

Abolition of Tax-Free Shopping

Two-page Overview Briefing Note

1. Background

- Tax-free shopping will end on December 31st, 2020.
- Britain will be only European country not to offer tax-free shopping.

2. The value of international tourist and the importance of tax-free shopping

- In 2018, international tourists spent £22 billion in the UK.
- £6 billion was spent on shopping. £3.5 billion was registered as tax free sales although only VAT was only reclaimed on £2.5 billion.
- While international tourists reclaim VAT on £2.5 billion of purchases, they pay VAT on the rest of the £20 billion they spend, earning the Treasury around £4 billion annually.
- In its 2013 response to consultation on the tax-free shopping, HMRC itself said -

“Inbound tourism makes a vital contribution to the UK economy, earning £18 billion in foreign exchange for the UK each year. When they come here, most visitors love to shop.”

“The VAT Retail Export Scheme – also known as Tax Free Shopping – plays a key part in the shopping experience for our visitors and positively influences their views on Britain as a value for money shopping destination.”

“The Government is encouraging more visitors to the UKThis will contribute to sustaining jobs and supporting economic growth across the UK. By 2020, the Government hopes to welcome more than 40 million visitors a year. This review of tax-free shopping in the UK supports this objective and aims to put the scheme in the best possible position to deal with the increase in visitors.”

3. The impact of the abolition of tax-free shopping in the UK

- Fewer international visits.
- Lower spending on retail and other goods and services.
- Tax-free spending moved to other EU countries. Paris likely to be the big winner.
- Loss of existing £3.5 bn and expected £2.1 bn from EU visitors.
- Additional unemployment costs. £3.5 bn supports 70,000 retail jobs.

4. Impact on London and the Global Britain brand and appeal

- International visitors are 25% of West End visitors but 50% of spending.
- West End spending already down 80% due to COVID-19 (down from £10 bn to forecast £2 bn).
- Furlough and business rate holiday ending will add to costs.
- Loss of international visitors and spend is a final blow.
- Businesses closing and investment moving out of UK.
- UK losing its soft power global asset.

5. Impact on the levelling-up agenda

- 20% of tax-free Shopping is outside London.
- Manchester, Birmingham and Edinburgh are attracting long haul visitors – this will damage them.
- £3.5 billion international spending in high street chains supports marginal store in UK high streets.
- EU visitors more likely to travel and spend outside London so extending tax-free to them would have been a regional boost.
- UK luxury brands London shop windows support 170,000 manufacturing jobs in UK.

6. Why has the government made this decision?

- WTO regulations say UK must offer tax-free to EU visitors after December 2020 (can't treat countries differently).
- EU visitors are 70% of international visitors.
- Current paper based HMRC validation system cannot manage the extra volume.
- Retailers have already digitalised their elements of the scheme (registration and recording of sales).
- HMRC have been trying to digitalise its validation element since 2013 but failed. Most other European government have already digitalised (usually within 18 months).
- Retailers have offered to instal a validation element at no cost to government (as they have done with other governments) but HMRC declined.
- HMRC failure to digitalise its validation element leaves no option but to withdraw the whole scheme and put UK at competitive disadvantage.

7. Why the government says it has made this decision

- Government acknowledges the capacity problem.
- But also says it is “a costly relief which does not benefit the whole of GB equally, with current use of the scheme largely centred in London”.
- This contradicts their 2013 position (section 2 above).
- The scheme is not costly. The government does not collect the £500 m VAT on the £2.5 bn tax free sales. But after December 2020 those sales will not happen in the UK (they will move to other European countries offering tax free) so still no VAT will be collected.
- But losing the scheme will cost HMT in lost taxes (VAT on £20 billion non-tax-free spending) as international visitor numbers and spending decreases.
- Treasury will also acquire additional unemployment costs.

8. The way forward

- Government should use the 18 month window of low international visitor numbers (due to COVID-19) to work with retailers and their partners to provide a digital solution to the validation element, linked to existing retailer digital infrastructure, which will provide the necessary capacity, within 12 months and at no cost to government. They have done this with many governments around the world

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Detailed Briefing Note

1. Background

The Government has decided to abolish, from December 31st, 2020, the VAT Retail Export Scheme (VAT RES) which allowed international visitors to the UK to reclaim the VAT paid on goods purchased, but not consumed in the UK.

