Dear Sirs,

Thank you for giving us the opportunity to submit evidence of the impact on businesses of the Government's decision to end tax-free shopping for non-EU international visitors to Britain from the 1st of January 2021.

Thank you also for the time, patience and openness of Treasury ministers and officials over the past three years as we and other businesses and organisations have continued in our efforts to persuade the Government that this policy should be changed.

AIR was created in early 2020 as a campaigning group by retail, tourism and property businesses and organisations to promote the growth of retail sales to Britain's international visitors. In 2019, 40 million international visitors spent £28.4 bn in the UK and shopping was the single biggest area of spending according to VisitBritain, accounting for around 25% of the £28.4bn total, or over £7bn.

Since the Government's announcement in September 2020 of the ending of tax-free shopping, AIR has led the campaign to restore and expand the schemes with a firm belief in their benefits to the UK economy and public finances and in the boost to growth that Britain would experience from being the only major European country where EU residents could shop tax-free.

Central to this submission is the role of the OBR in the decision making process. In a departure from normal procedure, the OBR did not assess the policy until November 2020, two months after the decision to end tax-free shopping had been announced. We are not suggesting that the Treasury acted improperly in any way and indeed, the 2021 Judicial Review concluded that the Government had followed due process. But Ministers made the decision based on the assumption that tax-free shopping made no impact on the of behaviour of international visitors, either in choosing to visit the UK or in their level of spending. Just two months later, as a result of the OBR's assessment, that assumption was changed and the Treasury accepted that ending tax-free shopping would lead to a 24% fall in spending.

While the Treasury reduced its forecast for VAT receipts accordingly, it still maintains a public position of no significant behaviour change on the Exchequer Impact or the Wider Economic Impact and has made no other amendments to its forecasts, including the impact on British businesses and the costs and benefits of tax free shopping. The Treasury's current position seems to be that tax-free shopping has no impact on spending levels, but that ending it will result in a 24% fall in spending. Both cannot be true.

Since international travel started to return in 2022, we can now assess forecasts based on actual spending levels. In Part One of our submission, we provide new evidence of the direct impact of ending tax-free shopping using actual data on spending by visitors from the GCC states and the USA in the UK, France, Italy and Spain in 2022 and early 2023. In 2022, these two groups of visitors accounted for 80% of all spending on tax-free shopping in Europe.

Our evidence shows the impact of ending tax-free shopping to be even worse than the OBR's -24% forecast. Spending in the UK fell by 28% on 2019 levels while in France, Italy and Spain spending increased to 138% of 2019 levels, even after deducting £400m of spending diverted from Britain. British retailers lost an estimated £1.2bn of international visitor spending as tourists chose to shop in France, Italy and Spain instead. Early data for 2023 shows that the situation is getting worse. These figures are for VAT RES alone and do not include airside tax-free shopping which adds a further £250m to the total spending lost. Our evidence shows that by ending tax-free shopping :

- British businesses lost out on £1.5bn of sales to non-EU international visitors in 2022.
- Spending in 2022 by GCC visitors to the UK was down 35% on 2019, falling by £405m but in France it was up 104% on 2019 levels, an increase of €433m (£390m).
- The Treasury would have received £459m in tax revenues in 2022 if tax-free shopping had still been available, £206m more than the £253m VAT it collected on the reduced level of actual spending. The Treasury's VAT receipts of £253m were only half its original £500m forecast.
- The situation has worsened in 2023 as international travellers become increasing aware that they can no longer shop tax-free in Britain.
- Early data on Chinese spending as they start to return in 2023, confirms AIR's forecast £400m drop in spending based on 2019 and even more when expected growth is factored in.

Our evidence confirms at a national level the negative impact of ending tax-free shopping that many individual businesses have reported in evidence they have submitted to the Treasury and in the media.

With the central assumption of "no impact on visitor behaviour" abandoned so soon after Ministers announced their decision, the forecast of no change in spending levels being revised to one of a 24% fall, and evidence showing an actual fall of 28% in spending, this calls into question all the other forecasts on tax-free shopping which still appear to be based on an assumption of "no impact." In particular we are concerned about the loss of a potential new EU visitor market for all of the UK similar to that being witnessed in Europe now that Britons can now shop tax-free. The Treasury's forecast of just a 0.2% rise in EU visitor numbers seems suspect against official data showing an increase of 102% in British visitor nights in 2022 2019 and even greater in 2023.

We appreciate the financial pressures on the Government and the need to strengthen the public finances after a series of unexpected shocks. We also understand how the lack of data in 2020 might lead to the decision that was made. But we believe the actual data now available will show that the economic growth created by tax-free shopping is a positive for the Treasury, not a negative. The Prime Minister favours a data-driven approach to policy making to ensure the best use of public resources. It is clear that the facts have changed since the decision was made when he was Chancellor in 2020. In his recent Conference speech in relation to another policy decision he said "To those who backed the project in the first place, the facts have changed. And the right thing to do when the facts change is to have the courage to change direction." It is in the spirit of the Prime Minister's comment that we make this submission of evidence to the Treasury.

With Britain's billion pound loss of international visitor spending set to worsen in 2023, we ask the Chancellor to review this policy as a matter of urgency and restore tax-free shopping, so that the whole of the UK can benefit from the growth in spending by international visitors that Europe is experiencing. AIR believes that, working together, government and business can create a new, improved scheme that secures Britain's position as the best destination in the world for international shopping, creating thousands of jobs across the UK and providing additional revenues for the Treasury.

Thank you again for demonstrating that the Government listens to business and for all the time that you have given us in the past and, we very much hope in the future too. I would appreciate the opportunity to meet to discuss our submission in more detail.

Best wishes,

Paul Barnes
Chief Executive www.internationalretail.co.uk

The Ending of Tax-Free Shopping – Evidence of Impact

Executive Summary

Part One - evidence

1. **Background**

- From January the 1st 2021 Britain became the only European country not to offer tax free shopping to non-EU international visitors.
- The Treasury's decision, announced in September 2020, was based on the assumption that tax free shopping has little or no impact on international visitor behaviour either in choosing to visit the UK or on spending levels.
- In a departure from normal procedure, the OBR did not assess the policy until after the decision had been announced. The OBR suggested that the Treasury effective assumption of a price elasticity of zero should be replaced with a price elasticity 1.9 meaning a 24% impact on spending.
- The Treasury accepted this recommendation and adjusted forecast VAT receipts accordingly. But no other forecast regarding costs and benefits were adjusted and are still based on the assumption of "no impact on behaviour"

2. **The importance of shopping to the international visitor sector**

- Shopping is the single largest element of spending by international visitors to the UK accounting for 25% of all spending or over £7 billion in 2019. In 2019, £3bn were spent on the VAT RES and a further £1bn on air-side tax free shopping.
- In 2019 the three biggest spending groups were visitors from China, the GCC States and the USA who between them accounted for 76% of all tax free shopping in the UK.

3. **The impact of ending tax-free shopping British businesses**

- International travel to Europe has bounced back strongly post-pandemic in 2022 and 2023 and most European countries are experiencing a strong recovery in visitor numbers and spending levels.
- With China still in lockdown, visitors from the GCC States and the USA accounted for over 80% of all tax-free spending in Europe in 2022. We have compared actual spending levels for these visitors in France, Italy, Spain and the UK to assess the impact of ending tax-free shopping in the UK.
- The table below shows the level of tax-free shopping spending by visitors from the GCC states and the United States in France, Italy, Spain and the UK in 2019, 2022 and the 12 months to September 2023.

Spending on tax free shopping by visitors from GCC states and the USA in 2019, 2022 and the twelve months to September 2023 (note – no tax-free shopping in the UK after 2020)

Visitor Origin	Destination	2019 €m	2022 €m	Oct 22-Sept 23 €m
GCC	France	416	849	987
	Italy	262	427	540
	Spain	101	164	192
	UK	1,287	0	0
United States	France	504	1,157	1,485
	Italy	539	1,006	1,293
	Spain	160	320	463
	UK	290	0	0
Total UK		1,578	0	0
Total France, Italy, Spain		1,983	3,923	4,961
Total		3,561	3,923	4,961

- Using a representative sample of businesses to show actual spending levels in 2022 after the UK had ended tax-free shopping the data shows Britain performing significantly worse than the other three countries.

Visitor Origin	Destination	2022 spending v 2019
GCC	France	+98%
	Italy	+58%
	Spain	+66%
	UK	-35%
USA	France	+126%
	Italy	+90%
	Spain	+101%
	UK	+1%

The cost to Britain of ending tax-free shopping (€1:£0.9)

- The data shows France, Italy and Spain recording significant increases in spending with Britain far behind. In the UK, comparing 2022 spending with 2019 levels, we estimate that :
    - Spending by GCC visitors fell from £1,158m to £753m, a fall of £405m (-35%)
    - Spending by visitors from the USA rose from £258m to £261m, a rise of just £3m
    - Combined spending fell from £1,420m to £1,018m, a fall of £401m, a 28% fall
- In 2022 spending levels in the four countries combined rose by £1,346m. In 2019, 44% of tax-free shopping spending happened in the UK. If Britain had not ended the VAT RES we estimate spending would have increased by an additional £592m.
- We therefore estimate that in 2022 Britain lost £993m of spending by visitors from the GCC state and the USA on shopping alone. When the impact on the further 20% of spending is added this loss grows to £1,241m
- Based on actual spending data, airside spending was down 25% on 2019 levels, a further loss of £250m.
- AIR estimates that total amount of spending lost to British retailers in 2022 as a result of ending the VAT RES and airside tax-free shopping was £1,491.
- This would have supported over 26,000 retail jobs.

