The Impact of Taxes on the Competitiveness of European Tourism

Final Report

Written by PricewaterhouseCoopers LLP (PwC)
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PREFACE

This report has been prepared for the project "The Impact of Taxes on the Competitiveness of European Tourism", Specific Contract No. SI2.ACPROCE083933600, implementing the Framework Service Contract No. TAXUD/2015/CC/131 for the provision of economic analysis in the area of taxation.

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The information and views set out in this report are those of the authors and do not necessarily reflect the official opinion of the Commission. The Commission does not guarantee the accuracy of the data included in this study. Neither the Commission nor any person acting on the Commission's behalf may be held responsible for the use which may be made of the information contained therein.

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LIST OF ABBREVIATIONS

ABTA	Association of British Travel Agents
ATB	Agency for Tourism of the Balearic Islands
APD	Air Passenger Duty
ATM	Automated Teller Machine
CET	Contribution Economique Territoriale (Territorial Economic Contribution)
CFE	Cotisation Fonciere des Entreprises (Property Contribution of Enterprises)
CGE	Computable General Equilibrium
CIT	Corporate Income Tax(es)
CTO	Cyprus Tourism Organisation
CVAE	Cotisation sur la Valeur Ajoutée des Entreprises (Value-Added Contribution of Enterprises)
DPE	Dynamic Partial Equilibrium
EC	European Commission
EFTA	European Free Trade Association
ENFIA	Unified Real Estate Tax
EU	European Union
EY	Ernst & Young
GDP	Gross Domestic Product
GST	Goods and Services Tax
GVA	Gross-value Added
HOTREC	Hospitality Europe
IAAPA	International Association of Amusement Parks and Attractions
IAE	Tax on Business Activity
IATA	International Air Transport Association
ICT	Information and Communication Technology
IHA	Hotelverband Deutschland (German International Hotel Association)
MS	Member State(s)
OECD	Organisation for Economic Co-operation and Development
PIT	Personal Income Tax(es)
PPP	Purchasing Power Parity
PwC	PricewaterhouseCoopers
SME	Small & Medium Enterprises
TAMS	Travel Agents' Margin Scheme
UK	United Kingdom
USA	United States of America
VAT	Value-added Tax
WEF	World Economic Forum
WTTC	World Travel and Tourism Council
WWTS	PricewaterhouseCoopers Worldwide Tax Summaries

ABSTRACT

Tourism is an important economic sector bringing a very substantial contribution to the EU economy. Achieving growth in this increasingly competitive international market requires a supportive regulatory environment, and taxation is a core component of this. While on the one hand taxes directly impact the margins made by businesses and the prices faced by tourists, on the other hand they are an important source of government revenue, which in turn is used to finance infrastructure and support to the tourism sector.

This study's objective is to review the current tourism-related tax structures in place at a national level in the EU-28 countries. This includes compiling a database of the current tourism-related taxes at the national level in the EU and an analysis of the effects of tourism taxes on the competitiveness of tourism enterprises.

The study's empirical evidence suggests a strong case for reduced taxes on tourists in order to improve the competitiveness of tourist destinations and support the local tourism sector. However, given the need to raise revenue on the one hand and the need to maintain competitiveness on the other, policy makers need to carefully design the tax system so as to balance these conflicting objectives.

EXECUTIVE SUMMARY

Introduction

The tourism sector plays a vital role in the EU economy and is at the heart of the EU's strategy of promoting economic recovery and growth. The total contribution of the sector is already estimated at over 10% of EU GDP and tourist arrivals are projected to grow at almost 2% per annum over the next few years, reaching 557 million by 2030.

Achieving this growth in an increasingly competitive international market will require a supportive regulatory environment, and taxation is a core component of this. Taxation affects the competitiveness of the sector through the costs borne by firms such as accommodation providers and travel agents and tour operators, and through the prices faced by tourists, who are increasingly able to compare prices and quality from the comfort of their living rooms. This increased consumer awareness and price sensitivity puts pressure on competing tourism destinations to ensure that prices are competitive and that their offering to tourists is of the highest standard.

Of course, taxation plays two roles and it is important not to lose sight of both in any discussion of the impact of taxes on the competitiveness of the tourism sector. While on the one hand taxes directly impact the margins made by businesses and the prices faced by tourists, on the other hand they are an important source of government revenue, which in turn is used to finance the building and maintenance of tourism infrastructure (e.g. airports, roads), ensure the safety and security of tourists, maintain tourist attractions and landmarks, and provide other services essential to a healthy and vibrant tourism sector.

In light of the importance of the tourism sector and the influence of taxes on its competitiveness, the European Parliament recommended that the EC carry out a review of the current tourism-related tax structures at a national level in the EU-28 countries.

Objectives and Approach

The key aims of this study are to build an understanding of the taxes facing the tourism sector across the EU and to measure their effects on its competitiveness. The study has the following core objectives:

- To identify the main features of national tax regimes in the EU-28 insofar as they impact significantly on tourists and the tourism sector.
- To present a small number of case studies highlighting best practices and business-friendly taxation policies at the national and local level.
- To evaluate how taxes impact the competitiveness of the tourism sector at the Member State (MS) level.
- To provide a calculation method for estimating the impact of tax policies on the tourist sector and the economy as a whole.
- To make recommendations with regards to the appropriate mix of taxation likely to have a limited impact on tourism business competitiveness.

This assessment comprises a mix of desk research, discussions with local tax practitioners, and quantitative economic analysis. Where the analysis focuses on specific businesses operating in the sector, we focus on accommodation providers and travel agents and tour operators as two representative industries. In many MS the former are charged with the collection and remittance of the tax most commonly considered a 'tourist tax' – the occupancy or bed tax – and are subject to a range of other taxes. The most unique tax consideration for the latter is the Travel Agents Margin Scheme (the TAMS) for VAT.

Taxes on the tourism sector in the European Union

Because of the broad range of economic activities that the tourism sector comprises, most taxes have an impact on some elements of the sector. However, we focus on the most relevant general and tourism sector specific taxes.

Corporate and personal income taxes. Corporate income taxes (CIT) vary significantly in rates and bases, but overarching CIT rates range from as low as 9% (in Hungary) to up to 35.53% (in Belgium) and average around 21%. Many of the lowest rates are applied in Eastern European countries, with rates between 9% - 21%. Marginal personal income tax (PIT) rates for average earners across the EU-28 range from 10% in Bulgaria to up to 54.5% in Belgium, with an average of just below 30% across all MS. Across the EU-28, there is a tendency for higher CIT to be associated with higher PIT, and there are very few exemptions or special schemes for tourism for either income tax. Croatia's tourism contribution tax on the income of businesses and individuals working in the tourism sector is the only significant income tax targeted at the sector.

Real estate taxes. Real estate tax rates can vary significantly within a country and are typically set by local municipalities, either as a percentage of real estate value, per square metre of land or buildings, or on the basis of deemed rental income. The only significant exemption or special scheme for tourism is a partial exemption in France.

Value-added tax (VAT). The EU Directive on VAT sets the broad parameters for the application of VAT across MS. The VAT is often used as a lever for reducing the tax burden on certain parts of the sector, with most MS applying some form of reduced rate to the key goods and services relating to tourism. Only two MS (Denmark and Slovakia) apply VAT at the standard rate for all tourism-related goods and services, although the UK provides a reduced rate only for passenger transportation, and there is limited scope for MS to further reduce VAT rates in support of the tourism sector.

Occupancy tax. Occupancy taxes are levied on short-term stays in 18 MS and typically charged per person, per night, with significant municipal discretion over the rates applied. The rate typically varies by the standard of accommodation (e.g. star rating of the hotel or resort), location and local authority, and children often attract reduced rates or are exempt entirely. Comparatively low rates are charged in the Eastern European MS, and the tax revenues are hypothecated for tourism purposes in a number of countries.

Air passenger duty/departure taxes. While almost every MS applies some sort of charge, fee or levy to departures, relatively few of these could be considered *taxes*, and most are better defined as charges related to a specific service. Across the EU-28, only seven countries apply a departure tax as defined here. Rates can vary significantly by airport within a MS, and are often distinguished by the length of journey and whether a flight is intra or extra EU. Rates may also vary depending on the type of aircraft and class of travel.

Other tourism-specific taxes and levies. Aside from occupancy and departure taxes, very few taxes are levied on the tourism sector specifically. In France, two different taxes apply to the skiing industry - a local municipal tax on gross revenues from the operation of ski lifts and a tax on accessing cross-country skiing trails - and Cyprus has introduced a gaming levy on the gambling sector as part of its drive to promote gambling tourism.

A 'tourism friendly' tax regime could include reduced VAT rates for accommodation and transport of passengers and no occupancy taxes or departure taxes. Cyprus, Estonia, Finland, Ireland, Latvia, Luxembourg and Sweden have used all of these policy instruments. On the other end of the spectrum, countries like Austria, France, Germany, Italy and the UK levy several taxes on tourism related services, although none of them combine high VAT rates on accommodation with occupancy tax and departure tax.

Case studies

To complement the high-level assessment of tax regimes and economic analysis, we examine the tourism sectors and tax regimes of three specific locations (one country, one region and one city) in more detail. Despite significant variation in tax regimes, all three locations have well-recognised tourism sectors.

The Balearic Islands (Spain). The Spanish system of strong regional autonomy allows the Balearic Islands Government and its city councils substantial authority in setting certain tax rates facing residents and visitors, and as a result tax rates vary significantly. The suite of taxes applied in the Balearics includes taxes on wealth, inheritance, gifts, property transactions and a range of tourism-related taxes. Perhaps the most interesting element of the Balearic Islands tax regime for the tourism sector is the recently introduced Sustainable Tourism Tax – an occupancy tax very similar to one introduced and then quickly withdrawn a decade prior. The difference in the way the two occupancy taxes appear to have been accepted by the sector provides a useful insight into best practices around the introduction and administration of such taxes, including the engagement and consultation process prior to introduction, transparency around the way the revenues are spent, and the degree of ongoing involvement from the sector itself.

Paris (France). Paris applies a wide variety of taxes to the tourism sector, including two separate departure taxes. There is a particularly strong property sharing culture in the city and, with around 78,000 properties listed on Airbnb, Paris is the platform's most popular location for landlords. Given its popularity – and the difficulties associated with collecting occupancy taxes directly from individual accommodation providers – the Paris government now requires platforms like Airbnb and HomeAway to collect and remit these

on behalf of the owners. The city has had to increase its expenditure on security measures following the terror attacks of 2015.

Cyprus. Cyprus is the second most tourism-intensive MS in the European Union (after Malta). Interestingly with respect to its tax regime, and in contrast to both the Balearic Islands and Paris, Cyprus levies very few taxes on the tourism sector. Its corporate and personal income taxes and VAT are low by comparison and it levies no property, departure or occupancy taxes of any kind. The government is seeking to diversify the tourism sector by promoting new tourism-offerings such as a luxury gambling industry.

Economic analysis of the impact of taxation

In addition to the tax database and case study analysis, we examine the literature looking at the impact of taxes on tourism economically, including the key drivers of competition in the industry and the implications of taxes on tourism flows. We then assess the impact of a change in tourism taxes using publicly available data.

Regulators have a key role to play in maintaining competitiveness in the tourism industry, particularly in light of increasing global competition. In recent years, price and quality have become increasingly important in driving competition. With the development of price comparison sites and the availability of online quality ratings, consumers are increasingly well informed about the price and quality of competing destinations. Taxes, if passed through to prices, can therefore readily impact on the competitiveness of one destination vis-a-vis another and hence on tourist flows.

In our review we have considered the implications of tourism taxes for the competitiveness of EU MS. The magnitude of the economic impact from changing tourist taxes depends on the elasticity of tourism demand (the responsiveness of demand to a change in prices) and on the rate of pass-through (the extent to which producers pass on changes in taxes to consumers as changes in price), both of which are dependent on a range of country-specific and context-specific factors. In general, the literature suggests both a high degree of pass-through, particularly in the long-run, and a high elasticity of demand, particularly for destinations with close substitutes. This implies that a reduction in taxes is likely to have a large positive impact on tourism flows and, by extension, on the wider economy.

We have assessed the potential impacts of changing occupancy taxes using a simple data tool. Findings from our analysis of a hypothetical change in occupancy tax rates indicate that countries are likely to be affected to varying extents. Given the extensive competition for coastal tourism, academic research finds that tourists tend to be particularly responsive to a change in price of a beach holiday. Accordingly, countries in Southern Europe, which rely more on coastal tourism, are expected to be most adversely affected by an increase in tourist taxes and, by the same token, also stand to gain the most from a reduction in tourist taxes. On the other hand, countries which are more frequently visited by business travellers, who are less sensitive to prices, are likely to be less affected by tax changes.

Overall, our analysis suggests a strong economic case for countries which compete heavily for tourism to apply reduced taxes to the sector, increasing their competitiveness and allowing them to draw in more tourists. However, a reduction in tourist taxes needs to be balanced against a short-term loss in fiscal revenues, which can impact the quality of publicly-provided tourism services and may offset the increased tourism demand from a fall in price. Although not explicitly measured in our analysis, impacts on demand due to price changes in competing destinations are also important, and emphasise the need for policy makers not to form their own tourism tax strategies in isolation.

Recommendations

Overall, our qualitative and empirical analysis suggests a strong case for reduced taxes on tourists in order to improve the competitiveness of tourist destinations and support the local tourism sector. Given the need to raise revenue on the one hand, and the need to maintain competitiveness on the other, policy makers need to carefully design the tax system so as to balance these conflicting objectives.

There are arguments for levying taxes on the tourism sector, notably the use of taxes to correct for the negative impacts of tourism which would otherwise not be factored into the cost faced by the tourist. However, the sector is particularly price sensitive (and evidence would suggest it is increasingly so) so it is important that the tax regime does not hamper its competitiveness. Therefore there is an argument for keeping taxes on the sector low.

However, the tax levers available to policy makers looking to reduce the burden on the tourism sector are limited. General tax levers such as corporate and personal income taxes provide very limited scope for targeting a given sector, and even those general tax levers that might be more amenable to specific targeting provide little scope in practice. For example, most MS already apply reduced VAT rates to tourism related services and many have little or no legal headroom to reduce these any further.

On the other hand, specific taxes such as occupancy tax provide much greater flexibility in adjusting the tax rates and base and are not subject to the same practical and legal constraints as general taxes. The recommendations below comprise a number of specific considerations for MS looking to reform or introduce tourism taxes such as these.

Recommendation 1: *Reduced taxes on tourism can increase the competitiveness of tourist destinations and bring wider economic benefits. However this needs to be balanced against a loss in short-term revenues, and cross-sector and cross-border implications*

Analysis suggests a strong economic case for countries which compete heavily for tourists to reduce specific taxes on the sector, increasing their competitiveness and allowing them to attract more tourists. However, a reduction in tourist taxes needs to be balanced against a short-term loss in fiscal revenues. Where government revenues are invested in the tourism sector this is particularly important, as a reduction in revenues can impact quality. MS also need to be mindful of tax rates in competing destinations, and potentially consider coordinated tax policies to avoid a race to the bottom.

Recommendation 2: *The perceived uniqueness of a location has a bearing on the effectiveness of its tax regime, and governments can influence this*

The distinction in uniqueness between the marketable elements of different destinations has real impacts on the price elasticity of that location, with clear implications for the appropriateness of various taxes and tax levels. Policy makers should be cognisant of these factors when designing and implementing tourism taxes in their respective economies. Governments can also help to improve the perception of uniqueness by supporting the promotion of the country's unique aspects, either through supportive regulation (e.g. opening up unique geographical attractions to sustainable tourism), distinctive international tourism marketing, or investment in the necessary infrastructure.

Recommendation 3: *How a tourist tax is introduced and administered has important implications for how the sector responds to it*

Governments can increase the public and sectoral support for a new tax through the way in which that tax is introduced. Measures to increase buy-in from the sector should include early notification of the government's intention to look at introducing such a tax and a process of proper engagement with stakeholders. Although it may be sub-optimal from an economic point of view, from a political point of view such taxes may also be better received and accepted by the industry if the revenues raised are set aside (hypothecated) to support the tourism sector. Any hypothecation should be done transparently, and potentially even with the involvement of the industry itself.

Recommendation 4: *Compliance issues should also be considered to avoid occupancy taxes from becoming a burden on compliant businesses*

The rapid growth of the sharing economy provides challenges for tax authorities in raising awareness of obligations, supporting providers to comply with them, and policing non-compliance. This can introduce a degree of inequity between compliant and non-compliant businesses, distorting the market, reducing tax morale and leading to a loss of revenues for the government. Ensuring compliance is an important component of levying occupancy taxes, and tax authorities have begun to make use of the establishment of large platform providers to facilitate the automated collection of occupancy taxes.

Recommendation 5: *The visibility of occupancy taxes is not just an administrative issue, but may also have implications for consumer behaviour*

Although the overall cost to the tourist would be the same irrespective of whether the tax is paid upfront or on checkout, the experience of paying the tax is quite different and may have consequences for tourist behaviour. Tourists can be frustrated by 'hidden' charges they had not retained sufficient local currency for, making it difficult for them to budget for their holidays in advance and even putting them off certain locations. This 'hassle factor' can be avoided by requiring the occupancy tax to be incorporated into the upfront payment taken by the accommodation provider.

Recommendation 6: *Occupancy taxes inherently favour some tourists over others, and should be designed or reformed with equity issues in mind*

The way occupancy taxes are levied means that they inherently favour certain groups of tourists over another, for example business tourists vs. leisure tourists or younger guests vs. older guests. This may be a result of a specific exemption or just inherent in the way the tax is levied, and demonstrates the flexibility occupancy taxes provide in achieving various policy objectives. Governments looking to introduce or redesign an occupancy tax should explicitly consider these equity implications in the design of this tax.

1. INTRODUCTION

1.1. Background

The tourism sector is at the heart of achieving the EU's strategy of promoting economic recovery and growth. Recent estimates of the significance of the industry suggest that the total contribution of the sector is over 10% of EU GDP, with the industry directly employing 5% of the total workforce (over 11 million jobs) and indirectly employing another 6.6% (in total employing 11.6% of the workforce, over 26 million jobs).[1] The industry is comprised mostly of small and medium-sized enterprises, and the Commission has noted that tourism is important "not only to countries' and regions' economic development, but also their social and cultural development and general well-being".[2]

Projections by the World Tourism Organisation show that international tourist arrivals to the EU-28 could reach up to 557 million by 2030, up from 380 million in 2010, implying an average annual growth rate of around 1.9%.[3] To achieve these growth rates, the European tourism industry needs to remain competitive. This is even more important given developments in ICT for searching and booking for holidays make it easier for customers to compare prices, customer ratings and convenience of all tourism destinations, European and non-European alike.

Regulators have a key role to play in helping to maintain competitiveness in the tourism sector, and taxation is a core component of this. For example, a 2013 study which analysed the impact of a reduced VAT rate on tourism-related goods and services in Ireland showed that it significantly increased activity and employment across the industry. Specifically, the reduction in the VAT rate applicable to tourism sectors from 13.5% to 9% increased activity in the industry by 16% (compared to the 12 months prior to the introduction of the reduce VAT rate) and increased employment by around 10,000.[4] Of course, reducing the impact of taxes on the sector is only one side of the story, and this needs to be balanced with the desire to support the sector through suitable investments and expenditures, which are often facilitated by such taxes.

Studies have found that the price elasticity of demand for tourist services can be high,[5] and in these cases taxes and other levies may have a disproportionate impact on consumption patterns. Furthermore, the tourism sector is characterised by a large number of small and micro-sized businesses that often operate at low profit margins and lack significant capital buffers, meaning small changes in the tax system can mean the difference between viability and bankruptcy. These businesses may be particularly vulnerable to changes in their fixed cost base (for example, via increases in real estate taxes as opposed to profit taxes). Such businesses also face significant disruption through the rise of the sharing economy, which has introduced greater competition and in some cases may test the adequacy of the tax policies currently in place.

[1] World Travel and Tourism Council, 2017c
[2] Eurostat, 2013
[3] World Tourism Organisation, 2016
[4] Deloitte, 2013
[5] For example Crouch, 1994

Finally, to the extent that tax increases are passed on to consumers, taxation of international tourism may lack the same degree of political accountability as other forms of domestic taxation. This makes the tourism sector an attractive target for governments seeking to raise revenue, while also increasing the risk of policies being implemented that raise short-term revenues at the expense of long-term growth.

It is in light of the tourism sector's economic importance, and its unique sensitivities to regulation and taxation, the present study has been commissioned.

1.2. Objectives

The European Parliament has recommended that the Commission carry out a review of the current tourism-related tax structures in place at a national level in the EU-28 countries. Promoting competitiveness and sustainable growth of the tourism sector is a main goal of EU Tourism policy, so the study provides an analysis on the implication of tourism taxes on the competitiveness of tourism enterprises and the wider sector.

The study has the following core objectives:

- To identify the main features of national tax regimes in the EU-28 insofar as they impact significantly on tourists and the tourism sector. Including any hypothecation of revenues for reinvestment in tourism-related infrastructure or services.

- To present a small number of case studies highlighting best practices and business-friendly taxation policies at the national and local level.

- To evaluate how taxes impact the competitiveness of the tourism sector at the Member State (MS) level, as regards costs, profitability and investments.

- To provide a calculation method for estimating the impact of tax policies on the tourist sector and the economy as a whole.

- To make recommendations on the appropriate mix of taxation likely to have a limited impact on tourism business competitiveness.

Given the diverse range of suppliers operating in the tourism sector (hotels, restaurants, tour operators, transport companies, taxi drivers, operators of cultural and sporting events, operators of visitor attractions, cruise vessels, etc.), the EC has requested we focus on the subsectors of accommodation and tour operator & travel agents.

1.3. General approach

The study is primarily based on desk research and analysis, supplemented by discussions with relevant local and international experts. The approach has closely followed the objectives outlined above, and includes:

1. **A schedule of relevant taxes in the European Union:** all relevant taxes have been identified and described for the 28 EU MS. The findings are presented in the following chapter, and in a separate database.

2. **Case study analysis of potential best-practice countries:** analysis of three tourism-intensive areas (one city, one region and one country, all from different MS) is presented in Chapter 3. These three locations were selected from an initial shortlist of six locations, and an outline of the other three locations is provided in Appendix I.

3. **Evaluation of the impact of taxes on competitiveness at the MS level:** Chapter 4 compares the impact of a key tax on the tourism accommodation sector: occupancy tax. The impacts of occupancy tax on sectoral and economy-wide GDP and employment are estimated.

4. **Recommendations on the appropriate mix of taxation for the tourism sector:** finally, Chapter 5 draws together the schedule of taxes, case studies and economic analysis in the previous chapters to provide an assessment of the appropriateness of tourism taxes and their impacts on the sector.

More detailed descriptions of the methodology for each component is provided in the relevant chapters.

This study is intended to provide an overview of the tax environment for the tourism sector across the European Union and an assessment of impacts of various taxes on the sector's competitiveness. It does not examine all tax types or tax regimes for MS in detail or provide specific recommendations for the tax regimes of individual MS.

Where the analysis looks at specific businesses operating in the sector, we have focused on accommodation providers and travel agents and tour operators as two of the key businesses operating in the sector. Although the sector comprises many different types of business, unlike many others these two would not exist without the tourism industry, and both contribute significantly to the sector's economic contribution.[6] Of course, these businesses operate in a complex and fragmented sector with a wide variety of contributors. The key considerations relating to the two businesses at the focus of this study are outlined below.

1.4. Tour operators and travel agents

The main unique tax consideration for travel agents and tour operators is the VAT margin scheme: the Travel Agents' Margin Scheme (TAMS). The scheme applies to those whose business activities bring them within the scope of the scheme, and not necessarily to all agents and operators. While the details of this scheme are the subject of another study and outside the scope of this paper, we note that the operation of the TAMS does not

[6] European Commission (2009)

affect the tax treatment of the underlying travel services. In effect, the tax costs on the underlying travel services should be incurred as a cost to the final consumers with the same effect as if the final consumers had sourced the underlying travel services directly from the suppliers. The only deviation from this is that the VAT rate on the margin itself (as opposed to the underlying services) is subject to VAT in the country in which the travel agent or tour operator is established.

Another important consideration regarding tour operators and travel agents is that their competitiveness is affected not only by the tax regime applicable in their country of residence, but also by the tax regime of the destination countries where the goods and services are supplied to their customers. For example, an increase in UK income tax rates may have a direct impact on a London based firm, but an increase in Spanish income tax rates may also - to the extent this is passed through to prices - impact the competitiveness of the Spanish holiday products that London firm offers to their customers. Although to some extent this relation occurs in other industries where international goods or services are inputs, for travel agents and tour operators this phenomenon is particularly relevant.

1.5. Accommodation providers

Accommodation providers such as hotels, motels, shared accommodation providers and campsites are typically subject to a range of general and tourism-specific taxes, as the following chapters will demonstrate. The tax most commonly considered to be a 'tourist tax' is the occupancy tax or bed tax, which accommodation providers collect from guests and remit to the (usually local or municipal) tax authority. As is discussed further below, accommodation providers may also be directly affected by VAT, real estate taxes, and corporate and personal income taxes.

The hotel industry is made up of direct accommodation providers as well as indirect providers such as online booking platforms, with many hotels now selling less directly and increasingly through intermediaries. The industry is complex, with capacity very rigid in the short term given the time taken to bring new supply onto the market, although this varies by accommodation type. Hotels and other booking agents are flexible and sophisticated in their pricing strategies, making it harder to determine the likely impact of tax vis-a-vis other drivers of price (season, location, capacity, etc).

