HM Treasury

VAT, Air Passenger Duty and tourism in Northern Ireland: summary of responses

October 2018

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Executive summary

The government recognises the importance of the tourism industry within the economies of Northern Ireland and Great Britain. Tourism and its associated industries support substantial employment and make an important contribution to gross domestic product (GDP). Despite consistently strong growth in recent years, with record breaking figures reported in Northern Ireland in 2017, the government recognises that there are concerns regarding the levels of Value Added Tax (VAT) and Air Passenger Duty (APD) and the effects that these taxes may be having on the industry in the specific circumstances of Northern Ireland.

In recognition of these longstanding concerns and to understand how best to balance support for the tourism industry and taxpayer value for money, at Spring Statement 2018 the government launched the call for evidence on the impact of VAT and APD on tourism in Northern Ireland. The call for evidence, which closed on 5 June 2018, also explored the potential impact of UK wide cuts to both APD and VAT rates on tourism related services. This document summarises the evidence presented during the consultation and the government's response.

Many respondents to the call for evidence argued in favour of cuts to the rate of VAT applied to accommodation and attractions in Northern Ireland. Others proposed cuts to the rate of VAT applied to food and beverage services, in addition to the aforementioned tax cuts. It was also argued that the rate of short-haul APD should be reduced in Northern Ireland, to help to support the tourism industry. Fewer representations were made in support of cuts across the UK as a whole, however those in favour argued that the cost of tax reductions would be offset in the longer term by industry growth.

Much of the evidence presented focused on competition between the tourism industries of Northern Ireland and Ireland. Tourism is argued to be extremely price sensitive in terms of consumer decision making. Ireland maintains a 9% reduced rate of VAT on tourism related services, including accommodation and restaurants. The Irish government announced on 8 October that from 1 January 2019 the VAT rate on tourism related services will rise to 13.5%. The UK maintains a standard rate of VAT of 20% which applies to most goods and services. Respondents felt this created a distortion of competition across the border, particularly as prices are normally advertised as VAT inclusive. Furthermore, the rate of APD is claimed to deter international short-haul visitors, although evidence presented suggested short-haul travellers are less price sensitive.

This is set within the context of a Northern Ireland economy currently dominated by domestic tourism and seeking to expand within the international market. Tourism Ireland advertises Northern Ireland and Ireland internationally. This is claimed to inadvertently cast a spotlight on price differences between the two markets.

However, marketing of the all-island economy is also argued to have certain advantages, with tourism in Northern Ireland benefitting from visitors to Ireland.

There are also a number of features of the existing tax regime that already support the tourism industry. The UK has the highest VAT registration threshold in the EU and Organisation for Economic Co-operation and Development (OECD). The threshold is significantly higher for businesses that provide services than the comparable rate in Ireland, benefitting many in the tourism industry.

The government also maintains a zero rate of VAT on passenger transport services and exemptions are available for cultural institutions such as art galleries and museums. In addition, in 2012, the UK government devolved the power to set direct long-haul APD rates to the Northern Ireland Executive, and the Executive subsequently set these at zero with the intention of supporting the long-haul market in Northern Ireland.

While the government recognises the difficulties that may arise from a higher rate of tax in Northern Ireland, the industry's growth demonstrates its success.

VAT and APD are important sources of revenue for the Exchequer, raising £125 billion and £3.4 billion in 2017-18 respectively. This money is used to fund the government's spending priorities such as health, education and defence and any loss of revenue must be balanced by increased borrowing, reduced public spending or increased taxation elsewhere. The existence of multiple VAT rates on the same territory would also likely lead to additional administrative burdens for taxpayers and businesses.

This evidence must also be considered within the existing legislative framework and, in the absence of an Executive in Northern Ireland, there is currently no scope for further devolution of any tax, including APD, in Northern Ireland. In addition, it is not possible to introduce differential VAT rates within a single VAT territory under EU law.

In light of the legal and fiscal considerations set out above, the government will not be making changes to the rates of VAT on tourism related services in Northern Ireland or the UK as a whole at this time. There will also be no changes to the APD regime in Northern Ireland at this time.

However, we will continue to analyse the evidence and receive representations on VAT and APD policy in order to keep these issues under close review. This is a complex area affecting important sources of revenue for the Exchequer. The arguments set out in this call for evidence have highlighted these complexities and the government will take them into consideration in future policy development.

In particular, the government will establish a technical working group to consider the practical and legal challenges to changing short-haul APD in Northern Ireland. Further details of this group will be provided in due course.

The government is keen to ensure a robust and reliable tax system, capable of generating the revenue required to support our public services. But it is also important to ensure that it is a system which encourages and supports economic activity. The government will continue to support the tourism industry in Northern Ireland and the rest of the UK, working further with stakeholders to ensure we build on the existing growth and success of the tourism industry.

Chapter 1
Introduction

1.1 Tourism makes a valuable contribution to the economy in both Northern Ireland and the rest of the UK. Taking the UK as a whole, tourism accounts for 3.8% of Gross Value Added, delivering £66.1 billion, and directly supporting over 1.6 million jobs.

1.2 The tourism industry in Northern Ireland has shown consistently strong growth in recent years. In the twelve months leading up to September 2017, the number of trips increased by 11% compared with the same period in 2016. Total expenditure by visitors rose by 18% to £951 million. This was largely due to an increase in visitors from Ireland and the growth of the industry in Northern Ireland outstripped that of the larger Great British market. 2017 marked a record breaking year for the tourism industry in Northern Ireland, contributing almost £1 billion to the economy.

1.3 Building on the success of the tourism sector has been a priority for both the UK government and the Northern Ireland Executive.

1.4 In 2016, the government published a 'Tourism Action Plan', outlining its priorities for supporting the tourism sector in the UK. These were: strengthening collaboration and co-ordination between partners, improving skill levels and retention, continuously improving the visa offer, examining the scope for deregulation, and making it easier for visitors to explore the UK.

1.5 The importance of tourism to Northern Ireland and its potential is embedded within the previous Northern Ireland Executive's Draft Programme for Government 2016-2021, and tourism was identified as a key sector in the Northern Ireland Industrial Strategy consultation 'Economy 2030 – A consultation on an industrial strategy for Northern Ireland'.

1.6 The government supports tourism across the UK in various ways, including through VisitBritain, the British Tourism Authority. The Northern Ireland Department for the Economy is responsible for delivering its tourism strategy and policy in Northern Ireland.

1.7 Under the Belfast Agreement, also known as the Good Friday Agreement, Tourism Ireland is responsible for promoting the Island of Ireland to visitors from 23 countries including other parts of the UK, reaching 800 million people globally. Tourism Northern Ireland is responsible for the development of tourism product and the marketing of Northern Ireland as a tourist destination to domestic tourists from within Northern Ireland and to visitors from Ireland.

1.8 There are a number of features of the existing tax regime that already support the tourism industry. The UK has the highest VAT registration threshold in the EU and Organisation for Economic Co-operation and Development (OECD) which benefits many of the smaller accommodation providers and exemptions are available for cultural institutions such as art galleries and museums. The government also maintains a zero rate of VAT on passenger transport services. In addition, in 2012, the UK government devolved the power to set direct long-haul APD rates to the Northern Ireland Executive, and the Executive subsequently set these at zero with the intention of supporting the long-haul market in Northern Ireland.

1.9 Despite the growing success of the tourism industry in Northern Ireland, there are long-standing concerns about the impact of tax on the sector. The government recognises the unique position of Northern Ireland as the only part of the UK with a land border with another EU member state and wishes to promote the continued growth of the tourism industry balanced with simplicity and sustainability in the tax system.

1.10 The government wanted, through the call for evidence, to better understand the ways that VAT and APD impact the tourism industry, and how the industry could be supported to build on its growing success. That is why, at Spring Statement, the Chancellor launched the call for evidence on VAT, Air Passenger Duty and tourism in Northern Ireland. The response document summarises the evidence presented.

Engagement with the call for evidence

1.11 The government received over 80 unique responses to this call for evidence from a wide range of stakeholders, including trade organisations, public sector bodies, campaign groups and wider industry. This document sets out a summary of these responses.

Chapter 2

The impact of VAT and Air Passenger Duty on tourism demand

2.1 This section asked about how the existing tax regimes impact on the tourism sector in Northern Ireland, specific challenges the sector faces and the impact of reducing tax rates in Northern Ireland and other countries. Questions were aimed at all respondents and we received responses from a wide variety of stakeholders.

Question 1: What evidence is there that demonstrates the impact of VAT and APD on the tourism sector?