Tax free shopping is a major draw to attract international visitors. Every country in Europe and most major tourist destinations worldwide offer tax free shopping. Britain will now be the only country in Europe not to offer tax free shopping, putting the UK at a major competitive disadvantage.

2. The value of international tourist and the importance of tax-free shopping

In 2018, International tourists spent £22billion in the UK.¹

£6 billion was spent on shopping. £3.5 billion was registered as tax free sales, although only VAT was only reclaimed on £2.5 billion²

Tax free shopping is an incentive for international visitors to visit the UK and spend more money. While they reclaim VAT on £2.5 billion of purchases, they pay VAT on the rest of the £22 billion they spend, earning the Treasury around £4 billion annually.

In its 2013 response to consultation on the tax-free shopping, HMRC itself said:

“Inbound tourism makes a vital contribution to the UK economy, earning £18 billion in foreign exchange for the UK each year. When they come here, most visitors love to shop.”

“The VAT Retail Export Scheme – also known as Tax Free Shopping – plays a key part in the shopping experience for our visitors and positively influences their views on Britain as a value for money shopping destination.”

“The Government is encouraging more visitors to the UK. This will contribute to sustaining jobs and supporting economic growth across the UK. By 2020, the Government hopes to welcome more than 40 million visitors a year. This review of tax-free shopping in the UK supports this objective and aims to put the scheme in the best possible position to deal with the increase in visitors.”³

3. The impact of the abolition of tax-free shopping in the UK

Britain will be the only country in Europe not to offer tax free shopping, making the UK a less attractive destination for business visitors and tourists. This will lead to fewer visits and of those who do visit, fewer will buy goods in the UK, waiting instead until they visit any other European country to make their purchases.

¹ VisitBritain

² a 65% reclaim rate, compared with around 85% for most European countries. The 20% difference is mainly due to shoppers being unable to make their claims at Heathrow due to the lack of a digital validation system.

³ HMRC “VAT: Retail Export Scheme Summary of Responses December 2013”

The direct cost to the UK economy is the loss of the existing £3.5 billion in tax free sales. The UK also loses the £2.1 billion of additional international tourist spend which it would have gained at the end of the transition scheme, when visitors from the EU became eligible.

With the UK being less attractive to international visitors, the inevitable fall in visitor numbers will reduce spending in all other areas (hotels, travel, restaurants, theatres, culture etc) not only damaging these businesses, but reducing HMRC VAT income.

HMRC will also lose business and employment taxes generated by international visitor spending and will acquire the cost of unemployment caused by the fall in international visitor spending. The £3.5 billion tax free spending supports 70,000 retail jobs.⁴

After December 31st, 2020 British shoppers visiting any EU country will be able to shop tax free, diverting a portion of domestic spending out of the UK, but we will not be reciprocating.

4. Impact on London and the Global Britain brand and appeal

The centre of London will be most badly hit by the fall in international visitor numbers and spending. Half of the £10 billion spending in the West End is from international visitors even though they account for only 25% of visits.

The West End is already suffering because of COVID-19. Perfect storm of low return of office workers (around 10% of 500,000), no domestic or international visitors, Footfall is less than 50% (compared with 75% UK average). Annual sales down 80% from £10 billion to £2 billion. Expected 50,000 retail redundancies by end of 2020. End of furlough (October 2020) and business rates holiday (April 2021) will increase costs significantly with still reduced income.

Expectation of the return of international visitors in 2021 has kept businesses supporting their West End presence, but the Treasury's decision to end tax free shopping has severely damaged that hope. Businesses will close or downsize, moving their operations to other European cities that will now be more attractive to international shoppers.

The West End is also a soft power asset for Global Britain. The ending of tax-free shopping; the fall of international visitor numbers and spending; the decline in investment and the closure and downsizing of stores, hotels, theatres and restaurants, all undermine Global Britain's brand and ambition as we leave the EU.

5. Impact on the levelling-up agenda

Areas outside London account for 20% of all tax-free shopping, as well as benefitting from all other spending by international visitors.

