tax on e-commerce are evolving (and becoming more complex as a result). Nevertheless, they do potentially offer a blueprint to manage the issues around attributing Local E-Commerce Revenues to local areas.
- **Reliefs, allowances and incentives.** There are any number of reliefs and allowances that policymakers may want to attach to a Local E-Commerce Levy. From the point of view of business these can create complexity and may create thresholds whereby small businesses switch from not paying a Local E-Commerce Levy to paying a Local E-Commerce Levy. This may have the negative effect of disincentivising business activity.
- **How 'levelling the playing field' of tax would work in practice.** If the intention of an e-commerce levy is to reduce the tax burden for one group of businesses and increase it on another group of businesses, there is a risk of creating perverse outcomes. For example, what tax burden would be faced by a business that made 50 per cent of the value of its sales through a website and 50 per cent through a high street store? One option may be for such a business to have a commensurate reduction in its business rates bill to compensate it for its Local E-Commerce Levy bill, ie for every pound a business pays in Local E-Commerce Levy, its business rates bill is reduced by a pound. If the business rates bill is reduced to zero, then any additional revenue from the Local E-Commerce Levy goes to the billing authority. Yet this still would add massive complexity into the system, lead to trade-offs for a business deciding whether to grow online sales or not and reduce the amount of revenue raised by the Local E-Commerce Levy.
- **Redistributing revenues.** When looking at the implementation of any new local levy there needs to be some discussion of if and how redistribution of revenues to different councils would occur. There are various options, ranging from not redistributing at all to devising an entirely new formula for redistribution.
- **Political opposition and public opinion.** Most business groups are against any new levies on business because they point out that different business models incorporate online sales to varying degrees, and it is simply not a case of 'bricks vs clicks'.

The specific pros and cons of each option for a Local E-Commerce Levy follow.

Recognising e-commerce in the business rates system

There are three methods by which e-commerce businesses could be recognised through the business rates system:

- apply a unique multiplier to e-commerce businesses
- set a levy as a proportion of e-commerce sales
- enable councils to impose an additional levy on certain businesses.

None of the above options are particularly appealing to introduce a Local E-Commerce Levy.

It is difficult to see how an e-commerce multiplier for e-commerce businesses could be applied fairly. As already noted, many businesses are a mixture of physical presence and online presence and this can vary significantly between businesses. There are theoretical ways of offsetting this unfairness, for example, categorising businesses by the extent of their online presence, but this would be complex.

Setting a levy as a proportion of e-commerce automatically offers differentiation – the more e-commerce sales a business makes, the more e-commerce levy it pays. However, the business rates system is not geared up to collect revenue on sales – and it is unclear why billing authorities would take on the extra burden of doing so.

Enabling councils to impose an additional levy on certain businesses would amount to an additional property tax which bears no relation to the ability of a business to pay. It is not clear how an additional levy could be fairly applied. For instance, say the additional levy is applied to an e-commerce business, there would still have to be judgement made as to what constitutes an e-commerce business and why it should face a rates bill that is not calculated in the same way as another business down the road.

Introducing a standalone e-commerce levy on e-commerce sales

The introduction of an e-commerce levy on e-commerce sales is relatively straightforward in theory. It would work much the same way as VAT does now, with the levy being a percentage of the value of a transaction, eg 1 per cent and indeed the VAT system itself could be used to administer it. This would mean revenues from an e-commerce levy being collected nationally and returned to the area where they originated (or redistributed).

The problem of hitting those businesses with a physical presence and online presence still arises. Again, however, there could be a mechanism whereby business rates liability is offset to compensate a business for effectively being taxed twice.

From an economic perspective, within this option it is clear what is being taxed (e-commerce sales), the tax rate will likely be clear (as it is a simple percentage) and administration costs will be low (given businesses act as administrators for the VAT system anyway).

Assigning the VAT revenue arising from e-commerce to local areas

The premise of assigning VAT revenues arising from e-commerce is that local areas receive the proceeds of the economic activity that takes place within their boundaries. HMRC could collect the VAT revenues as usual, calculate how much of this revenue is raised within a local area from e-commerce and then transfers that revenue to the local area (either all of it or some of it).

It is important to note that this means no overall increase in the tax burden. Instead, it is a shift in how the tax revenue is allocated and spent and is a form of fiscal devolution. However, HM Treasury would be reluctant to lose control of centralised revenue.

Modelling a Local E-Commerce Levy

The baseline source of data that we used for our modelling is the value of website sales to private customers, produced by the Office for National Statistics (ONS). These website sales totalled £160.2 billion at the end of 2017.

Our central scenario of these website sales growing by around 10.5 per cent a year (the average annual growth rate). The chart below shows the projected total revenues

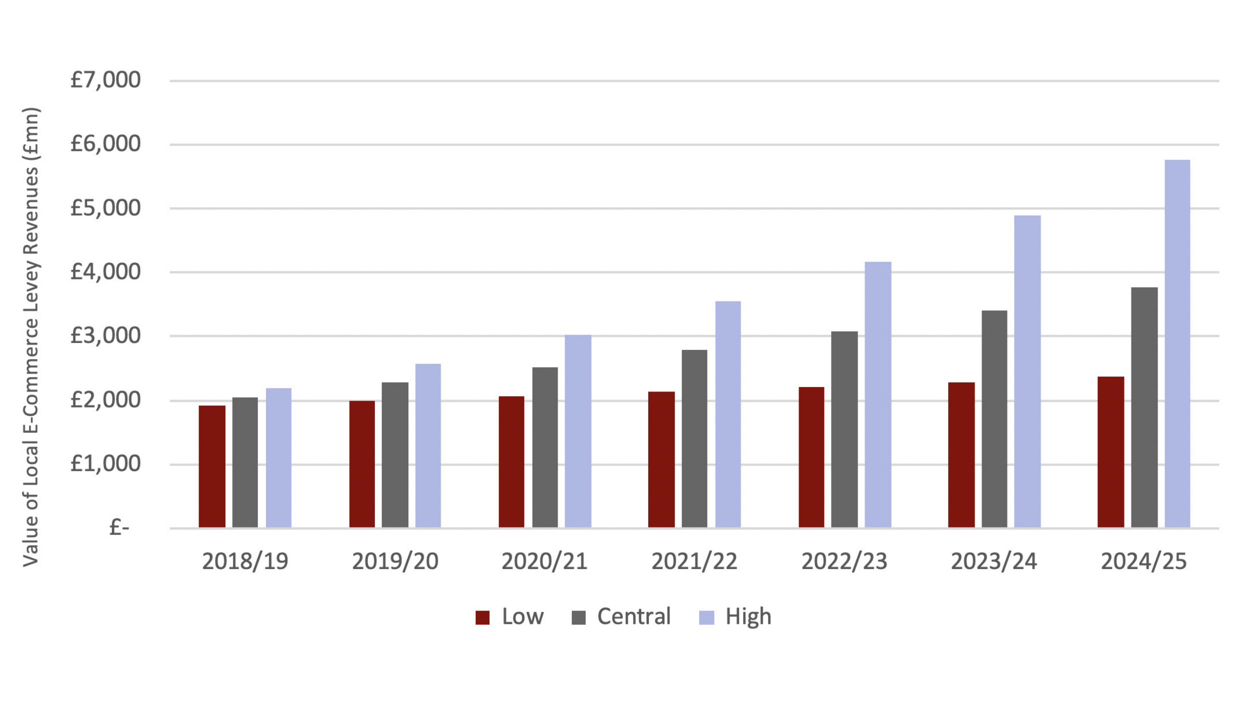


Chart one: value of total Local E-Commerce Levy revenues in England at a rate of 1.5 per cent (on low, central and high sales growth scenarios) Source: WPI Economics Analysis

arising from a Local E-Commerce Levy of 1.5 per cent, under our low, central and high growth scenarios. Under our central scenario revenues will reach around £4 billion by 2024/25.

These revenue figures are generated if all e-commerce sales are subject to a Local E-Commerce Levy. As an indication of how much revenue would be generated from a Local E-Commerce Levy with reliefs and exemptions, we assumed that the same proportion of revenue is foregone as is foregone under the VAT system. This reduces projected revenues for a 1.5 per cent Local E-Commerce Levy from £3.8 billion to £2.1 billion in 2024/25.

Our estimate of the amount of VAT revenue attributable to e-commerce sales is 15.8 per cent, which would – at its maximum – mean that under a system of assignment in 2018/19, local areas would be redistributed a portion of £19.9 billion.

Based on our modelling assumptions, the results for revenues at a local authority level are driven by two factors. The first is the number of businesses within a local authority area. The second is the sectors that those businesses operate in (see main report section for maps of the revenues by local area).