- The Treasury collected £253m in VAT on the retail spending by all non-EU international visitors 2022 spending. Based on the Oxford Economics model, we estimate that if the VAT RES was still in place, the £1,241m additional spending would have generated £459m in tax revenues for the Treasury, resulting in a net positive of £206m. The Treasury £253 VAT revenues are only half its original £500m forecast upon which the decision to end the schemes was taken.

4. <u>Chinese travellers 2022-2023</u>

- The 2022 data does not include Chinese visitor spending. In 2019 they accounted for £1bn (32%) of all tax-free shopping spending in the UK. Chinese shoppers are more price sensitive and we estimate that ending tax-free shopping will mean Britain losing £410m of the £1bn they spent in spending as they start to return to Europe.

5. <u>Evidence of indirect impact</u>

- The full level of spending and tax revenues lost in 2022 is likely to be higher when spending by international visitors other than those from the GCC states and the USA is included (20% of the total) and when the impact being reported by other sectors, such as hospitality, tourism, culture and leisure, are taken into account. In 2022 France and Britain both recorded international visitor numbers 24% down on 2019 levels but total spending was up 4% in France and down 7% in the UK. If Britain's performance had matched France's, the UK economy would have gained an additional £3bn of international visitor spending in 2022.

6. <u>Evidence of impact – changes to capital expenditure plans</u>

- The diversion of spending away from Britain is resulting in many companies reviewing their long-term capital expenditure plans which threatens Britain's future appeal for investors and visitors.

7. <u>Evidence of impact – tax-free shopping as the cause</u>

- That Britain's poor performance is the result of ending tax-free shopping is confirmed by :
  - Evidence provided by many individuals business.
  - Numerous consumer surveys, including HMRC's own 2020 survey of international travellers which concluded that when choosing where to visit "the VAT RES is a strong influence on the decision making process" and that "VAT RES encourages tourists to spend more in the UK."
  - Eliminating all other possible causes, such as inflation, exchange rates and rate at which countries opened up after COVID.

8. <u>Evidence of Impact – Behaviour change by British people now able to shop tax-free in the EU</u>

- The Treasury forecast that introducing tax-free shopping would result in just a 0.2% increased in visitor numbers. British people can now shop tax-free in the EU. Official data shows that in 2022, 138,000 refunds were made worth over €500m. This is on course to double in 2023. While some of this may not be additional spending we do not believe that 99.8% of it is. In 2022 bed nights in France by Germans visitors rose by 42% and by Dutch visitors by 10% whereas British visitor overnight stays rose by 102% of 2019 levels. This evidence suggests that introducing tax-free shopping does have a behavioural change on international travellers. The Government should examine this potential new market in more detail.

9. Evidence 2023

- Early evidence for 2023 shows the relative performance of Britain worsening against that of France, Italy and Spain. The table below shows the difference in performance in 2022 and in the first quarter of 2023 for spending by American visitors in the UK, France, Italy and Spain. In the UK it was around the 2019 level in both 2022 and Q1 2023. But in France, it was more than double 2019 levels in 2022 and more than three times 2019 levels in Q1 of 2023.

Spending by visitors from the USA in 2022 and Q1 2023 compared with2019

Visitor Origin	Destination	22 sales v 19 %	Q1 23 v Q1 19 %
USA	France	+126%	+213%
	Italy	+90%	+143%
	Spain	+101%	+212%
	UK	+1%	+4%

10. The case for reviewing the decision to end tax free shopping

- The decision to end tax free shopping was based on a forecast of no impact on international visitor behaviour i.e. a price elasticity of zero. The Treasury accepted the OBR's recommendation of a price elasticity of 1.9 resulting in a 24% impact. The Treasury amended its forecast for VAT revenues accordingly but has not amended any other forecasts. The Treasury is forecasting both no impact and a 24% impact.
- By deciding not to extend tax-free shopping to EU visitors, the OBR had no remit to assess the Treasury's forecasts on that option, which were central to Government decision making.
- In light of the £1bn loss of spending in 2022 and the worsening trend in 2023, AIR is calling for an urgent review of the economic impact of tax-free shopping.

Part 2 - AIR's commentary on the Treasury's positions

11. The decision to end tax-free shopping was a surprise because the consultation process was focused on ways of improving the system after Britain left the EU.
12. The Treasury's decision is based on the key assumption that tax-free shopping has no impact on the behaviour of international visitors.
13. This key assumption underpins all the Treasury's forecasts on the impacts of ending or extending tax-free shopping.
14. The OBR only assessed the policy after the decision had been made and announced, in a departure from normal procedure.
15. The Treasury states that tax-free shopping has no impact because it believes that i) shopping is not an attraction and ii) only 8% of international visitors use the VAT RES.
16. The Treasury does make the important distinction between non-EU international visitors (16m in 2019) and non-EU international tourists (6.4m in 2019 according to VisitBritain).
17. All reliable evidence shows that shopping is an important attraction for international tourists
18. The Treasury estimates that only 8%of non-EU international visitors used the VAT whereas in reality, 24% on all non-EU visitors and over 60% of non-EU tourists used the VAT RES.
19. The Treasury underestimates the economic impact of making Britain the only major European country where the 447m EU residents can shop tax-free.
20. Other minor points raised in the September 7th Parliamentary debate are examined including shop and ship, shopping levels without tax-free shopping, the role of the OBR, the relative recovery of the UK post pandemic compared with other countries, and refund charges.
21. Government and business should work together to create a better tax-free shopping system.

Part One

Evidence of the impact of ending tax-free shopping in the UK

1. Background

1.1 Until January 1st 2021, Britain offered tax-free shopping to all non-EU international visitors. Visitors buying goods in high street stores could reclaim the 20% VAT at the airport as they left the UK with their goods. This was called the VAT Retail Export Scheme or VAT RES. When airside, non-EU travellers could also buy goods with no VAT added. This was called the Extra Statutory Concession. All EU countries and most major tourist destinations throughout the world offer tax-free shopping for those international visitors.[1]

1.2 In September 2020 the Government announced that it had decided to end tax-free shopping for non-EU international visitors to the UK. The Government stated that Britain was obliged under WTO regulations to treat all international visitors equal when we left the EU. This would mean either extending tax-free shopping to visitors from the EU or ending tax free shopping for non-EU visitors. The Treasury had forecast the cost of a VAT RES extended to include EU visitors could be up to £1.4bn and this could not be afforded.[2] Instead Britain has now become the only European country not to offer tax-free shopping to non-EU international visitors.[3]

1.3 When tax-free shopping was included in the short-lived Growth Plan of 2022, the Government forecast a cost to the Treasury of £2bn per annum. When the measure was subsequently withdrawn by the current Chancellor in November 2022, the Treasury stated that this would save £2bn per annum.

1.4 The Treasury consistently states that it based its cost forecast on the assumptions that offering tax-free shopping made little or no impact on the behaviour of international visitors either in choosing to visit Britain or in the level of spending in shops. In April 2023 a Treasury Minister repeated this position in the answer to a Written Parliamentary Question[4] and it used it in response to recommendations made by the DCMS Select Committee on tax free shopping.[5]As a consequence, the Government maintains that withdrawing the schemes will have minimal impact on businesses and extending them to include EU visitors would have minimal benefits in terms of increased visitor numbers and spending.

1.5 In a departure from usual procedure, the OBR did not assess the policy before the decision was made to end tax-free shopping. When the OBR did review the policy as part of its November 2020 Economic and Fiscal Outlook it disputed the Treasury's assumption of no behaviour change. The OBR's assessment of the Exchequer Impact recommended a price elasticity of 1.9 and forecast a 24% fall in spending as a result of ending the VAT RES. The Treasury reduced its forecast for VAT receipts accordingly but no other specific amendments to any of the other forecasts were made. Effectively full cost and benefits are still based on the original assumption

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1 The Treasury rightly points out that the USA does not have tax-free shopping. This is because local sales taxes are levied by individual states so there is no federal policy. Some states do have tax refund schemes. New York is often cited as a visitor destination that has no tax refund. While VAT in the UK is 20%, the sales tax in NYC is just 8.875%

2 HM Treasury "Technical note on the VAT RES" September 2020

3 Apart from Moldova, Ukraine and Andora but we do not see them as competing destinations

4 Answer to WOPQ April 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."

5 DCMS Select Committee "Promoting Britain Abroad February 2nd 2023 The Treasury stated "The withdrawal of VAT-free shopping would raise a significant amount of revenue and have a limited behavioural effect on decisions to visit, or spend, in the UK."

of no impact on spending. The OBR did not assess the impact of extending the schemes to EU visitors.

