Association of International Retail

Tax-Free Shopping - Review of Costings
Executive Summary

- Costing of VAT RES options by HMT, OBR and AIR differ significantly as shown in tables 1-4.
- HMT costing are from 2020 during COVID-19 lockdown with limited access to behaviour data.
- OBR reviewed its 2020 costing in 2024 to take account of new behaviour data
- AIR is commissioning EY to review, using HMT compliant methodology and behaviour data since 2022.
- Tables use the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

1. Cost of VAT RES 2019. (£m)

COST 1	HMT	OBR	AIR
Fiscal Cost	500	500	500

2. Cost of abolishing VAT RES (£m)

OPTION 1	HMT	OBR	AIR
Fiscal Cost	-500	-500	-500
Behaviour &	0	125	250
Exch impact	-500	-375	-250

3. Cost of extending VAT RES to EU (£m)

COST 2	HMT	OBR	AIR
Fiscal Cost	900	-	50
Behaviour &	0	-	-1000
Exch impact	900	-	-950

4. Cost of VAT RES for all international visitors (£m)

OPTION 2	HMT	OBR	AIR
Fiscal Cost	1,400	-	550
Behaviour &	0	-	-1000
Exch impact	1,400	-	-450

Table 2 – Impact of ending tax-free (option chosen by government)

- September 2020 HMT forecast no reduction in spending resulting in Exchequer benefit of £500m
- OBR forecast 24% reduction, accepted by HMT, resulting in Exchequer benefit of £375m
- Data on actual spend in 2022 show reduction of 48%, resulting in Exchequer benefit of £250m

Table 3 - Cost of Extending VAT RES to EU option – (i) additional fiscal cost

- HMT £900m. Data proves HMT £900m VAT cannot be correct. It implies EU shopping spend of £5.7bn. Equal to total visit spend of EU shoppers. Implies international shopping spend is twice the total international visitor spend
- AIR £50m. Data on international shopping spend shows EU is just 10% of total. VAT for non-EU was £500m implying EU VAT of £50m

Table 3 – Extending VAT RES to EU option – (ii) behaviour and other effects

- HMT assumes EU short-haul visitors are the same as non-EU long-haul. They are different
- HMT assumes no additional EU visitors. Data on UK tax-free shopping in EU disproves this
- HMT assumes +0.3%. Hotel data on British in Paris 2022-23 shows +130% on 2019
- Data on UK spend in EU suggests 447m EU market of £5bn tax-free and £5bn other so +£1bn VAT

Table 4 – Cost of VAT RES for all international visitors (option rejected by government)

- HMT forecasts Exchequer cost of £1.4bn. AIR forecasts Exchequer benefit of £450m
- AIR forecasts additional indirect Exchequer benefits of £3.7bn

1) Extending to EU +£450m VAT & indirect +£3.7bn = £4.15bn (growth option - new market and annual growth)
2) Ending VAT RES (chosen) +£250m VAT (no growth option – OBR annual growth due only to inflation)
HMT 2024 cost = £1.4bn *1.78 = £2.5bn AIR 2024 cost = -£450m*1.78 = -£800m

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Section 1 – AIR's call for a review

In advance of a meeting with the Financial Secretary, AIR has produced this short brief on the costings of the VAT RES. This is to show government that there are significant differences between the costings of HMT and AIR and suggest why they have occurred. The aim is not to convince government that AIR's costings are correct, but to persuade the government of the need to review the original 2020 costing in light of new behaviour data, just as the OBR has recently done with its 2020 estimates.

AIR is considering commissioning EY to undertake a comprehensive costing review using HMT compliant methodology and drawing on real life data to assess the estimates of HMT and AIR and produce a expert opinion on costings.

