House of Commons

Northern Ireland Affairs Committee

Promoting the tourism industry in Northern Ireland through the tax system

Second Report of Session 2016–17

HC 50

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Northern Ireland Affairs Committee

The Northern Ireland Affairs Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of the Northern Ireland Office (but excluding individual cases and advice given by the Crown Solicitor); and other matters within the responsibilities of the Secretary of State for Northern Ireland (but excluding the expenditure, administration and policy of the Office of the Director of Public Prosecutions, Northern Ireland and the drafting of legislation by the Office of the Legislative Counsel).

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In recent years Northern Ireland's tourism sector has expanded significantly, with external visitor numbers reaching almost 2.5 million in 2016. The industry contributes over £0.8 billion to the economy per year, and directly employs more than 43,000 people. Despite this performance, the sector represents a much smaller share of GDP than is the case for other parts of the UK. Notwithstanding the current political situation in Northern Ireland, this suggests there is potential for greater growth in the tourism industry.

However, Northern Ireland's tourism industry is at a disadvantage because competitors in the Republic of Ireland benefit from significant tax and other advantages—in particular, a lower rate of tourism VAT and the fact that there is no equivalent to air passenger duty. This Report argues that these pressures on the sector in Northern Ireland should have a stronger bearing on policy formulation by the UK Government, particularly once the UK leaves the European Union.

The Report makes the case for the UK Government to implement regional variations in tourism VAT and introduce other tax changes to assist the sector. It highlights the substantial economic benefits to the Republic of Ireland's tourism industry of the Irish Government's decision to cut tourism VAT in 2011. Accordingly, the Committee recommends that the Government look constructively at a different rate of tourism VAT for Northern Ireland, and calls on HM Treasury and the industry to work together to estimate the potential costs and benefits of doing so.

The Report highlights the negative impact of high levels of air passenger duty on tourism in Northern Ireland and argues that abolishing APD on all flights would encourage airlines to bring new routes into Northern Ireland. These changes would connect Northern Ireland with key business and tourism markets. We recommend that the Government and the next Northern Ireland Executive should re-examine the economic case for abolishing APD on flights to and from Northern Ireland. We also call for the full devolution of APD to the Executive, and for the Executive to implement its planned air route development fund as soon as possible.

1 Introduction

Northern Ireland tourism: performance and potential

1. Northern Ireland's tourism industry has been one of the success stories of the post-Troubles era. People are travelling to Northern Ireland in numbers never seen before, with an estimated 2.48 million external visitors in the 12-month period to September 2016—eight per cent higher than in the previous 12 months.[1] In recent years, the region has experienced significant growth in its key markets, with the number of visitors from Great Britain having increased by 26 per cent, from mainland Europe by 31 per cent, and from North America by 68 per cent between 2010 and 2015.[2] Northern Ireland's share of overseas holidaymakers to the island of Ireland increased from 6 per cent in 2002 to 15 per cent in 2014.[3]

2. Notwithstanding the current difficulties in Northern Ireland following the recent elections, there is much to be optimistic about for the future. Visitor numbers are expected to increase further in the coming years, attracted by a range of exciting developments, including screen tourism arising from Game of Thrones, investment in Titanic Belfast and the Giant's Causeway, the reopening of the Gobbins cliff path, and the legacy of Northern Ireland's 2016 Year of Food and Drink. The Open Golf Championship, which is being held at Royal Portrush in 2019, will also bring a number of new visitors to Northern Ireland. As Niall Gibbons, Chief Executive of Tourism Ireland told the Committee, "there is an awful lot to shout about in the international marketplace. It is an excellent basis on which to maintain [visitor numbers] and build further growth".[4]

3. Growth in visitor numbers has brought substantial economic benefits to Northern Ireland. In the 12 month period to September 2016, tourism was worth £821 million to the Northern Ireland economy, of which £606 million came from outside the Province, a figure which has more than doubled since 2002 and is 10 per cent higher than in 2015.[5] The industry directly employed 43,000 people in 2015, accounting for one job in every 18. Increased employment in the industry has contributed to significant economic growth in both rural and urban areas.[6]

4. The Northern Ireland Executive's former Finance Minister, Mervyn Storey MLA, told the Committee that tourism was an area with huge potential for growth, and that the Executive's long-term goal was "to make tourism in Northern Ireland a £1 billion industry by 2020".[7] A review carried out by Deloitte in 2013 on behalf of VisitBritain estimated that there was the potential to create an additional 12,000 jobs in tourism in Northern Ireland over the next 10 years, and for the industry to contribute 7.4 per cent to GDP.[8]

5. This growth is also important to Northern Ireland's wider economy. It is estimated that tourism activity has a multiplier effect such that, on average, an additional 70p is

1 Quarterly tourism statistics publications, Department for the Economy, 19 January 2017
2 Tourism Ireland, Written Evidence, Para 1.7
3 Tourism Ireland, Written Evidence, Para 1.6
4 Q286 (Niall Gibbons, Tourism Ireland)
5 Tourism Ireland, Written Evidence, Para 1.6, and Quarterly tourism statistics publications, Department for the Economy, 19 January 2017
6 Q285 (John McGrillen, Tourism NI)
7 Q337 (Mervyn Storey, Minister for Finance)
8 Q285 (John McGrillen, Tourism NI)

spent in the local economy for every £1 spent directly in the tourism sector—a benefit much higher than that found in many other industries.[9] This multiplier reflects the fact that tourists use local shops, go to restaurants and use transport services.

6. Although Northern Ireland's tourism industry has been performing well in recent years, there is still potential for greater growth. For example, in 2015 just 32 per cent of external visitors to Northern Ireland came for a holiday, compared to 46 per cent in the Republic of Ireland, and 38 per cent across the UK as a whole.[10] A much larger proportion of visitors to Northern Ireland came to visit friends or relatives. Furthermore, tourism's contribution to GDP was just 5.2 per cent in 2013, compared to 10.3 per cent in Scotland and 13.9 per cent in Wales.[11] These figures suggest Northern Ireland is still underperforming in comparison with its direct competitors.

7. The current state of the Northern Ireland tourism sector partly reflects the country's relatively recent emergence from the Troubles era. As the former Finance Minister, Mervyn Storey, told the Committee, "it is fair to say that Northern Ireland's tourism is an industry that is still at an early stage of development compared with the tourism offering and infrastructure of our neighbours in Great Britain and the Republic of Ireland".[12] To a certain extent, this explains why the industry has lagged behind that of other parts of the UK.

8. However, we are also aware that the industry has struggled to compete with the tourism industry across the border in the Republic of Ireland. In particular, tourism operators point to the lower rate of VAT applied to the tourism and hospitality sectors in the Republic, as well as lower air travel taxes.[13]

9. **With world class tourist attractions including the Giant's Causeway and Titanic Belfast, forthcoming international sporting events such as the 2019 Open Championship, and emerging screen tourism opportunities, Northern Ireland's tourism industry can be optimistic. The sector is now reaping the rewards of its hard work over the last 20 years, with record numbers of visitors and a challenging ambition to be a £1 billion industry by 2020. We believe that, with support from the UK Government and the Northern Ireland Executive, there is scope for even greater success. However, Northern Ireland's tourism industry finds itself at a competitive disadvantage because competitors in the Republic of Ireland benefit from significant tax and other advantages. Unaddressed, this imbalance has the potential to inhibit growth within the region's tourism industry.**

Our inquiry

10. Powers over tourism strategy and policy are fully devolved to the Northern Ireland Executive, falling under the remit of the Department for the Economy. However, powers relating to taxation policies which affect the tourism industry in Northern Ireland, such as VAT and Air Passenger Duty, remain the responsibility of HM Treasury.

9 Q31 (Graham Wason, Campaign to Cut Tourism VAT)
10 Northern Ireland Annual Tourism Statistics 2015, Department for the Economy, May 2016
11 Tourism: Jobs and Growth: The economic contribution of the tourism economy in the UK, Deloitte, November 2013, p. 18
12 Q337 (Mervyn Storey, Minister for Finance)
13 Cited in evidence by all of our witnesses. For example, Q95 (Janice Gault, Northern Ireland Hotels Federation)

11. With this in mind, we decided to conduct an inquiry into *promoting the tourism industry in Northern Ireland through the tax system*. We wanted to know what effect the current rate of VAT had on the tourism industry in Northern Ireland, and whether reducing that rate would encourage more tourists to visit. We were interested to find out about the impact in other countries of a reduced rate of VAT on certain tourist services, especially in the Republic of Ireland, where the rate was reduced from 13.5 per cent to 9 per cent in 2011. We also wanted to know whether the tax revenue lost to the Exchequer by lowering VAT on tourism could be recovered through further growth in the sector, and indirect benefits such as job creation and increased expenditure. Finally, we considered whether there were any alternative tax changes the Government could implement to enhance the growth potential for the tourism industry in Northern Ireland.

12. In addition, the Committee was aware of claims that the continuing application of short-haul Air Passenger Duty (APD) in Northern Ireland had made it more difficult for the region's airports to obtain new routes and compete with the increasingly dominant Dublin Airport. In particular, we were told that more than 2 million passengers per year, either bound to or from Northern Ireland, travelled through Dublin Airport,[14] representing a significant missed opportunity not just for Northern Ireland's airports, but also for its hotels and restaurants which consequently lose business to their competitors in the Republic. As such, we wanted to look again at the Government's application of APD in Northern Ireland, as our predecessors had done twice in the last Parliament.[15]

13. It is important to note that most of our evidence was taken prior to the referendum on the UK's membership of the European Union, and also before the change of Prime Minister and much of the Government. During our inquiry, we were often reminded that EU legislation, in particular directives relating to VAT, limited the ability of the Government to assist the tourism sector in Northern Ireland. However, it is now apparent that these limitations will not exist in future.

14. Many of the recommendations made in this Report might have been different in the context of a vote to remain in the EU. However, the decision to leave has the potential to create new opportunities to make more targeted interventions in our economy, including in the tourism industry in Northern Ireland. The recommendations we make in this Report reflect these new opportunities and we urge the Government to bear them in mind when determining a new taxation policy after the UK's departure from the EU.

15. Over the course of our inquiry, the Committee took oral evidence from a wide range of industry representatives, including the Campaign to Cut Tourism VAT, the Northern Ireland Hotels Federation, Hospitality Ulster, Tourism Ireland, Tourism NI, the Irish Hotels Federation, Belfast City Airport and Belfast International Airport, as well as representatives from the Northern Ireland Executive and the Financial Secretary to the Treasury. We received written evidence from a range of tourism bodies, including the National Trust, Fermanagh and Omagh District Council, and Visit Derry. We are grateful to all those who gave oral evidence and provided informal briefings, to those who

14 Q184 (Graham Keddie, Belfast International Airport)

15 2nd Report - Air Passenger Duty: Implications for Northern Ireland, 2010–12, Northern Ireland Affairs Committee, and 1st Report - An air transport strategy for Northern Ireland, 2012–13, Northern Ireland Affairs Committee

submitted written evidence, to the former Speaker of the Northern Ireland Assembly, Mitchel McLaughlin MLA, for allowing us to hold our oral evidence session at Parliament Buildings in Stormont, and for the Assembly staff who facilitated our meeting there.