1.6 In his First Witness Statement for the 2021 Judicial Review, a Treasury official explained that the decision to end the VAT RES was based on a combination of the Fiscal Cost, the Exchequer Impact and the Wider Economic Impact.[6] He later explained that the Fiscal Cost based on VAT repayments was £500m in 2019. By ending the VAT RES the Treasury therefore assumed the Fiscal Cost would become zero and there would be a positive Exchequer Impact of +£500m. However he explained that any other Exchequer or Wider Economic Impact would depend on the level of behaviour change of international visitors both in choosing to visit the UK and on their level of spending. He said that, mainly due to a lack of data from retailers, it was not possible to forecast behaviour change.[7] As a result the decision was based on a forecast of no Fiscal impact and a positive Exchequer Impact of £500m.

1.7 In 2022 international travel started to resume across the world with the notable exception of China which remained in lockdown throughout most of last year. As a result there is now increasing data on international traveller behaviour and in particular on their actual levels of spending. This submission provides data that the Treasury rightly says was not available when the decision was taken to end the VAT RES in 2020. The actual data shows significant behavioural change by international visitors and we believe that this require a review of the Treasury's 2020 forecasts.

1.8 To set the context we thought it would be helpful to outline the importance of shopping both as an attraction for international tourists to choose to visit the UK and also as the single highest element of spending by international visitors when in the UK.

2. <u>The importance of shopping to the international visitor sector</u>

2.1 Shopping is a key draw for international visitors, in particular for tourists, who account for 41% of all international visitors (of the rest, 30% are visiting friends and relatives and 21% are on business and the rest are students).[8] 57% of all international visits involve shopping, with this rising to 70% for tourists.[9]

2.2 VisitBritain estimate that 25% of all international visitor spending is on shopping, more than any other single item (including accommodation, dining, or travel). Based on 2019 total spending of £28.4bn this suggests that international visitors spend £7.1bn. Shopping is particularly important for international visitors to London with London&Partners[10] estimating that 47% of all international visitor spending in London is on shopping.

2.3 HMRC state that in 2019 VAT refunds amounted to £500m suggesting sales of £3 billion including VAT. Spending on air-side tax-free shopping amounted to around £1bn in 2019, mostly at Heathrow airport.

2.4 The majority of VAT RES spending is in London, particularly in the International Centres of the West End and Knightsbridge. Bicester Village in Oxfordshire is another large centre for sales. But tax-free shopping benefits much of the UK. In 2019 spending on tax-free shopping in Edinburgh, Manchester, Liverpool, Leeds and Glasgow amounted to £225m. Many British

6 First Witness Statement of Michael Cunningham to the High Court of Justice pp2-3 Jan 27th 2021

7 Second Witness Statement of Michael Cunningham to the High Court of Justice pp147-149 Jan 27th 2021

8 VisitBritain – 2019 snapshot

9 VisitBritain – Inbound shopping research

10 London&Partners "Visitors spend more on shopping while in London" September 2017

brands, such as Burberry, Mulberry and Church's Shoes, are based outside London but use London as their UK shop window with sales in London supporting manufacturing and supply chain activities across the UK.

2.5 The biggest spenders are visitors from China and the GCC states followed by visitors from the United States of America. When you compare the number of visitors to the UK from China and the GCC states in 2019 as a percentage of total non-EU international visitors with the percentage of all tax-free shopping attributed to them, it highlights the importance of these groups to the UK economy.

- China: 32% of all spending on tax-free shopping and 5% of non-EU visitors
- GCC: 26% of all spending on tax-free shopping and 5% of non-EU visitors
- USA: 18% of all spending on tax-free shopping and 22% of non-EU visitors
- Rest of Asia: 12% of all spending.
- Rest of World: 12% of all spending.[11]

2.6 Not all tax-free shoppers spend the same. A small percentage of tax-free shoppers in the UK are responsible for a disproportionately large amount of spending:

- High spenders are 15% of the customers but 42% of all spending.
- All other spenders are 85% of the customers but 58% of all spending.

3. <u>The impact of ending tax-free shopping British businesses</u>

3.1 Our evidence is based on actual spending data for the UK, France, Italy and Spain in 2022. We have not adjusted these figures for inflation, which was rising in all these countries in 2022. The average rate in each country was 7.95% in the UK, 5.9% in France, 8.2% in Italy and 8.23% in Spain. We do not believe the difference in inflation rates could account for the substantial differences in the actual spending levels in each country.

3.2 Europe has experienced a strong bounce back in international visits and spending following the pandemic. This is likely to be due to pent-up demand for travel after two years of lock-down and the substantial levels of money saved by consumers during that time. As a result of additional spending power and inflation the level of spending by international visitors in the UK in 2022 shows a strong recovery with spending close to 2019 levels, despite the absence of tax-free shopping.

3.3 Because the level of international visitor spending was higher across Europe, to get a true assessment of the impact of ending tax-free shopping we need to compare the performance of Britain against that of our major European competitor destinations, specifically France, Spain and Italy. They are also seeing the benefits of additional spending power and the impact of similar inflation levels. By comparing the relative performance of Britain to these three countries we can understand the full impact of ending tax-free shopping in the UK. This can best be done by using tax-free spending levels for each country in 2019 and assessing spending in 2022 and early 2023 against this baseline. We now have new data on actual spending which we are submitting as our contribution to the Government's request for evidence.

3.4 The data shows that the biggest spenders in 2022 and early 2023 were visitors from the Gulf States and the USA. Together they accounted for 80% of all tax-free sales in Europe in 2022. In 2019 Chinese travellers were the biggest spenders on tax-free shopping, accounting for 32%

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11 Global Blue data

of all sales in the UK but Chinese visitor numbers in 2022 and early 2023 were very low due to continuing travel restrictions. We look separately at the Chinese market in section 5, below.

3.5 The new data we are presenting in this submission was gathered at AIR's request by Global Blue, the world's largest tax-refund agency. Global Blue is a company listed on the New York Stock Exchange and as a result, every piece of information it makes public has to meet the highest regulatory standards to ensure that it is accurate, complete and provides a true representation of the issue it relates to. The data on actual tax-free spending levels for 2019 in the four study countries and for France, Spain and Italy in 2022 and 2023 is based on the actual level of refunds made, in Euros, by all of the major refund agencies, including Global Blue and Planet, which includes around 99% of all refunds made. This is therefore the most extensive and accurate data available on non-EU international spending behaviour in Europe.

3.6 In order to compare the UK's performance in 2022 with that of the three EU countries, after tax-free shopping was ended, we created a sample group of 11 major brands with over 50 outlets in the four study countries. In 2019 our sample group members accounted for £500m of the £3 bn tax-free sales in the UK, around 17% of the total and importantly, each company collects the customer origin at point of sale. The group contains no outliers which might have distorted the total figures.

3.7 The sample group companies have provided actual spending data on visitors from the GCC states and the USA for 2019 and 2022 in each of the four countries. To confirm that the sample group is an accurate representation, we compared the results of the sample group and the sector on the percentage change in spending in 2022 v 2019 for France, Italy and Spain. Table 1 shows that the results are very similar, with the sample group slightly under representing the sector performance.

Table 1 – %age difference 2022v2019 for our sample group and for the whole sector

Visitor origin	Destination	Sample 22 v 19 %	Sector 22v19%	Difference sample v sector
GCC	France	+98%	+104%	-6%
	Italy	+58%	+63%	-5%
	Spain	+66%	+62%	+4%
USA	France	+126%	+129%	-3%
	Italy	+90%	+87%	+3%
	Spain	+101%	+101%	0%

Actual spending levels on tax-free shopping

3.7 Table 2 first shows the actual level of spending in all four countries in 2019. It then shows the actual levels of spending for 2022 and the 12 months to September 2023 when tax-free shopping was no longer available in Britain. The figures show how the UK dominated the market for tax-free sales to visitors from the GCC states in 2019 with 62% of the €2bn combined spending in France, Italy, Spain and the UK taking place in Britain. The figures also show that 44% of all spending on tax-free shopping by GCC and American visitors to these four countries was done in Britain.

Table 2 – tax-free shopping spending by visitors from GCC states and the United States in France, Italy, Spain and the UK in 2019, 2022 and the 12 months from October 2022. Note after 2020 there is no tax-free shopping in the UK so no spend figure is shown in this table.

Visitor Origin	Destination	2019 €m	2022 €m	Oct 22-Sept 23 €m
GCC	France	416	849	987
	Italy	262	427	540
	Spain	101	164	192
	UK	1,287	0	0
United States	France	504	1,157	1,485
	Italy	539	1,006	1,293
	Spain	160	320	463
	UK	290	0	0
Total UK		1,578	0	0
Total France, Italy, Spain		1,983	3,923	4,961
Total		3,561	3,923	4,961

Changes in spending levels

3.8 Table 3 uses the 2019 actual spending levels as a baseline and compares these with the actual spending levels in 2022 and for the twelve months to September 2023. For each country it shows the amount of spending above 2019 levels both in euros and as a percentage. The UK had no tax-free shopping in these two periods.

