AIR

Association of International Retail

Dear Ms Reeves,

A quick way to grow the economy across the whole country and boost tax revenues

In light of the economic challenges that your Government faces, with a £22bn black hole in the public finances, the Association of International Retail (AIR) has produced the attached paper which demonstrates how the reintroduction of tax-free shopping will result in an additional £11.5bn of foreign spending in the UK each year and generate over £4bn in additional tax revenues.

By making Britain the only major European country where the EU's 450m residents will be able to shop tax free, Britain would create a totally new, shopping-led tourism market which we calculate would be worth £10bn annually. This spending would be spread across the whole of the UK, with the regions particularly benefitting, in part due to the strong links of their regional airports to EU destinations. This would result in over 200,000 new jobs, accessible to all.

AIR calculates that the actual impact on the Exchequer is a tax revenue boost of £4bn a year, not the current government's increasingly discredited forecast loss of £2.5bn which has not been scrutinised nor certified by the OBR. Recent, actual spending data from across the UK and mainland Europe has consistently undermined the government's forecast, yet the current Chancellor has resisted repeated calls from British business across the whole country, politicians of all parties and the media to look again at his decision.

AIR shares your belief in fiscal prudence and evidence-based policy making. That is why we are first calling for a review of the full impact of tax-free shopping on the Exchequer using data on actual changes in international traveller behaviour and spending levels which has now become available after the COVID lockdowns.

In contrast to the procedure used by the then Chancellor in 2020, we are also calling for all the forecasts to be fully scrutinised and certified by the OBR before ministers make a decision on the restoration of tax-free shopping.

By not listening to business, the Conservative Government missed a unique opportunity provided by Brexit to grow the economy and create this significant new market. We are encouraged by the Labour Party's commitment to work with business and we hope this continues into Government, so that together we can make Britain the best place in the world for international travellers to shop.

We would appreciate the opportunity to discuss this with you and your team after the election.

Best wishes,

Paul Barnes

Chief Executive

AIR
Association of International Retail

Change.

Labour Party Manifesto 2024

Helping a new Labour Government fulfil its mission to kick-start growth by identifying an £11.5bn annual boost to the economy across the whole of the UK and a £4bn net annual benefit to the Exchequer

This paper shows how the restoration of tax-free shopping and extending it to EU visitors will help deliver key Labour Party manifesto commitments to create growth and kick-start the economy by **generating over £11bn of additional foreign spending annually across the whole of the UK** resulting in **over potentially £4bn of additional tax-revenues for the Exchequer.**

The Conservative Government ended tax-free shopping on leaving the EU in 2021 based on its forecast of the impact on the Exchequer of extending the scheme to EU visitors.

Overwhelming actual data since 2022 do not support the then Chancellor's 2020 forecasts, showing that billions of pounds of foreign spending has been diverted away from Britain to France, Spain and Italy. **The last Chancellor ignored multiple calls from British retailers, manufacturers, transport and tourism businesses from across the UK even just to review the government's original forecasts.**

The OBR has confirmed that **the then Chancellor did not allow it to scrutinise in advance the forecasts upon which he made the decision to end tax-free shopping** and that it has never certified those forecasts. Further, in March 2024 **the OBR stated that it has not scrutinised and does not endorse the last Chancellor's cost forecast for restoring tax-free shopping.**

1. Recommendations

AIR's recommendations are made in the context of the Labour Party Manifesto and evidence presented by AIR at a meeting with the former Financial Secretary to the Treasury in May 2024, attached as Appendix 1.

AIR recommends the following to a new Labour government:

- **Commission as quickly as possible an evidence-based review of the current government's 2020 cost forecasts using data on actual sales levels now available**
- **Submit the outcomes of the review to the OBR**
- **Consider the outcomes of the review only after they have been certified by the OBR, not before**
- **If the OBR certified costings forecast a net positive for the Exchequer, then work in partnership with industry to restore tax-free shopping quickly to prevent further diversion of spending to mainland Europe and to generate significant net additional tax-revenue from international visitor spending**

2. Background

The evidence of the actual impact of tax-free shopping since 2022 consistently suggests that, rather than the last government's forecast of a £2.5bn annual cost to the Exchequer, restoring tax-free shopping and extending it to EU residents will result in:

i. a £11.5bn boost to the economy across the whole of the UK, creating over 200,000 new jobs in all regions of the UK
ii. net positives to the Exchequer of potentially £450m in VAT annually and a further £3.7bn in indirect taxes

The importance of the Growth and Wealth Creating mission in the Labour Party Manifesto and all the evidence showing that the previous government significantly underestimated the positive impact of tax-free shopping for the Exchequer and the economy suggest that the new Labour Government should quickly order a review of the 2020 cost forecasts and ask the OBR to scrutinise the results.

