# VAT on tourism

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There has been a long-running campaign by the hospitality industry for the UK to introduce a rate on VAT below the standard rate of 20% on services supplied to tourists. Proponents have argued that this would allow hotels, restaurants, pubs and visitor attractions to cut prices, boosting sales and employment in this sector, which in turn would encourage growth in the wider economy. European VAT law limits the discretion of any Member State, the UK included, to set lower VAT rates on individual goods and services. That said, there is dispensation for a lower rate on certain supplies associated with tourism: specifically, hotel accommodation, certain restaurant services, and some types of admission charge, including charges for entry to amusement parks.

Several Member States make use of this dispensation to charge lower rates of VAT – between 5% & 15% – on these supplies, including Ireland, which introduced a 9% rate in July 2011. However, the Labour Government opposed a reduced rate on the grounds that it would not be well-targeted nor cost-effective.[1] Similarly the current Government have not given any indication that they are willing to consider a VAT cut for tourism.[2]

This note gives a short introduction to the way VAT works, and the significance of EU VAT law for setting VAT rates, before discussing the campaign for lower VAT on tourist services.

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1 HC Deb 1 December 2009 c605W

2 HC Deb 8 October 2013 c161W; HC Deb 11 February 2014 c214WH

# 1 VAT : structure, rates, reliefs, revenues

VAT is charged on the supply of all goods and services made in the course of a business by a taxable person, unless they are specifically exempt. All businesses must register for VAT if their turnover of taxable goods and/or services is above a given threshold – which is £79,000 at present.[3] VAT is charged on the additional value of each transaction, and is collected at each stage of production and distribution. A business pays VAT on its purchases - known as input tax, and charges VAT on its sales - known as output tax, settling up with HM Revenue & Customs for the difference between the two. In the end the cost of the tax is borne by the final consumer.

Most VAT law is consolidated in the *Value Added Tax Act (VATA) 1994*. VAT is charged either at the standard rate of 20% or the zero rate, though there is limited use of a reduced rate of 5%. Zero-rated supplies include: food; construction of new dwellings; domestic and international passenger transport; books, newspapers and magazines; children's clothing and footwear; water and sewerage services; drugs and medicines on prescription; and certain supplies to charities. Supplies liable to VAT at the 5% reduced rate include: the supply of domestic fuel and power, the installation of energy saving materials, women's sanitary products, children's car seats and certain types of construction work.

The exemption of goods and services from VAT should be distinguished from their being charged a zero rate. In the latter case these supplies are technically taxable and though no actual tax is paid on them, they still count as part of a business' taxable turnover. VAT charged on inputs relating to zero-rated activities can be reclaimed, unlike the VAT incurred by a business in the course of an exempt activity; in effect, a business making exempt supplies has to absorb the VAT charged to it by its suppliers. Categories of exempt supplies include land, insurance, finance, education, health and welfare.[4] HMRC's site gives further details on the rates of VAT applied to different goods and services.

HMRC publish estimates of the costs of the most significant zero and reduced VAT rates:[5]

**Estimated costs of the principal tax expenditure and structural reliefs**

£m

| Tax Expenditures | 2012-13 | 2013-14 |
|---|---|---|
| **Value added tax** [14] | | |
| Zero-rating of: | | |
| Food | 15800 | 16600 |
| Construction of new dwellings (includes refunds to DIY builders) * | 7450 | 8050 |
| Domestic passenger transport | 3850 | 4050 |
| International passenger transport (UK portion) * | 300 | 300 |
| Books, newspapers and magazines | 1650 | 1700 |
| Children's clothing | 1700 | 1800 |
| Water and sewerage services | 2100 | 2200 |
| Drugs and supplies on prescription | 2800 | 2950 |
| Supplies to charities [15*] | 250 | 300 |
| Certain ships and aircraft | 700 | 750 |
| Vehicles and other supplies to disabled people [15] | 650 | 700 |
| Reduced rate for: [16] | | |
| Domestic fuel and power | 4950 | 5200 |
| Certain residential conversions and renovations* | 200 | 200 |

3 *Budget 2013* HC 1033 March 2013 para 2.179. The threshold was increased in line with inflation for the 2013/14 year with effect from 1 April 2013, by Order (SI 2013/660).

4 Zero-rated supplies are set out in schedule 8 to *VATA 1994*. Reduced-rate supplies are set out in schedule 7A. Exempt supplies are set out in schedule 9.

5 HMRC, *Official Statistics: Main tax expenditures and structural reliefs (Table 1.5)*, December 2013

Notes:
[14] Some of these tax expenditures and reliefs are mandatory or permitted under the EC 6th VAT Directive and some are derogations from the Directive. All the cost estimates relating to VAT are based on the actual standard rate of VAT that applied in the relevant periods. The calculations for these estimates do not include any behavioural effects.
[15] Costs exclude the zero-rating of items appearing elsewhere in the list.
[16] The figures for all reduced-rate items are estimates of the cost of the difference between the standard rate of VAT and the reduced rate of 5 per cent.
* These figures are particularly tentative and subject to a wide margin of error.

VAT is forecast to raise £106.2 billion in 2013/14. Only income tax and National Insurance contributions raise equivalent sums for the Exchequer.[6] Statistics on VAT are provided in HM Revenue & Customs *Value Added Tax Factsheet*.[7]

VAT was introduced in the UK on 1 April 1973 at two rates: a standard rate of 10%, and a zero rate on selected goods and services (such as food, books, children's clothing, and certain supplies for charities). The main changes to the VAT structure since the introduction of the tax are:

- The standard rate was cut to 8% on 29 July 1974.
- A higher rate on selected goods and services was introduced on 18 November 1974, set at 25%. Initially this was applied to petrol only; it was extended to a list of other supplies from 1 May 1975. The higher rate was cut to 12.5% from 12 April 1976.
- The standard rate was increased to 15% on 18 June 1979; at this time, the higher rate of VAT was abolished.
- The standard rate was increased to 17.5% from 1 April 1991.
- Domestic supplies of fuel and power were charged VAT at a reduced rate of 8% from 1 December 1993. This was cut to 5% from 1 September 1997.
- The standard rate was cut temporarily to 15% from 1 December 2008 to 31 December 2009. The rate was set back at 17.5% on 1 January 2010.
- The standard rate was increased to 20% from 4 January 2011.[8]

Over the last 25 years there have been a number of changes to the coverage of the zero rate, affecting individual supplies. In addition, since its introduction in September 1997, the coverage of the 5% reduced rate has been extended to a small number of other supplies, including the installation of energy-saving materials.

