



Submission to HM Treasury

The impact of the offshore VAT loophole

on independent retailers

November 2005

Introduction

As a leading small and medium-sized business lobbying organisation, representing members across all sectors of the business spectrum, the Forum of Private Business (FPB) is in a perfect position to compare the pressure of the offshore VAT loophole on business in general. It is clear to the FPB that businesses in the retail sector and those in the retail supply chain suffer a disproportionate amount of unfair competition.

In the view of the FPB and its members, the policy having one of the most devastating effects on independent retailers is the Channel Islands VAT loophole, allowing large retailers to sell and import goods worth less than £18 into the UK mainland VAT-free.

A growing number of retail giants have set up operations in the Channel Islands to exploit the VAT loophole, thereby gaining an unfair competitive advantage over independent high-street retailers on mainland Britain. These retail giants include Tesco, Asda, Woolworths, Boots, WH Smith, HMV, Lastminute.com, Donald and Atchison, Britannia, and Amazon.

In November 2005, Tesco.com took advantage of Jersey's VAT-free consignments, igniting a price war by slashing 10% off all its CDs, DVDs and video games for one week only. HMV, based in Guernsey, quickly followed suit with a deal offering £3 off all purchases over £25.

FPB members and others in the retail sector are finding it increasingly difficult to compete with the big supermarkets and online retailers, which are offering goods at massively discounted prices that the smaller retailers just cannot match. Competition is justifiable through genuine means, but when the playing field is tipped in favour of large retailers because of distortions created by the fiscal and regulatory environment, this is both unjust and bad for the economy. Although the low-value loophole is not new, its increased use by high-volume retailers threatens to distort the marketplace, which is why we now want to see it closed.

This situation not only skews the market in favour of large retailers, but also results in reduced revenues. According to the Treasury's own figures, the Government is currently losing an estimated £80m-a-year because of this loophole; a figure which will rise to £200m in the next few years.

Presented in this document are case studies demonstrating the adverse impact of the VAT loophole and its effect on independent retailers.

What is abundantly clear when reading through the case studies is that this loophole is fatally undermining independent retailers. If this loophole is not closed, we believe:

- Businesses, livelihoods and jobs will be lost.
- The economy will suffer through reduced revenue caused by business closures and loss of employment.
- The music industry will suffer. With fewer independent record shops, fewer up-and-coming acts will be discovered. The vital role independent shops play in helping new acts on the first steps to fame, by promoting their first records and concerts, will be lost. The independents' passion for music is not shared by retail giants operating from the Channel Islands, which have no interest in promoting, as yet unknown new talent.
- The consumer will suffer as a result of fewer acts being discovered and through reduced choice.

Recently, the Jersey Government announced it is to limit the number of UK firms funnelling sales of CDs and DVDs through the Island to take advantage of its tax exemption. However, I include a direct quote from Jersey Post – a state-owned operator and fulfilment house for this activity – taken from an email to a business in mainland Britain worried about the existence of this loophole, which says:

“The VAT exemption on items below £18 (22 euros in the rest of Europe) is known as Low Value Consignment Relief (LVCR). LVCR has been in existence since 1983, and is part of an EU Regulation. There has been publicity generated by the Forum for Private Business to try and get it phased out, but this is not considered likely in the near future. The costs associated with assessment and collection of taxes on low-value items, which will be incurred by government agencies like Posts and Customs, far outweigh the actual tax collected. Nothing is certain, but if you have a good mail-order idea, I would go for it.”

This runs contrary to the statement from the Jersey Government. In fact, the 27 June 2005 press release announcing this move, from the States of Jersey, specifically said: “Jersey Post is a state-owned company and will therefore adhere to government policy, which is in the best interests of the Island.” This is clear evidence that, if the loophole is not closed, the situation will become even worse for independent retailers.

On behalf of FPB members, we urge the Treasury to close this unfair and anti-competitive loophole as a matter of urgency.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Nick Goulding', with a stylized flourish at the end.