2 Northern Ireland's unique position

16. Northern Ireland is the only part of the UK which has a land border with a foreign country. This comes with a unique set of challenges, especially in the tourism industry, where competitors in the Republic of Ireland are able to undercut their counterparts in Northern Ireland, aided in large part by the different tax regimes. This is a level of competition unique within the UK, but one which is not adequately addressed by its tax system.

Taxes on Tourism: North and South

VAT

17. The UK has a standard rate of VAT of 20 per cent. The Government chooses not to apply a lower rate of VAT to tourism-related services, although it is permitted to do so under EU legislation. In the 2016–17 financial year, the UK's VAT registration threshold is £83,000, below which businesses do not need to register for VAT.[16]

18. The Republic of Ireland has a standard rate of VAT of 23 per cent. However, since 2011, it has applied a lower rate of 9 per cent to tourism-related businesses, including hotel accommodation, restaurants, admission to cultural services, and admission to amusement parks. The Irish Government recently announced that it would continue to apply the 9 per cent rate "to help the tourism and hospitality sector to maintain competitiveness in light of recent currency movements" following the UK's decision to leave the European Union.[17] The Republic has applied various reduced rates of VAT on hotels and restaurants since 1986, ranging from 10 per cent to 13.5 per cent. In 2016, the VAT registration threshold was €75,000 (£64,103) for goods and €37,500 (£32,051) for services.[18]

Air Passenger Duty (APD)

19. Air Passenger Duty (APD) is an excise duty levied on the carriage, from a UK airport, of passengers on chargeable aircraft. APD is payable by the operator of the aircraft. The amount due is dependent upon the final destination and class of travel of the passenger. Table 1 below shows the APD rates applied by HMRC in Northern Ireland:

Table 1: Rates and allowances: Excise Duty - Air Passenger Duty

Destination bands and distance from London	Rates from 1 April 2016 (reduced/ standard/ higher)	
	Direct	Indirect
Band A (0 to 2,000 miles)	£13/ £26/ £78	£13/ £26/ £78
Band B (over 2,000 miles)	£0/ £0/ £0	£73/ £146/ £438

Source: HMRC

16 VAT registration thresholds, HMRC, April 2015
17 Getting Ireland Brexit Ready, Department of Finance (Irish Government), October 2016, page 7
18 VAT Registration, Irish Tax and Customs, 2016; Exchange rate conversion based on 2 March 2017 rate of €1.17.

There are three rates of APD: a reduced rate, for travel in the lowest class of travel available on the aircraft; a standard rate, for travel in any other class of travel; and a higher rate, for travel in aircraft of 20 tonnes or more, equipped to carry fewer than 19 passengers.

20. Following pressure from our Committee in the last Parliament and other campaigners, in 2012 the Government devolved long-haul APD to the Northern Ireland Assembly, which immediately abolished the tax on direct long-haul flights departing from airports in Northern Ireland.[19] At that time, the only flight affected by this change was the United Airlines Belfast International to New York Newark service. Although the company has since announced the closure of this route, in 2017 other companies will be operating services from Belfast International Airport to Orlando, Las Vegas, Cancun and Varadero.

21. The Republic of Ireland introduced an Air Travel Tax in 2009, setting the rate at €10 per passenger for journeys over 300km and €2 per passenger for shorter distances. In 2011, the Irish Government reduced both rates to €3 per passenger as part of a package of tax reforms to promote the tourism industry, before abolishing the tax entirely in April 2014.[20]

Exchange Rates

22. Exchange rate movements vary over time and can be favourable and unfavourable at different points. Unlike in other parts of the UK, the land border allows people to take advantage of cheaper prices in the Republic of Ireland when the Euro is weak, and vice versa when the Euro is strong. The impact of this is felt particularly in border areas, such as Londonderry.[21] Over the last five years, the Sterling-Euro exchange rate has varied such that, at its lowest point in July 2011, £1 was worth €1.11, and at its highest point in July 2015, £1 was worth €1.44.[22] Since the referendum on the UK's membership of the EU, the Sterling-Euro exchange rate has again moved, with £1 worth €1.17 in January 2017.[23]

23. The Committee was told that there is a strong correlation between movements in the Euro-Sterling exchange rate and changes in the number of people choosing to stay overnight in Northern Ireland.[24] Whilst the strength of Sterling in 2015 did not lead to a decline in the number of people coming across the border to visit Northern Ireland's main visitor attractions, more people were choosing to make day trips rather than staying in hotels overnight.[25] This trend should have reversed following the recent decline in the value of Sterling, and indeed overnight stays were up two per cent in the year to September 2016.[26]

24. However, it is important not to overstate the importance of the exchange rate. As Tourism Ireland told us, taxes, marketing and having a good product are also key to attracting tourists into Northern Ireland. Exchange rates are one part of the picture, but

19 2nd Report - Air Passenger Duty: Implications for Northern Ireland, 2010–12, Northern Ireland Affairs Committee
20 Air Travel Tax, Irish Tax and Customs
21 Q285 (John McGrillen, Tourism NI)
22 www.xe.com, accessed on 9 February 2016
23 www.xe.com, accessed on 2 March 2017
24 Q285 (John McGrillen, Tourism NI)
25 Q297 (John McGrillen, Tourism NI)
26 Northern Ireland tourism statistics October 2015 – September 2016, Department for the Economy

are "not the factor that drives everything".[27] Nevertheless, volatility in exchange rates creates uncertainty and has a disproportionate effect on the tourism industry in Northern Ireland compared to that for the rest of the UK.

Tourism Ireland

25. Northern Ireland also differs from the rest of the UK in the way it is marketed to overseas visitors. As part of the Belfast Agreement, Tourism Ireland promotes the island of Ireland as a single entity to its overseas markets. Whilst we do not criticise Tourism Ireland for promoting the island of Ireland in this way, as it has brought substantial growth to both the Republic of Ireland and Northern Ireland over the past 14 years,[28] we have nevertheless heard evidence that this strategy contributes to the competitive disadvantage faced by the hotel industry in Northern Ireland. The Northern Ireland Hotels Federation (NIHF) told us hotel room prices are promoted by Tourism Ireland inclusive of the VAT rate.[29] They said this added to the pressure on Northern Ireland's tourism industry to either compete on price with the Republic or lose out on business.

Price Competitiveness

26. The Campaign to Cut Tourism VAT told us there was considerable evidence that tourism was a highly price-sensitive industry, in which the spending patterns of visitors did respond to price changes:

> When prices go up, you get fewer tourists; when prices come down, you get more tourists. Possibly over 1,000 academic journal articles have examined that, and I do not think there is a single one of them that has shown zero effect. They have different arguments about the scale of the effect, but there are none that show price does not have an effect.[30]

27. This sensitivity to price is especially relevant in Northern Ireland, where consumers are able to choose to stay in the Republic. Tourism Ireland told us that, as technology had given people choice at the press of a button, price competitiveness was critical in the modern tourism industry. Niall Gibbons explained that "it is important when we are out there in the shop window in the 23 countries in which we operate that the consumer is being offered excellent value for money".[31]

28. HM Treasury appeared more sceptical of the argument that price was a key determinant for tourists when deciding whether to visit Northern Ireland, and called for more evidence on the correlation between the two. The Financial Secretary to the Treasury, Jane Ellison MP, told us in January 2017 she had "not yet seen compelling evidence that VAT alone is a factor" in influencing behaviour, or that it is "APD alone that drives decision-making" when tourists decide whether to travel directly to Belfast or via Dublin.[32]

29. In contrast, the British Hospitality Association told us that, according to research, people tended to decide first on the experience or location they wanted, then consider

27 Q297 (Niall Gibbons, Tourism Ireland)
28 Q291 (Niall Gibbons, Tourism Ireland)
29 Northern Ireland Hotels Federation, Written Evidence
30 Q23 (Professor Adam Blake, Campaign to Cut Tourism VAT)
31 Q287 (Niall Gibbons, Tourism Ireland)
32 Q381 and Q396 (Jane Ellison, Financial Secretary to the Treasury)

specific activities within that location, and finally look at the cost of local hotels. It was at this final stage that price competitiveness became key, especially in the context of Northern Ireland, where the land border added an element of choice. Ufi Ibrahim for the Association explained:

> […] it is experience first, activity second and then hotels. That is the point at which, for example in accommodation, the differentials in cost become apparent to the consumer to say, "That's interesting. If I were to stay in Dublin, for example, the price would be considerably different from the price if I wanted to stay in Belfast."[33]

This price differential is especially significant in border areas, where hotels often struggle to compete with their counterparts in the Republic of Ireland.

The price of being competitive

30. Tourism NI told us the vast majority of people who come to Northern Ireland see it as both a good experience and value for money.[34] This suggests that the tourism industry is attempting to compete on price with the Republic, despite the difficult competitive pressures.

31. The Department of Finance highlighted a recent Northern Ireland Hotel Industry Review and Prospects 2015 report by ASM Chartered Accountants which noted that pricing in Londonderry was being affected by its proximity to Donegal, and that hotels located closer to the border were feeling the combined effects of the lower rate of VAT and (at the time) the exchange rate.[35] Visit Derry agreed, telling us the competitive disadvantage faced by businesses in the area was demonstrated in the day-to-day transactions on overnight stays, restaurant choices and wedding venue packages.[36] This was echoed by members of Destination Fermanagh, who also told us tourism businesses in the county, particularly along the border area, were at a competitive disadvantage with businesses in the Republic.[37] In the case of the Fermanagh Lakelands, this competitive disadvantage was reflected in the hire cruiser market, where Fermanagh-based businesses were losing out to their competitors in the Republic due to cost.[38]

32. An inevitable consequence of competing on price in a climate of uncompetitive tax rates is that margins are necessarily reduced. Businesses in Northern Ireland have less money to invest in their hotels and restaurants, to create jobs or to improve the customer experience. One hotelier highlighted in NIHF's written evidence said they were not able to invest as heavily in their Northern Ireland hotels as they did in the Republic, "as margins are so tight, it diminishes confidence to put the extra resources in with the fear of leaving yourself exposed".[39] Over time, this effect on investment may well place Northern Ireland's tourism industry at an even greater competitive disadvantage vis-à-vis the Republic.

