

# Understanding the value of tax free shopping to destination economies

01/17

## Study No 1: The United Kingdom





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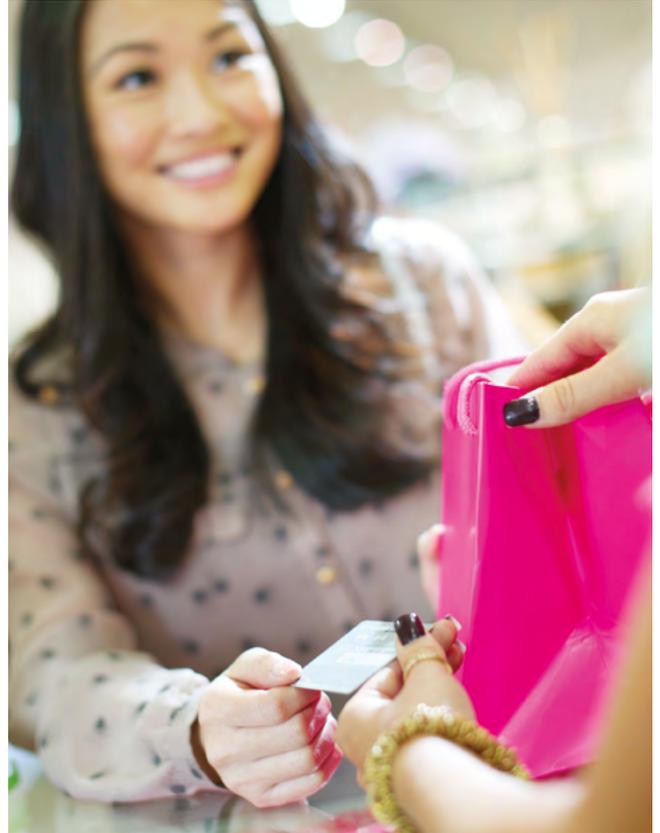
# Foreword

## Tax Free Shopping Impact Research

Global Blue has commissioned CEBR to undertake research into the value of tax free shopping to a country's economy and exchequer, using the United Kingdom as an example.

The research shows a clear benefit to the UK's economy and the HM Treasury from the country's tax free shopping scheme.

We believe that tax free shopping will show similar benefits to other countries although the extent of the benefit will vary according to the specific conditions of each economy.



### Global Blue

Global Blue was created in 1980 when we introduced the concept of TFS shopping now 36 years on, we have become the worldwide leader and expert in VAT Refunds. Our company has unrivalled experience in tourism shopping and is a reliable partner for more than 40 governments around the world.

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### Cebr

Cebr is a leading economics consultancy based in London. It was founded in 1992 and is prominent in research across a number of sectors including finance, tech, property, transport and tourism. It is also the leading economics expert on UK retail, running the ASDA Disposable Income Survey and the Cebr/Yougov Consumer Confidence survey.

[www.cebr.com](http://www.cebr.com)

# Executive Summary

- This is a study of the economic impact in the UK from the scheme whereby international visitors from outside the EU can reclaim VAT on purchases above a certain amount. The report shows that the impact of the VAT reclaim scheme is positive for the economy.
- The report estimates that VAT of £466 million was reclaimed on sales of £2,798 million in 2016.
- We estimate that the impact of Tax Free Shopping is to boost the number of visitors to the UK by 7.3% of the total number of non EU visitors; a total of 893,000. This is equal to a 2.4% increase in the total number of visitors.
- We assume that the number of additional visitors ceteris paribus would increase spending by 2.4%, not taking account of any additional spending per visitor. This amounts to £606 million additional spending.
- Using OBR estimates of the sensitivity of overall spending to VAT changes, which are probably on the low side for the impact on Tax Free shoppers, we calculate that the impact of Tax free is to increase the amount of spending per visitor by £21.8 for each non EU visitor creating a total increase in spending from this source of £265 million
- The total increase in spending resulting from Tax free is therefore £606+265 millions = £871 millions.
- After taking account of the indirect effects, GVA (Gross Value Added) in the economy is boosted by £1.3 billions.
- We have used the analysis of direct and indirect effects to estimate the number of jobs that depend on Tax free. Our analysis suggests that 20,800 jobs depend on the Tax free sector.
- The theoretical loss of revenue from Tax Free is the £466 millions of VAT reclaimed. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that are paid as a result of the direct and the indirect effects of the expenditure.
- In total these amount to £605 million. In other words, for every £1 rebated in Tax Free, the government gains £1.30 in return.
- We have also recalculated the impact of Tax Free using the elasticity of 1.3 often used for tourism price sensitivity. This calculation suggests a direct total increase in spending resulting from Tax Free is therefore £1,305 millions rather than the £871 millions calculated using the lower elasticity. The impact on value add or GDP is £1.992 billions rather than £1.330 billions. The impact on jobs is 32,000 rather than 20,820. The impact on tax receipts is £906 millions rather than £604 millions, giving a tax multiplier of 1.96 times as much additional revenue gained as a multiple of the revenue directly lost from Tax Free.