One major development in recent years in the accommodation sector has been the relatively rapid growth of the shared accommodation market (as part of a wider growth in the collaborative economy worldwide). This includes companies like Airbnb and HomeAway, who provide a collective platform for individual property owners to market accommodation to prospective tourists and then - to varying degrees - to support with the management of this process. As an example, Airbnb reports that since the company's founding in 2008 it has grown to the point where it now operates in 65,000 cities across 191 countries, having provided a combined total of 160,000,000 guest stays.[7] As is the case with many fast growing, technology-driven markets, local tax systems have often

[7] Airbnb website, May 2017

struggled to keep up with this growth - both in design and administration. Whether as a result of pressure from hotel industry groups or other factors, companies that provide these platforms for shared accommodation are increasingly being required by local authorities to collect these taxes on behalf of individual property owners.

The following chapters present the findings of an analysis of all the key taxes facing the tourism sector, focussing on these two categories of tourism business (travel agents and tour operators and accommodation providers) where appropriate.

2. TOURISM-RELATED TAXES ACROSS THE EU-28

In this chapter we present an overview of the main tourism-related taxes, fees and levies applicable to the tourism sector in each of the 28 European Union Member States.

Because of the broad range of economic activities that the tourism sector comprises, most taxes are likely to have an impact on at least some element of the sector. However, here we have focussed on the taxes we anticipate are likely to have the most direct impact, including these general and tourism sector specific taxes:

- Corporate income tax
- Personal income tax (excluding social charges)
- Real estate taxes
- Value-added tax (VAT)
- Occupancy tax
- Air passenger duty/departure taxes
- Other tourism-specific taxes and levies

The following sections explain the impact of each of these taxes on the tourism sector, provide an overview of how they are applied (or not applied) across the EU-28, and highlight the key trends.

2.1. Corporate and personal income taxes

The tables below show the rates for corporate income tax (CIT; taxes based on corporate income) and personal income tax (PIT; taxes based on personal income), excluding any special exemptions or schemes not relevant to tourism.

It is important to note that social charges - such as those commonly applied to personal income - are not considered taxes and are therefore not included here. Nonetheless, it is worth noting that they may be akin to income taxes and in some cases these may add a significant cost burden to individuals and businesses in the tourism sector.

Although neither of these are tourism-specific taxes, they have a significant impact on the profitability and competitiveness of businesses and individuals operating in the sector. For businesses such as large accommodation providers and travel agents, the CIT rate affects businesses' net income and has implications for the attractiveness of investments, and the PIT rate has implications for the supply of labour. Individuals providing tourism-related services or goods, such as those providing small-scale accommodation services, are directly affected by the PIT rate.

As countries usually apply PIT rates on business income received by individuals, the relevance of CIT rates is usually restricted to larger parties in the tourism industry. As tourism-related services tend to be labour intensive, the PIT rates for wages, self-employed income and private businesses are particularly relevant. High PIT rates could result in people withdrawing from the labour market (thereby reducing supply), higher

prices for tourism-related services and/or higher levels of non-reporting of income (which may particularly be the case for occasional income, such as freelance tour guides and services offered through the sharing economy).

Table 1: Corporate income tax rates in the EU-28

Member State	Overarching rate(s) facing businesses (including state and local taxes)	Underlying CIT rate	National surcharges (if any)	Local income taxes (if any)	Notes
Austria	25%	25%	-	-	-
Belgium	33.99% (over €322,500) 35.54% (€90,001-€322,500) 31.93% (€25,001-€90,000) 24.98% (up to €25,000)	33% (over €322,500) 34.5% (€90,001-€322,500) 31% (€25,001-€90,000) 24.25% (up to €25,000)	3% crisis surtax	-	Companies with taxable income over the €322,500 threshold pay this rate on their entire taxable income.
Bulgaria	10%	10%	-	-	-
Croatia	18% (over HRK 3m / €398k)) 12% (up to HRK 3m/ €398k)	18% (over HRK 3m / €398k)) 12% (up to HRK 3m/ €398k)	-	-	Reduced from 20% on 1 January 2017. Exemptions of 50% or 100% apply to certain businesses in designated areas of special concern.
Cyprus	12.50%	12.50%	-	-	-
Czech Republic	19%	19%	-	-	-
Denmark	22%	22%	-	-	-
Estonia	20%	20%	-	-	-
Finland	20%	20%	-	-	-
France	34.43% (over €763,000) 33.33% (€75,000-€763,000) 28% (up to	33.33% (over €75,000) 28% (up to €75,000)	3.3% social surtax applies to CIT over €763,000	The local property tax contains an income-related component	The 33.33% rate will be progressively reduced to 28% for all companies by 2020.

	€75,000)			(CVAE), described in more detail in the property tax section.	
Germany	30%-33% (on average)	15%	5.5% solidarity levy surcharge	7%-17.1%	The tax base for regional rates can vary from the federal rates.
Greece	29%	29%	-	-	-
Hungary	9%	9%	-	-	A local business tax of up to 2% is also applied to net sales revenue (not income) by municipalities.
Ireland	12.5% (trading income) 25% (passive income)	12.5% (trading income) 25% (passive income)	-	-	Passive income refers to sources such as investment and rental income.
Italy	24%	24%	-	-	Corporates are also subject to a locally levied production tax of approximately 3.9% (with variable bases and rates).
Latvia	15%	15%	-	-	Certain small businesses (turnover of less than €100,000) can opt into a scheme whereby they are taxed on up to 15% of turnover in place of CIT, payroll taxes and other duties.
Lithuania	15% (over €300,000) 5% (up to €300,000)	15% (over €300,000) 5% (up to €300,000)	-	-	Lower rate is only applicable to entities with fewer than 10 employees.
Luxembourg	29.22% (over €15,000) 28.15% (up to €15,000) (for Luxembourg	21% (over €15,000) 20% (up to €15,000)	7% solidarity surtax	Variable municipal business tax (6.75% in Luxembourg	-

	City)			City)	
Malta	35%	35%	-	-	-
Netherlands	25% (over €200,000) 20% (up to €200,000)	25% (over €200,000) 20% (up to €200,000)	-	-	Threshold is being gradually increased to €350,000 by 2021.
Poland	19% (standard) 15% (small entities)	19% (standard) 15% (small entities)	-	-	Small entities are defined as those with sales revenue of no more than €1.2m in the previous tax year.
Portugal	Up to 22.5% (over €15,000) Up to 18.5% (up to €15,000, SMEs in coastal regions) Up to 14% (up to €15,000, SMEs in inland regions) Plus national surcharge on profits for large businesses.	21% (over €15,000) 17% (up to €15,000, SMEs in coastal regions) 12.5% (up to €15,000, SMEs in inland regions)	7% (over €35m) 5% (€7.5m-€35m) 3% (€1.5m-€7.5m) (on profit)	Variable municipal surcharge of up to 1.5%	-
Romania	16%	16%	-	-	Certain small businesses (turnover of less than €100,000 and various other conditions) are charged a revenue tax rate in lieu of the CIT, ranging from 1% (two or more employees) to 3% (no employees).
Slovakia	21%	21%	-	-	-
Slovenia	19%	19%	-	-	-
Spain	25% (standard) 15% (new companies) Plus local profit tax of up to 15%.	25% (standard) 15% (new companies)	-	Variable local business and professional activities profit tax of	New companies receive the lower rate for the first two first years in which they have a positive taxable base.

				up to 15% for companies with a turnover in excess of €1m.	
Sweden	22%	22%	-	-	-
UK	19%	19%	-	-	Falling to 17% from 1 April 2020

Note: These headline rates do not include various special rates, schemes and exemptions available on particular types of income or industries, the details of which can be found in the sources listed below.
Sources: PwC WWTS - Taxes on Corporate Income, government websites.

The overarching CIT rates across the EU-28 range from as low as 9% (in Hungary) to up to 35.53% (in Belgium), however the average rate across MS is around 21%. Many of the lowest rates are applied in Eastern European countries (with rates between 9% - 21%), whereas most countries in Southeastern and Western Europe impose comparatively higher rates.

In addition to there being a mix of flat rates and progressive schemes, there are a number of aspects in which CIT schemes diverge. These include different tax rates depending on revenue thresholds, types of income (e.g. passive vs. trading income), size of the company, length of establishment, and location of the business (e.g. coastal vs. inland). In the case of Portugal and Spain, taxes are applicable for both income and profit. Although CIT rates are nationally standardised in most countries, there are a number of cases where a surtax is applied locally.

We now turn to income earned by individuals. Because PIT rates tend to be levied on a progressive scale in many cases, the table below provides two metrics for PIT: the highest marginal rate applicable, and the marginal rate applicable to someone earning the average wage.

Although the top rate provides an interesting view of how PIT ranges across the EU-28, the tourism industry is largely made up of smaller businesses and sole traders who are unlikely to be facing the top marginal rate and are better represented by the average income taxpayer. Marginal rates for average earners are based on the 2016 annual average estimated gross wage earning (OECD data) and marginal income tax rate data (PwC WWTS and government websites). Where OECD data on average salary are not available, we have constructed a measure based on Eurostat data on mean gross hourly wage and hours per week for each MS, assuming 48 working weeks per year.

Table 2: Personal income tax rates in the EU-28

Member State	Overarching rate(s) facing individuals (including state and local taxes)	Marginal rate facing individual on the average income (including state and local taxes)	Underlying PIT rate(s)	Surcharges and local income taxes (if any)	Notes
Austria	Up to 55%	42.0%	Up to 55%	-	-
Belgium	Up to 54.5%	50%-54.5% (depending on location)	Up to 50%	Variable local surtax of 0%-9%.	The PIT rate comprises of up to 50% state tax plus up to 9% local surtax.
Bulgaria	10%	10%	10%	-	Flat tax.
Croatia	Up to 42.48%	24%-28.32% (depending on location)	Up to 36%	Variable local surtax of 0%-18%.	Two rates: 24% and 36%, plus a local surtax of between 0% - 18%. Main rates reduced from 25% and 40% on 1 January 2017. There is also a tax on the income of businesses and individuals working in the tourism industry, with rates of up to 0.1615% varying by location and business activity. Funding is directed to the local tourist boards.
Cyprus	Up to 35%	20.0%	Up to 35%	-	-
Czech Republic	15%	15%	15%	-	Flat tax.
Denmark	Up to 51.95%	40.3%	Up to 15%	Variable municipal income tax of 24.91% (on average), plus a health tax of 3%.	-
Estonia	20%	20%	20%	-	Flat tax.
Finland	Up to 54%	21.5%	Up to 31.50%	Variable municipal income tax of 16.5%-22.5%.	-

France	Up to 49%	30%	Up to 45%	3% or 4% surtax for high income individuals (income over €250,000 and €500,000, respectively).	Tax reduction available to individuals who invest in the refurbishment of property used for tourist accommodation. This regime is temporary and applies to work performed in the 2017-2019 calendar years.
Germany	Up to 47.475%	40.50%	Up to 45%	5.5% solidarity surtax	40.5% is a complex calculation: Geometrically progressive rates of 14%-42% apply to income between €8,653 and €53,665 (estimated at 38.36%, multiplied by the solidarity surtax).
Greece	Up to 45%	29.0%	Up to 45%	-	-
Hungary	15%	15%	15%	-	Flat tax.
Ireland	Up to 40%	40%	Up to 40%	-	-
Italy	Up to 43%	38.0%	Up to 43%	-	-
Latvia	23%	23%	23%	-	Flat tax.
Lithuania	15%	15%	15%	-	Flat tax.
Luxembourg	Up to 40%	39%	Up to 40%	-	-
Malta	Up to 35%	25%	Up to 35%	-	-
Netherlands	Up to 52%	40.8%	Up to 52%	-	-
Poland	Up to 32%	18%	Up to 32%	-	Some individuals running businesses (sole traders or partners in a partnership) can opt for a flat 19% rate.
Portugal	Up to 48%	28.5%	Up to 48%	-	-
Romania	16%	16%	16%	-	Flat tax.
Slovakia	Up to 25%	19%	Up to 25%	-	-
Slovenia	Up to 50%	27%	Up to 50%	-	-
Spain	Up to 45%	37%	Up to 45%	-	-

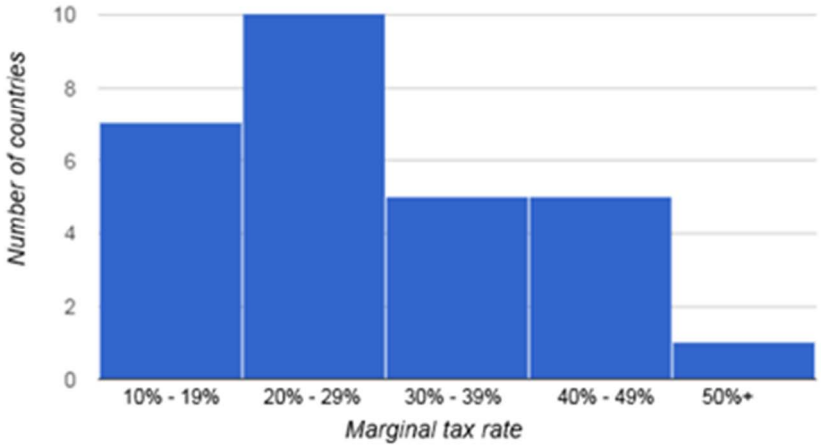
Sweden	Up to 57%	32% (based on average local rate)	Up to 25%	32% (average local rate)	Individual on average income faces 0% national income tax (falling just short of the SEK 439,000 (€46,357) threshold).
UK	Up to 45%	20%	Up to 45%	-	-

Note: These headline rates do not include various special rates, schemes and exemptions available on particular types of income (except where stated for tourism-related activities), the details of which can be found in the sources listed below.
Sources: PwC WWTS - Taxes on Personal Income, government websites, Eurostat 2016d, Eurostat 2017c, OECD 2017.

For PIT, it is particularly interesting to note that all the MS that apply a flat rate are located in Eastern Europe and the Baltics (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania and Romania). All other countries (predominantly in Southeastern and Western Europe and the Nordic region) tax personal income progressively and have much higher income tax rates for higher earners.

The marginal rates for average earners across the EU-28 range from 10% in Bulgaria to up to 54.5% in Belgium, with an average of just below 30% across all MS. The figure below shows that in almost two thirds of MS the average income payer faces a marginal tax rate of 30% or less. In only six countries do average income earners have tax rates of 40% or more. Of MS with progressive rates, only average income earners in Belgium and Ireland face the highest marginal rates.

Figure 1: Country count by marginal tax rates for an individual on the average wage



Sources: PwC analysis based on data from PwC WWTS, OECD 2017 and Eurostat (2016c and 2016d)

Across the EU-28, there is a tendency for higher CIT to be associated with higher PIT in a given country. Bulgaria, Estonia, Lithuania and Romania are the only four countries that have the same fixed rate for CIT and PIT.

Almost no significant exemptions or special schemes for tourism were identified for either CIT or PIT. The only significant exemption is France's temporary PIT reduction for individuals who invest in the refurbishment of property used for tourist accommodation. Croatia's tourism contribution tax on the income of businesses and individuals working in the tourism sector is the only significant income tax targeted at the sector (this is discussed further in the Croatia case study in Appendix I).

This is not entirely surprising, as EU state aid provisions (Article 107 and 108 of the Treaty on the Functioning of the European Union) restrict the ability of MS to apply different income tax treatment to different industries.

2.2. Real estate taxes

The table below summarises the real estate taxes applicable to land and/or property (immovable property) across the EU-28. Real estate tax primarily impacts the tourism sector through the accommodation sector (hotels and, increasingly, the online holiday home rental market), although can also have a significant impact on other tourism businesses where immovable property comprises a significant component of their business (e.g. restaurants and brick-and-mortar travel agents).

Because property taxes are typically charged on the value of the real estate regardless of its owner or function, these taxes would not typically distort the competition between different accommodation providers. As accommodation providers would need to recover the property tax as a cost before earning positive income, property taxes are expected to increase the room rates in a given location, particularly because substitution goods are not readily available or result in similar costs. However, as property taxes would affect the overall cost profile of a location, such taxes would affect competition between different holiday destinations.

In most cases real estate taxes are payable by the property/land owner. It is worth noting that we have focussed only on recurring taxes on real estate, and not any taxes associated with transfers of ownership or other ad hoc events.

Table 3: Real estate taxes in the EU-28

Member State	Tax base	Annual rate	Notes
Austria	Real estate value, varied by real estate type	0.05% - 0.2% and a municipal multiplier of up to 500%	-
Belgium	Deemed rental income ('cadastral income')	20% - 50%	-
Bulgaria	Real estate value (either tax value or gross book value)	0.01% - 0.45%	-
Croatia	No real estate tax		

Cyprus	No real estate tax (previous property tax was abolished at the start of 2017)		
Czech Republic	Rates set according to the type and size of the real estate, the purpose of usage, the number of floors and the location	Varies significantly by municipality	-
Denmark	1. Land value (excluding residential property) 2. Real estate value (residential only)	1. 1.6% - 3.4% 2. 1% - 3%	-
Estonia	Land value	0.1% - 2.5%	-
Finland	Real estate value	0.41% - 1.8%, depending on real estate type and location.	Higher rates apply to vacant plots in certain zones.
France	1. Residential & Commercial: Ownership tax on rental value of unimproved land 2. Residential & Commercial: Ownership tax on rental value of improved land 3. Commercial: Local economic contribution tax, made up of two components: i) a progressive tax on business 'value add' (more akin to a corporate income tax), and ii) a tax on property rental value 4. Residential: Personal dwelling tax, levied on residential occupants on the basis of property rental value.	Highly variable, depending on rates set by local commune (and departmental and regional councils in some cases), property type, and exemptions.	Exemption from both taxes is available for properties used as furnished tourist rentals.
Germany	A combination of the real estate value and a municipal multiplier.	0.26% - 1%	-
Greece	1. Main tax: based on the size (in square meters) of land and buildings. 2. Supplementary tax: based on real estate value	1. €2 -€13 per square meter for buildings; €0.0037 - €11.25 for land. 2. 0.5% for businesses; progressive scale for individuals	A new unified property tax was introduced in 2014, although it actually comprises these two taxes.
Hungary	1. Land area (in square meters) OR market value of land 2. The net floor space of the building OR the market value of the building	1. Up to HUF 200 (€0.64) per square meter OR up to 3% of value 2. Up to HUF 1,100 (€3.53) per square	-

		metre OR up to 3.6% of value	
Ireland	Real estate value	0.18% - 0.25%	-
Italy	Real estate value (based on a multiple of cadastral value)	0.2% - 1.06%	-
Latvia	Payable by businesses only, based on cadastral value of the real estate	0.2% - 3%	Only applicable to commercial property and residential property owned by a company (which attracts reduced rates).
Lithuania	1. Land value 2: Value of real estate used for commercial purposes	1. 0.01% - 4% 2. 0.3% - 3%	-
Luxembourg	Unitary value of the real estate (typically less than market value)	0.7% - 1%, multiplied by a municipal multiplier of up to 12.5, depending on the nature of the property and its location	-
Malta	No real estate tax		
Netherlands	Real estate value	0.04-0.21%	-
Poland	Usable area of property used for business purposes	Up to PLN 22.66 (€5.19) (for buildings) and PLN 0.89 (€0.20) (for land) per square meter	-
Portugal	Real estate value.	0.3% - 0.8%	Real estate that is part of a tourism complex granted with 'tourism utility' benefits from property tax exemption for a period of seven years
Romania	1. Land area (in square meters) 2. Building value	1. RON 0.0011 - RON 0.59 (€0.0024 - €0.13) per square meter 2. 0.08% - 0.2% for residential buildings and 0.2% - 1.3% for commercial buildings	-
Slovakia	Area of the property	From €0.57 - €8.30 (or more) per square metre, depending on location and number of floors	-
Slovenia	No real estate tax		

Spain	Real estate value	0.2% - 2.5%	Varies highly even within regions (local councils apply very different rates across the Balearic Islands, for example).
Sweden	Real estate value	Residential: Up to SEK 7,687 (€811.72) or 0.75% Commercial: 1% (business premises), 0.5% (industrial property) and other rates for special property	-
UK	Residential: Real estate value, split into 8 bands and varied by local authority Commercial: Determined by local council each year, based on the estimated rental value of the business property	Residential: Highly variable, depending on rate set by local authority for each of the 8 bands Commercial: 47.9% for standard rates, (or 46.6% for small businesses)	In addition there is an annual tax on high-value residential property held through a company (£3,500 (€4268.29)) for a £500,000 (€609,756) property, up to £218,200 (€266,097) max for a £20m (€24.4m) property).

Sources: PwC WWTS: Corporate - Other taxes, government websites

Real estate tax rates can vary significantly within a country and are typically set by local municipalities, either as a percentage of real estate value, per square metre of land or buildings, or on the basis of deemed rental income. For this reason, direct comparison across MS is difficult, although some general observations can be made.

Real estate tax is based on the value of the land or real estate in 19 MS, based on size in five MS, and based on rental income in two MS. Some countries set their rate based on more than one criteria (e.g. on both real estate value and rental income in the case of France). Four MS - Croatia, Cyprus, Malta and Slovenia - do not levy any form of tax on real estate.

Relevant rates start from 0.01% and do not rise above 4% of real estate value. The rate varies between residential and commercial property in approximately half of the MS, where businesses are charged slightly higher on average. In most cases, however, the average rates are between 0.34% and 1.6% of the real estate value, prior to adding any local/municipal multiplier. Although the maximum percentage may seem low, because of the large tax base, a slight variation in the rate can have a significant impact on annual tax liabilities.

As with income tax, the only significant exemption or special scheme for tourism was in France, where some communes grant a partial exemption for dwellings used by businesses for tourist accommodation.

2.3. Value-added tax (VAT)

The third general tax we have included is VAT. VAT is applied to the sale of most products and services across the EU (the Council of the European Commission sets the broad parameters for the application of VAT across MS through its Directive on VAT), including goods and services in the tourism sector. VAT is not the same as a general sales tax, in that registered businesses charge *output* VAT to their customers on the relevant goods and services they provide and are then able to offset this against the *input* VAT they themselves have paid to their suppliers.

VAT is often used as a lever for reducing the tax burden on certain parts of the sector, with most MS applying some form of reduced rate to the key goods and services relating to tourism, as outlined in the table below.

Table 4: Value-added tax rates in the EU-28

Member State	Standard rate	Renting hotel accomm.	Transport of passengers - domestic	Transport of passengers - intl air & sea	Transport of passengers - intl others	Admission to cultural services	Admission to amusement parks	Restaurant and catering services[2]	Admission to sporting events	Registration Threshold (in EUR equiv.)[3]
Luxembourg	17%	3%	3%	0%	0%	3%	3%	3%, 17%	[ex], 3%	€25,000
Malta	18%	7%	0%, 18%	0%	N/A	5%, 18%	18%	18%	18%	€14,000, €24,000, €35,000
Cyprus	19%	9%	5%, 9%	0%	0%	[ex], 5%	5%	9%	5%	€15,600
Germany	19%	7%	7%, 19%	0%	0%, 7%, 19%	[ex], 7%	19%	19%	7%, 19%	€17,500
Romania	19%	9%	19%	0%	0%	5%, 13%, 19%	19%	9%	5%	€48,998*
Austria	20%	13%	10%, 13%	0%	0%, 10%	[ex]	13%	10%	13%	€30,000
Bulgaria	20%	9%	20%	0%	0%	[ex], 20%	20%	20%	20%	€25,510*
Estonia	20%	9%	20%	0%	0%	20%	20%	20%	20%	€16,000
France	20%	10%	0%,	0%	[ex],	2.1%,	10%,	10%	5.50%	€33,100,

			10%		0%, 10%	5.5%, 10%, 20%	20%			€42,900, €82,800
Slovakia	20%	20%	20%	0%	0%	20%	20%	20%	20%	€49,790
UK	20%	20%	0%	0%	0%	20%	20%	20%	20%	€101,220 *
Belgium	21%	6%	6%	0%	6%	[ex], 6%	6%	12%	[ex], 6%	€25,000
Czech Republic	21%	15%	15%, 21%	0%	0%	15%	15%	21%	15%	€36,996*
Latvia	21%	12%	12%	0%	0%	[ex], 5%	21%	21%	21%	€50,000
Lithuania	21%	9%	9%, 21%	0%	0%	[ex], 21%	21%	21%	21%	€45,000
Netherlands	21%	6%	6%, 21%	0%	6%	6%, 18%	6%	6%	6%	None
Spain	21%	10%	10%	0%	10%	[ex], 21%	21%	10%	10%, 21%	None
Italy	22%	10%	[ex], 10%	0%	0%	10%	22%	10%	10%, 22%	€25,000, €30,000, €40,000, €45,000, €50,000
Slovenia	22%	9.5%	9.5%	0%	0%, 9.5%	9.5%	9.5%	9.5%, 22%	9.5%	€50,000
Ireland	23%	9%	[ex]	0%	0%	[ex], 9%	9%	[ex], 9%	[ex]	€37,500, €75,000
Poland	23%	8%	8%	0%	0%, 8%	8%, 13%	8%	8%	8%	€45,872*
Portugal	23%	6%	6%	0%	0%	[ex], 13%, 23%	23%	13%	23%	€10,000, €12,500
Finland	24%	10%	10%	0%	0%	[ex], 10%	10%	14%	[ex], 10%	€10,000
Greece	24%	13%	24%	0%	24%	6%, 24%	24%	24%	24%	€10,000
Croatia	25%	13%	25%	0%	25%	5%,	25%	13%	25%	€30,544*

						25%				
Denmark	25%	25%	[ex], 25%	0%	0%	[ex], 25%	25%	25%	[ex], 25%	€6,711*
Sweden	25%	12%	6%	0%	0%	6%	25%	12%	[ex], 6%	€3,168*
Hungary	27%	18%	27%	0%	0%	18%	27%	27%	27%	€25,696*

Notes: 1: International passenger transport by air and sea is exempt (with credit).
2: Most Member States exempt restaurants and catering services aboard cruise ships.
3: Registration thresholds are based on annual taxable turnover (i.e. all turnover that is not explicitly VAT exempt), and are presented in EUR for ease of comparison (exchange rates for thresholds indicated by a "" are provided in Appendix II).*
4: "[ex]" indicates that a particular good or service is exempt from VAT. In many cases Member States allow deductions for input VAT on exempt supplies, effectively treating those services as if they are zero-rated.
Sources: PwC WWTS: Corporate - Other taxes, EC 2017a, EC 2017b.

