

Ensuring the robustness of HMT's case for abolishing the VAT RES and airside tax-free shopping

The international visitor sector is a major growth area and job creator for the UK economy

The international visitor sector is vital for Britain's recovery, growth and for job creation, generating £28.4bn annually and employing 452,000 people all across the UK¹.

It has grown by an average 6% pa in the last 10 years², outstripping the growth of the wider economy.

Much of this growth is driven by Chinese visitors, already the world's top spending travellers³, and with a huge potential for future expansion⁴.

Shopping is the key motivator for Chinese visitors⁵ and they are highly price-sensitive⁶. In 2019, Chinese visitors were just 5% of non-EU visitors to the UK⁷ but accounted for 32% of all UK tax-free spending.

Chinese visitor numbers are forecast to grow by 300% by 2030⁸ generating an additional £2.2 billion in tax-free sales annually⁹ and creating 48,500 new jobs¹⁰.

Cities such as Edinburgh and Manchester have opened direct flights to and from China and base much of their local growth strategy on increasing Chinese visitor numbers¹¹.

Tax-free shopping is also a major motivator for high spending Middle Eastern visitors, who account for 26% of UK tax-free shopping.¹²

Tax free shopping generates £3.5 bn sales annually¹³. It supports 70,000 retail jobs directly¹⁴. It also supports British manufacturers throughout the UK who use London as their international shop window¹⁵.

High spending visitors are responsible for a disproportionate level of tax-free shopping. 13% of international visitors are responsible for 42% of all tax-free shopping. For these visitors, the refund is way above average. The top 1% of spenders account for 20% of all tax-free shopping and spend an average of £60,000 each year on tax-free shopping. Their average £12,000 refund is a major motivator to their choice of destination.

¹ VisitBritain and ONS. Employment figures based on VisitBritain model for calculating tourist jobs supported by income.

² VisitBritain and ONS

³ UNWTO Global Barometer. Chinese visitors are the World's largest travel spenders at \$258 billion in 2018, nearly twice as much as the second biggest spenders (USA at \$135 bn)

⁴ China Outbound Tourism Research Institute

⁵ VisitBritain "Market and Trade Profile China" November 2019 "going shopping is the number one activity which most Chinese visits will feature"

⁶ Chinese elasticity is 3.4. When sterling fell by 18% following the Brexit referendum, Chinese spending increased by 79%

⁷ Chinese visitor numbers to the UK grew from under 200,000 in 2012 to over 800,000 in 2019 (+400%). They are 5% of the 16 million non-EU visitors

⁸ China Outbound Tourism Research Institute

⁹ Based on current spending level of £1.1 bn (32% of all UK tax-free shopping)

¹⁰ Based on BRC model for calculating retail jobs based on income

¹¹ Marketing Manchester and Edinburgh Tourism Action Group - China-Ready Initiative

¹² Global Blue data

¹³ Based on HMRC refunds (£500 million) with refunds representing 75% of tax-free shopping sales

¹⁴ Based on BRC model for calculating retail jobs based on income

¹⁵ Eg Burberry, in the North East; Mulberry in the South West; Church's shoes in Northampton; Johnston of Elgin in the Scottish Highlands

The Government has decided to end tax free shopping from January 1st 2021 rather than extend the scheme to EU visitors

The Government says that:

- extending the scheme to EU visitors will cost £900 million
- the average refund is not big enough to change visitor behaviour, both in choosing to visit the UK and on their level of spending when visiting, if tax-free shopping is removed.
- the scheme is focussed on London and does not support the regions.
- the USA doesn't have a national tax free shopping system but still attracts visitors

Business believes that ending tax free shopping will have a negative impact on the UK economy and jobs

Retail, tourism, travel and hospitality businesses across the UK, sectors already hardest hit by the COVID-19 pandemic, are united in their belief that ending tax-free shopping and airside tax free shopping will lead to:

- the Government's positioning of Global Britain, after leaving the EU, being undermined by becoming the only European country not to offer tax-free shopping.
- the cost of extending the scheme to the EU is far lower than HMT predicts.
- it's not the average refund that counts, it's the much larger refunds that attract high spending, price-sensitive international visitors who will either divert to other European destinations or spend less time and less money in the UK¹⁶.
- 20,000 of the 70,000 retail jobs supported by tax free shopping being lost¹⁷; 5,000 airside jobs lost¹⁸; 15,000 manufacturing jobs across the UK lost¹⁹.
- regional airports, some of which generate up to 50% of their income from retail operations, put at risk, losing vital regional infrastructure.
- many British brands manufacture in the regions and use London as their shop window.
- there is not national tax-free shopping in the USA because sales taxes are state taxes. Many tourist states offer tax-free shopping or have no or very low sales taxes²⁰

Businesses believe that the Government has overestimated the cost of extending the scheme to EU visitors and underestimated the negative impact, across all the UK, of ending the scheme.

The need to get the policy right

Given the difference in opinion between HM Treasury and business and the potential impact on this vital sector of the economy and on jobs, it is important to examine the Treasury's case to ensure it is robust.

Businesses are already making plans regarding jobs and investment and are factoring-in the negative impact of this structural change to the UK's international visitor market.

The following ten questions are designed to test the robustness of HMT's case.

¹⁶ International travellers visit an average 2.6 European countries per trip. 42% of tax-free shopping is done by just 13% of international visitors (Global Blue figures). These high spenders spend disproportionately more on other (taxed) goods and services which will be lost.

¹⁷ Based on Cebr most conservative modelling, 28% of retail jobs directly related to tax free shopping

¹⁸ Based on Airport Operators' Association estimates

¹⁹ Based on Walpole estimate of up to 25% of 60,000 manufacturing jobs in relevant sectors.

²⁰ New York sales tax is less than half UK VAT. Florida has no sales tax so shopping is tax free.

Ten questions to test the robustness of the HMT position

Please could HMT provide responses to the following ten questions?

Cost of extending the VAT RES scheme to EU visitors

The Chancellor has said that the cost of extending the scheme to EU visitors will be £900 m

The HMT Technical Note states that:

“In 2019, HMRC estimate VAT RES refunds cost around £0.5bn for around 1.2m non-EU visitors at UK exit points. In 2019 the ONS estimate there were 1.7 EU passengers (24.8m) for every non-EU passenger (16.0m) to the UK. This implies an extension to the EU could significantly increase the cost of the scheme by up to an estimated £0.9bn”

Question 1: How does HMT justify its assertion that 24.8m/16 m is 1.7?

Reason for asking the question: $24.8m/16m$ is 1.55. This produces a cost of £775m, £125m less than the HMT estimated £900m

Question 2: Why does HMT only include relative visitor numbers but not relative visitor spending?

Reason for asking the question: Business believes that any prediction of costs must include the relative spending of EU and non-EU visitors. They do not spend the same

- As HMT stated in its Technical Note, the 24.8 m EU visitors spend £10.6 bn while the 16 m non-EU visitors spend £17.8 bn. With Non-EU visitors spending an average of £1,112 and EU visitors spending £427, each EU visitor spend is just 38% of non-EU visitor spend
- So, the predicted cost is not (£500 m x 1.7 = £900 m) it is (£500 m x 1.55 x 0.38 = £294 m), three times lower than the HMT estimate

Furthermore, industry sales data show that EU visitors spend very little on shopping and are responsible for only 10% of total international visitor shopping spend. This suggests that the true cost to HMT of extending the scheme to EU visitors is only around £50 m (£500 m x 0.1 = £50 m), not £900m.