# 1. The system of tax free shopping in the UK

## 1.1 Introduction

If you are a visitor to an EU Member State from outside the EU, then under the EU VAT guidelines you are entitled in certain circumstances to reclaim VAT paid on goods purchased within the EU<sup>1</sup>. As (still) an EU Member State the UK participates in this scheme and is likely to continue to do so (indeed when the terms of the UK's departure from the EU are finalised, it may be that the scheme will be extended to not only visitors from outside the EU but also those from the EU as well).

## 1.2 The UK system

The UK system for VAT reclaims is set out in VAT notice 704/1, Tax Free Shopping in the UK<sup>2</sup>. This sets out the specific rules that operate in the UK.

The scheme is restricted to eligible persons; to particular goods (not services); and to those following the appropriate procedures.

### Eligible persons

Those eligible to use the scheme are:

- 1) Overseas visitors if their home is outside the EU and if they plan to take the goods outside the EU within 3 months of purchasing the good;
- 2) Overseas students and workers studying or working in the UK (again provided that they plan to take the goods out of the UK within 3 months); and
- 3) residents of the EU who will be staying outside the EU for the next twelve months who will take the goods out of the EU within 3 months.

### Eligible goods

Eligible goods are all goods on which VAT has been paid except:

- 1) Those used or partly used in the EU (examples given are perfume and chocolates);
- 2) Motor vehicles or boats;
- 3) Goods over £600 in value that will be exported for business purposes (these are subject to VAT relief under a different system)
- 4) Goods that will be exported as freight or goods that need an export license (except antiques)
- 5) Unmounted gemstones and bullion (over 125 grammes)
- 6) Mail order goods including internet sales
- 7) Services eg hotel bills

### Eligible transactions

For the transaction to be eligible it generally has to be over a minimum amount to justify the administration. The shopper has to be physically present when the purchase is made, should inform the person making the sale and must collect the relevant reclaim form at this time so that it can be stamped and must present the form to customs when leaving the country before being returned to the shop from which the good was purchased for the refund. This is best handled through an agent with experience in this sector of whom Global Blue is the market leader.

<sup>1</sup> [https://ec.europa.eu/taxation\\_customs/individuals/travelling/travellers-leaving-eu/guide-vat-refund-visitors-eu\\_en](https://ec.europa.eu/taxation_customs/individuals/travelling/travellers-leaving-eu/guide-vat-refund-visitors-eu_en)

<sup>2</sup> <https://www.gov.uk/government/publications/vat-notice-7041-tax-free-shopping-in-the-uk/vat-notice-7041-tax-free-shopping-in-the-uk>

### 1.3 The scale of the system

Cebr has used its contacts in the sector to make estimates of the scale of operation of the system for international VAT reclaims.

Our estimate of the amount of purchases in the UK on which the international reclaim scheme takes place is shown in Table 1. Our estimates are based on confidential data from participants in the market of duty reclaimed through them; scaled up to take account of the other participants in the market. Visit Britain's shopping research<sup>3</sup> shows total UK shopping spend from all visitors of £5.5 billions in 2014. This seems low given the scale of purchases on which VAT is reclaimed but since it comes from a survey there is scope for error. Although the number seems low, since the calculations in this report are based on the estimates from our confidential data from the participants, it does not affect any of the subsequent calculations.