The *standard VAT rate* adopted across MS ranges from 17% (in Luxembourg) to 27% (in Hungary). The average standard VAT rate is 21%, with 20 countries in the range of plus/minus two percentage points of this.

Discounted VAT rates are offered across most MS for tourism-related categories of goods and services, and the most discounted category is the international transportation of passengers. Within this, international travel via air and sea is subjected to a general relief from VAT in the EU, and international travel via other modes of transport (i.e. road, rail and inland waterways, where applicable) attracts an average rate of 3%. VAT on domestic passenger transport is applied at reduced but slightly higher rates on average (13%), but also contains a large number of zero-rates and exemptions.

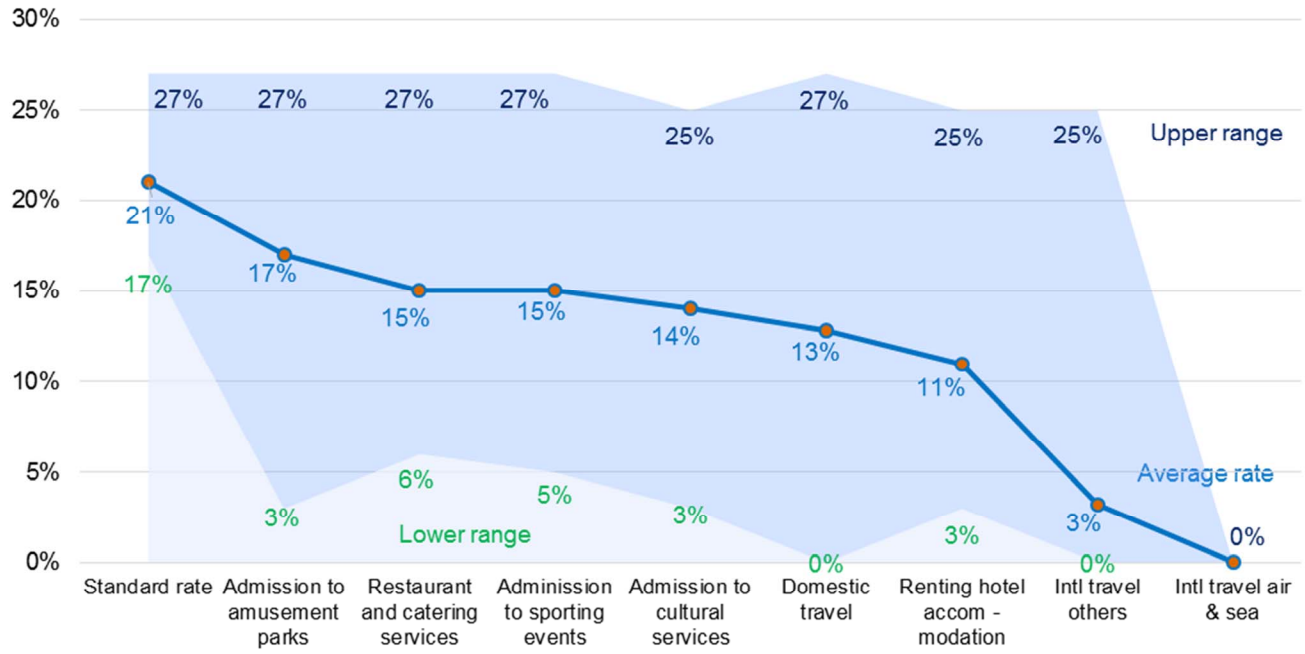
Hotel accommodation and cultural services have discounted VAT rates from 25 MS, with hotel accommodation being next most discounted category (with an average rate of 11% and rates as low as 3%). Admission to amusement parks is the least discounted category, having an average VAT of 17% and reduced rates in only 11 countries.

Since the application of VAT involves both output VAT and input VAT, the incidence of VAT and its impact on behaviour will differ depending on whether or not a 'tourist' is registered for VAT. For example, business travellers whose employer is registered for VAT should in a number of territories be able to deduct the VAT they pay on accommodation and should therefore be entirely unaffected by a change in rates. Some businesses may find themselves in an advantageous position where input VAT exceeds output VAT due to the application of reduced rates on their outputs. For travel agents and tour operators that are subject to the TAMS, VAT is currently due at the standard rate on the margins relating to EU travel services and input tax on the underlying travel supplies cannot be recovered. Therefore it is unlikely that such agents and operators will be in similar net refund positions as described above arising as a result of reduced rates on travel services. However, this will depend on the level of VAT on overhead costs, for which these business can receive credits for input tax subject to the normal VAT rules,

and whether this exceeds the VAT due on the TAMS margins and other outputs.

The figure below provides an overview of the average rates and range for all tourism-related VAT rates.

Figure 2: Comparison of standard and tourism-related VAT rates across the EU-28



Source: PwC analysis

Two MS offer no VAT discount for the specified categories (Denmark and Slovakia) except for the transport of passengers, although Denmark does provide exemptions in three tourism related categories (domestic transport of passengers, admission to cultural services, admission to sporting events). The UK provides a reduced rate in only one category, the transportation of passengers.

When considering VAT registration thresholds, Spain and the Netherlands have no lower limit and therefore all businesses in those MS are required to register for VAT. Similarly, Sweden has a very low rate that was introduced only recently. This registration threshold is particularly relevant for the tourism industry as many tourism-related services are provided through small business owners. The rise of the sharing economy suggests that the portion of small tourism-related businesses may have increased over the last few years (e.g. homeowners who rent out a spare room or car owners who rent out their car). Although the letting of immovable property without the provision of hotel-style services is generally exempt from VAT, in some instances these small businesses could have a competitive advantage if they are beneath the registration threshold, especially if i) the normal VAT rate for such services is substantial, ii) most of the cost incurred for such service is not subject to input VAT or iii) the compliance burden is high.

It is also worth noting that there is no VAT registration threshold for non-established

entities (those registered abroad) in any MS, which provides a marginal advantage to local businesses over foreign businesses.

2.4. Occupancy tax

Aside from the general taxes that impact the tourism sector, outlined above, there are a small number of taxes either solely or primarily focussed on the tourism sector. The most obvious of these is the occupancy tax. Occupancy taxes are levied on short-term (sometimes referred to as transient) residencies in paid accommodation. They are typically charged per person, per night, with significant municipal discretion over the rates applied. In many cases occupancy taxes are payable in person, and cannot be included in the pre-paid price of the accommodation. This makes them relatively hard to see in published accommodation prices but particularly visible to the end consumer, which may have a bearing on their impact on tourist activity (especially in cases of repeat business), something we discuss in the following chapters.

The table below outlines the relevant occupancy taxes levied across MS.

Table 5: Occupancy tax rates in the EU-28

Member State	Tax base	Tax rate	Notes / special features
Austria	Per person, per night	€0.15 to €2.18	Varies significantly by municipality.
Belgium	Typically per person, per night	€0.53 to ~€7.50	Varies by city. In Brussels, hotels must pay annual fees for each room (which vary by type), passing on the charge to guests on a per person, per night basis.
Bulgaria	Per person, per night	BGN 0.20 - BGN 3 (€0.10 - €1.53)	Varies by municipality. In some locations an €8 tax is applied per person, per stay, in littoral (seaside) resorts.
Croatia	Per person, per night	€0.27 to €0.94	Varies by municipality. Revenues are retained by local tourist boards to fund their activities.
Cyprus	No occupancy tax		
Czech Republic	Per person, per night	Up to €1.00	Varies by location.
Denmark	No occupancy tax		
Estonia	No occupancy tax		
Finland	No occupancy tax		
France	Per person, per night	€0.22 to €4.40 (including the additional 10% departmental council tax)	Varies by municipality. Municipalities may decide to apply the tax on the basis of actual visitor nights, or to apply a flat rate due by the accommodation

			providers on the basis of capacity. Revenues are hypothecated to be used for expenses related to encouraging tourism.
Germany	Either per person, per night, or based on the room rate	€0.25 to €5.00, or 5% of the room rate	Varies by city. VAT is applied on top of this tax. In some spa towns this allows access to certain facilities (spas, attractions, transportation).
Greece	No occupancy tax at present (will be introduced in 2018)		
Hungary	Per person, per night	4% of room rate up to HUF 469 (€1.51) per person per night	Varies by city.
Ireland	No occupancy tax		
Italy	Per person, per night	Up to €7.00	Varies by city.
Latvia	No occupancy tax		
Lithuania	Per room, per night	€0.30 to €0.60	Varies by city. In Palanga, the proceeds are used to fund improvement of the city's infrastructure and marketing of tourism.
Luxembourg	No occupancy tax		
Malta	Per person per night	€0.50, capped at €5	No regional variation. Proceeds are used for the maintenance of touristic zones.
Netherlands	Per person per night	€0.55 to €5.75, or up to 6% of room rate	Varies by municipality.
Poland	Per person per night	PLN1.6 to PLN2.4 (€0.37 to €0.55)	Varies by city.
Portugal	Per person per night	€1.00, capped at €7.00	Varies by municipality.
Romania	Room rate	1%	Varies by municipality.
Slovakia	Per person, per night	€0.50 to €1.65	Varies by municipality.
Slovenia	Per person, per night	€0.60 to €1.25	Varies by city.
Spain	Per person per night	€0.45 to €2.25	Varies by city and/or region. Up to a maximum of 7 nights.
Sweden	No occupancy tax		
UK	No occupancy tax		

Note: Figures are adult rates. In many cases reduced rates are available for children.
Sources: ETOA, Ernst & Young (2013), and other national sources and government websites.

Occupancy tax is mostly applied on a per person, per night basis, or sometimes charged as a percentage of the room rate. Apart from Malta, all 18 MS levy this tax at local government level (i.e. city, municipality or province). The rate typically varies by the

standard of accommodation (e.g. star rating of the hotel or resort), location and local authority, and children often attract reduced rates or are exempt entirely. In general, occupancy taxes make up a small proportion of the overall cost of accommodation compared with the cost of the accommodation itself and even the VAT that applies.

The full adult rates listed in the table above range from a minimum of €0.10 (the lowest rate in Bulgaria) to a maximum of €7.50 (the highest rate in Belgium) per person each night, with the average range being between €0.40 and €2.50. Most of this variation is attributable to the type of accommodation, with hostels and campgrounds attracting very low rates compared with five-star hotels and palaces.

Comparatively low rates are charged in the Eastern European MS, with much higher rates in Western and Southeastern Europe. As room prices tend to be higher in the latter regions, however, the difference in percentage terms is reduced.

The tax is hypothecated in Croatia, France, Lithuania, Malta, Poland, (and parts of) Spain and in all cases the revenues are directed towards the tourism sector, underlining the sector-specific nature of occupancy taxes. Interestingly, in Germany payment of the local occupancy tax in some resort towns allows access to certain public facilities otherwise shut off to the public. This may include spa facilities, the use of some public transport, and even entry to local attractions.[8]

Just over a third of MS do not levy any occupancy tax at all, including almost all countries in the Nordic and Baltic regions and some in Western and Southeastern Europe.

2.5. Air passenger duty/departure taxes

Although most businesses are less directly affected by them, taxes on passengers departing from, or arriving to, an airport have implications for the cost of air travel and may make a particular location more or less attractive on this basis.

Countries apply a broad range of taxes, levies and charges on passengers, not all of which can be reasonably thought of as taxes. The vast majority are levied on the basis of passenger departure, although in a few isolated cases (such as the Italian luxury tax) a passenger's arrival may also trigger a tax or charge.

Air passenger duty and departure taxes should be distinguished from airport charges that are effectively fees charged to recover the cost of providing facilities and services for civil aviation, such as the use of an airport. While there is no internationally recognised definition of a departure tax,[9] for the purposes of this study we define departure taxes as taxes accruing to government based on passenger departure, excluding charges related to the provision of a specific service (such as security or safety charges) or based on usage of the airport. While almost every MS applies some sort of charge, fee or levy to departures, relatively few of these meet this 'departure tax' definition, as most are better

[8] Fodor's Travel Guides, 2016

[9] The International Air Transport Association's classifications relate more to the method of collection than whether a payment meets the definition of a tax.

defined as charges related to a specific service (governed by a specific EC Directive: 2009/12/EC).

All of the taxes within this definition are included in the air ticket price, which means that none of the taxes listed below are payable in person at the airport. This is an important consideration for the visibility of the tax to the taxpayer - unlike with occupancy taxes, most tourists will already have based their purchase decision on the basis of a tax-inclusive price.

Table 6: Air passenger duty / departure tax rates in the EU-28

Member State	Classification	Base and rate
Austria	Air Transport Levy	Applies to passengers departing from Austrian airports. The current rates are €7 for short haul, €15 for medium haul and €35 for long haul.
Belgium		No air passenger duty / departure tax
Bulgaria		No air passenger duty / departure tax
Croatia	Civil Aviation Tax	Payable by both domestic and international passengers. The current tax rate is set at €1.37 for international departures, and €0.68 for domestic departures and transfers.
Cyprus		No air passenger duty / departure tax
Czech Republic	Departure Tax	Payable by all domestic and international passengers departing from Czech airports and varies by airport. The current rate for Prague is set at CZK 585 (€21.64).
Denmark		No air passenger duty / departure tax
Estonia		No air passenger duty / departure tax
Finland		No air passenger duty / departure tax
France	Civil Aviation Tax	Levied on all departures from a French airport. The current rates are set at €4.48 for destinations within metropolitan France, overseas territories and EU/EFTA Member States, and €8.06 for all other destinations. For business and first class the rates are €11.25 (France, EU/EFTA) and €45.07 (all other destinations).
	Solidarity Tax	Levied on passengers departing from French airports. The current rates are set at €1.13 for destinations within metropolitan France, overseas territories and EU/EFTA Member States, and €4.51 for all other destinations.
Germany	Air Transport Tax	The tax is levied on passengers departing from a German airport. The current rates are set at €7.47 for domestic flights, destinations within the EU/EFTA Member States or countries lying within the same

		distance band, €23.32 for other countries up to 6,000km and €41.99 for distances beyond 6,000km.
Greece	No air passenger duty / departure tax	
Hungary	No air passenger duty / departure tax	
Ireland	No air passenger duty / departure tax	
Italy	Luxury Tax	Levied on private aircraft at €10 per person for journeys of less than 100km, €100 for 100-1500km and €200 for more than 1500km. This applies to both departures and arrivals.
Latvia	No air passenger duty / departure tax	
Lithuania	No air passenger duty / departure tax	
Luxembourg	No air passenger duty / departure tax	
Malta	No air passenger duty / departure tax	
Netherlands	No air passenger duty / departure tax	
Poland	No air passenger duty / departure tax	
Portugal	No air passenger duty / departure tax	
Romania	No air passenger duty / departure tax	
Slovakia	No air passenger duty / departure tax	
Slovenia	No air passenger duty / departure tax	
Spain	No air passenger duty / departure tax	
Sweden	No air passenger duty / departure tax	
UK	Air Passenger Duty	Levied on passengers departing from a UK airport. The current rates are set at £13 to £78 (€16 to €95) for Band A (0 to 2,000 miles) and £75 to £450 (€92 to €549) for Band B (over 2,000 miles), depending on flight class. Compared to the cheapest rates, the tax is doubled for business and first class passengers and up to six times higher for passengers on private aircraft. The Scottish Government has recently been granted devolved powers around departure taxes and will bring its own Air Departure Tax into effect from April 2018.

Note: Figures are adult rates.
Sources: DG TAXUD 2015, IATA 2009, EBAA 2013, EBAA 2015, OECD 2014, government websites, travel websites.

Across the EU-28, only seven countries apply a departure tax as defined here. These countries are spread out across Eastern, Southeastern and Western Europe, and none are within the Baltic and Nordic regions.

Departure tax rates can vary significantly by airport within a MS, and are often distinguished by the length of journey and whether a flight is intra or extra EU. Rates within the EU are often at a lower rate than other international flights and independent of destination country, and three countries - France, Germany and Italy - extend this treatment to all countries in the EU/EFTA region. Rates may also vary depending on the type of aircraft and whether a passenger has chosen to fly economy, business or first class.

The UK imposes the highest rates for domestic passengers, charging each passenger up to €539 for long haul flights on private aircraft. Croatia has the lowest fixed rate for both domestic and international flights at below €1.50 per passenger.

2.6. Other tourism-specific taxes and levies

Interestingly, aside from occupancy and departure taxes very few taxes are levied on the tourism sector specifically (ignoring non-tax payments such as licensing charges).

In France, two different taxes apply to the skiing industry - a local municipal tax on gross revenues from the operation of ski lifts and a tax on accessing cross-country skiing trails; the Balearic Islands have recently introduced a new occupancy tax, with revenues set aside for sustainable tourism projects; and Cyprus has introduced a gaming levy on the gambling sector as part of its drive to promote gambling tourism.

Aside from the French skiing taxes, these taxes are described in greater detail in the case studies in Chapter 3.

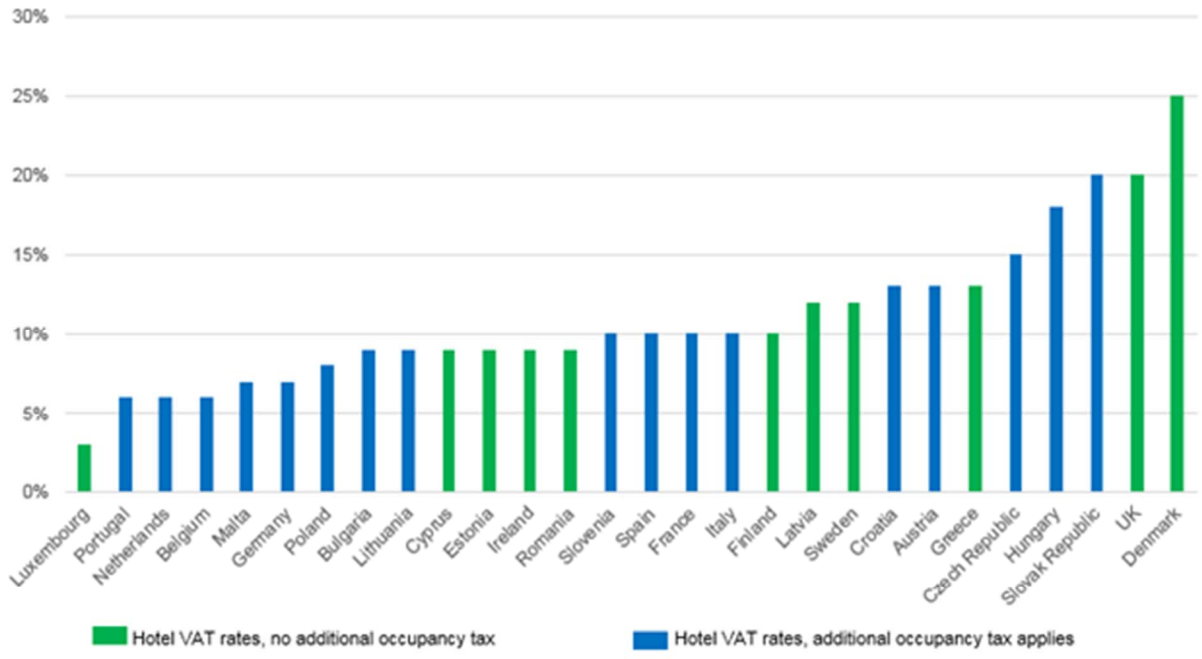
2.7. General observations

There are several taxes which EU MS can tailor to the tourism industry. A 'tourism friendly' tax regime could include reduced VAT rates for accommodation and transport of passengers and no occupancy taxes or departure taxes. Cyprus, Estonia, Finland, Ireland, Latvia, Luxembourg and Sweden have used all of these policy instruments. Greece uses all these instruments, except for the reduced VAT rate for the transportation of passengers. Malta, Poland, Portugal, Slovenia and Spain impose an occupancy tax, but use the other 'tourism friendly' policy instruments. What most of these countries have in common is their relative small size and/or a geographic position outside Central Europe. Both factors could be interpreted as signs that this group of countries see potential for inbound tourism for their economies which is not currently fully exploited. This could help explain the policy decisions taken around these tax regimes.

On the other end of the spectrum, countries like Austria, France, Germany, Italy and the UK use several elements to levy taxes on tourism related services, although none of them combine high VAT rates on accommodation with occupancy tax and departure tax. Some Eastern European MS such as Bulgaria, Croatia, Czech Republic, Hungary, Slovakia and Romania follow a similar approach.

Focusing on taxes specific to hotel accommodation, we note that of the 25 MS that offer discounted VAT rate on hotel accommodation, most also levy an occupancy tax on tourists. This effectively offsets part or all of the benefit of a lower VAT rate.

Figure 3: VAT rates on accommodation and occupancy tax indicator by Member State



Source: PwC analysis based on data in Table 4 and 5

The figure above shows the applicable VAT rate and whether or not an occupancy tax also applies. With a few exceptions, MS with relatively low VAT rates for hotel accommodation are more likely to charge an occupancy tax.

In terms of general taxes not specific to the tourism industry, countries with higher direct tax rates (PIT and CIT) have, on average, lower indirect tax (standard VAT) rates. In particular, it is observed that many countries in Eastern Europe and the Baltic region levy the lowest direct rates (PIT and CIT) whilst imposing the highest VAT rates. However, this could also be because these are young market economies seeking to attract capital from foreign investors. Conversely most countries in the Southeastern, Western Europe and the Nordic region levy comparatively higher direct tax rates but lower VAT rates.

3. CASE STUDIES

In this chapter we provide a high-level assessment of the general literature on the competitiveness of the tourism sector and the impact of taxes, and then present three case studies, focussing on the highly popular tourist destinations of the Balearic Islands, Paris and Cyprus. The methodology for how these case study locations were chosen is also presented.

A review of the technical economic literature relating to tourism and taxes is left to Chapter 4, and further detail on the other shortlisted locations is provided in Appendix 1.

3.1. General literature on the impact of taxes on the competitiveness of the tourism sector

As noted earlier, tourism is a major economic activity in the European Union with wide-ranging impacts on economic growth, government revenues, employment, and social development. Holidays and associated expenditures (on flights, hotels, restaurants, etc.) constitute significant items of consumer expenditure, and related taxes constitute a significant source of income for governments in many jurisdictions. As such there is a range of available literature and data on the tourism sector and its associated taxes in the region. This section provides a non-exhaustive overview of material relevant to the present study.

3.1.1. Defining "tourism taxes" and "tourism competitiveness"

To assess the impact of taxes on the competitiveness of the tourism sector, we first define what constitutes a "tourism tax", what is meant by "tourism competitiveness", and how the impact of the former on the latter can be assessed.

Forsyth and Dwyer (2002) placed tourism taxes in two categories, namely, general taxes and special or differential tourism taxes. General tourism taxes are "those imposed generally on the supply of tourism goods and services, income arising from tourism businesses, and compensation to employees of tourism businesses". As outlined in the previous chapter, we have followed this approach by including both general taxes that apply to tourism and non-tourism focussed businesses alike, and more specific taxes levied on the sector itself.

A widely accepted interpretation of tourism competitiveness was presented by Ritchie and Crouch (2003): "[W]hat makes a tourism destination truly competitive is its ability to increase tourism expenditure, to increasingly attract visitors while providing them with satisfying, memorable experiences, and to do so in a profitable way, while enhancing the wellbeing of destination residents and preserving the natural capital of the destination for future generations."[10] In line with this, our assessment of competitiveness must look not only at the impact of taxes on businesses and tourists, but also at the contribution of

[10] Mazanec et al, 2007

these taxes in funding the infrastructure and services required to ensure the tourism sector is (and remains) competitive.

3.1.2. Price competitiveness and the impact of tax

Price competitiveness is a frequent issue in the tourism competitiveness literature.[11] Economic theory suggests that if tourism demand is relatively price elastic, a reduction in the tax rate on tourism-related goods and services (such as hotels and restaurants) will lead to an increase in tourism demand, and vice versa for an increase in tax rates. However, this relies on the cost or cost-saving of the change in tax rate being "passed-through" to the consumer, affecting the price that they face. In light of the importance of tourism demand for many governments, there have been a number of studies commissioned that have explored the potential impact of changes in tourism taxation. Some of those also considered the question of pass-through in isolation, as a first step of their analysis.

Dwyer, Forsyth and Rao (2000) examine the price competitiveness of travel and tourism in 19 destination countries using efficiency and productivity as measures of the competitiveness among destination countries. By taking into account Purchasing Power Parity (PPP) and using Australia as a base country, the paper compares prices of a bundle of tourist goods and services in a range of competing destinations, through the development of indices of international price competitiveness. The study provides a method for quantitative assessment of how one destination compares in its tourism price competitiveness to another in supplying particular patterns of tourist purchases.

The UK Treasury undertook an assessment of the impact of reduced VAT rates on British tourism and the wider economy, using Dynamic Partial Equilibrium and Computable General Equilibrium models.[12] To inform their assumptions they conducted a survey of members of the British Hospitality Association, with 95% reporting that some or all of a VAT change would be passed on. The authors conclude that about 60% of a VAT reduction will feed through to lower prices, though the process would take approximately four years.

