REDUCE **VAT** ON ON-TRADE **ALCOHOL**

Support the recovery of thousands of enterprises and tens of thousands of jobs in Ireland by **temporarily applying the hospitality rate of VAT to the on-trade serving of alcohol**

Commissioned by
The Licensed Vintners Association (LVA), Vintners Federation of Ireland (VFI) and Ibec representative group Drinks Ireland

Authored by
Anthony Foley - DCU Economist

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INTRODUCTION

While Covid-19 has had an enormous effect on every part of the Irish economy, the drinks and hospitality sector has been uniquely affected. Drinks and hospitality businesses were among the first to close; many will be among the last to reopen on 20 July.

The vast majority of drinks and hospitality businesses in Ireland are small, family-owned businesses. They have been closed for almost four months, many will be closed for longer. As they prepare to reopen, the costs are significant. The combined cost of social distancing regulations, new overheads (like PPE and Perspex screens), reduced capacity with time-limited customer visits, together with already high consumption taxes like VAT and excise will make reopening these businesses in the present market commercially very challenging.

The current outlook is grave. Even if pubs regain half their usual capacity by year's end, which is an optimistic scenario, as many as 22,500 jobs could be permanently lost, not to mention countless more in supporting trades like catering, security, and entertainment.

It is a fallacy to presume that businesses that do close as a result of the Covid-19 recession will simply reopen in a different form next year. The impact of mass closures will be long lasting, especially in regional parts of the country. Indeed, the impact of this is more than economic; it is socially and culturally significant. The loss of a pub is the loss of a community centre. This has been very evident and apparent over the course of the past four months – pubs closed and local communities lost a part of their culture, heritage and their social hub, not to mention the loss to their local economy.

Faced with such a large-scale crisis, the Licensed Vintners Association, Vintners Federation of Ireland, and the Ibec representative group Drinks Ireland is calling for a **temporary reduction in the hospitality VAT rate and extending it to apply to sales of alcohol in the on-trade (pubs and bars) until 31 December 2020.**

Crucially, the new Government has the power to do this. European Commission directive (2009/47/EC) makes it possible for a member state to apply a lower VAT rate on on-trade alcohol with immediate effect, a fact unknown to many of Ireland's government decision-makers.

In Spain and Italy, VAT on on-trade alcohol has long been set at the hospitality rate. In Cyprus, in response to Covid 19, the VAT rate on services has been reduced from 9% to 5% from June to January 2021, which includes alcohol sold in the on-trade. Similar measures are being considered in the UK.

A VAT reduction would substantially increase the business confidence of Ireland's publicans and bar owners. It would improve the current difficult business model by providing a much-needed cash float and lead to long-term survival rates, including the continued employment of existing staff without the need to pay Covid-19 benefits.

We look forward to discussing this proposal in detail with our new Government this week.