## 2 Cutting VAT rates – the role of EU VAT law

VAT law in this country, as in all Member States, is based on European VAT law. It has long been recognised that national sales taxes across EU need to interlock effectively for the Single Market to function. The first steps toward harmonising the VAT systems of Member States were taken in the late 1960s. However, it was the sixth VAT directive (77/388/EEC), adopted on 17 May 1977, which marked a turning point in the development of EU VAT law – as governments agreed on common criteria for the VAT base in all Member States (ie, specifying those goods and services which could be exempted from tax).

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6 Office for Budget Responsibility, *Economic and fiscal outlook*, Cm 8748, December 2013 p106 (Table 4.5). In 2013/14 income tax (gross of tax credits) and NICs are forecast to raise £155.5bn and £106.9bn respectively.

7 This is published on HMRC's UK Trade Info site.

8 HM Treasury, *Tax Benefit Reference Manual* 2009/10 ed. (Commons Library Deposited paper 2009-1987) pp100-102. The Coalition Government's decision to increase the standard rate of VAT to 20% is discussed in a second Library standard note (SN5620, 3 September 2013).

Initially the sixth directive focused on the VAT base rather than VAT rates, though it had implications for the UK's zero rates. Article 28(2) allowed Member States to maintain "reduced rates and exemptions... which are in force on 31 December 1975 and which satisfy the conditions stated in the last indent of Article 17 of the second council directive of 11 April 1967." Article 17 refers only to exemptions maintained for "clearly defined social reasons and for the benefit of the final consumer." As a result the UK was allowed to maintain its zero rates, *provided* they satisfied these criteria.[9] Of course, all Member States are governed by these directives on decisions they take on the coverage of VAT, and - under the terms of later amendments to the sixth directive - on decisions taken about their VAT rates. Though the UK and Ireland are the only countries to use zero rates very much, there is considerable variety in VAT rates on certain goods and services across the EU.[10]

Agreement between Member States on harmonising the rates of VAT took much longer, but was reached in June 1991, and encompassed by directive 92/77/EEC, which came into effect on 1 January 1993.

In brief, all Member States:

- have had to apply a standard VAT rate of 15% or more from 1 January 1993.
- have the option of applying one or two reduced rates, no lower than 5% to certain specified goods and services, as listed in Annex H of the directive.
- may continue charging any lower rates, including zero rates, that had been in place on 1 January 1991 for the duration of the "transitional period", assuming these rates were in accordance with Community law.

In November 2006 the European Council of Finance Ministers adopted a new principal EC VAT directive (2006/112/EC), which revised or recast both the first and the sixth EC VAT directives, to reorganise the provisions and set them out in a clearer way.[11] The new directive made no change to EC or UK VAT law.

The UK secured a special right to bring any of its zero rates into a reduced rate band, even if they were not in Annex H. However, the UK would not be allowed to reintroduce a zero rate that had been in place on 1 January 1991 which it had then withdrawn. Naturally most attention in this country is paid to the aspects of the directive which directly affect the UK. Even so, it is worth noting one aspect of this agreement: no Member State can introduce a new zero rate.[12] In the absence of any new agreement, these 'transitional' arrangements may continue indefinitely – and this is what has happened, though there have been some minor additions to the list of supplies which may be charged a reduced rate.[13] It should be noted that any amendment to these rules – as with any VAT directive – must be agreed *unanimously* between the Member States.[14]

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9 In June 1988 the European Court of Justice found that certain zero-rated supplies – including supplies of fuel and power to industry – did not meet these criteria. As a result the UK was required to standard-rate these supplies, which it did on 1 July 1990.

10 European Commission, *VAT rates applied in the Member States of the European Community*, January 2014

11 Council Directive 2006/112/EC of 28 November 2006 (OJ L 347, 11 December 2006). Annex H to the revoked sixth directive is now recast as Annex III to the new directive

12 There is limited provision for those countries whose standard rate was below 13% at 1 January 1991 to charge a rate below 5% on certain supplies

13 This is discussed in another Library note: *VAT : European law on VAT rates*, SN2683, 28 August 2013

14 The Treaty base for all proposals to harmonise excise duties and turnover taxes is Article 113, which requires unanimity.

# 3 The campaign to cut VAT on tourism

As noted, under EU VAT law Member States have the option, should they wish, to introduce a reduced rate of VAT on certain specified supplies. This list is set out in Annex III to the principal EC VAT directive (2006/112/EC).[15] Three items on this list are of particular importance to the campaign there has been for a VAT cut on tourism:

- Item 7: admission to shows, theatres, circuses, fairs, amusement parks, concerts, museums, zoos, cinemas, exhibitions and similar cultural events and facilities.
- Item 12 : accommodation provided in hotels and similar establishments, including the provision of holiday accommodation and the letting of places on camping or caravan sites.
- Item 12a : restaurant and catering services, it being possible to exclude the supply of (alcoholic and/or non-alcoholic) beverages.

Some Member States take advantage of this dispensation to charge a lower rate of VAT on some or all of these supplies – an appendix to this note gives more details. In July 2011 the Irish Government announced a new 9% VAT rate to apply to admissions, accommodation, restaurant services and some other supplies, all of which had previously been charged VAT at 13.5%. The Government anticipated that the 9% rate would be a temporary stimulus, to last until 31 December 2013, though the 9% rate has now been extended indefinitely.[16] The Irish Finance Ministry has published some analysis of the introduction of the 9% rate: this suggests that the degree to which traders passed on the VAT cut in lower prices varied between sectors, but that it was "likely that the VAT rate reduction on some of the categories acted as a temporary employment stimulus, either through direct pass through or by enabling the retention or expansion of labour demand without offsetting reductions in firm margins."[17]

In 2008 the British Hospitality Association published some analysis that it had commissioned which argued that cutting VAT on visitor accommodation & attractions would raise £600m a year, and create 23,000 new jobs.[18] The Irish Government's decision to introduce a 9% rate generated more interest in the campaign: 17 Members signed an Early Day Motion in June 2011 citing Ireland's 9% rate and arguing that the UK should introduce this type of targeted VAT reduction.[19] When the BHA's work was first published, the Labour Government took the view that the case for a reduced rate on these supplies was unconvincing:

> **Mr. Liddell-Grainger**: To ask the Chancellor of the Exchequer whether his Department has made an assessment of the likely effect on the economy of applying a reduced rate of value added tax to visitor attractions, accommodation and restaurants.