VAT

2.2 Currently the UK maintains a standard rate of VAT of 20%. This applies to most goods and services (collectively referred to as supplies), including many tourism related supplies. Ireland introduced a reduced rate of VAT of 9% on tourism related services in 2011 to support growth following the financial crisis. This rate applies to hotels, restaurant and café services, and cinema entrance.

2.3 It is important to consider the rates of VAT and APD in the context of the wider tax regime. The UK has a competitive tax regime internationally, across both business and personal taxes, attracting business and investment.

2.4 When analysing the impact of VAT, for the purposes of the call for evidence, the majority of the respondents and evidence presented focused on some or all of the following three sectors: visitor accommodation (such as hotels, guest houses, self-catering establishments, camping sites); visitor attractions (such as theme and leisure parks, zoos, historical sites, piers and museums); and food and beverage services. This reflects difficulty in isolating the tourism sector to a limited number of goods and services since tourists consume a wide range of things. The three sectors listed above are those for which respondents felt a reduced rate of VAT would induce the greatest impact on the tourism industry.

2.5 Respondents pointed to various pieces of relevant research, spanning the previous 25 years, which explored and modelled the theoretical impacts of reduced VAT rates on the three main tourism sectors. Some of the research suggested that VAT reliefs are an economically efficient means of boosting GDP and providing long term and sustainable growth for the industry.

2.6 More generally, price elasticity is a fundamental aspect in understanding the impact that tax changes may have on the tourism industry. Representations were made to suggest that tourism is highly price sensitive and this is explored in greater detail in a subsequent section of the document. There were also claims, within the evidence presented, that VAT cuts have a disproportionate effect on the economy. This is based on the assumption that a reduction in the price of tourism results in a greater than equal increase in demand. Some theorise this results in 'multiplier effects' with additional job creation and supply chain spending throughout the economy. None of these claims took account of the reduction in demand that would flow from having to raise the foregone revenue elsewhere in the economy.

2.7 Tourism revenues, according to respondents, are up to eight times higher in Ireland than those of the industry in Northern Ireland. The entire Island of Ireland is advertised internationally by one body, and 80% of tourism revenue in Ireland results from international visitors. By contrast, the majority of visitors to Northern Ireland arrive from the UK's domestic market. Several responses assume that these differences are at least in part due to the VAT differential found in the two countries.

2.8 Evidence was presented, highlighting research which suggested that exchange rates have a substantial impact on UK tourism earnings and employment. Clearly, this has a more substantive impact on visitors travelling from outside the UK, whereas tourism in Northern Ireland is dominated by intra-UK travel. Nevertheless, a favourable exchange rate is reported to have had a significant effect on the intent to travel for visitors to the whole of the UK from India, China and the USA.

2.9 Some respondents highlighted evidence of bunching of businesses below the VAT registration threshold. It was argued that UK's high threshold acts as a disincentive to growth, particularly in the accommodation sector. Small businesses below the threshold may limit their turnover to avoid accounting for and charging VAT. This reduces their administrative burden and allows the business to maintain lower prices. It is argued that the high rate of VAT in Northern Ireland aggravates this issue as small businesses compete with those across the border.

APD

2.10 The predominant view from respondents was that APD contributes to a lack of connectivity from airports in Northern Ireland. The majority of respondents highlighted the large number of airports that are connected to Dublin airport when compared to the number served by the two Belfast airports. As one respondent noted:

> "Dublin flies to a total of 134 airports (including airports within Ireland and the UK) compared to Belfast's two airports, which fly to 62 European airports (including airports within Ireland and the UK)."

2.11 Respondents, including airlines and airports, argued that APD inhibits route development as the tax constricts yield for airlines, making it riskier to start new routes, particularly when they can establish routes from a major airport (Dublin) on the same island not applying the tax. Some respondents provided specific examples of routes that have recently been 'lost' to airports in Ireland.

2.12 Other evidence of APD's impact cited by many respondents was the number of passengers from Northern Ireland who were choosing to use airports in Ireland, mainly Dublin, which increased after the removal of Ireland's Air Transport Tax (equivalent to APD).

2.13 Many respondents also indicated that APD increases the fares available to consumers travelling via airports in Northern Ireland, increasing the cost of travel for both inbound and outbound tourism.

Question 2: What evidence is there that cost is a significant factor to tourists considering visiting Northern Ireland?

2.14 As highlighted above, tourism has been suggested to be highly price sensitive and price cuts are argued to lead to a disproportionate increase in consumer demand. Much of this research has been carried out outside of the unique context of the Island of Ireland, however. Evidence was presented, however, to suggest that value for money perceptions significantly influence consumer decision making and that the value for money perception of Ireland has improved since the introduction of the reduced VAT rate.

2.15 One trade organisation reported that:

> "53% of respondents believed that cost was a significant factor when visitors to the Island of Ireland are deciding whether to stay in Northern Ireland or the Republic of Ireland. Only 6% felt it had no impact."

2.16 It was also highlighted by some respondents that price should not be taken as the sole indicator of competitiveness. The quality of the tourism offer was argued by some to be of equal importance to price, although engagement over the course of the call for evidence highlighted particular issues of competition for accommodation providers very close to competitors across the border in Ireland.

2.17 There appear to be differences, on the basis of evidence presented, between the price sensitivity for those travelling long or short haul, where long haul travel is reported to be significantly more price sensitive. According to some of the research presented, similar differences can be observed between those travelling for leisure versus business with the latter exhibiting significantly lower price sensitivity.

2.18 As highlighted in the previous section, various respondents stated that exchange rates seem to have a significant impact on decision making for holiday makers, particularly those travelling long-haul. An additional range of other factors were often listed as significant influencers on tourism consumer decision making. These include but are not limited to: quality of the tourism offer, consumer experiences, safety of the destination and infrastructure.

What proportion of the cost of a holiday in Northern Ireland is made up of VAT and APD?

How much does the cost of a holiday in Northern Ireland differ from other parts of the UK, and from other parts of the Island of Ireland?

2.19 Little evidence was presented to suggest specific costings for the proportion tax makes up of holiday costs; however, estimates expressed a range of 12-20%.

2.20 Some respondents did reference lower average spend per visit by tourists in Northern Ireland compared with Ireland, argued to reflect increased cost as a result of the high rate of VAT. VAT has been reported by some respondents to make up a greater proportion of the cost for visitors to the UK than rival destinations.

2.21 Comparisons of pricing between Northern Ireland and the rest of the UK referenced research which suggested that prices in Northern Ireland compare favourably with and are often lower than the rest of the UK. This was in part due to the reliance on domestic tourism. Average disposable income is also significantly lower in Northern Ireland and this may be depressing prices. Views were divided on how prices compare between Northern Ireland and Ireland. Evidence suggested that prices in Northern Ireland were competitive with Ireland's, although businesses are argued to cope with narrower profit margins in order to achieve this.

2.22 Much of the discourse focused on the unique circumstances of Northern Ireland, with lower tourism growth than Ireland or the rest of the UK. Various responses attributed this to the existence of a land border within the Island of Ireland and consumers shopping for high value goods and services where the VAT rates are lower. Others, however, drew comparisons with areas of England, Scotland and Wales which were perceived to be facing similar challenges. This has been highlighted, in particular, regarding coastal and rural regions.

2.23 Regarding air travel choices, the majority of respondents indicated that price was very important to consumers when deciding where to travel from/to. Negative price elasticities outlined in different studies provided by respondents seem to reflect this point of view.

2.24 A range of views were presented on how price impacts different types of traveller. One respondent provided evidence to suggest that long-haul travellers are more influenced by price than short-haul travellers. However, there was alternative evidence provided to suggest the impact is much greater on those travelling domestically as APD must be paid on both legs of the journey, making APD a higher proportion of the ticket price if passed on directly by airlines.

2.25 Further, other respondents provided evidence to suggest that the price sensitivity of tourists is increasing due to the development of price comparison sites.

Question 3: Are there additional challenges, unique to the tourism industry in Northern Ireland, which might be addressed through VAT or APD changes?

2.26 The predominant view was that Northern Ireland's unique geographic position within the UK created particular challenges for the tourism industry.

2.27 One challenge described was the reliance of the citizens and businesses of Northern Ireland on air travel to remain connected with the rest of the domestic market. Whilst there is alternative travel available via ferries, many respondents suggested that this was unfeasible for many travellers due to the extensive travel times.