D. O' Keeffe
Donall O'Keeffe
CEO
Licensed Vintners Association

Padraig Cribben
Chief Executive
Vintners Federation of Ireland

Patricia Callan
Patricia Callan
Director
Drinks Ireland

EXECUTIVE SUMMARY

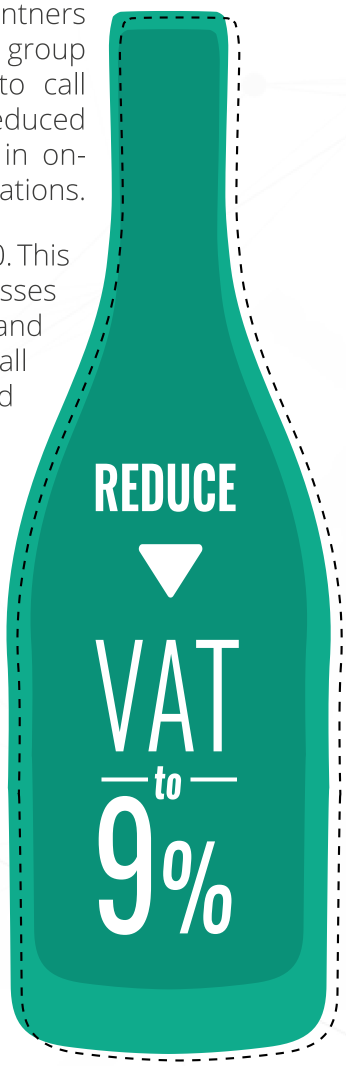
- We propose a **temporary reduction in the hospitality VAT rate to 9%; and extending it to apply to alcohol sales in the on-trade (pubs and bars), until 31 December 2020.**
- This is a **temporary measure for the August to December period** to support the short-term severe business circumstances and constraints of the on-licensed sector related primarily to Covid-19 and, to a lesser extent, the recession.
- Reduced VAT rates have been used, and are being used, extensively in Ireland and in the EU to support specific employment-intensive sectors such as hospitality.
- **EU legislation allows a reduced rate of VAT** for on-licensed alcohol.
- Some EU members have made use of a reduced VAT rate for on-licence consumption including Italy, Spain and Cyprus - to support businesses in these significant tourism economies.
- This recommendation is made as a supply-side measure. It is intended to help the public house business model, which has been severely damaged by the Covid-19 related physical distancing and cost increasing requirements. The "old viable business model" is not currently possible. In effect, the revenue generating capacity of a physical space has been dramatically reduced.
- The **cost of the temporary VAT reduction to 9% for on-licence serving of alcohol until end 2020 will be €143 million** on the assumption of the on-licence market for August to December reaching 50% of its "usual" level.
- The expectation is that the **lower VAT rate will substantially increase the business confidence of publicans, generate much higher survival and revival rates, and enable an improved business model** that will drive the sector to increase supply capacity and thereby win back more of the "lost" market.
- Why should policymakers care about pubs? After all, alcohol can be sourced from supermarkets and independent off-licences. **There are many economic and social reasons:**
    - Public houses and other bars generate almost 50,000 jobs.
    - Public houses and other on-licensed enterprises are very employment intensive compared to off-licence retailers of alcohol.
    - It is a flexible labour market that serves a variety of different employment demands.
    - Pubs generate much more VAT revenue than off-licences from the same amount of alcohol. While excise receipts are the same between on and off-licences, a unit of alcohol sold in a pub generates more VAT than the same one sold in an off-licence because of the higher (service-related) price in pubs. A weak pub sector costs the Exchequer money.
    - The low-priced alcohol available in multiple off-licences is not a feature of pubs and other bars.
    - Pubs help social interaction and provide a place to meet.
    - Pubs support the international and domestic tourism product by both the widespread physical infrastructure and their hospitality.
    - Pubs support music and entertainment.
    - Pubs support domestically produced alcohol, such as beer, to a greater extent than off-licences.
    - Consumption of alcohol in pubs takes place in a more managed and controlled environment

1 Temporarily reduce hospitality VAT rate and extend it to apply to sales of alcohol in the on-trade

The Licensed Vintners Association, the Vintners Federation of Ireland and Ibec representative group Drinks Ireland have convened as a group to call on Government to immediately apply a reduced hospitality VAT rate of 9% to alcohol served in on-licensed premises as permitted in EU VAT regulations.

This lower rate should apply until the end of 2020. This will support the survival of on-licensed businesses such as public houses, licensed restaurants, and licensed hotels. It can save thousands of small enterprises and tens of thousands of jobs and can promote the eventual reclaiming of the sector's substantial economic, regional and employment contributions.

The sector is being hit from all sides. This proposal is necessary to support the much-weakened commercial model of drinks enterprises, a result of Covid, and to ameliorate the severe shock to the supply side of the sector. It is relatively easily implemented with minimum administrative requirements.



2 The alcohol tax wedge: a big burden on the on-licensed sector

The on-licensed sector is primarily a small-enterprise sector; despite this, the tax wedge on on-licensed alcohol sales revenue is very large. A substantial portion of the revenues received by alcohol on-retailers from customers is diverted to the Exchequer through excise and VAT. While VAT is borne by almost all sectors of the economy, very few activities have the additional indirect tax of excise.