33 Q110 (Ufi Ibrahim, British Hospitality Association)
34 Q300 (John McGrillen, Tourism NI)
35 Department of Finance, written evidence, para 3.9
36 Visit Derry, written evidence
37 Destination Fermanagh, written evidence, para 3
38 Fermanagh Lakeland Tourism, written evidence, para 4
39 Northern Ireland Hotels Federation, Written Evidence

Tour Operators

33. Tour operators are key to creating growth in Northern Ireland's tourism industry. In crucial markets, such as North America, France and Germany, they comprise 30 to 40 per cent of business.[40] This is why Tourism Ireland has been actively encouraging overseas tour operators to include more Northern Ireland tourist destinations in their programmes. As a result, approximately 775 traditional and online tour operators currently feature Northern Ireland in their itineraries.[41]

34. However, tour operators are a very low-margin business and, as such, are highly price sensitive.[42] It is at this level in particular that the UK's higher VAT rate has a significant effect on where tour operators decide to book hotels and restaurants. The National Trust told us that under the Tour Operators Margin Scheme, which regulates how businesses must account for VAT if they buy-in and re-sell travel facilities, VAT incurred on the cost of buying-in goods and services cannot be reclaimed by the tour operator but must be incorporated into the margin scheme calculations.[43] As such, a tour operator providing a service in Northern Ireland either has to charge higher prices or reduce their margins, compared with the Republic of Ireland.[44] We also heard that tour operators in Northern Ireland are additionally burdened by the requirement to be licensed and bonded by the Republic of Ireland's Commission for Aviation Regulation where they sell flights from airports in the Republic, leaving Northern Ireland-based businesses facing double-regulation and double-bonding.[45]

35. Hospitality Ulster gave the Committee evidence that most tour operators operated from bases in the Republic of Ireland and avoided hotel accommodation in Northern Ireland:

> You will see them: they will do Giant's Causeway, Titanic Belfast and then be back in Drogheda or somewhere to bed […], because it is cheaper on the accommodation […] if you are operating as a tour operator, you can save money by operating outside Northern Ireland.[46]

36. The NIHF agreed with this assessment, noting that many tour operators avoided Northern Ireland, or spent less time there than they otherwise would have done, on the basis of cost. The Federation explained that this was a situation that had improved in recent years, but not to the level the industry would like.[47]

Weddings

37. Evidence was submitted to the Committee that Northern Ireland's hotels had been losing domestic trade on weddings to hotels across the border, with businesses reporting a 10 to 15 per cent drop in weddings since 2011.[48] Mr Colin Neill of Hospitality Ulster stated that, with the decline in the value of the Euro over 2014–15 and the continuing

40 Q293 (Niall Gibbons, Tourism Ireland)
41 Tourism Ireland, Written Evidence, Para 3.4
42 Q293 (Niall Gibbons, Tourism Ireland)
43 VAT Notice 709/5, Tour Operators Margin Scheme, HMRC
44 National Trust, written evidence, para 4.2
45 Travel Trade Regulation, ABTA, June 2013
46 Q175 (Colin Neill, Hospitality Ulster)
47 Q114 (Janice Gault, Northern Ireland Hotels Federation)
48 Northern Ireland Hotels Federation, Written Evidence

11 per cent VAT differential, it had been a third cheaper to hold a wedding reception in the Republic of Ireland.[49] Although recent exchange rate movements will have improved the price competitiveness of Northern Ireland, this still represents a substantial loss of business for Northern Ireland's hotel and wedding industry.

Conclusion

38. **Northern Ireland is the only part of the UK to share a land border with a foreign country, one in which the tourism industry benefits from substantial tax breaks. The lack of a level playing field for Northern Ireland's tourism industry, especially given that tourism is promoted on an all-Ireland basis, means that its hotels and restaurants, particularly in border areas, are at a significant competitive disadvantage. They have the difficult choice of losing out on business for being too expensive, or competing on price with the Republic, but in doing so, damaging Northern Ireland's tourism offer in the longer term by limiting its capacity to invest and create jobs. We believe the unique pressures Northern Ireland's tourism industry faces should have a stronger bearing on policy formation by the UK Government with respect to the effects of taxation on the sector.**

49 Q148 (Colin Neill, Hospitality Ulster)

3 Value Added Tax

39. In this chapter, we explore the effect of EU rules on UK VAT policy, the economic case for a reduction in tourism VAT and the competing arguments therein, and the main arguments made for maintaining the status quo. We also examine the impact of the VAT reduction in the Republic of Ireland, alternatives to cutting VAT and consider how additional funding could be used by the tourism industry.

European Union rules

40. Following the June 2016 referendum on the UK's membership of the EU, it is now the Government's policy to negotiate the UK's departure from the EU. However, the UK remains a member of the EU for the duration of the period in which negotiations will take place and, as such, continues to be subject to EU legislation, including that governing VAT.

41. The EU has a policy to promote the harmonisation of VAT systems across Member States. In 1992, the European Council agreed to establish new rules limiting the discretion of all Member States to set VAT rates. Current rules dictate that governments must apply a standard VAT rate of 15 per cent or more, with the option of applying one or two reduced rates, no lower than 5 per cent, to certain specified goods. Member States may continue to apply lower rates, including zero rates, if they were in place on 1 January 1991. Since October 1999, countries have also had the option of implementing a reduced VAT rate to specific labour-intensive services.

42. For tourism, the EU allows Member States to have lower rates on the following relevant activities: hotel accommodation, restaurants, admission to some cultural services, admission to amusement parks, and admission to sporting events. 25 Member States impose lower VAT rates on hotel accommodation; 16 impose lower VAT rates on restaurants; 23 impose lower VAT rates on admission to some cultural services; 16 have lower VAT rates on admission to amusement parks; and 18 have lower rates on admission to sporting events. The UK is one of only three countries, alongside Denmark and Slovakia, which does not apply a lower rate of VAT in any of these categories.[50]

43. At present, EU law does not permit Member States to have regional variations in their VAT rates. The Preamble to the legislation states:

> The common system of VAT should, even if rates and exemptions are not fully harmonised, result in neutrality in competition, such that within the territory of each Member State similar goods and services bear the same tax burden, whatever the length of the production and distribution chain.[51]

44. It is worth noting, however, that this rule does not appear to have been applied universally. The EU Directive gives explicit permission for Greece to apply different rates of VAT in its islands and departments, with Article 120 permitting Greece to apply a

50 See Appendix 1. We note that the UK Government does apply a lower rate of VAT to the category of non-profit making cultural services.

51 Preamble (para 7), Council Directive 2006/112/EC of 28.11.2006

rate up to 30 per cent lower than the corresponding rates applied in mainland Greece in the departments of Lesbos, Chios, Samos, the Dodecanese and the Cyclades, and on the islands of Thassos, the Northern Sporades, Samothrace and Skiros.[52]

Post-Brexit considerations

45. In its written evidence, submitted prior to the EU referendum, the Government asserted that any change in tourism VAT could only take place for the whole of the UK.[53] However, with the power to establish its own rules on VAT after the UK leaves the EU, the Government could implement regional variations for tourism if it so wished. The Financial Secretary to the Treasury acknowledged this in evidence to the Committee in January 2017. Jane Ellison MP said, "You are right; there may well be more freedoms. We do not yet know the final shape of agreements. There are a lot of imponderables about the next couple of years, but it is likely that we will have an environment where those rules might be different".[54]

46. However, Treasury officials also suggested the Government might continue to be restricted by other international trade bodies of which the UK is a participant. They told us the Organisation for Economic Co-operation and Development (OECD) VAT/GST guidelines for international trade encourage 'neutrality' in the application of VAT, such that similar rules should operate across the entire jurisdiction.[55] This might limit the ability of the Government to permit a lower rate of tourism VAT in Northern Ireland. However, it was also noted that the OECD does not establish law or have any enforcement mechanism, but rather offers guidelines and a direction of travel for its members.

47. The Treasury also suggested it might not want to create regional rates of VAT after the UK has left the EU on the grounds that to do so could add undue complexity to the system.[56] They told us different regional rates of VAT could complicate trade between businesses and create unwelcome administrative burdens. It could be argued, however, that because VAT is paid where the consumer is at the time of the transaction, and that Northern Ireland is clearly separated from other UK regions geographically, such concerns are unlikely to be realised.

48. It is also important to note that, even if the UK was able to implement a regional variation in its VAT rate, current EU State Aid rules require any such variations to be paid through adjustments to the block grant. Treasury officials told us it would be wrong to assume the UK would have no State Aid obligations when it is no longer a member of the EU, and highlighted that for example, WTO rules might still limit the ability of the UK Government to implement regional rates of VAT without making adjustments to the block grant.[57]

49. **The UK's decision to leave the European Union changed the scope of the debate around the implementation of a lower rate of tourism VAT in Northern Ireland. Prior**

52 Article 120, Council Directive 2006/112/EC of 28.11.2006
53 HM Treasury, written evidence, para 1.2
54 Q360 (Jane Ellison MP, Financial Secretary to the Treasury)
55 Q361 (Mike Cunningham, HM Treasury)
56 Q376 (Mike Cunningham, HM Treasury)
57 Q413 (Mike Cunningham, HM Treasury)

to the referendum, EU VAT legislation prohibited the implementation of regional rates of tourism VAT, with a legal requirement to apply any reduction across the UK. These rules will continue to apply until the UK leaves the EU.

50. **However, once the UK has left the EU, the Government is likely to have substantially more freedom to implement variable VAT rates. Subject to the forthcoming negotiations with the EU, this potentially opens the door to the implementation of a lower rate of tourism VAT in Northern Ireland, without necessitating a more expensive reduction in other parts of the country which do not share the same competitive pressures.**

51. ***We believe as a matter of principle that the UK Government should have the power to implement regional variations in tourism VAT.***

Tourism VAT Reduction in the Republic of Ireland

52. The Financial Secretary to the Treasury told us she had not yet seen compelling evidence that VAT alone was a factor in influencing consumer behaviour in the tourism industry, and that such decisions were usually based on a more complex range of factors.[58] However, throughout our inquiry, tourism groups repeatedly cited the Republic of Ireland as an example of where a reduction in tourism VAT has had a clear and demonstrable benefit for the local tourism industry.[59]

53. In July 2011, the Republic of Ireland temporarily reduced its rate of VAT on tourism-related goods and services from 13.5 per cent to 9 per cent, with the intention of boosting the tourism and hospitality industry to encourage job creation in the sector. The rate reduction was extended indefinitely by the Irish Government in 2013, and reaffirmed following the UK's decision to leave the European Union and changes in the Sterling-Euro exchange rate. The new VAT rate was applied to certain categories of tourism-related goods and services, including: hotel and holiday accommodation; restaurant and catering services; and admissions to cinemas, certain live theatrical or musical performances, museums, art exhibitions and galleries, fairgrounds and amusement parks. These categories had previously been liable to VAT at a rate of 13.5 per cent, which itself had been reduced from the Republic of Ireland's standard 23 per cent rate of VAT.