Previous work by the authors of the same report found that the price elasticity for international tourism in the UK was -1.28[13]; in other words a 10% decrease in the price of tourism increases tourism demand by 12.8%. Across OECD countries, a similar analysis[14] found that the elasticity of tourism was -1.2, very close to the UK figure. Again though, the authors indicate that the adjustment is not immediate and their simulations find that it would take 2 years for 80% of the impact of the price change to be realised. For a fuller discussion of the impact of taxes and the price elasticity of tourism demand, please refer to Section 4.3.2.1.

A 2011 paper by Ihalanayake (2011) analyses the economic effects of tourism tax

[11] Craigwell, R., 2007
[12] Cut Tourism VAT, 2012
[13] Wason & Nevin, 2001
[14] Nevin, Wason and Deloitte, 2011

changes in Australia. The author uses a tourism tax model and a computable general equilibrium (CGE) model to simulate abolishing tourism taxes and financing these through an increase in the goods and services tax (GST). As one might expect, the results suggest that the tourism sector does indeed expand as a result of tax abolition, while the other sectors contract. The increase in the GST leads to an increase in commodity prices which leads to a reduction in GDP.

3.1.3. Non-price factors affecting tourism competitiveness

The World Economic Forum (WEF)'s Travel & Tourism Competitiveness Report 2017[15] provides a measure of the overall competitiveness of the tourism sectors of 136 economies. This Tourism Competitiveness Index is comprised of multiple measures, some of which are more relevant to taxation and the business environment than others. Among the 90 individual indicators of competitiveness, four relate to price competitiveness. Europe, with six economies in the top 10 (i.e. Spain, France, Germany, the United Kingdom, Italy and Switzerland) consistently dominates the WEF rankings, which are published bi-annually. However, it is worth noting that the contributing factors to this success are Europe's cultural richness, world-class tourism service infrastructure, excellent health and hygiene conditions, and visa simplification in the Schengen area and the high degree of international openness as well as its perceived safety, despite slightly declining security perceptions in Western and Southern Europe. On the other hand, European economies tend to perform very poorly on measures of price competitiveness.

Tax is important for non-price factors because it provides the revenue necessary to spend on other factors that contribute to tourism competitiveness, such as infrastructure, cultural, safety, openness, technology, social development and the environment. In many cases the taxes on the sector are relatively higher than those on other sectors. For example, in 2013, the World Travel and Tourism Council (WTTC) researched the proportion of taxation paid by the sector in the USA compared to other sectors, and found that the US travel industry is taxed at a higher rate than other sectors.[16] Direct Travel & Tourism taxes in the US represented 3.2% of all taxes collected in 2012 whilst the sector's GDP contribution was just 2.7% - a significant premium over its GDP share.

3.1.4. Literature on taxes relating to accommodation providers

Many EU MS apply reduced rates on VAT for accommodation providers, although this does not necessarily translate into commensurate price differentials. Copenhagen Economics found that pass-through in the hospitality sector varies a lot across countries and across the different hospitality products/services.[17] For example, they find that pass-through for restaurants in Portugal is only 25% while pass-through for hotels in Finland is 100%. They suggest that this is largely the result of context-specific factors, in particular the potential for businesses and the market to expand capacity in the short- and medium-term. The report suggests that lower VAT rates may expand both domestic

[15] World Economic Forum, 2017
[16] World Travel and Tourism Council, 2013
[17] Copenhagen Economics, 2007

demand in the hospitality sector as well as induce more incoming tourists, though there is no evidence presented in regards to changes in demand.

Other, more specific, studies have been completed to assess the impact of particular VAT rate change. For example, EY completed an assessment of the impact of a potential increase in the VAT rate on Greek hotels in 2013.[18] The study estimated that a significant portion of the VAT change would be passed through to accommodation prices gradually, peaking in 2015, two years after the change. It also concluded that demand would suffer significantly with spending on hotels to fall between €290 and €480 million in the first year.

Occupancy taxes on overnight stays receive a lot of media attention, and the introduction or increase of such taxes often generates a flurry of news articles, blog posts and opinion pieces. However, academic literature on the impact of occupancy taxes in Europe is limited.

3.1.5. Literature on taxes relating to travel agents and tour operators

The Travel Agents' Margin Scheme (TAMS) for VAT is the most notable tax feature specific to travel agents and tour operators across the EU.[19] It is a compulsory VAT accounting simplification mechanism for any supplier that deals with customers in their own name and uses supplies of goods or services provided by other taxable persons, in the provision of travel facilities.[20]

The TAMS is a simplifying mechanism for businesses in the sector and does not affect the tax cost borne by the consumer in respect of the underlying supply of tourism goods and services. This is because no input tax credit is available to the travel agent or tour operator in respect of the travel services that are bought in and resupplied to their customers under the TAMS. Therefore, unless the agent or operator offsets this cost in their overall price, the VAT cost on the underlying supply is carried through to the price paid by the traveller. The TAMS effectively allows the countries in which the underlying travel services take place to collect the VAT due on these services, while the countries in which the travel agents and tour operators are established collect the VAT on the margins made by those businesses. This effectively allocates VAT revenues between the destination and departure countries.

Aside from the scheme, however, travel agents and tour operators are subject to the same tax regime as other businesses in the economies of most EU countries. Literature specifically on how tourism taxes affect travel agents and tour operators is limited.

3.2. Criteria for the selection of case study countries

To complement the high-level assessment of tax regimes and economic analysis, we

[18] EY, 2015
[19] European Commission, 2017
[20] Council of the European Union, 2006

examine the tourism sectors and tax regimes of three specific locations (one country, one region and one city) in more detail.

In order to focus on the most appropriate mix of locations, we identified those which met or partially met the following criteria:

1. Locations with a large or intensive (per capita) tourism sector
2. Locations which score well in measures of tourism sector competitiveness
3. Locations with a high reliance on tourism revenues (as a percentage of GDP)
4. Locations which have seen notable changes in relevant taxes in recent years
5. Locations with a tax regime with unusual or interesting components (with a particular focus on hypothecated taxes)

As an additional consideration, we have endeavoured to include sufficient diversity of tax regimes, geographies and tourism types. Our assessment of locations against these attributes is based on a few key measures and publications, described below.

To measure tourism sector size and intensity, we use data from three Eurostat sources. The first is the number of nights spent at tourist accommodation establishments by non-residents: a measure of the international attractiveness of a country as a tourism destination. The second is the number of nights spent by both residents and non-residents at tourist accommodation establishments, per inhabitant: a measure of the intensity of the tourism sector. The third is the number of nights spent in tourist accommodation establishments in the top EU-28 tourist locations by NUTS 2 classification (second-tier administrative divisions roughly corresponding to states, provinces or regions): a measure of local attractiveness to tourists.[21] The locations scoring highest on these three measures are presented in the table below.

Table 7: Measures of tourism sector size and intensity

EU Ranking	**Most popular Member States** (international tourist nights)	**Highest tourism intensity** (tourist nights per capita)	**Most popular tourist destinations** (EU NUTS level 2, 273 total)
1	Spain	Malta	Canary Islands (ES70, Spain)
2	Italy	Cyprus	Ile de France (FR10, France)
3	France	Croatia	Catalonia (ES51, Spain)
4	United Kingdom	Austria	Adriatic Croatia (HR03, Croatia)
5	Austria	Greece	Balearic Islands (ES53, Spain)
6	Germany	Spain	Veneto (ITH3, Italy)
7	Greece	Ireland	London (UK1, UK)

[21] Eurostat, 2017

8	Croatia	Italy	Andalucia (ES61, Spain)
9	Portugal	France	Provence (FR82, France)
10	Netherlands	Netherlands	Rhone-Alpes (FR71, France)
11	Czech Republic	Sweden	Tuscany (ITI1, Italy)
12	Belgium	Portugal	Valencian Community (ES52, Spain)
13	Poland	Denmark	Emilia-Romagna (ITH5, Italy)
14	Sweden	Luxembourg	Tyrol (AT33, Austria)
15	Ireland	United Kingdom	Lombardy (ITC4, Italy)

Source: Eurostat, 2017

To compare tourism sector competitiveness we use the 2017 WEF Travel & Tourism Competitiveness Report's Tourism Competitiveness Index, described earlier. The locations scoring highest on this index are presented in the table below.

Table 8: WEF Tourism Competitiveness Index rankings

EU Ranking	Global Ranking	Member State
1	1	Spain
2	2	France
3	3	Germany
4	5	UK
5	8	Italy
6	12	Austria
7	14	Portugal
8	17	Netherlands
9	20	Sweden
10	21	Belgium
11	23	Ireland
12	24	Greece
13	28	Luxembourg
14	31	Denmark
15	32	Croatia

Source: World Economic Forum, 2017

And finally, to compare reliance on tourism revenues, we use Eurostat data on receipts from international travel services (a balance of payments measure) as a percentage of

GDP. This includes leisure and business travel receipts.[22] The locations scoring highest on this measure are presented in the table below.

Table 9: Contribution of tourism to the balance of payments

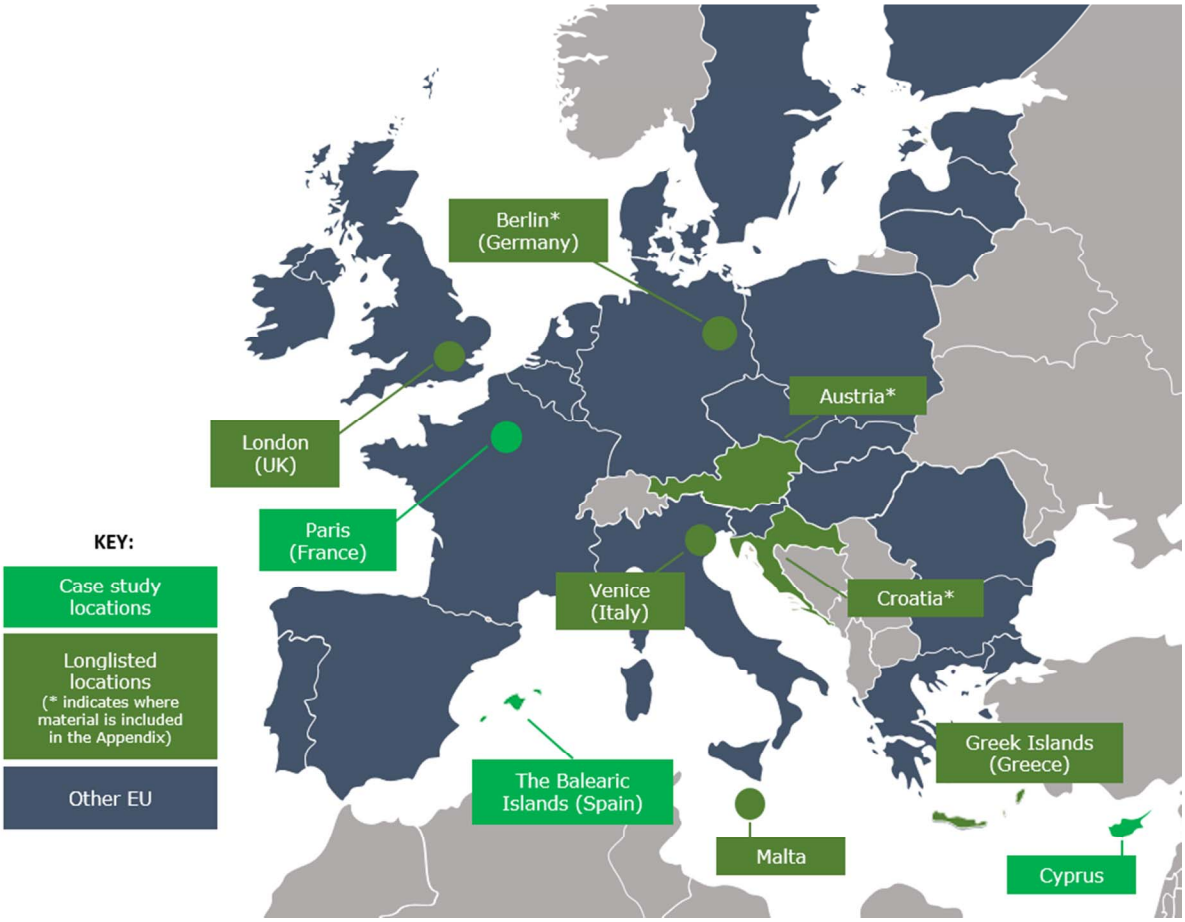
EU Ranking	Member State	Travel Services as % of GDP
1	Croatia	17.2%
2	Malta	13.6%
3	Cyprus	12.2%
4	Luxembourg	8.4%
5	Greece	7.5%
6	Estonia	6.9%
7	Bulgaria	6.9%
8	Portugal	6.0%
9	Slovenia	5.5%
10	Austria	4.7%
11	Spain	4.7%
12	Hungary	4.2%
13	Czech Republic	3.3%
14	Latvia	3.0%
15	Lithuania	2.9%

Source: Eurostat, 2017b

These readily rankable aspects were examined alongside the tax regime data presented in Chapter 4, and considered for diversity, to produce a list of locations for further analysis. The map below presents the longlist of ten locations that were considered, including the three that were subsequently chosen for inclusion in our case studies.

[22] Eurostat, 2017b

Figure 4: Longlisted and shortlisted case study locations



To complement the desk research and quantitative analysis that was undertaken for these locations, we interviewed local tax experts. This provided a richer understanding of the relevant factors and allowed us to test and verify these findings.

The three case studies are presented in the remaining sections of this chapter.

3.3. Case study 1: The Balearic Islands (Spain)

The first of our case studies is the group of Spanish Mediterranean islands comprising Majorca, Minorca, Ibiza, Formentera and a number of smaller islands, collectively known as the Balearic Islands. As well as being a very popular destination for tourists, the Balearic Islands have recently introduced a Sustainable Tourism Tax.

3.3.1. The tourism sector in the Balearic Islands

Spain is Europe's most popular tourist destination, with over 250 million tourist nights per year[23] and the highest international tourism revenues of any EU country.[24] Despite

[23] Eurostat, 2017a

being one of the most populous countries in Europe, the sheer scale of tourism means that it has the sixth highest number of tourists per capita of the EU.[25] According to the World Travel and Tourism Council, tourism contributes 5.8% of the country's GDP and employs (both directly and indirectly) over 16% of the country's workforce.[26] Three of the EU's five most popular tourist destinations are in Spain, including the Canary Islands, Catalonia, and the Balearic Islands.[27]

Of the over 68 million tourists who visit Spain each year, around 13 million of these visit the Balearic Islands. These primarily consist of non-Spanish residents, with over three million coming from both Germany (3.6m per year) and the United Kingdom (3.2m). Over 70% of these make Majorca their primary destination, with the remainder visiting the smaller islands.[28] The Balearic Islands Government, rather than the national government, takes the lead in promoting and supporting tourism to the archipelago.

Most visitors to the Balearics are 'sun-and-sea' tourists, visiting for the warm climate, proximity to the ocean and a thriving nightlife. The island of Ibiza is also a UNESCO World Heritage site due to its rich biodiversity and cultural attractions, including the Phoenician archaeological site of Sa Caleta, the necropolis of Puig des Molins and the historic centre of Eivissa.

The Government of the Balearic Islands has a dedicated Agency for Tourism of the Balearic Islands (ATB), which is part of the Regional Ministry of Tourism and Sports. Covering all the Balearic Islands, the Agency is charged with research and analysis and the implementation of measures to organise and protect the destination's brand.[29]

3.3.2. Taxes on tourism in the Balearic Islands

Overview of tourism taxes in the Balearic Islands (Spain)						
Corporate Income Tax	Personal Income Tax	Property Tax	Value Added Tax	Occupancy Tax	Departure Tax	Other Taxes and Levies
25% (standard) 15% (new companies) plus local profit tax of up to 15%	Up to 45% (37% at average income)	YES	21%, 10%	YES (Sustainable Tourism Tax)	YES	-

The Spanish system of strong regional autonomy allows the Balearic Islands Government and its city councils substantial authority in setting certain tax rates facing residents and visitors, and as a result tax rates vary. The suite of taxes applied in the Balearics include taxes on wealth, inheritance, gifts, property transactions and a range of tourism-related taxes, as outlined below.

[24] Eurostat, 2017b
[25] Eurostat, 2016a
[26] World Travel and Tourism Council, 2016
[27] Eurostat, 2016b
[28] Statistical Institute of the Balearic Islands, 2017
[29] CERTESS website, agency for tourism of the Balearic Islands (ATB), June 2017

3.3.2.1. Corporate and personal income taxes

A flat corporate income tax rate of 25% applies across the whole of Spain, with a reduced rate of 15% for companies created since the start of 2015 for the first two years after they first record a profit.

Personal income in Spain is taxed differently according to the type of income (classified as either savings income or general income) and the location the individual is resident in. Savings rates are fixed nationally at a progressive scale of between 19% and 23%, while the rates on general income are a composite of nationally and locally determined rates.

Prior to 2016, rates in the Balearic Islands compared favourably to almost all other Spanish regions, with rates ranging from 19.5% to 45% (for income over €60,000).[30] In 2016, however, higher rates were added for high income earners, and rates now vary from 19.5% up to 47.5% (for income over €175,000), only slightly behind the top rates in other regions. An individual earning the average income in Spain faces a marginal income tax rate of 37%, the ninth highest in the EU. Various deductions apply to individuals in certain circumstances, but not for any directly related to tourism.[31]

In addition, a locally levied tax on commercial and professional activities applies to all businesses and professionals (the IAE, or Economic Activities Tax), with exemptions for individuals, and companies with turnover of less than €1m or in their first two years of operation. This applies across all regions, including the Balearic Islands. The rates vary by location, business size, type of business and number of employees, but may not exceed 15% of the presumed average profits of the activity.

3.3.2.2. Real estate tax

A local real estate tax (the Impuesto Sobre Bienes Inmuebles) is applied to all owners of property located in Spain, based on the rateable value of the property and the region and municipality in which it is located.

Local city councils within the Balearic Islands may set their own rates, and these do vary significantly by locality. For example, base rates are 0.653%-0.877% for Manacor, 0.67%-1.3% for Mao, 0.473%-0.718% for Felanitx, and 0.651%-0.89% for Consell,[32] (which compares with national rates ranging between 0.2% and 2.5%). Some exemptions apply, and these also vary by locality.

The standard approach for Balearic Island local councils is to vary rates according to the location of the property (e.g. urban, rural or special use), but there are cases where rates are specified for properties used in tourism. This is the case for Mao, for example, although the rate applied (0.67%) is the same as those applied for most other property types.

[30] Citizens' Advice Bureau Spain, 2015
[31] Ministry of Finance and Public Administration, Spain, 2016
[32] Government of the Balearic Islands, 2017a

3.3.2.3. Value-Added Tax (VAT)

The standard rate for VAT in Spain is 21% of the value of goods and services, and this does not vary by region or locality except in a few small locations (slightly different taxes apply in the Canary Islands, Ceuta and Melilla). As is the case with most EU MS, Spain applies reduced rates to a number of tourism-related goods and services. A reduced rate of 10% is applied to accommodation services, passenger transportation, restaurant and catering services and admission to some sporting events, and admission to some cultural services is entirely exempt from VAT. As in other MS, car rental is subjected to the standard non-reduced rate of VAT (21% for the Balearic Islands, and Spain generally).

In September 2012 the standard VAT rate was increased from its previous rate of 18%, with the reduced rate increasing from 8% to its current level. These general rate rises were not targeted at the tourism sector, although at the same time the VAT applicable to admission to some cultural and sporting events became subject to the (new) standard rate, increasing from 8% to 21% (13 percentage points).

3.3.2.4. Occupancy tax

The Balearic Islands are not subject to the tasa turistica, an occupancy tax that applies across much of Spain. Instead, the Balearic Islands Government has introduced another occupancy tax known as the Tax for Sustainable Tourism, which applies across the whole archipelago. The tax is charged per overnight stay and varies according to the type of accommodation, ranging from €0.5 per person, per night, for campsites and hostels, to €2 for five-star hotels. VAT applies on top of the tax and the rate drops by 50% for stays longer than 8 days. Children under 16 are exempt and the rate is halved for stays during the off-season.[33]

Revenues from the tax are hypothecated for tourism purposes. A Commission for the Promotion of Sustainable Tourism has been established - as required by law - to decide which islands and projects to invest into. Since the tax was introduced on 1 July 2016, €30 million worth of projects have been approved by the Commission, ranging from water infrastructure, cultural restoration and environmental preservation to marketing, research and training, and covering all the main islands.[34]

This is not the first time an environmental bed tax has been applied in the Balearic Islands - a controversial version of the tax was introduced in 2001 and was then repealed the following year. We discuss this further in section 3.3.5.1.

3.3.2.5. Air passenger duty/departure taxes

There are no departure taxes levied in Spain, although two other charges do apply to all passengers: a small security tax (ranging from €0.18 to €0.59 per passenger) and an airport tax.

[33] Government of the Balearic Islands, 2017b
[34] Ibid.

3.3.3. The tax regime facing accommodation providers and travel agents and tour operators in the Balearic Islands

Not all of the taxes outlined above are applicable to all businesses operating in the tourism sector, and some may be more relevant to the business decisions and competitiveness of particular businesses. In this section we outline the tax regime facing three key tourism businesses: a large hotelier, an individual provider of shared accommodation, and a large travel agent and tour operator.

3.3.3.1. Taxes on hoteliers

Here we focus on the most relevant taxes facing a corporate hotelier of a large hotel (or chain of hotels). Hoteliers are directly impacted by nearly all of the tourism taxes applicable in the Balearic Islands, the only exclusion being the air passenger duties (although, less directly, these will still have an impact on the number of tourists flying into the Balearic Islands).

Large hoteliers face the flat national corporate income tax rate of 25%, with newer companies benefiting from a reduced rate of 15% for the first two years. In addition to this, the locally determined Economic Activities Tax is applied to company profits depending on a number of highly variable factors, but not exceeding 15%.[35]

Staff working in the hotel(s) face marginal personal income tax rates of up to 45% for those earning more than €60,000 per annum, although this is slightly lower (37%) for those on the average wage. These taxes are in addition to the social security contribution workers must pay on employment income (*Securidad*). Although staff themselves, rather than the hotelier, bear the direct burden of personal income tax, the impact on net wages does affect the rates the hotelier must offer in order to attract and retain the mix of skilled staff required to run the hotel(s). This is in addition to other staff costs faced by the hotelier, such as the company social security contribution (typically 23.6% of staff remuneration).[36]

Assuming the hotelier owns the real estate on which the hotel(s) are sited, they will also be subject to the local real estate tax, with rates varying by specific locality within the islands. For hoteliers this is typically in the range of 0.6%-0.8% of the hotel's rateable value per annum (in some cases slightly higher or lower).

Hotels in the Balearics are also required to charge VAT of 10% on both the accommodation and restaurant and catering services they provide (excluding the provision of alcohol, which attracts the standard, 20%, rate), and are allowed to deduct input VAT accordingly. There are no special schemes for hoteliers with regards to VAT.

Finally, Balearic Island hotels must charge the Sustainable Tourism Tax for hotel guests

[35] Ministerio de Hacienda Y Functión Pûblica, 1990
[36] Seguridad Social, 2017

aged 16 or more. These rates are per person, per night and range from €1 per night for rural hotels to €2 per night for high-end 4 and 5 star rated hotels (with a 50% reduction for longer and off-season nights).[37] VAT is charged on top of this.

Combined, these taxes have a sizeable administrative and financial cost for hoteliers operating in the Balearic Islands.

3.3.3.2. Taxes on individual accommodation providers

Individuals providing tourist accommodation (such as a room or dwelling rented out on an online platform) in the Balearics face a somewhat different array of taxes to those faced by large hoteliers. In addition, there are strict rules around the types of dwellings that can be rented out in this way, and apartments are not allowed to be rented for tourism purposes at all.[38]

Although they do not face corporate income tax, income earned in this way is subject to the general income (rather than savings income) tax for individuals and must be declared at the end of each year. This attracts marginal rates of up to 45% for those earning more than €60,000 per annum from their combined rental and other income. Individuals are exempt from paying the Economic Activities Tax.

Individual accommodation providers who are also the property owners are subject to the same real estate taxes as hotels. With rates typically in the range of 0.6%-0.8% of the property's rateable value per annum, depending on location.

Depending on the type of services provided alongside the accommodation, hosts in the Balearic Islands may also be required to charge VAT of 10% on lettings. This applies if a homeowner hires an employee or if hospitality services (such as cleaning, breakfast, and new linen) are provided to guests during their stay.[39] As there is no registration threshold for VAT in Spain, this applies to all providers of accommodation who meet this test. Those not required to register can avoid the administrative cost of accounting for VAT and charge their guests lower prices.

The Sustainable Tourism Tax is required to be charged and collected by all registered accommodation providers, including individuals using online sharing platforms, although unlike in Paris there are no requirements for platform companies to collect the tax on behalf of their hosts. The rate is €1 per adult guest, per night, with a reduction for stays over 8 nights or during the off-season.[40]

3.3.3.3. Taxes on travel agents and tour operators

Finally, we look at the taxes facing large travel agents and tour operators who are based in the Balearic Islands. These must be distinguished from the travel agents and tour

[37] Government of the Balearic Islands, 2017b
[38] Spain Holiday, 2017
[39] Ibid.
[40] Government of the Balearic Islands, 2017b

operators selling packages of goods and services to tourists *to the Balearic Islands from abroad*, the prices of whose products will be impacted by taxes on the tourism sector in the Balearics but whose direct tax burdens (e.g. CIT, PIT, real estate taxes) will be determined by the tax regime of the country in which they are established. They must also be distinguished from excursion providers - i.e. those who operate specific excursions, such as sightseeing tours and diving trips, to tourists.