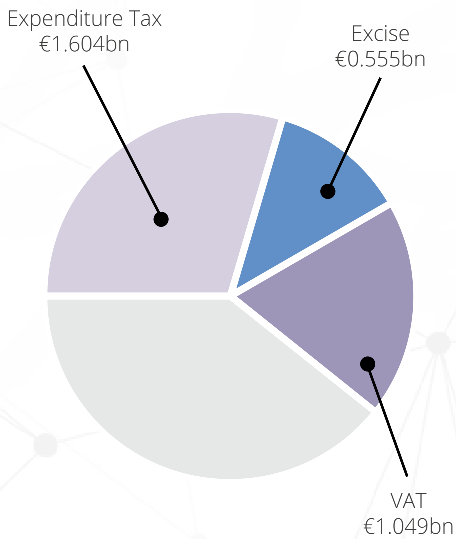
Personal expenditure on on-licence alcohol was €5.677 billion in 2019. Of this, €1.604 billion, or 28%, is expenditure tax. Excise is €0.555 billion, and VAT is €1.049 billion. Over one quarter of the alcohol revenues generated by the on-licensed sector, including public houses, licensed restaurants, and hotels, from customers, is taken by Government and diverted from customers, staff, entrepreneurs and investment.

This, of course, excludes income tax, USC, employer and employee PRSI, profits tax, and other state-determined fees such as licences and commercial rates. This very large tax burden is not justifiable in the emergency national and sectoral economic situation caused by Covid-19.

All enterprises must adjust to the new reality, and the Exchequer should adjust its tax expectations accordingly.

The Irish on-licensed alcohol tax burden should be seen in the context of the current very high levels of Irish alcohol excise compared to other EU economies. Ireland has the highest wine excise of the EU27 and UK. Ireland has the second-highest beer excise and the third-highest spirits excise.

On the composite indicator (unweighted average of the three individual rates for wine, spirits, and beer), Ireland has the second-highest average aggregate alcohol excise of the 27 EU members and UK, behind only Finland. Only eleven of 28 European have a composite rate of more than €1,000 per hectolitres of pure alcohol (HLPA). Only four countries have a composite rate of more than €2,000 per HLPA and only three, including Ireland, have a rate of more than €3,000. Seven countries have a composite rate of lower than €500.



2019 PERSONAL EXPENDITURE ON ON-LICENCE ALCOHOL

3 Covid-19 aggregate demand and aggregate supply impact and policy measures

Economic performance is determined by both supply and demand factors. Most discussion on stimulating the economy in the post-lockdown period has been on aggregate demand. The usual dominant issue in a recession is a lack of aggregate demand. The aggregate supply capacity may be sufficient to employ the workforce but concerns about inadequate demand results in a failure to utilise the capacity.

The appropriate macroeconomic policy response is to stimulate aggregate demand by various fiscal (lower taxes and increased public expenditure) and monetary policy measures. If aggregate supply (or a specific sectoral supply) cannot respond to the increase in aggregate demand, because of public health-related capacity constraints, there is no point in stimulating the economy (or the sector) through boosting aggregate demand.

The capacity of significant elements in the drinks and hospitality sector is undoubtedly constrained relative to the pre-Covid position because of public health measures and social distancing requirements. Consequently, it could be argued that there is little point in introducing measures to stimulate the sector through higher demand.

Historically, lower expenditure taxes such as VAT would be expected to lead to lower prices and would therefore stimulate demand. However, that is not the justification for the proposed lower VAT rate. Instead, the proposed reduction is to support the significantly worsened business and more costly model in the on-licensed sector. It is intended to work on the supply side of sectoral economic activity and to increase the possibility of trading commercially in the present terrible conditions.