If the review confirms the positive impact suggested by all the data, then a Labour Government should move quickly to restore tax-free shopping to boost the economy and minimise the growing diversion on billions of pounds of spending from Britain to mainland Europe.

The last government consistently refused even to review the original HMT impact forecasts which were used to inform the decision to end tax-free shopping in September 2020, even in light of evidence showing beyond doubt that they were not correct and had not been OBR certified.

The OBR has confirmed that none of the original HMT forecasts, which informed the Conservative's September 2020 decision to end tax-free shopping, have ever been certified by the OBR.

In 2024 the OBR believed it necessary to review its later, limited, November 2020 forecasts. We believe the last government's September 2020 forecasts should also be reviewed.

Appendix 1 compares the 2020 cost forecast of the government, upon which the decision to end tax-free shopping was made, the OBR forecasts where it was made, and the actual impact based on data on spending levels in the UK and mainland Europe after the return of international travellers from 2022.

3. <u>How restoring tax-free shopping contributes to achieving the key mission Labour of the Labour Government of economic growth everywhere and for everyone</u>

Mission-driven government

Government is at its best when working in partnership with business, trade unions, civil society, faith groups, and communities. But without a shared project those partnerships barely get off the ground.

For the past four years, retail and tourist businesses have offered to work in partnership with the previous government to review the 2020 HMT forecasts on the impact of ending tax-free shopping. Business were constantly rebuffed by the Government, despite mounting evidence suggesting that HMT' forecasts were not robust and that the British economy is needlessly suffering as billions of pounds of international spending is being diverted to France, Italy and Spain

So, as well as a new administration with new priorities, Britain needs a new approach: mission-driven government.

1) Kickstart economic growth

to secure the highest sustained growth in the G7 – with good jobs and productivity growth in every part of the country making everyone, not just a few, better off.

Tax-free shopping extended to the EU will create growth and jobs throughout the whole of the UK, with half of the estimated £10bn additional foreign spending taking place outside London, creating an additional 200,000 new jobs across the whole of the UK

Sustained economic growth is the only route to improving the prosperity of our country and the living standards of working people. That is why it is Labour's first mission for government. It means being pro-business and pro-worker. We are the party of wealth creation.

Restoring tax-free shopping and extending it to EU visitors, making Britain the only major European country where the 447m EU residents can shop tax-free will generate an additional £11.5bn of foreign spending annually, produce over £4bn of additional tax for the Exchequer and create over 200,000 new jobs across the UK.

We are asking a pro-business, pro-worker government to review the previous government's disputed 2020 forecasts of the impact of tax-free shopping and restore the scheme if the forecasts are positive.

Sustainable growth requires government to be a strategic partner with business – that markets must be shaped, not merely served.

The previous government abolished tax-free shopping with little consultation with businesses and has ignored all the evidence from businesses that consistently and significantly questions the 2020 impact forecasts.

Despite the proven £1.5bn damage done annually by making Britian the only major European country not to offer tax-free shopping, and the potential £10bn new market demonstrated by studying the spending behaviour of British visitors now able to shop tax-free in the EU (£780m tax-free shopping spending in 2023 and bed nights in Paris up by over 230% in 2023 over 2019 , compared with around just 10% for other European visitors) the Conservative Government refused even to review its forecasts.

Labour will seek involvement from industry, trade unions, and civil society in our plans for growth, so they can contribute to building a stronger economy in all parts of the country. We will strategically use public investment where it can unlock additional private sector investment, create jobs, and provide a return for taxpayers.