Conclusions

There are five headline conclusions from the research and modelling that we have undertaken, which are as follows:

- **The argument for introducing a Local E-Commerce Levy to 'level the playing field' in relation to business rates is weak.**
- **There is a defensible argument for introducing a more general Local E-Commerce Levy to help high streets.**
- **There are two viable options for a fiscal mechanism to help our high streets.** (The first is a Local E-Commerce Levy on a proportion of e-commerce sales. The second is the assignment of VAT revenues arising from e-commerce to local areas).
- **Potential revenues from a Local E-Commerce Levy are not insubstantial**

Finally, we think the understanding of the impact of an e-commerce levy could be improved with better data. We know that the ONS is looking at ways to record sub-national estimates of e-commerce sales, which would help in our understanding of the revenue implications of a Local E-Commerce Levy.

Introduction

The digital revolution is now decades old, but the growth of digital business is still rapidly changing our world. As the World Economic Forum comment:

> "The speed of current breakthroughs has no historical precedent...disrupting almost every industry in every country."[1]

Everyone is aware of how this disruption has affected – and is still affecting – how businesses sell. The obvious example is that products and services that were previously sold at physical stores are now bought online and either delivered there and then (eg streaming music or an e-book) or arrive at our doors through expanding logistics networks.

Yet we may still only be in the early stages of the transformation. Despite growing by 326 per cent between 2008 and 2017, e-commerce still only accounts for less than a fifth of all retail spending. This transformation is raising an increasing amount of issues for policymakers. How the tax system should be designed to account for digital disruption is a major one of these issues:

- **On corporation tax**, HM Treasury has recognised that the development of certain business models has challenged our understanding of how and where companies create value and is leading to a mismatch between where business profits are taxed and where value is created.[2] In November last year the Government therefore consulted on a potential new Digital Services Tax.[3]
- **On business rates** there is an active public debate about whether the current system provides for a fair burden of taxation for those businesses with physical high street premises compared to businesses operating through a predominantly digital footprint. This has led to assertions that different business models are not trading 'on a level playing field' when it comes to tax (as well as more general claims that it is contributing to the decline of the high street).

It is this latter issue that this report tackles. The LGA has asked WPI Economics to consider the case for a Local E-Commerce Levy as part of a future tax system, and look at three things particularly:

- the case for a Local E-Commerce Levy as part of a future tax system
- what a Local E-Commerce Levy would look like
- how a Local E-Commerce Levy could be implemented.

This report is intended to inform and promote the debate on an e-commerce levy and does not represent LGA policy. It is structured as follows:

- **Section 1:** E-commerce and the high street
- **Section 2:** The case for a Local E-Commerce Levy
- **Section 3:** Designing a Local E-Commerce Levy
- **Section 4:** Modelling a Local E-Commerce Levy
- **Section 5:** Conclusions and recommendations

Section 1
E-commerce, business rates and the high street

The growth of e-commerce

E-commerce sales by businesses in the UK non-financial sector were £586 billion in 2017.[4] Statistics on e-commerce distinguish between two types of transaction:

- **Website sales (£300 billion in 2017)**. Website sales are divided into sales to private customers and sales to businesses or public authorities. When looking solely at website sales for 2017, the majority, £160 billion, were to private customers.[5]
- **Electronic data interchange sales (£286 billion in 2017)**. Electronic Data Interchange (EDI) is the electronic exchange of business documents, such as orders, delivery slips and invoices.

When considering issues around high street retail the relevant figures are those for website sales. These are not all retail sales, however; the Office for National Statistics (ONS) reports that in 2017 online retail sales were £59.8 billion.[6]

Perhaps surprisingly, e-commerce accounts for less than a fifth of all retail spending. In 2017 (the last full calendar year for which there are statistics) the amount of money spent in the retail industry (excluding fuel) was £366 billion[7], meaning that e-commerce transactions accounted for 16.3 per cent of all retail spending. This story is similar across all retail sub-sectors as Figure One shows.

However, e-commerce has been growing at a significantly faster rate than all retail.

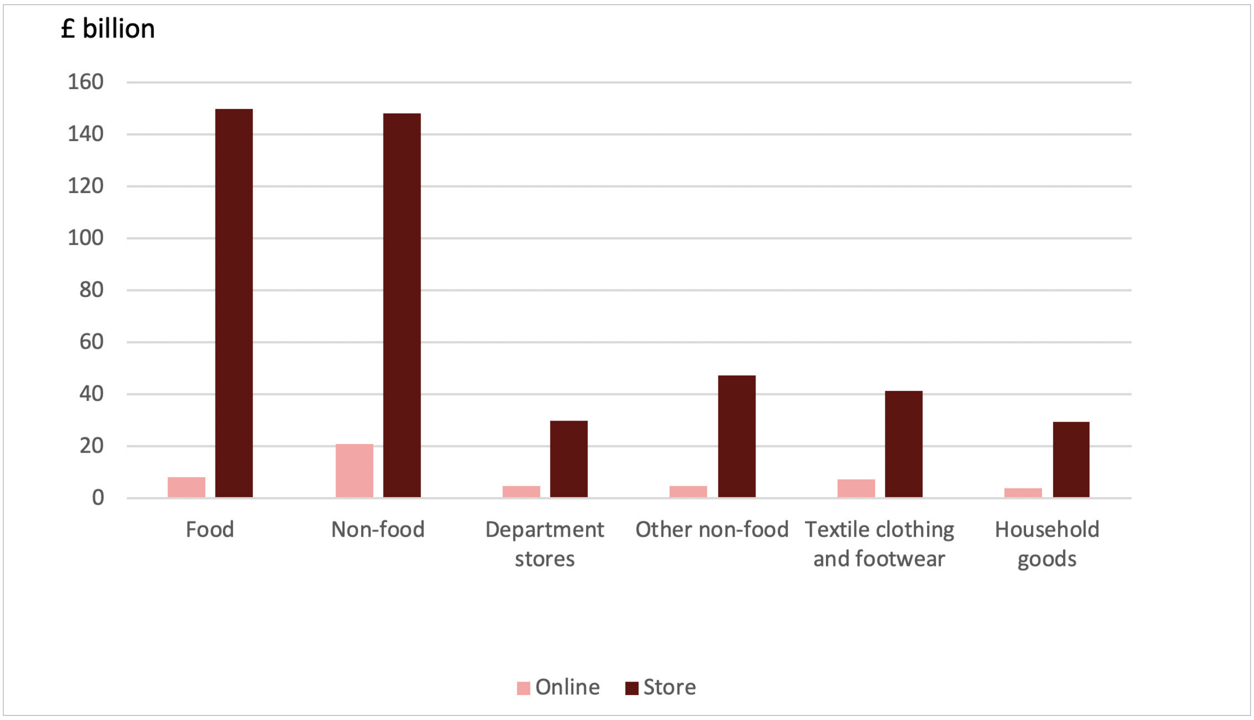


Figure one: online sales compared with store sales by retail sub-sector, Great Britain, 2017 Source: Monthly business survey, retail sales inquiry, ONS

Table one shows this rapid change; over the decade from 2008 online sales grew by 326 per cent whilst store sales grew only 13 per cent. As a proportion of all retailing, money spent online has increased from an average of 4.9 per cent in 2008 to an average of 16.3 per cent in 2017.

Table one: store retailing and online retailing, £bn and annual growth
Source: WPI calculations based on ONS Monthly Business Survey annual retail sales figures[8]

Year	Store retailing (£bn)	Store sales annual growth	Online retailing (£bn)	Online sales growth annual
2008	271		14	
2009	268	-1.3%	18	26.4%
2010	271	1.3%	21	19.7%
2011	278	2.4%	25	18.1%
2012	282	1.5%	29	15.3%
2013	288	2.1%	33	15.4%
2014	301	4.7%	39	15.1%
2015	297	-1.5%	43	10.6%
2016	299	0.8%	52	21.2%
2017	306	2.4%	60	15.9%
Total growth between 2008 and 2017	**£35bn**	**13%**	**£46bn**	**326%**

The high street evolution to an 'activity-based' economy

The Local Data Company visit the top 500 centres in the country regularly to record the status of retail shops. The data in Chart two shows that for many years more stores have been closing than opening, but this has been accelerating over the last three years.

