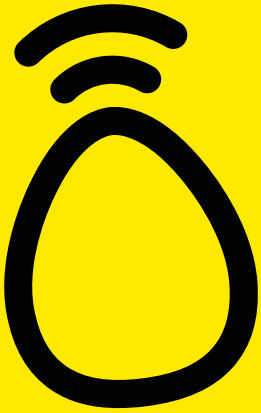

cuckoo

August 2020

Government urged to cut VAT on broadband to 5% and help fix digital poverty

- Broadband challenger Cuckoo Internet is calling on the Government to reduce the outdated broadband tax and reduce VAT to 5%, saving UK households £1.8 billion a year.
- Low income households in the North spend three times as much disposable income on broadband bills than average London households.
- Connectivity is a utility, not a luxury: households and businesses should not be taxed at 20% VAT rate.
- Cuckoo commits to pass on savings to customers in full, and calls on other providers to do the same.

www.cuckoo.co

Executive Summary

- **Broadband has become an essential part of daily life and UK households should not be taxed for this utility.** Its importance has accelerated over the past six months as the country relies on the internet to keep the economy going during the coronavirus outbreak. Reducing VAT to 5% would save UK households £6 per month on average, £72 annually, and make access to the internet more affordable. This would be an overall saving of £1.8 billion a year for UK households.

- **Access to digital connectivity cannot be the preserve of wealthy households.** For many households, broadband is simply one utility bill too many. 27% of homes in the lowest income bracket don't have access to the internet in comparison to just 3% of the highest earning households who don't. This means that low income families are seven times less likely to have access to broadband.

- **Regional disparity shows this regressive tax is contributing to the digital poverty divide.** Low income households in the north spend 3.6% of disposable income on broadband - three times that of the average London household (1.2%). Reducing the tax would support the Government's 'levelling up' agenda and help plug the digital divide.

- **Low income households are more likely to struggle to pay bills, given they are disproportionately affected by the economic crisis that coronavirus has brought about.** Research by The Resolution Foundation found that almost a third of low-paid employees in the UK have lost their jobs or been furloughed compared to less than one in ten of the top-earning employees.

- **Digital connectivity is a right, not a luxury, and nor should it be taxed as such.** Household utilities shouldn't be taxed at the same rate as tobacco, alcohol and other luxury items. Our research shows that this tax is regressive: in every region across the UK, the poorest households spend the highest percentage of disposable income on accessing the internet; are less likely to have a broadband connection; and are more likely to have been hit by unemployment and the economic effects of the pandemic.

- **Given the importance of broadband for every household and business across the country, the Government needs to take urgent action to make broadband more affordable by reducing the rate of VAT and bringing it in line with other essential domestic utilities such as electricity and gas. In this document we outline the impacts of changing the VAT level to 5%.**

Image 1: Breakdown of broadband spend as a percentage of household income across UK regions

Background context

Coronavirus has made the UK more digital dependant than ever before

The coronavirus crisis has accelerated the UK's shift to a digital-first economy: everyday healthcare, business, retail and communication activity has come to rely on broadband. Connectivity has been at the heart of the crisis, and will continue to be a central pillar to the success of the recovery, and how we live and operate in the future.

Access to the internet has now become an essential good thanks to its importance as a vehicle to deliver education, healthcare, communication, business, banking services and more. Ofcom data shows that the pandemic has sped up the adoption of online services. More than seven in 10 people in the UK are now making video calls at least weekly, an increase of 35% pre-lockdown.

Equal access to connectivity is central to delivering the Government's levelling up agenda

Having access to the internet is essential for today's digital economy. It creates jobs, allows people to communicate, promotes entrepreneurship, spreads wealth, helps reduce carbon emissions, provides access to education and creates new opportunities to develop skills.

Changing patterns of working can be expected in the medium term as companies evaluate the risks of opening offices and see the opportunities of remote working policies. Investing in broadband, and making it affordable to all, is not just essential to keep the nation working remotely as much as possible, it will also be an important success factor in achieving the UK's 2050 net zero carbon reduction targets.

Taxing broadband like a luxury item is regressive, and wrong

To tax this essential good is fundamentally regressive, as it disproportionately impacts the lowest income households, many of which have been hardest hit by the pandemic. The average UK household spends 1.5% of their disposable income on broadband, and this figure more than doubles as a percentage for low income households, at 3.4%. The true scale of the issue is apparent when looking at the regional divide that this creates for the affordability of digital access. Low income

households in the North spend 3.6% of disposable income on broadband - three times that of the average London household, at 1.2%.