The Covid-19-related social distancing and other regulations have caused a shift to the left in the short-run aggregate and sectoral supply curves. Social distancing significantly reduces the capacity of premises relative to the pre-Covid position even if there were no demand constraints. Enterprises must also finance increased virus-related operating costs. There has been a substantial negative impact on sectoral and aggregate supply due to the virus-related regulatory changes. This problem is not unique to the drinks and hospitality sector but the impact on this sector is relatively large.

The proposed VAT reductions would be a substantial cost reduction for drinks enterprises and would improve their supply position. This will assist the sector to operate in the survival and initial recovery phase and to start to re-establish its substantial pre-Covid economic contribution.

4 The EU VAT directives: Government has freedom to move

Regarding reduced rates of value added tax, the relevant EU directive 2009/47/EC of 5 May 2009, amending directive 2006/112/EC, states:

> *With respect to the supply of alcoholic and/or non-alcoholic beverages in the framework of restaurant and catering services, it may be justified to provide a different treatment of those beverages from the treatment provided for in the framework of the supply of foodstuffs; it is appropriate to provide explicitly that a Member State may include or exclude the supply of alcoholic and/or non-alcoholic beverages when applying a reduced rate to the supply of restaurant and catering services referred to in Annex III of Directive 2006/112/EC.*

Reduced rates of VAT for hospitality activities and other labour-intensive activities are long-established policy instruments in both Ireland and internationally to support economic activity. Never has the state faced such a massive sudden economic collapse with, as of end June, almost a million people on unemployment payments or wage subsidies.

The Government should grasp the opportunity to support the on-licensed sector efficiently and effectively by lowering the VAT on on-licensed serving of alcohol. Some EU members have made use of a reduced VAT rate for on-licence consumption including Italy, Spain and Cyprus.

5 The on-licensed sector in the immediate post-lockdown situation

Public houses and other bars and on-licences have been closed from March. A very small number of pubs have operated various forms of off-licence sales on a small scale. Off-licences have been open for business throughout the period and have enjoyed substantially increased sales. Manufacturers and distributors have continued to operate throughout the full period.

The overall alcohol market during the lockdown is characterised by no on-licence sales and greatly increased off-licence sales. The net overall market will probably decline during the lockdown. The great majority of enterprises have had to, or will have to, introduce cost increasing and capacity reducing Covid-related measures. Public houses and other bars and restaurants are particularly affected by capacity reducing public health measures.

A recent LVA/VFI report outlined the stark impact on capacity of operating under the current HSE social distancing guidelines. The report indicates that when the HSE social distancing guidelines are applied in any 100m² area in an on-licensed premises, standing capacity will diminish to 12.5%, while seating capacity is reduced to 34% of pre-crisis levels.

This has a substantial negative effect on revenue generation and raises questions of viability for very many licensed premises when operation is allowed. Even if there is sufficient demand at current prices to fill this reduced capacity, commercial operation may not be justified.

It is primarily for this reason that the LVA, VFI and Drinks Ireland proposes the radical step of a reduced VAT rate on on-trade alcohol to improve the post-Covid commercial model. The bar sector (pubs and other bars) of the drinks and hospitality sector directly employed almost 50,000 persons with thousands more employed providing inputs such as catering, cleaning, music, and security. The greatly worsened post-Covid commercial model puts these thousands of jobs and enterprises at permanent risk.

Less demanding health requirements would have a lower, but still substantial negative impact on capacity. Under the WHO provisions, standing capacity would drop from 200 people to 100 (50%), while seated capacity in pubs and bar/restaurants would decrease from 100 to 65 (65%). Failte Ireland research has also identified the constraints of the post-Covid operating regulations.

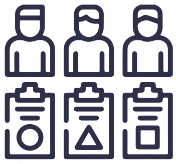
6 Why support the pubs and other on-licensed sectors?

Why should public houses be supported? If people do not drink in pubs and other off-licences, they will buy in off-licences and drink at home. The Government will collect the same excise revenue.

However, there are still very solid economic and social reasons to support public houses and to work to avoid the closure of many:

Public houses and other bars generate almost **50,000 jobs**.

Public houses and other on-licensed enterprises are very **employment intensive** compared to off-licence retailers of alcohol.



