

Tax-Free Shopping Briefing, December 2020

Following concerns expressed by the Office for Budget Responsibility about the assumptions and figures used by HMT when determining to end tax-free shopping, The Chairman of the Treasury Select Committee has called on the Chancellor to undertake a comprehensive, independent assessment of the impact of this decision.

Business believes that the overall impact of ending tax-free shopping on the spending by international visitors will result in a net loss to the Exchequer and 40,000 redundancies over and above COVID-19 job losses.

Given this level of uncertainty and clear disagreement over the figures and impact, we support the Treasury Select Committee's call for a comprehensive, independent assessment to be undertaken.

1. Politicians of all parties and businesses are calling for a comprehensive, independent assessment into the impact of ending the VAT RES and airside tax-free shopping (ESC) following concerns expressed by the OBR over the Treasury's costings

1.1 The independent Office for Budget Responsibility told the Treasury Select Committee on December 1st that it had grave doubts about the Treasury's assessment of the revenue benefits of ending tax-free shopping. The OBR said that:

- it had given the policy its highest possible uncertainty rating
- it had no confidence in any specific numbers
- HMRC had no data of its own on the cost of the VAT RES
- HMT was wrong to assume that introducing a 20% tax would have no impact on visitor behaviour
- it had assumed a price elasticity of 1.9 (i.e. if the price goes up by 20%, sales would fall by 38%) but was not certain whether this was high enough. ¹
- it had not looked at the knock-on impact on associated sectors, such as hotels, or taken into account any falls in VAT revenue from fewer and shorter trips

1.2 Given all this uncertainty, there is a real risk that a fall in retail sales combined with a loss of VAT from lower spending in hotels, restaurants, travel, etc could turn HMT's predicted increase in VAT revenue into a significant loss for the Exchequer.²

1.3 Businesses are also warning of 40,000 job losses in retail, hospitality and manufacturing across the UK, as a direct result of the Chancellor's policy.

1.4 The Chairman of the Treasury Select Committee has called on the Chancellor to undertake a comprehensive and detailed assessment of the tax-free shopping scheme to test the robustness of the Treasury's case for ending it. The low level of international visitors in early 2021 gives an ideal opportunity to do this and will not impact on Treasury forecast.

¹ Note -retail sales data show that the price elasticity for Chinese shoppers, who form 32% of all tax-free shoppers, is much higher at over 3, meaning a sales fall of 60% as a result of this 20% tourism tax

² In 2019 the 16 million non-EU visitors spent £3bn on tax-free shopping and 14.6bn on all other goods and services (worth £2.9 bn in VAT)

- 1.5 He is supported in this call for a full impact assessment by leaders of the retail, hospitality and tourism sectors, Conservative MPs and the main opposition parties.
- 1.6 In light of the OBR's lack of confidence in any specific numbers and the overwhelming concerns of business throughout Britain about the damage this move will do the tax income, jobs and business growth, we urge the government to undertake this comprehensive, independent assessment to test the robustness of HMT's case.

2. Why a comprehensive, independent assessment is needed - examples of issues where industry believes the Government's rational and costings are seriously wrong

- 2.1 Business, with decades of experience of managing the tax-free shopping schemes and understanding the behaviour of their international shoppers, have pointed out many flaws in the Treasury's case. Here are just four examples of serious disagreements which show why a comprehensive, independent assessment is required:
- 2.2 Example 1 - HMT says that only 8% of non-EU visitors (1.2m) use tax-free shopping. Industry says 1.2m is the number of refunds made, not the number of users. Industry says there are around 4.8m users (30% of non-EU visitors). This is because only 75% of the 1.6m registered tax-free sales are actually refunded and because most international visitors travel in groups (average size 3) not alone, as HMT assumes.
- 2.3 Example 2 - HMT's prediction of VAT revenue raised for the Exchequer by ending tax free shopping is unrealistically high. HMT assumes price elasticity of zero (i.e. that adding a 20% tourist tax will make no difference to consumer spending behaviour) and predicts it will collect £500 million of VAT, exactly the same amount refunded by the tax-free shopping scheme in 2019. The OBR was clear that this was unrealistic and assumed a price elasticity of 1.9 (i.e. if the price rises by 20%, sales will fall by 38%). But business has years of sales data which shows that for Chinese shoppers, who account for over 30% of all UK tax free shopping, price elasticity is over 3 (i.e. the 20% tax will lead to a fall in spending of over 60%+).
- 2.4 Example 3 - HMT says that visitors can still use its "shop and ship" option. Industry says the scheme is not popular, too expensive and most international visitors will instead use the tax-free shopping schemes of other European countries rather than spend in the UK.
- 2.5 Example 4 - HMT has estimated the cost of extending the scheme to EU visitors as £900 million. Industry says HMT has failed to take into account that EU visitors spend only one third as much as non-EU visitors.³ This reduces the predicted cost from £900m to less than £300m. And based on actual retailer sales data, EU visitors spend even less on shopping, just one tenth of non-EU visitors, cutting the cost to just £50 million.