2.28 A further challenge relating to geography highlighted by the majority of respondents was Northern Ireland's unique position as the only part of the UK with a land border with another EU member state. Respondents argued this creates specific challenges for the tourism industry in Northern Ireland as many tourists treat the Island of Ireland as one destination yet due to the lack of an aviation tax in Ireland, respondents felt that airports in Northern Ireland are put at a competitive disadvantage with their Irish counterparts when competing for routes and passengers.

2.29 Respondents argue that this impacts not only on inbound tourism, but outbound tourism as consumers in Northern Ireland are able to cross the border to fly from airports in Ireland if the flights are cheaper.

2.30 Evidence provided to support these arguments include the growth of Dublin Airport in recent years and the routes served when compared with airports in Northern Ireland (see question 1). Further evidence included data to show that growth in the tourism sector in Northern Ireland has historically lagged behind both the rest of the UK and Ireland.

"During the period between 2009 and 2016, inbound tourism to Northern Ireland increased by 13.9% in terms of volume and 19.5% by value. While these figures seem respectable, they are poor in comparison to the UK as a whole, where visitor numbers increased by 25.8% and expenditure increased by 35.8% over the same period."

2.31 According to the latest official data, this has not, however, been the case in recent years. Total expenditure by visitors to Northern Ireland rose by 18% to £951 million. This was largely due to an increase in visitors from Ireland and the growth of the industry in Northern Ireland outstripped that of the larger Great British market.

2.32 Owing to the fact that the Island of Ireland is marketed as a single destination internationally, it is argued that many tourists do not see them as separate destinations. As a result, some respondents suggested that Northern Ireland, operating within both the all-island economy and the UK domestic market, experiences heightened price sensitivity. Limitations in Northern Ireland's size are also reported to contribute with visitors seeing many of the most famous attractions in a short space of time, resulting in competition across the Irish border not experienced elsewhere in the UK.

Some respondents also noted that the tourism offering is considered relatively "young" due to the sector still developing following the Troubles.

2.33 Some suggested that price competition was particularly acute in Northern Ireland and in the tourism sector in particular. One response stated that a reduced rate of VAT on visitor accommodations and attractions:

"would have the most significant positive effect in stimulating investment"

2.34 It is argued that these factors combine to lead to many visitors staying in Ireland and taking day trips to travel to Northern Ireland. This results in the majority of a visitor's spend taking place in Ireland. Profitability in Northern Ireland was also thought to be significantly lower by some respondents, with some respondents raising concerns about National Living Wage obligations exacerbating pressure on tight margins.

Question 4: What impact do current VAT reliefs, exemptions and refunds have on the tourism industry in Northern Ireland? Are they a significant benefit?

2.35 As in question 1, respondents highlighted the UK's VAT registration threshold as an obstacle to growth. It is claimed that businesses will limit their trade to remain below the registration threshold in order to avoid charging and accounting for VAT, preventing growth for small businesses and in the tourism sector in particular. It was also claimed that the high relative VAT rate for businesses operating in Northern Ireland intensifies this 'cliff edge effect'. This is alleged to increase the seasonality of the tourism sector, with some businesses electing to close for portions of the year, rather than register for VAT.

2.36 Conversely, the UK's high registration threshold (one of the highest in the OECD) was also criticised for allowing accommodation providers in the sharing economy – on platforms where companies act as platforms for sellers to provide services, such as accommodation websites – to compete without having to charge VAT, to the detriment of registered providers.

2.37 Some regarded the range of existing reliefs within the VAT system as offering little meaningful benefit to the tourism sector, on the basis that they were thought to be common throughout the EU, although this is not the case for several aspects of the UK VAT system. It was also reported that the benefits derived from the zero rate on food are eliminated by the higher cost of catered meals. Other responses, however, highlighted advantages in the zero rate on transport and that the exemption available for museums and art galleries provided benefit, but that this may distort competition with commercial attractions.

2.38 It was, however, noted in some of the evidence presented that most of the tax reliefs have been in place for long periods of time and it is therefore difficult to isolate their impact. The widespread view is that a substantial proportion of tourist spending is subject to the standard rate, suggested to some that existing reliefs have little impact on decisions to visit, particularly with UK domestic tourism.

Question 5: What impact do VAT and APD have on people considering visiting Northern Ireland for business purposes?

2.39 The majority of respondents agreed that business passengers were less price sensitive than those travelling for leisure and are more responsive to the levels of economic activity.

2.40 There were repeated concerns about the impact of APD on direct connectivity from Northern Ireland to certain markets, which respondents argue precludes business travel from/to these destinations.

2.41 Other respondents argued that the major market for businesses in Northern Ireland is the domestic market, and as APD is charged on both legs of a domestic journey, it increases the cost of doing business.

"59% of respondents [to a trade organisation's survey] reported that they were heavily dependent on air links to Great Britain to conduct their business operations.

2.42 32% [of respondents to the same survey] reported that they spent £50,000+ on flights to Great Britain each year."

2.43 A small number of respondents suggested that as APD is not refundable, unlike VAT, it has a larger impact on smaller businesses.

2.44 With respect to VAT, many business visitors are able to reclaim the VAT incurred during the course of making further taxable supplies and they make up a small proportion of Northern Ireland's tourism sector (8%); the impact of VAT is therefore less significant. It was suggested, however, that reduced rates for event space and catering services may improve the value for money perceptions around hosting events in Northern Ireland. This argument is made in the context of the increased prevalence of price comparison websites and the routine advertisement of VAT inclusive prices. Hotels in Belfast are reported to face particularly challenging competition with the both Ireland and the rest of the EU on event space hire, an important aspect of their business models.

2.45 Evidence presented suggested that an important driver of costs for delegates attending conferences in Belfast is the need to stay at least two nights in the city. This is reported to be because of limited accessibility and flexibility of transport than experienced by competing cities in the rest of the UK. Reduced rates for hotel accommodation were therefore also highlighted as a way to allow Belfast to:

"compete more effectively with other cities across Europe and generate significant additional business for all in Belfast and Northern Ireland."

Question 6: What evidence is there that changes to the VAT rate applied to tourism in other countries has had a significant impact on the demand for tourism in those countries?

2.46 Much of the evidence presented focused on the impact of the reduced rate in Ireland and representations were made to assert that Ireland has benefitted from the introduction of a reduced rate on tourism. The Irish economy reportedly experienced increased employment, increased economic activity and improved perceptions of value for money. Further research presented the need for Ireland to retain its 9% reduced rate, citing the rate's impact on visitor numbers and levels of investment.

2.47 One report stated that, following engagement with Irish industry members:

"The view is that the VAT [reduction] has probably been the most significant measure introduced in Irish tourism over the last 20 years"

2.48 Regarding VAT rates on tourism in other countries, some respondents suggested that the existence of tourism taxes in some EU member states, including Germany and France, had little impact on the countries as a whole. It is argued that this is because tourism taxes are often levied at a regional level, are set at a lower rate than the prevailing rate of VAT and, in some countries, are hypothecated to fund schemes supporting tourism growth. Respondents also pointed to research analysing the benefits of low VAT rates across Europe. The report concluded that tourism is an export market, taxed in situ, and that European VAT levels are often higher than in other destinations.

2.49 Sweden was highlighted as a country having experienced a significant drop in unemployment as a result of VAT relief on restaurant services. It should be noted, however, that this research also showed consistent growth in the tourism industry for European countries and that the UK performs well. Equally, the comparison with non-EU countries did not explore the possibility of low average earnings suppressing prices or the general trend of increased VAT rates internationally.

2.50 Various reports were presented to affirm the view that a reduced rate has benefitted Ireland, stating that there was pass through of the reduced cost to consumers, an increase to the number of visits, and increases to spending and investment. The research attributed 13% of 38,000 new jobs created by the tourism industry since the reduction were as a result of the relief's introduction.

What evidence is there to suggest the reduced rate of VAT in Ireland has positively or negatively affected tourism in Northern Ireland?

2.51 Respondents suggested that the effects of the VAT cut in Ireland have been felt most acutely in Northern Ireland as visitors have been attracted to Ireland to take advantage of lower costs. It was also suggested, in engagement during the course of the consultation, that tourism in Northern Ireland had improved after the UK wide cut in VAT in 2008/09. This was contradicted by other evidence, showing a decline in overnight trips over this period.

