ITI Response to the
Online Sales Tax: Policy Consultation

19 May 2022

Thank you for the opportunity to provide feedback to the HM Treasury’s open consultation on the issues and the potential impacts of an online sales tax (OST).

The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world’s most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

As an opening point of principle, it is very concerning that the United Kingdom is considering development of a new digital tax as negotiators from more than one hundred governments are simultaneously working to finalize reforms to the international tax landscape. The premise of the OST also attempts to establish a false dichotomy within the broader business sector. Most if not all businesses have adopted elements of digitalisation to streamline operations, enter new markets, better engage with consumers, or achieve other business objectives. The trend towards omnichannel distribution started prior to the onset of the COVID-19 pandemic and has only accelerated over the past two years: one in three small and medium-sized enterprises (SMEs) reported that they would not have survived the pandemic without digital tools.1 Pursuing an OST would effectively tax business modernisation and transformation, reduce incentives to adopt digital tools as means of strengthening resilience and productivity, and contravene long-standing international tax principles. It would also create significant tax controversy as the consultation is vague as to the outer boundaries of scope and does not rule out inclusion of business-to-business transactions or overlap with the existing Digital Services Tax (DST).

For these reasons, we strongly discourage HM Treasury from further consideration of the OST and instead urge focusing all its efforts to aligning domestic tax policy with the Organisation for Economic Cooperation and Development (OECD)/G20 Inclusive Framework’s outcomes by removing the DST and forbearing new taxes aimed at ring-fencing the digital economy, including the OST.

Respecting Commitments in the Multilateral Project
The OECD/G20 Inclusive Framework’s October 2021 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy notably included a commitment to provide for the withdrawal of relevant unilateral measures and to refrain from the introduction of new ones.2 The consultation attempts to pre-empt comparisons of the UK’s DST and OST by emphasising the former’s temporary nature and application to certain services, but negates to dispel

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1 https://digitallyempowered.connectedcouncil.org/pdf/3C-DigitallyEmpowered-S2720v2.pdf
the core issue that the OST would be a unilateral, gross-revenue tax that is targeted at specific elements of a digitalising economy. Continuing to press ahead with an OST risks undermining the multilateral outcomes, as such a tax is in contravention of the October 2021 Statement signed by the United Kingdom and 136 other governments that commits parties to remove existing unilateral tax measures and forebear new ones.

The introduction of an OST would also further perpetuate the trend of increasingly widespread application of targeted, unilateral digital taxes that serve to undermine a functioning international tax system and compromise the predictability the international system has afforded companies to conduct business globally – exactly the outcome that participants in the ongoing multilateral negotiations are now seeking to avoid. There is real concern that a further unilateral move by the UK would be emulated in other jurisdictions and lead to a new wave of unilateral, overlapping, gross-based taxes. The April 2021 OECD Secretary-General Tax Report to G20 Finance Ministers plainly states the broader trade and economic risks associated with pursuing unilateral approaches: “In the current context, international tax cooperation is even more important to ensure that tax disputes do not turn into trade wars, which would further harm recovery at a time when the global economy can least afford it.” These considerations reinforce the importance of forgoing a unilateral approach and focusing governments’ energy on finalizing the multilateral negotiations and implementing the commitment to remove existing relevant unilateral measures.

**Recognising the Entire Economy is Digitalising**

Strong tax policy should ensure neutrality, apply consistently across all taxpayers, and not discriminate by business model or location. ITI has long agreed with the OECD and the Inclusive Framework that it would not be feasible to ring-fence the digital economy “because the digital economy is increasingly becoming the economy itself” – a position that the OECD and the Inclusive Framework have also expressed as a key underpinning of its work to address the tax challenges presented by the digitalisation of the economy. The introduction of an OST would directly contravene this long-standing, multilateral conclusion to the detriment of consumers and businesses in the UK market.

Many of the consultation questions demonstrate the breadth of policy and practical challenges that arise when attempting to ring-fence the digital economy. The boundary between online and offline activity is difficult to not only define in theory but also identify in practice, inevitably generating uncertainty in interpretation. This is particularly relevant given that retailers are increasingly shifting to omnichannel models where customers can buy goods in physical stores and online, a trend that has accelerated during the pandemic where a shift to online sales has been an essential part of many businesses’ strategies to remain viable and resilient. For example, the distinction between delivery and click and collect, or order in store and deliver to home, is blurred, especially as a delivery method can be changed after the point of sale. The type of goods sold or method of delivery should not be a deciding factor in the amount of tax payable in respect of the sale. Likewise, a customer who opts to purchase consumer goods online rather than through other means should not be penalised through the imposition of an additional tax.