The tax on broadband cannot be justified given its utility in people's lives, and the role it plays in unlocking innovation and growth in the economy. Connectivity and a thriving digital economy will be central to the UK's recovery from coronavirus. It has never been more essential that every home has access to the internet for education, work, essential communication, heath services, and much more.

Digital poverty is locking children out of learning

Despite the shift to digital, an estimated 1 million children and their families did not have access to connectivity during the lockdown. Education charity Teach First surveyed teachers working in the UK's most disadvantaged schools, with only 2% confident that their pupils had adequate access to online learning.

Research by Oak National Academy, the Department for Education-backed online school has revealed that a significant number of pupils in the UK don't have the necessary access to the internet or devices to engage with Oak. On average, 220,000 people benefitted from Oak everyday during the pandemic, but many missed out on months of learning, with 25% of teachers telling Oak that their pupils didn't have internet access at home.

Educational materials such as books, magazines, newspapers and, most recently, digital versions of publications, have a zero-rated VAT level. In stark contrast, internet access is now central to delivering education during the coronavirus crisis, yet is taxed at the highest rate of VAT.

The Government is taking action but more can be done

The Government has promised to achieve full fibre and gigabit-capable broadband access for every home and business across the UK by 2025. However, we need to make sure that high speed broadband is affordable before we can hope to see the benefits for the country. Right now, 27% of UK households in the lowest income bracket don't have access to the internet, in comparison to just 3% of the highest earning households who don't.

The same low income households that are much less likely to have access to the internet are also disproportionately affected by the economic crisis that coronavirus

has brought about. Research by The Resolution Foundation found that almost a third of low-paid employees in the UK have lost their jobs or been furloughed compared to less than one in ten of the top-earning employees.

The coronavirus crisis has accelerated the urgency of fixing the digital divide and making sure it internet connectivity is accessible to all. Investment in broadband will be essential to maintain productivity levels, boost enterprise opportunity and make sure everyone can take part in a digital-first economy.

Our solution is simple and effective

The UK has a standard VAT rate of 20%. EU rules mean the UK cannot reduce VAT on goods and services below 15% - the standard rate of VAT in the EU. Countries must apply a minimum standard VAT rate of 15%, but they do have an option of applying reduced rates to certain specified goods.

For example, domestic fuel such as gas and electricity has a VAT rate of 5%. Now that the UK has left the EU, the UK has the ability to change this tax and the Chancellor should lower the rate of VAT on broadband to help make vital connectivity more affordable.

Policy measures proposed

The Government should reduce the rate of broadband VAT to 5%

In the UK, broadband is subject to standard-rate VAT of 20%. This stands in contrast to other utilities such as power, electricity, gas, solid fuel and heating oil for domestic and residential use - all of which are subject to a quarter of the VAT rate of broadband, at 5%.

The UK is no longer bound by EU VAT laws

Whilst the UK was part of the EU VAT area, it was subject to European Commission (EC) Directives which set VAT rates across Member States. Now that the UK has officially left the EU, this tax can officially be readdressed and lowered from 20% to 5%, in line with domestic energy and other utilities.

Many countries already consider broadband a utility

In Finland, the Ministry of Transport and Communications made broadband access a legal right in 2010, making telecommunications providers responsible for providing all Finnish residents with 1Mpbs broadband speeds. 10 years on, Finland has the most advanced digital economy in the EU. In 2018, Hungary reduced the rate of VAT on broadband to 5%, and now reports some of the highest rates of ultrafast broadband access.

In fact, the UN has already said that it believes the internet should be classified as a human right. In July 2016, the UN issued a resolution calling for countries to declare the importance of "applying a comprehensive human rights-based approach when providing and expanding access to the internet and for the internet to be open, accessible and nurtured".

Policy objective

Ensuring a resilient, dynamic economy throughout the recovery

The objective of this measure is to make digital connectivity affordable for everyone, encourage greater participation in the digital economy and support the Government's levelling up agenda.

This need is especially apparent right now. Following the outbreak of the coronavirus pandemic, social distancing measures have been in place for families and workplaces across the country. With the need for people to stay at home as much as possible, broadband usage has increased dramatically as people turn to it for work, education and communication needs. Ofcom data shows that in April 2020, at the height of the country's lockdown, UK adults spent an average of four hours and two minutes online every day. This is a 16% daily increase in internet usage from September 2019.

From accessing critical government guidance and health services, to running businesses and staying connected; broadband is fundamental to participating in our economy. Broadband should be considered an essential utility, and the Chancellor should reduce the cost of access to broadband to make sure everyone has access to digital services.