2.52 Evidence presented drew out comparisons between the levels of growth of tourism in Northern Ireland since the rate change in Ireland. Respondents suggested that Northern Ireland's tourism sector has experienced consistent growth, but this has been less rapid than that experienced in Ireland or the rest of the UK, when analysed over the past 10-20 years. In recent years, the rate of growth in Northern Ireland has surpassed that of the UK and has benefitted from increased international recognition as a tourist destination,

2.53 It is also suggested by some respondents that confounding factors other than rate differentials may have played a role in this contrast. Respondents argued that the international perception of safety in Northern Ireland in the wake of the Troubles has taken time to rebalance and, accordingly, the levels of investment in tourism relative to Ireland and elsewhere. This may have caused a lag effect in growth of the tourism industry in Northern Ireland which has shown improved growth in recent years following investment and international recognition.

2.54 In spite of these factors, many responses suggested that the reduced rate in Ireland had benefitted Ireland to the detriment of Northern Ireland. The substantial discrepancy between the relative levels of overseas visitors between the Northern Ireland and Ireland is argued to result from accessibility, the scale of Northern Ireland and price competition across the Irish border.

What was the impact of the Northern Ireland Assembly's 2012 decision to set a £0 APD rate on direct long-haul flights departing Northern Ireland?

2.55 Many respondents acknowledged the decision as a positive step, but argued that it had had limited impact in supporting tourism in Northern Ireland.

2.56 Respondents varied in their reasoning for this view, but evidence given suggested that as the air market in Northern Ireland is mostly short-haul passengers action on long-haul would not offer the level of support needed to significantly benefit tourism.

2.57 The other commonly cited view was that even without APD on direct long-haul, airports in Northern Ireland were unable to compete with Dublin, which due to its size, provides airlines with economies of scale and the ability to interline (connect with onward short haul routes) as connecting long-haul flights were still liable for APD.

2.58 Alternative views suggest that by zero rating direct long-haul but not connecting long-haul, the decision created a market distortion between different types of carriers, penalising those who did not fly direct.

The impact of VAT and APD on tourism demand: government response:

2.59 When analysing the impact of VAT, a broad-based tax on consumption, it is difficult to isolate sectors affected by the tax which are specific to the tourism sector. This is because the principle of fiscal neutrality dictates that a particular VAT treatment must be applied to all equivalent goods or services and not a particular business. For example, a reduced rate of VAT for food and beverage services must apply to all equivalent transactions and may not be limited on the basis of whether a consumer is a tourist or not.

2.60 Issues surrounding the VAT registration threshold have been previously identified, including by the Office of Tax Simplification (OTS) in its 2017 review of VAT. The OTS highlighted the disincentives to growth that arise from having one of the highest VAT registration thresholds in the OECD. The government launched its call for evidence on the design of the threshold at Spring Statement 2018. The government has now published its response.

2.61 Taking the arguments made regarding the threshold and its effects on tourism in Northern Ireland in isolation, the substantial proportion of businesses found below the threshold also demonstrates how much of the tourism industry are outside the VAT system altogether. These businesses benefit from not charging VAT at all, and can therefore charge lower prices than a registered business in Ireland (with the same turnover). While there is an argument that the threshold creates a disincentive to growth, the consistent achievements and growth of the tourism industry in Northern Ireland confound this.

2.62 Comparisons with Ireland emphasise the significance of the UK's high VAT registration threshold, and removing the majority of businesses from VAT altogether. Ireland maintains a threshold of €75,000 for businesses supplying goods. They have a separate threshold, however, of €37,500 for businesses supplying services only. This is considerably lower than the £85,000 turnover threshold found in the UK. This is an important consideration when comparing the level of tax burden on businesses in the tourism sector in Northern Ireland and Ireland.

2.63 The UK's high registration threshold is one of several aspects of the UK's VAT system which is not common throughout the EU. This also includes various zero-rates for VAT offered by the UK government which benefit the tourism industry, including on passenger transport.

2.64 Many respondents felt that airports in Northern Ireland were in direct competition with those in Ireland for routes and passengers, as tourists tend to treat the Island of Ireland as one destination. Furthermore, respondents suggested that, since the abolition of Ireland's equivalent Air Travel Tax in Ireland airports in Northern Ireland are less able to compete with airports in Ireland.

2.65 The government recognises that Northern Ireland is in a unique position as the only part of the UK with a land border with another EU member state, and that this has ramifications for competition in the aviation market.

2.66 Respondents also highlighted the growth at airports in Ireland following the abolition of Air Travel Tax as evidence of how APD restricts growth.

2.67 The timing of reforms to the Irish air travel tax regime must be considered. The tax was introduced at a time of passenger growth slowing globally and was abolished as Ireland was recovering from the Financial Crisis. The tax cut may have contributed to the recovery and growth of the sector; however, this took place during the wider global economic recovery. The current context in Northern Ireland, and the other factors that impacted aviation growth in Ireland, including the large population of Dublin relative to Belfast, make comparisons between the two challenging.

Chapter 3
Business considerations

3.1 This section asked about the impacts of any changes to the VAT and APD regimes on different types of businesses, different sectors of the economy and tourism across the UK. Questions were aimed at businesses operating in Northern Ireland and across the rest of the UK, although a number of responses were received from trade bodies.

Question 7: What is the composition of the tourism industry in Northern Ireland?

How have the individual tourism related sectors listed in 4.1 performed in recent years?

3.2 Difficulties can arise in defining the highly diverse tourism industry, particularly given the multiplier effects – referring to economic activity occurring as a result of tourism but downstream of the mainstream tourism sector – described by many respondents. Nevertheless, statistics presented demonstrate that the food and beverage service sector is the most substantial in the tourism industry in Northern Ireland, both by turnover (£1.3 billion) and employment (36,000). The accommodation sector followed (turnover: £430 million, employment: 10,000) while the activities sector made up the smallest sector of the three principal areas explored by respondents (turnover: ~£56 million and employment: ~5,000). This split of the three sectors is reported to also be roughly reflective of the tourism industry in the UK as a whole.

3.3 In Northern Ireland, the visitor attraction and amusement park sector are small and dominated by a limited number of large attractions, such as the Titanic Belfast and the Causeway Coast. The tourism economy also benefits from major sporting events and screen tourism opportunities arising from enterprises such as Game of Thrones.

3.4 In response to this question, some noted that certain industries within the wider tourism sector may be disproportionately affected by VAT rates and the VAT registration threshold. The attractions industry and coastal communities were some of those reported to be particularly affected.

3.5 Concerns regarding the interaction of the tourism industry with the VAT registration threshold were substantiated by further evidence characterising the industry as dominated by small and medium-sized enterprises (SMEs).

3.6 Some of the research presented estimated the net turnover of the tourism industry in Northern Ireland at approximately £1.8 billion per year. This industry as a whole was estimated to support between approximately fifty and sixty thousand jobs with average turnover per job calculated to be roughly £36,000. The employment of the tourism industry was claimed by one piece of research to account for 7% of total employment in the Northern Ireland economy.

3.7 Responses also highlighted that, while employing a significant number of individuals, the industry is characterised by a very high proportion of part-time and casual workers, relative to the UK as a whole. Northern Ireland also reportedly exhibits lower average turnover and remuneration per job than in the UK as a whole.

3.8 The hotel industry has achieved record occupancy levels in recent years and have increased their revenue per room per night. Investment in Belfast hotels is also expected to increase stock by 25% by 2018 and by 50% by 2020. The research also reported the food sector to be experience consistent growth from a low starting position, although investment in the industry was negative in 2015.

3.9 We received evidence on the number of people employed in the air transport sector from tourism sector trade bodies. Evidence suggests that Full Time Equivalent employee job growth in the Northern Ireland air transport sector has shrunk by 22.1% between 2000 Q4 and 2017 Q4.

3.10 We also received evidence on the reported contribution of aviation to the tourism sector.

"69% of visitors [to Northern Ireland] arrive by air"

3.11 Trips and spending in Northern Ireland was estimated to have tripled over the last two decades, according to evidence presented. Major attractions such as Titanic Belfast and awards from institutions such as Lonely Planet and the National Geographic serve to demonstrate the strength of the cultural offer. Industries which have experienced the largest growth were suggested to be land transport and the food and beverage service industries.

Question 8: Do VAT and APD impact different tourism related businesses in different ways? For example, do restaurants derive a greater benefit from the UK's high registration threshold than accommodation providers?

3.12 Responses were inconsistent regarding the specific industries most acutely affected by VAT rates. A few reiterated their statements from previous questions that the attractions industry is more significantly affected than other sectors due to wider financial pressures.

3.13 No specific evidence was given in support of this theory, and a more substantial number of respondents listed accommodation providers as under greater pressure as a result of the high registration threshold and competition from the sharing economy. Equally, issues regarding the threshold are felt more in the accommodation sector as it exhibits a greater proportion of unregistered businesses. It was also suggested by some that a reduced rate on accommodation would also have consequential benefits for the other tourism industries.