Large Balearic travel agents and tour operators face the same flat-rate 25% income tax regime as large hoteliers (with newer companies benefiting from the temporarily reduced 15% rate), and must pay the Economic Activities Tax on profits which is applied to company profits depending on a number of highly variable factors, but not exceeding 15%.[41]

Bricks-and-mortar travel agents are also subject to the local real estate tax, with rates varying by specific locality within the islands but typically in the range of 0.6%-0.8% per annum of the rateable value of the travel agent's premises (in some cases slightly higher or lower).

The most unique tax process faced by travel agents and tour operators in the Balearic Islands is the TAMS (Travel Agents' Margin Scheme) for VAT. In practice, travel agents and tour operators based in Spain are required to apply Spanish VAT at the standard rate of 21% on the margins they make from the packaging and on-selling of tourism services, leaving local service providers to account for and pay VAT at the appropriate (typically reduced) rate applicable to the services provided locally, and to pay this to the authorities in the location where the service itself is provided. Although the mechanism differs slightly for each case, the fundamental application of the standard 21% rate to the margin applies regardless of whether the travel agent or tour operator provides the services in their own name and accounts under TAMS or acts as an agent of a local provider and is required to charge and account for VAT on any commission (assuming the underlying service provider is established in Spain), although VAT charged on such commissions may be recovered as input tax by the local provider. Any VAT accounted for on the margin under the TAMS is not recoverable. Therefore the application of the TAMS does marginally increase the overall tax cost in the supply chain.

Occupancy taxes are not directly relevant for travel agents and tour operators, but will have an impact on the price of packages sold to their customers. The Sustainable Tourism Tax is likely to be much less relevant here, as we would expect most of the business of travel agents based in the Balearics to be to locals travelling out of the islands.

3.3.4. Competitiveness of the Spanish tourism sector

In line with its success as a tourism destination, Spain itself ranks at the very top of the latest Travel and Tourism Competitiveness Index in the World Economic Forum 2017

[41] Ministerio de Hacienda Y Functión Pûblica, 1990

report, maintaining its number one position from the 2015 publication.[42]

Of the 14 pillars assessed in the WEF index, Spain's achievement can be attributed to its unique offer of both cultural (2nd) and natural (9th) resources, combined with sound tourism service infrastructure (2nd), air transport connectivity (9th) and strong policy support (5th). It is suggested by the authors that Spain has benefited from the recent ease of its fiscal policy as well as diverted tourism from the security troubled Middle East.

The 2015 publication indicated room for improvement in a few areas - particularly the relatively poor business environment reflecting unhelpful processes around construction permits and an inefficient legal framework. These themes continue into the 2017 report as potential growth areas. While Spain's ground transportation is ranked in the top 15 economies, it has started to show signs of initial decline, suggesting that upgrades and modernizations may be needed. In addition, the business environment (75th) can be improved, as dealing with construction permits remains burdensome (104th), and there is room to improve international openness further (43rd, down two places).

There are 90 individual indicators distributed amongst the 14 pillars of the competitiveness ranking, seven of which are directly related to tax and are presented in in the table below.

Table 10: Spain's tax-related competitiveness indicator rankings

Overall WEF ranking for Spain: 1 / 136	
Tax related indicator	WEF rank (out of 136)
Effect of taxation on incentives to work	101
Effect of taxation on incentives to invest	80
Total tax rate	105
T&T government expenditure	23
Ticket taxes and airport charges	44
Hotel price index	51
Purchasing power parity	113

Source: World Economic Forum, 2017

Despite Spain's top overall rank in the WEF index, its total tax rate (which directly impacts the business environment) scores within the bottom 25% of all countries assessed. Although the rankings for the effect of taxation on incentives to work and invest have already increased significantly since the 2015 report (up 27 places and 48 places respectively), the index suggests that there is further room for improvement compared to other countries. It is important to note, however, that the government of Spain recognises the importance the tourism sector for the country and dedicates a significant amount of its expenditure to reinforce the tourism sector in transfers and subsidies to travel and tourism services.

3.3.5. Qualitative evidence for the impact of taxes on tourism sector

[42] World Economic Forum, 2015 and 2017

competitiveness in the Balearic Islands

This section provides an overview of the existing literature on taxes and tourism in the Balearic Islands.

Surprisingly, although the Sustainable Tourism occupancy tax is now in operation, there is currently limited information available regarding the impact it has had on the sector. The impact of the other elements of the tax regime around tourism in the Balearics, such as reduced VAT and real estate taxes, is even less evident, and as a result the majority of the existing literature still relates to the Sustainable Tourism Tax.

Prior to the introduction of the Balearic Islands Government's Tax for Sustainable Tourism on 1 July 2016, the move received significant negative media attention in both the Balearics and the UK (where many Balearic Islands tourists originate). The main focus of the criticism was around the tax causing direct increases in the costs of a trip to the islands for visitors, with the UK's largest travel association, ABTA, expressing concerns that the tax "could have the unintended consequence of driving tourists away from the islands."[43] Numerous English and Spanish based articles, opinion pieces, fora and blog posts expressed similar concerns. While it may be too soon to see whether this has played out in practice, the scale of publicity around the changes does indicate a degree of sensitivity of tourism to this tax.

In support of this notion is evidence from the Balearic government's last occupancy tax, the repealed 'ecotasa' (Eco-Tax) which was applied from May 2002 to October 2003. The Eco-Tax, although not identical to the Sustainable Tourism Tax, operated similarly, and therefore has been used as a basis of media support for expectations amongst many that the current occupancy tax will adversely affect competition. The Eco-Tax was created to obtain financial resources for the rehabilitation of tourist resorts and recovery of natural areas and heritage sites of relevance to tourism.[44] It was a direct tax levied on stays by individuals in tourist accommodations in the Balearic Islands, and cost most visitors older than 16 approximately €1-€2 per night.

During the period between the announcing of the Eco-Tax in 2001 and its repeal, the Balearic Islands saw a 2-year decline to international tourist arrivals.[45] This was seen particularly amongst visitors from Germany, as German arrivals in the same period dropped significantly by 25%, from more than four million per annum to a little over three million.[46] Although several potential reasons were cited as possibilities for the dramatic decline in visitors, it is often claimed that the Eco-Tax was a large contributor. Indeed, one study suggested that tour operators may even have reacted by moving their business to other Mediterranean countries as a result of the tax, contributing to the decision to remove it after less than two years of application.[47] On this basis, many believe a similar outcome may result from the Sustainable Tourism Tax's

[43] Abta, 2015
[44] Garín-Muñoz and Montero-Martín, 2007
[45] Ibid.
[46] Cabi, 2003
[47] Gago et al, 2006

implementation.

Conversely, a key study was carried out more recently by researchers at the University of the Balearic Islands, who carried out an estimation of the impact of the tax on tourist stays.[48] In this study, the researchers applied a price increase, which represented the Sustainable Tourism Tax, to 2014 data on the number of tourist stays and price-elasticities of Balearic tourism from past studies, to estimate the effects on tourism demand. The research predicted that in the most extreme scenario, tourist demand would fall by 1%, and in less extreme scenarios by 0.5%.[49] Although this is not insignificant, it indicates that the impacts of the tax may well be overwhelmed by other factors influencing tourism demand. For example, according to the Confederation of Spanish Travel Agencies, almost 10% of the tourists to Spain were 'borrowed' from competing destinations of Egypt, Tunisia and Turkey which have been suffering from terrorism and instability.[50] In addition to this, several commentaries written in response to the study underline how little impact has been observed to date.

A key statistic and early indicator we can use to support these findings is that, according to Statista, the Balearic Islands actually saw a 1.3 million increase in the annual number of international tourists visiting in 2016 (from 11.6 million in 2015 to 13 million).[51] This comes despite the well-publicised introduction of the Sustainable Tourism Tax in 2015, and its official commencement on 1 July 2016. Considering this study alongside the strong visitor figures, this suggests that tourism taxes have had a minimal impact on the competitiveness of the tourism sector in the Balearic Islands.

3.3.5.1. Comparing the impacts of the Eco-Tax and the Sustainable Tourism Tax

One explanation for the difference in impacts of the two taxes may lie in the way they were introduced and the degree of stakeholder involvement and transparency around the way the revenues were used - with direct consequences for what Palmer and Riera (2002) refer to as the social factor, i.e. "the sociological and institutional response to the introduction of the tax".[52] The two taxes were levied in fundamentally the same way, but various elements of their introduction and administration were quite distinct.

The Sustainable Tourism Tax was introduced following a period of public consultation, increasing buy-in from stakeholders within the tourism sector. This is in contrast to the Eco-Tax, which was heavily criticised for failing to involve sufficient consultation with the industry prior to its introduction.[53] Travel agents, given insufficient notice to even notify existing customers ahead of the changes, were unlikely to do anything other than speak negatively about the new taxes.[54] In addition, although both taxes are hypothecated for touristic purposes, the new Sustainable Tourism Tax covers a broader scope of allowable

[48] Nadal and Rosselló, 2016
[49] Ibid.
[50] The Guardian, 2016
[51] Statista, 2017
[52] Palmer and Riera, 2002
[53] CABI, 2003
[54] The Telegraph, 2003

expenditure - focussing not just on environmental rehabilitation, but on vital infrastructure and other expenditure highly valued by the sector.

Both taxes were introduced with rules around what each tax's revenues could be spent on, however the process around determining which projects would be funded was remarkably different. While it was not clear how the Eco-Tax funds were distributed by the local government, the funds from the Sustainable Tourism Tax are allocated by a committee of key stakeholders known as the Commission for the Promotion of Sustainable Tourism. Designed to maximise "social consensus", this committee involves government officials, employers' associations, trade unionists, environmental protection movements and other representatives of civil society.[55]

Unlike the Eco-Tax, the new Sustainable Tourism Tax was introduced alongside a dedicated website designed to increase the transparency of key details, including how much is raised and which projects the money is spent on. The website lists all projects and their values alongside other important details such as the names of all 32 committee representatives. Information is available in English, German Spanish and Catalan - making it accessible to both locals and the two key tourist demographics.[56]

On this basis, it could be argued that the way in which the taxes were both introduced and administered had very significant consequences for the impact each one had on the tourism sector. This was clearly articulated by the incoming Director General of Tourism at the time the Eco-Tax was repealed, who said that "it wasn't the idea of an ecotax that was the problem, it was the way it was set up and administered."[57]

3.3.6. Economic impact of accommodation taxes in the Balearic Islands

This section provides an assessment of the potential economic impact of changing occupancy taxes in the Balearic Islands. As discussed in Chapter 4, the Balearic Islands already apply a reduced rate of VAT on hotel accommodation, therefore the scope for reducing VAT rates is more limited. The assessment below is based on our country-specific data tool (discussed in greater detail in Chapter 4), tailoring the country-level analysis for Spain to identify specific impacts for the Balearic Islands.

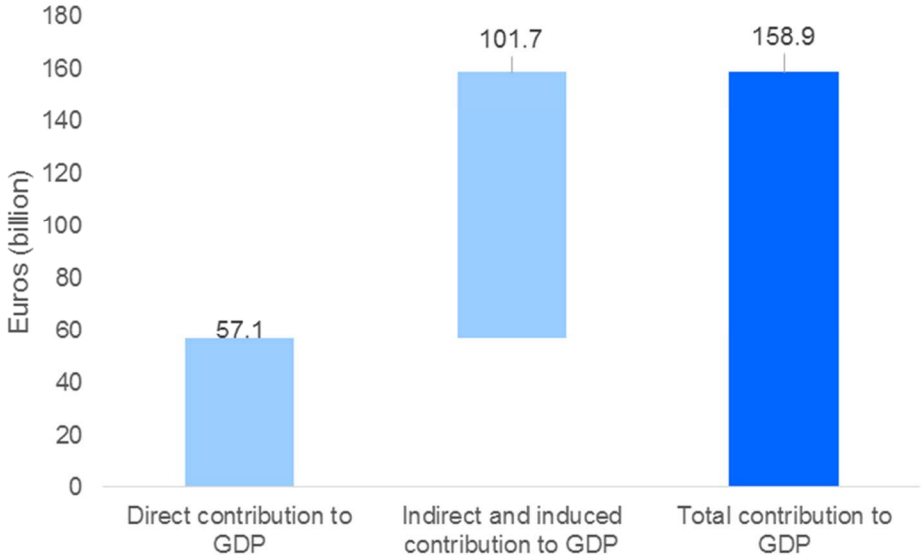
Our analysis draws on findings from the World Travel and Tourism Council on the total wider economic contributions to GDP and employment of tourism revenues. The total contribution includes the direct impact (the sectoral impact of spending in the tourism industry by residents and non-residents), the indirect impact (the impact on suppliers of businesses in the tourism industry) and the induced impact (the impact on all sectors of spending by those employed in the tourism industry and those employed by suppliers to the tourism industry).

In 2016, the WTTC estimated total spending by tourists visiting Spain of €108bn in the tourism industry. After accounting for purchases by the tourism industry, the direct

[55] Govern Illes Balears, 2017
[56] Govern Illes Balears, 2017
[57] CABI, 2003

contribution of the spending to Spanish GDP was estimated to be €57bn.[58] Combined with the indirect and induced contributions of activity in the tourism industry, it was estimated that the total contribution of the industry in Spain in 2016 was €159bn. This is illustrated in Figure 5 below. Similarly for employment, the WTTC estimates that tourism activity in Spain generated a direct contribution to employment of 862,000 jobs and a total contribution of 2,652,000 jobs, as shown in Figure 6. Overall, it is estimated that the tourism industry in the country generated a total contribution to the economy equivalent to 16.0% of GDP and 16.2% of total employment, the 7th highest contribution of 185 countries.[59]

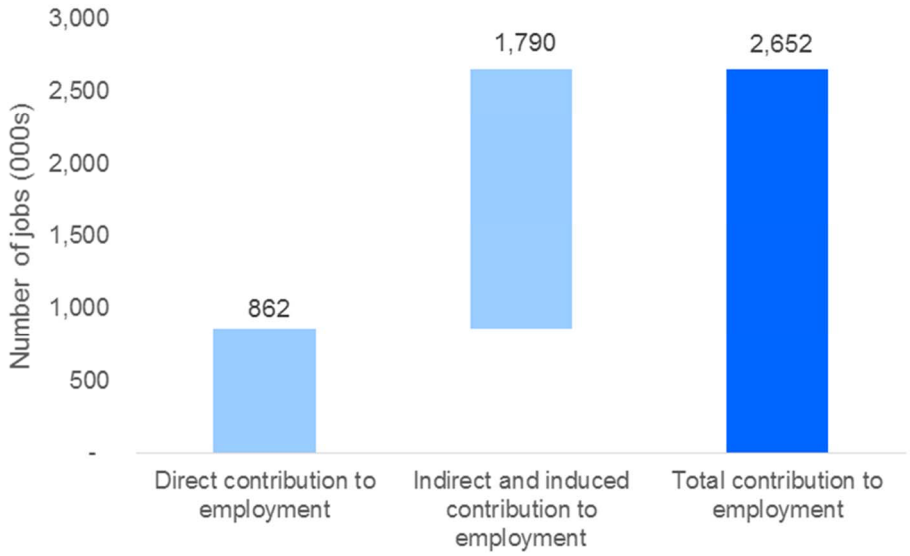
Figure 5: Contribution to GDP of the tourism industry in Spain



Source: World Travel and Tourism Council, 2016b, PwC

Figure 6: Contribution to employment of the tourism industry in Spain

[58] World Travel and Tourism Council, 2016b
[59] World Travel and Tourism Council, 2016a



Source: World Travel and Tourism Council, 2016b, PwC

As discussed above, the occupancy tax rate in the Balearic Islands ranges from €0.5 per person, per night, for campsites and hostels, to €2 for five-star hotels, with additional discounts applied for children and off-peak season travel. We have converted this occupancy tax into a standardised composite index, as described in detail in Chapter 4.

In order to assess the impact of a change in these taxes in the Balearic Islands on tourist spending and tourism revenue for producers and the government, and the resulting economic impact, we first need to establish a baseline of current spending and revenues. We do this based on the share of tourism nights in the Balearic Islands; of the total tourist nights spent in Spain by residents and non-residents, approximately 15.5% are spent in the Balearic Islands.[60] Assuming that spending per tourist night is the same across all regions of Spain, we estimate that of the total tourism spending in Spain in 2016, €16.7bn was spent in the Balearic Islands, split by purpose as follows: €2.1bn spent by business tourists and €14.6bn by leisure tourists spending on coastal holidays.[61] With 24% of tourism spending going toward accommodation[62], we estimate that, of the €16.7bn of tourism spending in the Balearic Islands in 2016, approximately €4.0bn accounted for spending on accommodation.

Using the total spend on accommodation and the quantity demanded (i.e. the number of nights spent in the Balearic Islands by tourists), we estimate that the average per night price of accommodation for tourists in the Balearic Islands is €62. Adjusting the consumer price for VAT and currency occupancy taxes in the accommodation sector, and multiplying this by the number of tourists provides us with an estimate of total revenue in the accommodation sector of €3.7bn. Scaling the WTTC's estimates of the direct and

[60] Eurostat, 2015b
[61] This assumes that the split between business and leisure tourism in the Balearic Islands is the same as the split at the national level; while it is conceivable that the share of business tourism will be lower than the national average in the Balearic Islands, in the absence of data we have not made any further assumptions.
[62] Eurostat, 2015c

total contributions of tourism activity to GDP and employment discussed above for the share of spending in the accommodation sector suggests that, in 2016, every €1bn of revenue earned in the accommodation sector in Spain contributed €0.6bn directly to GDP and €1.6bn to GDP when accounting for the indirect and induced effects. In the same way, every €1bn of revenue generated 8,800 jobs in the accommodation sector and 27,100 jobs in the economy as a whole. Assuming the impact of tourism revenue on GDP and employment is the same across all sectors and regions in Spain, we can use these estimates to assess the impact of a change in tourism revenue in the accommodation sector in the Balearic Islands resulting from a change in tourism taxes.

Next, to assess the change in revenue resulting from a change in tourism taxes on accommodation, we used assumptions on the level of pass-through of a change in tax to prices and combined this with estimates of the elasticity of tourism demand to prices in the Balearic Islands based on existing literature. As with our country-level tool, discussed in Chapter 4, we have used a conservative assumption of an initial pass-through rate of 60%, although users of the tool have the flexibility to change this assumption as appropriate. With regards to the elasticity of tourism demand, Garin-Munoz, T. and Montero-Martin, L. (2007) estimate a long-run elasticity of -1.65 for the Balearic Islands; this is a relatively high elasticity and implies that a 1% increase in prices would decrease the number of tourist nights by 1.65%. This suggests that because tourists visiting the Balearic Islands have a number of close alternative destinations, they display a high degree of sensitivity to a change in price in the islands. Using these assumptions on pass-through and elasticity, we estimate the change in tourism spending and producer revenues in the accommodation sector from a change in VAT and a change in occupancy taxes, and the resulting impact on GDP and employment.

Table 11 below summarises findings from our analysis on the impact of a hypothetical change in occupancy taxes in the Balearic Islands. The current tax applied ranges from €0.5 to €2.00, however a 50% discount is applied for travel outside the peak season. Accounting for this, we estimate a weighted average of charges ranging from €0.46 to €1.84.[63] We have considered the impact of increasing the minimum and maximum charges by €0.5. The same percentage decrease in tax would yield the same magnitude of findings presented below, however the direction of impact will be reversed.

This hypothetical change in taxes is expected to decrease tourism spending on accommodation by 0.09% and tourism revenues by 0.31%. As a result, as illustrated in Table 12, the total contribution of the industry to GDP and employment in the economy is expected to reduce by €18.5m and 310 jobs respectively.

The relatively high estimated impact of a change in occupancy taxes in the Balearic Islands is driven by the high price elasticity of tourism demand. One explanation for the high estimated elasticity for the Balearic Islands is the fact that as the primary purpose of travel is for beach holidays, for which tourists have a wide range of alternative options, tourists are highly price sensitive to accommodation in the islands. Therefore, a small increase in price has a large negative impact on tourism demand. The increase in

[63] See Chapter 4 for a discussion of our methodology.

price is not sufficient to offset the decrease in demand in this case, and therefore tourism spending falls.

Obviously, changes in assumptions on the rate of pass-through and the elasticity of tourism demand in the Balearic Islands to a change in price will change the magnitude of these findings. Tables 11 and 12 also present the impact of our hypothetical change in tourism under different assumptions. Increasing the pass-through rate to 100% increases the magnitude of impact on tourism spending and producer revenues, and the resulting economic impacts.

A higher level of pass-through implies a higher percentage change in consumer prices, and given the high elasticity of demand for tourism, this has a more significant impact on tourism demand. On the other hand, reducing the price elasticity of demand has the opposite effect. With inelastic demand, the reduction in quantity demand is offset by the increase in consumer prices. Therefore, with inelastic demand of -0.8, the impact on consumer spending of an increase in taxes is positive. As producer prices still fall, the impact on producer revenues is negative, but lower in magnitude than before given the more muted impact on demand.

Table 11: Estimated impact of a change in occupancy taxes in the Balearic Islands

Assumptions	Change in tax			Impacts	
	Current occupancy tax	New occupancy tax	Change in effective tax rate (% points)	Change in tourism spending in accommodation (%)	Change in producer revenues in accommodation (%)*
Pass-through = 60% Elasticity = -1.65	€0.46-€1.84	€0.96-€2.34	0.25	-0.09%	-0.31%
Pass-through = 100%, Elasticity = -1.65	€0.46-€1.84	€0.96-€2.34	0.25	-0.15%	-0.37%
Pass-through = 60%, Elasticity = -0.8	€0.46-€1.84	€0.96-€2.34	0.25	0.03%	-0.20%

Source: PwC, using various sources
**Note: By construction, the percentage change in producer revenues in the accommodation sector is equivalent to the percentage change in GDP and employment at the sectoral and economy-wide levels*

Table 12: Estimated economic impact of a change in occupancy taxes in the Balearic Islands

Assumptions	Sectoral impact on the accommodation sector	Economy-wide impact

	GDP impact (Euros, millions)	Employment impact (number of jobs)	GDP impact (Euros currency, millions)	Employment impact (number of jobs)
Pass-through = 60%, Elasticity = -1.65	-6.6	-100	-18.5	-310
Pass-through = 100%, Elasticity = -1.65	-7.9	-120	-22.0	-370
Pass-through = 60%, Elasticity = -0.8	-4.2	-60	-11.7	-200

Source: PwC, using various sources

It should be noted that the findings from the analysis above should be treated as only indicative of the potential impacts of a change in occupancy taxes. The tool does not account for the visibility of the change in occupancy taxes; it is often the case that occupancy taxes are not visible to consumers hence the impact on demand from first-time tourists to a destination is likely to be low. Furthermore, other administrative costs are not taken into account and neither are the direct impacts on other tourism sectors or on other competing tourist destinations. Section 4.4.1.2 discusses in greater detail the caveats in using our data tool, which is only intended to provide indicative impacts in a partial equilibrium framework.

3.3.7. Impacts on public expenditure in the Balearic Islands

It can be tempting to draw the conclusion that the best 'tax regime' for a given sector is to not tax it at all, since this will reduce the costs to businesses and consumers alike and minimise distortions to the sector. However this omits the very significant impact those tax revenues can have on the public expenditure required to maintain and improve the competitiveness of the sector. In this section we outline some key considerations regarding the link between taxes on tourism and the expenditure of the Balearic Islands Government on the tourism sector.

It is inherently difficult to draw a direct link between the taxes levied on a sector and the amount subsequently spent by the government on the infrastructure and services required to support that sector. Of course, across all sectors the link is entirely clear: governments that are not saving, running down funds or raising debt must spend exactly what they raise in tax revenue. But expenditure decisions are seldom made on the basis of where revenues have come from. The exception to this is in the case of hypothecated taxes - where revenues are explicitly set aside for a specific purposes. Many such taxes do exist, including the Sustainable Tourism Tax (Balearic Islands Government).

Spain as a whole dedicates a large portion of government expenditure to its tourist sector. According to the WEF, 6.5% of government expenditure is dedicated to the provision of travel and tourism services, placing Spain at 23rd globally and 5th for the EU

- the highest of any of the six large MS.[64] When expenditure on the provision of infrastructure such as roads and water services is included, this represents a very large portion of government spending. Although the data is not available at the regional level, we would expect public expenditures as a proportion of total expenditure to be at least this high in the Balearic Islands (if not higher) given their popularity as a tourist destination.

The Sustainable Tourism Tax generated €30m in revenue for the Balearic Islands Government in 2016 and can be expected to generate at least twice this amount in 2017 given its mid-year introduction and the continued growth in tourist arrivals.[65] Some 46 projects were selected for funding in January 2017, with 80% of spending focussed on environmental protection and water supply and the remaining 20% focussed on other tourism related projects. All four main islands received significant amounts, and almost €6m was dedicated to projects in other, smaller, islands.

Public expenditure is vital for the effective functioning of a sector as broad as the tourism sector, with the government supporting the industry through the provision of things like public infrastructure, security services, international 'brand' promotion and environmental protection.

3.3.8. Conclusions

The Balearic Islands are an example of a location with a particularly high degree of autonomy to determine their own tax policy, even allowing for regional variation across the islands. The tax system in the Balearic Islands has evolved and changed with some regularity in the recent past – including changes to rates and the introduction and removal of entirely new taxes – but despite the location competing strongly with other sun-and-sea destinations for international visitors, the tax regime facing the tourism sector has consistently comprised a comprehensive array of taxes.

The introduction, removal, and subsequent reintroduction of environmental bed taxes in the Balearic Islands provides an interesting natural experiment. While the 2001 version of the tax was poorly received and was repealed the following year, the more recent iteration appears to have been better received by the sector and may provide insights into how the introduction and administration of such a tax may influence its impacts on competitiveness (discussed earlier in this case study and then further in the recommendations). Although there are other forces at play as well, the number of tourists to the islands has continued to show strong growth over the period since the new Sustainable Tourism Tax was announced and established.

