

VAT RES Scheme – Briefing on HMT’s Technical Note

HM Treasury has countered various arguments about the decision to end the VAT RES (and airside tax-free sales) by saying that extending the scheme to EU visitors would be too expensive and that removing it would have little impact on sales, jobs and tax revenue because the majority of refunds are low value and are unlikely to change the spending behaviour of current users .

On Friday October 9th HMT produced a Technical Note to explain the rationale behind the decision and support these assertions.

It is concerning that in just one and a half pages on the VAT RES there are at least six examples of where HMT’s assertions and understanding of the process can be proven, by evidence, to be wrong. This brings into question the validity of HMT’s case and, given the implications if its assumptions are wrong (up to 41,000 job losses and a loss of up to £680 million in tax revenue from ending the VAT RES according to the Cebr study) suggests that it is worth revisiting the decision.

1. The Treasury has got its costs wrong

The Government estimates that the cost of extending the existing scheme to EU visitors is £900 million.

HMT says in its Technical Note that there are 1.7 EU visitors for every 1 non-EU visitor and simply multiplies the £500m cost of the non-EU refunds by 1.7 to reach the £900 m figure.

But that assumes they spend the same amount of money. They don’t

VisitBritain states that in 2019 the 24.8 million EU visitors spent £10.6bn, just 60% of the £17.8bn spent by the 16 m non-EU visitors.

So the multiplier should be 0.6, not 1.7. This gives a cost of £300m, not £900m. An error of 300%

2. The Treasury has got its VAT RES user numbers wrong

In its Technical Note, HMT says that, because HMRC estimates 1.2 million refunds were made in 2019, the number of users of the scheme is 1.2 million. It is not. It is around 1.8 million

This is because refunds are not the same as users.

Only around two thirds of registered tax-free sales made are actually claimed as refunds. (This is mainly because the queues at Heathrow to reclaim are so long because HMRC has failed to digitalise the system, so that around a third of uses simply give up trying to claim their refunds).

So HMRC has underestimated the number of users of the scheme by around one third, 600,000, a significant error.

3. The Government hasn’t understood the difference between non-EU visitors and non-EU tourists

The VAT RES is a measure which adds to Britain’s attraction for international tourists when they are choosing where to visit.

The Government assumes that all 16 million non-EU visitors are tourists. They are not.

VisitBritain state that only 40% of the 16 million non-EU visitors to the UK are tourists.

The rest are either on business trips or visiting friends and relatives. The attraction for these groups are business, and friends and relatives, not tax free shopping.

By mistaking all international visitors as tourists, the Treasury makes the wrong conclusion about the level of use of the VAT RES scheme by its target market segment, tourists.

4. The Government severely underestimates ability of even small discounts to change spending behaviour.

HMT's Technical Note says that the low value of the majority of the discounts are insufficient to change visitor behaviour and that removing the VAT RES scheme won't effect the amount individuals spend on shopping.

But the Treasury is wrong. Evidence suggests that giving even a small discount does have a big impact on how much consumers spend.

The Treasury's own "Eat Out To Help Out" scheme showed that just a £10 discount dramatically effected the level of consumer spending.

The Treasury has significantly underestimated the behavioural change, even if the refund is low value.

5. The Treasury says that the VAT RES is unlikely to be a pull factor for visitors making higher value purchases

High spending visitors account for a disproportional amount of tax-free shopping.

20% of users are responsible for around 50% of all tax-free shopping.

Global Blue state that the highest 1% of spenders spend an average of £60,000 a year on tax free shopping, giving them a £12,000 discount.

This is more than enough to make them chose to shop in, say, Paris, that offers tax-free shopping, rather than London, which now will not.

And it's these super-spenders that spend much more on hotels, restaurants, culture and travel, all of which are taxed. Those sales and that tax revenue will be lost.

The Treasury has severely underestimated the behavioural change on these super-spenders and the impact on the wider economy of them choosing not to visit London to shop.

6. The Treasury misunderstands the nature of the job losses this policy will cause

Independent research predicts that up to 41,000 jobs throughout the UK will be lost as a result of abolishing tax-free shopping.

HMT's Technical Note responds to concerns about job losses by listing recent measures put in place to support jobs during the COVID-19 pandemic as a way of mitigating the impact on jobs of abolishing tax-free shopping.