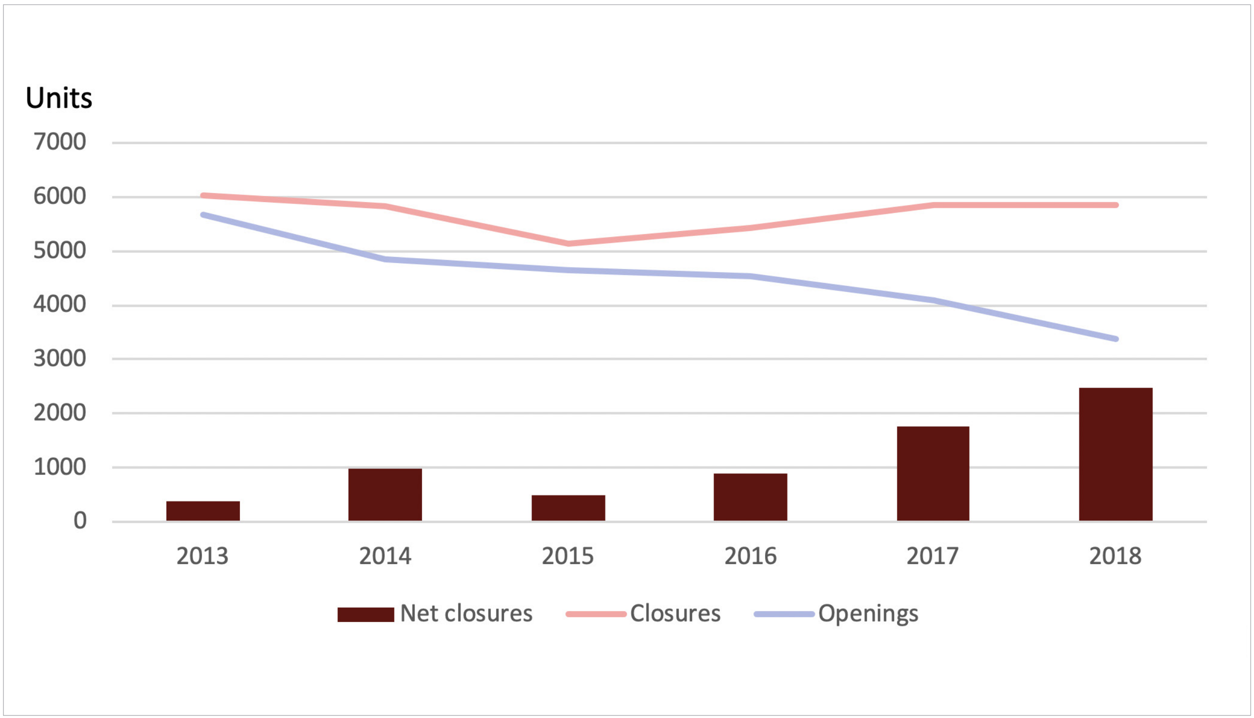


Chart two: store closures and openings, multiple retailers (those with more than five outlets nationally) Source: Local Data Company

Table two, below, shows the top 10 rising and declining categories of retailers. Many of the categories of retailer with net store closures are associated with activities that can move online (eg banking, estate agents, fashion and clothing retail). Many of the categories with high net store openings are associated with experiences or activities (eg barbers, restaurants and cafés, beauty and nail salons and health clubs) that does not face strong competition from online retail.

Table two: top 10 rising and declining retail categories for store closures and openings, Great Britain, 2018 Source: Local Data Company Retail and Leisure Analysis Full Year 2018 report

Top 10 rising categories		Top 10 declining categories	
Category of retailer	**Net openings**	**Category of retailer**	**Net closures**
Barbers	813	Banks and other financial institutions	716
Beauty salons	495	Public houses and inns	636
Vaping stores and tobacconists	244	Estate agents	448
Restaurant and bar	218	Discount stores	380
Café and tearoom	214	Fashion shops	374
Nail salons	166	Newsagents	365
Bars	145	Clothes - women	317
Health clubs	144	Electrical goods	299
Ice cream parlours	92	Post office services	283
Supermarkets	90	Dentists	230

This paints a picture of a retail sector undergoing rapid change. The Housing, Communities and Local Government Committee's report 'High streets and town centres in 2030' reviews research by the Centre for Retail Research that shows, 'since 2008, 34 medium and large retailers have gone into administration ... affecting 12,997 stores and 178,576 employees. Among these are well-known national chains, such as HMV, House of Fraser, Maplin, Poundworld and Toys 'R' Us.'[9]

This is a structural change in the economy, with associated economic difficulties affecting many towns and cities across the country. Although it is important to note that despite the high rate of closures, vacancy rates on the high street have not increased. The Local Data Company found that the vacancy rate of 12.5 per cent in the first half of 2013 declined to 11.0 per cent in the first half of 2017, with a small uptick to 11.2 per cent in the second half of 2017. This suggests that owners are converting the use of their properties as this change occurs.

Changes in the high street are mainly driven by e-commerce, not business rates

Business rates are directly related to an assessment of the open market rental value for a property, and as such are higher for properties on high streets (which are in limited supply and at high demand) as opposed to out of town sites. This results in businesses with a large high street presence paying more as a proportion of sales than businesses who predominately sell over the internet and have out of town warehouses.

For example, Amazon confirmed to the Housing, Communities and Local Government Select Committee inquiry on High Streets and Town Centres in 2030 that it paid £63.4 million in business rates in 2018 compared to sales of £8.77 billion.[10] Business rates therefore amounted to around 0.7 per cent of Amazon's sales, which is less than major high street retailers such as John Lewis (business rates amounted to 1.5 per cent of their turnover in 2017/18)[11] or Debenhams (estimated 3 per cent annually).

This leads to a commonly expressed view amongst businesses that the business rates system is unfair, and as such could be causing high street decline. For example, the New West End Company (the Business Improvement District for the major shopping streets of London's West End) argue that, 'business rates put high street retailers at an unfair competitive disadvantage, with the growing online retailers who have less space in lower value areas'[12].

As businesses are the ones who pay the business rate tax bill, this view is understandable. However, economic insight and evidence suggests that the level of business rates on high street properties in comparison to non-high street properties is unlikely to be a significant cause of high street store closures. The Institute for Fiscal Studies (IFS) points out that in the long run – when all prices and costs have had time to adjust – it is likely that, '(higher) business rates will mostly be reflected in (lower) rents, passing the burden of the tax from the occupiers of property to the owners.'[13]

This means that if business rates were scrapped, the total cost of business premises including rents, would not be much lower. The IFS states this is because:

- **the supply of business property is relatively unresponsive to price**, primarily because of a combination of a fixed supply of land and a restrictive planning regime
- **demand for business property is much more responsive**, because prospective renters have a range of other options such as using smaller or less well-located premises or moving the business online.

Put another way, the need to pay increased business rates means that the amount that businesses will be willing to pay to rent a property is reduced. Property owners can accept lower rents, or otherwise leave the property empty (and receive no rent) or sell the property (but with a lower sale price because rental yields are reduced).

This theoretical argument is supported by empirical evidence. Cambridge Econometrics (2008) studied the impact of business rate relief for enterprise zones and concluded that, '100 per cent of the benefits from [business rates] relief are passed into rents and therefore accrue to landlords, although the range of uncertainty surrounding this statistical estimate puts the boundary at somewhere between 65 per cent and 150 per cent.'[14]

That all said, there are some reasons why business rates may have some influence on high street stores:

- business rates reduce the incentive for landlords to let out their properties for commercial, as opposed to other, purposes and therefore raise rents slightly due to this second-order effect
- there may be significant delays in adjustments to rents as result of changes in business rates which in the context of a fast-changing sector could lead to significant impacts for retailers
- temporary exemptions can benefit retailers as rental contracts may not adjust immediately
- sector exemptions (eg for pubs or broader retail) can benefit those particular types of business but this would be at the expense of other sectors.

So, business rates do have some influence on the number and type of businesses we see on the high street, but the impacts are not as straightforward as suggested by the difference in how much different retailers pay. Compared to the price competition that the retailers face from new, potentially more efficient, business models the influence of business rates on the health of the high street is likely to be relatively small.

This is summed up by the Centre for Cities who argue that:[15]

> 'The suggestion that new taxes should be levied to level the playing field between online and high street retailers is misguided. Business rates are a tax on property, not on retail, and they should be treated as such. We need to be wary of penalising companies that choose a different business model and succeed without the need for expensive city centre property. There are plenty of reasons to criticise Amazon's approach to tax, but its ability to sell without using physical retail space is not one of them.
>
> 'High street shops are struggling for more fundamental reasons than tax costs, and temporarily reducing these will not fix the underlying issues causing decline. A combination of low footfall and weak customer spending power is to blame for the empty shops in many city centres, driven by cities failing to attract enough jobs (especially well-paid, high-skilled ones) into their central areas. No matter how cheap it is for retailers to set up shop, this lack of customer demand will always prevent them thriving, so the focus of policymaking should be on improving these city centre economies rather than subsidising retail.'