This would be the industry's full and formal response to the government's request for evidence of the impact of ending tax-free shopping and the Chancellor's call for responses to the OBR's 2024 review of its 2020 costing. It will use HMT methodology and a format that matches that of HMT and OBR costings. It will draw on data now available on actual behaviour and spend since 2022 to test the 2

AIR's costing suggest a £4.1bn positive impact for the Exchequer from extending tax-free shopping to the EU compared with a £250m positive impact from abolishing it. This is mainly based on evidence that suggests first, a significantly lower deadweight cost than HMT estimates for including EU visitors in the VAT RES and secondly that, rather than there being no behaviour change, the creation of a new EU shopping-led market will lead to significantly higher visitor numbers generating additional VAT on other spending and a large indirect tax benefit.

However, businesses feel that in the past HMT has not responded in detail to earlier studies and evidence submitted. Before committing to investing a substantial sum in commissioning this report, businesses would like some assurance from Ministers that the report, as the authoritative industry submission, will be considered and responded to in detail, similar, for example, to the way that the OBR would scrutinise and respond to any HMT costing document.

AIR is not seeking prior commitment that government would accept the outcomes of the report. We are seeking assurances that the government will give a detailed, written response to the report, with evidence-based arguments explaining where and for what reasons HMT may disagree with any of the revised costing.

AIR's outline costing in this briefing follow the OBR review principle of focussing on the VAT RES with the assumption that the airside tax-free would mirror the VAT RES costings.

The OBR review focussed on its forecast for the impact of ending the VAT RES. The OBR did not have a remit to scrutinise either the costing for extending the VAT RES to EU visitors or HMT's cost estimates for introducing a VAT RES for all international visitors. These key HMT costings have not been certified by the OBR.

This briefing focuses on the HMT's 2020 costings for each of the two options available to ministers when they made the decision - to extend the VAT RES to EU visitors or to abolish it. Ministers maintain that it was this cost estimate of extending the VAT RES to EU visitors that was the determining factor in their decision to abolish tax-free shopping. AIR's evidence suggests that the real impact on the Exchequer is positive, not negative.

Section 2

Differences in costings of HMT, OBR and AIR for the two options for the future of the VAT RES after Britain left the EU

- In 2020, Ministers decided to end the VAT RES rather than extend it to EU visitors, based on the cost of extending the scheme.
- The tables below show HMT's 2020 cost estimates for each option alongside those of AIR's
- These are the costings that informed ministers' decision-making in 2020.
- The differences between the two sets of costings are explained in the following sections.
- The OBR has scrutinised only HMT's costing for abolishing the VAT RES. OBR certified the HMT costing in November 2020 only after HMT had amended its original September 2020 costing to incorporate OBR's recommendation of a 24% reduction in spending as a result of abolishing the VAT RES.
- The OBR estimates for 2024-25 in its 2024 review are based on its November 2020 forecast, adjusted for inflation.
- OBR's 2024 Revue broadly confirmed its 2020 costing, and maintained its estimate of a 24% reduction in spending.
- The OBR has not scrutinised or certified HMT's costing for extending the VAT RES or its estimated cost of restoring the VAT RES for all international visitors.
- The costings only include direct impact on VAT. Indirect impacts would be additional.
- The tables use the convention that a negative number implies a decrease in borrowing, i.e. an increase in receipts.

Table One - Fiscal cost of VAT RES 2019. Actual level of VAT refunded to non-EU visitors (£ m)

COST 1	HMT	OBR	AIR
Fiscal Cost	500	500	500

Table Two -Estimated Exchequer impact of abolishing VAT RES (£m). Chosen Option

OPTION 1	HMT	OBR	AIR
Fiscal Cost	-500	-500	-500
Behaviour and Other Effects	0	+125	+250
Exchequer impact	-500	-375	-250

Table Three - Estimated Exchequer impact of extending VAT RES to EU (£ m)

COST 2	HMT	OBR	AIR
Fiscal Cost	900	-	50
Behaviour and Other Effects	0	-	-1000
Exchequer impact	900	-	-950

Table Four - Estimated Exchequer impact of VAT RES for all international visitors (£ m). Rejected Option