3.14 It was argued by some that the distortive impact of VAT was greater on specific businesses than resulted from APD. This is because the distortive impact of APD is thought to affect visitor numbers more generally. Additionally, the margins in the tourism industries are small and businesses are of a labour-intensive nature. These factors, combined with the high VAT rate, reportedly mean that crossing the registration threshold is more challenging for tourism businesses than others.

3.15 There were mixed views from respondents on how APD impacts on different businesses within the tourism sector, with no clear consensus over the impact beyond those experienced by the aviation sector as whole (see question 1).

3.16 Some evidence was provided to show that the majority of air travel in Northern Ireland is due to leisure travel, and therefore any change in APD that supports aviation will have a large benefit for the whole tourism sector. Other evidence provided agreed with this view suggesting that by encouraging travellers to visit Northern Ireland, APD reduction would increase spend on all other tourism related activities.

3.17 A small number of respondents argued that an APD reduction would benefit low cost carriers more than other carriers, as their business model focuses on a pricing strategy to maximise load factor. Therefore, APD is less likely to be passed on directly to the consumer, and the cost of the tax is absorbed by the carrier.

3.18 One response highlighted the relative importance of tourists to the aviation and accommodation sectors when compared with other sectors. Tourism reportedly accounts for a sizeable proportion of both sectors, which the respondent argued would justify a reduction in VAT and APD to support the sectors, in order to effectively support tourism in Northern Ireland.

3.19 Evidence presented argued that a reduced rate on food and catering would also reduce prices or increase margins for businesses. However, the beneficiaries of these cuts would largely be local residents, since tourism accounts for less than a third of Gross Value Added in that sector. VAT cuts to the food and beverage services sector may not, therefore, be an efficient means of supporting the wider tourism industry.

Question 9: What evidence is there that the impacts of VAT and APD on tourism differ from the impacts of VAT and APD on other sectors of the economy?

3.20 The cliff edge effect identified around VAT registration threshold was again noted by respondents as a particularly problematic issue in the tourism industry. This is theorised to be in part due to the relatively high rate of VAT in Northern Ireland compared to competitors in Ireland and elsewhere in

Europe. However, it must also be noted that the cliff edge effect around the VAT registration threshold is thought to also be a product of intra-national competition between registered and unregistered businesses. Nevertheless, the prevalence of SMEs and unregistered businesses, particularly in the accommodation sector is thought by some to demonstrate particular issues for the tourism industry regarding the prevailing VAT regime.

3.21 Evidence presented also raised again the issue of price sensitivity. Tourists were reported to be more mobile than consumers in other sectors, and therefore more likely to be influenced by price differentials resulting from VAT rates. Equally, other evidence presented explored in this document suggests that prices in Northern Ireland compare favourably. One response suggests that tourists do not differentiate between Northern Ireland and Ireland except on price, although other responses asserted that there are additional factors that play a significant role in consumer decisions, arguably more so than in other sectors.

3.22 Research presented also emphasised the labour-intensive nature of tourism businesses. It is claimed that this results in far lower levels of reclaimable input VAT (VAT incurred during the course of making further taxable supplies). This evidence estimated VAT to account for roughly 17% of tourism turnover, thought to be significantly higher than high input industries such as manufacturing. As a result, changes in the VAT rate applied to tourism supplies have a more profound effect on the businesses.

3.23 Additionally, evidence presented defined the tourism industry as an export market, consumed in situ but taxed at the standard rate, unlike the zero-rate applied to goods exports. The effects of differential tax rates between Northern Ireland and Ireland are thought to be compounded for the tourism industry because of the mobility of tourists across the border and the existence of an all island tourism economy and marketing strategy.

3.24 The majority of respondents argue that if changes to APD resulted in cheaper air travel and increased connectivity from airports in Northern Ireland, then this would have a bigger positive impact on the tourism sector than any other sector of the economy:

"…the contribution of an individual passenger go far beyond the direct value to airlines, accommodation providers, restaurants and other service industries to the tourism industry."

Question 10: How would different VAT rules for tourism related activities in Northern Ireland, and/or a lower rate of APD in Northern Ireland affect the tourism industry in other parts of the UK?

What impact would VAT and/or APD changes have on businesses administrative burdens?

3.25 Many respondents felt that there would be an increase in administrative burden resulting from different VAT rules in Northern Ireland and the rest of the UK. However, those arguing for a reduced rate of VAT consistently felt that the negative effects of increased complexity would be outweighed by the economic benefits.

3.26 Others felt that the introduction of different VAT rules in Northern Ireland may create unnecessary administrative burdens and complexity for those trading within both Northern Ireland and the rest of the UK. These views were evidenced alongside research stating that VAT is already a burdensome tax for business and that increased complexity is undesirable for small businesses in particular.

3.27 Equally, the introduction of divergent rate regimes in the UK may create undesirable competition within the UK's internal market, creating a competitive advantage for Northern Ireland within the UK's domestic tourism market. It was noted in some of the evidence presented that this new complexity would offer increased scope for tax avoidance within the system and increase pressure elsewhere in the UK to slash tax rates in a 'race to the bottom', leading to revenue shortfalls across the country.

3.28 In the wider context of tax devolution, the importance of a coherent strategy for the whole of the UK was emphasised in this response:

"With the devolution of tax powers, the success of the tax systems in each jurisdiction of the UK depend on each being an integrated and coherent part of the wider economic, legal and constitutional package."

3.29 This view was contrasted elsewhere, where the scale of the tourism market in Northern Ireland was remarked to be sufficiently smaller than the rest of the UK's so as not to displace its consumers. Where there was recognition of impact to the UK market, this was also reported to be limited by the differences between the markets, with the rest of the UK offering a more clearly distinct cultural offer than is found in the all-island economy. These respondents felt that new visitors would be drawn chiefly from Ireland and the impact of rate changes in Northern Ireland would be insignificant for the UK market.

3.30 Some respondents claimed that, while there would be a negligible impact on VAT registered businesses as a result of new tax reliefs, new administrative burdens would be most keenly felt by unregistered businesses. This would result from pressures to remain open, increase turnover and register for VAT. This was particularly highlighted in the scenario of a reform to VAT whereby businesses operating in the sharing economy must charge and account for VAT. The burdensome effects of this reform were suggested to be minimised by collecting the tax from the agents of online platform users.

3.31 Several representations advocated the introduction of reduced VAT rates for Northern Ireland on the basis of a trial period. If this proved successful, this could serve as a test for the potential benefits of a wider reduced rate for the whole of the UK.

3.32 Many respondents argued that a lower rate of APD in Northern Ireland would have minimal impact on overall levels of UK tourism. However, some evidence was provided to suggest that it may encourage those travelling domestically to visit Northern Ireland rather than other regions of the UK.

3.33 A small number of respondents argued there may be a small negative impact on overall levels of UK tourism if APD is lowered, as evidence suggests that there is a growing preference among outbound tourists from Northern Ireland to go to foreign short-haul destinations rather than domestic destinations.

3.34 There was no clear consensus on how a different APD rate in Northern Ireland might impact business administrative burdens.

3.35 A number of respondents argued that this would increase administrative and compliance complexity for airlines. However, survey results provided by one respondent suggest that business would be willing to accept this if it led to other benefits.

3.36 Alternative views from respondents, including some airlines, state there will be no administrative burden in a different APD rate being applied in Northern Ireland than the rest of the UK.

Question 11: Would a lower rate of APD encourage outbound tourism from Northern Ireland? What effect would this have on the tourism industry there?

3.37 The predominant view was that a lower rate of APD would encourage outbound tourism from Northern Ireland, by creating cheaper fares to and increasing route development from airports in Northern Ireland.

3.38 However, there was no clear consensus on the economic impact of the increase in outbound tourism. Several respondents noted that outbound tourism makes a "significant contribution" and provided evidence that the outbound tourism sector in Northern Ireland contributed £260 million to the Exchequer in 2016, without taking into account indirect impacts.

3.39 Alternative views suggested that a lower rate of APD would encourage outbound tourism more than inbound tourism, and that an increase in outbound tourism would have a negative impact on spend in the domestic economy as domestic travellers tended to spend more per trip than overseas visitors.

Business considerations: government response:

3.40 There was no clear consensus in the evidence presented on what the impact of changes to the VAT and APD would be for businesses.

3.41 Whilst many respondents felt that any increased administrative burdens would be worth it in the event of economic benefits, there is no clear consensus on the scale of these benefits.