Table 3 – changes in spending on tax-free shopping by visitors from GCC states and the United States in France, Italy, Spain and the UK, in euros and as percentages

Visitor Origin	Destination	22 v 19 €	22 v 19 %	Year to Sept 23 v 19 €	Year to Sept 23 v 19 %
GCC	France	+433m	+104%	+571m	+137%
	Italy	+164m	+63%	+278m	+106%
	Spain	+63m	+62%	+91m	+90%
	UK	-1,288m	-100%	-1,288m	-100%
USA	France	+653m	+129%	+981m	+194%
	Italy	+467m	+87%	+754m	+140%
	Spain	+161m	+101%	+304m	+190%
	UK	-290m	-100%	-290m	-100%
Total for all destinations		+362m	+10%	+1,399m	+39%
Total for France, Italy and Spain		+1,941m	+98%	+2,978m	+150%

UK performance in 2022 compared with France, Italy and Spain

3.9 Because there is no tax-free shopping in the UK after 2020 we used the sample group to compare the UK's performance in 2022 with that of the three EU countries. Table 4 shows the actual level of spending recorded by the sample group for visitors from GCC states and the USA in 2022 as a percentage of the 2019 actual refund levels.

3.10 The results clearly show a strong bounce back of spending in the three EU states but a far weaker performance in the UK. The EU states saw spending by GCC visitors rise to over one and a half times 2019 levels while in the UK spending was at only around two thirds of 2019 levels. Spending by American visitors in the UK in 2022 returned to 2019 levels, but in the EU it doubled.

Table 4 – spending by visitors from GCC states and the USA in 2022 compared with 2019

Visitor Origin	Destination	2022 spending v 2019
GCC	France	+98%
	Italy	+58%
	Spain	+66%
	UK	-35%
USA	France	+126%
	Italy	+90%
	Spain	+101%
	UK	+1%

Impact on spending in the UK in 2022

3.11 The tables 3 and 4 show substantial increases in spending by visitors from the GCC states and USA. By using the actual spending levels in 2019 and the percentage changes reported by our sample group we can estimate the spending levels in 2022 and that year's cost to the UK of ending tax-free shopping. We have converted the € amounts in section 3 to £ at €1 : £0.9

3.12 In 2019 the amount spent by visitors to the UK from the GCC states was £1,158m and from USA was £261, a total of £1,419m. The OBR recommended, and the Treasury accepted, a price elasticity of 1.9 and forecast a fall in spending of 24%[12] on 2019 levels of £341m.

3.13 Based on our sample, actual spend in 2022 by GCC visitors was down 35% on 2019 levels at £753m, a fall of £405m, and spending by USA visitors was £261m, up 1% , a rise of £3m. Total spending was £1,018m, down £401m, a fall of 28%, 4% higher that the fall forecast by the OBR of 24% , and far higher than the Treasury's 0% fall forecast when the decision to end tax-free shopping was made.

3.14 However, in 2022, spending in the three EU countries increased by £1747 on 2019 levels. £401m would be the spending diverted from the UK meaning that across the four countries additional spending above 2019 levels was £1,346m. Based on 2019 figures that show that 44% of all the spending across the four countries took place in Britain, then we would expected that 44% of the additional £1,346m, a amounting to £592m, would have been spent in the UK if Britain still offered tax-free shopping.

3.15 Together this suggests that if Britain still offered tax-free shopping spending by GCC and American visitors would have been £2,011m (£401m decline on 2019 levels plus £592m as the

[12] Based on a 20% VAT refund minus administration charges. OBR "Policy Costings Document" November 2020

UK's share of additional spending) instead of the actual £1,018m This suggests that ending the VAT RES cost Britain £993m of lost spending by GCC and American visitors alone in 2022.

3.15 The GCC and American visitors accounted for 80% of tax-free shopping spending in Europe in 2022, so to get an estimate of the full impact of ending the VAT RES we need to add a further 25% of the combined GCC and American spending loss figure.[13] This takes the total to £993m + £248m, or £1,241m.

3.16 It is likely that the impact on spending levels of ending the airside tax-free shopping would be similar. The majority of the airside tax-free sales were made in Heathrow, since most UK airports operate flights only within Europe. In October 2023 Heathrow Airport reported that retail sales in the period of July-September 2023 were down 25% on the same period in 2019.[14] Based on the Treasury's estimate of £1bn of tax-free spending airside in 2029, this would suggest a loss of £250m.[15]

3.17 Based on actual spending data for 2019 and 2022, AIR therefore estimates that ending the VAT RES and airside tax-free shopping has resulted in a direct loss of spending to British retailers of £1,491m.

3.18 The retail industry model states that every £57,000 of income supports one job. The £1,491m spending lost would have been enough to create over 26,000 FTE retail jobs across the UK.

3.19 The £1,018m spent by visitors to the UK from GCC states and the USA in 2022 would raise £203m VAT. Including spending by visitors from other countries, this would increase by 25% to £253m. Oxford Economics' analysis on behalf of AIR found 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. Applying this ratio to the estimated additional £1,241m of spending in 2022 if the VAT RES had been in place implies a total gain to the Exchequer of £459m, resulting in a net positive impact of £206m just for spending by visitors from the GCC States and the USA. This is new money being spent in the UK by international visitors, not diverted domestic spending.

3.20 Treasury's original fiscal forecast, upon which the decision to end tax-free shopping was made, was of £500m VAT receipts based on 2019 spending levels, subsequently revised to £400 following the OBR assessment. In 2022 Europe experienced a 38% increase in spending on 2019, suggesting the revised fiscal forecast should be increased by £152m to £552m. In 2022 the VAT payable on the estimated £1,018m spending by visitors from the GCC states and the USA was £203m. GCC and USA spending was 80% of the total spending by non-EU visitors in 2022 so we have assumed a further £50m of VAT receipt1, giving a total of just £253m as the fiscal impact in a year when spending was 40% higher than HMT's base for its original £500m forecast upon which the decision to end tax-free shopping was taken. This does not seem a good result for the Treasury and again brings into question the forecasts and adds to AIR's reasons for calling for a new review.

3.21 All these spending figures relate to just the direct impact of tax-free shopping on retail spending. It does not include any indirect loss of spending, VAT and other taxes on other goods

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14 Reported in The Times, October 27th 2023

15 The 2022 spending level compared with 2019 would have been even worse

and services that are purchased by non-EU international visitors, either through choosing to visit France, Spain and Italy rather than Britain or those that chose shorter stays in the UK.

4. Spending levels and relative performance in 2023

4.1 In future years, as more international visitors learn in advance that Britain no longer offers tax free shopping, and as international visitor spending on tax-free shopping increases, the level of retail sales that Britain loses out on is likely to increase. This is borne out by the early 2023 spending data.

4.2 Table 2 also shows the actual spending levels for the three EU countries for the 12 month period up to September 2023 and Table 3 shows the difference in spending for that period compared with 2019 in euros and percentages. This shows the level of spending increasing further as international travel increased in 2023.

4.3 Our sample group supplied data only for 2022. To illustrate the performance of the UK going into 2023 we have compared New West End Company's recorded spending levels by visitors from the USA in Quarter 1 of 2023 with the actual spending levels in the same period for the three EU countries. New West End Company is the Business Improvement District for London's West End. It has a long established data collection system for London's West End which in 2019 was responsible for 65% of all tax-free shopping in the UK. Table 5 shows the 2022 performance for the four countries using the sample study, and the Q1 2023 performance, using actual spending data based on refunds and New West End Company data.

4.4 The results show the performance gap widening. While the Q1 2023 data showed just a 4% increase on 2019 in the UK, spending in France and Spain were over three times the 2019 level. This is a worrying trend and we assume that it is the result of growing awareness that the UK no longer offers tax-free shopping.

Table 5 – spending by visitors from the USA in 2022 (sample) and Q1 2023 (NWEC) compared with 2019

Visitor Origin	Destination	22 sales v 19 %	Q1 23 v Q1 19 %
USA	France	+126%	+194%
	Italy	+87%	+140%
	Spain	+101%	+190%
	UK	+1%	+4%

4.5 The figures examined above are for spending by visitors from the USA and GCC states. In 2022 these account for 80% of the non-Chinese tax-free shoppers. We have not included the remaining 20% of this group but there is no reason to believe that their behaviour is any different. If they were included this would increase spending losses in Britain by up to a further £245m.

5. Chinese travellers 2022-2023

5.1 To understand the full impact of ending tax-free shopping we need to include Chinese shoppers, who were responsible for 32% of all tax-free shopping in the UK in 2019. They were not travelling in 2022 and all the evidence points to them having a price elasticity far higher than 1.9.

5.3 In August 2023 AIR produced a report on the Chinese tourist market.[16] Based on historical responses to exchange rate changes, for example immediately after the results of the 2016 referendum, we estimated that the price elasticity for Chinese travellers is 3.4. A price increase of 20% would lead to a 68% fall in spending. Using the OBR's reduced figure of 12,.5% (which takes account of the cost of administration fees), this would mean a fall of 43%.

5.4 Heathrow Airport Limited actual figures for July 2023 show a 67% fall in spending now that tax free shopping has been removed, almost exactly matching our projected percentage fall in sales.

5.5 Using the OBR's assumptions (i.e. using 12.5% rather than 20%), its recommended price elasticity of 1.9 would result in a fall in spending by Chinese visitors of £240m on 2019 levels. Using a price elasticity of 3.4 would see a fall in spending of £410m. This assumes no increased spending.

6. Evidence of impact – changes to capital expenditure plans

6.1 In addition to its impact on consumer spending, ending tax-free shopping has led to major global brands reviewing their long-term capital investment plans to divert foreign investment away from London to Paris and Milan, since many international travellers are diverting spending from London to these other European shopping destinations.