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15 Details of the existing EU legal framework for VAT, including the text of the principal VAT directive, are collated on the Commission's site.

16 The Irish Revenue authorities publish details of the coverage of the 9% VAT rate on their site. At present the standard rate of VAT in Ireland is 23%; further details of VAT rates are given on the Revenue's site.

17 Brendan O'Connor, *Measuring the Impact of the Jobs Initiative: Was the VAT Reduction Passed On and Were Jobs Created?*, Department of Finance (Economics Division), September 2013

18 G.Wason & M.Nevin, *The impact of lower VAT rates on UK visitor attractions and accommodation*, British Association of Leisure Parks, Piers and Attractions/British Hospitality Association, February 2008. The report was the subject of an Early Day Motion (EDM 2209 of 2008-09, 2 November 2009) – which 36 Members signed. Subsequently Guto Bebb MP cited these conclusions in a debate on jobs and growth in October 2011 (HC Deb 12 October 2011 c417).

19 EDM 1972 of 2010-12, 22 June 2011

> **Mr. Timms**: No such assessment has been made. VAT is a broad-based tax on consumer expenditure and reliefs from it have always been strictly limited. Where reduced rates are available, these are applied only where they provide the most well-targeted and cost-effective support for the Government's policy objectives, compared to other measures.[20]

Subsequently the Exchequer Secretary, David Gauke, suggested that the BHA's analysis was flawed, in answer to a PQ in November 2011:

> **Mr Sanders**: To ask the Chancellor of the Exchequer what assessment he has made of the British Hospitality Association's proposals for the tax regime for the hospitality sector.
>
> **Mr Gauke**: Assessments of the impact of the BHA proposals predict a loss in revenue to the Exchequer of well in excess of £1 billion in the first year alone. The BHA argues that a reduction in VAT on tourism would pay for itself over time and increase growth and employment. Their case does not take account of the impact of such a cut on the economy as a whole, or the significant additional taxation or borrowing needed to fund the cut. Higher interest rates and falling international confidence would undermine the recovery and have an adverse impact on families and small businesses, including businesses in the tourism sector. [21]

Similarly, when asked about the Irish Government's 9% rate at Treasury Questions in September that year, Mr Gauke said, "we will of course keep all taxes under review, but we have to bear in mind the state of the public finances, our limited room for manoeuvre and concerns about adding complexity to our VAT system."[22]

In September 2012 the BHA, in association with other trade bodies and tourist businesses, launched a new campaign for a VAT cut,[23] underpinned by further research which suggested that over 10 years "the loss of fiscal income from the cut in VAT will more than be made good by additional income tax receipts, savings in social security payments, and an increase in profits, corporation tax payments and tax on dividends."[24] The Campaign has a series of FAQs on its site, from which the following is taken:

> **So how would you summarise the impact of a VAT reduction?**
> In short, a reduced rate of VAT would:
> 1. Generate higher levels of employment, with increased wage levels and training. These benefits would occur throughout the age and socio-economic spectrum and throughout the UK.
> 2. Increase additional tax receipts as a result of this additional employment with consequential savings on social security payments.
> 3. Increase profits, corporation tax payments and shareholder dividends.
> 4. Lead to further investment in the industry, improving overall quality and therefore further improving the UK's competitiveness.
> 5. Feed through to higher expenditure in other sectors of the economy, which in turn will generate further tax receipts – the 'tourism multiplier'. Every additional £1 of

20 HC Deb 1 December 2009 c605W
21 HC Deb 28 November 2011 cc717-8W
22 HC Deb 6 September 2011 c159
23 Cut Tourism VAT Campaign press notice, *Parliamentary launch for Campaign for Reduced Tourism VAT*, 4 December 2012
24 Cut Tourism VAT Campaign, *The Impact of Reduced VAT Rates on British Visitor Accommodation, Attractions and the Wider Economy*, December 2012 para 11. See also, Cut Tourism VAT Campaign, *Campaign Factsheet*, October 2013.

tourism expenditure generates 70p of extra expenditure in other sectors of the economy …

**Doesn't reducing VAT just mean that operators will make more profits?**
In a survey of BHA members in January 2012, over 95 per cent of over 200 respondents said that if a five per cent VAT rate was achieved some or all of it would be passed on. 82 per cent said they would invest more in their product/facilities, 67 per cent would employ more people, 57 per cent would invest more in training and just under half (48 per cent) would increase staff wages.

Competition within the sector eventually compels operators to lower prices. [A study commissioned by the European Commission from a consultancy, Copenhagen Economics, published in 2007] … analysed six case studies where a VAT rate reduction had occurred. The report concluded that: '…there is little doubt that permanently lowering the VAT rate on particular goods (or services) sooner or later will lead to a reduction in the price of the goods more or less corresponding to the monetary equivalent of the lower VAT rate … In economics jargon, there will be a strong tendency towards full pass-through.' [para 1.1].

('Pass through' here means that the full impact of the reduction in VAT is reflected in lower prices equivalent to the reduction in VAT.)