<sup>3</sup> <https://www.visitbritain.org/shopping>

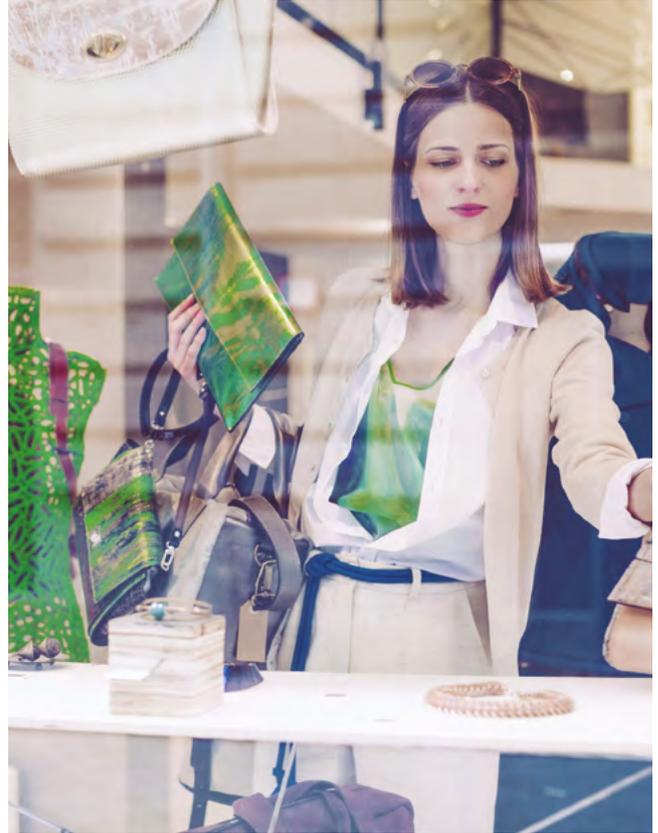


Table 1  
Scale of purchases in the UK on which international VAT reclaims are made

	2014	2015	2016
Purchases on which VAT reclaimed £ millions	2389	2445	2798

Table 2  
Amount of VAT reclaimed by international travellers

	2014	2015	2016
VAT reclaimed £ millions	398	407	466

# 2. Methodology

## 2.1 Introduction

This section describes how Cebr has calculated the economic impact of the VAT reclaim system.

## 2.2 Methodology

Our aim is to measure four items:

- 1) Impact of Tax free shopping on number of inbound tourists to the UK
- 2) Impact of Tax free shopping on average spend per tourist
- 3) Economic Impact of Tax free shopping
- 4) Fiscal impact of Tax free shopping

Once we have measured these we can calculate the additional tourist spending that takes place as a result of Tax free shopping compared with the amount that would take place if Tax free shopping were not available.

We then run this through our economic impact model which measures how these changes flow through the economy in different sectors and how they multiply through the economy.

## 2.3 Impact on the number of tourists

We measure the impact on the number of tourists by translating the impact of Tax free into an assessed impact on the average cost of a visit to the UK for those tourists affected by it. We then multiply this by the elasticity of travel into the UK with respect to price. We do this by concentrating on those tourists (Non EU) who are affected by Tax

Free. We have used an elasticity of 1.3 for tourist numbers with respect to the average cost of a visit<sup>4</sup>. This is a conventional elasticity used for tourism and is (see footnote 4) the official elasticity quoted by the UK's Tourism Alliance.

## 2.4 Impact on the amount of spending per tourist

The impact on average spend can be calculated again by multiplying the effective impact on cost by the relevant elasticity. Cebr works with all the main retailers in the UK and is familiar with their internal assumptions about the sensitivity of spending to price.

## 2.5 Economic impact

Having calculated the direct impacts on tourism and on spending, we then calculate the indirect impacts. This is done using Cebr's Input Output Model which calculates, using ONS data, how spending in any part of the economy feeds through to the rest of the economy. These impacts are broken down by sector.

## 2.6 Fiscal impact

Having calculated the direct and indirect impacts, finally we calculate the fiscal impact again using Cebr's Input Output model. This works out the amount of tax (or government spending) that would be affected by these direct and indirect effects, taking all taxes into account like income tax, corporation tax, national insurance contributions and other taxes paid in the economy.

<sup>4</sup> Source: UK Tourism Statistics 2016, The Tourism Alliance Section 7 [http://www.tourismalliance.com/downloads/TA\\_390\\_415.pdf](http://www.tourismalliance.com/downloads/TA_390_415.pdf)



# 3. Results – the impact of Tax Free Shopping

## 3.1 Introduction

This section describes the direct impacts on tourism and spending of Tax Free Shopping. It compares the existing situation with a hypothetical situation called the Base Case where Tax Free Shopping did not exist.