54. Fáilte Ireland, the National Tourism Development Authority, commissioned Deloitte to examine the effect of the VAT reduction in the Republic and published a report in July 2014.[60] The Treasury told us the report concluded that evidence of a positive effect on the Irish economy was "not so crystal clear", and specifically cited the report as a counterbalance to more optimistic claims from industry groups.[61]

55. However, the report appears to be considerably more positive than implied by HM Treasury. Whilst recognising that it was difficult to come to a definitive conclusion as to its impact on the tourism sector—as a range of factors could influence tourism demand, such as a recovering economy, competitor destination activity or exchange rates—the 2014 report was nevertheless clear there had been demonstrable economic benefits. The report concluded:

58 Q381 (Jane Ellison MP, Financial Secretary to the Treasury)
59 For example, Q296 (Niall Gibbons, Tourism Ireland) and Q321 (Stephen McNally, Irish Hotels Federation)
60 Analysis of the Impact of the VAT Reduction on Irish Tourism & Tourism Employment, Deloitte, July 2014
61 Q382 (Mike Cunningham, HM Treasury)

> [...] the introduction of the reduced VAT rate appears to have met its original aims of driving employment and stimulating activity in the sector and has achieved this without placing a significant burden on the exchequer.[62]

56. Deloitte stated that there was strong evidence that the reduction in the VAT rate had resulted in lower consumer prices, which varied by category, but was evident in all of the tourism and hospitality sectors affected.[63] They estimated that half the benefit of the VAT reduction was passed on to customers in the form of lower prices.[64] The report also found that there had been a strong, positive impact on tourists' perception of the Republic of Ireland as providing value for money.[65] This was an area of particular concern for the Irish tourist industry, where, in 2009, 41 per cent of British visitors said that Ireland was poor value for money, compared to just 3 per cent in 1999.[66] Ratings achieved after the VAT cut had returned to the levels found in the early 2000s. Growth in tourist expenditure, especially from international visitors, was partly due to a higher average spend per tourist per day, which Deloitte suggested could be related to improved perceptions of value for money.[67]

57. Deloitte argued that there had been a positive improvement in both international and domestic tourism numbers since the introduction of the VAT rate cut, with visitors from mainland Europe and North America seeing the strongest growth. However, they also noted that it would be difficult to attribute all this growth to the VAT cut, given the range of factors that could affect such activity.

58. In particular, Deloitte estimated that the level of employment was 30,000 higher than would have been the case had tourism performed in line with overall employment in the economy, bringing an overall benefit of €165 million to the public purse from additional income tax and social welfare savings.[68] One in three of all new jobs created in the Republic of Ireland since 2011 has been in the tourism and hospitality industries.[69] One witness told us that, because 60 per cent of hotels in the Republic of Ireland were undergoing refurbishment using funds made available by the VAT reduction, this created additional employment for builders, electricians, painters and carpenters, and likely accounted for even more jobs than the 30,000 estimated.[70]

59. With regard to the cost to the Exchequer of introducing the lower VAT rate, the tax foregone was lower than initially estimated by the Department of Finance. Actual VAT receipts in the reduced categories fell by €107 million in the first 12 months following the introduction of the reduced rate. This compared with initial estimates that the reduction would cost €350 million each year. Deloitte stated:

62 Analysis of the Impact of the VAT Reduction on Irish Tourism & Tourism Employment, Deloitte, July 2014, page 8
63 ibid, page 4
64 Ibid, page 23
65 Ibid, page 6
66 Q297 (Niall Gibbons, Tourism Ireland)
67 Analysis of the Impact of the VAT Reduction on Irish Tourism & Tourism Employment, Deloitte, July 2014, page 6
68 Ibid, page 8
69 Restoring Competitiveness to Ireland's Tourism Industry: The Role of Reduced VAT, Professor Alan Ahearne, February 2015
70 Q321 (Stephen McNally, Irish Hotels Federation)

> While it is difficult to establish how much of the benefits and costs outlined […] are directly attributable to the reduced VAT rate, it is clear that the costs of the initiative are lower than originally thought while there are also considerable benefits which at least partly offset these costs.[71]

60. A 2015 report into the effect of the VAT reduction in the Republic of Ireland by the National University of Ireland, Galway, was cited by a number of witnesses. This outlined evidence suggesting that the VAT reduction had contributed significantly to growth in the tourism industry since 2011. It noted: "The VAT reduction was a radical policy move that has proven to be successful in boosting tourism activity, employment and investment in the sector".[72] The role of the VAT reduction in helping to create jobs in the tourism sector had exceeded expectations, while the cost to the Irish Revenue had been substantially lower than predicted. Overall, the report concluded that the stimulus from the reduced rate of VAT remained hugely important to the future viability and growth of the tourism industry.[73]

61. Indeed, Niall Gibbons of Tourism Ireland explained that, "if you talk to any of the Irish industry members […] the view is that the VAT has probably been the most significant measure introduced in Irish tourism over the last 20 years."[74] The Irish Hotels Federation was equally convinced that the VAT reduction was directly responsible for the significant growth in the tourism industry in the Republic since 2011. Referring to an increase in international tourist numbers from 5.9 million in 2011 to 8 million in 2015, and the additional jobs in the tourism sector, the President of the Federation, Stephen McNally, told us, "I am in absolutely no doubt that it is not coincidental that all these numbers have grown: […] the VAT came down; the numbers of jobs grew".[75] However, HM Treasury was more sceptical of such evidence from industry groups in the Republic of Ireland. The Financial Secretary to the Treasury stated that, "It is also worth noting that, in my relatively brief experience as the tax Minister, most people say that they welcome a tax cut and that it has been nothing but good news for them".[76]

62. We heard from a number of Northern Ireland-based witnesses who pointed to the experience of the Republic of Ireland as proof of the economic benefits a VAT reduction could bring to the Province's tourism industry. Hospitality Ulster described it as, "one of the best examples in Europe of how this economic lever can work to the advantage of the tourism and hospitality sector".[77] They argued that, given similar key markets and geographical location, Northern Ireland could expect to see comparable growth to that seen in the Republic, were it also to have a lower rate of VAT on tourism. If this were the case, annual visitor numbers would increase by 15.8 per cent to 5.2 million, tourism revenue would increase by 13.25 per cent to £850 million, and there would be an additional 8,550 jobs in the tourism sector.[78]

71 Analysis of the Impact of the VAT Reduction on Irish Tourism & Tourism Employment, Deloitte, July 2014, page 7
72 Restoring Competitiveness to Ireland's Tourism Industry: The Role of Reduced VAT, Professor Alan Ahearne, February 2015, page 15
73 Ibid, page 1
74 Q296 (Niall Gibbons, Tourism Ireland)
75 Q321 (Stephen McNally, Irish Hotels Federation)
76 Q385 (Jane Ellison MP, Financial Secretary to the Treasury)
77 Hospitality Ulster, written evidence, page 5
78 Hospitality Ulster, written evidence, pages 5–6

63. **Despite HM Treasury's view to the contrary, we have seen considerable evidence from industry experts and respected academics that the Republic of Ireland's decision to reduce its rate of VAT on tourism in 2011 brought substantial economic benefits to its tourism industry and the wider economy.**

The economic case for a VAT reduction

What has been proposed?

64. The Campaign to Cut Tourism VAT promotes the view that reducing VAT on visitor accommodation and attractions to a level in line with other EU countries would increase the UK tourism industry's competitiveness, create jobs and increase GDP, whilst also raising overall revenue to the Exchequer. It claims that the UK is at a "major competitive disadvantage compared to other EU countries" because the Government does not apply a reduced rate of VAT for the tourism industry.[79] Its recommendation is to reduce the rate of VAT to 5 per cent.[80]

65. The Campaign highlighted a number of potential benefits to Northern Ireland if the Government reduced the rate of VAT on tourism to 5 per cent. In its written evidence, it was argued that there was a potential to create 2,600 new jobs, providing an annual boost to Northern Ireland's economy of £81 million.[81] The tourism industry would be better placed to invest in its businesses, improving the quality of staff training, accommodation and facilities, and helping to increase wages in one of the lowest paid industries.[82] The Campaign also suggested that the VAT reduction would particularly benefit Northern Ireland's rural and coastal communities, where growth within the tourism industry could help to alleviate ongoing social and economic deprivation.[83]

66. The unique in the UK competitive pressures faced by Northern Ireland are also important when considering the economic case for a reduction in VAT on tourism. As outlined in the previous chapter, Northern Ireland's tourism industry is at a significant competitive disadvantage because of the proximity to the Republic of Ireland, and the fact that tourism is promoted on an all-Ireland basis, both of which present a problem because of the differing rates of VAT. The Campaign to Cut Tourism VAT told us that, because Northern Ireland is the only part of the UK that shares a land border with another country, "the potential for Northern Ireland from this measure is greater than any other part of the UK".[84]

How a VAT reduction would be spent

67. One area of concern for the Committee was the extent to which a VAT reduction would be passed on to customers in the form of lower prices, as this would give an indication of the extent to which the industry truly believed that price was deterring tourists from visiting Northern Ireland. The responses witnesses gave to this question were varied.

79 Campaign to Cut Tourism VAT, written evidence, Para 1
80 Q2 (David Bridgford, Campaign to Cut Tourism VAT)
81 Campaign to Cut Tourism VAT, written evidence, Para 2.1
82 Campaign to Cut Tourism VAT, written evidence, Para 2.3
83 Campaign to Cut Tourism VAT, written evidence, Para 2.5
84 Q35 (Graham Wason, Campaign to Cut Tourism VAT)

68. The Campaign to Cut Tourism VAT told us their three main supporters—Merlin Entertainments, Bourne Leisure and Premier Inn—had promised to pass on every penny of a VAT cut in the form of lower prices.[85] Visit Derry told us a VAT reduction would enable businesses in the Derry/Londonderry and Strabane areas to compete with counterparts in the Republic on a more equitable basis.[86]

69. However, Ufi Ibrahim of the British Hospitality Association told us that, according to a recent survey of their members, while 90 per cent would pass on some or all of a VAT reduction to customers through lower prices, 82 per cent would also invest in their product or facilities, 67 per cent would employ more people, 57 per cent would invest in training, and 48 per cent would increase wages for staff.[87] Others, such as Hospitality Ulster, pointed to the experience in the Republic of Ireland, where approximately 50 per cent of the VAT reduction had been passed on, and suggested it would be a fair assumption to expect something similar to happen in Northern Ireland.[88] The National Trust, and others, told us a VAT cut could also be used to help many businesses pay the new National Living Wage.[89]

Estimating the cost of a VAT reduction

70. Inevitably, an important question is whether a reduction in the rate of VAT would lead to a loss of revenue to the Exchequer. The Northern Ireland Executive's former Finance Minister told us the tourism industry in Northern Ireland contributed between £150 million and £160 million in VAT receipts to the Exchequer in 2014 and 2015.[90] From these figures, we can infer that a reduction in tourism VAT from 20% to 9% in Northern Ireland—matching the rate in the Republic of Ireland—would incur a direct cost of approximately £70 million, although it is important to note that this does not include any of the indirect benefits that would arise, such as from increased tourism expenditure or higher employment. This compares to the estimated £270 million cost of the reduction in Corporation Tax to 12.5% in 2020–21.[91]

71. The Campaign to Cut Tourism VAT argued that the Exchequer would see a significant net benefit from reducing VAT to 5 per cent on hotel accommodation and visitor attractions across the UK. It estimated that, whilst there would be a net cost of between £0.5 billion and £0.75 billion in the first year, over a 10-year period the Treasury would make a net gain of £2.6 billion due to the additional revenue raised through higher corporation tax receipts, lower welfare payments and other indirect benefits.[92] The Campaign also estimated that a VAT reduction for the tourism industry would improve the UK's balance of trade by £20.1 billion over 10 years.[93]

72. The Campaign's evidence was supported by the work of Professor Adam Blake of Bournemouth University, who used HMRC and HM Treasury's Computable General Equilibrium (CGE) model to compare the effect of reducing VAT on hotel accommodation