Classifying broadband as a utility and reducing the tax on it is the step forward we need to address digital poverty and make sure the households that have been hardest hit during the pandemic aren't shut out from participating in the economy.

Summary of impacts

The benefits will outweigh the investment costs of this measure

Reducing the VAT rate of broadband would have an impact on the Exchequer as well as individual households and businesses. Reducing the rate of VAT on broadband to 5% would cost the Exchequer **£1.8 billion every year.**

The wider economic impact of reducing the rate of VAT on broadband will deliver beyond the cost to the Exchequer. The benefits of this policy are twofold. It would:

- **Make broadband more affordable for households and businesses families and increase the number of people purchasing high-speed broadband.**
- **Encourage more people to participate in the digital economy, spreading wealth and encouraging innovation.**

Ofcom data shows 27% of low income households don't have broadband, 10% of which cite cost as the primary factor holding them back from accessing the internet. Increasing access and improving the affordability of broadband would unlock new opportunities to access services, information and knowledge. This would deliver in terms of commercial and trade benefits, educational value, community connectivity and cultural benefits.

The operational impact for the UK telecommunications sector and HMRC would not be significant.

Impact to the Exchequer

Based on the current levels of broadband access and using the average tariff, our calculations show that reducing the rate of VAT on broadband to 5% would cost the Exchequer £1.8 billion every year.

Table 1: Illustrative costs to the Exchequer of other broadband VAT policy options

Annual cost to HMT of reducing VAT by 20%	£2,432,344,320
Annual cost to HMT of reducing VAT by 15%	**£1,824,258,240**
Annual cost to HMT of reducing VAT by 10%	£1,216,172,160
Annual cost to HMT of reducing VAT by 5%	£608,086,080

Table 2: Estimated cost to the Exchequer of reducing VAT on broadband over a 5-year period

Level of VAT	2020/21	2021/22	2022/23	2023/24	2024/25
15%	£608,086,080	£623,379,445	£638,994,791	£654,938,338	£671,216,417
10%	£1,216,172,160	£1,246,758,890	£1,277,989,583	£1,309,876,676	£1,342,432,834
5%	£1,824,258,240	£1,870,138,335	£1,916,984,374	£1,964,815,014	£2,013,649,251
zero-rating	£2,432,344,320	£2,493,517,780	£2,555,979,166	£2,619,753,352	£2,684,865,668

Our calculations are based on a 1.5% rate of inflation year on year and a gradual increase in the number of households that have access to broadband, starting at the current rate of 92% of households across the country and rising by 1% every year.

Household and individual consumer impact

Households and consumers will benefit from lower prices where VAT reductions are passed through to final prices by broadband providers.

Savings to lower income households would be significant because these consumers spend a considerable amount more of their household disposable income on broadband bills. These homes spend twice as much of their income on household energy bills than the richest households.

According to Ofcom data, take-up of superfast broadband is lower than average among low income (DE) households. 80% of households claim to have fixed broadband, but ownership levels drop significantly for DE households, at 64% respectively. For over 75s, this drops to 48% ownership. At the lowest income band, 27% of households have no access to broadband.

Half (49%) of broadband customers in the UK say they have a standard-speed service and 37% say they have Superfast. Those in DE households with broadband are less likely than average to say they have a superfast service (28%). Ofcom says that only 5% of UK households say their connection is ultra-fast.

DE households representing the lowest quartile of households by income also spend disportionately more on VAT for broadband every month than they do for other utilities, such as electricity or gas. (see table 8)

Where prices are reduced, this would help expand the economic, educational and social privilege that comes with accessing the internet, especially among those who are financially vulnerable. This would include low income households, those that usually rely on public libraries and community services for internet access, students, and those that have been made redundant or are in unstable work.

With a 5% VAT rate, and assuming the full VAT saving is passed on to customers, we estimate that the average saving on broadband bills for consumers would be £6 every month, or £72 annually.

We anticipate that a high rate of pass-through of savings to the consumer is likely. This

will vary across different providers due to different pricing models. All broadband providers should be encouraged to reduce prices in line with the rate of VAT cut.

Table 3: Average monthly savings on broadband

We calculate this using Ofcom's estimates for the average monthly price paid for domestic broadband services in the UK - currently £40 per month.