6.2 In June 2023 New West End Company, the BID for London's West End, surveyed its member businesses. Over half (54%) said they were reviewing their long-term capital investment programmes to take account of the fall in relative performance of their West End stores compared with their stores in continental Europe.[17] This has an immediate impact on spending in the UK on construction, fitting out and on employment numbers. It also risks London becoming a second division investment choice by global brands which will have a knock-on effect on London's global status. Over one fifth of companies surveyed(22%) are considering closing their London stores and relocating to mainland Europe.

7. Indirect impact

7.1 The actual sales data provided in section 3 shows the impact on retail spending. We have not looked at the indirect impact on other tourist related sectors. Businesses in other sectors have publicly stated that their sales have been negatively impacted by the ending of tax-free shopping. The Treasury's assumption that tax-free shopping has no impact on international visitor behaviour means that it has not included any potential impact on these sectors.

7.2 The indirect impact is on :

- Hospitality – hotels, bars and restaurants – e.g. in their annual report the Dorchester Hotel Group reported that their Paris Hotel was overperforming and their London one is underperforming as a direct result of ending tax-free shopping. Data for 2022 from Planet, a leading payment and tax-refund agency in Europe, show that the recovery of UK hotels has been far weaker than in competitor European countries. Spending in hotels in the UK in 2022 was down 9.5% on 2019 levels while in mainland Europe it was down by only 2.5%.

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[16] AIR Research Briefing "Impact on Chinese visitors" August 2023

[17] New West End Company evidence submitted to the Treasury

In 2023 spending in hotels in the UK was up by 7.6% compared with 2019, but in mainland Europe it was up by 12.4%.[18]

- Culture & Leisure - museums, galleries, theatres, casinos – e.g. The Royal Opera House, The Globe, West End Theatres, and Rank Casinos have all publicly criticised ending tax-free shopping and cited it as a major reason for poor recovery performance relative to European institutions.

- Manufacturing – international travellers buy more goods from brands of the country they are visiting. So British brands like Mulberry and Burberry suffer most. This impacts on their London stores but also on the manufacturing plants and jobs throughout the UK. Mulberry has announced the closure of its flagship Bond Street store, citing the ending of tax-free shopping as the main reason.

7.3 To illustrate this wider impact the relative recovery in spending levels of France and Britain in 2022 suggests that Britain is underperforming in terms of overall international visitor spending. The figures show that both countries recorded visitor numbers at 24% down on 2019 levels, visitor spending was up by 4% in France but down by 7% in the UK. Data is from the French Ministry for tourism and VisitBritain.

Table 7 Comparison of recovery of international visitor numbers and spending in France and the UK

International visitor numbers

	2019	2022	22 v 19	22 v 19 %age
France	88m	67m	-21m	- 24%
UK	40m	30m	-10m	-24%

International visitor spend

	2019	2022	22 v 19	22 v 19 % age
France	€56bn	€58bn	+€2bn	+4%
UK	£28bn	£26bn	-£2bn	-7%

8. Assessing whether Britain's underperformance is the result of ending tax-free shopping

8.1 The Treasury has asked for evidence that the cause of the underperformance is the ending of tax-free shopping. We have addressed this in three ways.

Evidence of the impact of tax-free shopping on international visitor behaviour 1– business reports

8.2 All the evidence submitted by businesses to HM Treasury that AIR has seen state that it is tax-free shopping that has caused their relative underperformance. They have reached this conclusion based on customer behaviour and their knowledge of their businesses. This is supported by official data on the behaviour change of British travellers as a result of EU countries extending tax-free shopping to UK residents, as mentioned in section 6.

18 Planet "Payments data and insights report" March 2023. Not all of this underperformance will be due to ending tax-free shopping but an element of it will be.

Evidence of the impact of tax-free shopping on international visitor behaviour 2 – consumer surveys

8.3 HMRC's own 2020 survey of non-EU international visitors to the UK showed that travellers will change their behaviour and visit and spend less if tax-free shopping was removed. Examining the impact on visits to the UK, HMRC concluded that "VAT RES does play a role in attracting overseas visitors to the UK" and that "VAT RES is a strong influence in the decision making process."[19] Examining the impact of tax-free shopping on spending behaviour, the HMRC survey concluded that "VAT RES encourages tourists to spend more in the UK" and "around 36% would not have purchased all of the goods if the incentive was withdrawn."[20] The survey also found that "Most spend all or some of their savings in the UK, with a trickle down into hospitality and entertainment services, as well as further spending in retail."

8.4 Without exception, every consumer survey commissioned by industry show the same significant behaviour change both in choosing to visit the UK and on the level of spending by international visitors.

Evidence of the impact of tax-free shopping on international visitor behaviour 3 – eliminating all other possible causes

8.5 We have examined all the key variables that could have caused these substantial performance differences, in particular the exchange rates for 2019 compared with 2022 and the different speeds at which European countries opened-up after the pandemic. There is nothing in these which could have produced such a significant difference in the performance of the UK and other EU countries.

9. **<u>Evidence of Impact – Behaviour change by British people now able to shop tax-free in the EU</u>**

9.1 Another way to test the Treasury's assumption of little or no behaviour change is to look at the impact of the EU offering tax-free shopping to visitors from the UK. HM Treasury forecast that allowing the 447 million EU residents to shop tax-free in Britain would only generate 50,000 additional trips annually (just 0.2% on the 24 million EU visitors in 2019). By this logic, now that 66 million British residents can shop tax-free in the EU, this would generate an additional 9,000 trips

9.2 In reality, in 2022 around 138,000 refunds were claimed by British visitors to the EU for spending of over £500 million. In 2023 that figure has more than doubled so that we estimate around 300,000 British visitors will spend some £1bn on tax-free shopping in the EU this year.[21]

9.3 HM Treasury may argue that this is not all additional spending but the high volume of spending and anecdotal evidence suggests that a significant amount is new activity generated by the prospect of buying goods with the VAT refunded. The French Tourist Authority reported that in 2022 overnight stays by British tourists rose by 102% above 2019 levels. This compares to an increase of 42% for visitors from Germany, 10% for visitors from Holland. This exceptional growth in British visit to France since tax-free shopping is continuing in 2023. The French Institute for National Statistics reports that In Q2 2023 "the British customers attendance increased by 34.9% (compared to Q2 2022) and the German attendance increased by 8.1%. On

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19 HMRC "VAT RES Digitalisation – online survey with non-EU visitors to the UK" June 2020. Slide 19

20 HMRC "VAT RES Digitalisation – online survey with non-EU visitors to the UK" June 2020. Slide 31

21 According to EU tax refund data for 2022

the contrary, customers from Belgium were less numerous (decreasing) by 5.4% and from the Netherlands (decreasing) by 4.6%"[22]

9.4 This £1bn of tax-free shopping by British people in the EU is a further diversion of spending away from British high streets with no reciprocation. £1bn spent on tax-free shopping by British visitors gives an indication of the level of spending British businesses could expect if tax-free shopping was extended the 447 million EU residents, over six times greater than the UK's population of 66 million.

9.5 The behaviour of British shoppers suggests that tax-free shopping does significantly change visitor behaviour. AIR believes that the Treasury has not accounted for the potential of creating a whole new tourist market of short shopping-led trip by EU residents if Britain was to become the only European country to offer tax-free shopping to the 447m EU residents. The Treasury's forecasts regarding EU behaviour simply adjusts the non-EU numbers to take account of the relative proportions of non-EU to EU visitors (1:1.7). It fails to recognise that long-haul and short haul are very different markets.

9.6 Travellers from outside Europe take long and expensive flights once every few years to visit the UK. EU residents are far closer to Britain and, thanks to EuroStar and low cost airlines, can travel often, quickly and cheaply to Britain. We believe that making Britain the only major European country to offer tax-free shopping to the 447 million EU residents would create a whole new tourist market in shopping-led breaks, with multiple trips supporting not just London but, through our regional airports and their flights to European cities, opening new markets to cities and regions across the whole of the UK.

9.7 The French visitor figures show a significantly higher growth in British trips compared with other EU countries and there can be no other explanation than the introduction of tax-free shopping. The decision not to extend tax-free shopping to EU visitors was based on HMT's estimates that EU visitor numbers will increase by just 0.2% over 2019 levels. The actual data from France of a 102% increase in British bed nights in 2022 and of a further 32% increase in Q2 2023 suggest that the Treasury's 0.2% forecast should be reviewed. AIR urges the Government to examine this unique new market as a potential growth opportunity and explore it in more detail and in a context wider than the narrow approach taken by the Treasury's VAT team.

10. <u>Why we are calling for a review.</u>

10.1 In the summer of 2020 Ministers decided to end TFS on advice that it would have no impact on visitor behaviour, either in choosing to visit the UK or levels of spending. The 2020 Budget originally included a forecast of +£500m VAT as a result of ending the VAT RES, exactly the amount refunded in 2019.

10.2 The OBR did not assess this policy until November 2020, two months after the decision was announced. This is a "departure from normal practice" as the treasury official stated in written evidence to the 2021 judicial review. The OBR normally assesses the cost of HMT policy proposals as part of the decision making process, not after the decision has been made and announced by ministers.