Industry wants to work with Government to assess the real impact of tax-free shopping on the economy and the Exchequer, based on evidence of actual behaviour and spending levels, not on the original forecasts which were never scrutinised or certified by the OBR.

The Mayor of London and business and political leaders in the regions have all called for a review and restoration of tax-free shopping

The country remains too centralised, with the economic potential of too many regions and communities ignored.

Industry is working with regions and the devolved nations, who support the call for the return of tax-free shopping as a way of boosting local economies, creating local jobs and supporting vital local infrastructural, particularly regional airports.

The previous government was concerned that the majority of the £3bn tax-free shopping (80%) sales were in London and only a small amount in the regions. But that would not be the case for the new EU market. Based on to VisitBritain data on EU visitor spending patterns, 50% of the new estimated £10bn shopping-led tourism market that would be created would be spent outside London – a £5bn annual boost to regional economies.

The innovation, dynamism and sheer hard work of British business and workers has never been in question. The next Labour government will partner with them to kickstart economic growth and rebuild Britain.

Labour will take a sectoral approach and be clear-eyed about where the UK enjoys advantages over other countries. Our approach will back what makes Britain great: our excellent research institutions, professional services, advanced manufacturing, and creative industries.

Britain's international visitor sector is one of the top ten in the world. It is a sector in which Britain excels. Ending tax-free shopping has resulted in Britain slipping back against international competitors, particularly France, Spain and Italy.

Reintroducing tax-free shopping and making Britain the only major European country where EU residents can shop tax-free would make Britain the best place in the world for international shopping for all – both luxury and high street.

We are committed to one major fiscal event a year, giving families and businesses due warning of tax and spending policies.

We ask a new Labour government to work with industry and commit to a review as soon as possible the original September 2020 impact forecasts. If the review, based on new data, shows a direct net benefit to the Exchequer we would ask the government to commit to reintroducing tax-free shopping at the earliest possible opportunity before Britain's global reputation suffers even more.

We will ensure our industrial strategy supports the development of the Artificial Intelligence (AI) sector.

The growth of AI will lead to massive new global wealth and lots more free time. This suggests a boom time for international travel. Increased international travel is the flip side of AI but we need tax-free shopping to encourage travellers to chose to visit and spend in Britain rather than France, Italy and Spain.

At the centre of our approach is a new statutory requirement for Local Growth Plans that cover towns and cities across the country. Local leaders will work with major employers, universities, colleges, and industry bodies to produce long-term plans that identify growth sectors and put in place the programmes and infrastructure they need to thrive. These will align with our national industrial strategy.

Industry is already working with the Mayor of London to include tax-free shopping within the emerging London Growth Plan as a major growth measure for London. We estimate a £6.2bn annual foreign spending boost for London along if Britain becomes the best place for all international visitors to shop tax-free in Europe.

Labour will also work with the Scottish and Welsh Governments, and the Northern Ireland Executive, to drive growth across the country.

The Scottish Executive already supports the reintroduction of tax-free shopping and formally objected to the previous government's abolition of the schemes. Industry estimate that Scotland would earn an additional £1bn annually from EU visitor spending alone

Unlike the Conservatives, Labour will never sideline the Office for Budget Responsibility (OBR) for political convenience. Instead, we will strengthen the role of the OBR. Every fiscal event making significant changes to taxation or spending will be subject to an independent OBR forecast.

The previous government's decision not to extend tax-free shopping to EU visitors but instead to end tax-free shopping for non-EU visitors was made on the basis of impact forecasts that were not scrutinised or certified by the OBR.

The OBR was prevented from scrutinising HMT's £900m forecast of the fiscal cost of extending tax-free shopping to EU visitors. Industry's forecast, based on actual behaviour and spending data, suggests a fiscal benefit to the Exchequer of £450m annually plus £3.7bn in indirect tax benefits. The difference is so great but the previous government would not review its forecasts and this has prevented the OBR from making an independent assessment.

The OBR was asked to scrutinise the Treasury's September 2020 impact forecast for ending tax-free shopping upon which ministers made the decision to end the scheme in September 2020. But only in November 2020, two months after the decision to end it had been announced

In November 2020, the OBR did not certify the HMT forecast of no fall in spending levels if tax-free shopping was ended and suggested instead that there would be a fall 24%.