3.42 There is however, experience in other OECD countries of regionalised consumption taxes (VAT or Goods and Services Tax – GST). Regionalised differences in rates structure within a VAT or GST system have been demonstrated to increase administrative complication for businesses and consumers. Businesses must engage with an additional layer of complexity and borderline issues, disrupting the internal market of a VAT territory. The government's objective is also to minimise the level of complexity within the VAT system, and is therefore keen to understand whether evidence in favour of reform would help ensure that businesses can grow and succeed.

3.43 Respondents have argued in favour of a trial period to test the effectiveness of tax cuts for the tourism industry in Northern Ireland. This carries potential risk, given the immediacy of the introduction of new administrative burdens and complexity, whereas the theorised economic benefits are not predicted to yield tangible benefit until the longer term. The experience of other countries, including Ireland, suggests that new tax reliefs, even when initially trialled, can be difficult to remove for fiscal or economic reasons. Businesses will plan and budget on the basis of the taxes in place and require the stability of strategically planned changes to the tax system.

3.44 There is a risk that changes to the tax regime in Northern Ireland alone could have a detrimental impact on the UK internal market and overall levels of UK tourism. The government must ensure that any decision does not come at the expense of consumers and businesses in other parts of the UK.

Chapter 4

Revenue and the economy

4.1 This section asked about the overall economic impact of any changes to the VAT and APD regimes in Northern Ireland and the UK, and how these benefits might be passed on to consumers. Questions were aimed at all respondents and we received responses from a wide range of stakeholders.

Question 12: What would be the individual and/or collective impact of a change to VAT on: accommodation, leisure activities and restaurants, other tourism related activities and/or a change to APD rates in Northern Ireland on tax revenue and the wider economy?

4.2 Evidence presented included various attempts to model the effects of a VAT reduction on tourism industries, although many of the responses relied upon only several pieces of unique research. Unfortunately, a great deal of this research relied on a limited dataset and it is difficult to draw strong conclusions. Much of this research, however, suggested that there would be an increase in turnover for the tourism industry resulting from an increase in demand greater than the relative cut in price. Within this, it was thought by the majority of respondents that a VAT reduction would have the greatest effect on the accommodation sector but that this would positively impact the other tourism industries. The food and beverage service industries were thought to have the least impact on the economy, if offered a VAT reduction.

4.3 Those that predicted a net economic benefit presented a broad range of estimates for the scale and timeframe of gains for the tourism industry in Northern Ireland. Various responses suggested that there would be an initial loss to the Exchequer with tax revenues attaining a surplus (relative to no tax cut) over a period of three to ten years. Research focused on a reduction for only the accommodation and visitor attraction sectors, predicted a net additional tax income for the Exchequer over 10 years and increases to growth and employment. An important assumption underpinning many of these arguments, in addition to labour market effects, is that there would be a significant price reduction resulting from the VAT cut and substantial increase in demand.

4.4 Some respondents highlighted that in Ireland, while the revenue loss of the VAT reduction was less than expected, there remains a significant, consequential fiscal cost. This is suggestive that some of the modelling presented, assuming increased employment resulting from the introduction of a relief, may be optimistic. The Exchequer would have to bear the cost of this and any loss in revenue would have to be balanced by increased borrowing, reduced public spending or increased taxation elsewhere. It was also suggested in some representations that a reform would drastically improve the UK's balance of payments in trade.

4.5 Given the distance between estimates of the economic effects of a VAT reduction by HM Treasury and those in favour of a VAT reduction and due to the limitations of data and modelling in Northern Ireland, it was recommended by some respondents that the change is assessed through a trial period. Others suggested that the assessment should be carried out with a methodology agreed between HM Government and a restored Northern Ireland Executive and that any block grant adjustment should be based on net costs.

4.6 It was restated by some that the introduction of VAT reliefs in Northern Ireland, in the context of wider tax devolution, could lead to a race to the bottom effect. This, in turn, may create revenue shortfalls across the UK which would be hard to recover.

4.7 The majority of respondents believe that a reduction or abolition of APD would create jobs, boost economic activity and increase revenue from inbound tourism by stimulating route development and creating cheaper fares.

4.8 Many of these responses are based on one report that suggests that abolition of APD on a UK wide basis would result in a boost to economic activity to the extent that loss of revenue from APD would be offset by increases in other tax receipts.

4.9 Other evidence provided by respondents supports the argument that a reduction or removal of APD in Northern Ireland would result in more jobs, increased economic activity and tourism revenue but there are mixed views on the extent of these impacts and over what timescale they would occur.

4.10 We have also received evidence that suggests that a complete abolition of APD in Northern Ireland would have a relatively small economic benefit that diminishes over time, and if block grant impacts are higher than the study assumes, then abolition of APD could have a net negative impact.

Question 13: How would businesses in the tourism sector respond to VAT and APD changes and to what extent would those changes would be passed through to consumers in the form of lower prices?

4.11 Views are divided on the level of pass through anticipated in the tourism industries, resulting from a reduced rate of VAT. Several major attractions operators have pledged to reduce prices by the full value of any VAT reduction. Others, however, notably representatives of the accommodation and food and beverage services sectors, have stated that pass through may be limited by the narrow margins businesses are operating under. This is complicated somewhat by small businesses operating near the VAT registration threshold who are currently absorbing some of the costs of the tax.

4.12 Accommodation providers have claimed that the reduced rate would allow increased scope for investment in the industry, boosting employment and that some of the savings from a relief would be passed through to consumers. More broadly, savings are also predicted to be invested in increased salaries for employees, increased profit margins and staff training. Many respondents point to evidence which estimates the figure for pass through of savings to consumers at approximately 60%, whereas other prominent research has concluded that of a 4.5% reduction in VAT, 1.2-2.5% was passed through in other countries.

4.13 Some industry representatives would be willing to sign a charter committing businesses to price reductions. There is precedent of such a charter in France which committed businesses to invest, reduce prices and hire more staff. A further benefit predicted in some of the research presented is based on a reduction in VAT fraud observed in the food and beverage service sector when the French government reduced VAT rates on restaurant meals. Equally, others have predicted that a diminished cost pressure on SMEs crossing the VAT registration threshold will encourage both growth and compliance.

4.14 Given the price sensitivity of tourism proposed by various respondents, the evidence presented suggests a high elasticity of demand resulting from a VAT reduction. Across all respondents, it appears that the pressure to consequentially reduce prices varies by sector. It was also reiterated that while most predict revenue shortfalls in the short to medium term, some believe that these will be offset by longer term gains.

4.15 Many respondents argue that the competitive nature of the aviation market would ensure that the saving from any APD reductions would be passed on to consumers as lower fares.

4.16 However, there are alternative views that suggest that a reduction in APD will not necessarily translate to lower fares. There are various reasons given for these views, including:

- low cost carriers already use price structures to maximise load factor, and do not directly pass on the cost of APD, therefore a reduction may not translate into lower fares
- the level of pass through from carriers depends on "a number of considerations including the way in which the airlines currently impose this tax, whether the airline is expanding or contracting, its cost structure, level of competition and what it refers to as the 'extent of interlining' where long-haul carriers use short-haul journeys to feed their long-haul offering"

4.17 Further, many respondents, particularly airlines and airports, argue that a lower rate of APD would reduce the risk for airlines looking to start new routes or increasing frequency on existing routes, due to the increased yield they could gain from tickets.

Question 14: What evidence is there that VAT and/or APD rate changes are a relatively cost-effective means of supporting the tourism industry?

4.18 Evidence presented reflected upon the impact of VAT rate reductions in Ireland. Some argued that the government in Ireland had significantly overestimated the cost of introducing the relief. While there remains a revenue cost to Ireland, the government there has ultimately elected to maintain the relief beyond the original temporary proposal. Nevertheless, respondents suggested that the government in Ireland consistently receives lobbying to increase the VAT rate from those favouring increased tax revenue to support government spending.

4.19 Other evidence pointed to research which claimed, following attempts to model the effects of reduced VAT rates across the UK, that VAT cuts on tourism is one of the most efficient means of generating GDP gains at low cost. This was supported by further research based on additional modelling attempts which suggested that VAT cuts would deliver substantial benefits to the economy. As a result, various respondents anticipate the Exchequer benefitting in the long term.

4.20 This research differs significantly from previous evidence presented by HM Treasury and the views of some respondents. This has previously been explored in the response document, but discrepancies are largely due to differing methodologies and the assumptions underpinning the research.

