FAIRER AND MORE INTELLIGENT TAX POLICIES IN TRAVEL & TOURISM

A POLICIES FOR GROWTH WHITE PAPER
FAIRER AND MORE INTELLIGENT TAX POLICIES IN TRAVEL & TOURISM

INTRODUCTION

Travel & Tourism is one of the world’s largest and fastest growing sectors, generating over US$2.3 trillion in direct contribution to global GDP in 2016. Together with the value of the supply chain in the form of indirect and induced impacts, the sector contributed 10.2% to world GDP in 2016. As Travel & Tourism expands, naturally it should contribute its fair share of taxation and support public sector spending on services and the infrastructure that enables the sector to thrive.

However, some governments, eager at the prospect of rapidly growing revenues, apply new or increased taxes on the industry, which can stifle the demand for Travel & Tourism and, consequently, lead to falling tax income.

The World Travel & Tourism Council (WTTC) has developed a set of five Principles for Intelligent Taxation. If taxes follow these Principles, they are more likely to result in both increased revenues for governments and strong, competitive economies locally, nationally, and globally.

Background Context: The Hidden Cost of Taxes to Travel & Tourism

Travel & Tourism can often be seen by policy makers as an attractive option for taxation. Tourists don’t vote, are often perceived to be high income, and can, after all, choose not to travel if they can’t afford it. However, the ramifications of ill thought-out tourist taxes can be far more impactful than at first sight.

Taxation increases prices which can lead to fewer visitors. This means less income for tourism businesses, many of whom are small and medium sized enterprises and operate on very tight margins. As well as putting them in jeopardy, this will also result in lower sales across the full range of businesses dependent upon visitors as direct customers (e.g. restaurants, hotels, entertainment providers), with a knock-on effect through the supply chains, on wholesalers, builders and so on. All these businesses pay property and other local taxes and, importantly, employ local residents who also pay taxes and spend the majority of what they earn in the local economy. In this way, taxes on Travel & Tourism do affect constituents.

Travel & Tourism often incurs more arbitrary taxes, charges, and add-on fees than many other industry sectors. WTTC research¹ found that direct Travel & Tourism taxes in the USA, for example, represented 3.2% of all taxes collected in 2012. By comparison, Travel & Tourism GDP was 2.7% of the US economy. This means that Travel & Tourism was taxed at a higher rate than the average of the economy by 0.5 percentage points, a 15% premium over its GDP share. An average industry's contributions to the tax base and GDP would be equal.

Travel & Tourism is a willing contributor to public welfare and a major supporter of government infrastructure that can enable the sector to thrive. However, the sector is particularly vulnerable to non-productive taxation that essentially discriminates against travellers or travel companies in relation to goods and services similarly offered in other industry sectors. WTTC has therefore proposed five ‘Principles of Intelligent Taxation’ which, if applied, can ensure increased revenues for the public purse as well as a thriving tourism sector.
WTTC PRINCIPLES FOR INTELLIGENT TAXATION

Poorly conceived and implemented taxation can cause Travel & Tourism demand to fall sharply, resulting in job losses and a worsening economy. Intelligent taxation, however, is a useful tool for generating revenue and stimulating economic activity.

By intelligent taxation, we mean that governments should recognise the link between Travel & Tourism’s economic growth and jobs and the contribution to the country’s growth. This will result in tax policies that promote the expansion of the travel market and its tax base, rather than ones that simply increase tax rates and create a negative influence on demand. This approach often requires a long-term perspective.

In an effort to simplify the tax policy-making process, a WTTC study of taxation policy, originally prepared by the London School of Economics, has produced five basic economic principles that should be applied to the design of taxes and user charges for all industries, including Travel & Tourism. These five principles are:

1. Equity
2. Fair revenue generation
3. Efficiency
4. Simplicity
5. Effective stimulus to growth

If followed when taxation policy is being determined, these principles will help dynamic industries to thrive.

1. EQUITY

All economic sectors should be treated fairly in regard to taxation. Even-handed treatment of all sectors reduces the imbalances that can lead to political, social, and economic difficulties.