## 3.2 Impact on the number of visitors

We estimate that in 2016 the UK had 37.5 million visitors of whom 12.2 million were from outside the <sup>5</sup>EU<sup>6</sup>. We also estimate that this will have led to spending of £25.4 billions, scaling up the official data from 2015 for our estimates of the increase in tourist numbers and spending since then<sup>7</sup>.

Shopping is one of the key reasons for international non EU visitors to visit the UK and their average spend is high as is reflected in the £2.8 billion of shopping on which VAT is reclaimed (compared with an estimated £6.4 billion spending on ALL shopping by ALL (including EU-based visitors) to the UK. It has been noted that the UK is one of the premier shopping destinations in the world<sup>8</sup>. Our calculations based on the amount of VAT reclaimed suggest that for non EU visitors 33.8% of their spend within

the UK is on tax free shopping<sup>9</sup>, reflecting the UK's premier position as an attractive destination for shopping, especially when it is tax free. We estimate that the impact of Tax Free shopping is to reduce the cost of a visit to the UK for non EU visitors (including money spent on shopping) by 5.6%. This calculation takes account of the cost of travel to the UK as well as the spending in the UK<sup>10</sup>.

We estimate that the impact of Tax Free Shopping is to boost the number of visitors to the UK by 7.3%. This is calculated by multiplying the 5.6% reduction in the cost of shopping from the paragraph above by the elasticity of 1.3 from Section 2.3 above) of the total number of non EU visitors; this gives a total of 893,000. This is equal to a 2.4% increase in the total number of visitors

## 3.3 Impact on total spending of the additional visitors

We assume that the number of additional visitors *ceteris paribus* would increase spending by 2.4%, not taking account of any additional spending per visitor. This amounts to £606 million additional spending using the data from the first line of Section 3.2.

<sup>5</sup> This may appear to have been a significant increase from the 2015 data but the evidence points to both a significant increase

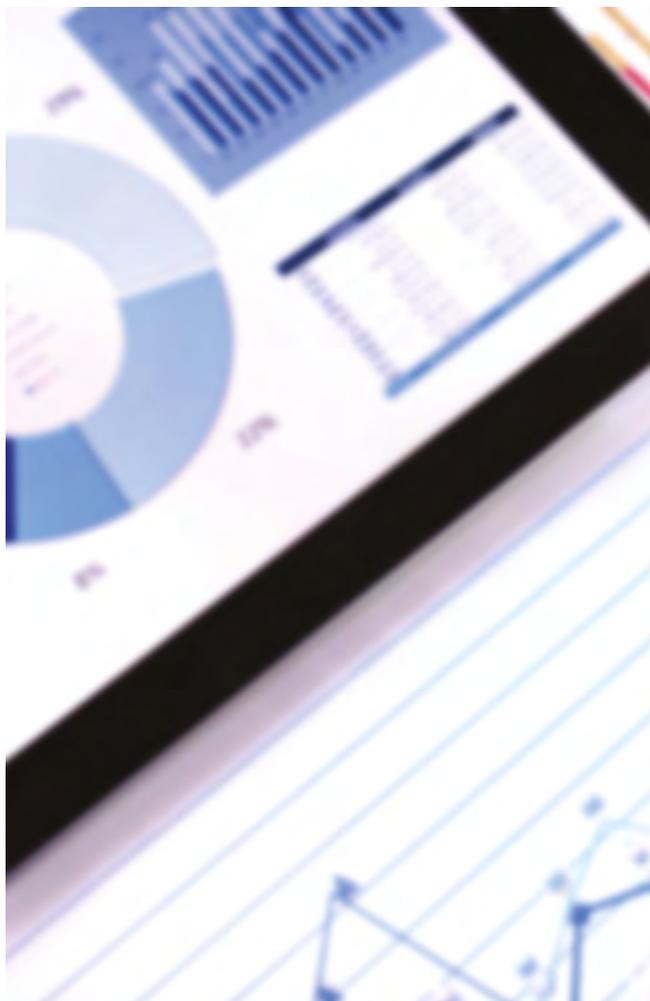
<sup>6</sup> Source ONS statistics for 2016 Qs 1-3; Cebr estimates for Q4

<sup>7</sup> This estimate reflects the large jump in tourism to the UK post the devaluation in sterling post Brexit. It appears (including from Global Blue's own data) that the increase in shopping in the UK has been even greater than the increase in visitor numbers.