Similarly, there is little doubt, according to Copenhagen Economics, that the price cuts that result from a permanent lowering of VAT rate will lead to increased consumption and consequently to increased production and employment. Such increases will occur more rapidly and be more significant in sectors with high price elasticity, strong competition and labour-intensive sectors. Tourism displays all three of these characteristics. It can typically take two to three years for this full effect to be realised.[25]

The work cited by the Campaign was commissioned by the Commission with a view to concluding the vexed and protracted negotiations between States over the future of the EU VAT rules. However, the report, which identified a number of sectors where there was a strong case for extending lower VAT rates – including 'some parts of the hospitality sector' – did not lead to a consensus for reform. Indeed Member States have only approved relatively minor amendments to these rules in the last six years.[26]

The report by Copenhagen Economics concluded that, "there is a strong general argument for having uniform VAT rates in the European Union. Uniform rates is a superior instrument to maintain a high degree of economic efficiency, to minimise otherwise substantial compliance costs and to smooth the functioning of the internal market." That said, "there are real and valid economic arguments for extending lower VAT rates to some very specific sectors in member states characterised by specific economic structures" – and recommended extending reduced VAT rates to "sectors whose services are easily substituted for do-it-yourself or underground work, e.g. locally supplied services and some parts of the hospitality sector."[27] In its response to the report, the Commission raised some concerns about the use of reduced rates, notably those for tourist services, as there was the risk to creating distortions in the Single Market:

25 Cut VAT on Tourism Campaign, *FAQs*, undated (retrieved 6/2/2014)

26 Library standard note SN2683, cited above, has more detail on the history to these negotiations. The following paragraphs on the case made in this report for lower VAT rates on selected goods and services is adapted from this note. The Commission collates material on this issue, including this report, on its site.

27 Copenhagen Economics, *Study on reduced VAT applied to goods and services in the Member States of the European Union*, 21 June 2007 pp 3-4

> From a job creation point of view, there is a theoretical but not an empirical argument for extending reduced VAT rates to sectors employing many low skill workers in order to boost low skill demand, e.g. hotels, restaurants and locally supplied services. However, there may be a case for a limited, supplementary role via carefully targeted reductions in the context of grander labour market reform.
>
> The theoretical argument is that reduced VAT rates, by boosting demand for such services, stimulate demand for low skill workers, and push up their wages such that employment becomes a more attractive option than unemployment. However, simulations indicate that the overall impact on demand for low skill workers is unimpressive because differences in low skill employment between industries are limited.
>
> From an Internal Market point of view, reduced VAT rates may have some limited implications, in particular through tourism. Services provided by restaurants and hotels are mainly directed at domestic consumption, but may also affect distribution of tourism between Member States and may have a non-negligible impact in border regions. Possible distortion as regards restaurant and hotel services is likely to be different in magnitude across Member States (stronger for smaller and/or tourist oriented areas) and the degree of possible substitution of holiday destinations plays an important role. As far as the business consumption of these services is concerned, the rules on VAT deductibility may also impact on the functioning of the internal market.[28]

Member States were invited to respond to this study; the UK made its submission in May 2008, and the European Scrutiny Committee has reprinted the introduction of this document. In this, the Labour Government made the case for using reduced VAT rates to address certain social policy objectives:

> Reduced VAT rates benefit consumers by reducing the price of certain essential goods and services. They can also reflect consensus among citizens within a Member State, such as the UK, that VAT should be chargeable on such essentials at the lowest rate possible ... VAT can also be effective when combined with other (economic and non-economic) measures and incentives, as a means of providing cost-effective, targeted support for social policy objectives, and as an immediate and effective means of increasing citizen access to 'merit' goods ...
>
> Reduced VAT rates can also address externalities. The consumption of goods with environmental benefits, such as energy-saving materials and the most energy-efficient electrical appliances, has a positive externality … VAT reductions have certain advantages when compared with alternative instruments such as direct subsidies or incentives. Using VAT reductions minimises burdens, administration and other inconveniences for both consumer and retailer, which should maximise take-up and benefit. By reducing the retail prices available to all customers, VAT reduced rates work in a transparent and effective way at the point of transaction.[29]

At this time the case *against* the use of reduced VAT rates was made by a paper, prepared as part of the 'Mirrlees Review' of the UK tax system commissioned by the Institute for Fiscal Studies.[30] The authors argued that, "differential commodity taxation is a very blunt instrument

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[28] European Commission, *Communication on VAT reduced rates MEMO/07/277*, 5 July 2007

[29] European Scrutiny Committee, *Twenty third report*, 23 May 2008 HC 16-xxiii 2007-08 pp87-8

[30] Details of the review are given on its site: http://www.ifs.org.uk/mirrleesReview

for the pursuit of equity objectives, with the zero-rating of food and children's clothing in the U.K. being a classic example":

> Take food, for example. It is indeed the case that the less well-off spend a higher proportion of their income on food than do the better off. But this is not in itself a good reason—even on distributional grounds, leaving the need to raise revenue aside—for subjecting it to a differentially low rate of tax. This is for two reasons.
>
> First, looking only at a snapshot of spending and income patterns in the population at any moment may be misleading given the variability of income over a lifetime: those with low incomes now may be the young or elderly who will be, or have been, amongst the high income groups at other times. Put differently, a commodity tax looks regressive when assessed relative to current incomes in part because those with high incomes tend to have high savings, and so appear to escape the tax—but they will face it when they come to spend those savings.
>
> One way to address these issues is to relate food spending not to income in any period but to total spending, since the latter may be a better reflection of household's perceptions of their own long-run spending ability. Doing so, as Kay and Davis (1985)[31] show for items zero-rated in the U.K.—and as subsequent studies have shown for a range of taxes on particular commodities—tends to greatly dampen the apparent distributional case for tailoring commodity taxation to consumption patterns.
>
> The second reason—perhaps potentially more persuasive to non-economists—is that even if the better off spend a smaller *proportion* of their current income on such items as food than do the less well-off, they are likely to spend a smaller *absolute* amount on them. If there were no other way of transferring resources to the poorest, setting a low tax rate on these items might be sensible policy. But it is unlikely to be so when, as in the U.K., there are a range of other instruments—not only the income tax, but tax credits and benefits—that could be targeted more directly upon them: it seems likely that, by such means, more than £11.50 of each £100 raised by eliminating the zero-rating could be channelled to the poorest, making that a better way of pursuing equity goals.
>
> Kay and Davis (1985) and Hemming and Kay (1981)[32] provided early illustrations of this point for the U.K., the latter showing for example that the distributional impact of eliminating zero-rating could be very largely offset by cutting the standard rate of income tax and increasing the tax threshold. We revisit this simple but crucial insight, using more recent data, [in a later section of the paper, not reproduced here] and show that it has lost no force over the years.[33]

