

The fiscal impact of tax-free shopping on the Exchequer

Examining HMT's estimate of the deadweight of lost VAT if tax-free shopping is reintroduced

1. The case for reviewing Treasury forecast of the cost of tax-free shopping

- 1.1 The Chancellor has been clear that if he is to consider reinstating tax-free shopping, the fiscal impact on the Exchequer must not be negative. HMT is concerned that the deadweight of lost VAT will result in a net negative to the Exchequer which it estimates would be £2.5bn annually, based on its original 2020 forecast.
- 1.2 The future of tax-free shopping was part of the wider Brexit programme. This made it particularly difficult for the Treasury because this period coincided with the 2020 COVID lockdowns which halted all international travel. Forecasts on the impact of tax-free shopping depend heavily on the behaviour of international travellers in response to ending or extending tax-free shopping and there was limited data for the Treasury to use at that particular time. The Treasury was also under great pressure, not just to focus on steering the UK through the pandemic, but also to identify areas for potential savings as the pandemic created the need for unprecedented levels of government spending.
- 1.3 As the pandemic receded, the immediate pressure on the government lessened and international travel started to return in 2022. So there is now the opportunity to review and refine initial forecasts based on the growing body of data on international visitor behaviour and spending levels.
- 1.4 This submission, based on evidence of actual spending levels in 2022 and 2023, suggest that:
- ***The level of deadweight will be £525m, just 21% of HMT's £2.5bn forecast***
 - ***The level of additional VAT generated as a result of increased EU visitor numbers and spending is estimated to be around £1bn and so this results in a net positive fiscal impact of £475m+ in VAT receipts alone.***
 - ***The net positive fiscal impact is significantly enhanced when the indirect impact on the economy is included, estimated to be £3.8bn pa.¹***

2. HMT's forecasts of the deadweight cost of tax-free shopping

- 2.1 HMT's original forecast were made on the assumption that tax-free shopping has little or no impact on the behaviour of international travellers, either in choosing to visit the UK or in their level of spending².
- 2.2 Based on this assumption, HMT forecast in 2020 that ending tax-free shopping (the VAT RES) for non-EU visitors would result in little or no fall in spending levels and HMT's original forecast showed a fiscal benefit to the Exchequer of £500m VAT, exactly the same amount as was refunded in 2019.

¹ All the evidence of actual spending levels of non-EU visitors in 2019 and 2022 used in this paper are from AIR's November 2023 impact evidence submitted to HMT. You can see this [here](#)

² E.g. The Exchequer Secretary's answer to a WPQ on February 25th 2023 "..... withdrawing the scheme would raise a significant amount of revenue and have a limited behavioural effect on decisions to visit, or spend, in the UK."

- 2.3 The Treasury then used this £500m figure to estimate the cost of extending tax-free shopping to EU visitors mainly by multiplying it by the ratio of non-EU to EU visitor numbers (1:1.7) to give an estimate VAT refund cost of £900m.³ While the HMT Technical Note says that the cost is “up to £900m”, the £900m figure has been used as the basis for all the Treasury’s calculations.
- 2.4 Because HMT believes that the VAT RES has no impact on visitor behaviour, HMT assumes that the £500m non-EU VAT refund figure and its estimated £900m EU VAT refund figure is the actual level of VAT that international visitors would otherwise have paid if there were no tax-free shopping. This is the Treasury’s deadweight forecast, as stated in the Technical Note.
- 2.5 This led HMT to forecast that the total net cost of the VAT RES, if extended to EU visitors, would be £1.4bn. This is the cost figure in the Technical Note and is used by Ministers to justify ending tax-free shopping.
- 2.6 In September 2022, the Growth Plan put a cost to restoring tax-free shopping of £2bn. Treasury officials told AIR at the time that the £2bn figure included the £1.4bn cost of the VAT RES plus the cost of VAT not charged on airside tax-free shopping. This figure was repeated by the current Chancellor when he cancelled this policy in November 2022 and was used by the Financial Secretary in the September 2023 Westminster Hall Debate.
- 2.7 In her response during the September 2023 Westminster Hall debate the Financial Secretary stated that the £2bn cost incorporated a range of factors.⁴ While she stated that the £2bn figure included changes to visitor numbers and behaviour, HMT has been clear that it believes there will be little or no behavioural change.
- 2.8 More recently the £2bn cost estimate has increased to £2.5bn. In February 2024 the Financial Secretary explained this as “updating that figure with the latest economic determinants.”
- 2.9 We believe that data of actual spending levels shows that the deadweight cost to the Exchequer in terms of refunded VAT is in reality around £525m in 2023/4 not £2.5bn. This is explained in the following sections.