<sup>8</sup> Global Blue's December 2016 Newsletter quotes 'global shoppers cement London's status as Europe's most affordable luxury shopping destination'

<sup>9</sup> This share looks high and might reflect the fact that the data comes from inconsistent sources. However, for the purposes of the calculation in the report it does not actually matter whether the real share is a lower share of a higher number. If this were so it would give the same overall result

<sup>10</sup> We have calculated the average savings from Tax Free and expressed this as a proportion of the total spend.



### 3.4 Impact on the average spending per visitor

This calculation is derived by working backwards from the OBR's calculation of the estimated impact of rises in VAT, it would appear that they assume an elasticity of spending volumes of around 0.5 with respect to VAT changes<sup>11</sup>. We have used the same figure to estimate the impact of Tax Free status for non EU visitors. This implies that Tax Free spending increases the amount of spending that would have taken place had the number of tourists remained the same by £265 million<sup>12</sup>.

This estimate is very much on the low side and in real life we suspect that the impact is noticeably greater (using an elasticity the same for that of the sensitivity of overall tourism – 1.3 – gives an impact of £699 billion). But the lower figure, even if an underestimate, is clearly more defensible.

### 3.5 Total increase in spending

The total increase in spending resulting from Tax Free is therefore the sum of the impact of the increased number of visitors and the increase in the spending per visitor. This is £606+265 millions = £871 millions.

<sup>11</sup>The OBR (Office for Budget Responsibility) is the official UK body charged with understanding the impact of fiscal changes. Its latest estimates which include the impact for changes in VAT are shown in this publication: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/571367/Nov16\\_Direct\\_effects\\_illustrative\\_tax\\_changes\\_bulletin\\_final.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/571367/Nov16_Direct_effects_illustrative_tax_changes_bulletin_final.pdf)

<sup>12</sup>Multiplying the percentage change in cost by the spending by the tourists concerned and then by the elasticity.

# 4. Results – economic and fiscal impacts on the UK economy

## 4.1 Introduction

This section describes Cebr's analysis of the economic impact of tourism and shows how the input output model thus derived is used to estimate the economic impact of Tax Free on the UK economy. Section 4.2 gives a brief description of how this was used for Cebr's report for the Association of British Travel Agents (ABTA) in July 2014 'Understanding the tourism and travel labour market'. Section 4.3 uses the analysis in the initial part of the Chapter to derive the indirect economic effects on the UK economy from Tax Free shopping. Section 4.4 shows the jobs impact and Section 4.5 uses the same analysis to derive the fiscal impacts on the UK economy. Section 4.6 recalculates this analysis assuming a higher elasticity of spending with respect to VAT.

## 4.2 The knock on effects of tourism

The travel and tourism industry, comprising portions of the many sectors set out in Section 1, is a significant contributor of employment for the UK labour market. Cebr's calculation for ABTA shows that in 2012 (see footnote <sup>13</sup>), tourism activity within the UK supported the employment of 1.7 million people, amounting to around 5.8% of total employment.

As well as the direct employment discussed above, the travel and tourism industry also has further employment impacts. For example, in the sectors which provide goods and services to the travel and tourism sector, there will be indirect employment sustained. This describes the additional employment within the sector's supply chain, which is dependent upon intermediate demand presented by the travel and tourism sector.

In order to quantify this indirect employment, we use Cebr's input-output models. These are used to calculate employment 'multipliers' for each of the

detailed industries in the ONS' supply-use tables. We first disaggregated the travel and tourism industry's FTE employment into its constituent SIC (Standard International Classification) 2007 sectors, before applying these SIC sectors' employment multipliers to these sub-totals. This allowed us to quantify how much additional employment is sustained within the travel and tourism industry's supply chain, as a result of the scale of direct employment. The results are dependent on these models, but we have great confidence in them as they have been used for a range of purposes and have not been challenged.