85 Q42 (Graham Wason, Campaign to Cut Tourism VAT)
86 Visit Derry, written evidence
87 Q116 (Ufi Ibrahim, British Hospitality Association)
88 Q180 (Colin Neill, Hospitality Ulster)
89 National Trust, written evidence, para 2.1
90 Q339 (Mervyn Storey, Minister for Finance)
91 Corporation tax cut to cost Northern Ireland £500m, Belfast Telegraph, 28 July 2016
92 Campaign to Cut Tourism VAT, written evidence, Para 7.3
93 Campaign to Cut Tourism VAT, written evidence, Para 7.4

and visitor attractions with other tax changes designed to boost the economy, including a 2p reduction in the standard rate of corporation tax or a 1p reduction in the standard VAT rate. Professor Blake explained that their proposed cut to tourism VAT performed substantially better in the model than other tax cuts in terms of the cost to the Exchequer and the effect on GDP. Cutting VAT on hotel accommodation and visitor attractions provided three times the level of benefit than cuts to corporation tax or to the headline rate of VAT.[94]

73. However, the Treasury has disputed this analysis. It argued that the Cut Tourism VAT campaign had made a number of assumptions about what might happen were tourism VAT to be reduced, which it was not possible to validate to the standard required by the Office for Budget Responsibility (OBR).[95] The Treasury also suggested that some of the figures used by the Campaign to Cut Tourism VAT campaign were now out of date. For example, the Campaign had made calculations based on older estimates of the VAT tax gap, which is lower now than in the past.[96]

74. For now, the Government's position is that a VAT cut would not lead to sufficient growth to outweigh the revenue shortfall, as outlined by the then Financial Secretary to the Treasury, David Gauke MP, in a statement to the House in March 2013:

> 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.[97]

75. Treasury official, Mike Cunningham, Deputy Director of VAT and Excise, stated that, based on figures provided by HMRC, reducing VAT to 5 per cent across the UK for all services provided by restaurants would cost the Exchequer £7 billion a year, while cutting VAT to 5 per cent for accommodation and attractions would cost an estimated £3 billion a year. The total direct cost of reducing VAT on tourism across the UK was therefore estimated to be in the region of £10 billion per year.[98]

76. It was acknowledged that the £10 billion figure only reflected the direct cost of cutting VAT, and not the indirect benefits that would likely arise from any reduction. However, the Treasury stated that it would need to follow the "stringent" OBR process to calculate the necessary mitigation on this figure, requiring substantial evidence from industry groups and others. We were told this was a very complex process and "quite a lot of work would need to be done".[99]

77. The Campaign to Cut Tourism VAT did not dispute the Treasury's assessment that a VAT cut for catering services would be more expensive than one simply for accommodation

94 Q26 (Professor Blake, Campaign to Cut Tourism VAT)
95 Q398 (Mike Cunningham, HM Treasury)
96 Q398 (Mike Cunningham, HM Treasury)
97 HC Deb 12 March 2013 c140W
98 Q398 (Mike Cunningham, HM Treasury)
99 Q398 (Mike Cunningham, HM Treasury)

and attractions, although Mr Wason described the £10 billion estimate as a “spurious figure”.[100] He agreed, however, that it was unrealistic to demand a VAT cut to catering services in the current economic climate, given the significant direct cost to the Treasury.

78. This was not a view shared by advocates of a reduction in VAT for restaurants and catering services, such as Hospitality Ulster.[101] They told us a reduction for restaurants would be particularly beneficial in Northern Ireland, where disposable incomes are approximately half the UK average and the market is more price sensitive.[102] In particular, Hospitality Ulster noted that, as food ingredients are zero-rated for the purposes of VAT, restaurants were not able to claim this back against the VAT they were charging.[103]

79. However, it is worth noting that even the British Beer and Pub Association (BBPA) did not give its support to cutting VAT to 5 per cent for restaurants, pubs and catering services. The BBPA told us many pub owners considered a beer duty reduction to be a better targeted and more effective policy for their businesses.[104] Other witnesses, such as the British Hospitality Association, told us a cut in VAT for restaurants, pubs and catering services should be part of a second phase of VAT reductions, once a reduction for accommodation and attractions had proven its value to the Treasury.[105]

80. There is, then, a clear discrepancy between the economic analysis undertaken by the Treasury and the Campaign to Cut Tourism VAT. The former estimated a cut in VAT to 5 per cent would cost the Exchequer £2 billion a year, whilst the latter estimated a net gain of £2.6 billion over 10 years and an improvement in the UK’s balance of trade by £20.1 billion.

81. The Campaign to Cut Tourism VAT told us the Treasury based its figures on a broader definition of tourism, which included things that the Campaign was not asking for, such as a VAT cut on theatre admissions. They also argued that the Treasury had miscalculated the number of business visitors who reclaimed VAT, overestimating the consequential loss that a VAT cut would bring.[106] Others suggested that the Treasury had not adequately taken into account the multiplier effects arising from the benefits of a VAT reduction, and had focused too closely on the direct costs to the Exchequer.[107]

82. **Much of our evidence was received prior to the UK’s decision to leave the European Union, in the context of needing to make a UK-wide decision as to whether to reduce VAT for the tourism and hospitality industries. However, the UK’s departure from the EU enables the Government to consider this issue from the perspective of Northern Ireland alone.**

83. **Using figures provided by the former Finance Minister, Mervyn Storey in January 2016, we estimate that a reduction in tourism VAT from 20 per cent to 9 per cent in Northern Ireland—matching the rate in the Republic of Ireland—would incur a direct cost of approximately £70 million per year. However, this figure does not reflect the indirect benefits likely to arise from a reduced VAT rate, such as increased tourist**

100 Q38 (Graham Wason, Campaign to Cut Tourism VAT)
101 Q140 (Colin Neill, Hospitality Ulster)
102 Q143 (Colin Neill, Hospitality Ulster)
103 Q173 (Colin Neill, Hospitality Ulster)
104 Q149 (David Wilson, British Beer and Pub Association)
105 Q111 (Ufi Ibrahim, British Hospitality Association)
106 Q19 (Graham Wason, Campaign to Cut Tourism VAT)
107 Q121 (Janice Gault, Northern Ireland Hotels Federation)

expenditure, higher corporation tax receipts and lower unemployment. In Northern Ireland, where competitive pressures in the industry are far more pronounced than in the rest of the UK, the indirect benefits could be sizeable.

84. **Unfortunately, there is no consensus between industry and government on the true cost or benefit of reducing tourism VAT across the UK. Industry groups are accused of using out of date figures and making unverifiable assumptions, while the Treasury is criticised for focusing too closely on the direct tax cost, and placing insufficient emphasis on the indirect benefits.**

85. ***It is clear further analysis is required from the Government, Executive and tourism industry to build greater consensus around the true cost, or benefit, to the Exchequer of reducing tourism VAT.***

Alternatives to cutting VAT

86. The Treasury told us the vast majority of the fiscal levers likely to benefit the tourism and hospitality industry already rested with the Executive.[108] The Financial Secretary highlighted the additional £250 million that had been allocated to Northern Ireland through the National Productivity Investment Fund, which could be used "imaginatively" to, for example, invest in hotel capacity or improve connections between major towns in Northern Ireland.[109]

87. Although we did not receive any further detailed evidence on alternative ways to support the tourism industry in Northern Ireland through the tax system, some high-level ideas were expressed in our informal meetings. For example, National Trust recommended that a grant scheme be developed for the tourism industry, equivalent in value to the cost of VAT, and modelled on similar schemes, such as for repairs to churches. The organisation also suggested that the implementation of targeted reliefs on business rates for the tourism industry, such as those that currently exist in the retail industry, could also be effective.

88. Tourism NI told us a capital allowance scheme to promote the development of hotels in rural areas might be another way to encourage the tourism industry in Northern Ireland. This would ensure that there was enough capacity to meet the needs of large tour operators visiting, for example, the Giant's Causeway, and to take advantage of major sporting events, such as the 2019 Open Championships.

UK competitive advantages: relevance to Northern Ireland

89. In its evidence to us, the Treasury highlighted a number of reasons why the UK tourism industry was well placed internationally, despite not having a lower rate of VAT. First, the UK has the highest VAT registration threshold in the EU (£82,000), meaning that many small businesses providing goods and services to tourists do not have to charge VAT at all.[110] Second, visitors benefit from the UK's zero rates for public transport, children's clothing, newspapers and books, and many foodstuffs.[111] Third, visitors to other

108 Q381 (David Willis, HM Treasury)
109 Q374 (Jane Ellison MP, Financial Secretary to the Treasury)
110 HM Treasury, written evidence, para 4.1
111 HM Treasury, written evidence, para 4.2

countries may be subject to other indirect taxes in addition to VAT, including levies such as road tolls, additional charges for overnight stays, such as hotel bed taxes, and specific tourist taxes which are not features of the UK tax system.[112] Finally, entry to not-for-profit cultural attractions is VAT exempt, and the UK Government provides significant direct funding for a range of cultural institutions, enabling free entry to a large number of world class exhibits.[113]

90. However, on the issue of the UK's high VAT registration threshold, many in the tourism industry consider this to be a disincentive to smaller businesses, such as B&Bs and guest houses, from expanding, with many choosing to remain below the threshold to avoid VAT. They argue a VAT cut would encourage these smaller businesses to expand.[114]

91. With regard to the number of services that are zero-rated for VAT in the UK, there is no competitive advantage to Northern Ireland, as the Republic also has a zero per cent VAT rate on certain food and drink, certain books and booklets, and children's clothing.[115] Similarly, Northern Ireland gains no advantage from the lack of levies, such as road tolls and additional charges for overnight stays, as these taxes do not exist in the Republic of Ireland either. We also note that Northern Ireland's most popular tourist attractions—the Giant's Causeway and Titanic Belfast—are both profit-making and, consequently, do not qualify for the Government's VAT exemption for not-for-profit cultural attractions.