Impact – user numbers

The HMT Technical Note states:

“In 2019 the HMRC estimate VAT RES refunds cost around £0.5 bn for around 1.2 m non-EU visitors at UK exit points..... Based on ONS passenger estimates and the 1.2 m visitors who use the VAT RES in 2019, HMRC estimate that fewer than one in ten (8%) non-EU visitors use the VAT RES”

Question 3: Why does HMT believe that the number of VAT RES refunds is the same as the number of VAT RES users?

Reason for asking the question: 1.2 m (8%) is the number of VAT refunds made, not the number of users. The number of users is around 4.8 m, 30% of all non-EU visitors

1.6 m sales are made but only 75% of sales are refunded (1.2 m), due partly to the difficulty in reclaiming at Heathrow because the validation system is not digitalised.

HMT assumes that visitors all travel as individuals. That is not true. Most visitors travel in groups (average 3) so the actual number of users is $3 \times 1.6 \text{ m} = 4.8 \text{ m}$ (30%).

As an example, when HMT counted the number of users of its “Eat Out to Help Out” scheme, if one person paid the bill for a group, did HMT count that group as one user or did it count everyone in that group as users?

The reason why this is important is because HMT use this 1.2 m user number to question the validity of the Cebr report which predicted that abolition would lead to 1.16 m fewer visitors (only around 8% of non-EU visitors). HMT says that it is not credible that 1.16 m of 1.2 m users of the scheme would no longer visit the UK. But the actual user number is 4.8 m, so 1.16 m is just 24% of users, a credible prediction.

The Cebr report predicts that 92% of existing non-EU visitors will still come to the UK. Many non-EU international visitors come to visit family and friends rather than as tourists (e.g. those from India and other commonwealth countries) and tax-free shopping is not a major motivator. But the 8% predicted fall in non-EU visitor numbers includes high spenders from China and the Middle East and therefore this will have a disproportionately negative impact on the UK economy.²¹

Impact- UK wide benefits

In its Mythbuster Note HMT stated:

“The benefit from the VAT RES flows almost entirely (c90%) to just two places: Central London (80%, West End and Knightsbridge) and Bicester Village (10%). This is not levelling up.”

Question 4: Do the responses from Edinburgh, Manchester, Birmingham, and the North West to the decision to end tax-free shopping support or refute HMT’s assertion that tax free shopping does not help regional economies and growth?²²

Reason for the question: the HMT statement does not seem to take account of the impact of tax-free shopping on regional economies. Edinburgh, Manchester, Glasgow, Liverpool, Leeds and Birmingham generate over £225 million of tax-free sales for their local economies, as well as the indirect increases in other visitor spending.

Question 5: What assessment has HMT made of predicted manufacturing jobs losses from British businesses that use London as their global shop window and rely on tax free shopping?

Reason for the question: HMT does not seem to have taken account of the fact that London is the global shop window for British brands that manufacture their goods all around the country. Burberry, in the

²¹ VisitBritain states that, in 2019, 883,000 Chinese visitors spent £1.71 bn but 692,000 Indian visitors spent just £752 m

²² Marketing Manchester - “The visitor economy of Greater Manchester, which secures over 100,000 jobs, will be dealt a hammer-blow by this decision.”

Birmingham Chamber of Commerce - “The abolition of the VAT Retail Scheme would be a major blow to our visitor economy. The proposal to remove the tax-free shopping scheme undermines a central pillar of Government policy – notably the desire to ‘level up’ the country and bring prosperity to all four corners of the country.”

The North West Business Leadership Team - “Tax free shopping is not just a stimulus for us as an international retail destination. It is a crucial part of our visitor economy offer.”

Essential Edinburgh - “Tax-free shopping is fundamentally crucial for Edinburgh city centre. On top of the existing challenges, the loss of tax-free shopping would be catastrophic for the city”

North East; Mulberry in the South West; Church's' shoes in Northampton; Johnstons of Elgin in the Scottish Highlands. Up to 15,000 manufacturing jobs outside London are likely to be lost.²³

Impact – shopping as a motivator for international visitors

HMT's Mythbuster Note says:

"Tourists visit the UK for a number of reasons, with the key motivator being cultural attractions. Tax-free shopping does not even make the list of reasons for visiting GB."