The Travel & Tourism sector and its customers should not face a heavier tax burden than other industries. Yet policies often fail to reflect that international Travel & Tourism is a competitive export sector for countries. Whereas other industries export their product to where customers reside, in Travel & Tourism markets, consumers are mobile and the products are fixed. So international Travel & Tourism is a competitive export sector for countries. Whereas other industries export their products, Travel & Tourism must transport its product to where customers reside in Travel & Tourism markets.

Most countries avoid export taxes and favour, if anything, export subsidies to gain competitive advantage. The Travel & Tourism sector is an exception. No other exporting sector is systematically taxed like Travel & Tourism, with indirect taxes including VAT and sales taxes.

If international Travel & Tourism is a competitive export sector for countries, these taxes may distort international competitiveness and ultimately depress the general economy.

Poorly conceived and implemented taxation can cause Travel & Tourism demand to fall sharply, resulting in job losses and a worsening economy. Intelligent taxation, however, is a useful tool for generating revenue and stimulating economic activity.

2. FAIR REVENUE GENERATION

The capturing of tax revenue within Travel & Tourism should be even-handed. It is unreasonable to assign special fees, levies or inappropriate user charges on specific goods or services. Special charges may appear, at face value, to be modest, but they aggregate to become a cumulative burden to a sector.

The charge should operate on a level playing field and not disproportionately affect certain types of tourists or businesses. For example, backpackers shouldn’t have to pay a higher proportion of taxes than more wealthy tourists. Progressive taxation, where rates vary depending on the amount spent on the product or service, can help with this. For example, visitors to Rome must pay a tax of €3 per person per night when staying in a two-star hotel, but €7 in a five-star hotel.

CASE STUDY: VAT ON HOTELS ACROSS THE EUROPEAN UNION

VAT rates on accommodation in the European Union (EU) currently range from 3% (Luxembourg) to 25% (Denmark). Member states must apply a standard VAT rate of at least 5% but have the option of applying a reduced rate to hotel accommodation. The United Kingdom (UK) is one of the few EU countries not to take advantage of the reduced rate, and only Denmark has a higher VAT rate than the UK for accommodation.

The ‘Cut Tourism VAT Campaign’ is lobbying for the rate of tourism VAT in the UK to be brought into line with competitor destinations within the EU, with a reduction from 20% to 5%. Its model analysis indicates that this would result in a £1.65 billion net improvement in the UK’s balance of trade after three years, generated by a combination of more overseas visitors visiting the UK and more UK residents switching from overseas visits to holidays at home.

3. EFFICIENCY

Taxes must generate revenue without choking off demand (unless the tax is designed to modify behaviour) or increasing production costs, and should only apply to the final stage of production or service. Over-taxation forces up prices, depresses Travel & Tourism demand and ultimately depresses the general economy.

At a certain threshold, the benefits of a tax become less significant than the costs of reduced demand. The decrease in demand sends a debilitating wave throughout the economy as linked suppliers are affected, with the subsequent loss of tax revenue in many sectors.

A modelling study of five countries in the APEC region found that a 1% increase in a tax rate would lead to an average reduction of US$56.7 million in Travel & Tourism’s contribution to GDP because of the subsequent drop in visitor numbers. In South Korea, a 1% increase in VAT would lead to a drop in visitor demand and a reduction in total contribution to GDP of US$117 million.

In recent years, several governments have reversed taxation policies due to their negative effect on visitor demand. Others have seen positive results after introducing lower tax rates on the Travel & Tourism sector or giving tax refunds to international visitors. For example, the substantial reduction of air-ticket taxes and fuel prices to encourage a growth in domestic flights has, according to the World Economic Forum (WEF), helped Japan become more cost-competitive in relation to other countries. It has climbed 25 places to 94th on that measure in WEF’s 2017 Travel & Tourism Competitiveness Index.