92. **It is concerning that the Treasury's main justifications for maintaining the status quo ignore the realities of the cross-border competition that exists on the island of Ireland. The UK's tourism industry may be generally well-placed internationally, but it is clear that the tourism industry in the Republic of Ireland continues to enjoy a significant competitive advantage over the tourism industry in Northern Ireland arising from the tax system. The Government has recognised the problem caused to Northern Ireland by the lower rate of Corporation Tax in the Republic, but seemingly not the loss of revenue to the tourism industry.**

Building the evidence base

93. Some witnesses gave evidence that it was the Treasury's lack of transparency that was stifling constructive dialogue between the industry and Government on the potential benefits of cutting tourism VAT. The NI Department of Finance told us that, as there were a number of different methodologies being used, it would be helpful for the Treasury to be more transparent around the approach they were using. The former Northern Ireland Executive Minister told us there would always be slight variations in economic modelling, but it was difficult to narrow the gap without understanding more about the Treasury's approach to this issue.[116]

94. The British Hospitality Association echoed this view. It told us it would be helpful if the Treasury was willing to have a constructive dialogue with the industry so that it could look carefully at the assumptions underpinning its economic modelling to identify the

112 HM Treasury, written evidence, para 4.4
113 HM Treasury, written evidence, para 4.3
114 Campaign to Cut Tourism VAT, written evidence, Para 7.5
115 Goods and Services at the Zero rate, Irish Tax and Customs, accessed on 16 February 2016
116 Q348 (Tony Simpson, Department of Finance)

differences between the outputs of the research. Ufi Ibrahim for the Association told us, "as the fourth largest employer in the UK, we think Treasury should at the very least agree to have our economists in and look at the differentials in our research".[117]

95. Interestingly, Graham Wason of the Campaign to Cut Tourism VAT claimed that over the past three to four years, the Treasury had moved its position on this issue, coming down to "one or two arguments that are far more political than economic".[118] Treasury officials had hinted to them that, were there political will to cut VAT on tourism, they would not stand in the way in terms of the economic arguments.[119]

96. It is encouraging, then, that the Financial Secretary of the Treasury was willing to engage with the tourism industry to discuss the case for a VAT reduction in greater detail.[120] She urged the Campaign to Cut Tourism VAT to submit more up-to-date evidence of the benefits they believe are likely to arise from a VAT reduction, and agreed they would be able to meet with officials to talk through their evidence.

97. **We believe the Treasury should be far more transparent with the tourism industry and the Northern Ireland Executive in terms of the assumptions and methodology which underpin its economic modelling in respect of the potential effects of a reduction in tourism VAT. We are encouraged, therefore, that the Treasury is now willing to take further evidence from industry groups and meet with representatives to talk about this issue in greater detail.**

98. ***The Government should look constructively at a different rate of VAT on tourism in Northern Ireland. The Treasury should work with the tourism industry and the Northern Ireland Executive to estimate the costs and benefits of a reduction in tourism VAT in Northern Ireland, to the standard required by the Office for Budget Responsibility, to determine conclusively whether or not there is a strong economic case for a VAT reduction in the Province. We would invite HM Treasury to provide regular updates to the Committee on these discussions throughout the lifetime of this Parliament.***

117 Q121 (Ufi Ibrahim, British Hospitality Association)
118 Q18 (Graham Wason, Campaign to Cut Tourism VAT)
119 Q19 (Graham Wason, Campaign to Cut Tourism VAT)
120 Q373 (Jane Ellison MP, Financial Secretary to the Treasury)

4 Air Connectivity

99. Air connectivity is vital for Northern Ireland's tourism industry, as it is for the region's entire economy. For people travelling to Northern Ireland, the only realistic way to do so is by air, and without a well-connected air transport infrastructure, a formidable barrier is put in the way of growth. As Graham Keddie, the Managing Director of Belfast International Airport put it, "We are an island beyond an island; we need air transportation. It is not a luxury; it is crucial to our development".[121] With this in mind, we were interested to hear about tax changes that could be made to support Northern Ireland's airports in obtaining new routes and, through this, attract more visitors to the region.

Air Passenger Duty

100. Air Passenger Duty (APD) has been a contentious issue in Northern Ireland for many years. The Treasury makes substantial revenues from APD, estimated at £3.08 billion in 2015–16 with the amount contributed by Northern Ireland's airports estimated by different bodies to be between £55 million and £78 million.[122] However, some people argue that the revenues raised by the Treasury are vastly outweighed by the costs to the wider economy.

101. The Treasury told us APD was the principal way in which the aviation industry contributed to public revenue-raising, noting that VAT was not applied to airline seats or fuel.[123] The Treasury also highlighted recent changes to APD—including a cut to the rate on the longest haul flights and exemptions for children—as evidence that, as with all taxes, APD is kept under regular review.[124]

Former Inquiries into Air Passenger Duty

102. In the 2010 Parliament, our predecessor Committee carried out two inquiries that addressed the issue of APD in Northern Ireland. In the first Report, published in July 2011, the Committee called for the abolition of APD on all flights out of Northern Ireland airports and on flights from Great Britain into Northern Ireland.[125] The Committee was particularly concerned about the viability of the transatlantic route from Northern Ireland to Newark in the United States, which was under threat, as Continental Airlines (now United Airlines) was absorbing the cost of APD itself, but had indicated it would not be able to continue to do so in future. The Government was persuaded by the arguments and, in October 2011, reduced the rate of APD on the Belfast to Newark route. In the Finance Act 2012, the Government went further, devolving the power to set APD on direct long-haul flights to the Northern Ireland Assembly. The Assembly subsequently abolished the tax entirely on direct long-haul flights, but paid for the loss of that APD by a cut in the block grant. Although, United Airlines has since announced the closure of the Belfast International to New York Newark service, in 2017 other companies will be operating services to Orlando, Las Vegas, Cancun and Varadero out of Belfast International.

121 Q184 (Graham Keddie, Belfast International Airport)

122 HM Revenue & Customs, 'Tax & Duty bulletins', accessed 8 August 2016, and Air Connectivity in Northern Ireland: The economic impact of changes to air fares and short-haul Air Passenger Duty, University of Ulster, December 2014, Para 141

123 Q387 (Jane Ellison MP, Financial Secretary to the Treasury)

124 Q387 (Mike Cunningham, HM Treasury)

125 2nd Report - Air Passenger Duty: Implications for Northern Ireland, 2010–12, Northern Ireland Affairs Committee, para 27

103. Despite this success, the Committee remained concerned that APD was having a negative effect on the Northern Ireland economy. Its second inquiry considered the broader issue of 'An air transport strategy for Northern Ireland' and in its Report, published in November 2013, the Committee again recommended that HM Treasury and the Northern Ireland Executive explore ways to reduce or, preferably, abolish APD on all flights into NI from GB and, crucially, on all direct flights from Northern Ireland to any destination.[126] However, the Government's response to the Report made clear it had no further plans to reform APD:

> APD makes an essential contribution towards helping the Government meet its deficit reduction plans. Any further devolution of APD to NI, as a means to achieve a reduction in rates, would need to be funded by the Northern Ireland Executive, in order to protect the public finances and also to comply with EU State Aid rules. It would not be possible under EU law to have different rates of APD on intra-UK flights from GB to NI than on flights from UK to other EU destinations.[127]

104. As is the case with EU VAT legislation, while it is true that EU State Aid rules will continue to apply while the UK remains a member of the EU, they will not apply once the UK leaves. In such circumstances, the Government could, if it wished, provide funding for a reduction in APD in Northern Ireland or implement different rates of APD on intra-UK flights from Great Britain to Northern Ireland than on flights from the UK to other EU destinations.

105. We were keen to examine whether, three years on, APD continued to have a negative impact on the Northern Ireland economy and, in the context of our current inquiry, the tourism industry.

The impact of APD on the airline industry

106. The airline industry has long campaigned for reform of APD in Northern Ireland. Many argue that APD is a socially regressive tax that has an especially negative impact on the people of Northern Ireland, for whom air travel is a necessity.[128]

107. Industry leaders told us APD had been especially damaging in the context of the emerging dominance of Dublin Airport. The Irish Government abolished its Air Travel Tax entirely in April 2014 and, since then, passenger numbers have increased by at least 25 per cent. This compares with a 13.7 per cent increase in passenger numbers in NI airports over the same period. Dublin Airport now attracts over 27 million passengers a year, in comparison to just under 7.9 million air passengers into Northern Ireland. The dominance of Dublin Airport is likely to be further entrenched, given the recent decision by the Irish Government to build a second runway.

108. While both the Chief Executive of Belfast City Airport and the Managing Director of Belfast International Airport conceded that neither airport would ever be as large as Dublin Airport, they told us it was nevertheless clear that Northern Ireland was

126 1st Report - An air transport strategy for Northern Ireland, 2012–13, Northern Ireland Affairs Committee, para 48

127 2nd Special Report - An air transport strategy for Northern Ireland: Government Response to the Committee's First Report of Session 2012–13, Northern Ireland Affairs Committee, pages 3–4

128 For example, Q184 (Doreen McKenzie, ABTA - The Travel Association)

underperforming.[129] Although APD was not the only reason for this underperformance, it was a significant factor, which made it difficult for Belfast and Londonderry to compete with other European cities—and especially Dublin—when seeking to attract airlines into Northern Ireland.[130]

109. With a population approximately a third of that of the Republic of Ireland, industry leaders told us it could reasonably be assumed that Northern Ireland's airports should be able to support an equivalent proportion of the flights available in Dublin.[131] However, this was not proving to be the case in practice. For example, we were told that Dublin had over 130 flights a week to Germany, the largest outbound market in the world, but that Northern Ireland had no flights at all, although Ryanair have since announced a new route to Berlin, with flights three times a week.[132]

110. A number of airlines cited APD as a barrier to growth in Northern Ireland. The Managing Director of Belfast International Airport told us Ryanair would be willing to introduce more routes, but that APD prevented the company from doing so.[133] We were also told EasyJet would be willing to add more capacity and take greater risks with new routes if APD were abolished.[134] City of Derry Airport told us, "every airline we speak to says routes are not viable because of APD".[135] Brussels Airlines has also recently announced the closure of its route between Belfast City and Brussels.

111. An inability to obtain sufficient new routes has left Northern Ireland poorly connected to mainland Europe. This lack of connectivity has led to a situation where more than two million passengers a year, either bound to or from Northern Ireland, travel through Dublin Airport.[136] The costs of this are felt not just by Northern Ireland's airports, but in the wider economy, and especially within the tourism industry, where there will have been missed opportunities for hotels, restaurants and transport companies. The airline industry estimated that, were those two million passengers able to fly directly to and from Northern Ireland, this would lead to an additional 2,000 jobs in the wider economy, many of which would be in the tourism industry.[137]

112. **Air Passenger Duty is clearly a material factor in the comparative underperformance of Northern Ireland's airline industry. There is compelling evidence that Northern Ireland's tourism industry is missing out on significant levels of business and jobs because the region's airports find it increasingly difficult to obtain crucial new routes. With two million passengers a year travelling to Northern Ireland via Dublin Airport, the UK's aviation tax regime places Northern Ireland at a significant competitive disadvantage.**

129 Q187 (Brian Ambrose, Belfast City Airport)
130 Q187 (Brian Ambrose, Belfast City Airport)
131 Q187 (Brian Ambrose, Belfast City Airport)
132 Q185 (Graham Keddie, Belfast International Airport) and 'Ryanair announce seven new Belfast routes including Berlin and Milan', Belfast Telegraph, 29 February 2016
133 Q199 (Graham Keddie, Belfast International Airport)
134 Q200 (Graham Keddie, Belfast International Airport)
135 Q191 (Clive Coleman, City of Derry Airport)
136 Q184 (Graham Keddie, Belfast International Airport)
137 Q184 (Graham Keddie, Belfast International Airport)

NI Executive reluctance to abolish APD

113. In 2014, the Northern Ireland Executive published a report commissioned from the Northern Ireland Centre for Economic Policy (NICEP), based at Ulster University, on the impact on the economy of air passenger pricing, including short-haul APD.[138] The report concluded that, when reductions to the block grant were factored in, the benefits of reducing or abolishing APD were marginal, and that a strong case for abolishing APD in Northern Ireland had not been made.[139]

114. The NICEP report has been used by the Executive to justify its reluctance to request the full devolution of APD from the Government and fund its abolition. However, the report has been heavily criticised by the industry. The Managing Director of Belfast International Airport argued that, when the Executive commissioned the report, "… it was a case of 'the answer is no. Now put the report around it'".[140] The Chief Executive of Belfast City Airport accused NICEP of not engaging with the industry, especially with regard to some of the core assumptions underlying their analysis.[141] City of Derry Airport told us the NICEP analysis seemed to select the worst case scenario for each potential economic impact, for example, that only 400 jobs would be created for every additional million passengers, whereas industry estimates range from 750 to 1,000 jobs per million passengers.[142] However, the Department of Finance disputed the assertion that NICEP had not sought industry input into the research and stood by the reliability of the report.[143]

115. ABTA—The Travel Association, outlined what it saw as a number of errors in the NICEP report.[144] In particular, ABTA highlighted an assumption made in the report on the estimated expenditure by NI residents on outbound holidays. NICEP estimated it to be just a quarter of what ABTA and the Centre for Economic and Business Research (CEBR) believed it should be, despite using ABTA and CEBR estimates at other points in the report. ABTA explained that this assumption was integral to the NICEP analysis and, if proven to be inaccurate, could have much wider implications for the report's overall conclusions.