OPTION 2	HMT	OBR	AIR
Fiscal Cost	1,400	-	550
Behaviour and Other Effects	0	-	-1000
Exchequer impact	1,400	-	-450

- AIR's costings suggest that extending the VAT RES to EU visitors (+£450m) is a better option for the Exchequer than abolishing the VAT RES (+£250m).
- AIR estimates £3.7bn of additional indirect revenue benefits to the Exchequer from extending the VAT RES

Section 3 - Reasons for the variations in costings

1. **Table Two – Estimated Exchequer impact of abolishing the VAT RES**

1.1 When ministers made the decision on the future of the VAT RES in September 2020, the HMT costing assumed no impact on spending levels. HMT forecast that abolishing tax-free shopping would not reduce spending by non-EU visitors, implying a price elasticity of 0.

1.2 The OBR was asked to review the HMT costings in November 2020 only after the decision to end the VAT RES had been announced. The OBR rejected HMT's costing and instead assumed a price elasticity of 1.9 implying a reduction in spending of 24%. HMT accepted this recommendation and reduced its forecast Exchequer impact, after the decision had been made.[1]

1.3 AIR's evidence, based on data of actual spending levels by non-EU visitors in the UK and mainland Europe in 2022, showed that spending fell by 48% in the UK compared with 2019 levels. This suggest that the impact on the Exchequer of ending the VAT Res for non-EU visitors is a net positive of £250m not HMT's original £500m or revised £375m.

2. Table three – Estimated Exchequer impact of extending the VAT RES to the EU

2.1 HMT estimates a negative impact on the Exchequer of £900m in refunded VAT. AIR estimates a positive impact of £950m

Fiscal cost estimate – HMT estimate fiscal cost of £900m. AIR estimates fiscal cost of £50m

2.2 HMT estimate is based on non-EU VAT refund level 2019 (£500m) adjusted for relative visitor numbers.

2.3 HMT Technical Note on the VAT RES, October 2020, states "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 UK1 . 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."[2]

2.4 £900m VAT implies sales of £5.4bn. Data on actual spend shows that HMT's estimate cannot be right.

2.5 Example one - VisitBritain's International Passenger Survey states "49% of visits from the EU to the UK involved shopping. In total these visits were worth £5.4bn to the UK (total spend rather than spend on shopping alone)."

- HMT £900m VAT estimate implies spend on shopping is £5.4bn
- IPS data shows total spend is £5.4bn
- HMT estimate therefore suggests that spend on shopping by EU visitors is the same as their total spend. This cannot be correct.

2.6 Example Two - Data on actual spending levels.

- Actual spending data shows EU visitors account for just 10% of total international spending on shopping and non-EU account for 90%.[3]

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[1] Incidentally, by admitting that its "no impact" assumption was wrong, HMT has undermined its costing on the impact of extending the VAT RES to EU visitors which is also based on a "no impact" assumption.

[2] HMT say of the £900m estimate that "this is likely an upper bound of the cost due to EU visitors tending to spend less time and money when visiting the UK." However, HMT's costings are based on £900m, e.g. the cost estimate of £1.4bn of the VAT RES for all international visitors is £500m plus £900m.

[3] Data from various retailer sources give a consistent response that EU accounts for 10% of all international spend on shopping. E.g. Findings from New West End Company data collection and analysis system, operated in partnership with PwC for London's West End, where 65% of all VAT RES spending takes place.

- HMT EU VAT estimate of £900m implies shopping spend of £5.4bn
- If 10% of international visitor shopping spending is £5.4bn, then total shopping spending is £54bn
- VisitBritain states that total spend by all international visitors on everything in 2019 was £28.4bn[4]
- HMT's VAT estimate therefore suggests that spend on shopping by EU visitors is almost twice as much as the total spend by all international visitors. This cannot be correct.

2.7 Data on actual spend levels of EU visitors relative to non-EU (around 10%) and HMT VAT refund levels for 2019 suggests the static cost is £50m not £900m.