3. Non-EU visitor deadweight level - Data on actual spending levels show that the deadweight cost of tax-free shopping for non-EU visitors is less than £500m at approximately £250m

- 3.1 We believe that the data on actual spending levels shows that the deadweight cost of tax-free shopping for non-EU visitors is significantly less than the £500m assumed in the 2020 forecast. The £500m is the actual level of VAT refunded through the VAT RES in 2019. Because HMT believes that tax-free shopping has little or no impact on visitor behaviour and spending levels, it assumes that non-EU shoppers would spend the same amount even if tax-free shopping was

³ HMT “[Technical Note on the VAT RES](#)” September 2020. “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. This would result in a large amount of deadweight loss by subsidising spending from EU visitors which already happens without a refund mechanism in place, potentially taking the total cost up to around £1.4bn per annum.”

⁴ Hansard September 7th 2023. “Tax-Free shopping for International Shoppers”. Financial Secretary “Let me try to reassure observers about the Treasury’s methodology. I know that the concern is raised that it does not properly account for an increase in visitors. I reiterate that the fiscal cost of £2 billion was made up not just of that factor, but of many other components. For example, the cost includes the VAT loss on purchases from EU and non-EU visitors. The cost also takes account of changes in behaviour. It includes an adjustment for the changes in the number of visitors, the changing spending patterns of visitors and the impact of digitalising a VAT RES scheme.”

ended. So HMT believe that the £500m refunded is the level of deadweight. The evidence shows that this is not the case. Without tax-free shopping, spending levels fell in 2022 and 2023 and so VAT returns were around half of the £500m level.

- 3.2 Evidence based on actual spending levels for non-EU international visitors in 2019 and 2022 show a fall of 28% in spending by non-EU visitors in the UK compared with 2019 levels, while mainland Europe saw an increase of 198%.⁵ However, the 2022 fall of 28% in non-EU spending is based on 2019 levels of spending. In fact, the data for 2022 shows significant increases in spending levels in Europe by non-EU visitors with total spending up by £1.36bn compared with 2019.⁶ If Britain had not ended tax-free shopping, Britain's share of this additional spending would have been £592m.⁷ Taking this into account, this suggests that the fall in spending levels from as a result of ending tax-free shopping was 49%. So the evidence of actual spending levels in the UK shows that without tax-free shopping, the level of spending by non-EU visitors to the UK is halved. This suggest that the deadweight of repaid VAT would not be £500m but £250m.
- 3.3 Interestingly, in November 2020, the OBR assessment of HMT's forecasts questioned the Treasury's central assumption that tax-free shopping had little or no impact on visitor behaviour. The OBR recommended that the Treasury's "no-impact" forecast should be replaced with a forecast of a fall in spending of 24% based on a price elasticity of 1.9. HMT accepted this recommendation and changed its forecast to reduce expected revenue of £500m by 20%, in effect accepting that tax-free shopping does have an impact on spending levels.