Further to this, the Housing, Communities and Local Government Committee in their report 'High Streets and Town Centres in 2030' note that town centres are being forced to change, saying that, 'one of the systemic issues is that our high streets and town centres are too retail-focused ... Tony Ginty of Marks and Spencer said that: Town centres cannot rely on retailing as they have done in the past. They will only succeed in the future if they get the right balance between retailing, leisure, hospitality, health, social care, services and indeed the residential links'.[16]

A range of groups (such as the British Retail Consortium, the Federation of Small Businesses and The Countryside Alliance[17]) have called for a broad review of business taxation, that considers business rates alongside other taxes that businesses face. Our work suggests that such a review would be required in order to identify reforms that could assist bricks and mortar retail in any substantial way.

Section 2
The case for a Local E-Commerce Levy

Why e-commerce?

In the context of the previous section, we have identified two arguments in favour of imposing a levy on e-commerce:

1. to assist bricks and mortar retail stores by attempting to reduce the disparity in tax paid by them as compared to predominantly digital businesses

2. to raise funds to enable Local authorities to deal with the transformation that high streets need.

We conclude that the first argument is weak. As previously explained – over the long-term – the level of business rates is unlikely to have much of an effect on the cost or business premises due to how it interacts with the level of rents. As such, changes to business rates policy should not be seen as an effective way to help high street retailers. Alternative approaches such as online sales taxes will also be limited in their ability to hold back the structural change the high street is undergoing as many businesses sell through both physical and digital channels. The British Retail Consortium point out that, 'eight of the top ten online retailers are also on high streets, and of the £1 in £5 spent online, more than half is spent with retailers that also have shops'. This is a crucial point more generally in what will and will not work in designing an e-commerce levy (which we discuss later).

The second argument is stronger. Transforming a high street towards an 'activity-based economy' requires funding; the Housing, Communities and Local Government Committee comments, 'Such work will involve acquisition and assembly of land usually through compulsory and voluntary purchase, work on the public realm and supporting changes of use'.

Recognising this need, the Government have created the Future High Streets Fund of £675 million to, 'help local areas make their high streets and town centres fit for the future'[18] which the committee concludes reflects the right approach but says that given the scale of the challenge, its funding needs to be enhanced. They comment that, 'a total of £675 million with a maximum grant of £25 million per applicant will inevitably mean that the vast majority of high streets and town centres will miss out on the funding they need to adapt for the future.'

Given that e-commerce is contributing to this need for costly changes to our high street landscape, some form of levy could be appropriate to help raise further funds for local authorities to support this transition.

The decline of the high street, driven predominantly by e-commerce, can also be expected to reduce the revenue that local government receives from business rates over time as property is converted to other uses. It is not clear what the overall impact of this change will be however, as those alternative uses may also generate local tax revenue. For example, residential use will result in increases in council tax receipts (whilst also increasing the demand for local authority services).

Why local?

The arguments for giving local areas more financial levers to use are now relatively well-established. These arguments can be summarised as: [19]

- **The UK is more centralised in terms of tax and spend than internationally comparable countries.** In Britain, only 5 per cent of total local public services expenditure is raised locally, compared to 29 per cent in Germany.
- **Financial freedoms for local government mean that resources are better allocated.** There is a fundamental belief that decisions are, **'best taken as close to the citizen as possible'**.
- **Financial freedoms for local government can have a positive impact on accountability.** More financial freedom at the local level bring tax and spending decisions closer to the people, allowing local politicians to be judged on their performance.
- **Financial freedoms for local government would support innovation in policy.** With more control and responsibility over funds, local government would be able to try new approaches to addressing policy challenges.
- **There is a wide body of support for greater financial freedoms.** For example, London residents support fiscal devolution, both the general concept and the devolution of some specific tax measures, such as stamp duty, reforming council tax and assigning revenues. A 2014 poll found 82 per cent of respondents supporting giving more decision-making powers on issues such as tax, education and policing to local areas.

Recent years have also seen moves towards providing local areas with more financial freedom. For example, Scotland now has powers to independently set rates and bands of income tax[20] and half of VAT receipts raised in Scotland will be assigned to the Scottish Government, starting in 2019/20.[21] New local levies occasionally crop up. For example, the Workplace Parking Levy in Nottingham – a charge on employers who provide car parking spaces – was enabled by the Transport Act 2000 and implemented in 2012 in Nottingham.[22] The same piece of legislation enabled London's congestion charge.

In summary, there is a solid evidence base to suggest that providing local areas with more financial freedoms is a good thing and there is going precedent of it happening in practice. This, combined with the specific arguments relating e-commerce to the hyper-local issue of high street decline, offer a good rationale for why an e-commerce levy – if one were to be introduced – should be local.

Section 3
Designing a Local E-Commerce Levy

There are different options for introducing a Local E-commerce Levy. Each option has economic, political and implementation issues that should be considered alongside them.

1. **Economic issues.** Economists tend to agree on the broad principles that should underpin the design of a new tax. The first of these principles is minimising the negative behaviours that a new tax may encourage (such as reducing the incentive for people to enter the jobs market). The second is that administering and complying with the new tax should be as low cost as possible (both for those paying the tax and those collecting it). The third is that a new tax should be transparent, so what is being taxed and by how much it is being taxed is well understood. The fourth is that the tax should be fair, ie non-discriminatory.[23]

   It must be noted, however, that much of the current tax system does not adhere to the principles of well-designed taxation. Hence, the principles act as guidance, rather than being an absolute necessity.

2. **Political issues.** Some taxes are more palatable to the public than others. For instance, at a national level increasing Insurance Premium Tax is politically easier to do than increasing Fuel Duty. At a local level, the possible introduction of tourist levies appears to be more acceptable to the public than introducing congestion charges. Moreover, some politicians and campaign groups do not believe in the introduction of any new taxes at all, and some governments are reluctant to hand local government additional financial freedoms.

3. **Implementation issues.** This has crossover with the principles of good tax design set out above but is worth considering on its own. Given that we are discussing a Local E-Commerce Levy, consideration needs to be given to whether collection would happen locally or nationally (where revenues would be redistributed locally). In other words, would existing collection systems – such as the business rates or VAT systems – be more suited to the implementation of a Local E-Commerce Levy? There are also issues in identifying those businesses that are undertaking e-commerce activity (which is discussed below).

Options for a Local E-Commerce Levy

Our research identified three options for recognising e-commerce in the tax system:

- embedding a Local E-Commerce Levy in the business rates system
- introducing a standalone Local E-Commerce Levy on e-commerce sales
- assigning the VAT revenue arising from e-commerce to local areas (although not technically a Local E-Commerce Levy, we felt it is an interesting option worth considering).

These options are outlined individually below, but the following considerations are relevant to all of them:

Collection and administration
New tax collection and administration infrastructure would need to be built for any

form of an e-commerce levy.

First and foremost, there would need to be a decision made about where Local E-Commerce Levy revenues are attributable. For example, are they attributable to the local area where the goods and services are purchased? Or the local area where the business selling goods and services is based? Or – if a business operating over a wide geography – where the goods and services are distributed from? The answers to these questions will affect how revenues from a Local E-Commerce Levy are distributed across the country.

The US rules on applying a sales tax on e-commerce are evolving (and becoming more complex as a result). Nevertheless, they do potentially offer a blueprint to manage the issues around attributing Local E-Commerce Revenues to local areas. To broadly summarise their system, a business has to identify whether not it has a defined physical or economic presence within a state, register as an e-commerce seller, calculate and collect the revenues that they owe in a particular state, before remitting the revenues to the tax authorities.[24]

Setting up this system of collection and administration will come at a cost. Given that a Local E-Commerce Levy would be an entirely new system of tax collection, it is difficult to assess what the set-up and ongoing costs will be to collection authorities. That said, there are some numbers that we can use as a basis for comparison. For implementing Scotland's new tax powers, the UK government provided a one-off payment of £200 million to the Scottish Government, with £66 million transferred to cover ongoing costs. The Scottish Government then covers any additional administration costs arising from policy change that it implements.[25] Looking at one element of this, HMRC estimates that the cost of implementing the Scottish income tax will be £7.7m, with the latest figures for the annual costs of running the programme being £0.3m.[26]

It is also important to note that there is a high likelihood that new legislation would be needed to introduce a new system of collection and administration for a Local E-Commerce Levy.

Reliefs, allowances and incentives

There are a large number of potential reliefs and allowances that policymakers may want to attach to a Local E-Commerce Levy. These reliefs and allowances could, for example, reduce the burden of a levy on selling specific products, on specific sectors, or on those e-commerce businesses that already have a significant business rates bill.