- EU visitors are low spenders and receive no tax refund incentive to shop. They account for 10% of total international shopping spend.
- Non-EU international visitors are high spenders and receive a 20% tax refund which encourages more spending. They account for 90% of international shopping spend.
- HMT data shows the level of VAT refund to non-EU visitors in 2019 was £500m. This implies that the actual level of VAT paid by EU visitors in 2019 was 10% of £500m, so £50m not £900m

Behaviour and other effects

2.8 HMT assumes little or no behavioural effect as a result of extending the VAT RES to EU visitors, forecasting very few additional visitors attracted by tax-free shopping. AIR believes the evidence shows the opposite, that introducing tax-free shopping does create a significant number of additional short-haul visitors.

2.9 The Government said of the estimated number of additional EU visitors as a result of extending the VAT RES "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 (of additional visitors) 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)."[5] HMT's 50,000 top estimate of additional EU visitors is just 0.2% of the 24.8 m EU visitors in 2019.

2.10 The Financial Secretary stated in Parliament "the Government estimate that 50,000 to 80,000 more people would come to the UK if we introduced such a scheme (extended VAT RES)…… the 50,000 to 80,000 figure has been endorsed by the OBR."[6] The OBR has stated that it has not scrutinised or certified the HMT costings for including EU visitors and so cannot have endorsed these figures. HMT's estimates of increased EU visitor numbers are extrapolated from its non-EU visitor estimates. Evidence shows that this is not valid because the two groups are qualitatively different.

2.11 Non-EU visitors are mostly making infrequent, long-haul trips to Europe, often multi-country tours with London as the main UK focus and where shopping is one of a number of attractions. The impact of ending the VAT RES has therefore been a small reduction in non-EU visitor numbers[7] but a significant fall in spending as they defer their shopping until they are in an EU country offering tax-free shopping. AIR evidence submitted to HMT estimate that in 2022, £1.5bn spend was diverted from the UK to EU countries.

2.12 EU visitors are very different. Their proximity means they can make multiple short-haul trips, travelling quickly and inexpensively. They currently spend relatively little on shopping because there is no great difference between UK and EU prices and they do not have the attraction of shopping tax-free.

[4] VisitBritain figures, from IPS, quoted by HMT
[5] Reply to WPQ by Financial Secretary February 2023
[6] Westminster Hall Debate September 7th 2023
[7] AIR suspects that any fall in non-EU visitor numbers is from those high-spending travellers who make multiple trips for shopping, such as visitors from the GCC states who now chose to visit Paris rather than London. So while the fall in visitor numbers is low, the impact on spending is high

2.13 The evidence shows that introducing tax-free shopping into this short-haul market has a significant impact on visitor numbers and spending levels. Since 2021 British visitors to the EU can shop tax-free. France is the most popular destination. In 2023 British bed nights in Paris were 230% of 2019 levels.[8] Bed nights for other European visitors increased by just 5%-30% in the same period. The latest report from the French Institute of Statistics on hotel stays in France in Q4 2023 compared with Q4 2022 states "Hotel occupancy decreased for Dutch (-17.7%), Belgium (-5.9%) and German customers (-5.6%). On the other hand, British customers increased by 17.9%."[9] AIR cannot think of any reason for this dramatic growth in British visitor numbers other than the introduction of tax-free shopping. This 130% increase in bed nights calls into question HMT's forecast EU visitor increase of just 0.2% in response to introducing tax-free shopping.

2.14 Data on tax-free shopping refunds in the EU shows British spending went from zero in 2021 to €500m in 2022 and €780m in 2023 and continuing to grow. Based on this data, AIR estimates that if the UK became the only major European country to offer tax-free shopping to the 447m EU residents, additional shopping spending would be around £5bn. In addition, based on the hotel data, AIR, estimates this new market would spend a further £5bn on other goods and services, resulting in £1bn additional VAT receipts for the Exchequer.