4. EU visitor deadweight level - The deadweight cost of tax-free shopping for EU visitors is significantly less than HMT's estimated £900m, at approximately £50m

- 4.1 Because HMT assumes little or no impact on behaviour from extending tax-free shopping to EU residents, it forecasts little if any additional spending. The Treasury assumes that the result would therefore be that the VAT currently paid would simply be reclaimed, leading to a cost to the Exchequer of £900m. The Treasury has extrapolated the £900m figure from the level of VAT refunded to non-EU visitors, as shown in 2.3.
- 4.2 There are two ways in which evidence of actual spending levels by EU visitors to the UK suggest that the level of VAT paid on their purchases is significantly lower than £900m. First, if £900m is the level of VAT already being paid on shopping by EU visitors, that suggests that EU visitors are spending £3.6 bn on shopping (2019 figures) giving a total spend, inc. VAT, of £4.5bn. However, VisitBritain reports that total spending by EU visitors in 2019 was £10.6bn.⁸ HMT's estimate of £900m VAT being paid by EU visitors in 2019, suggest that 42% of all EU visitor spending was on shopping. The evidence does not support this. VisitBritain states that shopping accounts for just 25% of all international visitors,⁹ including the high spending non-EU visitors. The £2.5bn tax-free shopping by non-EU visitors in 2019 was just 14% of the £17.8bn that they spent in total.¹⁰ It seems unlikely that the deadweight from extending the VAT RES to EU visitors would be £900m.

⁵ See section 4 of AIR's evidence of impact, submitted to HMT in November 2023

⁶ This is mainly due to post-lockdown pent-up demand to travel and increased disposable income as a result of the lockdowns.

⁷ Based on historic data up to 2019 which shows that 44% of all tax-free shopping by non-EU visitors in the EU was done in the UK. See section 3 of AIR's evidence of impact submission

⁸ VisitBritain 2019 Snapshot

⁹ VisitBritain Inbound Shopping Research

¹⁰ £2.5bn tax-free shopping is from HMT's Technical Note. £17.8bn non-EU visitor spend is from VisitBritain's 2019 snapshot

- 4.3 Secondly, in reality, all the evidence on actual EU visitor spending levels on shopping in the UK shows that EU visitors spend relatively little on shopping in the UK. This is because the price of goods in the UK is no cheaper than in the EU so there is no incentive to shop.
- 4.4 Data on actual spending from two of London's major stores that account for a high proportion of international spending is consistent in showing that EU spending accounts for less than 10% of all international spending. In one store, in 2019, only 7.9% of international spending was by EU visitors. In the other only 8.1% of international spending was by EU visitors.¹¹
- 4.5 This low level of spending on shopping by EU visitors is reflected in the difference in total spending by EU and non-EU visitors. According to VisitBritain, in 2019 the 24.8 million EU visitors spent a total of £10.6bn while the 16 million non-EU visitors spent a total of £17.8bn.¹²
- 4.6 According to the HMT, non-EU tax-free shopping amounted to £2.5bn in 2019.¹³ This would suggest that EU spending on shopping, at around 10% of this figure, was £250m, not £4.5bn, which produces a VAT figure of £50m. All the evidence of actual spending levels suggest that the actual level of deadweight cost to the Exchequer from extending tax-free shopping to EU visitors is £50m, not £900m.¹⁴

5. VAT RES Deadweight

- 5.1 These two elements (non-EU VAT and EU VAT paid in 2019) lead us to believe that the deadweight for the VAT RES is not HMT's 2020 forecast of £1.4bn (£500m + £900m), but rather £300m (£250m + £50m) or just 21% of HMT's original estimate. We make the assumption that this applies to airside tax-free shopping as well.
- 5.2 All these factors lead us to conclude that the cost of lost VAT is not £2.5bn, the Treasury's current 2024 forecast, but £525m (21% of the forecast)¹⁵

6. Net impact on VAT

- 6.1 HMT's forecast that reintroducing tax-free shopping will result in a net cost of £2.5bn is based on two assumptions that are not supported by the subsequent data on actual spending levels.
- 6.2 Assumption One – the deadweight cost of refunded VAT will be £2.5bn (current estimate). We believe the data suggests a lower figure £525m
- 6.3 Assumption Two – there will be no benefits in terms of additional visitor numbers or higher spending levels as a result of tax-free shopping to net against this cost. We believe that the

¹¹ We can, in confidence, share more detail on this if required but the data is commercially confidential and so is anonymised.