The Treasury accepted this and amended its forecast accordingly – but this was after it had been used to inform the decision to end tax-free shopping.

In reality, the data on the actual impact on behaviour and spending in 2022 as international travel returned showed a 48% fall in spending levels.

By deciding not to extend tax-free shopping to EU residents, the OBR has not had the remit to scrutinise the impact of extending tax-free shopping to EU residents. Ministers have consistently stated, was this forecast cost was the main reason for deciding to end tax-free shopping rather than including EU visitors.

The original EU forecast, unscrutinised and not certified by the OBR, suggested a £900m annual cost to the Exchequer. Evidence, based on actual data on the impact of now allowing British visitors to the EU to shop tax-free, suggests that a new £10bn short-haul, shopping-led tourism market would be created across the whole of the UK, worth £10bn annually with a direct fiscal benefit of £450m and an indirect benefit of £3.7bn annually.

4. Recommendations

In light of:

- the Labour Party's manifesto commitment to work with business to identify and promote areas for economic growth across the whole of the UK;
- the imperative for the next government to find ways of raising additional tax revenues to meet spending commitments and ambitions;
- the importance to a Labour government of identifying new areas for raising tax revenue based on economic growth;
- the estimated £11.5bn annual additional economic benefit to the UK from restoring and extending tax-free shopping based on data on actual spending levels in 2022-23;
- the estimated annual net benefit to the Exchequer of £450m in additional VAT, paid by international visitors not UK tax-payers;
- the estimated £3.7bn paid in indirect taxes annually, based on the evidence of actual spending levels by international visitors in the UK and mainland Europe since 2022;
- the previous government's original forecast of the cost of tax-free shopping being significantly undermined by the mass of mounting data on actual spending levels;
- data on the behaviour of international visitors not supporting previous ministers' central assumption that adding or removing VAT at 20% would have little or no impact on the behaviour or spending levels of international traveller;
- the £5bn discrepancy between the government's 2020 forecast of a £1.4bn cost to the Exchequer and the industry estimates based on a mass of data on actual spending levels since 2022 which suggest a net benefit to the Exchequer of £450m in VAT alone and a further £3.7bn in indirect tax revenues

and in light of:

- the Labour Party's manifesto commitment that "Unlike the Conservatives, Labour will never sideline the Office for Budget Responsibility (OBR) for political convenience"
- Labour's Manifesto commitment to strengthen the role of the OBR
- confirmation by both the Treasury and the OBR that, in a departure from normal procedure, none of the cost forecasts used by ministers to inform their decision to end tax-free shopping in September 2020 had been scrutinised by the OBR and none were certified by the OBR

- confirmation by the OBR that when it subsequently scrutinised the previous Government's forecast of the impact of ending tax-free shopping, two months after the decision was announced, it did not support the ministers' central assertion of no impact on spending levels;
- confirmation by the government and the OBR that the OBR certified the government's forecast impact of ending tax-free shopping – two months after the then Chancellor had had announced his decision - only after the government agreed to revise its forecast of zero impact to one of a 24% fall, equating to a £1.25bn loss to British businesses;
- confirmation by the OBR that the government prevented the OBR from scrutinising the government's key forecast that the impact of extending tax-free shopping to EU visitors would be a loss of £900m VAT
- proof that government's own data at the time of deciding to end tax-free shopping shows that it is not possible for this key government forecast cost of £900m to be correct[1]
- evidence of data on actual spending levels suggesting the annual impact on the Exchequer from extending tax-free shopping to EU visitors would not be a net loss of £900m but a net gain of £950m, a difference of £1.85bn;
- the OBR's statement in its 2024 review that it had not scrutinised and did not endorse the governments' current £2.5bn cost estimate for restoring and extending tax-free shopping

AIR recommends the following to a new Labour government:

- **Commission as quickly as possible an evidence-based review of the current government's 2020 cost forecasts using data on actual sales levels now available**
- **Submit the outcomes of the review to the OBR**
- **Consider the outcomes of the review only after they have been certified by the OBR, not before**
- **If the OBR certified coatings forecast a net positive for the Exchequer, work in partnership with industry to restore tax-free shopping quickly to prevent further diversion of spending to mainland Europe and to generate significant net additional tax-revenue from international visitor spending**

5. <u>Cost /Benefits for a Labour Government of adopting these recommendations</u>

There are virtually no costs to the government if it adopts this two stage approach.