3.4. Case study 2: Paris (France)

Our second case study is the French capital of Paris. Paris makes for an interesting case study as it is the most popular tourist destination city in the European Union and its tourism sector is subject to an extensive and complex tax regime, covering all the tax

[64] World Economic Forum ranking, 2017
[65] Some estimates are as high at €76m for 2017, see Majorca Daily Bulletin, 2017

types included in this study.

3.4.1. The tourism sector in Paris

France is one of the world's most popular tourist destinations, with 83 million tourists visiting each year and tourist spending accounting for approximately 7% of French GDP, or €35.8 billion per annum. Tourists mainly come from Germany and Britain, with an increasing number coming from elsewhere in Europe and Asia (in particular China).[66]

France is an attractive location for all main varieties of tourism, including city breaks (most notably to Paris), rural breaks, skiing holidays (the French Alps), business tourism and beach holidays. Although Paris is seen by many as the quintessential French destination, France also competes well in these other areas: with 55 million skier days per annum, for example, France is the most popular skiing destination in the world.[67]

According to Eurostat, France boasts 130 million tourist nights per year - the third highest in the EU[68] - and is the second highest in terms of international tourism revenues.[69] Despite its large population, it is ranked ninth in the EU for tourism intensity (a measure of tourism per capita).[70]

Paris itself is the second most popular tourist destination in the European Union, and the most popular of all European cities, with 78 million tourist nights per year and the majority of these being from non-residents of France.[71] Most leisure tourists come for the purpose of discovering the city and its cultural attractions.[72] Tourism is a very significant sector for the Paris economy, with nearly 400,000 people employed in the sector across the Greater Paris region - 12.4% of all salaried employment. Despite major terrorist attacks in January and November 2015 the tourism sector proved relatively resilient, with only a 1.1% drop in tourist arrivals from 2014 to 2015.[73]

There is a strong property sharing culture in Paris, and with around 78,000 properties listed on Airbnb, Paris is the platform's most popular location for landlords. As an indication of the less-seasonal nature of the Paris tourism industry, in the three months spanning June 1 to September 1, 2016, Airbnb noted a 20% increase in guest arrivals to Paris compared with an increase of 80% across the rest of France.[74]

The government of France recognises the country's comparative strength in the tourism sector and makes efforts to maintain its position as a favourite destination from tourists from around the world.[75] The same announcement indicates that a significant proportion

[66] French Ministry of Foreign Affairs, 2017
[67] Ibid.
[68] Eurostat, 2017a
[69] Eurostat, 2017b
[70] Eurostat, 2016a
[71] Eurostat, 2016b
[72] Paris Convention and Visitors Bureau, 2017
[73] Ibid.
[74] Forbes, 2017
[75] French government website, Nov 2016

of the government's financial efforts targets safety measures, in light of the recent terrorist attacks in Paris.

3.4.2. Taxes on tourism in Paris

Overview of tourism taxes in Paris (France)						
Corporate Income Tax	Personal Income Tax	Property Tax	Value Added Tax	Occupancy Tax	Departure Tax	Other Taxes and Levies
28%-34.43% (incl. local social surtax)	Up to 49% (with deduction for tourism investment) (30% at average income)	YES, multiple (with exemption for tourism)	20%, 10%, 5.5%, 2.1%	YES	YES	-

As noted earlier, the tax regime as it applies to tourism in Paris is extensive and complex, with a wide variety of relevant taxes applied. In the sections below we address each of the key tax types.

3.4.2.1 Corporate and personal income taxes

The corporate income tax rate facing businesses in France varies by business size. Although the standard rate itself is one of the highest in the EU, at 33.33%, for larger companies (with a tax liability above €763,000) the addition of a social surtax increases this effective rate to 34.43%. Very small companies, however, with a taxable profit of not more than €38,120 and certain other restrictions, can benefit from a reduced rate of 15%. A 2017 Act of parliament will reduce the standard rate to 28% (from 33.33%) for all companies by 1 January 2020, and this will be done progressively, with smaller companies benefitting from the lower rate earlier (and even smaller companies already facing the lower rate).

Personal income tax rates are similarly high (and complex), with standard rates of up to 45% and an additional 3% or 4% surcharge on high income individuals (earning over €250,000 and €500,000 per annum, respectively).[76] The marginal income tax facing the average income earner is 30% - slightly above the EU-28 average.

Interestingly from a tourism perspective, the French government allows a personal income tax reduction for individuals who invest in the refurbishment of private dwellings qualifying as a tourist residence, provided they will be dedicated to tourist accommodation for at least five years following completion of the work. The tax reduction corresponds to a maximum of €4,400 per dwelling and is a temporary measure relating to work undertaken during 2017-2019, although it follows the application of similar temporary measures in previous years.

[76] PwC WWTS, 2017

3.4.2.2. Real estate tax

Real estate taxes in France are applied on the basis of both ownership and occupancy, and there are effectively four different real estate taxes that may apply across these two categories.

Firstly, one of two separate taxes are levied on owners of property (both commercial and residential). The *taxe fonciere sur les proprietes non baties* is a tax on unimproved land and the *taxe fonciere sur les proprietes baties* is a tax on improved land. Both taxes are calculated on the basis of the rental value of the real estate, with a rebate (intended to proxy expenses) of 20% for unimproved land and 50% for improved land. The rental value is assessed unilaterally by the French tax authorities on the basis of an estimation of the annual rent that would be generated if the property was rented. The assessment is based on a valuation last updated in 1980 and adjusted for inflation, although a new valuation for commercial premises will apply from 2017.

Rates applied to unimproved land are decided by the local commune, while those on improved land are decided jointly by the local commune and the departmental council. The total rate for central Paris is only 13.5% (made up of 8.37% to the City of Paris commune and 5.13% to the department of Paris), which is significantly lower than the French national average of 35.96% (20.52% to local communes and 15.44% to departmental councils). [77] This excludes charges for services provided by local government, such as domestic waste disposal.

Secondly, occupants of property are charged one of two taxes in addition to the ownership tax applicable to that property. Unlike ownership taxes, however, the occupancy taxes differ depending on whether the property is being used for commercial or residential purposes.

Commercial occupants are charged a territorial economic contribution (*Contribution economique territoriale* (CET)), which actually comprises two separate taxes: the CVAE (*Cotisation sur la Valeur Ajoutee des Enterprises*), and the CFE (*Cotisation Fonciere des Enterprises*). The CVAE is a progressive tax determined on the basis of the 'value added' by an entity (based on turnover and some income, minus certain costs), and does not apply at all to businesses with a turnover of less than €500,000 per annum. In this sense it is more akin to a local company tax than a real estate tax. The CFE, however, is based on the estimated rental value of a property, with rates determined jointly by the local commune and the departmental and regional councils, and is currently set at 16.52%.[78]

Residential occupants are subject to the personal dwelling tax (*taxe d'habitation*), which is based on the gross rental value of the property, just like the CFE. The current rates for the Paris commune are 13.38%.

Although these four real estate taxes apply across all business sectors, there is one aspect that relates directly to tourism. In some communes, including Paris, some

[77] Paris Council, 2017
[78] Ibid.

businesses receive an exemption from CET for parts of a dwelling used for tourist accommodation. Although not applicable to individuals, this includes unincorporated businesses such as a bed-and-breakfast or short-term let.

3.4.2.3. Value-Added Tax (VAT)

As with most EU MS, France applies a reduced VAT rate for many tourism related activities. The standard rate of 20% is reduced to 10% for accommodation services, the transportation of passengers, restaurant and catering services (excluding alcohol, which is standard rated), and admission to amusement parks, and is reduced even further for admission to sporting events (5.5%) and various cultural activities (2.1%, 5.5% and 10%). As in other MS, car rental is subjected to the standard non-reduced rate of VAT (20% for Paris, and France generally).

3.4.2.4. Occupancy tax

Tourist communes impose an occupancy tax (*Taxe de séjour*) on tourists and may choose to apply this on the basis of either the exact number of tourist nights or a flat rate calculated on the basis of the provider's capacity. The base rates for this vary from €0.20 to €4.00 per person per night, depending on the type of accommodation and the rate set by the local commune. The wider departmental council applies a 10% surtax on top of this, bringing the total tax to between €0.22 and €4.40 per person, per night. Legislation requires the revenue generated from this tax to be applied to expenses intended to encourage tourist visits to the area.[79]

For Paris, the rates range from €0.22 for budget campgrounds to €3.30 for five star hotels and for €4.40 for palaces. Paris applies a small number of exemptions to this tax, including all minors.[80] As described below in section 3.4.3.2, shared accommodation providers in Paris are charged the lowest hotel rate of €0.83 per person, per night, which is collected by the provider on behalf of the individual landlords and remitted to the authorities.

3.4.2.5. Air passenger duty/departure taxes

All passengers leaving Paris (and France generally) via an aircraft are subject to two main departure taxes - the Civil Aviation Tax and the Solidarity Tax - both of which are collected by the carrier as part of the final ticket price.

The Civil Aviation Tax is fixed at €4.48 per passenger travelling domestically or to another European Country, and €8.06 for passengers travelling to countries outside Europe. For business and first class travellers, the tax rises to €11.25 within Europe and €45.07 for all other destinations.

The Solidarity Tax is fixed at lower rates of €1.13 and €4.51, respectively, and is not levied on passengers only travelling through France in transit.

[79] Legifrance, 2017
[80] Paris Convention and Visitors Bureau, 2017a

Interestingly, the Solidarity Tax is hypothecated for a non-tourism related purpose. Proceeds up to a fixed ceiling are directed to the Solidarity Fund for Development, which finances international public health programs and access to medicines for certain diseases in developing countries and the achievement of international development goals.[81] Proceeds beyond this ceiling are used for aviation purposes.

Passengers and aircraft departing from French airports are subject to other taxes not classified as departure taxes for these purposes (including an airport tax and a tax on air transport noise pollution).

3.4.2.6. Other tourism-specific taxes and levies

Although it is not relevant for the case of Paris, it is worth noting that in addition to the extensive suite of tourism related taxes outlined above, further taxes apply in areas with ski resorts. This includes a tax on ski lift transportation and a tax on the use of cross-country skiing trails.

3.4.3. The tax regime facing accommodation providers and travel agents and tour operators in Paris

As with the Balearic Islands, not all of the taxes outlined above are applicable to all businesses operating in the Paris tourism sector, and some may be more relevant to the business decisions and competitiveness of particular businesses. In this section we outline the tax regime facing three key tourism businesses: a large hotelier, an individual provider of shared accommodation, and a large travel agent and tour operator.

3.4.3.1. Taxes on hoteliers

Here we focus on the most relevant taxes facing a corporate hotelier of a large hotel (or chain of hotels). As you might expect, hoteliers are directly impacted by nearly all of the tourism taxes applicable in Paris, the only exclusion being the air passenger duties (although, less directly, these will still have an impact on the number of tourists flying into Paris).

Large hoteliers face a corporate tax rate of 34.43%, comprising an underlying CIT of 33.33% and a social surtax of 3.3%. The CIT component is set to be reduced to 28% by 2020 and the recently elected President has promised to reduce this even further to 25%.[82] Distributed dividends for the hotelier are subject to an additional 3% tax (although the European Commission is currently undertaking infringement proceedings against France, claiming this additional tax is non-compliant with EU law[83]).

Staff working in the hotel(s) will face marginal personal income tax rates of up to 45%, although this is only 30% for those on the average wage, and the most senior hotel

[81] French Senate, 2015
[82] BBC article, 2017
[83] PwC tax summaries, France, 2017

management staff may face an additional surtax of 3% or 4%. These taxes are in addition to the social surcharge on employment income. Although the hotelier does not pay the personal income tax themselves, the impact on net wages does affect the rates the hotelier must offer in order to attract and retain the mix of skilled staff required to run the hotel(s). This is in addition to other staff costs faced by the hotelier.

Assuming the hotelier owns the real estate on which the hotel(s) are sited, they will also be subject to three different real estate taxes. The first is a 6.75% ownership tax on the rental value of the improved land, comprised of a 13.5% underlying tax rate with a 50% rebate to proxy expenses.

The other two real estate taxes are the two halves of the CET tax, which replaced the previous business tax. The first half is a progressive tax (the CVAE) on the 'value added' by the hotel of up to 3%, with 'value added' being measured by total revenue minus allowed expense deductions. The second half is the CFE - another tax on the rental value, although this time attributable to the occupant of the hotel - of 16.52%.[84]

Hotels in Paris are also required to charge VAT of 10% on both the accommodation and restaurant and catering services they provide (excluding the provision of alcohol, which attracts the standard, 20%, rate), and are allowed to deduct input VAT accordingly. There are no special schemes for hoteliers with regards to VAT.

Finally, Parisian hotels must charge an occupancy tax on guests aged 18 or more. These rates are per person, per night and range from €0.83 per night for a 1-star hotel to €4.40 per night for a luxury hotel. Mid-range, 3-star hotels attract a rate of €1.65 per night. These rates include a base rate plus a 10% local surtax.[85]

As outlined above, some of these taxes have an impact on the competitiveness of the sector through their direct impact on the profitability of hotels, and others through the prices hotels must charge on their goods and services in order to remain profitable. Whether driven primarily by tax or other factors, hotel room rates in Paris are significantly higher than those in most major European cities, with Trivago's 2015 Hotel Price Index ranking Paris as the 7th most expensive of the 50 most popular city destinations in the EU.[86]

3.4.3.2. Taxes on individual accommodation providers

Individuals providing tourist accommodation (such as a room or dwelling rented out on an online platform) face a somewhat different - but not necessarily simpler - collection of taxes to those faced by large hoteliers.

Although they do not face corporate income tax, income earned in this way is subject to personal income tax of rates up to 49% (including the surtax for high income individuals). This may be reduced by way of a deduction available to individuals who

[84] Paris, 2017
[85] Paris, 2017a
[86] Reference same data as economics section

invest in the refurbishment of property used for these purposes, under a temporary scheme available for work performed from 2017-2019. This allows for 20% of eligible expenditure to be offset against a person's annual PIT liability.[87]

Individual accommodation providers are subject to two separate real estate taxes. The first, in line with large hotels, is the 6.75% ownership tax on the rental value of the improved land (a 13.5% underlying tax rate with a 50% rebate to proxy expenses). The second is the personal dwelling tax, which in Paris is charged at a rate of 13.38% of the gross rental value of the property - slightly lower than the 16.52% faced by hoteliers.

For many individual providers of accommodation VAT is not a direct consideration. Although still required to pay VAT on any goods and services required in maintaining the property, advertising vacancies, etc, most smaller providers will operate below the turnover threshold of €82,800 that applies to VAT registration for businesses in France (as this implies rental income of almost €1600 per week). However, even where providers do exceed this threshold they are only required to register for VAT where the accommodation services they provide are of a certain nature. The VAT directive states that "the leasing or letting of immovable property" should be treated as exempt for VAT, but that the provision of accommodation in sectors with a similar function to hotels should be treated as VAT-able. In France, the test applied to determine whether an accommodation provider falls within this definition is whether it passes any three of four key measures: i) the ability to offer breakfast, ii) a regular cleaning service, iii) the provision of linen, and iv) the means to provide a reception service.[88] Individual providers of accommodation that fall within this definition are required to register for VAT and charge guests VAT of 10% on their accommodation services.

Finally, individual accommodation providers in Paris must charge their guests the same occupancy tax as hotels. Following discussions between online platform providers (such as Airbnb), hotel groups and the French authorities, legislation was passed in November 2014 requiring shared accommodation platforms to collect this tax on behalf of individual accommodation providers as a means of tackling low compliance with the tax.[89] Unlike hotels, however, all Airbnb accommodation attracts a fixed nightly payment irrespective of the quality of the accommodation, charged at the lowest hotel rate of €0.83 per guest, per night.[90]

3.4.3.3. Taxes on travel agents and tour operators

Finally, we look at the taxes facing large travel agents and tour operators who are based in Paris. These must be distinguished from the travel agents and tour operators selling packages of goods and services to tourists *to Paris from abroad*, the prices of whose products will be impacted by taxes the tourism sector in Paris but whose direct tax burdens (e.g. CIT, PIT, real estate taxes) will be determined by the tax regime of the country in which they are established.

[87] Legifrance, 2017
[88] Ministère de L' Action et des Comptes Public, 2012
[89] France24, 2015
[90] Airbnb Action, 2015

Large Parisian travel agents and tour operators face the same fundamental income tax regime as large hoteliers, facing a corporate tax rate of 34.43% (including underlying CIT of 33.33% and the 3.3% social surtax) and an additional 3% tax on any distributed dividends. Staff working for travel agents and tour operators in Paris will be subject to PIT rates of up to 45% (30% for those on an average wage), with associated impacts on the total wage rate a company must provide in order to attract and retain appropriately skilled staff.

For bricks-and-mortar travel agents in particular, Paris' complex array of real estate taxes is especially relevant. If the land on which the travel agent is based is owned by the travel agent themselves then they will be subject to an ownership tax on the rental value of the site 6.75% (13.5% with a 50% rebate), and even where the land is leased by the travel agent it may be assumed that the burden of this tax is at least partially passed on to the travel agent through the rents they are charged by the owner. As the occupier, a travel agency will also be subject to the two components of the CET, including the up to 3% tax on value added and the 16.52% tax on rental value.

As with the Balearic Islands, the most unique tax process faced by travel agents and tour operators in Paris is the Margin Scheme for VAT. In practice, travel agents and tour operators based in Paris are required to apply French VAT at the standard rate of 20% on the margins they make from the packaging and on-selling of tourism services, leaving local service providers to account for and pay VAT at the appropriate (typically reduced) rate applicable to the services provided locally, and to pay this to the authorities in the location where the service itself is provided. Although the mechanism differs slightly for each case, the fundamental application of the standard 20% rate to the margin applies regardless of whether the travel agent or tour operator provides the services in their own name and accounts under TAMS or acts as an agent of a local provider and is required to charge and account for VAT on any commission (assuming the underlying service provider is established in France), although VAT charged on such commissions may be recovered as input tax by the local provider. Any VAT accounted for on the margin under the TAMS is not recoverable. Therefore the application of the TAMS does marginally increase the overall tax cost in the supply chain.

Occupancy and departure taxes are not directly relevant for travel agents and tour operators, but will have an impact on the price of packages sold to their customers. The Paris occupancy tax is likely to be much less relevant here, as we would expect most of the business of Paris-based travel agents to be to Paris locals travelling elsewhere, but the two French departure taxes will have an impact on the price of all packages involving air travel out of Paris. Combined, the Civil Aviation and Solidarity taxes add €5.61 per passenger for each departure to the EU and €49.58 to departures to all other destinations. For travel agents based in Paris and servicing Paris residents, the impact of this on prices is difficult to mitigate.

3.4.4. Competitiveness of the French tourism sector

It is not surprising to find that France ranks very highly in the World Economic Forum's

Travel and Tourism Competitiveness Index, being ranked number two globally (behind only Spain) and maintaining this position from the 2015 publication despite the effects of the terrorist attacks in 2015 and 2016.[91]

The index highlights France's natural resources, cultural resources and tourism-related infrastructure as being particularly strong, as well as its emphasis on environmental sustainability and strong enforcement of regulation. Of the 14 pillars assessed in the WEF index, France's achievement can be attributed to its cultural resources (3rd) and well-connectedness with a good network of ground transportation (7th) and air connectivity (13th). The authors commented that the decline in the security landscape and the usage of natural resources (13th, down 5 places) has been more than offset by the significant reduction in prices of hotel and ticket taxes and airport charges. Additionally, it is interesting to note that France has improved its environmental sustainability ranking (17th, up 6 places) and enhanced its ranking for business environment mainly as a result of improved rankings for efficiency of legal framework in settling disputes (22nd, up 19 places) and cost to deal with construction permits (85th, up 24 places).

Interestingly, taxation is listed alongside lengthy construction permit procedures as being an area of relative weakness for France, with France near the bottom of the rankings for tax burden on the sector. The time required to deal with construction permits procedure are lengthy (93th) and could be improved further. Although safety and security is emerging as a sensitive issue that are costly to business (112th), in light of events such as the 2016 Nice terrorist attack and the major attacks in Paris during 2015, the authors suggests that France has begun to strengthen its travel and tourism fundamentals, which helps to make the sector more resilient to shocks and primed to grow even further in the future.

Table 13: France's tax-related competitiveness indicator rankings

Overall WEF ranking for France: 2 / 136	
Tax related indicator	WEF rank (out of 136)
Effect of taxation on incentives to work	123
Effect of taxation on incentives to invest	122
Total tax rate	126
T&T government expenditure	76
Ticket taxes and airport charges	51
Hotel price index	80
Purchasing power parity	119

Source: World Economic Forum, 2017

Looking at specific tax-related indicators in France, its total tax rate and tax incentives which directly impact the business environment are both ranked at the bottom 25% among all countries assessed. Further development for the sector would therefore require improvements to the business environment, where the total tax rate is relatively high and the effect of taxation on incentives to work and invest are relatively low. Although

[91] World Economic Forum, 2015 and 2017

France's overall ranking for price competitiveness is relatively poor (118th), it is worth noting that this is a considerable improvement compared to its 2015 ranking (up 21 places) as a result of a significant reduction in relative hotel prices (up 13 places) and tickets taxes and airport charges (up 63 places). The level of expenditure allocated to the travel and tourism sector by the French government ranks just eight places below the in the median country, with no significant changes between 2015 and 2017.

3.4.5. Qualitative evidence for the impact of taxes on tourism sector competitiveness in Paris

This section provides an overview of the existing literature on taxes and tourism in the city of Paris.

Despite Paris operating an extensive and complex tax regime, there is limited literature available evidencing the impacts these taxes have had on the tourism sector, particularly recently. A key factor that appears to have contributed to the lack of literature in recent years has been the magnitude of major terrorist attacks in the city. The effects of these attacks have been significant, with the Regional Tourism Committee recently reporting that in 2016, hotel owners welcomed around one million fewer tourists to the region compared to 2015, a drop of 4.5% in the number of hotel arrivals (both foreign and domestic) in Greater Paris.[92] Much of the available literature considers these attacks to be primarily responsible for this significant decline. As a non-price factor, however, this makes it difficult to isolate the specific influence of taxes in recent times and, as a result, much of the literature cited in this section precedes 2015. It is also worth noting that most literature available relates to Paris' VAT regime.

In 2014 a study was undertaken by the International Association of Amusement Parks and Attractions (IAAPA) on the fiscal impact of lower VAT rates on amusement parks in the EU, including an assessment of the impact of the reduced VAT regime for tourist activities in Paris.[93] The report included a detailed case study on Disneyland Paris, which faced incremental increases of the reduced VAT rate (applicable to admissions, food, non-alcoholic beverages and hotel accommodation), from 5.5% in 2009, to 7% in 2012, and then to 10% in 2014. This found that day trip visitors to Disneyland were amongst the most price sensitive, with dedicated overnight-stay visitors less price sensitive. The paper also found that over 80% of respondents in a sample said that a great offer influenced their decision when last booking a short (amusement) break and nearly two-thirds of respondents said that a discount is a key influencer in their booking decision. These findings indicated that a price increase could lead to a significant fall in demand.

The case study reports that due to these concerns over price sensitivity, Disneyland Paris opted to absorb the 2012 VAT increase rather than pass it on to their guests through higher ticket prices, and indicated that they were similarly unlikely to pass on the 2014 VAT rise to customers.[94] As the second most visited site in the Paris region, the price-sensitivity observed at Disneyland Paris indicates that wider impacts could be felt across

[92] Paris Convention and Visitors Bureau, 2017
[93] IAAPA, 2014
[94] Ibid.

the tourism sector where tax changes were to flow through into prices. A similar expectation has been expressed by other lobby groups, for example one article expresses the concern of hoteliers that the 2014 VAT rate rise would force them to pass the cost on to consumers, which could temper demand.[95]

Looking at the trend in the number of arrivals to Greater Paris, we can see that between 2014 and 2016 numbers decreased year on year.[96] This may be attributed to the effect of the terrorist attacks, as well as increases in the reduced rates of VAT for tourism-related activities to 10% in 2014 and the *'taxe de séjour'* occupancy tax transitions in 2015. In fact, France's overall ranking for price competitiveness with the WEF is relatively poor (118th), and a recent study by PwC France found Paris to be among the most expensive European cities.[97]

However, the effect of taxes on tourism demand depends not only on the tax rates but also how the tax is passed through to the consumer. A report produced by a board of the French Court of Auditors, who denounce the various reduced VAT rates, deemed changes in VAT rates are costly and often ineffective. Their findings indicate that restaurateurs have taken advantage of the reduced rates to improve their margins rather than to lower their prices or increasing hiring,[98] and they suggest that the VAT measures did little benefit to consumers, with as little as 20% of the reduction passed on to prices.[99] If correct, this modest pass-through would suggest that these taxes have limited impact on the competitiveness of the restaurant sector in Paris.