116. The airline executives and ABTA all agreed that the Executive should look again at this issue. The Chief Executive of Belfast City Airport called on it to use the NICEP report and modelling as a framework, but improve its analysis by engaging with the industry to address what he saw as erroneous assumptions about how airlines would respond to the removal of APD. Belfast City Airport suggested that, with better informed and more aggressive assumptions, the NICEP methodology would validate the industry's view that abolishing APD would have a significant net benefit for the economy.[145]

117. However, other witnesses questioned even the methodology of the NICEP report. Belfast International commissioned consultants Mott MacDonald to carry out a critique of the NICEP report, and concluded that there were calculation errors, outdated data and

138 Air Connectivity in Northern Ireland: The economic impact of changes to air fares and short-haul Air Passenger Duty, University of Ulster, December 2014
139 Air Connectivity in Northern Ireland: The economic impact of changes to air fares and short-haul Air Passenger Duty, University of Ulster, December 2014, page 65
140 Q195 (Graham Keddie, Belfast International Airport)
141 Q195 (Brian Ambrose, Belfast City Airport)
142 Q196 (Clive Coleman, City of Derry Airport)
143 Q341 (Tony Simpson, Department of Finance)
144 ABTA - The Travel Association, written evidence
145 Q190 (Brian Ambrose, Belfast City Airport)

unreasonable, unexplained and unsupported assumptions within the report.[146] ABTA also called into question the methodology of crucial aspects of the NICEP report, and recommended that it be recommissioned, using an independent research source and with closer cooperation with the industry.[147]

118. It was noted by our witnesses that the Scottish Government had committed to reducing APD by 50 per cent from 2018 with a view to abolishing it completely when finances allowed. This contrasted with the much more conservative approach of the Northern Ireland Executive, which the Managing Director of Belfast International Airport accused of "bottling it", due to its unwillingness to support the airline industry in order to encourage growth in the wider economy.[148] ABTA highlighted that in the event of an APD reduction in Scotland, Northern Ireland's airports would then be facing competition not only from the Republic of Ireland, but across the Irish Sea, and called for any potential reduction or abolition in Scotland to be matched elsewhere in the UK so that no part of the country was disadvantaged.[149]

119. The former Finance Minister, Mervyn Storey MLA, told us he was concerned that abolishing APD was not an effective way to boost the tourism industry in Northern Ireland:

> […] what I do not want to have is a sun subsidy. I think that we need to ensure, whatever it is we would do, it is clearly focused and clearly directed towards those strategic economic groups that will be to the benefit of our economy. I am not interested in having a situation whereby we are giving a subsidy to people to go on holidays and take their money out of Northern Ireland.[150]

However, the Chief Executive of Belfast City Airport told us that, while he would like to obtain additional 'sun routes', his aspiration was to develop a network of 10 European cities that have invested in Northern Ireland, or have a large inbound tourism potential, and would benefit from enhanced connectivity.[151]

120. ***It is clear that the analysis of the costs and benefits of abolishing Air Passenger Duty in Northern Ireland commissioned by the Northern Ireland Executive does not command the support of the air travel industry. The Government and the Northern Ireland Executive should re-examine the economic case for abolishing APD on flights to and from Northern Ireland, liaising fully with the air travel industry to ensure that economic assumptions are accurate, and reflect the reality of the growing dominance of Dublin Airport on the island of Ireland.***

121. ***In the last Parliament, our predecessor Committee recommended that HM Treasury and the Northern Ireland Executive explore ways to reduce or, preferably, abolish APD on all flights into Northern Ireland from Great Britain and on all direct flights from Northern Ireland to any destination. At the time, the Committee was told that EU rules prohibited the Government from implementing such changes. However,***

146 Airport calls on Ministers to re-think APD, Belfast International Airport, 22 April 2015
147 ABTA - The Travel Association, written evidence
148 Q212 (Graham Keddie, Belfast International Airport)
149 Q184 (Doreen McKenzie, ABTA - The Travel Association)
150 Q341 (Mervyn Storey MLA, Minister for Finance)
151 Q200 (Brian Ambrose, Belfast City Airport)

in light of the decision of the UK to leave the EU, we urge the Government to reconsider our predecessor Committee's recommendation, which we believe will greatly improve connectivity for Northern Ireland.

122. **We disagree with the suggestion that reducing or abolishing APD would amount to a 'sun subsidy' that would be to the detriment of the Northern Ireland economy. We believe that abolishing APD on all flights would encourage airlines to bring new routes into Northern Ireland, connecting the region with key business and tourism markets, both outbound and inbound, bringing substantial benefits to the region's economy. The Executive should seek the full devolution of APD, and follow the Scottish Government's example by recognising the potential benefits of reducing or, preferably, abolishing APD.**

An air route development fund

123. One area of agreement between the airline industry and the Northern Ireland Executive was that an air route development fund would be an effective way to target tourism markets in order to attract visitors into Northern Ireland. Belfast City Airport told us this should be a short-term priority for the Executive, and could help Northern Ireland's airports to make immediate gains while waiting for APD to be devolved and abolished.[152]

124. In June 2013, the Government announced a new Regional Air Connectivity Fund, open to airports with fewer than 5 million passengers per year. It provided £56 million to cover three years of financial support for 'start-up aid' on new routes. The fund will support two routes in Northern Ireland: one from Carlisle to Belfast City Airport, and another from City of Derry Airport to Dublin.[153] However, all of Northern Ireland's airports told us the fund had "delivered next to nothing" for Northern Ireland because the sums available were not sufficient to cover the losses airlines could expect to make on a new route.[154]

125. The airport executives told us a Northern Ireland-specific fund would be more successful. A similar fund existed in the early 2000s, which provided approximately £4 million a year to support 10 new routes. Belfast International Airport said that a similar level of commitment from the Executive would be required for any new air route development fund, if it were to be effective.[155] We were told that progress in establishing such a fund had been slow, with only limited dialogue on the issue between the Department for the Economy and the industry.[156] The Chief Executive of Belfast City Airport emphasised that airlines were likely to make decisions on new routes for 2017 by the middle of 2016, so it was vital that a fund be set up as soon as possible. Without urgent movement from the Executive, Northern Ireland's airports would miss out on another opportunity to grow for a further year.[157]

126. We were pleased, therefore, when in March 2016, the NI Department for the Economy announced a new air route development fund, making available £4 million over

152 Q190 (Brian Ambrose, Belfast City Airport)
153 New regional air routes offer fast journeys across UK and Europe, Department for Transport, 2 December 2015
154 Q193 (Clive Coleman, City of Derry Airport)
155 Q204 (Graham Keddie, Belfast International Airport)
156 Q207 (Brian Ambrose, Belfast City Airport) and Q207 (Graham Keddie, Belfast International Airport)
157 Q207 (Brian Ambrose, Belfast City Airport)

the next three years to support the development of new routes into Northern Ireland. On announcing the fund, the Minister explained that funding would be provided through enhanced co-operative marketing and would be specifically for the development of un-served routes with a high potential for inbound tourism and business.[158]

127. **We welcome the Department for the Economy's announcement of a new £4 million air route development fund, which we believe has the potential to help the region's airports bring vital new routes into Northern Ireland and will greatly benefit the region's tourism industry. We urge the Northern Ireland Executive to implement the fund as soon as possible. In particular, we hope that the City of Derry Airport, the smallest of Northern Ireland's main airports, will benefit from this fund and improve its connectivity.**

158 Bell announces £4million for air route development, Department for the Economy, 25 March 2016

Conclusions and recommendations

Introduction

1. With world class tourist attractions including the Giant's Causeway and Titanic Belfast, forthcoming international sporting events such as the 2019 Open Championship, and emerging screen tourism opportunities, Northern Ireland's tourism industry can be optimistic. The sector is now reaping the rewards of its hard work over the last 20 years, with record numbers of visitors and a challenging ambition to be a £1 billion industry by 2020. We believe that, with support from the UK Government and the Northern Ireland Executive, there is scope for even greater success. However, Northern Ireland's tourism industry finds itself at a competitive disadvantage because competitors in the Republic of Ireland benefit from significant tax and other advantages. Unaddressed, this imbalance has the potential to inhibit growth within the region's tourism industry. (Paragraph 9)

Northern Ireland's unique position

2. Northern Ireland is the only part of the UK to share a land border with a foreign country, one in which the tourism industry benefits from substantial tax breaks. The lack of a level playing field for Northern Ireland's tourism industry, especially given that tourism is promoted on an all-Ireland basis, means that its hotels and restaurants, particularly in border areas, are at a significant competitive disadvantage. They have the difficult choice of losing out on business for being too expensive, or competing on price with the Republic, but in doing so, damaging Northern Ireland's tourism offer in the longer term by limiting its capacity to invest and create jobs. We believe the unique pressures Northern Ireland's tourism industry faces should have a stronger bearing on policy formation by the UK Government with respect to the effects of taxation on the sector. (Paragraph 38)

Value Added Tax

3. The UK's decision to leave the European Union changed the scope of the debate around the implementation of a lower rate of tourism VAT in Northern Ireland. Prior to the referendum, EU VAT legislation prohibited the implementation of regional rates of tourism VAT, with a legal requirement to apply any reduction across the UK. These rules will continue to apply until the UK leaves the EU. (Paragraph 49)

4. However, once the UK has left the EU, the Government is likely to have substantially more freedom to implement variable VAT rates. Subject to the forthcoming negotiations with the EU, this potentially opens the door to the implementation of a lower rate of tourism VAT in Northern Ireland, without necessitating a more expensive reduction in other parts of the country which do not share the same competitive pressures. (Paragraph 50)

5. *We believe as a matter of principle that the UK Government should have the power to implement regional variations in tourism VAT.* (Paragraph 51)