2.15 HMT was concerned that the VAT RES previously was focussed on London. VisitBritain data shows that EU travellers are more likely to visit UK destinations other than London, with 50% of their spending outside the capital. This implies that £5bn of this new market spending would be in the regions, with a particular benefit for regional airports who would also gain from airside tax-free shopping.

3. **Table 4 – Estimated Exchequer impact of introducing VAT RES for all international visitors**

3.1 AIR's estimate of the fiscal cost and the additional behavioural and other effects result in a forecast net positive for the Exchequer of £450m. This compares with HMT's forecast of a negative impact of £1,400m.

3.2 AIR's costing does not include indirect impact on tax revenues. 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. This implies that the new EU market alone would generate £3.7bn of additional indirect tax revenue for the Exchequer.

3.3 AIR's costings do not include consideration of wider issues, such as the impact of the VAT RES on the multi-million pound capital expenditure plans and investment in the UK by global brands.

4. **Conclusions**

4.1 HMT's forecast of a negative impact on the Exchequer of £1.4bn for a VAT RES available for all international visitors is the basis for HMT's now £2.5bn cost. When tax-free shopping was included in the 2022 Growth Plan, the cost to the Exchequer was given as £2bn, and it now risen to £2.5bn. Treasury officials explained to AIR at the time that the £2bn was the cost to the Exchequer of the VAT RES plus the cost of airside tax-free shopping, adjusted for inflation since 2020. The OBR has not scrutinised or certified these costs.[10] This suggests that if HMT's 2024 estimate of restoring tax-free shopping is now a cost to the Exchequer of £2.5bn, AIR's 2024 cost estimate is benefit to the Exchequer of £800m.

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[8] Office de Tourisme, Paris

[9] National Institutre of Statistics and Economic Studies, France

[10] OBR 2024 Review stated "The reinstatement of these measures and their extension to both non-EU and EU visitors was announced as part of the September 2022 Growth Plan, but the costing was not scrutinised or certified by the OBR. The reinstatement was not confirmed as Government policy in the subsequent 2022 Autumn Statement or implemented, so we have never assessed its costing as our remit only allows us to consider confirmed Government policy."

Table Five– Estimated 2024 Exchequer impact of restoring tax-free shopping (£m)

	HMT	AIR
2020 VAT RES cost	1,400	-450
Airside & inflation	x 1.78	x 1.78
2024 forecast	2,500	-800

4.2 HMT's costings were made in 2020, when all international travel had been halted, on a range of economic forecasts and assumptions but with little data on behavioural response of international travellers. AIR's costings are from 2023, based on data of actual spending levels and traveller behaviour now available post-COVID-19. In 2024 the OBR decided to review its 2020 forecasts given the level of uncertainly and the lack of behavioural data at that time. AIR believes that HMT should also review its 2020 forecasts for the same reason.

4.3 AIR's costing suggest that extending the VAT RES to EU visitors is a better option for the Exchequer than abolishing the VAT RES

- ***Option 1 – Extending VAT RES to EU. £4.15bn additional tax revenues***

    - Exchequer impact is a direct benefit of £450m plus indirect benefit of £3.7bn.
    - The growth option. Annual increase in Exchequer revenue driven by both economic growth and inflation

- ***Option 2 – Abolishing VAT RES. £250m additional tax revenues***

    - Exchequer impact is a direct benefit of £250m.
    - The no-growth option. OBR suggests annual increase in Exchequer revenue due only to inflation.

4.4 The scale of the difference in estimates between HMT and AIR, the availability of behaviour change data that did not exist in 2020, the positive impact on the Exchequer if AIR's forecasts are more accurate than those of HMT, the unique new market opportunity potential, the impact on the regional economies and jobs, and the impact on British businesses all suggest that the Government should, at the very least, support a review of 2020 costings. It is for this reason that AIR is considering commissioning EY to undertake a review of HMT and AIR costings.

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