4.21 Evidence was presented on the limited effectiveness of tax cuts as an intervention to support industry. High dead weight risks were noted in the context of tax reform both when increasing or reducing the rate of a tax; the removal of taxpayers from making contributions, in the absence of behavioural change, results in lower revenues without a corresponding increase in growth. It was, however, noted that there are few alternative options in the current environment. Respondents reported that the absence of a Northern Ireland Executive was reducing the effectiveness of government programmes.

4.22 Many respondents argue that a reduction or abolition of APD would be a cost-effective means to support the tourism sector, as alongside increasing tourism spend, it would create jobs and result in a net increase in tax receipts (see question 12).

4.23 Several respondents highlighted that any boost to the aviation sector is likely to benefit tourism more than other areas of the economy.

4.24 A small number of respondents have suggested that as a reduction of APD would benefit all travellers, including business passengers, not just tourists that it is a relatively cost-effective measure.

4.25 Others have provided evidence that abolishing APD would result in a relatively modest increase in the number of passengers travelling, and therefore removing the tax for all travellers would result in a large deadweight cost.

Question 15: How would a UK-wide change to VAT or APD benefit the tourism industry?

How would the industry in Northern Ireland benefit relative to other regions in the UK?

4.26 The majority of respondents felt that the benefits of changes to VAT, where they exist, would be greatest in Northern Ireland. This is largely due to the unique circumstances of the country's land border with Ireland and rate competition arising from Ireland's VAT regime, the all-island economy and the joint international marketing strategy for tourism.

4.27 Some respondents stated that in spite of the particular circumstances within the Island of Ireland, reform in Northern Ireland should be followed by action across the UK as a whole. They believe that the impact would be similar to the expected outcome in Northern Ireland; an initial loss of VAT receipts for the Exchequer offset over time by increased demand, employment and growth. It was felt that these gains would be proportionally smaller than in Northern Ireland, but would affect a broad range of businesses:

"Unlike changes to other sectors of taxation on the economy, reducing VAT on tourism would benefit every region and every local authority and every political constituency in the UK, including many where few other growth opportunities exist."

4.28 Much of the evidence presented favouring a VAT reduction again relied upon a limited number of studies, exhibiting similar modelling to that referenced in relation to Northern Ireland specifically. While these studies remain divergent from HM Treasury analysis, they again predict a net surplus in tax receipts over a period of five years and consequential multiplier effect benefits elsewhere in the economy. It was also suggested that a UK wide reform would reduce the distortion between unregistered and registered businesses, including interactions with the sharing economy. This was reported to further encourage growth in the accommodation sector in particular.

4.29 Some emphasised the need for a trial period, in the absence of sufficient evidence to proceed. The relative effect on the UK as a whole was also disputed, with some representations identifying London and the South East of England's more established tourism industry as in a better position to capitalise on tax cuts and attract new visitors.

4.30 The most common position of those in favour of VAT reform in the UK as a whole was to target the accommodation and visitor attractions sectors. Evidence presented suggested that such a reform would result in a substantial net benefit to the Exchequer and improve the UK's balance of trade by tens of billions of pounds. However, a greater number of responses were in favour of a reduced rate targeting the same sectors but in Northern Ireland only.

4.31 Most respondents argued that the same benefits that they believe will occur in Northern Ireland (see question 12) would be seen across the UK if APD was reduced or cut nationwide.

4.32 Further views put forward by respondents included that reduction or abolition of APD across the UK would help boost trade, foreign direct investment and dispersal of tourism across the regions of the UK.

4.33 A small number of respondents held the view that Northern Ireland would benefit the most of all the UK regions if there was a national reduction in APD.

4.34 Several respondents have argued that any reduction in APD in Northern Ireland should be matched by an equivalent cut in the rest of the UK.

Revenue and the economy: government response

4.35 Respondents have highlighted that changes to the VAT and air travel tax regimes in Ireland were followed by a period of robust growth in the tourism and aviation sectors. These reforms were introduced in the early 2010s, as Ireland was recovering from the Financial Crisis. The Irish economy was characterised by high unemployment and the global growth of tourism was sluggish. The tax cuts may have contributed to the recovery and growth of the sectors; however, this must be set in the context of the wider global economic recovery. The current context in Northern Ireland is quite different and future tax reforms must therefore consider fiscal and economic circumstances.

4.36 Almost all of the evidence presented in the call for evidence predicted a short to medium term fall in receipts, this represents a significant fiscal decision which would impact other industries through tax and spending policies. Any loss in receipts resulting from changes to the tax regime must be balanced by increased borrowing, reduced public spending or increased taxation elsewhere.

4.37 There is also a deadweight risk associated with reducing the rate of VAT or APD, and there may be more cost-efficient and effective ways that the government can support the tourism industry outside of the tax system.

4.38 More generally, extensive research has been carried out by organisations such as the OECD, the International Monetary Fund and the Institute of Fiscal Studies to suggest that differentiation of VAT rates creates economic inefficiency in the tax system. This research proposes that it is economically favourable to broaden the consumption tax base and reduce the levels of complexity in the system. Following the Office of Tax Simplification’s (OTS) 2017 review of VAT, the Chancellor agreed that there was merit in a review of the rates system in the long term. HMT and HMRC officials are taking forward the recommendations of the OTS in line with the Chancellor’s response letter, published at Autumn Budget 2017.

Other responses to the call for evidence

4.39 We received 19 responses generally in support of a reduction in APD and VAT for tourism without giving specific recommendations or evidence.

Chapter 5
Government response

5.1 The government is grateful for all of the evidence that has been presented during the call for evidence, which will be used in informing policy development over the coming months and years. The government is also grateful for the continued constructive engagement of stakeholders in this important subject for the economies of Northern Ireland and the whole of the UK.

Legal context

5.2 Under the current legislation, the UK is unable to offer different rates of VAT across the UK. This is in accordance with rules, set out in the Principle VAT Directive (Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax), designed to ensure that similar goods and services bear the same tax burden, within the territory of a member state.

5.3 Under EU law, member states are currently permitted to maintain a reduced rate of VAT on tourism related services. This includes passenger transport, which the UK currently has a derogation to apply a generous zero rate to, accommodation, attractions and food and beverage services. This could be legally implemented across the entirety of the UK but at a significant cost to the Exchequer.

5.4 In the absence of a Northern Ireland Executive, options for differentiated rates of APD within a member state are limited by the legislative framework. According to the requirements of State aid law (Case C-88/03 Portugal v Commission, 2006), further tax devolution in Northern Ireland cannot take place until a restored Executive is in place. The UK government cannot unilaterally vary rates for different regions of the UK.

5.5 In the future, the government is committed to continuing the control of anti-competitive subsidies by creating a UK-wide subsidy control framework. This would include a commitment to maintain a common rulebook with the EU on State aid, enforced by the Competition and Markets Authority.

5.6 Tax devolution in Northern Ireland requires that a restored Executive takes on the responsibility of the devolved tax and that the cost of any reduction in the rate results in a block grant adjustment for that administration.

5.7 In summary, action on VAT and APD in Northern Ireland only is not currently possible under EU State aid law and EU VAT law.

5.8 The government triggered Article 50 on 29 March 2017 to start the process of leaving the European Union. Although there may be opportunities to make changes to the VAT system in the future, there will be no immediate changes to our relationship with the EU until we have left. The UK therefore remains a member of the EU with all of the rights and obligations that membership entails. That includes the application of EU VAT rules.

VAT

5.9 The tourism industry has experienced consistent growth in recent years, and the government is keen to build on that success. While the potential benefits of a reduced rate of VAT have been clearly set out by various respondents, the evidence in support of tax reform remains inconclusive and reform in this complex area would require further exploration.

5.10 Many responses refer to the potential of VAT reform to ease pressure on businesses, both in the profit margins of tourism related service industries in Northern Ireland and in attracting tourists. It is argued that this will enable Northern Ireland to effectively compete with Ireland, resulting in economic growth. These arguments are mirrored with respect to the VAT rate on tourism related services across the UK, although the consensus amongst respondents was that the unique circumstances of Northern Ireland warrant more urgent consideration in this context. There may be merits in these arguments. However, the potential benefits of reform to VAT must also be viewed alongside other considerations.

5.11 Consideration of the legal framework clarifies that options for VAT reform are restricted under EU law and a reduced rate of VAT for Northern Ireland only is not possible. Until the UK leaves the EU, our rights and obligations remain unchanged. As has been set out in the 'Legal context', it is therefore impossible for the government to take action on VAT in Northern Ireland exclusively.

