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Public Finance Scrutiny Unit

Rating Online Retailers in Northern Ireland: preliminary considerations

This briefing gives an overview of issues relating to the charging of non-domestic rates to online retailers in Northern Ireland.

Introduction

This Briefing Paper is prepared for the Committee for Finance and Personnel (CFP), as part of its consideration of the charging of non-domestic rates to online retailers in Northern Ireland (NI). It seeks to increase understanding as follows:

- Section 1 presents background information to contextualise the subsequent sections of the paper;
- Section 2 highlights key challenges if legislating to extend the scope of rates liability to all online retailers in NI;
- Section 3 provides a comparative perspective from Great Britain, the United States and Canada; and,
- Section 4 presents concluding remarks.

1 Background information

To contextualise the rest of this Paper, this section explains: key terms and concepts; relevant online trends in the UK; central relevant elements of NI's non-domestic rates law; and, key CFP developments relating to its consideration to date of this issue.

1.1 Definitions

Key terms and concepts that are central to a discussion about taxing online retailers are explained in the below sub-section.

1.1.1 What is an 'online retailer'?

Conducting commercial activity online is complex, involving numerous participants and activities. Both individuals and companies can conduct retail transactions online. Any reference to an *'online retailer'* in this Briefing Paper refers to a company or individual who conducts online retail transactions, i.e. the sale of goods or services, online *via* the internet.

1.1.2 What are 'online retail transactions'?

Having reviewed relevant literature in this area, it appears that several terms are used interchangeably to describe 'online retail transactions', including those listed below:

- electronic commerce;
- e-commerce;
- electronic business;
- e-business;
- remote sales;

- internet shopping; and,
- online retailing.

Such interchangeable use can result in confusion. For clarity, this Paper uses the term '*online retail transactions'* to describe retail business activity that is conducted online, with or without the ownership and occupation of commercial premises. This definition builds on the Organisation for the Economic Co-Operation and Development (OECD) definition of an 'e-commerce transaction', i.e.:

> *...the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders. The goods or services are ordered by those methods, but the payment and the ultimate delivery of the goods or services do not have to be conducted online.*[1]

1.2 Online retailing trends in the UK

This sub-section first explains how online retailing has transformed the retail sector in the UK generally. It then highlights the apparent commercial advantages experienced by online retailers in terms of the non-domestic rating system, as opposed to more traditional, bricks and mortar retailers.

1.2.1 Rise of online retailing

In 2013, the OECD reported that 40% of the world's population is connected to the internet.[2] In 2014, online retail transactions accounted for 9% of all retail sales in the UK.[3] In 2012, mobile retail sales, i.e. online sales using a smart phone or tablet, increased by 304% on the 2011 figures.[4] In 2011 a review was undertaken for the UK Government into the future of UK high streets. Commonly known as 'the Portas Review'; it cited the growth of online retailing as a factor in changing the UK retail landscape:

> *The phenomenal growth of online retailing, the rise of mobile retailing, the speed and sophistication of the major national and international retailers, the epic and immersive experiences offered by today's new breed of shopping mall, combined with a crippling recession, have all conspired to change today's retail landscape.*[5]

Following this rapid rise in online retailing, it seems policy makers in the UK and other countries have become more concerned about the impact of the online retailer on the

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[1] OECD (2013) *Glossary of Statistical Terms*: http://stats.oecd.org/glossary/

[2] OECD (2014) *The Internet economy- Regulatory challenges and Practices*: http://www.oecd-ilibrary.org/docserver/download/5jxszm7x2qmr.pdf?expires=1430218094&id=id&accname=guest&checksum=56335B11912564C915A7CFF8ED900232

[3] Business, Innovation and Skills Committee (2014) *The Retail Sector: Eight Report of Session 2013–14 Volume II* :http://www.publications.parliament.uk/pa/cm201314/cmselect/cmbis/168/168ii.pdf

[4] British Retail Consortium (2012) *Retail Stats & Facts: Sector Stats & Facts.*

[5] Portas, Mary (2011) *The Portas Review: An independent review into the future of our high streets*: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/6292/2081646.pdf

traditional, bricks and mortar/high street retailer. One identified concern is how the rating system appears to provide a commercial advantage to online retailers over bricks and mortar retailers, without the ownership and occupation of commercial premises.

