

UK Airports:

# Impact of Changes to Duty Free and Tax Free Rules

January 2021





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# Duty and Tax Rule Changes

10%-15% potential increase in duty-free shop margin

## HOW IS UK AIRPORT RETAIL CHANGING?

In September 2020, the UK Government announced that from 1<sup>st</sup> January 2021 (post-Brexit), British passengers travelling to EU countries will be able to take advantage of duty-free shopping, meaning that passengers will be able to buy duty-free alcohol and tobacco products in UK airports, ports, international train stations and on-board ships, trains and planes.

The amount of goods that passengers can bring back with them from non-EU Countries will also be significantly increased and extended to EU countries.

However, at the same time, the UK Government is also ending tax-free sales in airports of goods such as electronics, beauty and clothing for passengers travelling to non-EU countries, though we understand that this does not apply to alcohol and tobacco products.

## WHAT IS THE EXPECTED IMPACT?

57% of passengers will now benefit on alcohol and tobacco purchases, which exclude excise duty and VAT from 1<sup>st</sup> January 2021 (based on 2019 CAA UK airport traffic statistics).

This is almost a return to the UK airport retail environment that existed prior to the abolition of intra-EU duty-free in June 1999, when airport duty-free shops had a single 'value' proposition which only excluded domestic passengers.

One key difference is that VAT will be now payable on ALL sales (excl. alcohol and tobacco products) regardless of destination.

We expect this to result in a comprehensive change in the range and pricing in airport duty-free shops across the UK.

Overall, we expect UK airport gross margin at duty-free shops to increase by 10%-15% (c. £50m - £100m) which would be shared by the duty-free operator and airport.

# Duty and Tax Rule Changes

Majority of passengers will see a positive / neutral impact

## HOW ARE DIFFERENT MARKETS AFFECTED BY THE CHANGES?

The impact from 1<sup>st</sup> January 2021 will vary by market type (based on 2019 CAA UK airport traffic statistics)

### EU Passengers – 171m / 57% of total UK Airport Traffic

#### POSITIVE / NEUTRAL IMPACT

Alcohol & tobacco products purchased at UK airports will no longer be subject to excise duty and VAT. Other products (e.g. electronics, beauty & clothing) will **continue** to be subject to VAT.

### NON-EU Passengers – 85m / 28% of total UK Airport Traffic

#### NEGATIVE IMPACT

Goods purchased at UK airports which were not previously subject to VAT, will now have VAT included in the sale price (excl. alcohol & tobacco products). Non-EU pax can continue to buy alcohol and tobacco products without excise duty.

### DOMESTIC Passengers – 45m / 15% of total UK Airport Traffic

#### NEUTRAL IMPACT

Goods purchased at UK airports will continue to remain subject to excise duty and VAT.

# Duty and Tax Rule Changes

## Potential for EU Pax increased sales AND higher margin

**EU Pax** (57% of UK Airport traffic, 2019) will be more likely to buy alcohol & tobacco products at UK airports due to the potential price discount versus the High Street and other EU airports, as these will no longer be subject to excise duty or VAT from 1st Jan 2021.

Duty-free retailers and the airport should both benefit from increased sales per passenger and higher margin on these sales.

Airport sales of tax-free products to EU Pax should be largely unaffected as these are currently subject to VAT, and therefore pricing and margin should be unaffected.

**Non-EU Pax** (28% of UK Airport traffic, 2019) will continue to benefit from significant price discounts versus the High Street for alcohol & tobacco products, therefore pricing and margin should be unaffected.

However, airport sales of tax-free products to Non-EU Pax will be affected by the introduction of VAT on sales of electronics, beauty products and clothing. This is likely to result in a combination of higher prices and reduced sales, and lower margin on those sales.

**Historic Context:** In some respects the changes to airport retail from 1<sup>st</sup> January 2021 will wind back the significant losses experienced by UK airports following the abolition of intra-EU duty & tax free in 1999, but notably the changes will remove tax-free sales for Non-EU passengers.

In 1999, BAA plc operated six of the largest UK airports (LHR, LGW, STN, EDI, GLA & ABZ) and also owned and managed the airport duty free shops (World Duty Free) and experienced significant YoY reduction in profits – leading to a profit warning and 17% share price decline.

The situation was compounded in May 2004 when a further 10 countries acceded to the EU, further reducing the scale of duty & tax free sales from UK airports.

# Duty and Tax Rule Changes

Pricing, communications and promotion will be key

## MAXIMIZING THE POTENTIAL OF A REVISED AIRPORT RETAIL OFFER

- The changes from the passenger perspective, both positive and negative, give UK airports and the duty-free operator the opportunity to simplify and improve the strength of the airport's 'value' proposition.
- ALL passengers (excl. domestic) will be eligible to make duty free alcohol & tobacco purchases at a significant price discount to the equivalent High Street price. This will improve spend per passenger on products generating a much higher gross margin.
- Whilst the tax-free allowance is being removed, this nevertheless gives airports and retailers the opportunity to consolidate merchandising and communication around a single 'value' proposition. Historically the 'tax-free' and 'tax-free equivalent' price (for Non-EU and EU passengers) was confusing and reduced the legitimacy of the price benefit available at UK airports.
- Pricing, communications and promotion will be key to delivering the potential improvement in spend per passenger from 1<sup>st</sup> January 2021, which we understand both parties have been working towards (although Covid-19 will have undermined the impact of the changes due to the huge reductions in passenger traffic).
- If successful, the duty-free operator and the airport should realise financial improvements from the new legislation vs pre-Brexit trading (all other things be equal, particularly the pandemic).
- The key change will be the potential for the duty-free operator to improve the gross margin (GM), the benefits of which should be shared between the retailer and the airport.

# Duty and Tax Rule Changes

Potential £50m-£100m net gain in gross margin

## WHAT IS THE LIKELY NET OUTCOME FOR UK AIRPORTS?

- AviaSolutions has estimated the size of the market for EU and Non-EU sales and spend per head by category at UK airports in 2019; alcohol, tobacco, beauty, food and tax-free products.
- The response to the changes and how these are communicated by the airport and retailer will determine whether the impact versus 2019 performance is positive or negative (ignoring the volume impact of Covid-19).
- We have based our impact estimates on the assumed spend per departing passenger at duty-free shops across UK airports in 2019 and the post-Brexit changes in both the spend per head and the gross margin % (net sales less cost of sales / net sales).
- In aggregate, we estimate a net gain in gross margin in the order of £50m - £100m (10%-15%).
- **Please contact AviaSolutions for more details on the assumptions, background and impact of the changes in legislation.**