New VAT rate of broadband	Monthly savings per household	Annual savings per household	Total annual savings for UK households
5%	£6	£72	£1,824,258,240

Notes to editors

Calculating the average cost of home broadband

Calculations are based on the average cost of dual-play voice and superfast broadband bundles as of Q2 2019, which Ofcom estimates as £40 per month. We use the cost of a dual-play contract as a reference point for the calculations because four in five UK households buy two or more types of communications service from their provider.
Source: Ofcom Pricing trends for communications services in the UK

Table 4: Broadband spend as a % of average and low income (LI) household disposable income (DI)

Region	GDHI* (£)	Average equivalised household DI bottom Q ** (£)	Average equivalised household DI 2nd (£)	Average equivalised household DI 3rd (£)	Average equivalised household DI top (£)	Average (£)	Broadband spend as a % of average household disposable income (£)	Broadband spend as a % of average household DI low income households
North East	45,171	13,266	21,085	28,429	49,862	28,161	1.7	3.6
North West	133,897	13,391	22,133	30,803	54,222	30,137	1.6	3.6
Yorkshire and The Humber	96,796	13,915	22,569	32,339	56,715	31,385	1.5	3.4
East Midlands	87,804	13,891	23,117	31,974	55,447	31,107	1.5	3.5
West Midlands	107,526	13,412	21,873	31,403	55,833	30,630	1.6	3.6
East of England	137,698	15,002	24,826	35,569	63,528	34,731	1.4	3.2
London	261,562	16,018	26,345	39,841	79,941	40,536	1.2	3.0
South East	222,113	16,526	27,411	39,117	70,533	38,397	1.3	2.9
South West	117,071	16,013	24,835	33,785	59,038	33,418	1.4	3.0
Wales	53,669	13,831	22,267	31,267	51,041	29,602	1.6	3.5
Scotland	106,433	13,364	23,061	33,066	57,961	31,863	1.5	3.6
Northern Ireland	32,627	13,003	20,805	28,684	45,914	27,102	1.8	3.7
National average						**32,256**	**1.5**	**3.4**

GDHI calculation

* Gross disposable household income (GDHI) is the amount of money that all of the individuals in the household sector have available for spending or saving after they have paid direct and indirect taxes and received any direct benefits.

GDHI is used to reflect the material welfare of the household sector, covering all individual households in the economy, including people living in traditional households as well as those living in institutions, such as retirement homes and prisons. It also includes sole trader enterprises (the self-employed) but excludes non-profit institutions serving households (NPISH), for example charities and most universities.
Source: ONS

Defining household types by socio-economic group (SEG)

** For the purpose of this research we have used ONS data to break down the average equivalised household disposable income by quartile (lower, 2nd, 3rd, upper) and by region in the UK. These quartiles are designed to be representative of the overall UK population. We have taken the households that fall in the bottom quartile of average equivalised household disposable income in the UK to represent low income households, referenced throughout the report.
Source: ONS

We also use social classification groups, defined as follows:

AB: Professionals and fully qualified people with a large degree of responsibility or senior jobs such as doctors, senior civil servants, senior business executives, middle management in business organisations, bank managers, and upper grades in the armed forces.

C1/C2: All other professionals doing non-manual jobs, including nurses, technicians, pharmacists, salesmen, publicans, clerical workers, police sergeants and middle ranks of the armed forces. This also covers skilled manual workers, foremen, manual workers with special qualifications such as lorry drivers, security officers and lower grades of the armed forces.

DE: Semi-skilled and unskilled manual workers, including labourers and those serving apprenticeships. Machine minders, farm labourers, lab assistants and postmen. This criteria would also include those on the lowest levels of subsistence including all those dependent upon the state long-term, or casual workers and those without a regular income.

Table 5: UK representation of social classification groups

	Most financially vulnerable (MFV)	Potentially financially vulnerable (PFV)	Least financially vulnerable (LFV)
AB	5%	22%	51%
C1/C2	35%	63%	46%
DE	60%	16%	3%

Household internet access

93% of UK households (25,854,000) have access to the internet, and 98% of UK households (25,336,920) have internet access supplied by broadband.
Source: ONS

Table 6: Access to the internet amongst working-age people (16-64)

	Number of households with no access to internet
AB	4%
C1	7%
C2	14%
DE	27%

Source: Ofcom Adults' Media and Use Attitudes Report

Table 7: Access to the internet amongst low income households

	Number of households with no access to internet
C1	6%
C2	12%
DE	27%

Source: Ofcom Access and Inclusion

Table 8: Ownership of Fixed broadband by financial vulnerability

	Number of households with fixed broadband
Most financially vulnerable	63%
Potentially financially vulnerable	86%
Least financially vulnerable	94%