CASE STUDY: NETHERLANDS

In 2008, passengers flying abroad from the Netherlands had to pay a new aviation departure fee (€11.25 short-haul and €45 long-haul). But a year later it was abandoned after Amsterdam Schiphol airport saw a decrease of around two million passengers (many deciding to book flights from Belgian and German airports instead), and an estimated cost to the economy of US$1.7 billion.

CASE STUDY: USA

A WTTC report analysing the tax burden on the US Travel & Tourism sector found that its tax contribution was far higher proportionally than other major US industries. For every US$3 million in business sales, the accommodation sector generated the most tax - $375,229, followed by recreation and entertainment services at $364,100. In contrast, agriculture generated only $251,002 and manufacturing $267,705 in tax proceeds.

The air transport sector also faces many indirect taxes. Customers pay proportionately more in federal taxes for air travel in the USA than they do on alcohol, tobacco, or guns. Travel & Tourism’s contribution to US GDP is 2.7% of the economy. Yet its direct taxes in the USA represented 3.1% of all taxes collected in 2012. Each of the seven other sectors analysed was taxed at a lower rate than its share of GDP. An average industry’s contributions to the tax base and GDP would be equal.

CASE STUDY: VAT ON HOTELS ACROSS THE EUROPEAN UNION

VAT rates on accommodation in the European Union (EU) currently range from 3% (Luxembourg) to 25% (Denmark). Member states must apply a standard VAT rate of at least 5% but have the option of applying a reduced rate to hotel accommodation. The United Kingdom (UK) is one of the few EU countries not to take advantage of the reduced rate, and only Denmark has a higher VAT rate than the UK for accommodation.

The ‘Cut Tourism VAT Campaign’ is lobbying for the rate of tourism VAT in the UK to be brought into line with competitor destinations within the EU, with a reduction from 20% to 5%. Its model analysis indicates that this would result in a £1.65 billion net improvement in the UK’s balance of trade after three years, generated by a combination of more overseas visitors visiting the UK and more UK residents switching from overseas visits to holidays at home.

3. EFFICIENCY

Taxes must generate revenue without choking off demand (unless the tax is designed to modify behaviour) or increasing production costs, and should only apply to the final stage of production or service. Over-taxation forces up prices, depresses Travel & Tourism demand and ultimately depresses the general economy.

At a certain threshold, the benefits of a tax become less significant than the costs of reduced demand. The decrease in demand sends a debilitating wave throughout the economy as linked suppliers are affected, with the subsequent loss of tax revenue in many sectors.

A modelling study of five countries in the APEC region found that a 1% increase in a tax rate would lead to an average reduction of US$56.7 million in Travel & Tourism’s contribution to GDP because of the subsequent drop in visitor numbers. In South Korea, a 1% increase in VAT would lead to a drop in visitor demand and a reduction in total contribution to GDP of US$117 million.

In recent years, several governments have reversed taxation policies due to their negative effect on visitor demand. Others have seen positive results after introducing lower tax rates on the Travel & Tourism sector or giving tax refunds to international visitors. For example, the substantial reduction of air-ticket taxes and fuel prices to encourage a growth in domestic flights has, according to the World Economic Forum (WEF), helped Japan become more cost-competitive in relation to other countries. It has climbed 25 places to 94th on that measure in WEF’s 2017 Travel & Tourism Competitiveness Index.

CASE STUDY: NETHERLANDS

In 2008, passengers flying abroad from the Netherlands had to pay a new aviation departure fee (€11.25 short-haul and €45 long-haul). But a year later it was abandoned after Amsterdam Schiphol airport saw a decrease of around two million passengers (many deciding to book flights from Belgian and German airports instead), and an estimated cost to the economy of US$1.7 billion.

CASE STUDY: USA

A WTTC report analysing the tax burden on the US Travel & Tourism sector found that its tax contribution was far higher proportionally than other major US industries. For every US$3 million in business sales, the accommodation sector generated the most tax - $375,229, followed by recreation and entertainment services at $364,100. In contrast, agriculture generated only $251,002 and manufacturing $267,705 in tax proceeds.