- The review would be of part of the Treasury's standard policy costing programme and carry no additional cost.
- Industry has offered to commission and fund a major review of the impact of restoring tax-free shopping from EY, using HMT certified methodology and data on actual behaviour and spending levels, but need some confirmation that HMT will assess the report in an unbiased manner and respond in detail to its findings and recommendation
- Agreeing to a review carries no commitment to reintroduce tax-free shopping

[1] The main reason given by the then Chancellor in 2020 for ending tax-free shopping was his forecast of the cost of refunding VAT already being paid by EU shoppers. He put this at £900m in 2019. With VAT at 20% this would mean that EU visitors had spent a total of £5.4bn on shopping. But VistBritain figures show that the total spent on *everything* by EU shoppers in the UK was £5.4bn. So the then Chancellor's forecast can only be true if those visitors spent nothing at all on transport, accommodation, food etc. This cannot be possible. But the OBR and the government have publicly confirmed that, because the then Chancellor made the decision not to extend the scheme to EU visitors, he prevented the OBR from scrutinising this figure and it has not been OBR certified. And yet the government refuses to review its discredited forecasts, costing British businesses £11.5bn in lost sales and the Exchequer an estimated £4bn in lost tax revenues.

- Industry believes that data on actual costs and benefits of tax-free shopping will show a significant benefit to the Exchequer so that, if the Government subsequently decided to reintroduce tax-free shopping, there would be no cost to the Exchequer but instead a significant benefit

There are significant benefits to a Labour Government of adopting these recommendations

- The review will give a Labour government comprehensive and up-to date evidence on the potential impact of tax-free shopping on the Exchequer and the economy to replace the disputed and incomplete forecasts made in 2020 by the Conservative government
- The review forecasts would be certified by the OBR, unlike the forecast used the previous government to justify ending tax-free shopping
- This would illustrate the importance of making decisions based on OBR certified forecasts compared with those made on forecast not certified by the OBR
- Assuming a net positive impact, the reintroducing tax-free shopping would significantly contribute to achieving the government's growth mission. It would make Britain the most attractive European destination for international visitors and investors in retail and associated sectors
- Reintroducing tax-free shopping would be a boost to Britain's retail, hospitality, travel and tourism businesses, the sectors most hard hit by COVID lockdowns
- The impact to the Exchequer and economy will be seen from the first year and grow annually as more international travellers realise the benefits of shopping in the UK, particularly those from the EU
- Offering tax-free shopping to EU visitors would particularly benefit the regions and boost regional economies, tourism and airports and create hundreds of thousand of new jobs, easily accessible to all.
- Just commissioning the review will win support from thousands of British businesses and all interested business, tourism and travel organisation, frustrated by the lack of response from the current government. It will demonstrate that the Labour Government listens to business

October 2024

Paul Barnes
Chief Executive
Association of International Retail
paul@internationalretail.co.uk
07969111619

www.internationalretail.co.uk

Appendix 1 – Briefing for meeting with the Financial Secretary, April 24, 2024
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

Association of International Retail

Briefing for meeting with the Financial Secretary, April 24, 2024

Tax-Free Shopping - Review of Costings – Section 1

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 2020 forecasts

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.[2]

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."[3]

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%.[4]

---

[2] 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.
[3] 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.
[4] 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

- 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[5]
- 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)."[6] 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."[7] 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[8] 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.

system, operated in partnership with PwC for London's West End, where 65% of all VAT RES spending takes place.

[5] VisitBritain figures, from IPS, quoted by HMT

[6] Reply to WPQ by Financial Secretary February 2023

[7] Westminster Hall Debate September 7th 2023

[8] 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

2.12 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.

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.[9] 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%."[10] 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

[9] Office de Tourisme, Paris
[10] National Institutre of Statistics and Economic Studies, France

2020. The OBR has not scrutinised or certified these costs.[11] 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.

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.

[11] 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."