The very smallest businesses would need to be recognised in the system somehow, as it is generally accepted that the smallest businesses should be exempt from the administrative and cost burden of paying some taxes.[27] In this context, there is also an important point about incentives. From the point of view of business, introducing reliefs and allowances can mean creating thresholds whereby small businesses switch from not paying an e-commerce levy to paying an e-commerce levy. This may have the negative effect of disincentivising business activity and growth.

How 'levelling the playing field' of tax would work in practice

If the intention of an e-commerce levy is to reduce the tax burden for one group of businesses and increase it on another group of businesses, there is a risk of creating perverse outcomes. For example, what tax burden would be faced by a business that made 50 per cent of the value of its sales through a website and 50 per cent through a high street store? One option may be for such a business to have a commensurate reduction in its business rates bill to compensate it for its Local E-Commerce Levy bill, ie for every pound a business pays in Local E-Commerce Levy, its business rates bill is reduced by a pound. If the business rates bill is reduced to zero, then any additional revenue from the Local E-Commerce Levy goes to the billing authority. Yet this still would add massive complexity into the system, lead to trade-offs for a business deciding whether to grow online sales or not and reduce the amount of revenue raised by the Local E-Commerce Levy.

Redistributing revenues
A central feature of the current system of local government finance is the redistribution of revenues based upon the relative resources and needs of councils (a system that is currently being reviewed by the government). As such, when looking at the implementation of any new local levy there needs to be some discussion of if and how redistribution of revenues would occur.

There are five options for the redistribution of e-commerce levy funds:

1. **Do not redistribute revenues.** This approach would mean that some local areas will receive more than others from a Local E-Commerce Levy.
2. **Redistribute revenues based on the current system of local government finance.** Essentially, this means signing up to the formulas that assess resources and needs across local areas.
3. **Redistribute revenues on the basis of a new formula.** Given that this work is being conducted in the context of providing funds to reinvigorate the high street, some method of assessing which high streets need the most funds would need to be addressed.
4. **Redistribute revenues within local areas.** Groups of local authorities would form a local area. The revenues from a local area would be redistributed between local authorities within the local area. The constituent local authorities of a local area could be tasked with deciding themselves how this redistribution would work.
5. **Redistribute revenues within local areas and between them.** This would be a combination of the approach in 2 and 3 above.

Political opposition and public opinion
Our assessment is that business lobby groups would generally be against the idea of an e-commerce levy, highlighting the additional complexity and increased tax burden that would arise. As noted earlier, most business lobby groups also point out that different business models incorporate online sales to varying degrees. There is some limited support amongst businesses for some form of digital sales tax. For example, a representative of UKHospitality has supported a root-and-branch reform [of business rates] that looks at a digital sales tax[28] and Mike Ashley of the Sports Direct Group has proposed a 20 per cent tax on retailers which make more than 20 per cent of their sales online.[29] However, the majority of business group positions that we have reviewed on this topic are sceptical that a new tax could help high street businesses.

While potentially introducing significant complexity into the design and operation of a Local E-Commerce Levy, none of the above issues are insurmountable.

The specific pros and cons of each option for a Local E-Commerce Levy are now discussed in turn.

Embedding a Local E-Commerce Levy in the business rates system

As noted, the evidence suggests that the current business rates system is not to blame for the problems facing the high street (or, at most, is one small factor among many). Moreover, the business rates system is a **property tax**; the only way we can think of to raise a specific levy on e-commerce activity is through a **sales tax**.

Yet the infrastructure of the business rates system, with its link to local areas, could be used to facilitate the collection and administration of a Local E-Commerce Levy. We have identified three outline options for this:

1. **Apply a unique multiplier to e-commerce businesses.** A basic business rates bill is calculated by multiplying the rateable value of a property by the 'multiplier'. A property's rateable value is set by a government body (Scotland and Northern Ireland have separate bodies from that of England and Wales). The multiplier is set by the government (or devolved executive). The idea would be for an e-commerce business to have a unique multiplier, greater than that paid by non-e-commerce businesses, attempting to equalise their tax burden.
2. **Set a levy as a proportion of e-commerce sales.** This would be similar to the way that VAT works now, with the very smallest businesses exempt from paying it.
3. **Enable councils to impose an additional levy on certain businesses.** As suggested by the Barclay Review in Scotland, a new levy could simply be added to the existing rates bill of certain businesses where a local council feels it is justified (the Review suggests that this could be trialled in a pilot scheme). The Review suggests the additional levy may apply to out of town retail or on predominately online businesses. It further suggests that the revenues from such a scheme could be used to reduce rates in towns centres or on other facilities within town centres, such as car parks.[30] The billing authority's infrastructure would be used to apply the additional levy (as happens through Business Improvement Districts).

None of the above options are particularly appealing to introduce a Local E-Commerce Levy.

On the first option, it is difficult to see how an e-commerce multiplier for could be applied fairly. As already noted, how much of a business's activity is conducted through its physical presence and how much is conducted through its online presence can vary to a large degree. One solution may be applying a specific 'E-Commerce Value' to different extents of e-commerce within a business, much the same way that properties are given different rateable values in the business rates system, ie a business that makes 100 per cent of its sales online would have a higher E-Commerce Value than a business that makes 50 per cent of its sales online. But this would be complex to administer, and in the fast-moving world of online sales would require repeated reassessments of what the 'E-Commerce Value' is.

On the second option, setting a levy as a proportion of e-commerce levy automatically offers differentiation – the more e-commerce sales a business makes, the more e-commerce levy it pays. However, the business rates system is not geared up to collect revenue on sales. For example, whole new enforcement teams may be necessary, or at least existing ones may need to be expanded. Some local authorities may be reticent to take on this type of extra burden (although, it has been pointed out to us that local authorities may see benefit in local collection as it means a greater chance of the revenues staying within local government).

On the third option, this would amount to an additional property tax which bears no relation to the ability of a business to pay. It is not clear how an additional levy could be fairly applied. As far as we can tell, the additional levy would be applied at a council's discretion. For instance, say the additional levy is applied to an e-commerce business, there would still have to be judgement made as to what constitutes an e-commerce business and why it should face a rates bill that is not calculated in the same way as another business down the road.

In our view, HMRC – given that it already collects revenue on sales through the VAT system – would be the logical vehicle for collecting a Local E-Commerce Levy. The only argument we can see for using the business rates system would be if it minimised administrative burdens, but we cannot see how this would be the case (in fact, it would be quite the opposite). In addition, the direction of travel for the business rates system is decided at a national level, meaning that interlinking a Local E-Commerce Levy with it may create issues as the tax base evolves over time.

Introducing a standalone Local E-Commerce Levy on e-commerce sales

The introduction of a Local E-Commerce Levy on e-commerce sales is relatively straightforward in theory. It would work much the same way as VAT does now, with the levy being a percentage of the value of an e-commerce transaction, ie 1 per cent. Again, there could be some allowances, such as an exemption for a proportion of online sales (like an income tax allowance) or designing the levy to take proportionally less revenue from smaller businesses.

Given this option relates to sales – the VAT system could be used to administer it. This would mean revenues from a Local E-Commerce Levy being collected nationally and returned to the area where they originated.

The problem of hitting those businesses with a physical presence and online presence still arises. Again, however, there could be a mechanism whereby business rates liability is offset to compensate a business for effectively being taxed twice. Indeed, this is an important consideration in the context of EU State Aid rules, which it has been suggested could apply to new taxes that distort competition (although will presumably be less of a problem if the UK exits the EU).[31]

From an economic perspective, within this option it is clear what is being taxed (e-commerce sales), the tax rate will likely be clear (as it is a simple percentage) and administration costs will be low (given businesses act as administrators for the VAT system anyway).

Assigning the VAT revenue arising from e-commerce to local areas

The premise of e-commerce assignment is that local areas receive the proceeds of the economic activity that takes place within their boundaries. It would be a three-stage process:

- HMRC collects VAT revenues
- HMRC calculates how much of this VAT revenue is raised within a local area from e-commerce
- HMRC transfers the assigned VAT revenue to the local area (either all of it or some of it).

It is important to note that this means no overall increase in the tax burden. Instead, it is a shift in how the tax revenue is allocated and spent. It is a form of fiscal devolution that essentially gives local areas more control over the revenue that is raised in their areas. It would mean that central government has less money to spend, but the amount this would be would depend on how much of VAT attributable to e-commerce would be devolved.

This last point is important – the fact that HM Treasury would be reluctant to lose control of centralised revenue cannot be escaped.