5.12 The provision in EU VAT law which prevents differential VAT rates in the same VAT territory is intended to minimise the administrative burden experienced by businesses and competition issues among other things. The complexity of VAT and the associated administrative burden will continue to be an important consideration, maintaining a VAT system that is as simple as possible for businesses and taxpayers.

5.13 Equally, consideration of VAT rates must be viewed alongside the other features of the tax system, which make the UK an attractive location for tourists and businesses. For example, the high VAT registration threshold removing the majority of businesses from VAT altogether. These factors add further complexity to predicting the outcome of any tax reform.

5.14 Economic modelling, referred to by those arguing for reform, sets out the possibility that growth of the tourism industry following cuts would benefit the Exchequer in the long term but makes assumptions regarding labour market effects and the impact of wages on consumer prices. Currently, there are near record high vacancies in the market and, in the current climate, it may not be the case that growth would be supported through labour market effects.

5.15 This demonstrates the complexity of the issue and that the effects of tax reform to the tourism industry and the wider economy will depend on a range of factors. This level of complexity makes it difficult to accurately predict the economic effects of such a tax reform.

5.16 VAT remains a vital source of revenue for the UK government, raising £125 billion in 2017-18. It is used to fund the government's spending priorities and any loss in receipts resulting from a new relief must be balanced by increased borrowing, reduced public spending or increased taxation elsewhere. Almost all of the evidence presented in the call for evidence predicted a short to medium term fall in VAT receipts, if a reduced rate of VAT on tourism related services were introduced.

5.17 A UK wide reduced rate of VAT on accommodation, attractions and food and beverage services is possible in the current legal framework, however recent estimates suggest that this would cost the Exchequer approximately £10 billion per year. This represents a significant fiscal decision which would impact other industries through tax and spending policies. In this context, the importance of exploring all options thoroughly before making a reform is clear.

5.18 The price sensitivity of the tourism industry remains a central argument underpinning the wider debate. If a VAT rate cut for tourism related services was introduced and resulted in no consequential growth in the industry, this would come at a significant cost to the Exchequer. Evidence presented in support of cuts suggests that tourism is extremely price sensitive and some research was provided in support of this view. However, evidence around the scale of impact of price reductions remains inconclusive when the consistent growth of the tourism industry both in Northern Ireland and internationally, the evidence as to the scale of impact of price reductions remains inconclusive.

5.19 Much of the evidence relied on the success of the tourism industry in Ireland since its cuts to VAT. The tax relief was introduced in Ireland in the aftermath of the Financial Crisis at a time when there was high unemployment and scope for growth. The upsurge in the tourism industry there has reflected, to some extent, global economic recovery and that of Ireland. Tourism demand has also increased over the same period and Northern Ireland has also benefitted, starting from a lower point of Gross Value Added.

5.20 The industry's consistent and prolific growth has been demonstrated quantitively by Northern Ireland's official tourism statistics and qualitatively through recent recognition of its desirability as a destination. The Lonely Planet travel guide listed both Belfast and the Causeway Coast as top places to visit in 2018, the only UK destinations to be included.

5.21 Northern Ireland's increasingly recognised and expanding cultural offer is demonstrably important when attracting visitors to Northern Ireland. Ireland does remain dominant in the scale of its tourism offer at this stage, and the government recognises the continued need to support growth in Northern Ireland this respect.

5.22 In light of the legal restrictions on VAT reform for VAT in Northern Ireland exclusively, and the fiscal implications of reform on a UK wide basis, the government will not be making a change to the rate of VAT on tourism related services at this time.

5.23 However, the government recognises the arguments set out by respondents to this call for evidence and will continue to analyse the evidence and receive representations on VAT in order to keep these issues under close review. While there may be scope to make changes in the future, this is a complex area affecting important sources of revenue for the Exchequer which requires further exploration.

5.24 The government is keen to ensure we have a robust and reliable tax system, capable of generating the revenue required to support our public services. But it is also of great importance to ensure that it is a system which encourages and supports economic activity.

5.25 The government will continue to support the tourism industry in Northern Ireland and the rest of the UK, working further with stakeholders to ensure we build on the existing growth and success of the tourism industry.

APD

5.26 The government recognises the importance of a thriving aviation industry for Northern Ireland, not just for the benefits it brings to the tourism industry, but for businesses and those with family in Great Britain and overseas. We welcome the ambition of airports and airlines in Northern Ireland to grow.

5.27 Respondents have clearly outlined their views on the challenges faced by the aviation sector in Northern Ireland. The government recognises that Northern Ireland is in a unique position as the only part of the UK with a land border with another EU member state, and that this has ramifications for competition in the aviation market.

5.28 The UK government cannot unilaterally vary rates for different regions of the UK without contravening current EU law on State aid. And in the absence of a Northern Ireland Executive, further tax devolution is not possible as the State aid criteria is not met as set out in Case C-88/03 Portugal v Commission.

5.29 Abolishing APD across the whole of the UK is possible in the current legal framework, however the tax raises approximately £3.5 billion per year for the Exchequer. Abolishing or cutting APD at a UK level would have to be balanced by increased borrowing, reduced public spending or increased taxation elsewhere.

5.30 Further, in making changes to the tax regime, the government would hope to deliver benefits for both consumers and the industry. Whilst many respondents argued that a reduced rate of APD would allow airlines and airports to sustain more routes, providing greater choice for customers, there was no clear consensus on the scale of this growth. Additionally, there were mixed views on how much of the tax reduction would be passed through to consumers as cheaper fares.

5.31 When taking these factors into consideration, it is not clear that changes to APD would be the most cost-efficient and effective way that the government could support the tourism industry. However, the government recognises that due to its unique position, that a thriving aviation industry in Northern Ireland has wider economic impacts beyond tourism.

5.32 The government already supports the aviation industry in several ways. For example, commercial aviation fuel is not taxed and there is no VAT charged on airline tickets. Aviation would be relatively under taxed when compared with other sectors without APD.

5.33 Due to the current legal constraints, the government will not be taking forward any changes to the APD regime in Northern Ireland at this time.

5.34 The government will continue to support the tourism and aviation industries in Northern Ireland and the rest of the UK, working further with stakeholders to ensure we build on the existing growth and success of the sectors.

5.35 In particular, the government will establish a technical working group to consider the practical and legal challenges to changing short-haul APD in Northern Ireland. Further details of this group will be provided in due course.

Annex A
List of respondents

A Fair Tax on Flying

Airlines UK

Andras House Hotel

Andrew Turner

Association of British Travel Agents (ABTA)

Aer Lingus

Bayview Hotel

Beacon Hill Farm Holiday

Bed & Breakfast Association

Beech Hill Country House Hotel

Belfast City Airport

Belfast International Airport

Belle Grove Barns

Board of Airline Representatives in the UK

Bosinver Farm Cottages

Broomhill Manor

Bullitt Hotel Belfast

Canal Court Hotel & Spa

Carswell Group

Chartered Accountants Ireland

Cheviot Holiday Cottages

City of Derry Airport

Clayton Hotel Belfast

Confederation of British Industry Northern Ireland (CBI NI)

Cut Tourism VAT

Dove House & Swallows

Dunamoy Cottages and Spa

Eaton Manor Country Estate

Easyjet

Federation of Small Businesses (FSB)

Field House Farm

FlyBe

Heathrow Airport

Higher Menadew Farm

Higher Wiscombe

Hospitality Ulster

Institute of Chartered Accountants of Scotland (ICAS)

International Airlines Group

Kerridge End Holiday Cottages

Killyhevlin Lakeside Hotel & Lodges

Llanfendigaid Estate

Loughview Leisure Group

Maldron Hotel

Mid and East Antrim Borough Council

My Country Houses

Newcastle International Airport

Northern Ireland Chamber of Commerce and Industry

Northern Ireland Hotels Federation

Northern Ireland Local Government Association

Northern Ireland Tourism Alliance

Old Inn

Paulton House

Pitt Farm

Professional Association of Self Caterers

Roe Park Resort

Rosehill Lodge

Ryanair

Social Democratic and Labour Party (SDLP)

South West Tourism Alliance

Tara Lodge

The Ballymac Hotel

The British Association of Leisure Parks, Piers & Attraction (BALPPA)

The Consumer Council

Thomas Cook Group

Titanic Hotel Belfast

Tourism Alliance

Tourism Ireland

Tourism Management Institute

Tullyglass Hotel

UKHospitality

Ulster Unionist Party

Ulster University Economic Policy Centre

Visit Belfast

Visit Derry

Wallops Wood Cottages

Wellington Park Hotel

Wheeldon Trees Farm Holiday Cottages

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