The air transport sector also faces many indirect taxes. Customers pay proportionately more in federal taxes for air travel in the USA than they do on alcohol, tobacco, or guns. Travel & Tourism’s contribution to US GDP is 2.7% of the economy. Yet its direct taxes in the USA represented 3.1% of all taxes collected in 2012. Each of the seven other sectors analysed was taxed at a lower rate than its share of GDP. An average industry’s contributions to the tax base and GDP would be equal.
4. SIMPLICITY

Taxes should be administered and collected easily. Complicated taxation schemes involve high administrative costs that eat into the revenues of taxpayers but also of governments when collecting and enforcing taxes. They should be applied in a standardised way among different sectors of the industry and it should be clearly defined what the tax rates are, and what the revenues are intended to be used for.

An objective of good tax policy is to achieve the highest possible ratio of revenues generated per dollar invested in collecting the tax. The way that the tax is implemented should not cause unnecessary costs to the industry. It should be clear to taxpayers how the tax will be collected and whether the revenues will be hypothecated to specific areas relevant to increasing growth in Travel & Tourism.

CASE STUDY: AUSTRALIAN TAX OFFICE

The Australian Tax Office provides clear and direct guidance to people earning money from the sharing economy with a series of short, plain-language pages on its website www.ato.gov.au that explain simply the tax implications of earning income in different ‘sharing economy’ businesses.

CASE STUDY: SLOVENIAN GOVERNMENT REFORM

As part of its National Reform Programme 2017–2018, the government pledges tax measures to stimulate the business environment. These include ‘improving the efficiency of collecting public taxes…continuing activities to shorten deadlines for resolving complaints’ and ‘improving the transparency of tax rulings’.

5. EFFECTIVE STIMULUS TO GROWTH

Taxes should be used to stimulate and promote, not hinder, economic growth and job creation. As a labour-intensive industry, Travel & Tourism has a large, indirect impact on the wider economy. Taxes on the sector should be hypothecated, with revenues put back into relevant infrastructure projects to enhance growth potential. Ideally this will attract investment and subsequent employment.

In many countries, Travel & Tourism faces excessive taxation in relation to the amount of government investment in the sector. In Argentina, for example, according to WEF, the taxes and charges levied on tickets and airport services are among the highest in the world. Yet less than 2.5% of the federal budget is allocated to Travel & Tourism.

Other nations have, however, made strides to hypothecate taxes for tourism promotion and development. The revenue from aviation taxes is the primary source of funding for Costa Rica’s Tourism Board, while dedicated taxes on gambling form 39% of Turismo de Portugal’s budget.

Faced with increasing visitor numbers in popular cities, resorts and ports, governments are increasingly experimenting with taxation as a means of stifling demand. However, reducing numbers without addressing the income part of the equation is short sighted. Extra revenue should be used to finance infrastructure, overall maintenance of the city or training of staff. It should also incentivise providers (such as hoteliers) or visitors to behave in a more sustainable way, such as encouraging travel to less visited areas or in the low season.

Barcelona’s authorities plan to expand the tourism tax on overnight visitors in 2018 to people on day-trip tours to the city, even if there for only a couple of hours. The funds raised will support the expansion of critical infrastructure overstrained by tourists, protect tourism resources, and promote responsible tourism.

CASE STUDY: THE TOURIST TAX RETURNS TO THE BALEARIC ISLANDS

In 2016, the government of the Balearic Islands in Spain introduced an accommodation tax on all visitors, ranging from €0.25 to €2 per day, depending on type of accommodation, the season, and length of stay. It has made clear that the revenue will fund promotion of sustainable tourism. This includes preserving the natural and rural environment, rehabilitating historical and cultural heritage, and creating and promoting tourist products in low season.

This is not the first time the Balearic Islands have experienced an accommodation tax designed to fund sustainable tourism. A tax introduced in 2002 raised £2 million and paid for projects such as the development of themed tours around Palma and planting of traditional tree species. However, the number of international visitors during 2002 plummeted, and a newly-elected alternative government scrapped the tax a year later.

9 World Economic Forum Travel & Tourism Competitiveness Report 2017
10 OECD Tourism Trends and Policies 2016