Section 4
Modelling a Local E-Commerce Levy

The options for a Local E-Commerce Levy detailed in the previous chapter all relate to measuring e-commerce sales, which is the focus of our modelling analysis. Specifically, we wanted to answer the following questions through the modelling process:

- What is the value of e-commerce sales that arise nationally? And what is the value of e-commerce sales that arise in each local authority area?
- What would be the revenue implications – both nationally and locally – of introducing a standalone Local E-Commerce Levy on e-commerce sales?
- How much VAT revenue arises from e-commerce sales? And how much of this revenue could be assigned to local areas?

In answering each of the above questions, different scenarios were used in the modelling process so that our findings were not reliant on one single assumption.

The methodology and data sources used for the modelling are included in an annex to this report.

Headline findings

The baseline source of data that we used for our modelling is the value of website sales to private customers, produced by the ONS. These website sales totalled £160.2 billion at the end of 2017. Based on assumptions about the proportion of businesses that undertake e-commerce sales, we estimate that these website sales are generated by roughly 218,000 businesses.

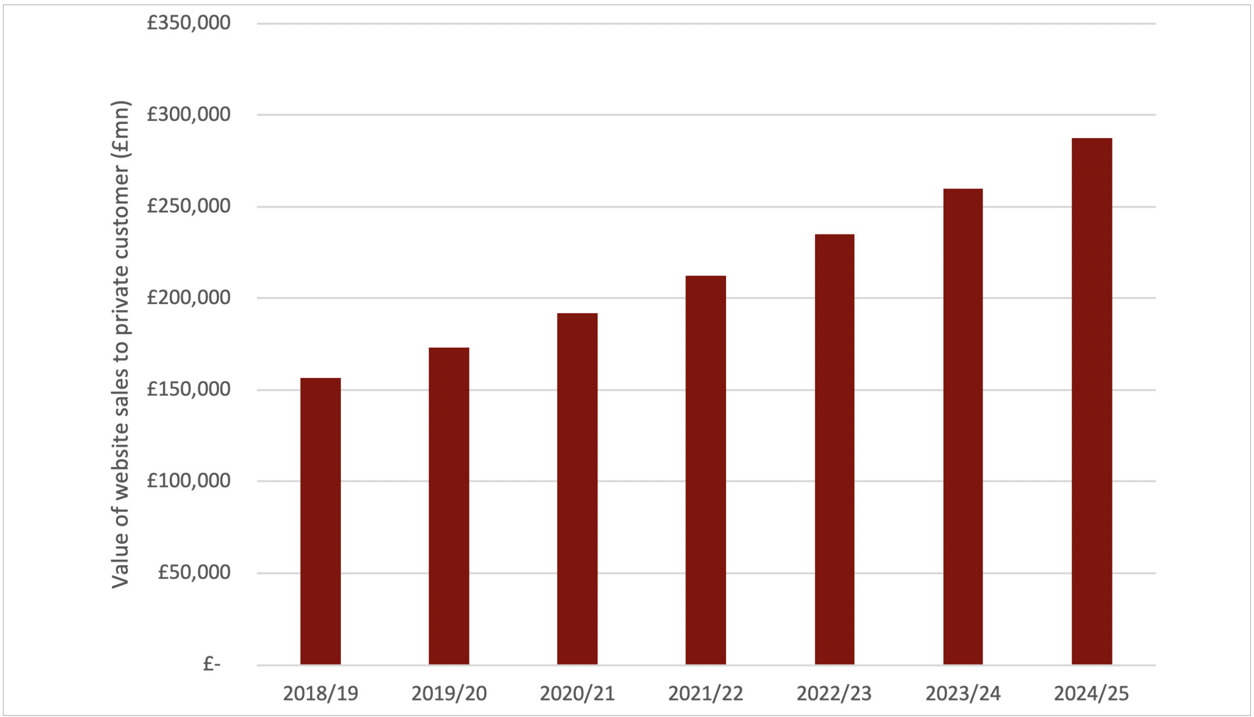


Chart three: projected value of website sales to private customers 2018/19 – 2024/25
Source: WPI Economics Analysis

Using our central scenario of these website sales growing by around 10.5 per cent a year (the average annual growth rate that has been recorded in official statistics), and that roughly 90 per cent of these sales are to UK customers, our projection is that the value of these sales will grow to a total of £287.6 billion by 2024/25 (see chart, below).

There is a question about the rate of Local E-Commerce Levy to apply to these sales. There is not much precedent from overseas, and what precedent for recognition of e-commerce sales is usually wrapped up in broader sales taxes. We have modelled a Local E-Commerce Levy at a rate of 1.5 per cent. This is the midpoint of the rates at which some have suggested that an online sales tax should be applied.

The chart below shows the projected total revenues arising from a Local E-Commerce Levy of 1.5 per cent in England. We project that revenues will reach £3.8 billion by 2024/25.

Of course, the revenue figures for a 1.5 per cent levy vary if we change our scenarios for growth of website sales. Our 'low' scenario is that website sales grow in line with the economy, at around 3.5 per cent. Our 'high' scenario is that website sales grow at a rate consistent with the rate of online retail sales (which is a narrower range of sales than the broader website sales to private customers), at a rate of 17.5 per cent. The chart below shows how revenue from a Local E-Commerce Levy at 1.5 per cent differ across each of the website sales growth scenarios. The revenues range from £2.4 billion in 2024/25 on the low scenario and £5.8 billion in 2024/25 on the high scenario.

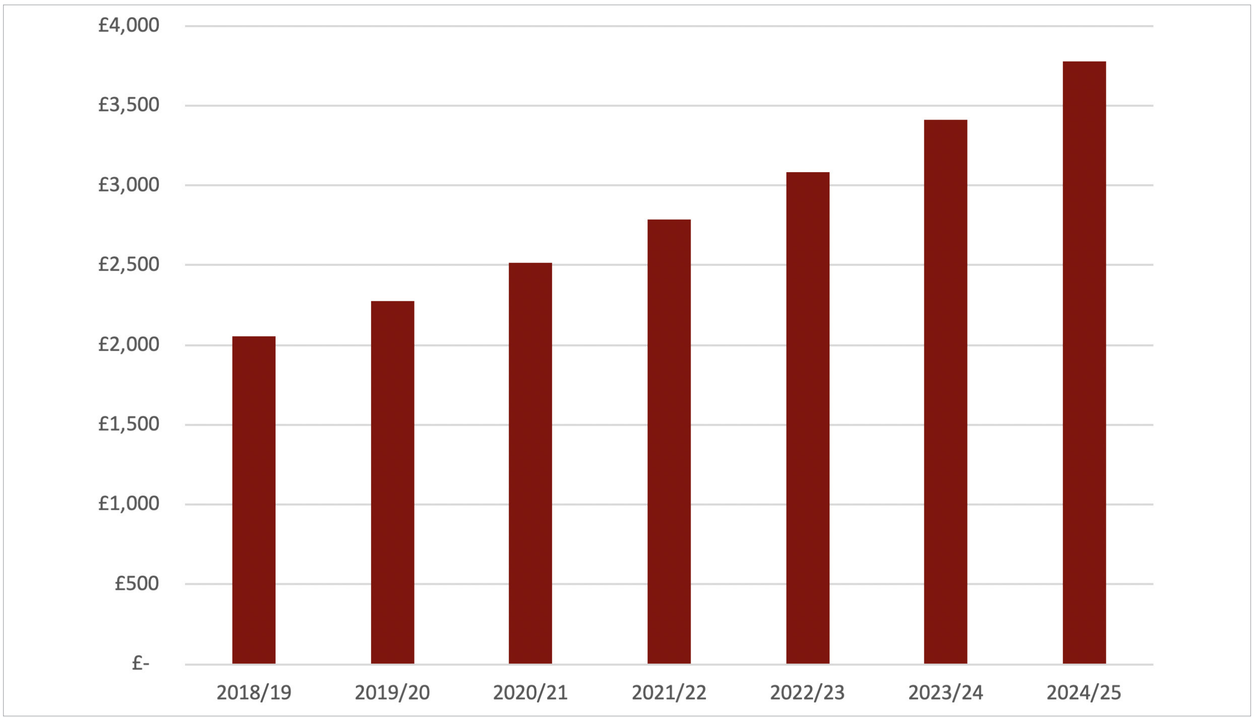


Chart four: value of total Local E-Commerce Levy revenues at a rate of 1.5 per cent in England (on central sales growth scenario Source: WPI Economics Analysis