1.2.2 Commercial advantages

Identified commercial advantages experienced by online retailers appear to arise from their distribution centre location and their use of technology for distribution purposes. Each is explained below.

Distribution centre location

Mixed use property

Online retailers (or any other businesses) may operate from, e.g., their home, a shop with a flat above, or a solicitor's office in a domestic property, using part of that property as, e.g., an online retailer distribution centre. The property in this scenario is often referred to as a 'mixed use property'.

Cheaper rates area

An online retailer can hold its stock in a distribution centre or warehouse that is located in the cheapest non-domestic rates area. Of course traditional, bricks and mortar retailers are free to do the same: but generally speaking they situate their premises within the locality of the market they serve.

An example of this is seen in the different rate liabilities of the London bricks and mortar retailer Harrods and the online retailer ASOS. Both retailers have similar turnovers, £716.3 million (m) and £769.4m respectively. Harrods, however, faces a non-domestic rates bill of £11.5m in 2014-15, while ASOS' bill for 2014-15 was £935,000.[6]

Based on a valuation date from 2008, Harrods was three times the size of the ASOS property. This differential is based on the geographic location of each. Harrods is located in the affluent area of Knightsbridge, central London; whereas the ASOS distribution centre is based in Grimethorpe, Barnsley.[7]

This is particularly relevant in NI where all non-domestic property have been re-valued during the 2014-15 financial year. (Non-domestic rates due for each property located in NI can be viewed on the Land and Property Service (LPS) website.) Generally

[6] Emily Young, BBC News online (2013) *Autumn Statement 2014:Business rates reform demanded*: http://www.bbc.co.uk/news/business-30232504

[7] Emily Young, BBC News online (2013) *Autumn Statement 2014:Business rates reform demanded*: http://www.bbc.co.uk/news/business-30232504

speaking, non-domestic rates are cheaper in NI rural areas, such as Fermanagh, rather than larger urban areas, such as Belfast.[8]

Technology for distribution purposes

Another commercial advantage for online retailers over bricks and mortar retailers is the fact that they can make use of technology for distribution cost saving purposes, which enables faster communication between the different stages of the supply chain. These include the practices know as *drop-shipping* and *just-in-time*.

Drop-shipping

The OECD defines *'drop-shipping'* as follows:

> *...under a drop-shipping system wholesalers will directly handle the shipping to final consumers, hence the order, originated by the retailer, will be entirely fulfilled by the wholesaler, skipping the extra step of transporting the good from the wholesaler to the retailer. This system significantly reduces distribution costs and speeds up the whole process.*[9]

Essentially, under the drop-shipping system the online retailer does not require a bricks and mortar distribution centre or storage unit, as the distribution of their products to their customers is undertaken by the wholesaler. Therefore they will not be liable for any non-domestic rates.

Just-in-time

Online retailers can reduce non-domestic rate liability under a '*just-in-time'* system of distribution. Under just-in-time the online retailer only orders products from the wholesaler when the online retailer has secured a buyer for the item. Once the online retailer receives the item from the wholesaler, the online retailer will immediately ship it to its customer. This significantly reduces the amount of physical space that the online retailer needs for storage because the item is not purchased to be stored. Rather it is shipped immediately to the final customer.

Depending on the online retailer's and the wholesaler's delivery set up, the online retailer could collect the item from the delivery company and immediately re-address it to its final customer, eliminating the need for storage. In some instances the retailer can avoid storing stock items completely.

Consequently online retailers may not require commercial premises in NI to conduct online transactions.

[8] The UK has decided to delay their five yearly business rates revaluation from 2015 to 2017.
[9] OECD (2013) Vertical Restraints for On-line Sales:http://www.oecd.org/competition/VerticalRestraintsForOnlineSales2013.pdf

Each of the arrangements described above has the potential impact of reducing the retailer’s non-domestic rates liability when utilised, given the calculation of rates under current law in NI.[10]

1.3 Non-domestic rates law in NI

Explained below are central elements of prevailing non-domestic rates law in NI, including those that are relevant to the issue of charging non-domestic rates to online retailers in NI.