Nick Goulding
FPB Chief Executive

Case studies

Name: Richard Allen (business owner)

Business: Delerium Mail Order Ltd
 Ground Floor Churchfield House
 Churchfield Road
 Chalfont St. Peter
 Gerrards Cross
 Buckinghamshire
 SL9 9EW

Sector: Retail: Independent record shop

Established: 1991

Employees: Full-time: 4 Part-time: 2

Comments:

Mr Allen runs an independent record shop, selling merchandise both in his shop and over the internet.

Mr Allen firmly believes the existence of the offshore VAT loophole is seriously affecting sales in his shop, to the extent that he may be forced to close his business.

CD pricing structures:

Purchase prices

Excluding discounts, CDs generally wholesale at a Budget Price (£3.95), a Mid Price (£5.95) or a Full Price (£9.95). DVDs have a similar pricing structure.

Mail order retailers need to make a minimum margin of around 40% on purchase cost plus VAT in order to generate enough profit to keep the business liquid.

Postage and packing costs

These are not normally absorbed by the retailer. In the UK, VAT is charged on postage and packaging.

Cost breakdown

Item	Cost from UK business (£)	Cost from offshore (£)
Price of CD (inc delivery)	5.95	5.95
Profit margin (40%)	2.38	2.38
Postage (2 nd class)	0.35	0.35
Packaging and labour	0.50	0.50
VAT on CD	1.45	-
VAT on postage	0.15	-
TOTAL	10.78	9.18

Price advantage from offshore retailer for no extra cost = **£1.60**

This price advantage of £1.60 is enough for the average consumer to buy CD's from the offshore retailers at the detriment to Delerium Mail Order Ltd.

Name: Jim Cooke (Manager)
Business: Selecta Disc
19/21 Market Street
Nottingham
N61 6HX
Sector: Independent record shop
Established: Mid-60s
Employees: Approximately 20

Comments:

Selecta Disc is an award winning, independent record shop that has been running for about 40 years, but the offshore VAT loophole is having a detrimental impact on the running of the business.

It is based very close to Nottingham Trent University, which provides it with a robust consumer base. At one time, students used to queue up on a Monday morning to obtain new releases. This has now depleted because they can simply order or download these new releases online. In addition, the existence of the VAT loophole means customers are coming into the store and simply browsing the physical copies before making a purchase from one of the offshore retailers.

Selecta Disc has reported a drop in sales of between 5 and 25%. While it plans to operate through the Christmas period, it will then undertake a serious review of particular commercial lines. The shop has already discontinued selling chart titles because it simply cannot compete with the offshore retailers.

Name: Paul Callaghan (business owner)
Business: F-Minor
8 Commercial News North
45a Commercial Road
Eastbourne
BN21 3XF
Sector: Specialist distributor
Established: 2002
Employees: 5

Comments:

F-Minor is a specialist distributor of niche vinyl and CDs. It used to have a client base of 40, which has now diminished by between 10 and 15%. It believes this is directly attributable to the sale of CDs online. It also believes the market has diminished because small independent record shops:

- Cannot compete on price
- Are now losing out on second-hand items because of eBay

A number of the independent record shops that F-Minor deals with have been in operation for more than 30 years; however, increased costs, coupled with a severe drop in sales have made it impossible for them to continue trading.

Name: Andy Harding (Manager)
Business: RPM music (Mail order: CD X press)
25 High Bridge
Newcastle-Upon-Tyne
NE1 1EW

Sector: Independent record shop

Established: 1989

Employees: 3

Comments:

RPM music has been operating for 16 years and used to employ five workers, but has had to cut back on staff due to a lack of sales. Similar to other independent record shops, it has also stopped selling chart CDs because it cannot compete with the likes of Tesco and Amazon.com

It obtains CDs for between £7 and £9 and sells them on for £10 to £11. Amazon, Play.com and Tesco are selling the same CDs for around £7/8, sometimes even less.

Sales over the last two years have remained stagnant, when previously they would have experienced a steady increase, with sharp increases over the Christmas period.

The existence of the offshore VAT loophole is damaging sales at RPM Music and, if this downfall is sustained, it predicts closure within the next five years.