[22] Institute National de la Statistic et des Etudes Economiques "Q2 2023 collective tourist attendance"

10.3 AIR is not suggesting that the Government acted improperly in any way. Indeed, the Judicial Review, held in early 2021 concluded that the Government had acted within the due process and this included the "departure from the norm" of taking the decision in advance of the OBR assessment. AIR's point that as a result of the departure from the norm, growing evidence is demonstrating that the Treasury's forecast of "limited impact" on retailers from ending tax-free shopping is unsound.

10.4 The ORB assessment was that HMT's effective zero impact forecast was wrong and instead forecast a 24% reduction in spending. This is a significant difference. HMT accepted the OBR recommendation and reduced its VAT revenue forecast in the Budget accordingly. AIR's analysis of 2022 actual spending shows a fall of 26% confirming the OBR forecast and undermining the Treasury's original 0% forecast.

10.5 When the higher level of spending in 2022 is taken into account, the result is a loss of at least £980m for UK businesses. It is getting worse in 2023 and will be even worse as Chinese traveller return to Europe. If the VAT RES had not been abolished , in 2022 British businesses would have earned an additional £933m, created 17,400 jobs and generated for the Treasury £164m more than the £203m VAT it collected on 2022 sales. That is one reason why we believe the Treasury should review its forecasts, not just on VAT revenues but on all other issues, including costs, benefits and indirect impact.

10.6 But in addition, we are also concerned that by not seeking an OBR assessment until after the decision was made, the OBR has never assessed the Treasury's forecasts for extending tax-free shopping to EU visitors. Making the decision to end tax-free shopping in advance of the OBR assessment meant that extending it to EU visitors was not a policy option and so the OBR never had the opportunity to assess the Treasury's forecasts relating to EU extension. This is important for two reasons.

10.7 First, because the cost of extending the schemes to EU visitors is one of the main reasons given by the Government for making the decision to end the schemes. As we show in sections 16, 17 and 18 below, we believe that the Treasury's assumptions on the impact on visitor numbers and spending, on which those costs are based, are not an accurate understanding of the international visitor economy. Yet the Treasury's forecast cost of extending the schemes to the EU were not independently assessed.

10.8 Secondly, because, as shown in section 9, above, the potential of creating a unique new tourism market which would have instant growth benefits for the whole of the UK has been dismissed without an serious examination.

10.9 With the Government actively seeking growth measures and prioritising regional growth through its Levelling-Up programme, we believe that this exciting new opportunity that has arisen as a result of leaving the EU and could be worth billions of pounds to the UK economy, deserves a thorough investigation. Instead it has been dismissed without due considerations on questionable assumptions and inappropriate calculations.

10.10 If the Government was persuaded to restore tax-free shopping AIR believes that this would provide the opportunity, now that Britain is outside the EU, for the Government and business to work together to create a new, enhanced approach which would -

- make Britain the best place in the world for international shoppers
- create thousands of new jobs across the whole of the UK
- give a particular boost to regional airports and the regions they serve

- produce substantial new growth opportunities for the UK's retail and tourism sectors and
- result in a net positive impact on Treasury revenues.

Part Two

AIR's commentary on the Treasury's positions

11. The consultation process and the decision

11.1 In early 2020 the Government launched a consultation on the VAT RES and Airside tax-free shopping as part of its wider programme of preparations for Britain leaving the EU. The paper sought view on a range of options for developing tax-free shopping outside the EU. While the options did include ending tax-free shopping, it was clearly not the preferred option. The section on airside tax-free shopping specifically stated that "the UK is minded to extend airside tax-free sales to those travelling to the EU by air, sea and rail." The option of ending the VAT RES was covered in just two sentence in the 22 page consultation paper. This focus on reforming rather than ending tax-free shopping was further reinforced by an ongoing consultation by HMRC into ways of digitalising the tax-free shopping system. The consultation on options for tax-free shopping post-2020 was launched on March 11th 2020, nine days before the first COVID lockdown, and ran until May 20th with the result that eight of the nine weeks of the consultation were during an unprecedented period of crisis which hit the retail, hospitality and tourism sectors particularly hard.

11.2 On September 11th 2020 the Government announced its decision to end tax-free shopping rather than extend in to visitors from the EU as required under WTO regulations. Given the tone, content and context of the consultation, the decision was a surprise to industry. Most consultation responses focussed on the options for extending tax-free shopping rather than making the detailed case against abolition. While many approaches were made to HM Treasury after September 11th, the Treasury was no longer in a consulting mode, but was instead focussed on implementing and defending the decision.

12. The Treasury's key assumption – tax-free shopping has little or no impact on the behaviour of international travellers, either in choosing to visit the UK or on their level of spending in the UK

12.1 The Treasury's case, made many times since the decision was announced and more recently in an answer from the then Exchequer Secretary to a Written Parliamentary Question on February 25th 2023 and in the response of the Financial Secretary to the Treasury at the end of a Westminster Hall debate on tax-free shopping on September 7th 2023, is that tax-free shopping has little or no impact on the behaviour of non-EU international visitors, either in choosing to visit Britain or on the level of spending when they are here. In his Parliamentary Answer the Minister said "Following the initial withdrawal of VAT-free shopping in November 2020, the independent Office for Budget Responsibility (OBR) published their assessment of the withdrawal of the schemes. Their assessment showed that 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."[23]

13. The Treasury's key assumption of little or no behavioural change leads it to forecast little or no impact on visitor numbers or spending.

13.1 From this assumption the Treasury concluded that ending tax-free shopping would not impact on spending levels for non-EU visitors and extending the system to EU visitors would lead to very few additional EU visitors. The Parliamentary Answer cited the OBR's forecast of the number of non-EU travellers who would choose not to visit the UK now that tax-free shopping

[23] Answer to WPQ February 25th 2023

had been abolished and used that to estimate the number of additional EU visitors likely to be attracted by an extended scheme saying "The OBR… put this figure at 20,000-30,000 for non-EU visitors, which would imply a figure of 60,000-80,000 of total visitors (EU and non-EU)" This equates to 0.1%-0.2% of the 40m international visors in 2019.

13.2 The Treasury's key assumption that tax-free shopping makes little or no behaviour change in visitor numbers or spending leads to the conclusion that there is a cost to the Treasury in the level of VAT refunded but limited or no benefits in terms of increased visitor numbers or spending. The Financial Secretary said "I reiterate that the fiscal cost of £2 billion was made up not just of that factor (*minimal additional visitors*), 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."

13.3 The core assumption of little or no behavioural change is also why the Treasury, having decided that the direct impact on retail sales would be minimal, assumed no indirect impact on other areas of spending such as hospitality, tourism, leisure and culture.

14. By accepting the OBRs recommendation on price elasticity, the Treasury has weakened its key principle of no behaviour change, which supports all its impact forecasts

14.1 The decision made by Ministers in or before September 2020 was made on the key assumption of little or no behaviour change effectively basing the policy on a price elasticity of zero. This is shown both in the statements that continue to be made by the Treasury and by the fact that the figure included in the November 2020 budget for VAT receipts as a result of ending the VAT RES was £500m the exact figure for the level of VAT refunded in by the VAT RES in 2019.

14.2 The decision and September announcement were made on advise that forecasted no behaviour change. In a departure from process, the decision was made before the OBR had assessed the Treasury's forecasts for the policy. Giving written evidence at the Judicial Review in January 2021 a Treasury Official stated that "the Government is committed to understanding the wide range of impacts and evidence bases associated with tax policy options to inform decision making…… The OBR is also a key part of that process as they independently review and publish information about tax policy decisions" (para 13).[24] But he then explained that, when deciding to end tax free shopping, based mainly on the estimated cost of extending the scheme to EU visitors, "the process for the 'Decision' departed from this norm as the policy changes were not announced at a Budget or alongside an OBR forecast. Therefore, the Government was unable to know what OBR's 'reasonable and central' view of the Exchequer Impact would have been before announcing the policy decision. Instead, the OBR-certified figures were necessarily published at a later date (25 November 2020) than would have ideally been the case." (para 15).

14.3 The OBR's assessment challenged the Treasury's effective assumption of a price elasticity of zero and instead recommended one of 1.9. [25] Based not on the 20% VAT refund rate but on one of 12.5% to take account of deductions in administrative fees and other issues, the OBR forecast a 24% fall in spending levels as a result of ending tax free shopping. It stated that a small amount of this would be because some international tourists will choose not to visit the UK and the largest amount as a direct result of a reduction in the level of spending of those

[24] Second Witness Statement of Michael Cunningham, January 27, 2021
[25] OBR "Economic and Fiscal outlook" November 2020

who do visit. The OBR's conclusion was "The overall behavioural impact reduces the static yield by approximately 24%."[26]

14.4 Giving evidence to the Treasury Select Committee on December 21st 2020 an OBR official said of its VAT RES forecast "I think the fact that we gave it a highly uncertain ranking should tell you that we're not particularly confident in any specific number." He continued "We assumed a relatively high price elasticity response from those affected, but whether that's going to be high enough or not is something that I don't think we can be very confident in."[27]

14.5 The Treasury accepted the OBRs recommendation and amended the VAT receipts forecast in the Budget accordingly. This has two significant consequences. First on the impact on businesses. The Treasury has accepted that there will be a significant level of behaviour change, with British businesses now forecast to lose around a quarter of their sales, not the zero impact that was forecasted when Minister made their decision. As the actual spending data for 2022 shows the OBR forecast was very accurate, (OBR -24%, actual -26%) although 2023 trends suggest the fall in spending will be even higher in future years. The decision to end the VAT RES was made on a Treasury forecast of no effect on British businesses but just two months after it was announced the Treasury amended this to a £750m annual loss and a reduced income for the Treasury of £125m. However, Ministers are still stating that ending tax-free shopping will have little or no impact on overall visitor spending even though the Treasury forecast in now of a 24% fall.