6. Despite HM Treasury's view to the contrary, we have seen considerable evidence from industry experts and respected academics that the Republic of Ireland's decision to reduce its rate of VAT on tourism in 2011 brought substantial economic benefits to its tourism industry and the wider economy. (Paragraph 63)

7. Much of our evidence was received prior to the UK's decision to leave the European Union, in the context of needing to make a UK-wide decision as to whether to reduce VAT for the tourism and hospitality industries. However, the UK's departure from the EU enables the Government to consider this issue from the perspective of Northern Ireland alone. (Paragraph 82)

8. Using figures provided by the former Finance Minister, Mervyn Storey in January 2016, we estimate that a reduction in tourism VAT from 20 per cent to 9 per cent in Northern Ireland—matching the rate in the Republic of Ireland—would incur a direct cost of approximately £70 million per year. However, this figure does not reflect the indirect benefits likely to arise from a reduced VAT rate, such as increased tourist expenditure, higher corporation tax receipts and lower unemployment. In Northern Ireland, where competitive pressures in the industry are far more pronounced than in the rest of the UK, the indirect benefits could be sizeable. (Paragraph 83)

9. Unfortunately, there is no consensus between industry and government on the true cost or benefit of reducing tourism VAT across the UK. Industry groups are accused of using out of date figures and making unverifiable assumptions, while the Treasury is criticised for focusing too closely on the direct tax cost, and placing insufficient emphasis on the indirect benefits. (Paragraph 84)

10. *It is clear further analysis is required from the Government, Executive and tourism industry to build greater consensus around the true cost, or benefit, to the Exchequer of reducing tourism VAT.* (Paragraph 85)

11. It is concerning that the Treasury's main justifications for maintaining the status quo ignore the realities of the cross-border competition that exists on the island of Ireland. The UK's tourism industry may be generally well-placed internationally, but it is clear that the tourism industry in the Republic of Ireland continues to enjoy a significant competitive advantage over the tourism industry in Northern Ireland arising from the tax system. The Government has recognised the problem caused to Northern Ireland by the lower rate of Corporation Tax in the Republic, but seemingly not the loss of revenue to the tourism industry. (Paragraph 92)

12. We believe the Treasury should be far more transparent with the tourism industry and the Northern Ireland Executive in terms of the assumptions and methodology which underpin its economic modelling in respect of the potential effects of a reduction in tourism VAT. We are encouraged, therefore, that the Treasury is now willing to take further evidence from industry groups and meet with representatives to talk about this issue in greater detail. (Paragraph 97)

13. *The Government should look constructively at a different rate of VAT on tourism in Northern Ireland. The Treasury should work with the tourism industry and the Northern Ireland Executive to estimate the costs and benefits of a reduction in tourism VAT in Northern Ireland, to the standard required by the Office for Budget Responsibility, to determine conclusively whether or not there is a strong economic*

case for a VAT reduction in the Province. We would invite HM Treasury to provide regular updates to the Committee on these discussions throughout the lifetime of this Parliament. (Paragraph 98)

Air Connectivity

14. Air Passenger Duty is clearly a material factor in the comparative underperformance of Northern Ireland's airline industry. There is compelling evidence that Northern Ireland's tourism industry is missing out on significant levels of business and jobs because the region's airports find it increasingly difficult to obtain crucial new routes. With two million passengers a year travelling to Northern Ireland via Dublin Airport, the UK's aviation tax regime places Northern Ireland at a significant competitive disadvantage. (Paragraph 112)

15. *It is clear that the analysis of the costs and benefits of abolishing Air Passenger Duty in Northern Ireland commissioned by the Northern Ireland Executive does not command the support of the air travel industry. The Government and the Northern Ireland Executive should re-examine the economic case for abolishing APD on flights to and from Northern Ireland, liaising fully with the air travel industry to ensure that economic assumptions are accurate, and reflect the reality of the growing dominance of Dublin Airport on the island of Ireland.* (Paragraph 120)

16. *In the last Parliament, our predecessor Committee recommended that HM Treasury and the Northern Ireland Executive explore ways to reduce or, preferably, abolish APD on all flights into Northern Ireland from Great Britain and on all direct flights from Northern Ireland to any destination. At the time, the Committee was told that EU rules prohibited the Government from implementing such changes. However, in light of the decision of the UK to leave the EU, we urge the Government to reconsider our predecessor Committee's recommendation, which we believe will greatly improve connectivity for Northern Ireland.* (Paragraph 121)

17. We disagree with the suggestion that reducing or abolishing APD would amount to a 'sun subsidy' that would be to the detriment of the Northern Ireland economy. We believe that abolishing APD on all flights would encourage airlines to bring new routes into Northern Ireland, connecting the region with key business and tourism markets, both outbound and inbound, bringing substantial benefits to the region's economy. The Executive should seek the full devolution of APD, and follow the Scottish Government's example by recognising the potential benefits of reducing or, preferably, abolishing APD. (Paragraph 122)

18. We welcome the Department for the Economy's announcement of a new £4 million air route development fund, which we believe has the potential to help the region's airports bring vital new routes into Northern Ireland and will greatly benefit the region's tourism industry. We urge the Northern Ireland Executive to implement the fund as soon as possible. In particular, we hope that the City of Derry Airport, the smallest of Northern Ireland's main airports, will benefit from this fund and improve its connectivity. (Paragraph 127)

Appendix 1: Rates of VAT in the Tourism Sector in EU Countries

	Standard rate	Hotel Accommoda-tion	Admissions to Cultural Services	Admissions to Amusement Parks	Restaurants
Belgium	21	6	Ex, 6	6	12[159]
Bulgaria	20	9	20	20	20
Czech Republic	21	15	15	15	21
Denmark	25	25	25	25	25
Germany	19	7	Ex, 7	19	19
Estonia	20	9	20	20	20
Greece	23	6.5	13, 6[160]	13	23
Spain	21	10	21[161]	21	10
France	20	10	5.5 , 20	10[162], 20	10[163]
Croatia	25	13	5, 13[164], 25[165]	25	13
Ireland	23	9	Ex, 9	9	9[166], Ex[167]
Italy	22	10	10	22	10
Cyprus	19	9	Ex, 5	5	9
Latvia	21	12	Ex, 21[168]	21	21
Lithuania	21	9	Ex[169], 21	21	21
Luxembourg	17	3	3	3	3
Hungary	27	18	27	27	27
Malta	18	7	5	18	18
Netherlands	21	6	6	6	6[170]
Austria	20	10	Ex, 10	10	10[171]
Poland	23	8	8	8	8[172]
Portugal	23	6	Ex, 13	23	23
Romania	24	9	9	9	24
Slovenia	22	9.5	9.5	9.5	22, 9.5[173]
Slovakia	20	20	20, Ex	20	20
Finland	24	10	10	10	14
Sweden	25	12	6	25	12
UK	**20**	**20**	**20**	**20**	**20**

Source: Campaign to Cut Tourism VAT

159 All beverages are excluded
160 Only for the theatre
161 Supplied by bodies governed by public law or by other organisations recognised as charitable by the Member State concerned
162 Amusement parks which do not illustrate any cultural issue are liable to the standard rate of 20 per cent
163 Alcoholic beverages are subject to the standard rate
164 Admissions to cinema
165 Admissions to concerts
166 All beverages are excluded
167 Catering services supplied to patients in a hospital or students at their school
168 Admissions to cinema
169 Supplied by non-profit making legal entities
170 Alcoholic beverages are subject to the standard rate
171 10 per cent on food, 10 per cent on milk and chocolate, 20 per cent on coffee, tea and other beverages
172 Alcoholic beverages are subject to the standard rate
173 VAT rate of 8.5 per cent applies to the preparation of meals

Formal Minutes

Wednesday 15 March 2017

Members present:

Kate Hoey, in the Chair

Tom Blenkinsop
Mr Gregory Campbell
Lady Hermon
Danny Kinahan
Dr Alasdair McDonnell
Nigel Mills
Jim Shannon

Draft Report (*Promoting the tourism industry in Northern Ireland through the tax system*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 127 read and agreed to.

Summary agreed to.

Appendix agreed to.

Resolved, That the Report be the Second Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 29 March 2017 at 9.15 am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Wednesday 25 November 2015

Question number

Professor Adam Blake, Economist, **David Bridgford**, Campaign Ambassador, and **Graham Wason**, Economic Advisor, Campaign to Cut Tourism VAT — Q1–87

Wednesday 2 December 2015

Janice Gault, Chief Executive, Northern Ireland Hotels Federation, and **Ufi Ibrahim**, Chief Executive, British Hospitality Association — Q88–139

David Wilson, Director of Public Affairs, British Beer and Pub Association, and **Colin Neill,** Chief Executive, Hospitality Ulster — Q140–183

Wednesday 13 January 2016

Brian Ambrose, Chief Executive, Belfast City Airport, **Clive Coleman**, Contracts Director, Regional and City Airports, **Graham Keddie**, Managing Director, Belfast International Airport and **Doreen McKenzie**, Board Member, ABTA – The Travel Association — Q184–284

Thursday 21 January 2016

Niall Gibbons, Chief Executive, Tourism Ireland, and **John McGrillen**, Chief Executive, Tourism NI — Q285–312

Stephen McNally, President, Irish Hotels Federation — Q313–336

Mervyn Storey MLA, Minister for Finance and Personnel, Northern Ireland Executive, **Lorraine Fleming**, Head of Tourism Policy, Department of Enterprise, Trade and Investment, and **Tony Simpson**, Strategic Policy Director, Department of Finance and Personnel — Q337–353

Wednesday 18 January 2017

Jane Ellison MP, Financial Secretary to the Treasury, **Mike Cunningham**, Deputy Director, VAT and Excise and **David Willis**, Deputy Director, Devolution, HM Treasury — Q354–414

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

TAX numbers are generated by the evidence processing system and so may not be complete.

1 ABTA – The Travel Association (TAX0009)

2 ABTA – The Travel Association (TAX0017)

3 British Beer and Pub Association (TAX0003)

4 British Hospitality Association (TAX0004)

5 Campaign To Cut Tourism VAT (TAX0001)

6 Department of Enterprise, Trade and Investment (TAX0019)

7 Department of Finance and Personnel (TAX0012)

8 Fermanagh and Omagh District Council (TAX0008)

9 Fermanagh Lakeland Tourism (TAX0010)

10 HM Treasury (TAX0014)

11 Hospitality Ulster (TAX0005)

12 Mr Christopher Luke (TAX0016)

13 Mrs Catherine Keaney (TAX0002)

14 National Trust (TAX0011)

15 Northern Ireland Hotels Federation (TAX0006)

16 Tourism Ireland (TAX0013)

17 Visit Derry (TAX0018)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website.

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2016–17

First Report	Northern Ireland and the EU referendum	HC 48
First Special Report	Northern Ireland and the EU Referendum: Government Response to the Committee's First Report	HC 924

Session 2015–16

First Special Report	Northern Ireland Affairs – First Special Report Northern Ireland: banking on recovery?	HC 344
Second Special Report	Northern Ireland Affairs – Second Special Report The administrative scheme for "on-the-runs"	HC 345