1.3.1 Calculating non-domestic rates payable in NI

In NI, non-domestic rates are a tax paid on property. Non-domestic property in NI is assessed on the annual rental value the property could reasonably be expected to achieve on the open market. This assessment is known as rateable net annual value or NAV. Each council sets its own poundage rate for properties within its district every financial year. To calculate the rates payable on the non-domestic property, the NAV is multiplied by the non-domestic rate poundage of the district council in which the non-domestic property is located.

1.3.2 Establishing rateable occupation

The fundamental legal test for assessing rateability is ‘rateable occupation’. This is defined in a 1936 House of Lords’ decision as follows:

> *First, there must be actual occupation; secondly, that it must be exclusive for the particular purposes of the possessor; thirdly, that the possession must be of some value or benefit to the possessor; and fourthly, the possession must be for not to transient a period.*[11]

The Chief Executive of the Institute of Revenues Rating and Valuation (IRRV) in correspondence to RaISe stated the following in relation to the rateability of online retailers:

> *Any* [online] *retailer operating in Great Britain or Northern Ireland will have an administrative centre, which consists of call centre facilities, administrative buildings and a distribution warehouse. Any of these facilities that satisfy the four ingredients of rateable occupation would attract a rate liability.* ***However the actual internet traffic determining the transaction itself would escape liability.*** [emphasis added][12]

1.3.3 Relevant NI Statutory Provisions

[10] An example of a mixed use property is where an online retailer uses part of their home as a distribution centre.
[11] *Westminster Council v Southern Railway Company* [1936]
[12] Correspondence from IRRV Chief Executive David Magor received by RaISe 12.02.15

The legislation governing cases where there is a mixed domestic and non-domestic use is Schedule 5 Paragraph 3 of the *Rates (Northern Ireland) Order 1977, it states:*

> *A hereditament shall not be deemed to be used otherwise than wholly for the purposes of a private dwelling by reason of either or both of the following circumstances—*
>
> *(a)that it includes a garage, outhouse, garden, park, pleasure ground, yard, court, forecourt or other appurtenance which is not used, or not used wholly, for the purposes of a private dwelling;*
>
> *(b)that part of the hereditament, not being a garage, outhouse, garden, park, pleasure ground, yard, court, forecourt or other appurtenance, is used partly for the purposes of a private dwelling and partly for other purposes, unless that part was constructed, or has been adapted, for those other purposes.*[13]

1.3.4 LPS Guidance on rating mixed use properties

When a property is used for both domestic and non-domestic purposes it may be liable for both domestic and non-domestic rates. The LPS must inspect the property and assess what part of the property is for domestic use and what part is for non-domestic (commercial) use. The non-domestic activity at the property may not be immediately obvious for assessment purposes, presenting challenges.

The LPS provided RaISe with specific examples of mixed use properties and advised how they would rate the properties accordingly. These examples are presented at **Table 1** below:

Table 1: Examples of mixed use occupation and LPS advice:[14]

Example	LPS Advice on Rateable Occupation
1. Commercial use within the main house.	If a commercial use is taking place within part of the main dwelling, that part is not valued as non-domestic unless it is constructed or adapted specifically for that purpose. A common example is a dentist's surgery.
2. Construction of a separate building or store used only for commercial purposes.	Where the use of the building is exclusively commercial. This is straightforward, the building is valued as non-domestic.
3. Commercial and domestic use taking place in a separate store, outbuilding or garage.	This is less clear cut and depends on individual circumstances. **If there is a mix of commercial and domestic use within that building then, generally, the commercial use is not valued.**

[13] Rates (Northern Ireland) Order 1977 *Schedule 5 Paragraph 3*: http://www.legislation.gov.uk/nisi/1977/2157/schedule/5
[14] Land and Property Services (2015) Correspondence with RaISe dated 9. 02.15.