The authors concluded that abolishing zero and reduced rates of VAT would "cut compliance and administration costs for business and government, interfere less with people's spending decisions, and raise enough revenue both to improve the living standards of poorer families and to cut other taxes by £11 billion." Commenting on the report, the then director of the IFS, Robert Chote, noted that "the authors make a powerful case on efficiency, fairness and practical grounds for moving to a uniform rate of VAT, rather than the complex mix of full, zero and reduced rates and exemptions we have at the moment", going on to observe that "the main obstacle to such a reform appears to be a lack of political leadership, which is

31 Kay, John A. and Evan Davis (1985), "Extending the VAT base," *Fiscal Studies*, Vol. 6, pp.1-16.

32 Hemming, Richard, and John A. Kay, 1981, "The United Kingdom," pp. 75-89 in Henry J. Aaron (ed) *The Value-Added Tax: Lessons from Europe* (Washington DC: Brookings Institution).

33 Ian Crawford, Michael Keen & Stephen Smith, *Value-Added Tax and Excises*, IFS July 2008 pp 9-10.

perhaps understandable when the public focus on individual elements of the tax system rather than on the whole."[34]

In the event there was little consensus between Member States for a major reform of these rules – and in March 2009 European Finance Ministers agreed to some minor changes to the list of supplies that may be charged a reduced rate. Indeed it was at this time that "restaurant and catering services" were added to this list.[35]

Turing back to the case made in this country for cutting VAT on tourism, in May 2013 twenty two Members signed an EDM supporting the campaign, and arguing that a reduced VAT rate would "encourage growth in the wider economy, support job creation and generate investment in local businesses."[36] However the Government has reiterated its opposition to such a reform in answer to PQs; two examples are given below:

> **Dan Jarvis**: To ask the Chancellor of the Exchequer what assessment he has made of the value of lowering VAT for businesses involved in UK tourism. [147532]
>
> **Mr Gauke**: The Treasury has worked closely with industry representatives to consider the impact of a VAT cut for the tourism sector on growth and jobs. The conclusion the Government has reached is that a VAT cut would not produce sufficient economic growth to outweigh the revenue shortfall. A VAT cut for this sector would therefore need to be funded either by additional borrowing or by raising other taxes, both of which are likely to have a negative effect on the economy. The Government therefore has no plans to introduce a VAT cut for this sector.[37]

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> **Mr Weir:** To ask the Chancellor of the Exchequer (1) what assessment he has made of the effect on (a) employment, (b) revenue and (c) tax receipts of introducing a reduced rate of valued added tax applied to tourism-related goods and services; and if he will place copies of all documentation relating to such an assessment in the Library; (2) what recent discussions he has had with the Secretary of State for Culture, Media and Sport on the effect on the visitor economy of the introduction of a reduced rate of valued added tax to be applied to tourism-related goods and services.
>
> **Mr Gauke:** Based on ONS data from 2012, the revenue foregone by reducing VAT to 5% on all hospitality (which includes rooms, food and alcohol) would have an estimated cost of £11 billion to £12 billion a year to the Exchequer.
>
> Ministers from the Treasury and the Department for Culture, Media and Sport have discussed the Cut Tourism VAT campaign, and I have met and engaged in correspondence with the campaign, including in relation to their report analysing the impacts of a VAT cut for the sector. The analysis undertaken by the Cut Tourism VAT campaign assumes that the revenue shortfall associated with such a VAT cut should be met by increasing Government borrowing. This would undermine the Government's fiscal strategy, risking a loss of credibility that could have a far larger negative impact on the economy than the positive economic impact that might otherwise be expected as a result of a VAT cut.

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34 IFS press notice, *Simplify VAT to cut costs, raise revenue and help the poor, says study prepared for the Mirrlees Review*, 31 July 2008. The final report of the review also makes the case for removing nearly all zero & reduced rates: see, "Chapter 9: Broadening the VAT base" in *Tax by design*, September 2011.

35 With effect from 1 June 2009, under Directive 2009/47/EC of 5 May 2009.

36 EDM 78 of 2013/14, 14 May 2013

37 HC Deb 12 March 2013 c140W

> I have written to the Chairman of the Campaign for Reduced Tourism VAT explaining that while there is no prospect of a VAT cut for tourism, the Government is committed to a wide range of measures to support tourism that we believe are better targeted and more cost effective, including the GREAT campaign and initiatives designed to simplify the visa application process for Chinese tourists.[38]

The proposal for cutting VAT on tourism was supported by several Members in a Westminster Hall debate on this issue on 11 February 2014. The debate was initiated by Ms Margaret Ritchie MP, who summarised the case as follows:

> As a labour-intensive industry, the tourism sector is a leading employer. In particular, it offers younger people entry-level jobs at the start of their careers, and more than 44% of people employed in the sector are less than 30 years old. We face a youth unemployment crisis, with more than one in four young people out of work, and the Government's lack of support for the tourism sector is clearly impairing job creation. A cut in the rate of VAT would create demand, which would spur job creation and go some way towards reducing youth unemployment. In Ireland, the VAT cut for tourism has produced an extra 10,000 jobs in just over a year. A prominent report on the subject published by Deloitte produced evidence that a similar tourist VAT cut in the UK would create some 80,000 jobs.[39]

Although most Members who spoke on this occasion argued for a cut in VAT, Shabana Mahmood, the Shadow Exchequer Secretary, said that the Opposition could not make a commitment to do this as "an incoming Labour Government in 2015 will inherit a difficult financial situation." In turn the Exchequer Secretary, Mr Gauke, reiterated the Government's position:

> Several other member states have chosen to implement a reduced rate of VAT on tourism, but the Government have yet to find any evidence of a causal link between VAT rates and tourism activity. Comparisons with other countries tend not to take into account the significant VAT reliefs that the UK provides for cultural attractions and public transport, or the other tourist taxes that other member states choose to levy. In addition to the sector-specific reliefs, the UK's VAT registration threshold is the highest in the EU. Therefore, many tourist attractions do not have to charge any VAT to their customers.
>
> It is interesting to note that France, which is often the country quoted as reducing the rate and reaping the rewards, put its VAT rate on restaurant services up from 7% to 10% in January. Also, many businesses in the tourism sector are small businesses and will benefit from the £2,000 cut in national insurance contributions, the employment allowance, that will come into effect in April …
>
> The campaign's analysis assumes that the revenue shortfall associated with a VAT cut should be met by increasing Government borrowing, but the latest figures from the Office for National Statistics suggest that reducing VAT to 5% for all catering services provided by restaurants, pubs, cafes and canteens would cost the Exchequer between £9 billion and £10 billion a year. Cutting VAT to 5% for accommodation would cost the Exchequer an estimated £2 billion a year …
>
> The conclusion that we reached, therefore, which I announced in Parliament last year, is that a VAT cut would not produce sufficient economic growth to outweigh the

38 HC Deb 8 October 2013 c161W

39 HC Deb 11 February 2014 c192WH

revenue shortfall. I have not seen any new evidence since then that has led me to revisit that conclusion, so, at present, the Government have no plans to introduce a VAT cut for the sector.[40]

## Appendix: Use of reduced VAT rates across EU Member States

The following pages reproduced one table from the European Commission's survey of the rates of VAT charged across all Member States; this charts the use, in selected countries, of the dispensation to charge a reduced rate of VAT on specific goods and services, as listed in Annex III to the principal EC VAT directive.

This table is accompanied by a long series of detailed notes, on the precise coverage of the reduced rate in individual cases. For convenience, the notes which refer to the three items of direct interest to the campaign for cutting VAT on tourism are also reproduced: ie, the notes to, item 7 (admission to cultural services and amusement parks); item 12 (hotel accommodation); and, item 12a (restaurant and catering services).

Source: *VAT rates applied in the Member States of the European Community*, January 2014 (Table II, pp4-6).

[40] HC Deb 11 February 2014 c212WH; cc213-4WH

| | Category | BE | BG | CZ | DK | DE | EE | EL | ES | FR | HR | IE | IT | CY | LV | LT | LU | HU | MT | NL | AT | PL | PT | RO | SI | SK | FI | SE | UK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1. | Foodstuffs | 6 | 20 | 15 | 25 | 7 | 20 | 13 | 4 | 5,5 | 5[1] | 0 | 4 | 5 | 21 | 21 | 3 | 18[2]<br>27 | 0[3] | 6 | 10 | 5 | 6 | 9<br>24 | 9,5 | 20 | 14 | 12 | 0 |
| | | 12 | | | | 19 | | | 10 | 10 | 13[4] | 4,8<br>13,5 | 10 | 19 | 12[5] | | | | | | | 8 | 13 | | | 10 | | 25 | 20 |
| | | 21 | | | | | | | | 20 | 25 | 23 | | | | | | | | | | 23 | 23 | | | | | | |
| 2. | Water supplies | 6 | 20 | 15 | 25 | 7 | 20 | [ex][6]<br>13 | 10 | 5,5 | 13[7] | [ex][8] | 10 | 5 | 21 | 21 | 3 | 27 | 0 | 6 | 10 | 8 | 6 | 24 | 9,5 | 20 | 24 | 25 | 0 |
| | | | | | | | | | | | 25 | 23 | | | | | | | | | | | | | | | | | |
| 3. | Pharmaceutical products | 6 | 20 | 15 | 25 | 19 | 9 | 6,5 | 4 | 2,1 | 5[9] | 0 | 10 | 5 | 12 | 5[10] | 3 | 5[11] | 0 | 6 | 10 | 8 | 6 | 9 | 9,5 | 10 | 10 | 25 | 0 |
| | | | | | | | | 13 | | 10 | | | | | | | | 27 | | | | | | | | | | | |
| | | 21 | | | | | | 23 | 21 | 20 | 25 | 23 | 22 | | | | 15 | | | 21 | | | 23 | | | | | 0 | 20 |
| 4. | Medical equipment for disabled persons | 6 | 20 | 15 | 25 | 7 | 9 | 13 | 10 | 5,5 | 5[12] | 0 | 4 | 5 | 12 | 5[8] | 3 | 5 | 5 | 6 | 20 | 8 | 6 | 9[13] | 9,5 | 10 | 24 | 25 | 0 |
| | | 21 | | | | | | | | | 25 | 23 | 22 | | | | 15 | 27 | | 21 | | | | | | | [ex] | [ex] | |
| | Children's car seats | 21 | 20 | 15 | 25 | 19 | 20 | 23 | 21 | 20 | 25 | 13,5 | 22 | 5 | 21 | 21 | 15 | 27 | 18 | 21 | 20 | 8 | 6 | 24 | 22 | 20 | 24 | 25 | 5 |
| 5. | Transport of passengers (+see n° VI) | 6 | 20 | 15 | [ex] | 7 | 20 | 13 | 10 | 10 | 25 | [ex] | 10 | 5 | 12 | 9[14] | [ex] | 27 | 0[15] | [ex] | 10 | 8 | 6 | 24 | 9,5 | 0 | 10 | 6 | 0 |
| | | 0 | | 0 | 0 | 19 | 0 | | | | | | [ex] | 9 | [ex][16] | 21 | 3 | | | 6 | | | | | | 20 | | 0 | |
| | | | | | | | | | | | | | | 19 | | | | | | 21 | | | | | | | | | |
| 6. | Books | 6 | 20 | 15 | 25 | 7 | 9 | 6,5 | 4 | 5,5 | 5[17] | 0 | 4 | 5 | 12 | 9[18] | 3 | 5 | 5 | 6 | 10 | 5 | 6 | 9 | 9,5 | 10 | 10 | 6 | 0 |
| | | 21 | | | | | | | 21 | 20[19] | | | 22 | | | | | | | | | 23 | | | | | | | |
| | | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Books on other physical means of support | 21 | 20 | 21 | 25 | 19 | 20 | 23 | 4 | 5,5<br>20[19] | 5 | 23 | 4[20]<br>22 | 19 | 21 | 21 | 3 | 5 | 18 | 6 | 20 | 23 | 6 | 9 | 9,5 | 20 | 24 | 6[21]<br>25 | 0[22]<br>20 |
| | Newspapers | 0 | 20 | 15 | 0 | 7 | 9[23] | 6,5 | 4 | 2,1 | 5[24] | 9 | 4 | 5 | 12 | 21 | 3 | 5 | 5 | 6 | 10 | 8 | 6 | 9 | 9,5 | 20 | 10[25] | 6 | 0 |
| | | 6 | | | 25 | | | | 21 | 20 | 13[26] | | | | | | | | | | | 23 | | | | | 24 | | |
| | | 21 | | | | | | | | | 25 | | | | | | | | | | | | | | | | | | |
| | Periodicals | 0 | 20 | 15 | 25 | 7 | 9[27] | 6,5 | 4 | 2,1 | 5[28] | 9 | 4 | 5 | 12 | 21 | 3 | 5 | 5 | 6 | 10 | 5 | 6 | 9 | 9,5 | 20 | 10[25] | [ex] | 0 |
| | | 6 | | | | | | | 21 | 20 | 13[29] | | 22 | | | | | | | | | 23 | | | | | 24 | 6 | |
| | | 21 | | | | | | | | | 25 | | | | | | | | | | | | | | | | | | |
| 7. | Admission to cultural services (shows, cinema, theatre) | [ex] | 20 | 15 | 25 | [ex] | 20 | 13 | [ex][30] | 5,5 | 5[31]<br>13[32] | [ex] | 10 | [ex] | [ex] | [ex][33] | 3 | 27 | 5 | 6 | [ex] | 8 | [ex] | 9 | 9,5 | 20 | 10 | 6 | 20 |
| | | 6 | | | | 7 | | 6,5[34] | 21 | 20 | 25 | 9 | | 5 | 21[35] | 21 | | | | | 10 | | 13 | | | [ex] | | | |