3.4.6. Economic impact of accommodation taxes in Paris

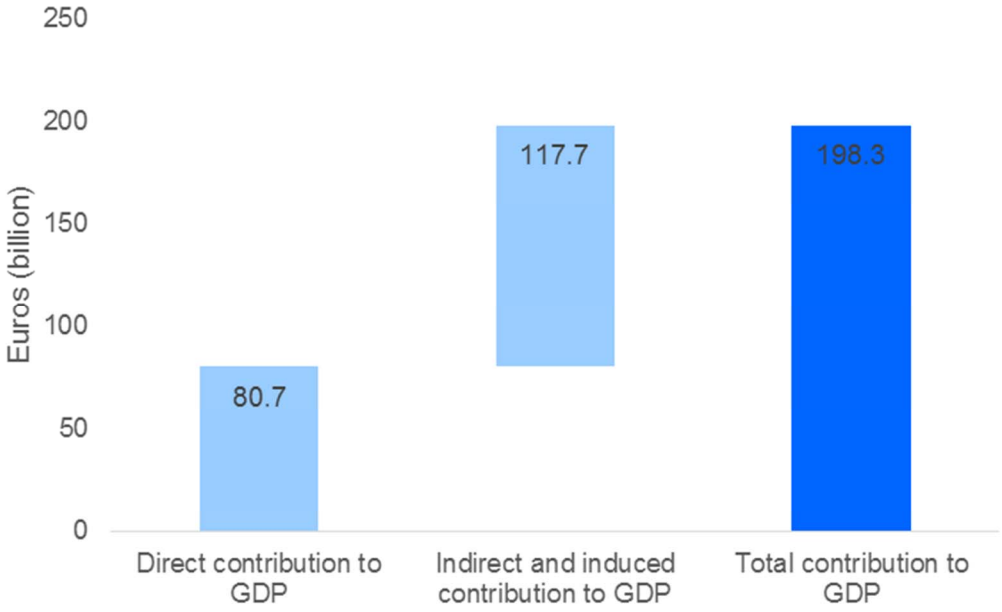
This section summarises our findings from an assessment of the potential impact on GDP and employment, in the accommodation sector and the economy of Paris, resulting from changes to the city's occupancy tax rates. As discussed in Chapter 4, France already applies a reduced rate of VAT on hotel accommodation, therefore the scope for reducing VAT rates is more limited. This analysis is based on the country-specific data tool we have developed, discussed in greater detail in Chapter 4, tailoring the country-level analysis for France to identify specific impacts for Paris.

The World Travel and Tourism Council (WTTC) estimates the total wider economic contributions to GDP and employment of tourism spending, including the direct, indirect and induced impacts. Total spending by tourists in France was estimated as €153bn in 2016. This activity in the tourism industry was associated with a direct GDP contribution of €81bn.[100] Accounting also for the indirect and induced impacts of activity in the industry, the total contribution of tourism spending was estimated by the WTTC as €198bn. This is illustrated in Figure 7 below. In terms of employment, the WTTC estimates that approximately 1.2m people were employed directly in the tourism industry

[95] The Local, 2017
[96] Paris Convention and Visitors Bureau, 2017
[97] PwC France, 2016
[98] Ibid.
[99] Challenges France, 2016
[100] World Travel and Tourism Council, 2016b

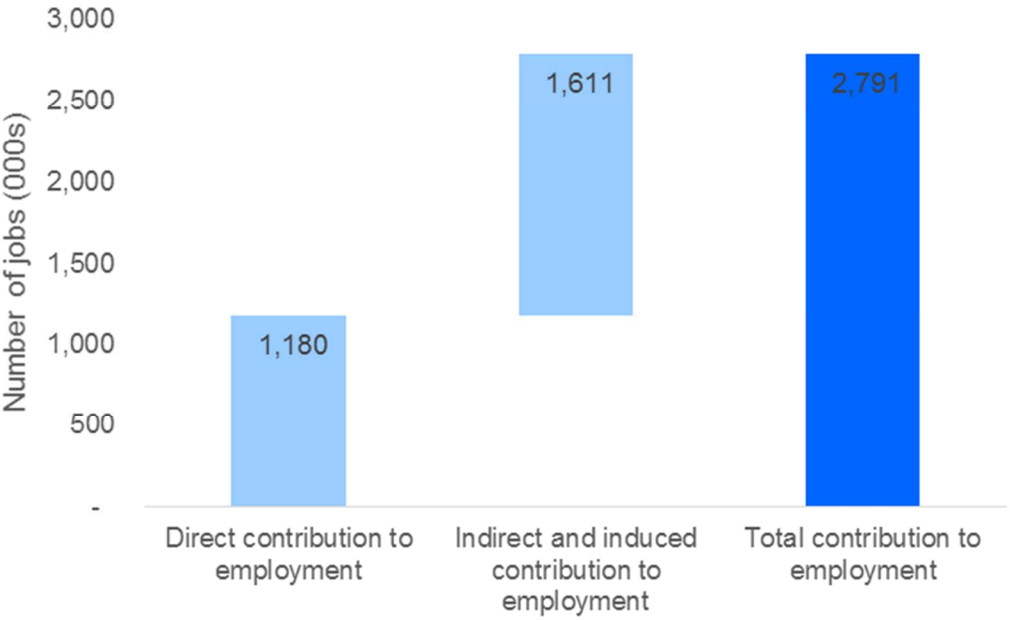
in France in 2016. Purchases by businesses in the tourism industry from suppliers, and consumption by employees in the tourism industry and employees of suppliers, supported an additional 1.6m jobs resulting in a total contribution to employment of 2.8m jobs, as shown in Figure 8.

Figure 7: Contribution to GDP of the tourism industry in France



Source: World Travel and Tourism Council, 2016b, PwC

Figure 8: Contribution to employment of the tourism industry in France



Source: World Travel and Tourism Council, 2016b, PwC

In estimating the impact of a change in tourist taxes on tourism spending and producer revenues, and the resulting economic impact, our first stage is to establish the baseline spending and revenues in the accommodation sector. In 2015, the total number of tourist nights spent in France by residents and non-residents was over 400m.[101] Of these, 77m, or 19%, were spent in the Ile de France region which we use as a proxy for

[101] Eurostat, 2015b

Paris. Assuming that spend per tourist night is the same across all regions of France, we estimate that 19% of total tourism spending in France, equivalent to €28.6bn, is spent in Paris. Based on the national level split between business and leisure tourism, the approximate split in tourism spending in Paris would be €5.7bn by business travellers and €22.9bn by leisure travellers.

At the national level, the share of total tourism spending on accommodation is approximately 26%.[102] Assuming the same split for Paris, we estimate that of the €28.6bn of tourism spending in Paris in 2016, €7.5bn accounted for spending on accommodation.

Using the total spend on accommodation and the quantity demanded (i.e. the number of nights spent in Paris by tourists), we estimate that the average per night price of accommodation for tourists in Paris is €97. Adjusting the consumer price for VAT on accommodation and existing occupancy taxes, and multiplying this by the number of tourists, provides us with an estimate of total revenue in the accommodation sector of €6.7bn. Scaling the WTTC's estimates of the direct and total contributions of tourism activity to GDP and employment discussed above for the share of spending in the accommodation sector suggests that, in 2016, every €1bn of revenue generated in the accommodation sector in France contributed €0.6bn directly to GDP and €1.4bn to GDP when accounting for the indirect and induced effects. Similarly, every €1bn of revenue generated 8,600 jobs in the tourism industry and 20,300 jobs in the economy as a whole. In order to estimate the impact of a change in tourism revenues in the accommodation sector in Paris resulting from a change in tourism taxes, we assume that the wider contribution to GDP and employment per unit of spending is the same as at the national level for France.

In order to assess the change in spending and producer revenues resulting from a change in tourism taxes on accommodation, we used assumptions on the level of pass-through of a change in tax to prices and on the elasticity of tourism demand to prices in Paris based on existing literature. As with our national level tool, discussed in Chapter 4, we have used a conservative assumption of an initial pass-through rate of 60%, however flexibility in the tool allows users to change this assumption. With regards to the elasticity of tourism demand, Li, Song and Witt (2006) estimate a long-run elasticity of -1.17 for British demand for tourism in France. We use this as a proxy for the elasticity of tourism demand to a change in price in Paris. Using these assumptions on pass-through and elasticity, we estimate the change in tourism spending and producer revenues in the accommodation sector from a change in occupancy taxes, and the resulting impact on GDP and employment.

Table 14 below summarises findings from our analysis on the impact of a hypothetical change in occupancy taxes in Paris. The current charge in Paris ranges from €0.22 to €3.30 per person per night excluding the charge for palace stays, as discussed above. We have assessed the impact of a hypothetical increase in the minimum and maximum tax charged of €0.5 per person per night. The same percentage decrease in tax would

[102] Eurostat, 2015c

yield the same magnitude of findings presented below, however the direction of impact will be reversed.

As shown in Table 14, this hypothetical change generates a 0.02% decrease in spending in the accommodation sector, and a 0.25% decrease in producer revenues and economic contributions of the sector in Paris. As illustrated in Table 15, this is equivalent to a reduction in the total contribution of the industry to GDP and employment in the economy by €24.4m and 340 jobs respectively.

The relatively high estimated impact of a change in occupancy taxes in Paris is driven by the high price elasticity of tourism demand. This suggests that tourists visiting Paris are highly sensitive to a change in price. Therefore, a small increase in price has a large negative impact on tourism demand. The increase in price is not sufficient to offset the decrease in demand in this case, and therefore tourism spending falls.

It could however be the case that the elasticity we have assumed is relatively higher than the average elasticity of demand for tourism in Paris. Our assumption is based on the responsiveness of British tourists to a change in price in France; given the relatively small distance between France and the UK, British tourists may be more sensitive than an average tourist to a change in price in France, for example compared to tourists who are traveling from further away.

Obviously, changes in assumptions on the rate of pass-through and the elasticity of tourism demand in Paris to a change in price will change the magnitude of these findings. Tables 14 and 15 also present the impact of our hypothetical change in tourism under different assumptions. Increasing the pass-through rate to 100% increases the magnitude of impact on tourism spending and producer revenues, and the resulting economic impacts. A higher level of pass-through implies a higher percentage change in consumer prices, and given the high assumed elasticity of demand for tourism, this has a more significant impact on tourism demand.

On the other hand, reducing the price elasticity of demand has the opposite effect. With inelastic demand, the reduction in quantity demand is offset by the increase in consumer prices. Therefore, with inelastic demand of -0.8, the impact on consumer spending of an increase in taxes is positive. As producer prices still fall, the impact on producer revenues is negative, but lower in magnitude than before given the more muted impact on demand. Given the uniqueness of the location, it could be argued that a lower elasticity is more accurate for Paris. As a result of a lack of supporting evidence, we have used an assumption of a more elastic demand as discussed above, however users of the tool are able to change this assumption as appropriate.

Table 14: Estimated impact of a change in occupancy taxes in Paris

	Change in tax	Impacts

Assumptions	Current occupancy tax	New occupancy tax	Change in effective tax rate (% points)	Change in tourism spending in accommodation (%)	Change in producer revenues in accommodation (%)*
Pass-through = 60% Elasticity = -1.17	€0.22-€3.30	€0.72-€3.80	0.25	-0.02%	-0.25%
Pass-through = 100%, Elasticity = -1.17	€0.22-€3.30	€0.72-€3.80	0.25	-0.04%	-0.27%
Pass-through = 60%, Elasticity = -0.8	€0.22-€3.30	€0.72-€3.80	0.25	0.03%	-0.20%

Source: PwC, using various sources
**Note: By construction, the percentage change in producer revenues in the accommodation sector is equivalent to the percentage change in GDP and employment at the sectoral and economy-wide levels*

Table 15: Estimated economic impact of a change in occupancy taxes in Paris

Assumptions	Sectoral impact on the accommodation sector		Economy-wide impact	
	GDP impact (Euros, millions)	Employment impact (number of jobs)	GDP impact (Euros currency, millions)	Employment impact (number of jobs)
Pass-through = 60%, Elasticity = -1.17	-9.9	-150	-24.4	-340
Pass-through = 100%, Elasticity = -1.17	-10.6	-150	-26.0	-370
Pass-through = 60%, Elasticity = -0.8	-7.9	-120	-19.5	-270

Source: PwC, using various sources

It should be noted that the findings from the analysis above should be treated as only indicative of the potential impacts of a change in occupancy taxes. Section 4.4.1.2 discusses in greater detail the caveats in using our data tool which is only intended to provide indicative impacts in a partial equilibrium framework. For example, the tool does not account for the direct impacts on other tourism sectors or on other competing tourist destinations, or the visibility of such taxes.

3.4.7. Impacts on public expenditure in Paris

Although it is difficult to draw a direct link between the taxes levied on a sector and the amount subsequently spent by the (local and national) government on the infrastructure and services required to support that sector, in this section we outline some key considerations regarding the link between taxes on tourism and public expenditure on the tourism sector in Paris.

France as a whole does not dedicate a particularly large portion of government expenditure directly to its tourist sector. According to the WEF, 3% of government expenditure is dedicated to the provision of travel and tourism services, placing France at 76th globally and 18th in the EU - in line with the UK but well below Spain's 6.5%.[103] (Interestingly, the WTTC estimates total government expenditure on travel and tourism to be €14.0 billion, slightly higher than Spain's €12.3 billion).[104] However, although the data is not available at the regional level we would expect public expenditure on tourism as a proportion of total expenditure to be at least this high in Paris (if not higher) given the city's popularity as a tourist destination.

The *Taxe de séjour* brings in around €95 million to the Paris municipal government every year.[105] With total operating and capital expenditure of €9.5 billion by the Paris municipal government alone on Paris, the revenue generated by this occupancy tax is far outweighed by public expenditure. Tourism-specific expenditure includes things like €815,000 for the maintenance of tourist areas and €6.6m for the operation of the Paris Convention and Visitors Bureau (which promotes Paris as a destination, provides local information centres and supports business tourism).[106]

Although there are no hypothecated tourism taxes in Paris, the revenues generated from the sector for both the municipal and national government fund public expenditures that are crucial to the competitiveness of the Parisian tourism industry. Following the terror attacks in 2015, for example, the national government announced extra spending of €600 million to increase security in safety in the city the following year,[107] without which the sector would almost certainly have suffered. The national government has also introduced initiatives like the France Développement Tourisme programme which actively promotes investment in French tourism and aims to support the tourism industry through large investments in accommodation capacity, infrastructure, facilities and the promotion of innovation in the sector.[108]

3.4.8. Conclusions

Paris provides an interesting example of a location with a very extensive tax regime facing tourists and tourism-focussed businesses, but which scores very highly in measures of international competitiveness. It is also one of the few examples where

[103] World Economic Forum ranking, T&T government expenditure, 2017
[104] World Travel and Tourism Council, 2017e, 2017f
[105] Mairie de Paris, 2016
[106] Mairie de Paris, 2016
[107] Deccan Chronicle, 2016
[108] Caisse de Depots, 2015

certain tax exemptions are used to incentivise investments in the tourism sector specifically.

The sharing economy is particularly important for the Parisian accommodation sector, and has created challenges for local tax authorities in administering its occupancy tax. Paris was an early adopter of legislation requiring shared platform providers to collect and remit the tax on behalf of individual property owners – an approach that is being increasingly used elsewhere. Paris also highlights the importance of a well-functioning tax system for the protection and promotion of the tourism sector, with the government channelling significant revenue into increased security measures following the terrorist attacks of 2015.

3.5. Case study 3: Cyprus

Cyprus is an interesting case study as its tax regime is almost the polar opposite of France's. Despite its importance to the Cypriot economy, very few taxes apply to the tourism sector.

3.5.1. The tourism sector in Cyprus

With around thirteen million tourist nights a year and a population of just under 850,000,[109] Cyprus is the second most tourism-intensive MS in the European Union, after Malta.[110] The economy relies heavily on tourism, with receipts from travel services being equivalent to over 12% of GDP (the third highest in the EU).[111] The United Kingdom and Russia account for the majority of all tourists to the country, with 1.2 million and 900,000 per year, respectively.[112]

2016 was a record year for tourism in Cyprus, for the first time reaching over 3 million tourists arrivals. This was undoubtedly impacted by the Russian government's embargo on travel to Turkey (another popular destination for Russian citizens) and a diversion of tourism away from some of the Middle East's more high-risk countries. Russian arrivals increased by an astonishing 49% from 2015 to 2016, and arrivals from the Middle East increased around 33% in the same period.[113]

The majority of tourists come to Cyprus for beach holidays, although the sector is expanding into more niche areas of tourism as well. This includes sailing and cruise ships, religious and cultural tourism, wedding tourism, operating as a winter practice venue for sports groups and athletes, golf, health and wellbeing tourism, and medical tourism, in particular cosmetic surgery, diagnostic tests and fertility treatment. The Cyprus Tourism Organisation (CTO) is active in its promotion of Cyprus as a tourist destination and supports the growth of new and niche sectors. The CTO has invested in diving tourism,

[109] Eurostat, 2017c
[110] Eurostat, 2016a
[111] Eurostat, 2017b
[112] Republic of Cyprus, Ministry of Finance, Statistical Service, 2017
[113] Ibid.

for example, acquiring four sunken ships in 2015 as artificial diving reefs for tourists.[114]

A recent development in Cyprus' tourism industry is a move into gambling tourism. Building on a base of luxury tourism (including numerous five star hotels), the government has approved the licence of the island's first integrated casino resort, costing around $538 million and due for completion at the end of 2019.[115] The new integrated resort will be allowed a number of satellite locations, and will be the sole proprietor of casino table games and gaming machines. The government's objectives with this move include the promotion of tourism growth through diversification of the industry (in particular to strengthen tourism outside the summer months), to attract foreign investment, and to generate employment and government revenues.[116]

3.5.2. Taxes on tourism in Cyprus

Overview of tourism taxes in the Balearic Islands (Spain)						
Corporate Income Tax	Personal Income Tax	Property Tax	Value Added Tax	Occupancy Tax	Departure Tax	Other Taxes and Levies
12.5%	Up to 35% (20% at average income)	-	19%, 9%, 5%	-	-	Gaming duty

As already alluded to, the tax regime as it applies to tourism in Cyprus is not very comprehensive, and few taxes are levied on the sector in addition to the general (non-industry specific) taxes.

3.5.2.1. Corporate and personal income taxes

Corporate income tax in Cyprus is among the lowest in the EU - at just 12.5% it exceeds only the rates in Hungary and Bulgaria. Tax credits are granted to companies who pay tax abroad, avoiding the need for double-taxation agreements to be in place. There are no local government taxes on income.

Personal income is taxed on a progressive scale, up to a maximum of 35% for income of €60,000 per annum or above. Average income earners in Cyprus face the country's lowest (non-zero) marginal rate of 20%. It is important to note that a number of income types are exempt from income tax, such as interests and dividends.[117]

3.5.2.2. Real estate tax

As at 1 January 2017 there are no taxes on property in Cyprus. Prior to 2017 a progressive immovable real estate tax applied to owners of immovable property in Cyprus, with rates ranging from 6% to 19% of the total market value of a person's property. A small number of exemptions applied, but nothing for tourism related

[114] CountryProfiler (Cyprus) Ltd, 2016
[115] World Casino News, 2016
[116] Ministry of Energy, Commerce, Industry and Tourism, Republic of Cyprus, 2015
[117] PwC, Tax Facts & Figures 2017

property.[118]

3.5.2.3. Value-Added Tax (VAT)

The standard rate of VAT in Cyprus is 19%, with reduced rates applied to many tourism related activities. Accommodation services, some passenger transport and restaurant and catering services all face a 9% rate, while other passenger transport, admission to amusement parks and sporting events, and admission to cultural services all attract a 5% rate (some cultural services are exempt). As in other MS, car rental in Cyprus is subjected to the standard non-reduced rate of VAT (19% for Cyprus).

VAT rates have increased across most goods and services over recent years. The standard rate was raised from 15% to 17% in 2012, then to 18% in 2013 and 19% in 2014, with the larger of the two reduced rates increased from 8% to 9% in 2014.[119] These changes were driven by a general need to bridge a gap in public finances, rather than a desire to increase the specific contribution of the tourism (or any other) sector.

3.5.2.4. Occupancy tax

Cyprus does not levy any taxes or levies on the basis of occupancy.

3.5.2.5. Air passenger duty/departure taxes

Similarly, there are no air passenger duties or departure taxes charged on passengers travelling out of Cypriot airports.

In fact, rather than charging departure taxes, the government of Cyprus has a history of *subsidising* air travel to and from the island (sometimes unsuccessfully in light of EU restrictions around the provision of state aid[120]) and currently offers payments to airlines that operate new routes, increase their traffic during the winter season, or commit to long-term passenger growth. These subsidies depend on a number of factors and can be as high as €25 per passenger on qualifying flights. They are administered through the operator of the country's two international airports (Paphos and Larnaca), but are financed by the government.[121]

3.5.2.6. Other tourism-specific taxes and levies

Following its intention to generate strong public revenues from the newly integrated gaming industry, the government has set a gaming duty rate of 15% of gross gaming revenue across all activity.[122] While in many countries we would not consider this a tourist tax, it is more relevant here due to Cyprus' focus on gambling as a tourist activity.

Cyprus markets itself as having an "attractive tax system" for investors, including a

[118] PwC, 2017a
[119] Ministry of Finance, Republic of Cyprus, 2017
[120] Independent, 2015
[121] The Islands Commission website, 2017
[122] Ministry of Energy, Commerce, Industry and Tourism, Republic of Cyprus, 2015

number of exemptions for corporates and individuals.[123] These work to lower the effective tax rate facing some corporates and individuals operating in Cyprus, but there are no specific tax exemptions provided for the tourism sector.

3.5.3. The tax regime facing accommodation providers and travel agents and tour operators in Cyprus

Not all of the taxes outlined above are applicable to all businesses operating in the tourism sector, and some may be more relevant to the business decisions and competitiveness of particular businesses. In this section we outline the tax regime facing three key tourism businesses: a large hotelier, an individual provider of shared accommodation, and a large travel agent and tour operator.

3.5.3.1. Taxes on hoteliers

Here we focus on the most relevant taxes facing a corporate hotelier of a large hotel (or chain of hotels). As in the Balearic Islands and Paris, hoteliers are directly impacted by nearly all of the tourism-related taxes applicable in Cyprus.

Cyprus has one of the lowest corporate tax rates in the EU, at just 12.5%. As this is a flat rate, large hoteliers face the same rates of as smaller businesses. A Cypriot hotelier can distribute tax-free dividends of common stock (bonus shares) proportionately to all common stock shareholders.[124]

Staff working in the hotel(s) will face marginal personal income tax rates of up to 35%, although this is only 20% for those on the average wage. Although the hotelier does not pay the personal income tax themselves, the impact on net wages does affect the rates the hotelier must offer in order to attract and retain the mix of skilled staff required to run the hotel(s). This is in addition to other staff costs faced by the hotelier, such as the social security contribution required to be paid by both the employer and employee.[125]

Hotels in Cyprus are required to pay a VAT of 9% on both accommodation and the restaurant and catering services they provide, and are allowed to deduct input VAT accordingly. There are no special schemes for hoteliers with regards to VAT.

Finally, Cypriot hotels do not pay any taxes on property or on the basis of occupancy, as neither of these taxes are levied in Cyprus.

3.5.3.2. Taxes on individual accommodation providers

Individuals providing tourist accommodation (such as a room or dwelling rented out on an online platform) face an even simpler collection of taxes to those faced by large hoteliers.

[123] Invest Cyprus, 2017
[124] PwC Tax summaries, Cyprus, 2017
[125] Ministry of Labour and Social Insurance, Cyprus, 2015

Although they do not face corporate income tax, income earned in this way is subject to personal income tax of rates up to 35%.

With a VAT registration threshold of €15,600 - which implies average rental income of €300 per week - VAT may be a direct consideration for many individual providers of accommodation. For accommodation with a character similar to that of a hotel, and that brings in revenue above this threshold, providers must register for VAT and charge it to all their guests at a rate of 9%.[126] However, the accommodation provider should be able to recover VAT on costs subject to the normal rules. Failing to comply, carries a fine of €85 for every month or part of month of the delay, refusal or omission.[127]

As in the case with large hoteliers, there are no real estate tax in Cyprus for individual accommodation provider. Similarly, there are no taxes or levies on the basis of occupancy.

3.5.3.3. Taxes on travel agents and tour operators

Finally, we look at the taxes facing large travel agents and tour operators who are based in Cyprus. These must be distinguished from the travel agents and tour operators selling packages of goods and services to tourists *to Cyprus from abroad*, the prices of whose products will be impacted by taxes in the tourism sector in Cyprus but whose direct tax burdens (e.g. CIT, PIT, real estate taxes) will be determined by the tax regime of the country in which they are established. They must also be distinguished from excursion providers - i.e. those who operate specific excursions to tourists.

Large Cypriot travel agents and tour operators as well bricks-and-mortar travel agents face the same flat-rate 12.5% corporation tax regime as large hoteliers, with no local variation. As mentioned in previous sections, there are no taxes on the basis of immovable property for Cyprus.

As with both the Balearic Islands and Paris, the most unique tax mechanism faced by travel agents and tour operators in Cyprus is the Margin Scheme for VAT. In practice, travel agents and tour operators based in Cyprus are required to apply Cypriot VAT at the standard rate of 19% on the margins they make from the packaging and on-selling of tourism services, leaving local service providers to account for and pay VAT at the appropriate (typically reduced) rate applicable to the services provided locally, and to pay this to the authorities in the location where the service itself is provided. Although the mechanism differs slightly for each case, the fundamental application of the standard 19% rate to the margin applies regardless of whether the travel agent or tour operator provides the services in their own name and accounts under the TAMS or acts as an agent of a local provider and is required to charge and account for VAT on any commission (again assuming the underlying service provider is established in Cyprus). Thus, VAT charged on such commissions may be recovered as input tax by the local provider. Any VAT accounted for on the margin under the TAMS is not recoverable. Therefore the application of the TAMS does marginally increase the overall tax cost in the

[126] Ministry of Finance, Republic of Cyprus, 2017
[127] Ministry of Finance, Republic of Cyprus, 2017

supply chain.