In addition, the LPS provided RaISe with answers to specific questions relating to the rating of online retailer in NI. The questions and answers are presented in **Table 2** below.

Table 2: Questions and answers relating to the rating of online retailers:[15]

Question	LPS Answer
How do LPS detect instances where a domestic property is used for non-domestic means?	Commercial use at a domestic property is normally notified to LPS via the standard channel of a district council Building Control notification. LPS will inspect and re-survey (if necessary) the property. Commercial use at a domestic property is also sometimes notified to LPS by the owner /occupier them self or by a third party, such as a neighbour.
What measures does LPS take to counteract online businesses/retailers (that have distribution networks set up in their domestic property/garage) evading the payment of non-domestic rates?	Non domestic use of a dwelling is notified to LPS as above. LPS prioritises all rating casework in line with agreed business targets and available resources.
Are there any penalties in place for this type of rates evasion?	I am not sure if it is appropriate to term operating an online business from a domestic property and it not being valued as “rates evasion”. This situation is not an offence under Article 60 of The Rates NI (Order) 1977.
If there are penalties available could you please provide details of the number of times they have been imposed and the extent of the penalties received for each of the last three years?	This situation is not an offence under Article 60 of The Rates NI (Order) 1977.
What problems do LPS encounter in valuing property (in the above scenario) for non-domestic use?	As noted above, examples 1 and 2 are straight forward; example 3 can sometimes throw up unusual situations
Are there any properties on the current (or draft) non-domestic list that are classified as online retailers, if so how many?	There are no properties in the current list or draft list classified online retailers; this is not a separate category of use for rating purposes.
How is the rate bill calculated for a property with both domestic and non- domestic use? What legislation / part of the Rates Order cover this?	The commercial portion will be valued by reference to its Net Annual Value (NAV) in line with the statutory provisions of Schedule 12 of the Rates (NI) Order 1977. The domestic portion is valued by reference to its Capital Value in line with the statutory provisions of Schedule 2 of The Rates (Capital Values, etc) (Northern Ireland) Order 2006. When property is classed as a ‘mixed hereditament’, i.e. there are domestic and non domestic uses at one property, the Capital Value of the domestic portion is used to calculate the domestic portion of the rate bill, and the NAV of the non domestic portion is used to calculate the non domestic portion of the bill. The occupier receives one single, combined bill.

[15] Land and Property Services (2015) Correspondence with RaISe dated 9. 02.15.

1.3.5 Non-domestic rates liability and online retailers

Given the current rating law in NI:

1. **Online retailers which use a property for distribution and other purposes**, **resulting in mixed use of a property**; their non-domestic rates liability is assessed by the LPS. After inspecting the property, the LPS determines the non-domestic (commercial) use for online retailing purposes and the other uses, and sets the rates for each accordingly.

2. **Online retailers which locate its distribution centre in a cheaper rates area**; they will be liable for less non-domestic rates.

3. **Online retailers which use technology for distribution purposes**; they will be liable for less non-domestic rates, possibly avoiding them altogether, depending on the circumstances.

1.4 Key CFP developments

Throughout 2014, the CFP received several briefings from representatives of the business community in relation to non-domestic rating, specifically the Small Business Rates Relief Scheme and the 2015 Non-Domestic Rate Revaluation.

Omagh Chamber of Commerce briefed the CFP at its meeting on 25 June 2014.[16] During the briefing members and witnesses discussed the issue of making online retailers liable for non-domestic rates. In their evidence, witnesses explained that the present rating system in NI unfairly advantages online retailers. They stated:

> *…rates are something that bear down on people who trade out of physical property in town centres. Those who trade in electronic media get a free ride here. Our platform is heavily taxed. The e-commerce platform is not taxed at all. So, for us, it is a system that is not fit for purpose in the e-commerce age. It needs a major overhaul.*[17]

On 15 October 2014, the CFP members further discussed the issue of online retailers and the rating system following an evidence session from the Northern Ireland Independent Retail Trade Association. After this meeting, CFP again asked DPF to consider the issue. DFP provided the following reply in November 2014:

[16] Northern Ireland Assembly: *Committee for Finance and Personnel (2014) Official Report*: http://www.niassembly.gov.uk/assembly-business/official-report/committee-minutes-of-evidence/session-2013-2014/june-2014/small-business-rate-relief-scheme-omagh-chamber-of-commerce/

[17] NITRA (2014) Minutes of Evidence from CFP briefing (25.07.14) Official Report: http://www.niassembly.gov.uk/assembly-business/official-report/committee-minutes-of-evidence/session-2013-2014/june-2014/small-business-rate-relief-scheme-omagh-chamber-of-commerce/

Online retailers are already subject to full business rates on their properties in the UK, which of course means their distribution warehouses and associated premises. The introduction of an additional liability for such businesses is not possible through the rating system because rates are a tax on property.[18]

And:

Any attempt to charge an additional rating levy on distribution properties occupied or owned by online retailers is highly likely to be successfully challenged through the courts. This is because many retailers have both a high street presence and an online one, and this in turn presents major difficulties in defining in legislation exactly who and what should be subject to such a levy. There are also likely to be State Aid difficulties surrounding the potential for such a levy to be viewed as an indirect state aid to those businesses not subject to the levy.[19]

The CFP may wish to seek clarification from the DFP in relation to the issues contained in the statement above, namely:

- What is meant by "an additional rating levy"?
- What State Aid difficulties do DFP foresee?

2 Challenges if extending non-domestic rate liability to all online retailers in NI

This section highlights key challenges if attempting to extend the scope of non-domestic rate liability to all online retailers in NI, bearing in mind the information set out in Section 1 of this Paper.

2.1 Establishing rateable occupation for mixed use properties

As mentioned above, a complication exists in terms of assessing rates liability for an online retailer when there is mixed use of property. The following sub-section outlines the challenges this presents for NI legislators in terms of taxing online retailers *via* the current rating system in NI.

2.1.1 Mixed use of properties in NI

In NI, advice on the *NI Business Info* website gives the following guidance regarding rating business use at domestic properties:

If part of a building is used for business and part for residential purposes – [...] the part used for business counts as non-domestic premises. So, if you live and work

[18] Department of Finance and Personnel (2014) Correspondence to CFP. *Options for the rating of online retailers. (*Dated20.09.14)

[19] Department of Finance and Personnel (2014) Correspondence to CFP. *Options for the rating of online retailers. (*Dated20.09.14)

in the same premises, you generally pay business rates on the part of the property used for business and domestic rates on the residential part.[20]

The following guidance is given regarding rates and working from home:

If you work from home, the part of the property used for work may be liable for business rates. You will still have to pay domestic rates on the rest of the property. Whether you are charged business rates or not depends on the degree of business use. You are more likely to have to pay business rates if a room is used exclusively for business, or has been modified, e.g. as a workshop. Each case is considered individually.[21]

3 Comparative perspective

The following section provides a comparative perspective, explaining how other jurisdictions – such as Great Britain, the United States and Canada - are addressing the rating challenges presented by online retailers in NI.

3.1 Great Britain

In England, Wales and Scotland, non-domestic rates are known as business rates.

3.1.1 Business, Innovation and Skills Select Committee: Sales Tax

The UK Chancellor announced a review of business rates in the 2014 Autumn Statement:

The government will carry out a review of the future structure of business rates to report by Budget 2016.[22]

The UK Business, Innovation and Skills (BIS) Select Committee's report on the retail sector in the UK recommended that the UK Government should consider as part of its review whether retail taxes should be based on sales rather than property. It argued that this would go some way towards levelling the playing field between online retailers and bricks and mortar retailers that occupy commercial or mixed use property:

With the increasing use of the Internet for retail transactions, another alternative way of calculating Business Rates would be to base the tax on sales, rather than on rents or rateable value.

