The Economic Case for the Retention of the 9% Hospitality Vat rate for Restaurants, Cafes, Pubs and Other Food Services

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Restaurants Association of Ireland

1. Restaurant reduced rate is widely operated internationally.

The principle of a reduced VAT rate (relative to the standard rate) for restaurants and food services is widely accepted internationally. The large majority of EU countries operate reduced VAT rates for the restaurant and food services sector.

2. 13.5% rate is not competitive. 9% is.

The key issue should be to have a reduced rate which is competitive with other countries. Eight of the other 26 EU countries have restaurant rates which are above 13.5%. Eighteen of the 26 other countries are below the intended Irish rate of 13.5%. Ireland with 13.5% would have a higher restaurant VAT rate than, for example, France, Germany, Italy and Spain. On the 9% restaurant rate Ireland is quite competitive with only four countries on a lower rate. Three are on 9% and nineteen have higher rates than 9%.

3. Other indirect taxes on elements of food services expenditure: the Irish standard VAT rate is high and Irish alcohol excise is high

The reduced hospitality VAT rate should be considered in the context of the other indirect taxes on various elements of food services. Many EU countries do not levy excise on wine but all EU countries levy it on beer and spirits. Various elements of the restaurant product such as alcohol are subject to the standard rate of VAT. Unfortunately, Ireland's restaurant and food services sector operates at a competitive disadvantage internationally with both alcohol excise and the standard rate of VAT.

Ireland has the highest wine excise in the EU27 and UK. Ireland has the second highest beer excise in the EU 27 and UK behind Finland. Ireland has the third highest spirits excise in the EU 27 and UK behind Sweden and Finland. Fifteen EU economies do not impose any excise on wine. On an overall composite alcohol excise level (measured by the unweighted average of the different beer, spirits and wine excise rates), Ireland is the second highest behind Finland.

The standard rate of VAT is charged on alcohol throughout the EU. Ireland's competitive position on the standard VAT rate is also weak. Ireland's rate of 23% is exceeded by only six countries, the highest of which is Hungary at 27%. Eighteen EU countries have standard VAT rates which are below 23%. The UK rate is 20%.

4. Inflation impact

While the inflation rate is declining, a return to 13.5% will increase the rate of inflation. The vast majority of restaurants and other food services enterprises would have to increase prices. The food services sector accounts for 7.1%of the consumer price index. A return to 13.5% will generate a restaurant price increase of 4.1%, on the assumption of a 100% pass-through. This has an impact of 0.3 percentage points on the overall inflation rate. A price pass through of 75% in restaurants and food services produces a restaurant price increase of 3.1% which has an impact of increasing the national annual inflation rate by 0.2 percentage points.

5. Increasing the cost of food and cost of living

Restaurant and other food services products are often seen as luxury or discretionary, and possibly occasional, items where higher prices and reduced demand would have negligible consequences for ordinary people. That is not the case. Food services on the reduced rate cover a wide range of food services including take-aways. Very many people use the products and services of the restaurant and food services sector as necessary or "normal" food consumption to support their lifestyles and labour force participation. They are necessities as opposed to luxuries for very many people. A return to 13.5% would increase the cost of a cooked lunch for workers and a take-home pizza as well as luxury food services.

Based on the Bord Bia Foodservice 2022 report the following is the island of Ireland mix of food services. Foodservices or out of home describes all food consumed and prepared out of home including restaurants, take-aways, hotels, pubs, coffee shops, workplaces, hospitals, education and other institutions. Full service restaurants and hotels together account for only 28% of total foodservice expenditure on the island of Ireland. Quick service, fast casual and food to go account for 38% of the total.

	Market share %	Value billion
Limited service restaurants (including, quick service, fast casual and food to go)	38	3.1
Hotels	16	1.4
Pubs	16	1.3
Institutions	8	0.7
Other commercial	4	0.3
Coffee shops and cafes	6	0.5
Full service restaurants	12	1.0
Total	100	8.2

Source: Bord Bia Foodservices Market and Consumer Insights report 2022

6. Slower recover than the overall economy from Covid

The restaurant, other food services and beverage serving sector has not matched the rest of the economy in recovering from Covid. Between quarter 1 2019 and quarter 1 2023 total employment increased by 13.5% while food and beverage services employment increased by only 3%.