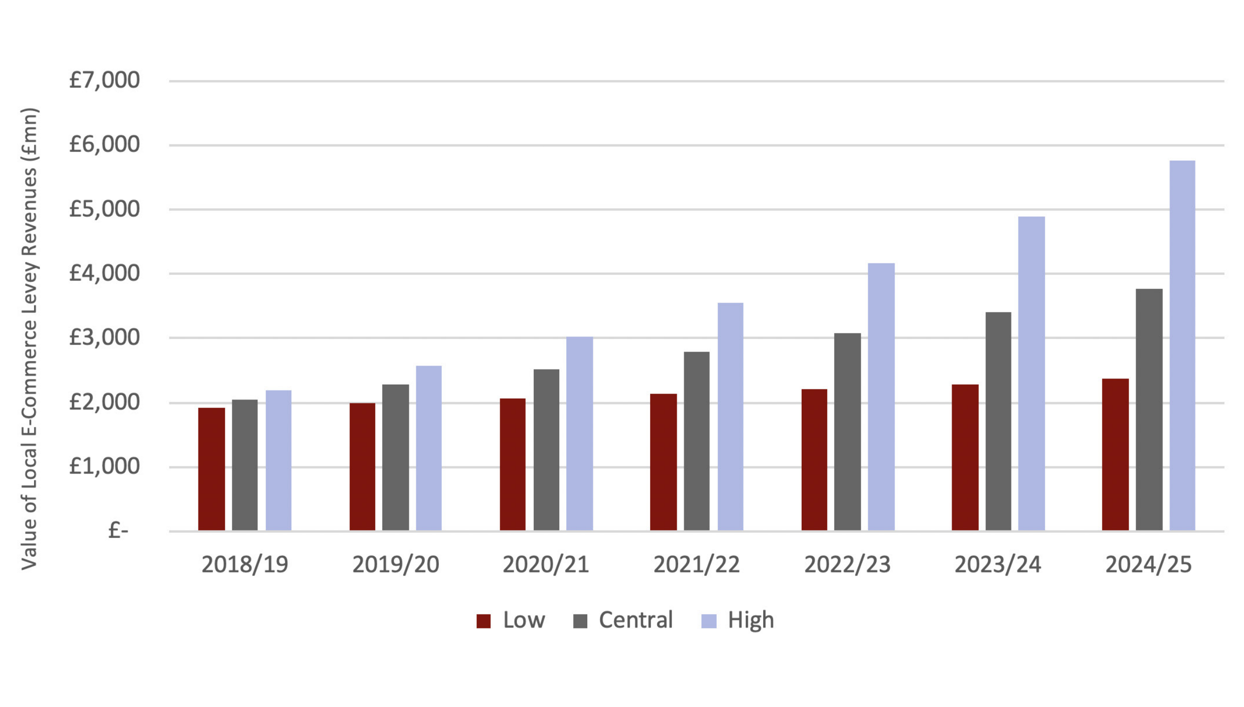


Chart five: value of total Local E-Commerce Levy revenues at a rate of 1.5 per cent (on low, central and high sales growth scenarios) Source: WPI Economics Analysis

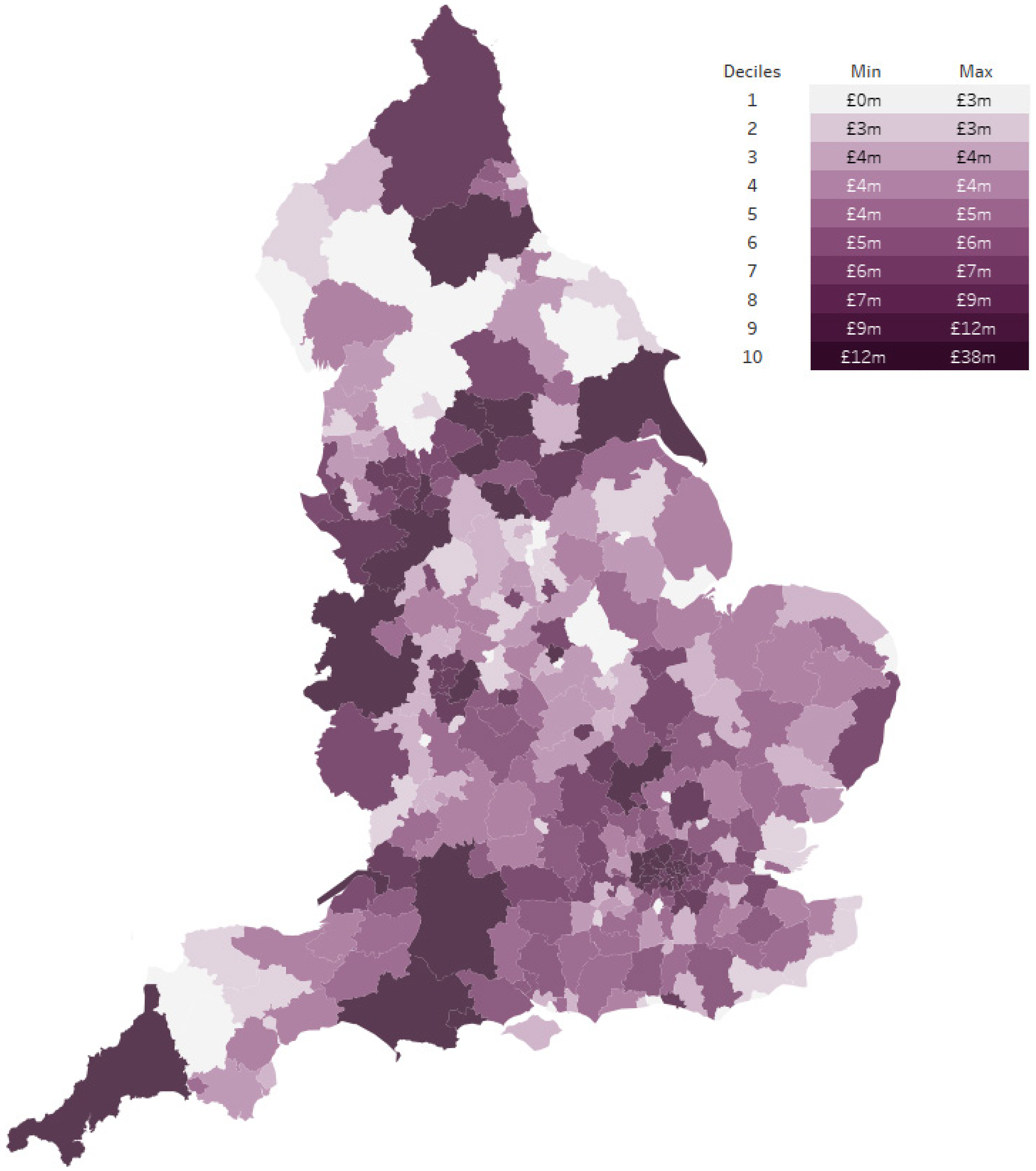
These revenue figures are generated if all e-commerce sales are subject to a Local E-Commerce Levy. As discussed, there are many reasons why this may not be the case. As an indication of how much revenue would be generated from a Local E-Commerce Levy with reliefs and exemptions, we assumed that the same proportion of revenue is foregone as is foregone under the VAT system. We found that this would reduce projected revenues for a 1.5 per cent Local E-Commerce Levy from £3.8 billion to £2.1 billion.

Our estimate of the amount of VAT revenue attributable to e-commerce sales is 15.8 per cent, which would – at its maximum – mean that under a system of assignment in 2018/19, local areas would be redistributed a portion of £19.9 billion.