Cities such as Manchester, Birmingham and Edinburgh, with international airports, are expanding their international visitor economy and tax-free shopping is a part of their appeal.

Much of the £3.5 billion of tax-free shopping is spent in high street chains, which enhances their performance and supports their more marginal stores and jobs in high streets throughout the UK.

London is the shop window for UK luxury brands supporting over 170,000 manufacturing jobs throughout the rest of the UK which will now be put in jeopardy.⁵

⁴ BRC calculate that one job is supported by every £50,000 of retail spending

⁵ Walpole

The extension of tax-free shopping to EU visitors, who travel and spend outside London more than long haul visitors would have been a boost to UK high streets.

6. Why has the government made this decision?

70% of all international visitors to the UK are from the EU, but they are not eligible for tax free shopping because of Customs Union membership.

When the UK leaves the EU, under WTO rules, the UK must treat all international visitors the same. Extending tax free shopping to EU visitors would triple the number of eligible tax-free shoppers.

The current paper-based system of validating VAT-refund claims is already overwhelmed at peak periods. Without that element of the system being digitalised, the system cannot cope with increased numbers.

Retailers have already digitalised their element of the system (registering applicants and recording sales). Since 2013, HMRC has been exploring ways to digitalise the claim-validation element. Most other European countries have already achieved this (often within 18 months). The problem is that HMRC has been pursuing, unsuccessfully, a totally new, end-to-end system to replace existing retailer digital infrastructure, but have not found a way forward. Other countries have instead successfully created simple bridges from existing retailer infrastructure to provide real-time validation of claims.

Retailers and their agents have offered to create and install, at no cost to government, these tested bridging models, as they have done in many other European countries. HMRC has declined to consider these models.

After seven years, HMRC's failure to create a digital system has left them no alternative but to end all tax-free shopping, because of lack of capacity which has put the UK at a competitive disadvantage to all its European competitors.

7. Why the government says it has made this decision

The Government acknowledges that the lack of digitalisation of its validation element has prevented the expansion of tax-free shopping to include EU members and therefore led to the abolition of the scheme.

But it also says that the scheme is "a costly relief which does not benefit the whole of GB equally, with current use of the scheme largely centred in London". The issue of benefiting the whole of the UK is addressed in section 5 above.

The Treasury has put forward no evidence to support its claim that the scheme is costly. It is not, and abolishing it saves the Treasury no money. On the contrary, its closure costs the Treasury money in terms of lost tax and increased unemployment costs.

The reason why, we assume, the Treasury says it is costly, is because the Treasury pays back £500 million of VAT on the £2.5 billion annual tax-free sales⁶. So, its VAT income from these sales is £0. By abolishing tax-free shopping, the Treasury believes that it will retain the £500 million. But this assumes that that £2.5 billion tax-free spending will still take place in the UK as non-tax-free. It will not. All or most of it will be spent in Paris, Rome and other European cities and towns that offer tax-free shopping. The VAT income will still be £0.

⁶ NAO report into the tax-free shopping scheme 2018

HM Treasury's proposed alternative, VAT-free scheme is unappealing to international visitors who are our customers and are now being offered more attractive traditional tax-free schemes by every other European country.

The Government also cites fraud and administration issues. But these are minimal and would be addressed by moving from a paper-based validation system to a digital system, as has happened in most other European countries.

8. The way forward

We believe that the decision to make the UK the only country in Europe not to offer tax free shopping will damage the economy and Britain's reputation and appeal as a destination for international visitors. We do not support the justifications put forward by the Treasury about costs or regional impact.

We believe there is a practical problem of managing the increased numbers if the scheme is extended to EU visitors, but that would be solved by the digitalisation of the HMRC validation element.

The low level of international visitors throughout 2020 -2021 will free up capacity over the next 12-18 months under the existing system and, if necessary, the number of claims could be further reduced by raising the minimum spending limit for tax-free shopping.

The retail industry and its partners are confident that they can provide a digital solution to the validation element, linked to existing retailer digital infrastructure, which will provide the necessary capacity and an end to end digital system, within 12 months and at no cost to government. They have done this with many governments across the world.