Name: Glen McTaggart
Business: Salvation Sounds
Unit U
Shawlands Arcade
Shawlands
Glasgow
G41 2R5

Sector: Independent record shop

Established: 1994

Employees: No employees – husband and wife only

Comments:

Salvation Sounds used to employ two people, but after a drop in sales of approximately 20%, it cut back its operations to husband and wife only. This drop in sales has been over the last two years and Mr McTaggart will not be renewing his lease, which ends after four years. In fact, he states that, if it wasn't for the lease, he would close his business now.

As before, the business simply cannot compete with the offshore retailers. Mr McTaggart even admits to having bought CDs off them himself because it is cheaper than buying from his wholesale distributor.

He constantly experiences customers coming into his shop and asking for further details on a particular album, single etc., only for them to walk away and purchase the goods online.

Name: Nick Swift
Business: Big Pink Music
61 Thomas Street
Manchester
M4 1NA
Sector: Independent record shop
Established: 2005
Employees: Partnership

Comments:

Mr Swift has recently opened up an independent record shop specialising in soul and jazz. He used to own a record shop, but was forced to close because his then business partner pursued another career. He has been in the industry for 30 years, either working for other people or himself, and has said there has never been such a big shake-up in the sale of records and CDs in all his lifetime in the record industry.

He attributes this shake-up to the offshore VAT loophole. He believes that, because of the loophole, retailers are able to run 'loss leaders', which prices the smaller independent record shops out of the market. He refuses, like so many others like him, to sell chart albums and singles because he simply cannot compete with the large retailers on price.

Name: Stephen Godfroy
Business: Rough Trade
130 Talbot Road
London
W11 1JA
Sector: Independent record shop
Established: 1976
Employees: 20

Comments:

The existence of the VAT loophole is seriously undermining the authoritative recommendations and the customer service Stephen Godfroy has given his customers over the last 30 years. His business is now perceived by customers as expensive and they now shop online instead of with him.

Effectively, what the loophole does is make the value of specialist, independent music retail seem more expensive than it is, when Rough Trade prices are compared to those offered by members of the offshore cartel. Only by removing the VAT loophole will the Government restore the true market rate value of specialist music retailers like Rough Trade, which seek to offer the music consumer value in ways other than discounting.

Mercury Prize-winning Antony & the Johnsons are a perfect example of how Rough Trade identified a yet-to-be-discovered artist and brought them to the attention of the UK record labels who then went on to license (or sign) them for the wider UK market.

Without specialist retailers like Rough Trade, artists such as Antony & the Johnsons stand far less of a chance of being discovered here in the UK.

What is the FPB?

The Forum of Private Business (FPB) was formed in 1977 and is a pressure group fighting on behalf of private businesses. The FPB represents approximately 25,000 UK-based businesses employing in excess of 600,000 people, and is a powerful lobbying voice in both the UK and the European Union.

The FPB, as the only full UK member of UEAPME – the organisation that represents small and medium-sized enterprises (SMEs) in Europe – is the most prominent advocate of UK SMEs in Brussels and has a track record of positively affecting legislation prior to its introduction in the UK.

The FPB also provides a range of business services aimed at increasing member efficiency and profitability.

FPB research

All of the FPB's campaigns are based on the views of its members. Members vote in a quarterly Referendum, using ballot forms to add the comments they want us to forward to their elected representatives. Referendum is a tool that business owners have been using since 1977 to make their voices heard.

The FPB has more than 20 years' worth of experience of accredited research into the small business community. We have been using the Quarterly Survey since 1980 to track business growth and the rise and fall of key issues. The Quarterly Survey has recently become even stronger following a merger with the Small Business Research Trust Quarterly Survey.

We survey businesses by mail, over the telephone and face to face. We also collect data electronically, which enables us to source opinions from hundreds of businesses within a matter of hours.

FPB contact details

FPB
Ruskin Chambers
Drury Lane
Knutsford
Cheshire
WA16 6HA

Telephone: 01565 634467
Facsimile: 0870 241 9570
Email: info@fpb.org
Website: www.fpb.org