It is a **flexible labour market** that serves a variety of different employment demands.

Pubs generate much more VAT revenue than off-licences from the same amount of alcohol. While excise receipts are the same between on and off-licences, a unit of alcohol sold in a pub generates more VAT than the same one sold in an off-licence because of the higher (service-related) price in pubs. A weak pub sector costs the Exchequer money.

The **low-priced alcohol** available in multiple off-licences is **not a feature of pubs and other bars**.

Pubs help social interaction and provide a **place to meet**.

Pubs **support the international and domestic tourism** product by both the widespread physical infrastructure and their hospitality.

Pubs **support music**.

Pubs **support domestically produced alcohol**, such as beer, to a greater extent than off-licences.

Consumption of alcohol in pubs takes place in a **more managed environment**.

The economy-wide and on-licensed-related levels of consumer demand will be lower after lockdown due to the higher level of unemployment and reduced earnings. It will be probably 2023 before we reach pre-Covid labour market conditions again. Most bars will reopen on the reduced physical capacities and on-licence sales will increase.

In terms of employment impact and VAT sales revenue, the larger the on-licence resumption the better. The improved commercial model caused by the lower VAT rate will support the survival of pubs as they eventually move back towards pre-Covid operating criteria as the health restrictions are relaxed over time.

The alternative is many bars will never open again, and the pre-Covid employment and economic contributions will not be regained. Of course, if effective treatment is found and consumer confidence returns to pre-Covid levels, the business sector will be able to operate at previous capacity levels but will still have to cope with the weaker macro economy and lower level of consumer demand.

> “The alternative is many bars will never open again, and the pre-Covid employment and economic contributions will not be regained.”

The government report Economic Considerations for Reinstating Economic Activity (2020) concluded that the accommodation and food sector (including pubs and restaurants) had a high vulnerability to permanent damage or output loss. It reported: “Many businesses [in this sector] will not be able to operate effective social distancing and therefore will be unviable and remain closed”. We must attempt to ensure that enterprises and jobs are not permanently lost and that they will resume.

We must also avoid the expectation that if many pubs fail to survive the next few months other entrepreneurs and investors will seamlessly enter the industry and replace those that closed without fuss or delay. That will not be the case. Many will not be replaced. Some replacements will take a long time. A large sectoral skill and expertise, as well as entrepreneurial resource, will be lost, and the tourism product as well as social life will be negatively affected.

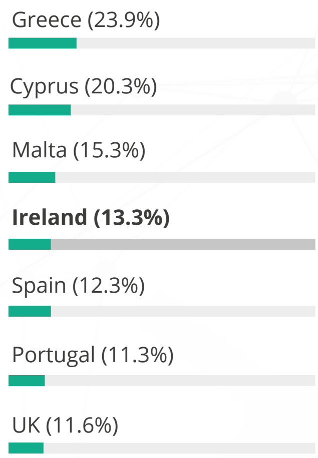
The difference between “no bars” and resumption of pre-Covid position is approximately 45,000 direct jobs when allowance is made for off-licence jobs lost to the increasing on-licence sector. Even if the on-licensed sector regained half its previous annual position, the permanent negative job impact is about 22,500.

* Eurostat Statistics Explained, 'Tourism industries-employment', 2019.

7 | Ireland has a high reliance on tourism employment by international standards

Ireland has a high reliance on tourism employment compared to other EU countries. Hospitality enterprises such as public houses, bars, and restaurants are a core element of the Irish tourism product.

Measured as share of employment in the non-financial business sector in 2016, Ireland's tourism sector share of 13.3% was fourth highest in the EU after Greece (23.9%), Cyprus (20.3%), and Malta (15.3%). Spain's tourism share of employment was 12.3% and Portugal's was 11.3%. The UK share was 11.6%. The EU average share was 9.4%.



8 | Thousands of enterprises in drinks-related activities

There are thousands of enterprises involved in the on-licensed drinks industry. These include public houses and other bars, off-licences, manufacturers, wholesalers, importers, licensed restaurants, and visitor centres. These then support manufacturers and distributors.