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Because the OST would distort between distribution channels, as the same product or service supplied on-line would be subject to a greater burden of tax to that supplied off-line, it will violate tax principles of neutrality and equality and create a direct disincentive to digitalising distribution channels. There is also the risk that an OST could disincentivise traditional retailers from diversifying and innovating through online sales routes if they are then penalised with a new tax. Both outcomes would appear to be at odds with the Government’s agenda to promote digitalisation, which is premised on the reality that “digital technologies are the engine driving the UK’s economic growth,” and highlight how the implementation of an OST would be a short-sighted attempt to generate revenue with potentially disastrous long-term effects.

More generally, the design features set out in the consultation could have the effect of broadening scope and would undermine even further the policy’s stated intent to modernise business rates. While online retail may not pay rent or rates associated with physical storefronts in a city centre, online stores do pay rates on storage, distribution, and back office premises, and incur other costs such as delivery logistics and marketing. There is already business rate taxation on companies that distribute via digital channels, and an OST would clearly result in a doubling of this tax.

**Adhering to International Tax Principles**

Taxing corporate revenue, rather than income, is inconsistent with international tax principles — as reflected, for example, in the OECD Model Tax Convention on Income and on Capital and over 3,000 bilateral tax treaties. This approach penalises low-margin and loss-making companies and subjects affected companies to potential multiple taxation and significant compliance costs. The structure of taxes on gross revenue also means the burden of the tax most likely falls on in-country consumers, rather than businesses.

This is especially likely for the incidence of an OST given its transactional nature. On-line retailers generally operate on very slim margins and would not be able to absorb such a cost. Similarly, SMEs, many of which may have not achieved sufficient profit margins, may see disproportionate harm because such businesses are unlikely to be able to absorb the tax, particularly in the current climate where many other costs are also rising, and will therefore be forced to pass on the tax through increased prices to consumers. Only the smaller online retailers that may not be able to update billing systems quickly enough to incorporate the OST into their check-out flows would bear this cost directly. Others will pass it on directly to end consumers as an additional line on their invoices after Value Added Tax (VAT).

Subjecting companies to a tax without regard to whether or to what extent they have a permanent establishment in-country would be inconsistent with the international tax laws vis-à-vis bilateral tax agreements.

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6 To illustrate how DSTs as gross receipts taxes compare to corporate income taxes, a DST of 3% applied to a company with a 10% profit rate equates to a 30% effective corporate income tax rate, with limited to no availability for credits. A DST of 3% applied to a company with a 2% profit rate equals a 150% effective corporate income tax rate. This is applied in addition to corporate income taxes paid by the company. The double taxation and subsequent effective corporate income tax rate are especially impactful to companies with lower profit margins and companies with losses.
treaties as well as international tax principles reflected in the OECD Model Tax Convention and other instruments, and would, like taxing revenue, create the risk of multiple taxation, significant compliance costs (including for HM Treasury), and greater uncertainty.

Further, digital goods and services in the United Kingdom are already subject to taxes levied on gross revenues, namely through the DST and VAT. Unlike the UK’s DST and other relevant unilateral measures that will be withdrawn as part of the political agreement reached in the October 2021 Statement, VAT is the appropriate means of levying tax on consumption. By providing an input credit for the various stages of production, the VAT ensures the tax is only levied on the value of the final good or service. An OST, in contrast, would discriminate based on the method of delivery of a product or service, and, in the case of business-to-business transactions, would result in tax being applied at each level of the value chain. Figure 2 demonstrates the cascading tax (and even more significant risk of distortion) that would occur in a hypothetical business supply chain of an online order, from supplier to manufacturer, wholesaler, retailer, and the end consumer.

**Pursuing an Impact Assessment**

If HM Treasury decides to pursue further consideration of an OST in conflict with its commitments in the Inclusive Framework, it should conduct a thorough impact assessment. Such an assessment should consider impacts of an OST in terms of the tax itself on business costs and incentives to invest in digital technology to improve productivity, as well as the impact of additional administrative costs of paying it on the adoption of digital technologies by a variety of businesses and consumers. Any assessment should particularly focus on businesses that have adopted digitalisation, smaller online retailers (including those that use online marketplaces), business government intends to benefit from the Levelling Up agenda,\(^7\) consumers in rural areas, consumers with mobility issues, etc.

\(^7\) [https://www.gov.uk/government/publications/levelling-up-the-united-kingdom](https://www.gov.uk/government/publications/levelling-up-the-united-kingdom)