And:

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[20] NI Business Info (2015): *Rates and your business premises*:https://www.nibusinessinfo.co.uk/content/rates-and-your-business-premises

[21] NI Business Info (2015): *Rates and your business premises*:https://www.nibusinessinfo.co.uk/content/rates-and-your-business-premises

[22] HM Treasury (2014) *Autumn Statement 2014*:https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382327/44695_Accessible.pdf

> *…a local sales tax, […] would obviously apply equally to online retailers and bricks-and-mortar retail. We would suggest that would be a very worthwhile review by Government—to try to make sure there is a level playing field.*[23]

The report also recommended that the retail sector (both online and bricks and mortar) should have its own form of taxation, calculated in a different way from other businesses.[24]

In its response to the BIS Select Committee report, the UK Government rejected the recommendation that it consider as part of its business rates review whether retail taxes should be based on sales rather than property, stating that:

> *The UK has a sales tax in the form of VAT.* ***Introducing a new sales tax alongside VAT would be double taxation which the Government wishes to avoid.*** *Reforming the basis of business rates would be a significant undertaking.* ***Creating a new tax based on sales is likely to be much more administratively complex and to have higher costs than the current system.*** *Furthermore the Government believes that taxes on property are less distortive and less harmful for growth than other taxes* [emphasis added].[25]

3.1.2 British Retail Consortium: Tax on Energy usage

The British Retail Consortium (BRC) argues that for retailers in particular, the system for business rates is unfit for purpose:

> *…the system for business rates is no longer fit for purpose because it disincentivises expansion and investment in property and creates an upwardly spiralling burden of costs for those in physical premises.*[26]

In its 2014 publication *Business Rates: The Road to Reform,* the BRC set out ways in which it believes the business rates system could be reformed. One of these proposals includes replacing the business rates system with a system that shifts away from taxing property and shifts towards taxing energy use (based on £x1 per kWh). The BRC argues that this proposal would encourage energy efficiency, reward employment and fairly balance the business tax burden.[27]

It is perhaps noteworthy here to mention that during a CFP evidence session by the LPS and the DFP in September 2014, the DFP officials advised the CFP that the BRC

[23] Business, Innovation and Skills Committee (2014) *The Retail Sector: Eight Report of Session 2013–14 Volume II* :http://www.publications.parliament.uk/pa/cm201314/cmselect/cmbis/168/168ii.pdf

[24] Business, Innovation and Skills Committee (2014) *The Retail Sector: Eight Report of Session 2013–14 Volume II* :http://www.publications.parliament.uk/pa/cm201314/cmselect/cmbis/168/168ii.pdf Paragraph 113.

[25] Business, Innovation and Skills Committee (2014) *The Retail Sector: First Special Report:*http://www.publications.parliament.uk/pa/cm201415/cmselect/cmbis/189/18902.htm

[26] British Retail Consortium (2014) *Business Rates: The Road to Reform*:http://www.brc.org.uk/brc_show_document.asp?id=4436&moid=8092

[27] British Retail Consortium (2014) *Business Rates: The Road to Reform*:http://www.brc.org.uk/brc_show_document.asp?id=4436&moid=8092

had commissioned some work on rating online retailers.[28] In later correspondence dated October 2014 relating to this matter, the DFP further informed the CFP that the BRC had ruled out the possibility of proposing changes to the rating system as a starting point for reform in favour of a programme of proposals within "*Road to Reform*".[29]

3.1.3 GB opposition to online retail transactions tax

A criticism of imposing a tax on online retail transactions is that it could hinder small businesses and restrict entrepreneurship. This view was expressed by the founders of online retailer Sofa.com:

> *A tax, if imposed could be a barrier to entrepreneurship, negatively impact small business, reduce consumer choice and hit at the heart of the UK's world-leading online retail industry.*[30]

This view was supported in a letter to the Treasury from six retail chief executives opposing the introduction of an online sales tax. The letter stated:

> *An online tax would kill entrepreneurial spirit by making it harder for smaller online retailers to get started. It would have a detrimental effect on the supporting industries in technology, manufacturing, logistics and marketing which have been key partners in the growth of online retail.*[31]

The chief executives also argued that online retailers already pay significant tax in the form of corporation tax and VAT.

3.2 United States

The United States (US) has looked at the issue of retailing through the lens of the transaction that has taken place, rather than the property from which it takes place. The following sub-sections provide information on how the US is addressing the issue of taxing online retail transactions.

