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BOOST BRITISH JOBS

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Briefing: Increasing HM Treasury revenue through Tourism VAT reduction

The high VAT rate imposed on tourist accommodation and attractions represents a significant competitive disadvantage to the British tourist industry compared to our European competitors, all but two of which (from 1st January 2015) reduce VAT for tourism. **A reduction in the Tourism VAT rate will stimulate the growth in overseas tourism to Britain, and provide cheaper days out, short breaks and domestic holidays for British families, helping to increase the taxation base, create jobs, increase wages, boost exports and improve the balance of payments.**

Because of the highly price sensitive nature of the sector, lower VAT rates that feed through to lower prices will stimulate higher turnover and employment. This in turn will increase income and corporation tax receipts and reduce benefit payments. Additional spending – from both foreign and domestic tourists – would be circulated and spent in the UK economy and would continue to benefit the Exchequer over a longer period of time

By growing the tourism sector, the UK can reduce its balance of payments deficit. In 2013 travel expenditure by non-residents visiting the UK totalled £24bn, accounting for 12.4% of UK service sector exports and 4.9% of total UK exports. A VAT reduction for the tourism industry would provide a significant boost to the UK export market.

Another indirect benefit to the Treasury would be a reduction in the so-called 'shadow economy'. The UK tourism industry is populated by a large number of small firms that may choose not to expand or invest in order to keep below the VAT threshold to avoid paying tax. In October 2014 HMRC estimated that the VAT gap in the United Kingdom expanded from £11.4bn to £12.4bn, or 10.9 percent of theoretical collections, last tax year. In France, the 'shadow economy' has been estimated to have reduced by €720 million a year due to VAT reductions implemented.

The impact of cutting VAT on tourist accommodation and attractions has also been examined using the Treasury's own model. This exercise was carried out by Professor Adam Blake, a Treasury Advisor, and shows that the Treasury could gain in each of the first four years following the VAT cut.[1]

[1] **Impact of Reduced VAT Rates on the UK Economy**
"The Impact of Reduced VAT Rates on British Visitor Accommodation, Attractions and the Wider Economy" - using HM Treasury's Computable General Equilibrium (CGE) model (December 2012)

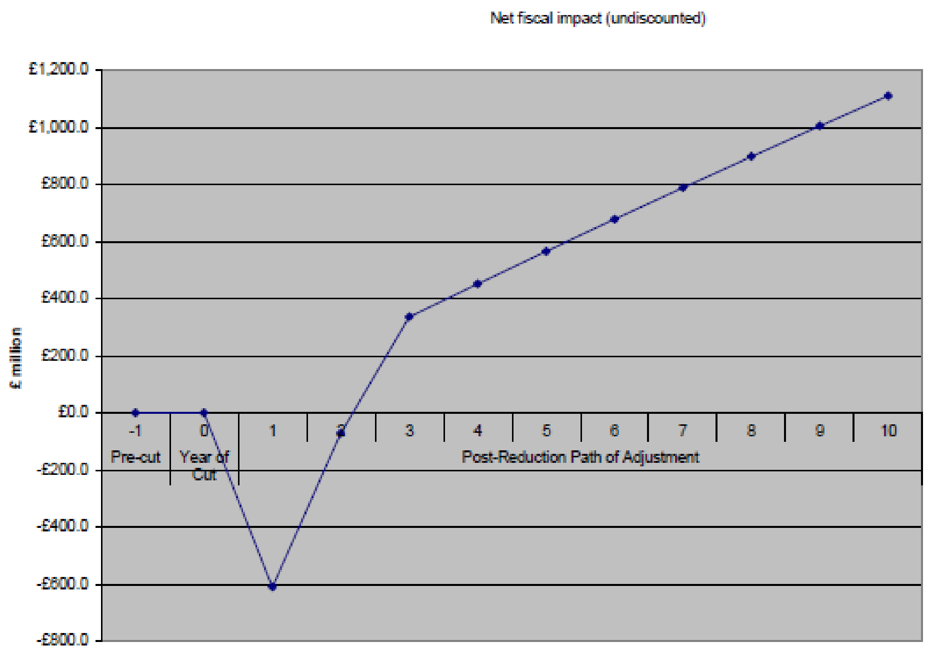
Analysis: Impact on HM Treasury tax receipts

Copenhagen Economics, in their 2007 report for the European Commission on labour-intensive services, concluded that full pass-through follows within 2-3 years of a VAT reduction.[2]

Analysis of a Tourism VAT reduction by Deloitte/Tourism Respect modelled the impact of pass-through on tax receipts. Using conservative assumptions for the model which assumes 75% of the VAT cut is passed on in lower prices and that full adjustment occurs within three years.[3]

Considered over a 10-year period, a VAT cut under this scenario would generate a positive Net Present Value of £515 million in the first five years. Over 10 years, the positive Net Present Value is £3,892 million. The below graph and table provides further detail on the period and breakdown.

Figure 1: Net Fiscal Impact



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[2] *Study on reduced VAT applied to goods and services in the Member states of the European Union.* Final Report by Copenhagen Economics, Thursday, 21 June 2007. http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/rates/study_reduced_vat.pdf

[3] The model assumes 50% of the full adjustment occurring in Year One, 80% in Year Two, and 100% by Year Three and thereafter.

Table: Impact of Reduction on the Exchequer's Position after four years

In Year 4 following a reduction – by which time most of the adjustment to lower VAT rates has occurred – the analysis indicates the following impact on tax yields:

Impact on the Exchequer's Position	**75% price through scenario**
(1) Net direct loss of VAT receipts	-£1,436.5
(2) VAT Yield on increased turnover at 5%	£80.8
(3) VAT Yield on wider base at 5%	£37.3
(4) Income and national insurance derived from new jobs & previously unreported (Shadow Economy) jobs	£246.9
(5) Income and national insurance derived from higher wages	£14.4
(6) Savings in social security payments	£263.4
(7) Corporation tax from higher margins on current turnover including previously unreported (Shadow Economy) turnover	£53.3
(8) Corporation tax from higher turnover	£112.0
(9) Income tax paid on dividends	£47.4
(10) Additional business rates	£37.1
Sub-total, direct and indirect fiscal impact	*-£543.9*
(10) Multiplier impact	£981.7
Net fiscal impact	**£437.8**