¹² VisitBritain 2019 snapshot

¹³ HMT "Technical Note on the VAT RES" September 2019

¹⁴ We also question the £900m forecast of the level of VAT refund to EU visitors. HMT's Technical note suggests that this forecast is based on the £500m refund level to non-EU visitors in 2019 adjusted to account of the relative visitor numbers (1 non-EU : 1.7 EU). We believe it should also take account of the relative spending levels. All evidence shows that the level of tax-free shopping spending by EU travellers is only one third the level of non-EU visitors. This suggests that the Treasury's forecast for VAT refunds should be £300m not £900m, of which £50m is deadweight.

¹⁵ In addition, we do not believe that there need be any costs to the Government in digitalisation. Most other governments worldwide do not pay for the design, installation and management of their digitalised systems. Industry has made submissions to HMT that the digitalised system can be designed, installed and managed by industry, to meet every specification the Government might have, at no cost to the Government.

evidence of actual international visitor behaviour shows that there will be significant additional spending and VAT.

- 6.4 Our paper on the opportunities of creating a whole new market in shopping-led tourism from the EU uses evidence of the impact of British people now being able to shop tax-free in the EU. This shows that it has led to significant additional spending. In 2022 tax-free shopping spending by British visitors in the EU was €500m, rising to €750m in 2023 and set to rise further in 2024.¹⁶
- 6.5 AIR has used this data on actual tax-free shopping spending levels by British visitors in the EU to estimate the likely level of spending on tax-free shopping by EU visitors to the UK if they were able to shop tax-free. We have adjusted the British spending levels to take account of the relative size of the populations of the UK and EU (UK 1: EU 6.7); relative wealth; and relative propensity to spend. AIR estimates that EU visitors to the UK are likely to spend around £5bn annually on tax-free shopping if Britain became the only major European country where EU residents could shop tax-free.¹⁷
- 6.6 The evidence also suggests that extending tax-free shopping to EU residents would not just result in existing EU visitor markets spending more. It would also create a new market of visitors which would result in additional spending on associated goods and services. The Paris Tourism Authority reports that number of bed nights for British visitors to Paris (the main shopping destination) rose in 2023 to 230% of 2019 levels while rising just 10-20% for visitors from other European countries.¹⁸
- 6.7 AIR has assumed a conservative ratio of 1:1 for relative spending on tax-free shopping and other goods and services by this new market.¹⁹ This suggests that an additional £5bn tax-free spending will be matched by a further £5bn in associated spending, this second element generating £1bn in additional VAT.²⁰
- 6.8 Combining these elements, based on actual spending data, AIR suggests that the impact on VAT receipts will be different from the Treasury's latest £2.5bn cost :
- VAT deadweight cost will be £525m, not £2.5bn
 - Additional VAT will be over £1bn, not £0
 - So the net impact on VAT receipts will be a positive of £475m

7. Indirect Impact

- 7.1 We believe that based on the net impact of VAT alone, the policy is not a cost to the Exchequer and is likely result in a net positive. But we believe that there will also be a significant positive indirect impact.
- 7.2 We understand that it is not normal Treasury or OBR practice to assess the wider economic impact of any particular policy. This is mainly due to the issue of a policy diverting some growth from one domestic area to another rather than all being net additional economic activity.

¹⁶ The details of this are in the first 2024 briefing AIR provided to the OBR

¹⁷ This is an early initial estimate of the value of this new market based on available data to give a general guide to its likely scale. If the government did decide to reinstate tax-free shopping we believe that a detailed study should be commissioned into this new market to enable government and businesses to plan to maximise its positive impact on the UK economy.