The Revenue Commissioners' alcohol licence data illustrates the large number of enterprises in the sector. An enterprise may have more than one licence.

As of 2018 there were:

93 brewing licences	**45** distilling licences	**17** cider manufacturing licences	**27** rectifier and compounding licences
964 dealer licences	**8142** publican and other bar licences	**2329** wine on licences (restaurants)	**476** special restaurant licences


ESTABLISHED
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VALLENCE & McGRATH
BAR
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PAY & DISPLAY
LOADING BAY
07.00-19.00
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9 Small enterprises dominate the drinks and hospitality sector

Of 19,205 enterprises in the hospitality (pubs, hotels, restaurants) sector 79.8% or 15,328 employ less than 10 persons. Only 44 enterprises employ 250 persons or more. 96.5% of hospitality enterprises employ less than 50 persons. The sector is dominated by small enterprises. This raises difficulties for the sector in surviving the effects of the lockdown.

The number and percentage of pubs and bars in each of the six licence net turnover bands published by Revenue are shown below. The data include both public houses and certain other bars. The very notable features are the small number with high levels of sales and the very large number with low levels of sales.

8.6% of pubs have average annual sales of €952.5k or higher. On the other hand, 49.5% of pubs or 3,923 enterprises, have annual sales of under €190.5k.

Pubs and bars in each turnover band for licensing 2018 (net sales)

Turnover band €k	Number of licences	% of licences
Under 190,500	3,923	49.5
190,500-380,999	1,862	23.5
381,000-634,999	881	11.1
635,000-952,499	499	6.3
952,500-1,269,999	291	3.7
1,270,000 or more	466	5.9
Total	**7,922**	**100**

Source: Revenue/Parliamentary question

10 Cost of the reduced VAT rate from August to December

There are major uncertainties about the path of the economy over the rest of the year, but there is reasonable certainty that the pubs and restaurants will face a very difficult time due to the space constraints and other virus-related issues, as well as the impact of the economic recession.

However, it is still feasible to identify the cost of the VAT proposal. **We are asking for the 9% VAT rate to be applied for the period August to December**. This is a temporary but significant support, and hopefully we will be more clearly moving forward by the start of 2021.

Based on CSO data the 2019 on-licence alcohol sales were about €5.722 billion including VAT. Of this, about 53% would have arisen in the second half of 2019. On a proportionate basis, the August to December period would have generated sales of about €2.527 billion in a normal period.

Our most optimistic market expectations for the second half of 2020 are that on-licence alcohol sales will be at most 50% of what is usual. This would give an on-licensed sales level of €1.264 billion. This is divided between VAT at 23% of €236 million and ex-VAT sales of €1.028 billion (it is assumed that VAT relates to 100% of sales). VAT at 9% on the €1.028 billion would be €93 million. Without anything else changing, the cost of reducing the likely second half 2020 on-licence alcohol sales to 9% VAT from 23% VAT is €143 million.

If the on-licensed sector's performance is lower than the 50% market expectation, a smaller total value of sales will be charged at the lower 9% rate instead of the 23% VAT rate. This will have indicated the even weaker nature of the sector, the threat to enterprises and jobs, and the strong need for the policy measure.

If the sector performs better than the 50%, the increased sales will drive up VAT revenue. Even if sales are diverted from the off to the on-sector of the alcohol market, the Exchequer will win as the average unit of alcohol priced at €10 in the off licence will generate VAT of €1.87 at 23%, while the same product in a pub will sell for €36.59 on average and generate VAT receipts of €3.02 at 9%. The large employment contribution of the on-licensed sector will also be supported and enhanced by the measure.

The cost of €143 million will be partly offset by the economic and Exchequer returns that flow from a stronger, as opposed to a weaker, public house sector. These include VAT receipts, employment, reduced unemployment payments, increased income tax and PRSI receipts, regional activity, social strengthening, and tourism support.

#NewGov PROTECT OUR PUBS

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