3.2.1 Individual states' sales taxes

Current position

[28] Land and Property Services. Minutes of Evidence from CFP briefing (10.09.14) Official Report: http://aims.niassembly.gov.uk/officialreport/minutesofevidencereport.aspx?AgendaId=9754&eveID=6430

[29] Department of Finance and Personnel (2014) Correspondence to CFP. *Non-Domestic Revaluation* (dated 2.10.14).

[30] Telegraph online (2013) *Online retailers hit back at tax plan* : http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/10122501/Online-retailers-hit-back-at-tax-plan.html

[31] Telegraph online (2013) *Retailers oppose online sales tax*: http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/10193895/Full-letter-Retailers-oppose-online-sales-tax.html

In the US each individual state has the option to levy a sales tax in addition to conventional property taxes that are imposed on real estate or personal property.[32] Sometimes sales tax is referred to as transaction tax since retailers collect the tax at the time of the transaction.

Sales taxes are collected in the US on retail sales at the time of the sale to the final consumer, and only the final sale in the supply chain is subject to tax, unlike VAT which is imposed on each stage of the supply chain. VAT is typically included in the price that the consumer pays and is often not even visible to the purchaser. Sales tax, on the other hand, is separately stated on the invoice to the customer.

Growing lobby

Recently there has been a growing lobby in the US to raise a levy on online retail transactions. Currently, online retailers must collect sales tax from out-of-state customers only if they have a physical presence (store, warehouse or office) in the customer's state**.** States cannot reach beyond their border and collect sales tax owed by state residents. Currently, online retailers do not have to send payments to state governments across the US.

3.2.2 Marketplace Fairness Bill

In 2013, the US Senate passed the "Marketplace Fairness Bill"[33] that would grant state authorities the power to compel sellers that have no physical presence in their state to collect sales tax on any online retail transactions made to their state residents. Sellers that make less than $1m in annual sales and with no physical presence in the state would be exempt. Under the Bill, states will be granted this authority only after they have simplified their sales tax laws.

For example, under the Bill, a large online retailer who sells to a resident of the state of Texas will be required to charge sales tax at the prevailing Texas sale tax rate and remit the revenue to Texas state authorities.

The National Conference of State Legislatures in the US (which promotes the collective interests of US states) noted that introducing this could raise around $23 billion across the US based on the estimated amount of tax that was not collected from internet purchases.[34]

However under the Bill, states would have to provide free computer software to help the online retailers calculate the sales taxes. This additional cost may prove expensive and unpopular with some state authorities.

[32]Correspondence from IRRV Chief Executive David Magor received by RaISe 12.02.15
[33]http://marketplacefairness.org/bill-text/
[34] National Conference of State legislators (2015). *Collecting E-Commerce Taxes | E-Fairness Legislation:* http://www.ncsl.org/research/fiscal-policy/collecting-ecommerce-taxes-an-interactive-map.aspx

3.3 Canada

Canada has also looked at the issue of retailing *via* the transaction that has taken place, rather than the property from which it takes place. The following sub-sections provide information on how Canada addresses this issue.

3.3.1 Sales taxes

Similar to the US, in Canada, customers pay tax at the point of sale when they buy goods and services, with the exception of online retail transactions conducted with online retailers outside Canada (see subsection 3.3.3 below).

In Canada, there are three types of sales tax, namely:

- Goods and Services Tax (GST);
- Provincial Sales Tax (PST) or Quebec Sales Tax (QST); and,
- Harmonised Sales Tax (HST).

GST is levied by the federal government, PST is an additional percentage collected by the provincial or state government. For example if GST is 5% in Canada and PST in Manitoba is 8%, a customer in a Manitoba shop will pay 13%.[35]

Some provinces such as New Brunswick and Newfoundland combine GST and PST in the form of HST which is paid to the Canadian Revenue Agency (CRA).[36] The CRA then pays the federal portion back to the province.