3. Why it is so important to test 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

- 3.1 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 UK⁴.
- 3.2 It has grown by an average 6% pa in the last 10 years⁵, outstripping the growth of the wider economy.

³ ONS estimates, quoted in HMT's Technical Note

⁴ VisitBritain and ONS. Employment figures based on VisitBritain model for calculating tourist jobs supported by income.

⁵ VisitBritain and ONS

- 3.3 Much of this growth is driven by Chinese visitors, already the world's top spending travellers⁶, and with a huge potential for future expansion⁷.
- 3.4 Shopping is the key motivator for Chinese visitors⁸ and they are highly price-sensitive⁹. In 2019, Chinese visitors were just 5% of non-EU visitors to the UK¹⁰ but accounted for 32% of all UK tax-free spending.
- 3.5 Chinese visitor numbers globally are forecast to grow by 300% by 2030¹¹, potentially generating for the UK an additional £2.2 billion in tax-free sales annually¹² and creating 48,500 new jobs¹³.
- 3.6 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 numbers¹⁴.
- 3.7 Tax-free shopping is also a major motivator for high spending Middle Eastern visitors, who account for 26% of UK tax-free shopping.¹⁵
- 3.8 Tax free shopping generates £3.5 bn sales annually¹⁶. It supports 70,000 retail jobs directly¹⁷. It also supports British manufacturers throughout the UK who use London as their international shop window¹⁸.
- 3.9 High spending visitors are responsible for a disproportionate level of tax-free shopping. In 2019, just 13% of international visitors were responsible for 42% of all tax-free shopping. For these visitors, the refund is way above average and is a motivator in choosing whether to visit and shop in the UK. 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.

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

3.10 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

⁶ 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)

⁷ China Outbound Tourism Research Institute

⁸ VisitBritain "Market and Trade Profile China" November 2019 "going shopping is the number one activity which most Chinese visits will feature"

⁹ Chinese elasticity is 3.4. When sterling fell by 18% following the Brexit referendum, Chinese spending increased by 79%

¹⁰ 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

¹¹ China Outbound Tourism Research Institute

¹² Based on current spending level of £1.1 bn (32% of all UK tax-free shopping)

¹³ Based on BRC model for calculating retail jobs based on income

¹⁴ Marketing Manchester and Edinburgh Tourism Action Group - China-Ready Initiative

¹⁵ Global Blue data

¹⁶ Based on HMRC refunds (£500 million) with refunds representing 75% of tax-free shopping sales

¹⁷ Based on BRC model for calculating retail jobs based on income

¹⁸ Eg Burberry, in the North East; Mulberry in the South West; Church's shoes in Northampton; Johnston of Elgin in the Scottish Highlands

Business believes that ending tax-free shopping will have a damage the UK economy and lead to 40,000 needless redundancies in retail, hospitality and manufacturing, over and above COVID-19 losses

3.11 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 UK¹⁹.
- 20,000 of the 70,000 retail jobs supported by tax free shopping being lost²⁰; 5,000 airside jobs lost²¹; 15,000 manufacturing jobs across the UK lost²².
- 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 taxes²³

3.12 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

3.13 Given the difference in opinion between HM Treasury, OBR 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.

3.14 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.

3.15 This is why we support the call by the Chairman of the Treasury Select Committee for a comprehensive, independent assessment of this policy

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¹⁹ 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.

²⁰ Based on Cebr most conservative modelling, 28% of retail jobs directly related to tax free shopping

²¹ Based on Airport Operators' Association estimates

²² Based on Walpole estimate of up to 25% of 60,000 manufacturing jobs in relevant sectors.

²³ New York sales tax is less than half UK VAT. Florida has no sales tax so shopping is tax free.