Source: Ofcom Access and Inclusion

Table 9: Annual amount spend on VAT by bottom quartile households per category

Category	
Alcohol (2.1)	£172
Food and beverage serving services (11.1)	£162
Maintenance, repair and security of the dwelling (4.3)	£130
Furniture, furnishings and loose carpets (5.1)	£107
Fuels and lubricants for personal transport equipment (7.2.2)	£103
Package holidays (9.8.0)	£102
Motor cars (7.1.1)	£96
Garments (3.1.2)	£73
Broadband	**£67**
Confectionary (1.1.8)	£55
Other services in respect of personal transport equipment (7.2.4)	£54
Other appliances, articles and products for personal care (13.1.2)	£45
Mobile communication services (8.3.2)	£44
Tobacco (2.3.0)	£39
Fixed communication services (8.3.1)	£34
Electricity (4.5.1)	£29
Other information and communication services (8.3.9)	£28
Recreational and sporting services (9.4.6)	£28
Footwear (3.2)	£27
Non-durable household goods (5.6.1)	£27
Accommodation services (11.2.0)	£25
Gas (4.5.2)	£25
Soft drinks (1.2.6)	£25
Hairdressing salons and personal grooming establishments (13.1.3)	£15
Vegetables (1.1.7)	£15
Non-motorised tools and miscellaneous accessories (5.5.2)	£14
Parts and accessories for personal transport equipment (7.2.1)	£14
Household textiles (5.2.1)	£12
Fruit and vegetable juices (1.2.1)	£11
Games, toys and hubbles (9.2.1)	£11
Glassware, tableware and household utensils (5.4.0)	£11
Assistive products (6.1.3)	£10
Equipment for the reception, recording and reproduction of sound and vision (8.1.4)	£10
Major household appliances, whether electric or not (5.3.1)	£10
Medicines (6.1.1)	£10
Other services (13.9.0)	£10
Pets and products for pets (9.3.2)	£9
Garden products, plants and flowers (9.3.1)	£8
Other personal effects (13.2.9)	£8
Services provided by cinemas, theatres and concert venues (9.6.1)	£8

Fruit (1.1.6)	£7
Recreational durables (9.1)	£7
Domestic services and household services (5.6.2)	£6
Information processing equipment (8.1.3)	£5
Internet access provision services and net storage services (8.3.3)	£5
Jewellery and watches (13.2.1)	£5
Motorised tools and equipment (5.5.1)	£5
Musical instruments (9.5.1), audio-visual media (9.5.2) and unrecorded recording media (8.1.5)	£5
Veterinary and other services for pets (9.4.5)	£5
Telephone and telefax equipment (8.1.1) and mobile telephone equipment (8.1.2)	£4
Water (1.2.5)	£4
Electrical appliances for personal care (13.1.1)	£3
Equipment for sport, camping and open air recreation (9.2.2)	£3
Haberdashery and accessories (3.1.3)	£3
Hire and repair of photographic and cinematographic equipment and optical equipment (9.4.1) and hire, maintenance and repair of major durables for recreation (9.4.2)	£3
Maintenance and repair of personal transport equipment (7.2.3)	£3
Passenger transport by air (7.3.3)	£3
Liquid fuels (4.5.3)	£2
Passenger transport by road (7.3.2)	£2
Postal and courier services (7.4.1)	£2
Small household appliances (5.3.2)	£2
Cleaning, repair and hire of clothing (3.1.4)	£1
Clothing materials (3.1.1)	£1
Combined passenger transport (7.3.5)	£1
Motorcycles (7.1.2), bicycles (7.1.3) and animal drawn vehicles (7.1.4)	£1
Passenger transport by railway (7.3.1)	£1
Passenger transport by sea and inland waterway (7.3.4) and other purchased transport services (7.3.6)	£1
Repair, installation and hire of household appliances (5.3.3)	£1
Secondary eduction (10.2.0)	£1
Services provided by museums, libraries and cultural sites (9.6.2)	£1
Early childhood and primary education (10.1.0)	£0
Explicit charges by deposit-taking corporations (12.2.2)	£0
Medical products (6.1.2)	£0
Not categorised	£0
Other financial services (12.2.9)	£0
Other outpatient care services (6.2.3)	£0
Photographic services (9.6.3)	£0
Refuse collection (4.4.2)	£0
Social protection (13.3.0)	£0
Solid fuels (4.5.4) and other energy (4.5.5)	£0
Tertiary education (10.4.0) and education not defined by level (10.5.0)	£0

Any questions?

- Cuckoo is a new challenger broadband company backed by successful investors.
- Cuckoo offers one fast speed, one low price and a flexible rolling contract.
- Monzo, Tide and Revolut took on the banks. Bulb, Ovo and Octopus took on the energy providers. Cuckoo will take on the broadband companies.
- They have been featured in TechCrunch, the Telegraph, CityAM and Sifted.
- Their Medium blog tracks the inside story.

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