¹⁸ Data from the Paris Tourism Authority – as quoted in AIR's November 2023 evidence of impact

¹⁹ VisitBritain reports that in 2019, non-EU visitors spent £2.5bn on tax-free shopping and a further £15bn on other goods and services, a ratio of 1:6

²⁰ Note – this figure is for the VAT RES only. It does not include airside tax-free shopping the value of which, in 2019, was around 40% of the VAT RES

- 7.3 We do not believe that this applies to tax-free shopping policy. Tax-free shopping is not about domestic spending. It impacts on international spending which, if not done in Britain will instead divert to France, Spain and Italy. We have already seen this happening as actual spending data for 2022 shows a diversion of £1.5bn away from Britain and towards mainland Europe.²¹
- 7.4 We therefore believe that it is legitimate to estimate the wider impact of new foreign spending in the British economy.
- 7.5 We appreciate that there are different ways of assessing indirect impact and HMT and the OBR will have their own models. Oxford Economics' analysis on behalf of AIR suggested that for each additional pound of spending by foreign visitors due to the reintroduction of tax-free shopping, the Treasury would recoup £0.37 in tax receipts through channels such as corporation tax, taxes on employee income etc.
- 7.6 With additional spending on non-EU tax-free shopping at £250m and the new EU market estimated to be worth £10bn, this means that the additional non-VAT income to the Exchequer would be £3.79bn to add to the net positive impact of VAT.
- 7.7 The appendix to this paper contains a table summarising all the elements of our submission.

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²¹ See AIR's evidence of impact section 4

Appendix

Fiscal impact of tax-free shopping – Estimates 2020,2022 and 2024

	Elements	2020	2022	2024
HMT	Deadweight	£1.4bn	£2bn	£2.5bn
	Additional VAT	£0	£0	£0
	Net impact VAT	-£1.4bn	-£2bn	-£2.5bn
	Indirect impact	£0	£0	£0
AIR	Deadweight	£300m	£420m	£525m
	Additional VAT	£1bn	£1bn	£1bn
	Net impact VAT	+£700m	+£580m	+£475m
	Indirect impact	+£3.8bn	+£3.8bn	+£3.8bn

HMT 2020 estimates based on:

- Assumption of no impact from VAT RES on international visitor spending levels
- Actual levels of refunds made in 2019 to non-EU visitors of £500m, suggesting total spending of £2.5bn
- Price elasticity of 0, suggesting that the level of VAT of £500m is the same with or without the VAT RES
- Estimated level of VAT on sales to EU visitors is £900m, based on visitor number ratio of 1 non-EU:1.7 EU (i.e. £500m x 1.7)
- Based on £900m VAT estimate, estimated spending by EU visitors on shopping of £5.4bn including VAT, or 51% of total EU visitor spending
- Additional VAT - Little or no additional visitor numbers or spending so no additional VAT

HMT 2022 deadweight estimate based on:

- £1.4bn 2020 estimate VAT refund cost for VAT RES
- £600m VAT zero rating for airside tax-free shopping

HMT 2024 deadweight estimate based on:

- 2022 estimate
- Updating that figure with the latest economic determinants

AIR 2020 estimates based on

- Evidence of impact on spending by non-EU visitors of ending VAT RES based on actual spending levels in UK, France, Spain and Italy, in 2022 compared with 2019 demonstrating a fall of 48% suggesting a deadweight of £250m, not £500m
- Evidence of actual spending levels by EU visitors to the UK in 2019, showing that EU spending was just 10% of all international spending, suggesting 10% of £2.5bn = £250m, of which VAT is £50m
- Additional VAT from new EU shopping-led tourism market, based on evidence of actual spending by British visitors to the EU in 2022 and 2023 and additional bed nights in Paris, adjusted for relative population size, and wealth per head.
- Oxford economics estimate of 0.37p in tax receipts for every additional pound spent by international visitors.

AIR 2022 and 2024 estimates based on 2020 evidence that actual VAT deadweight was 21% of HMT forecast, so based on HMT revised estimates x 0.21.