3.3.2 Sales taxes for online retailers in Canada

Canadian online retailers charge their customers the GST or HST of the province where the shipment is being delivered. For example, if the online retailer is registered in Nova Scotia and its customer is in Ontario, the customer will pay Ontario's HST of 13%. An exception applies when the customer and the online retailer are in the same province. In this scenario the online retailer charges the customer GST and PST. If the province harmonised its sales tax then the online retailer will charge the customer HST.

3.3.3 Selling online to customers outside Canada

If the customer's shipping address is outside Canada then no sales taxes apply to the product price or shipping rate. In 2014, the OECD released a draft discussion paper outlining recommendations for collecting sales taxes by non-resident vendors.[37] The paper endorses a simplified registration and compliance regime for non-resident suppliers. Put simply this refers to registration of online retailers selling to customers outside their own tax jurisdiction.

[35] http://canadaonline.about.com/od/money/a/sales-tax-rates-canada.htm
[36] The CRA administers tax laws for the Government of Canada.
[37] OECD(2014) *Guidelines on place of Taxation for Business-to-Consumer supplies of services and Intangibles*: http://www.oecd.org/ctp/consumption/discussion-draft-oecd-international-vat-gst-guidelines.pdf

4 Concluding remarks

As section 1 explains, there is a proliferation of internet use and the associated rise in online retail transactions has contributed to the transformation of the retail sector in NI and beyond. Some traditional, bricks and mortar retailers view the rise in online retailing as a threat to their existing markets.

The system for charging non-domestic rates in NI appears to favour the online retailer at the expense of their bricks and mortar counterparts. For example, the online retailer is not tied physically to the market they serve and can choose any distribution centre or warehouse across the UK to hold their stock. Consequently an online retailer can choose a distribution centre or warehouse located in the cheapest non-domestic rates area.

Another commercial advantage for online retailer is their ability to adopt modern retail distribution techniques - such as *drop-shipping* and *just-in-time* – which limit the amount of physical space needed to store their goods. In effect, this can reduce their non-domestic rate bills, as smaller commercial properties tend to attract a lower rateable value.

Generally speaking online retailers will have some form of storage or dedicated building, such as a warehouse, and as such they will be liable for non-domestic rates on these properties. In NI, there appears to be a perception amongst bricks and mortar retailers that online retailers often operate distribution or warehouse facilities from their own domestic dwellings, for example their garages, and thereby avoid the non-domestic rating system.

This scenario of *mixed use* property poses challenges for policy makers in NI and adds a level of complexity for valuers attempting to assess rateable value. (This is seen elsewhere, for example in GB.) In NI, the LPS have said that if there is a mix of commercial and domestic use within a building, then generally, the commercial use is not valued. However, the LPS also state that this scenario is not straightforward and each case should be assessed in light of the individual circumstances.

The UK Government are currently conducting a review into non-domestic rates. The review is due to be completed by the end of 2016. The BIS Select Committee suggested that the UK Government look at implementing an online retail sales tax to level the playing field between online retailers and traditional, bricks and mortar retailers.

The UK Government appear to have rejected this. In its view, the introduction of a new sales tax alongside VAT would amount to double taxation. It also views the introduction of a sales tax as administratively complex and more expensive than the current system of taxing online retail *via* the non-domestic rating system.

Retail sales taxes are already in place in the US and Canada. However, the introduction of online sales taxes for online transactions outside the home state and federal jurisdictions has also been mooted, mainly by the bricks and mortar lobby. However, the cost of implementing any of the proposed changes has been highlighted as potentially cost prohibitive.

The value of internet sales as a proportion of total retail sales appear to be rising across the world, e.g., rising in the UK from 2.7% to 11% in the period from January 2007 to 2013. Moreover, in December 2013, average weekly internet sales peaked at 8.1 billion in the UK.[38] Given these trends, legislators in NI need to ensure they consider all the pros and cons when legislating to tax online retailers, e.g. increasing revenue streams versus discouraging growth in the sector, weighing up which is best for NI.

[38] House of Commons Library (2014) *The retail industry: statistics and policy*: http://www.parliament.uk/Templates/BriefingPapers/Pages/BPPdfDownload.aspx?bp-id=sn06186