But these job losses are nothing to do with COVID-19. They are the result of a structural change to the market which will made them unviable.

The Chancellor has specifically stated that these COVID-19 measures are not meant to support unviable jobs. So their inclusion in the Technical Note is wrong and irrelevant.

Interpretation of WTO rules

We also have legal advice that the Government's position in relation to WTO rules may have been interpreted too narrowly

The Technical Note states that under WTO rules the Government did not have the choice of maintaining the VAT RES as it is today.

Our informal legal opinion (Appendix A) suggests that this is not the case. It advises that:

- i) VAT RES/ ESC do not fall under the WTO "most favoured nation" principle
- ii) Even if they did, the Government could apply for (and is likely to be granted) a transitional regime that would enable the existing scheme to continue for one or more years, which would remove the pressure on the Government to address this issue by the end of this year.

Appendix A

Briefing Note on the WTO Rules and ESC in respect of HM Government's VAT Retail Export Scheme (VAT RES) and Airside VAT-Free Shopping Proposals

There are two main assertions that HMG have made in respect of the need to introduce change at this time and these are as follows:

- 1) On WTO requirements:
 - a. *"The differential treatment between non-EU and EU residents will not be possible on 1 January 2021 as it is not tenable as a long-term solution, nor would it be compliant with WTO rules which broadly require the government to treat goods carried by passengers bound for different destinations equally."* (Consultation Response, para 3.19) (In relation to the VAT RES Scheme);
 - b. *"[the extra-statutory concession providing for airside VAT-free shopping (the ESC)] is a costly tax relief to maintain, which would increase if extending it to the EU (which would be required under WTO rules)"* (Confidential Passenger OGD Briefing); and
- 2) *"Currently, tax-free sales to passengers travelling to non-EU countries are permitted under an HMRC extra statutory concession (ESC). The legal scope for such an ESC is very limited and the ESC for tax-free sales, as it stands, could not apply after the end of the transition period, nor could it be amended. ... HMRC will therefore remove the ESC for tax-free sales across the UK with effect from 1 January 2021."* (Consultation Response, para 3.25) (In relation to the Airside VAT Free Shopping Proposals).

Both these assertions are considered to be incorrect – they do not tally with responses received from engagement with those experienced in WTO policy, or established legal principles.

VAT RES/ESC – WTO requirements

WTO rules only arise if no deal is reached with the EU (effective on 1 Jan 2021); if a deal is reached, the approach to VAT RES/ESC will need to align to that agreement.

Regardless of the above position, it is considered that:

- HMG's reliance on a "broad" interpretation of WTO rules is misplaced;
- There is no obligation on the UK to abolish VAT RES/ESC to meet WTO rules; and
- HMG should revisit the legal underpinning of the options and the decision, as it has flexibility to adopt a domestically beneficial regime, including on a transitional basis.

VAT RES/ESC do not fall within the WTO "most favoured nation" (MFN) principle.

Even if MFN is applicable, the WTO enables a reasonable and proportionate transitional regime that facilitates international trade and discussions with related parties indicate that this would in any event fall within such a scenario.

The UK is not meaningfully exposed to any adverse determinative ruling on VAT RES in any event due to the time it would take for a determination against any transition period, the requirements for challenge and the current lack of a functioning dispute settlement system.

ESC

The assertion that the ESC could not apply after the end of the transition period and/or could not be amended is also misplaced.

- HMRC have a discretionary power to grant concessions in certain circumstances, and the current ESC providing airside VAT-free shopping for passengers travelling outside the EU is within the scope of that power;
- Retaining the airside ESC is also within the scope of HMRC's powers, so long as the underlying legislation remains as it stands; and
- If the underlying legislation changes (e.g. to permit VAT-free exports from the UK to the EU), HMRC could amend the airside ESC to reflect such changes – with a further legislative solution always possible in the long term.

HMRC have a wide discretion in maximising overall tax take within the practicalities of exercising their tax collection functions, and as such would be acting within their powers to retain/amend the ESC, as appropriate in the context of the underlying legislative framework. The statement that the ESC could not be retained or amended after the end of the transitional period, in particular given the concern around (potentially) unconsidered implications for tax collection arising out of the withdrawal of the ESC, is therefore misguided.