14.6 The second consequence is that, although the Treasury has used this new price elasticity of 1.9 and a 24% impact on spending, it has used this to amend only the forecast level of VAT expected, down 24%. But every other forecast has been made based on the key assumption of no behaviour change, including the cost to the Treasury and the impact on visitor numbers and spending. No changes have been made to these forecasts which are vital to deciding whether or not to end or expand tax-free shopping. This was included in the Parliamentary Answer and in the Minisiter's September 7th speech where she said "We have looked at the Treasury's analysis and the OBR's analysis, which suggest that the increase in tourist spending is marginal." We do not believe that a minimum 24% change in spending levels is marginal. This is why we are calling for an independent review of the full impact of tax-free shopping on the economy and tax revenues.

15. The Treasury's two reasons for believing that tax-free shopping has little or no impact on the behaviour of international visitors

15.1 The Treasury's reasoning for assuming little or no behaviour change in visitor numbers is based on two arguments. First that shopping is not itself a major attractor to international visitors to the UK and so ending tax-free shopping would not affect their choice and extending it to EU visitors would not encourage many more to visit to visit (just 0.1%-0.2%).

15.2 The Treasury's second argument is that since 1.2m refunds were made in 2019, this shows that only 8% of the 16m non-EU visitors use the scheme, leaving 92% unaffected by the change. The OBR used the Treasury's 1.2m user figure for its calculations on the impact on visitor numbers of ending the VAT RES. In its "Policy Costing Document" of November 2020 the OBR said "we estimate start from the 1.2 million visitors who used the scheme in 2019 approximately 20,000 to 30,000 fewer tourists may visit GB a year because of the change in policy."

[26] OBR "Policy Costing Document" November 2020 page 42
[27] Treasury Select Committee evidence session with OBR, December 1st 2020

15.3 AIR believes that the evidence supports neither of these two points. All the evidence shows that shopping is one of the top five attractions and the VAT RES was used by over 60% of non-EU international tourists. We explain these two points in sections 15 and 16, below, but first it is important to understand the difference between international visitors and international tourist.

16. <u>To assess the full impact the Treasury should follow VisitBritain's distinction between people who choose to visit Britain as tourist and the majority who are on business or visiting family and friends.</u>

16.1 The Treasury assumes that all of the 16m non-EU visitors in 2019 were tourists. The Financial Secretary said in her Westminster Hall debate speech "the total number of tourists we welcomed in 2019 was just over 40 million." But VisitBritain is clear than only 41% of the 16m international visitors were tourists, who had chosen to visit Britain, out of many competing destinations, for all or part of their holiday. The majority of international visitors, 59%, are not tourist, but are mainly here on business or to visit family and friends. The behaviour of the last two groups in deciding to choose to visit Britain were never impacted by tax-free shopping.

16.2 But it is the 6.4m tourists, who are the highest spenders on the three groups, [28] for whom shopping is one of Britain's many attractions. We believe that tourists are responding in three ways to the ending of tax-free shopping. For most tourists, ending tax-free shopping will not affect their decision to visit the UK, but they are likely to spend less money than before on shopping. For a second group of tourists, tax-free shopping is more important, but they still want to visit Britain for all its other attractions, so they are likely to spend less in our stores and less time in the UK, rescheduling shopping days and spending to other countries on their trip.

16.3 The third group of tourists consists of regular visitors who come to Britain specifically to shop. These tend to be high spenders who are now choosing Paris or Milan over London for their shopping trips. The 35% drop in spending by GCC visitors in 2022 demonstrates the effects of the behaviour change of this group evidenced in table 4.

16.4 So we agree with the Treasury that most international visitors will still choose to visit the UK for all the attractions mentioned by the Financial Secretary in her speech. But some will change their behaviour, particularly high spending tourists from the GCC countries and China by visiting Britain less often or staying for a shorter time. Many long-haul visitors to Europe plan a multi-country tour so will reduce spending during the UK element and increase it in other countries they will be visiting. This is having a negative impact not just on retail spending but on spending in hotels, restaurants and on culture and leisure activities. The impact of ending tax-free shopping on visitor numbers will be low, but the impact on spending, and on VAT receipt, is high. This is shown by the difference between visitor numbers and total spending by international visitors in France and the UK for 2022.[29]

International visitor numbers – France and UK in 2022 v 2019

	2019	2022	22 v 19	22 v 19 %age
France	88m	67m	-21m	- 24%
UK	40m	30m	-10m	-24%

[28] VisitBritain – 2019 snapshot
[29] VisitBritain and the French Ministry for Tourism

Total international visitor spend – France and UK 2022 v 2019

	2019	2022	22 v 19	22 v 19 % age
France	€56bn	€58bn	+€2bn	+4%
UK	£28bn	£26bn	-£2bn	-7%

16.5 This effect is shown by actual data on visitor numbers and spending by visitors from GCC states in the West End in 2022. GCC Visitor numbers were 1% higher than in 2019 but spending was 17% down.[30]

17. <u>Industry believes that the Treasury is wrong to assume that shopping is not a major attractor</u>

17.1 All the evidence, including HMRC's own survey of international visitors mentioned by the Financial Secretary, demonstrates that shopping and tax-free shopping are major influences on decisions to visit Britain and on levels of spending. We know of only one survey in the UK that does not list shopping as an attraction for international visitors. It was quoted by the Lords Minister in response to a question by Lord Vaizey on October 20th 2020 and we believe that the Financial Secretary was referring to it in her speech although she mistakenly attributed it to the HMRC survey of VAT RES users. However the reason that uniquely this survey does not list shopping as an attraction is because shopping was not included in the 30 options for respondents to choose from. This survey is in a VisitBritain report on international tourists[31] which, just two pages further, cites the ONS International Passenger Survey showing shopping as one of the top five attractions of the UK and the top attraction for visitors from GCC countries.

17.2 Every other consumer survey by Government and by industry puts shopping as a top attraction for international tourists. VisitBritain further states that “going shopping is the number one activity which most Chinese visits will feature, followed by dining in restaurants, visiting parks or gardens, museums or galleries, and castles or historic houses”.[32]

17.3 Even the HMRC survey of VAT RES users, referred to by the Financial Secretary, conducted in June 2020[33] finds that the VAT RES was important, concluding that “VAT RES does play a role in attracting overseas visitors to the UK” and that “VAT RES is a strong influence in the decision making process.” Since another of the conclusions from the survey was mentioned in its 2020 briefings on tax-free shopping, the Treasury must have been aware that their own HMRC findings cast doubt on its assertion that tax-free shopping has no impact on the behaviour of international tourists.

18. <u>Industry believes that the Treasury’s assumption that only 8% of non-EU international visitors use the VAT RES is a misunderstanding of the VAT refund system. In reality over 60% of non-EU tourists in the UK used the VAT RES</u>

18.1 The Treasury maintains that only 8% of non-EU international visitors used tax-free shopping in 2019. We believe that this understates the importance of tax free shopping to non-EU international tourists.

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[30] New West End Company, reported in the Sunday Times October 15th 2023

[31] VisitBritain – 2019 snapshot

[32] VisitBritain “Market and Trade Profile – China” 2019

[33] HMRC “VAT RES Digitalisation – online survey with non-EU visitors to the UK” June 2020

18.2 The Treasury assumes that the number of refunds claimed (1.2 million in 2019) represents the number of people who use tax-free shopping. In reality each refund represents a group of visitors who have shopped tax-free. The Treasury's 1.2 million figure assumes that every group making a reclaim contains just one person. In reality people travel in larger groups of family or friends, with an average size of three. So whereas the Treasury assumes that 1.2 million people used tax-tree shopping, a more realistic figure is 3.6 million. This means that the percentage of non-EU visitors who used the scheme in 2019 is closer to 24% than the Treasury's estimate of 8%.

18.3 The Treasury's underestimation of the importance of the VAT RES is compounded by assessing it as a percentage of all 16m non-EU international visitors rather than the 6.4m who are tourists and for whom tax-free shopping is an attraction. Rather than the Treasury's estimation that only 8% of non-EU international visitors use the VAT RES in 2019, the reality is that around 24% of them did, including over 60% of those who were tourists.

18.4 This difference is important because, as shown in 13.2, above, the OBR used the Treasury's forecast of 1.2m users to base its forecast of the impact of ending the VAT RES on visitor numbers.