The outcome of this process was an employment multiplier of 1.51 – this implies that, for each 1 FTE employed within the travel and tourism industry, the employment of a further 0.51 FTEs is supported elsewhere in the economy, through the industry's interrelationships with other sectors. As such, the gross impact of this effect is therefore estimated at an additional 680,000 FTEs.

## 4.3 The impact by sector of Tax Free shopping

This section shows how the impact of Tax Free shopping impacts through the sectors through the mechanisms described above.

The direct impacts are those calculated in the previous chapter. These are then run through the Cebr Input Output model to show the indirect impact on the various sectors from the combination of the boost to tourism generally and the increase in shopping. We use the multiplier impacts calculated above to derive the effects.

Not surprisingly the biggest single impact is on manufacturing but it is interesting that the indirect impacts work their way through into every sector of the economy.

**Table 3**  
**Indirect impacts on value added produced by sector using Cebr Input Output model of the Economy**  
 (£ millions in 2016)

Agriculture etc	11
Mining	21
Manufacturing	198
Gas and Electricity	41
Other Utilities	15
Construction	103
Distribution	136
Transport	65
Hotels and Catering	45
Media, information and communication	73
Finance and insurance	109
Real Estate	106
Professional and scientific services	83
Business services	60
Public administration	71
Education	57
Health and care	98
Creative and sport	17
Clubs, personal services and other	15
Domestic services	3
<b>Total</b>	<b>1.330</b>

## 4.4 Jobs impact

We have used the analysis of direct and indirect effects to estimate the number of jobs that depend on Tax free. We have looked at the jobs impact by sector using the average ratio of jobs to value add for that sector and multiplying by the value add figures in Table 3 above. Our analysis suggests that 20,820 jobs depend on the Tax free sector based on this model.

## 4.5 Fiscal impact

This section looks at the total taxation impact from Tax Free. It may seem perverse that a tax relief generates additional revenue but this is because the extra economic activity that is generated causes additional tax revenues for the economy. Tax Free drives increased tourism AND increased spending, both of which have multiplier effects and the impacts of these offset the direct loss of tax.

The theoretical loss of revenue from Tax Free is the £466 millions of VAT reclaimed from Table 2. But this is offset by the income taxes, national insurance, indirect taxes, corporate taxes and rates that are paid as a result of the direct and the indirect effects of the expenditure. In total these amount to £604 million, calculated using the model.

In other words, for every £1 rebated in Tax Free, the government gains £1.30 in return.

## 4.6 Using a higher multiplier

We have also redone the calculations above using the higher elasticity of 1.3 which is often used for tourist price sensitivity for the calculation on visitor shopping spend. Because there is no direct research on the impact of VAT for inbound tourists from outside the EU specifically it is hard to prove which number is nearest to being correct. It is quite likely however that the elasticity is at least 1, since it would be unlikely that tourists would spend significantly more in cash terms if VAT were applied to their spending.

This calculation using the 1.3 elasticity suggests the direct total increase in spending resulting from Tax Free is therefore £1,305 millions rather than the £871 millions calculated using the lower elasticity. The impact on value add or GDP is £1.992 billions rather than £1.330 billions.

The impact on jobs is 32,000 rather than 20,820. The impact on tax receipts is £906 millions rather than £604 millions, giving a tax multiplier of 1.96 times as much additional revenue gained as a multiple of the revenue directly lost from Tax Free.





# 5 Conclusion

The research shows clear benefits to the UK economy and HM Treasury from the Tax Free Shopping scheme. Tax Free Shopping increases non-EU visitor numbers to the UK by an estimated 893,000. Tax Free Shopping provides a clear boost to the UK economy and to HM Treasury, using both OBR VAT and general tourism assumptions for elasticities. Table 4 shows the range of estimated impacts.

Table 4  
Impact on economy from Tax Free Shopping

	OBR VAT sensitivity	Tourism elasticity
Spend by additional visitors	£606 million	£606 million
Increase in spending per visitor	£265 million	£699 million
Total increase spend	£871 million	£1,305 million
Impact on GVA	£1.3 billion	£1.99 billion
Jobs dependent	20,800	32,000
Impact on tax receipts	£604 million	£906 million
HMT multiple	1.33	1.99
Additional HMT tax take	£155 million	£447 million

#### Disclaimer

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#### Authorship and acknowledgements

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The report does not necessarily reflect the views of Global Blue

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