| | Category | BE | BG | CZ | DK | DE | EE | EL | ES | FR | HR | IE | IT | CY | LV | LT | LU | HU | MT | NL | AT | PL | PT | RO | SI | SK | FI | SE | UK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Admission to amusement parks | 6 | 20 | 15 | 25 | 19 | 20 | 13 | 21 | 10[36] | 25 | 9 | 22 | 5 | 21 | 21 | 3 | 27 | 18 | 6 | 10 | 8 | 23 | 9 | 9,5 | 20 | 10 | 25 | 20 |
| | | | | | | | | | | 20 | | | | | | | | | | | | | | | | | | | |
| 8. | Pay TV/ cable TV | 21 | 20 | [ex] [37] | 25 | 19 | 20 | [ex] | 21 | 10 | [ex][38] | 23 | 22 | 19 | 21 | 21 | 3 | [ex] | 18 | 21 | 10 | 8 | 23 | 24 | 22 | [ex] | 24 | 25 | 20 |
| | | | | 21 | | | | 13[39] | | | 25 | | | | | | 15 | 27[40] | | | | 23[41] | | | | 20[42] | | | |
| | TV licence | [-] | 20 | [ex] [37] | 25 | [ex] | 20 | [ex] | 21 | 2,1 | N/A | [ex] | 4 | 19 | [-] | 21 | [ex] | [ex] | [ex] | [ex] | 10 | 23 | 6 | 24 | [ex] | [ex] | 10 | [ex] | [ex] |
| | | | | 21 | | | | | | | | | | | | | | 27[43] | | | | | | | 22[44] | 20[45] | | | |
| 9. | Writers, composers, … | 6 | 20 | 15 | [ex] | 7 | 20 | 13 | 21 | 5,5 | [ex][46] | 23 | [ex] | 5 | [ex] | 21 | 3 | 27 | 18 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | [ex] | 6 | 20 |
| | | 21 | | | | | | | | | 25 | | 22 | | | | | | | 21 | 10 | | [ex] | | | | 10[47] | | |
| | | [ex] | | | | | | | | | | | | | | | | | | [ex] | | | | | | | | | |
| 10. | Social housing | 12[48] | 20 | 15 | 25 | 19 | 20 | 13 | 4 | 5,5 | 25 | 13,5 | 4 | 19 | 21 | 21 | 3[49] | 27 | [ex] | 21 | 20 | 8 | [ex] | 5 | 9,5 | 20 | 24 | 25 | 20 |
| | | | | | | | | [ex] | | 20 | | | 10 | | | | 15 | | | | | | 6 | | | | | [ex] | 5 |
| | | 6 | | | | | | | | | | | | | | | | | | | | | | | | | | | 0 |
| 10a | Renovation and repairing of private dwellings (*) | 21<br>6[50] | 20 | 15 | 25 | 19 | 20 | 13[51] | 10[52] | 5,5<br>10[53]<br>20 | 25 | 13,5 | 10 | 5 | 21 | 21 | 15 | 27 | 18 | 6[54] | 20 | 8 | 6 | 24 | 9,5 | 20 | 24 | 25 | 5[55] |
| 10b | Window cleaning and cleaning in private households | 21 | 20 | 15 | 25 | 19 | 20 | 23 | 21 | 10 | 25 | 13,5 | 22 | 19 | 21 | 21 | 6 | 27 | 18 | 21 | 20 | 23 | 23 | 24 | 9.5 | 20 | 24 | 25 | 20 |
| 11. | Agricultural inputs | 6 | 20 | 15 | 25 | 7 | 20 | 13 | 10 | 10 | 25 | 13,5 | 4 | 5 | 21 | 21 | 3 | 27 | 18 | 6 | 10 | 5 | 6 | 24 | 9,5 | 20 | 24 | 25 | 20 |
| | | 12 | | 21 | | | | | | 20 | | | 10 | 19 | | | 15 | | | | | 8 | 13 | | | | 14 | | |
| | | 21 | | | | | | | | | | | 22 | | | | | | | | | 23 | 23 | | | | | | |
| 12. | Hotel accommodation | 6 | 9 | 15 | 25 | 7 | 9 | 6,5 | 10 | 10 | 13 | 9 | 10 | 9 | 12 | 21 | 3 | 18[56] | 7 | 6 | 10 | 8 | 6 | 9 | 9,5 | 20 | 10 | 12 | 20 |
| 12a | Restaurant and catering services | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | *Restaurants* | 12[57] | 20 | 21 | 25 | 19 | 20 | 13 | 10 | 10[58] | 13 | 9[59]<br>[ex][60] | 10 | 9 | 21 | 21 | 3 | 27 | 18 | 6[61] | 10[62] | 8[63] | 23 | 24 | 22<br>9,5[64] | 20 | 14 | 12 | 20 |
| 13. | Admission to sporting events | 6 | 20 | 15 | [ex] | 7 | 20 | 13 | 10 | 20 | 25 | [ex] | 10 | 5 | 21 | 21 | 3 | 27 | 18 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | 10 | [ex] | 20 |
| | | [ex] | | | 25 | 19 | | | 21 | | | | 22 | | | | [ex] | | | | | | | | | | [ex] | 6 | |
| 14. | Use of sporting facilities | 6 | 20 | 15 | [ex] | [ex] | 20 | 23 | [ex] | 20 | 25 | 9 | 22 | 19 | 21 | 21 | 3 | 27 | 18 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | 10 | 6 | 20 |
| | | [ex] | | | 25 | 19 | | | 21 | | | | | | | | | | | [ex] | | | | | | [ex] | | [ex] | 17.5 |
| 15. | Social services | 6 | 20 | [ex] | 25 | 7 | [ex] | 13 | 10 | 20 | 25 | [ex] | [ex] | [ex] | [ex] | [ex] | 3 | [ex] | [ex] | 21 | [ex] | [ex] | 6 | [ex] | 22 | 20 | [ex] | [ex] | [ex] |
| | | | | 15 | | | | [ex] | | | | | 4 | | | | | | | | | | 23 | | [ex][65] | [ex] | | | |
| | | 21 | | | | | | | | | | | 10 | | | | 15 | | | | 10 | | [ex] | | | | | 25 | |
| | | [ex] | | | | | | | | | | | 22 | | | | [ex] | | | | | | | | | | | | |