7. Weakened business model for restaurants: much of it caused by policy measures

The Foley 2022 report identified the negative impact of energy, food and other costs on the restaurant sector. The cost model has fundamentally deteriorated. VAT is a cost of doing business just like labour costs, energy or food ingredients. VAT reduces the proportion of customer expenditure which goes back to the restaurant business to cover costs and margin. There is a very large change in the operating model of restaurants due to recent cost and price increases. In 2019 the margin was 7.2% of turnover, in the new "normal" even with price increases the margin dropped to 3.5% on average, with many restaurants operating at margins below the average.

While the inflation rate is moderating there is no expectation that the overall price level will fall back to previous levels. Higher prices are here to stay and tax policy should acknowledge the changed circumstances.

Costs will continue to increase. The EU economy is in a period of increasing interest rates and higher interest rates will persist for the medium-term future.

Water charges, through a new tariff structure, are a substantial additional cost increase in the next few years. Some other policy/regulatory changes have implications for business costs. The introduction of a "living wage" measure will increase labour costs. This is intended to be introduced over a four-year period from 2023, or quicker. Ireland's current employer PRSI is low by EU standards and there have been various suggestions to increase it over the coming years. Already the Low Pay Commission has recommended a 2024 increase of 12% in the minimum wage. Some of these cost increases are necessary, unavoidable or desirable (in the context of higher pay for workers) but they directly damage sectoral viability. Some directly flow from policy decisions. The cost and viability impact on this labour intensive sector should be balanced by the retention of the 9% VAT rate.

8. The employment role of the restaurant and food services sector

The employment contribution of the sector is relevant at three levels. It is a substantial national employer. Its employment is regionally spread and provides jobs in areas with have limited opportunities. In 2023 71% of hospitality employment was outside Dublin compared to 47.3% of information and communication employment. The restaurant sector provides employment for those who require atypical hours. It provides flexible types of employment which are not available in many other sectors and provides opportunities for workers with limited skills. A relatively high proportion of Irish employment is provided by the overall tourism sector compared to other EU economies. The CSO's Labour Force Survey reports a food and beverage serving employment of 125.4k in Quarter 1 of 2023 and 121.7k in Quarter 1 2019. An alternative CSO source, the Annual Service Inquiry puts 2019 food and beverage serving employment at 151.2k which was divided between 103.3k in food services and 47.9k in beverage services. Even with full employment the hospitality sector will continue to be an important source of employment and job creation.

9. A small and micro business sector

The restaurant sector is mainly comprised of small and micro businesses. In 2019 of 19,418 hospitality enterprises, 76.7% had under 10 persons employed, 19.3% employed between 10 and 49 persons, 3.6% employed 50 to 249persons and only 0.4% employed 250 persons or over. Small businesses face particular operational difficulties compared to large enterprises.

10. The Exchequer: retention of the 9% VAT is affordable

Previous discussions on the effect of changing the hospitality VAT rate has included substantial consideration of the impact of the measure on the public finances, particularly the cost involved in having a 9% rate compared to a 13.5% rate. Revenue's Post Budget Ready Reckoner for Budget 23 estimated that the cost of extending the 9% rate for all the existing eligible activities for a full year was €758 million. The equivalent cost for the full hospitality sector was €563 million. However, the "cost" of the measure to the exchequer is much less of an issue in the current public financial circumstances. The public finances will be strong in both 2023 and 2024 and large surpluses are expected. The economic and policy issue will not be a shortage of tax revenue to meet desired expenditure intentions. The very strong state of the public finances indicates that the measure can be afforded, if it is otherwise considered to be a prudent economic policy. We argue that it is clearly a prudent economic policy.

11. Overview

The public finances are strong. Desired public expenditure is not being curtailed by financial limitations. It is a wonderful opportunity to establish the 9% VAT rate as the permanent restaurant and other food services rate. The sector is a large national and regional employment and economic contributor. It provides atypical employment opportunities to specific groups and individuals that are not provided by several other sectors to the same extent. As evidenced in this document, much of the expenditure on elements of food services sector is not in the luxury and discretionary sector. Take-aways and "normal" cooked food will face price increases as well as the more expensive food servings. The sector is primarily a small and micro enterprise sector and has faced many substantial difficulties in recent years from Covid, general inflation and specific business cost increases including energy.

We believe the overall food services sector is not sufficiently robust and profitable at present to absorb the proposed VAT increase without negative consequences. Government policy is increasing costs for restaurants. To balance this the 9% VAT rate should be retained.

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