Baroness Penn, responding for the Government, made the same point, using the same VisitBritain report, in response to a Question to Lord Vaizey in the House of Lords on October 20th 2020.

Question 6: Did HMT officials tell ministers that the survey they are referring to contains a list of 24 potential motivators which did not include shopping, so that shopping was not an option for responders to choose?

Question 7: Did HMT officials tell ministers that the same VisitBritain report, two pages later, cited the International Passenger Survey where 23% of holiday visitors said that they were motivated by shopping (including EU visitors who cannot use tax-free shopping) and that shopping was a motivational factor for 51% of visitors from Saudi Arabia and 41% of visitors from the UAE?²⁴

Reason for asking the question: Businesses believe that selective use of this report does not present Ministers with a true picture of the importance of shopping as a motivator for international visitors.

Impact – Ship and Shop option

HMT's Technical Note says:

"Visitors will still be able to purchase items VAT-free if retailers ship them direct to visitors' overseas addresses. This "Shop and Ship" arrangement will also be available to EU residents from 1 January 2021"

In its responses to media enquires, HMT consistently states that the "Shop and Ship" scheme is an alternative to the VAT RES.

Question 8: If the Shop and Ship arrangement is an alternative to the VAT RES, what is HMT's estimate of the cost of VAT refunds for the scheme and how has this been included in the cost/benefit analysis of abolishing the VAT RES and airside tax-free shopping?

Reason for the question: If Shop and Ship is a real alternative to the tax-free shopping schemes, then any saving HMT predicts from abolishing tax-free shopping will not be made. If HMT have predicted a lower level of VAT refunds, then the scheme should not be being promoted as an equivalent alternative.

Impact - behaviour change

HMT states that there will be no behaviour change, either in choosing to visit the UK or spend on shopping, when a 20% tax on shopping is introduced in the UK, but not in any other European country.

Question 9: what price elasticity has HMT used to assess the impact on Chinese shopper behaviour of increasing the cost of goods by 20%?

²³ Based on Walpole estimate of up to 25% of 60,000 manufacturing jobs in relevant sectors.

²⁴ VisitBritain Research and Planning - Foresight – issue 150. Q6 survey is on page 30. Q 7 survey is on p32

Reason for the question: Chinese (and other) visitors do not factor the specific savings from tax-free shopping into their planning when choosing a destination. Instead, the principle of tax-free shopping in itself is an additional motivator for their choice.

All evidence suggests that high spending visitors, particularly from China and the Middle East, are very price-sensitive. Retailers report that when they offer a 20% discount on goods, sales rise by between 32-40%. The VAT RES effectively offers a 20% discount on displayed prices so businesses expect that removing that discount would see sales drop by between 32-40%. HMT appear to believe that removing that 20% discount will have no impact on consumer behaviour, which is not borne out by any of the evidence.

Businesses believe that ending tax-free shopping will distort spending, with a significant element of Chinese and Middle Eastern spending diverted from the UK economy to European countries. This will impact on income, jobs and tax revenues.

Impact – airside tax-free shopping

HMRC estimate that around £150 million of VAT is not charged as a result of tax-free airside sales. It says that extending the relief to the EU would significantly increase the cost and result deadweight loss by subsidising spending from EU-bound passengers which already happens.

Question 10: What assessment has the Treasury made of a) any potential reduction in economic activity in the UK from non-EU passengers by withdrawing the airside tax-free concession from them, and b) any potential loss of new economic activity in the UK from EU passengers as a result of extending the airside tax-free concession?

Reason for the question: it is important to understand whether any predicted benefit of retaining and extending the scheme will outweigh any potential “deadweight loss”. The missed opportunity of not extending to EU passengers alone is predicted to be of greater value than £150m. This is in addition to any reduction in economic activity from non-EU passengers, and the resulting job losses and potential store closures.