19. <u>The impact of offering tax-free shopping to EU visitors.</u>

19.1 The Treasury's key assumption that tax-free shopping has little or no impact on international visitor behaviour leads it to the conclusion that extending the scheme to EU visitors would result in very few additional visitors from the EU. In the February Parliamentary Answer The then Exchequer Secretary said "The OBR, using a higher than usual price elasticity of demand to account for VAT-free shopping being targeted at luxury goods, put this figure at 20,000-30,000 for non-EU visitors, which would imply a figure of 60,000-80,000 of total visitors (EU and non-EU)." In her speech the Financial Secretary said "the Government estimate that 50,000 to 80,000 more people would come to the UK if we introduced such a scheme. My hon. Friend thinks the figure would be higher, and I think the Oxford Economics report suggested something in the region of 1.6 million, but the 50,000 to 80,000 figure has been endorsed by the OBR, which is the independent body that scrutinises Treasury calculations and assumptions. Indeed, my hon. Friend has asked the OBR to review the policy."

19.2 Industry does not believe that introducing tax-free shopping would result in only a 0.2% increase in visitor numbers, as the Treasury's figures suggest. We use as evidence, the impact on British visitor numbers and spending in the EU as a result of being able to shop tax-free. While the Treasury may rightly suggest that some of this is not additional it is difficult to believe that 99.8% is not additional.

19.3 The figure of "50,000 (sic) to 80,000 more people" has not been endorsed by the OBR. As the Exchequer Secretary said, the OBR put a figure of 20,000 to 30,000 non-EU visitors, but this was based on what AIR believes is the Treasury's underestimate of the number of people who use tax-free shopping as explained in section 16, above. It was the Treasury that implied this EU figures from the ORB's 2020 assessment. The Treasury seems to have taken the estimate made by the OBR for the increase in non-EU visitors, based on the Treasury's disputed figure for VAT RES users and applied a multiplier to reflect the larger numbers of EU visitors. We do not believe this is an accurate figure.

19.4 We have already mentioned in paragraphs 10.8 - 10.10 our additional concerns that the Treasury has not understood the difference between long-haul and short-haul travellers and has dismissed too quickly the potential for creating a whole new shopping-led tourism market with a particular boost for regional economies.

20. Other Treasury misunderstandings

20.1 At the end of September's Westminster Hall debate, Sir Geoffrey Clifton-Brown MP offered to write to the Financial Secretary having sought responses from industry to the various points she had raised. Many of the key points in her speech have been addressed in this evidence submission. However there are a number of other issues she mentioned and in this section we have responded to them.

Shop and ship

20.2 The Financial Secretary stated that" VAT RES is still available for all non-UK visitors who purchase items in store and have them delivered to their overseas address, which many shoppers would rather do than have to take them all home in their luggage." In response to Sir Geoffrey's observations that "while that scheme is available, it is very little used" she replied "In fairness, it may be that people do not know that it is available. I do not know whether shops or brands advertise it to their customers."

20.3 AIR has subsequently discussed this with many of the major stores that offered tax-free shopping. All of them demonstrated that they actively promote "Shop and Ship" but that it is not a popular option and does not compare with the tax-free shopping offered by EU competitor countries. Visitors buying fashion and jewellery want to wear their purchases, not send them home. The Shop and Ship system relies on third party couriers and incurs automatic import charges which are often higher than the tax refund.

20.4 The Treasury's original forecast for VAT receipts following the ending of the VAT RES assumed no refunds would be made, which questions its subsequent promotion of Shop and Ship as a way of reclaiming VAT. Shop and Ship is not a popular option and retailers believe that, if it was, the Treasury would treat it as a loophole and close it down as it did with the more popular scheme of delivering purchases to the airport within months of ending the VAT RES.

Most will continue to shop even without tax- free shopping

20.5 Referring to the HMRC survey of VAT RES users, the Financial Secretary said "two thirds of those surveyed said that they would have purchased the items regardless of the scheme, while 28% would have purchased fewer items, meaning that 95% of tourists would still shop even without the scheme."

20.6 The figure of 95% does not appear in the survey. Instead, the survey draws just four conclusions in the section on the impact of the VAT RES on spending behaviour:

- VAT RES encourages tourists to spend more in the UK.
- It accounts for more than half of spending for those who use it.
- Around 36% would not have purchased all of the goods if the incentive was withdrawn.
- Most spend all or some of their savings in the UK, with a trickle down into hospitality and entertainment services as well as further spending in retail.

20.7 The survey confirms our point in section 16, above, that most visitors will not stop visiting now that they cannot shop tax-free but many will reduce the level of their spending.

20.8 Interestingly, the last bullet point suggests that the money refunded is mostly spent back in the UK economy, not taken out of the UK.

The role of the OBR

20.9 The role and the endorsement of the OBR has been mentioned many times by the Government. In his Parliamentary Answer, the Exchequer Secretary said of the OBR "Their assessment showed that 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."* (AIR's italics). The OBR actually disagreed with the Treasury's forecast of no effect and recommended a price elasticity of 1.9 resulting in a fall of 24% in spending. Industry does not believe that this is a "limited effect."

20.10 The Minister's Answer also shows how the Treasury used the OBR's estimate on increased non-EU visitors to produce its own estimate of "60,000 – 80,000" additional EU visitor numbers saying "The OBR, using a higher than usual price elasticity of demand to account for VAT-free shopping being targeted at luxury goods, put this figure at 20,000-30,000 for non-EU visitors, which would imply a figure of 60,000-80,000 of total visitors (EU and non-EU).The Financial Secretary subsequently said "the 50,000 (sic) to 80,000 figure has been endorsed by the OBR"

20.11 AIR believes that the original OBR figure was based on unchallenged Treasury assumptions on VAT RES user numbers and we have seen no evidence that the Treasury's EU estimate has been endorsed by the OBR.

20.12 The most important number is the Government's £2bn estimated cost of tax-free shopping. AIR has suggested that the Treasury has overestimated the cost of extending the scheme to visitors from the EU and that it included very little as benefits because of its key assumption of no behaviour change, which it has subsequently changed. The Government constantly cites the £2bn cost as the reason for ending tax-free shopping. AIR can find no occasion where the OBR has examined the estimated cost, partly because its remit is to assess proposed government policy, not abandoned policies.

20.13 In September the Financial Secretary said "the Government still estimate that the measure would cost in the region of £2 billion each year, and the methodology for calculating that £2 billion cost is consistent with the methodology signed off and certified by the OBR in 2020" which suggests that the cost has not been signed-off and certified by the OBR. Later in her speech she said "I am obliged to stress that the independent OBR certified the Government's costings for the removal of the VAT RES scheme."

20.14 Sir Geoffrey Clifton-Brown MP wrote to the Chairman of the OBR on May 15th 2023 seeking clarification on the extent of the OBR's assessment but as yet, five months later, he has had no reply.

Relative recovery post pandemic

20.15 The data presented in Part 1 shows that Britain's post-pandemic recovery rate is significantly worse than our major competitor countries of France, Italy and Spain. In her speech the Financial Secretary said "Rather than ours being the weakest post-pandemic recovery in terms of visitor numbers, the post-pandemic recovery in the UK has been stronger than in countries, such as Germany and Japan, that continued to offer VAT RES." AIR believes that the comparison should be with France not Japan and that, as the Treasury and AIR agrees, it is not visitor numbers that will see the biggest hit, it is visitor spending.

20.16 On visitor spending, she said "the average spend per visit was £696 in 2019 and £848 in 2022, which is an increase of 8% in real terms. That tends to indicate that international spending habits in the UK are not directly informed by whether VAT RES is in place." As we have shown in Part One, visitor spending increased all across Europe as a result of pent-up demand and increased savings, so that the UK figures needs to be compared with those of competitor EU states to get a meaningful understanding of the impact of ending tax-free shopping. The best comparison is with France.

20.17 According to the French and British tourism authorities, in 2022 visitor numbers in both France and the UK were both 24% down on 2019 levels. But while total spending was up by 4% in France it was down by 7% in Britain. Based on the £28.4bn spending in the UK in 2019, if Britain had performed as well as France instead of showing a £2bn fall on 2019 spending levels, Britain would have recorded a £1.1bn increase, a difference of £3.1bn.

Refund Charges

20.18 The Financial Secretary raised the issues of fees charged to visitors claiming the VAT refund. She mentioned the findings of the HMRC survey showing that visitors do not receive the full 20%. This is standard practice worldwide. The fees are to cover administration costs, marketing tax-free shopping, provision of digital and other infrastructure, refund financing and extensive data collection and analysis to maximise the benefits to the UK economy.

20.19 We do not understand why this issue should be a factor in the decision making process, other than to estimate the impact of price elasticity. The HMRC survey concluded that :

- Most are aware of the fees from previous experience.
- Retailers are perceived to provide the required info up front.
- The most reasonable estimate of average fee is 28%.
- 21% feel the fees are too much, however most feel they are reasonable.

21 Conclusions

21.1 Our submission highlights a number of issues where we believe the Treasury's assumptions need to be reviewed. Most importantly the Treasury has accepted that its assumption of no behaviour change, upon which the decision to end tax-free shopping was made, was wrong but it has only amended its forecast of VAT receipts. We believe that all the other forecasts need to be reviewed. They assume no impact on spending behaviour when the almost £1bn loss of sales by British retailers in 2022 clearly prove that this is not the case.

21.2 AIR asks the Chancellor, as a matter of urgency, to review the forecasts and on the basis of the correct evidence, reconsider the Government's decision to end tax-free shopping. Government and business should work together to create a tax-free shopping system that makes Britain the top shopping destination for international travellers.

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