Local revenues

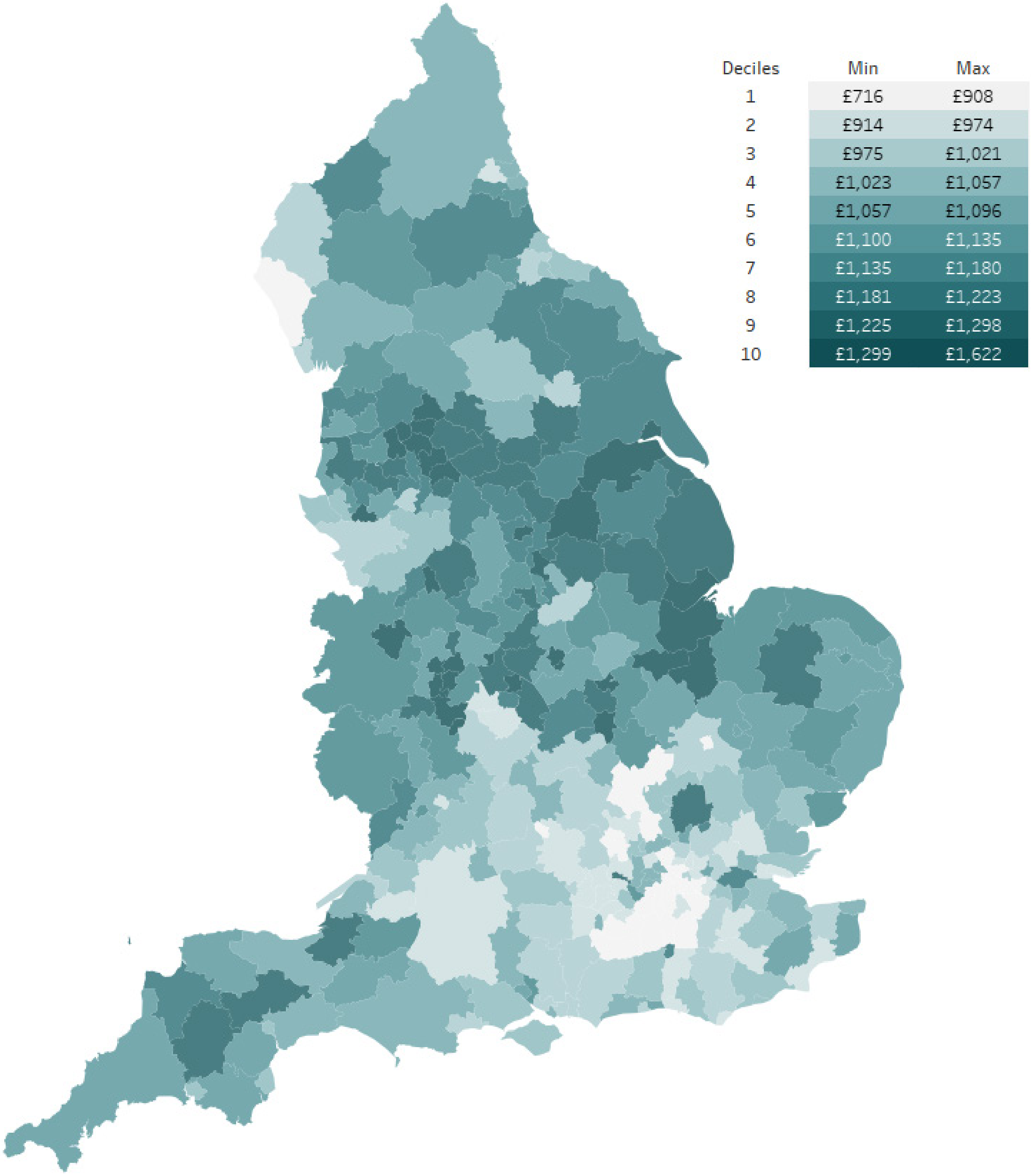
In our assessment of local revenues arising from a Local E-Commerce Levy, assumptions had to be made about what method to distribute the revenues on. The official data tells us that website sales can vary significantly between different sectors of the economy. Hence, we used this as the basis to distribute revenues locally. To note, this is by no means a perfect measure, but neither are any of the alternatives (this is discussed further in the technical annex).

The map overleaf shows the revenues by local authority of a 1.5 per cent Local E-Commerce Levy. Based on our assumptions, the results for revenues are driven by two factors. The first is the number of businesses within a local authority area – those local authorities with more businesses are more likely to have e-commerce businesses and so will generate more revenue from the levy. The second is the sectors that those businesses operate in – those local authorities with a higher proportion of businesses that undertake website sales.



Map 1: revenues from a Local E-Commerce Levy of 1.5 per cent 2018/19.
Source: WPI Economics Analysis

To get some sense of how the make-up of businesses within the area drive revenues, we calculated the Local E-Commerce Levy revenue per business within each local authority area. Those local authorities with a disproportionately high number of businesses that are in sectors that are less likely to conduct website sales are will have lower revenue per business scores. And vice versa for those local authorities with a disproportionately high number of businesses that are in sectors more likely to conduct website sales. This is shown in the following map.



Map 2: revenues per business from a Local E-Commerce Levy of 1.5 per cent 2018/19
Source: WPI Economics Analysis

Section 5
Conclusions

The headline conclusions from our research and modelling are as follows:

- **The argument for introducing a Local E-Commerce Levy to 'level the playing field' in relation to business rates is weak.** Economic insight and evidence suggest that the level of business rates on high street properties in comparison to non-high street properties is unlikely to be a significant cause of high street store closures. This, therefore, is the wrong focus.
- **There is a defensible argument for introducing a more general Local E-Commerce Levy to help high streets.** The rationale for introducing a Local E-Commerce Levy is that funds are needed because of the structural change to the economy – driven by e-commerce – that is changing our high streets. There is a good rationale for such a levy to be local based upon the well-rehearsed arguments in favour of fiscal devolution, such as addressing regional imbalances and promoting innovation.
- **There are two viable options for a fiscal mechanism to help our high streets.** The first is a Local E-Commerce Levy on a proportion of e-commerce sales. The second is the assignment of VAT revenues arising from e-commerce to local areas. Whilst being viable, they are not without problems in implementation. With the prospect of a new levy, there will be some opposition to the creation of any new tax (and business lobby groups – which have a powerful voice – will generally be opposed). The idea of assigning revenues avoids increasing the tax burden, but will run into opposition from HM Treasury, which would be reluctant to relinquish control of revenues.
- **Potential revenues from a Local E-Commerce Levy are not insubstantial.** The overall picture of our modelling is that on our central scenario a 1.5 per cent Local E-Commerce Levy will generate £3.8 billion by the year 2024/25 in England. Of course, the amounts vary depending upon the level that any levy is set at. From an individual local authority perspective, the levy revenue will depend on the number of e-commerce businesses it has and the types of sectors that operate within local authority boundaries.

Finally, we think the understanding of the impact of an e-commerce levy could be improved with better data. We know that the ONS is looking at ways to record sub-national estimates of e-commerce sales, which would help in our understanding and modelling of the revenue implications of a Local E-Commerce Levy. Moreover, obtaining estimates of how much turnover is generated from online sales by a business in relation to its business rates liability would help us better understand the structural shifts that are transforming the high street and our economy.

Annex Data sources and methodology for an E-Commerce Levy tax base

Our preferred option for an E-Commerce Levy is to use the sales generated via e-commerce as the tax base, from which revenues can be acquired. To estimate these revenues at a local, regional and national level, the following information was used:

- the number of businesses within a local authority area, split by sector
- the proportion of businesses within different sectors that undertake e-commerce sales
- the total value of e-commerce sales nationally (which can then be attributed to local authority areas).

On the first bullet point above, there is no single source for the number of active businesses in the UK.[32] The ONS estimate for the number of e-commerce businesses is generated from one of these sources – the Inter-Departmental Business Register (IDBR).[33] Hence, we used data from the IDBR to find the number of businesses within a local authority, split by sector. Using the IDBR means that the very smallest businesses – those not registered for PAYE or VAT – are excluded from our modelling of the E-Commerce Levy tax base (there are also good reasons to exclude them, which are explained in the main body of the report).

Using the IDBR business count data, we undertook the following process to create a baseline figure for the value of e-commerce sales in each local authority area:

- Identify the number of businesses in each local authority area, split by relevant sectors of the economy. The relevant sectors are those for which e-commerce sales data is collected by the ONS (primarily at two-digit SIC Code level).[34]
- Make assumptions about what proportion of businesses within each sector undertake website sales – these assumptions are largely taken from the ONS data on e-commerce sales.[35] For two sectors – utilities and transport and storage – this data is not available. Instead, for these sectors we based our assumption of businesses undertaking e-commerce sales within these sectors on the number of people they employ.[36]
- Use the total UK value of e-commerce sales in 2017 – the latest year of available data – as a figure to be allocated to each local authority area. This allocation occurs on the basis of the proportion of businesses within the local authority area, which we have estimated undertake e-commerce sales (split by sector).

To note, our assumptions for the proportion of businesses that undertake e-commerce sales is primarily based on sector because our instinct is that basing them all on firm size may distort our final results. This is because relatively small firms – in terms of the number of employees that they have – can produce relatively high e-commerce sales. Of course, no assumption is perfect in this regard, but we think our approach is the one with the fewest distortions.

For our projections up to 2024/25 we had to create low, central and high scenarios for annual average growth rates of e-commerce sales and the number of businesses undertaking e-commerce sales in each local authority area:

- For each the average annual growth rate of e-commerce sales, we used the average annual growth rate of total UK e-commerce sales as our central scenario. For the low scenario we used the Office for Budget Responsibility forecast growth for the economy. And for the high scenario we used the growth in online retail sales.
- For the average growth rate of business by sector in each local authority area we used the average growth rates across the entire economy.

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