| | Category | BE | BG | CZ | DK | DE | EE | EL | ES | FR | HR | IE | IT | CY | LV | LT | LU | HU | MT | NL | AT | PL | PT | RO | SI | SK | FI | SE | UK |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 16. | Supplies by undertakers and cremation services | 6 | 20 | 15 | [ex] | 19 | 20 | 13 | 21 | 20 | 25 | 23 | [ex] | 5 | 21 | 21 | 3 | 27 | 18 | [ex] | 20 | 8 | [ex] | 24 | 9,5 | 20 | [ex] | [ex] | [ex] |
| | | 21 | | | | | | | | | | [ex] | | | | | | | | | | | | | | | | | |
| 17. | Medical and dental care | 21 | 20 | [ex] | [ex] | 7 | [ex] | 13 | 21 | [ex] | [ex] | [ex][66] | [ex] | [ex] | [ex] | [ex] | 3 | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] | [ex] |
| | | [ex] | [ex] | 15 | | [ex] | | [ex] | [ex] | | | 13,5 | | | | | [ex] | | | 21 | | 8 | 6 | | | | | | |
| 18. | Collection of domestic waste and street cleaning, ... | 21 | 20 | 21 | 25 | [-] | 20 | 13 | 10 | 20 | 25 | 13,5 | 10 | 5 | 21 | 21 | 3 | 27 | 18 | 21[67] | 10 | 8 | [ex] | 24 | 9,5 | 20 | 24 | 25 | 0 |
| | | | | 15[68] | | 19 | | [ex][69] | | 10 | | | | | | | | | | | | | 6 | | | | | | 20 |
| 19. | Minor repairing (including mending and alteration) of: | | | | | | | | | | | | | | | | | | | | | | | | | | | | |
| | Bicycles | 21 | 20 | 21 | 25 | 19 | 20 | 13 | 21 | 20 | 25 | 13,5 | 22 | 19 | 21 | 21 | 6 | 27 | 5 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | 10 | 25 | 20 |
| | Shoes and leather goods | 21 | 20 | 21 | 25 | 19 | 20 | 13 | 21 | 20 | 25 | 13,5 | 22 | 19 | 21 | 21 | 6 | 27 | 5 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | 10 | 25 | 20 |
| | Clothing and household linen | 21 | 20 | 21 | 25 | 19 | 20 | 13 | 21 | 20 | 25 | 13,5 | 22 | 19 | 21 | 21 | 6 | 27 | 5 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | 10 | 25 | 20 |
| 20. | Domestic care services (**) | 21 | 20 | 15 | 25 | 19 | 20 | 13 | 21 | 5,5<br>10 | 25 | [ex] | [ex] | 19 | 21 | 21 | [ex]<br>15 | 27<br>[ex][70] | 5 | 21 | 20 | 23 | 6 | 24 | 9,5 | 20 | 24 | 25 | 20 |
| 21. | Hairdressing | 21 | 20 | 21 | 25 | 19 | 20 | 23 | 21 | 20 | 25 | 9 | 22 | 5 | 21 | 21 | 6 | 27 | 18 | 6 | 20 | 8 | 23 | 24 | 9,5 | 20 | 10[34] | 25 | 20 |

(*) excluding materials which form a significant part of the value of the supply
(**) e.g. home help and care of the young, elderly, sick or disabled

30 ES: Supplied by bodies governed by public law or by other organisations recognised as charitable by the Member State concerned
31 HR: Admissions to cinema (film shows)
32 HR: Tickets for concerts
33 LT: Supplied by non-profit making legal persons
34 EL: Only for the theatre
35 LV: Admissions to cinema (film shows)
36 FR: Amusement parks which do not illustrate any cultural topic are liable to the standard rate of 20%
56 HU: In force as of 1.07.2009
57 BE All beverages are excluded
58 FR: Alcoholic beverages are subject to the standard rate
59 IE: All beverages are excluded
60 IE: Catering services supplied to patients in a hospital or students at their school
61 NL: Alcoholic beverages are subject to the standard rate
62 AT: 10% on food, 10% on milk and chocolate, 20% on coffee, tea and other alcoholic or not alcoholic beverages
63 PL: Alcoholic beverages are subject to the standard rate
64 SI: VAT rate of 9,5% applies to the preparation of meals