3.5.4. Competitiveness of the Cypriot tourism sector

Despite its popularity as a tourist destination and its relatively low tax burden on the tourism sector, Cyprus doesn't rank as strongly on the World Economic Forum's Travel and Tourism Competitiveness Index as might be expected, coming in at number 52 globally of the 136 countries assessed, down 16 places from the 2015 WEF publication.[128]

This significant drop in ranking is surprising, given the government's explicit intention to boost the sector as one of the main engines of growth and the major rise in tourist arrivals in recent years. However this appears to be a combination of measures which are either new or for which there was no data for Cyprus in 2015, and a major drop in the "aircraft departures per 1000 population" measure, which fell from 10.3 to 0.3 from 2015 to 2017. The reason for this appears to be that the measure only includes locally registered carriers, and with the collapse of Cyprus Airways in early 2015 this dropped dramatically. However, air traffic to the island was replaced by alternative airlines not registered in Cyprus, meaning the underlying economic activity itself has not declined in line with the WEF measure.[129]

Despite the reduced ranking in tourist service infrastructure (down 18 places to 20th), Cyprus remains among the top of all countries assessed. The index also highlights the government's prioritisation of travel and tourism as particularly strong (10th). It is placed at the top of the list for a number of indicators, including number of international trade agreements in force, presence of major car rental companies, homicide rate, and health and hygiene factors such as access to improved sanitation and drinking water, and low rates of malaria incidence and HIV prevalence.

Table 16: Cyprus's tax-related competitiveness indicator rankings

Overall WEF ranking: 52 / 136	
Tax related indicator	WEF rank (out of 136)
Effect of taxation on incentive to work	26
Effect of taxation on incentive to invest	19
Total tax rate	22
T&T government expenditure	11
Ticket taxes and airport charges	30
Hotel price index	84
Purchasing power parity	112

Source: World Economic Forum, 2017

Cyprus ranks relatively poorly on price competitiveness (111th), which is mainly attributed to high fuel price and high PPP. However, the country has low overall tax rates and excellent tax incentives to work and invest, which are all flagged as areas of notable

[128] World Economic Forum, 2015 and 2017
[129] Ministry of Finance Republic of Cyprus, 2015

comparative advantage. It is clear that the travel and tourism sector is a priority growth area for the Cypriot government, which dedicates a substantial amount of expenditure to the sector (see Section 3.5.7 below for more details).

3.5.5. Qualitative evidence for the impact of taxes on tourism sector competitiveness in Cyprus

This section provides an overview of the existing literature on taxes and tourism in Cyprus.

In 2007, a research study by the University of Cyprus on tourism satisfaction and trends listed 'rising costs' as one of the most cited reasons for Cyprus' loss of competitiveness at the time.[130] The study results show the main drivers of tourism satisfaction rates in Cyprus to be directly related to costs.

In a 2012 research study on the determinants of tourism for Cyprus, it was found that tourism expenditure was significantly affected by relative prices between Cyprus and its main competitor, Greece.[131] The paper suggests that given the similarity in the offering of sunny beaches and proximity between Cyprus and Greece, when prices in Cyprus relative to Greece increase, tourist arrivals and expenditure in Cyprus decrease. Given the direct linkages between taxes and prices, lower taxes have a positive correlation with lower prices, and consequently higher demand. Of course, the extent to which taxes affect tourism prices depends on the degree to which businesses in the sector choose to absorb this to maintain competitiveness or pass them through to consumers.

Another 2007 paper by the University of Cyprus on the relationship between prices and demand finds that transportation costs are important for tourists in choosing Cyprus as a destination, with tourism from countries with direct flights to Cyprus price responsive with a price elasticity of roughly 0.7.[132] This may be one of the drivers behind the government's policy of levying no specific taxes on travel and subsidising air carriers, which has seemingly had a positive impact on its tourism competitiveness.

Although limited and less up-to-date, these studies provide some evidence that price related factors play an important role in the competitiveness of Cyprus' tourism industry. This may offer an insight to the rationale behind country's low tax regime.

3.5.6. Economic impact of accommodation taxes in Cyprus

This section summarises our findings from an assessment of the potential impact on GDP and employment, in the accommodation sector and the wider economy, from introducing occupancy taxes in Cyprus. As discussed in Chapter 4, Cyprus already applies a reduced rate of VAT on hotel accommodation, therefore the scope for reducing VAT rates is more limited.

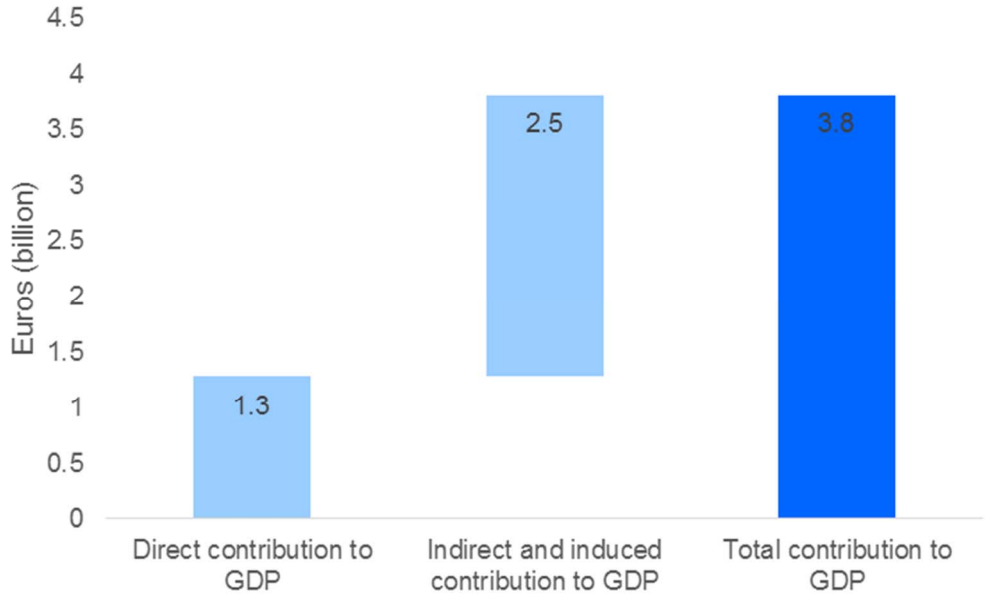
[130] Clerides and Pashourtidou, 2007
[131] Tsangari, 2012
[132] Cleanthous, 2007

As Cyprus does not currently levy any taxes on the basis of occupancy, we consider the potential impact of introducing an occupancy tax. Our analysis is based on the country-specific data tool we have developed, discussed in greater detail in Chapter 4.

The World Travel and Tourism Council (WTTC) estimates the total wider economic contributions to GDP and employment of activity in the tourism sector, including the direct, indirect and induced impacts. Total spending by tourists in Cyprus was estimated as €2.8bn in 2016. This activity was associated with a direct GDP contribution of €1.3bn.[133] Accounting also for the indirect and induced impacts of activity in the industry, the total contribution of tourism spending was estimated by the WTTC as €3.8bn. This is illustrated in Figure 9 below.

In terms of employment, the WTTC estimates that approximately 26,000 people were employed directly in the tourism industry in Cyprus in 2016. Purchases by businesses in the tourism industry from suppliers, and consumption by employees in the tourism industry and employees of suppliers, supported an additional 54,000 jobs resulting in a total contribution to employment of 81,000, as shown in Figure 10.

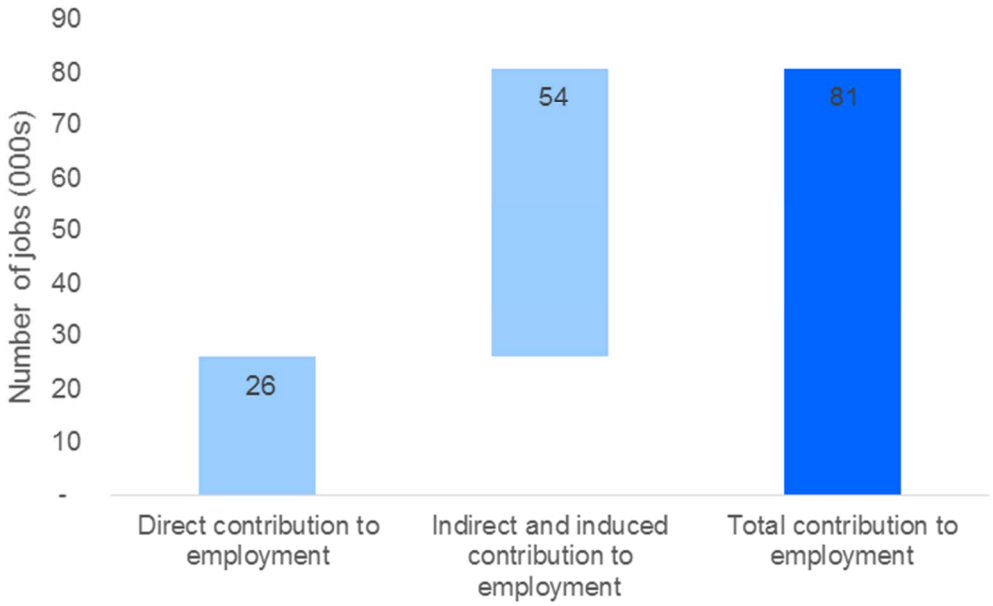
Figure 9: Contribution to GDP of the tourism industry in Cyprus



Source: World Travel and Tourism Council, 2016b, PwC

Figure 10: Contribution to employment of the tourism industry in Cyprus

[133] World Travel and Tourism Council, 2016b



Source: World Travel and Tourism Council, 2016b, PwC

Of the total tourism spending of €2.8bn by tourists in Cyprus, the WTTC[134] estimates that €0.2bn can be attributed to business travellers while the remainder, €2.6bn, can be attributed to leisure travel. Leisure travel can be further broken down into coastal and non-coastal tourism; based on Eurostat data[135] we estimate that approximately 97% of Cypriot leisure tourism can be classified as coastal with the remaining 3% as non-coastal, resulting in estimated coastal leisure spending of €2.5bn and non-coastal leisure spending of €0.1bn.

The share of total tourism spending on accommodation is estimated as 31%.[136] Applying this share to total spending, results in estimated spending on accommodation of €0.1bn, €0.8bn and €0.03bn by business, leisure (coastal) and leisure (non-coastal) tourists respectively.

Using the total spend on accommodation and the quantity demanded (i.e. the number of nights spent in Cyprus by tourists), we estimate that the average per night price of accommodation for tourists in Cyprus is €33. Adjusting the consumer price for VAT on accommodation and the existing occupancy tax rate, and multiplying this by the number of tourists provides us with an estimate of total revenue in the accommodation sector of €0.8bn. Scaling the WTTC's estimates of the direct and total contributions of tourism activity to GDP and employment discussed above for the share of spending in the accommodation sector suggests that, in 2016, every €1bn of spending by tourists in Cyprus contributed €0.5bn directly to GDP and €1.5bn to GDP when accounting for the indirect and induced effects. Similarly, every €1bn of spending by tourists generated 10,100 jobs in the tourism industry and 31,100 jobs in the economy as a whole.

In order to assess the change in spending and producer revenues resulting from a

[134] Ibid.
[135] Eurostat, 2015b
[136] Eurostat, 2015c

change in tourism taxes on accommodation, we used assumptions on the level of pass-through of a change in tax to prices and on the elasticity of tourism demand to prices in Cyprus based on existing literature. As with our national level tool, discussed in Chapter 4, we have used a conservative assumption of an initial pass-through rate of 60%, but flexibility in the tool allows users to change this assumption as appropriate.

With regards to the elasticity of tourism demand, Cleanthous (2008) estimates inelastic demand for visits to Cyprus of -0.2 in response to a change in price; this suggests that a 1% increase in price only leads to a less than proportionate reduction in demand of 0.2%. This assumption on the price elasticity is relatively low given the large share of coastal tourism for which our national-level tool (discussed in Chapter 4) assumes an elasticity of -1.39. This suggests that relative to other beach holiday locations, tourists visiting Cyprus are less influenced by a change in price. Using these assumptions on pass-through and elasticity, we estimate the change in tourism spending and producer revenues in the accommodation sector from a change in occupancy taxes, and the resulting impact on GDP and employment.

Table 17 below summarises findings from our analysis on the impact of the introduction of a hypothetical occupancy taxes in Cyprus. No occupancy tax is currently levied on tourists in Cyprus. We have therefore assessed the potential impact from introducing a 3% tax per room, assuming no additional discounts for children.

As shown in Table 17, the introduction of this hypothetical tax is estimated to generate a 0.71% increase in spending in the accommodation sector, and a 0.76% decrease in producer revenues and economic contributions in Cyprus. As illustrated in Table 18, based on the contribution of every unit of producer revenue, this is equivalent to a reduction in the total contribution of the industry to GDP and employment in the economy by €9.0m and 190 jobs respectively.

The estimated positive impact on tourism spending is driven by the inelasticity of tourism demand assumed for Cyprus. This suggests that tourists visiting Cyprus are not very sensitive to a change in price. Therefore, an increase in price has only a marginal impact on tourism demand. As a result, the decrease in demand is offset by the increase in price and tourism spending is therefore expected to increase. Producer revenues however fall as the price received by producers price is lower given the introduction of the tax, and demand is lower as well, albeit only marginally.

Clearly changes in assumptions on the rate of pass-through and the elasticity of tourism demand in Cyprus to a change in price will change the magnitude of these findings. Tables 17 and 18 also present the impact of our hypothetical change in occupancy taxes under different assumptions. Increasing the pass-through rate to 100% results in a higher percentage change in consumer prices than before. As a result, the magnitude of impact on tourism spending is even higher. However, in terms of producer revenues, the impact is lower as, although quantity demanded falls to a greater extent, the impact on producer prices is lower (in the case of 100% pass-through, there is no effect on producer price). As a result, the economic impact of the hypothetical occupancy tax is lower assuming a 100% rate of pass-through compared to a 60% rate of pass-through.

In terms of the impact of changing the elasticity of demand, we have assessed the impact of assuming elastic demand of -1.2. This is more in line with academic literature discussed in Chapter 4 which suggests that demand for coastal tourism tend to be elastic given the competition for coastal tourism and the availability of close substitutes. In the case of elastic demand for tourism in Cyprus, the impact of the introduction of our hypothetical occupancy tax on consumer spending is negative as the reduction in demand outweighs the increase in price.

Table 17: Estimated impact of a change in occupancy taxes in Cyprus

Assumptions	Change in tax			Impacts	
	Current occupancy tax	New occupancy tax	Change in effective tax rate (% points)	Change in tourism spending in accommodation (%)	Change in producer revenues in accommodation (%)*
Pass-through = 60% Elasticity = -0.20	No tax	3% per room	1.62	0.71%	-0.76%
Pass-through = 100%, Elasticity = -0.20	No tax	3% per room	1.62	1.18%	-0.30%
Pass-through = 60%, Elasticity = -1.2	No tax	3% per room	1.62	-0.19%	-1.65%

Source: PwC, using various sources
**Note: By construction, the percentage change in producer revenues in the accommodation sector is equivalent to the percentage change in GDP and employment at the sectoral and economy-wide levels*

Table 18: Estimated economic impact of a change in occupancy taxes in Cyprus

Assumptions	Sectoral impact on the accommodation sector		Economy-wide impact	
	GDP impact (Euros, millions)	Employment impact (number of jobs)	GDP impact (Euros currency, millions)	Employment impact (number of jobs)
Pass-through = 60% Elasticity = -0.20	-3.0	-60	-9.0	-190
Pass-through = 100%, Elasticity = -0.20	-1.2	-20	-3.5	-70

Pass-through = 60%, Elasticity = -1.2	-6.5	-130	-19.5	-410

Source: PwC, using various sources

It should be noted that the findings from the analysis above should be treated as only indicative of the potential impacts of a change in occupancy taxes. In Section 4.4.1.2, we discuss the key caveats to using our data tool. For example, the tool does not account for the direct impacts on other tourism sectors or on other competing tourist destinations, or the visibility of occupancy taxes. By not accounting for these nuances, our data tool is only intended to provide indicative impacts of marginal changes in taxes in a partial equilibrium framework.

3.5.7. Impacts on public expenditure in Cyprus

Again, although it is difficult to draw a direct link between the taxes levied on a sector and the amount subsequently spent by the government on the infrastructure and services required to support that sector, here we outline some key considerations regarding public expenditure on the tourism sector in Cyprus.

Cyprus dedicates a large portion of government expenditure to its tourist sector. According to the WEF, 9.3% of government expenditure is dedicated to the provision of travel and tourism services, placing the country at 11th globally and 2nd for the EU - behind only Malta.[137] The WTTC suggests that this amounts to around €225 million per year in support of general tourism activity.[138] General government expenditure as a proportion of GDP is particularly low in Cyprus compared with other MS,[139] so when expenditure on the provision of infrastructure such as roads and water services is included in this figure, this represents a relatively large component of government spending.

Interestingly, government expenditure on travel and tourism has actually declined slightly in recent years,[140] in line with the country's post 2012 austerity programme, but the government continues to invest in major programmes to support the industry. Most recently this has focussed around reducing the seasonality of Cypriot tourism through the promotion of year-round activities such as golf and gambling.[141]

3.5.8. Conclusions

Cyprus is unique among the case studies in that it's tax regime (both generally and as it relates to the tourism sector) is very light. Despite the sector contributing significantly to GDP, no occupancy, departure or property taxes are applied, and corporate and personal income taxes and VAT are applied at relatively low rates. In fact, rather than applying

[137] World Economic Forum, 2017
[138] World Travel and Tourism Council, 2017a
[139] Eurostat, 2015
[140] World Travel and Tourism Council, 2017a
[141] Cyprus Tourism Market Report, 2017

departure taxes, Cyprus is unusual in that it even applies a negative tax (subsidy) for air travel.

Cyprus is an example of a sun-and-sea destination that is actively promoting the diversification of its tourism offering – particularly tourist attractions such as golf courses and cultural landmarks, luxury tourism and gambling. This diversification not only distinguishes Cyprus from other sun-and-sea destinations, but also helps to smooth the seasonality of tourism activity. Perhaps as a result of this drive for diversification, Cyprus is estimated to have a significantly lower price elasticity of demand than other beach destinations, including the Balearic Islands.

4. ECONOMIC ANALYSIS OF THE IMPACT OF TAXATION

In this chapter, we discuss the potential economic and fiscal impacts of tourism taxes. The chapter is structured as follows:

- In Section 4.1, we provide a broad overview of the economic contribution of tourism in the EU;
- In Section 4.2, we discuss the drivers of competition in the tourism industry, focusing in particular on the role of prices in affecting the competitiveness of MS in attracting tourists;
- In Section 4.3, we present a literature review on the economic and fiscal impacts of tourism taxes, specifically VAT in tourism sectors and occupancy taxes, on the sector and the wider economy through impacts on price and competition in the tourism industry; and
- In Section 4.4, we discuss our methodology for assessing the impact of a change in tourism taxes levied on the accommodation sector, and summarise our key findings.

4.1. The economic contribution of tourism in the EU

Tourism is a major economic activity in the European Union constituting large items of consumer expenditure and providing a significant source of income for government in many jurisdictions through related taxes. Tourism activity is at the heart of achieving the EU's strategy of promoting economic recovery and growth.

The tourism industry[142] in the EU directly contributes over 5% of EU GDP, and indirectly approximately 10% when accounting for industries that produce goods and services with a tourism characteristic (for example, the distribution, transport and communications industries which form part of the supply chain for the tourism industry). [143] The contribution of tourism to GDP varies by MS, with some more reliant on the industry than others for creating jobs and generating growth. For example, analysis by the World Travel and Tourism Council (WTTC) suggests that the economic impact of the travel and tourism industry in France was 8.9% of GDP in 2016.[144] For most southern European countries, the contribution is even higher - in Spain the total contribution of the industry in 2016 was 14.2% of GDP, while for Greece it was 18.6%.[145] Therefore, the sector is central to economic recovery for many of the countries hardest hit by the financial crisis.

A common approach to estimating the economic contribution of different activities and

[142] The European Commission defines the tourism industry as "traditional suppliers of travel and tourism services (hotels, restaurants, travel agencies, car hire, charter airlines, tourist coaches, cruise vessels, etc.) offering goods and services directly to visitors." See Footnote 1 of the Commission's tourism strategy paper, available at: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2010:0352:FIN:EN:PDF
[143] European Parliament, 2015
[144] World Travel and Tourism Council, 2017
[145] Ibid.

sectors is the use of input-output (IO) tables.[146] These tables show how much output from each sector is used as inputs by other economic sectors, and purchased by final consumers (households, investors, the government and exports), illustrating the dependencies between economic sectors in the country. Input-output modelling uses these tables to assess three main channels of impact (direct, indirect and induced) through which activity in one industry, such as tourism, permeates through the economy and contributes to GDP, employment and growth. The sum across each impact is estimated as the total economic contribution of an industry. In the context of tourism, these impacts can be defined as follows:

- **Direct impacts:** this includes spending by residents and non-residents in those specific sectors which are defined as the tourism industry, for example, accommodation and food and beverage services. The WTTC estimates that the direct contribution of travel and tourism to the EU's GDP was 3.7% of total GDP in 2016, 36% of the total economic contribution of the sector[147];

- **Indirect impacts:** this covers the output of the supply-chain of the tourism sectors, for example, IT services purchased by travel agents or construction services in building new hotels or tourist attractions. According to the WTTC, indirect effects of tourism contributed 5.4% to total EU GDP in 2016[148]; and

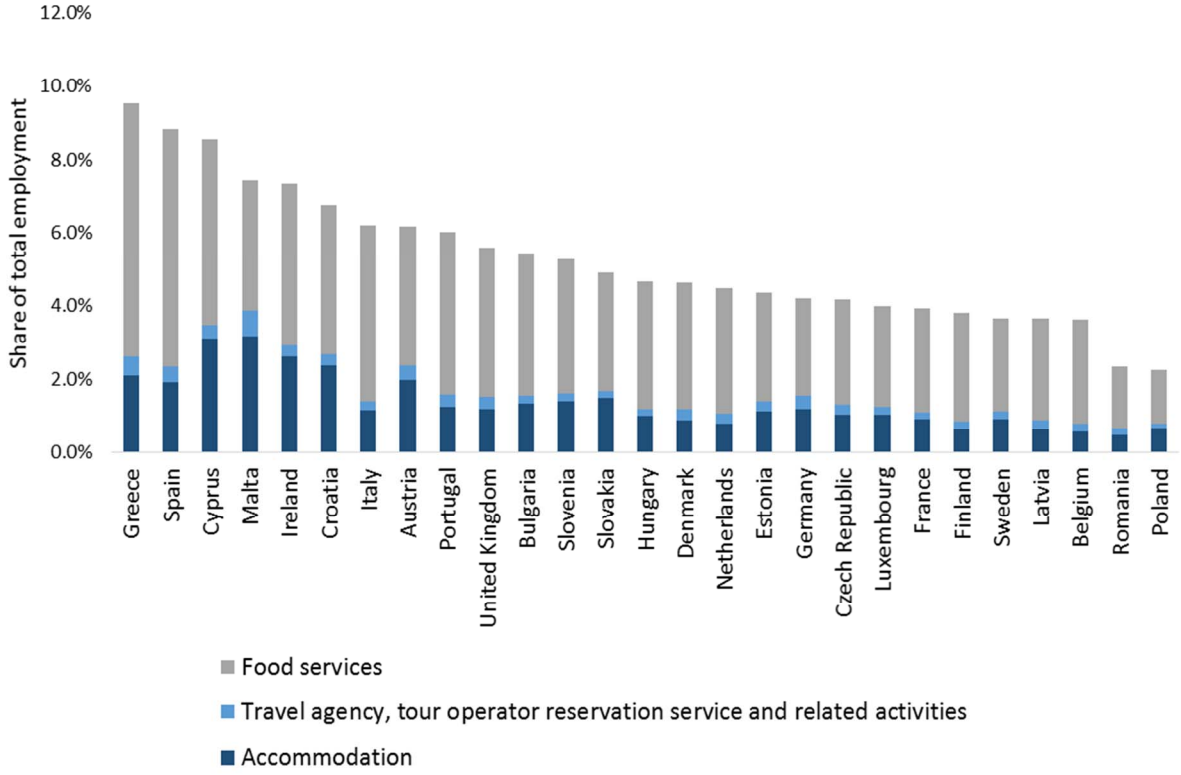
- **Induced impacts:** this is the impact of additional spending in the economy by households and businesses as a result of the additional jobs and profit created by the direct and indirect effects of tourism spending. The WTTC's analysis suggests that the induced effects of tourism contributed 1% of total EU GDP in 2016.[149]

In addition to spending by residents and non-residents directly on tourism, the sector therefore also contributes to the economy through the indirect effects on its supply chain and the induced effects of employment.

It is estimated that the tourism industry across the EU comprises approximately 2 million enterprises, the majority of which are small- and medium-sized enterprises (SMEs), and employs roughly 5.2% of the entire workforce.[150] The chart below illustrates the share of employment across MS in sectors traditionally considered to form part of the direct tourism industry: accommodation, food services and travel agency, tour operator and registration services. As illustrated, the industry employs a large share of all workers in the economy, particularly in Southern Europe.

[146] Eurostat 2008
[147] World Travel and Tourism Council, 2017
[148] Ibid.
[149] Ibid.
[150] European Parliament, 2015

Figure 11: Employment shares for tourism sectors across the EU



Source: PwC, using Eurostat data[151]

Overall, the contributions of the tourism industry to employment and GDP illustrate the importance of the sector to the macroeconomic performance of countries, and small changes in tourism levels can therefore have a significant impact on growth prospects. In particular, some MS have more complex value chains in their tourism sectors, relying on other economic sectors to a greater extent; these economies are likely to be more significantly impacted through indirect and induced channels by a change in demand resulting from a change in taxes in the sector.

4.2. Drivers of competition in the tourism industry

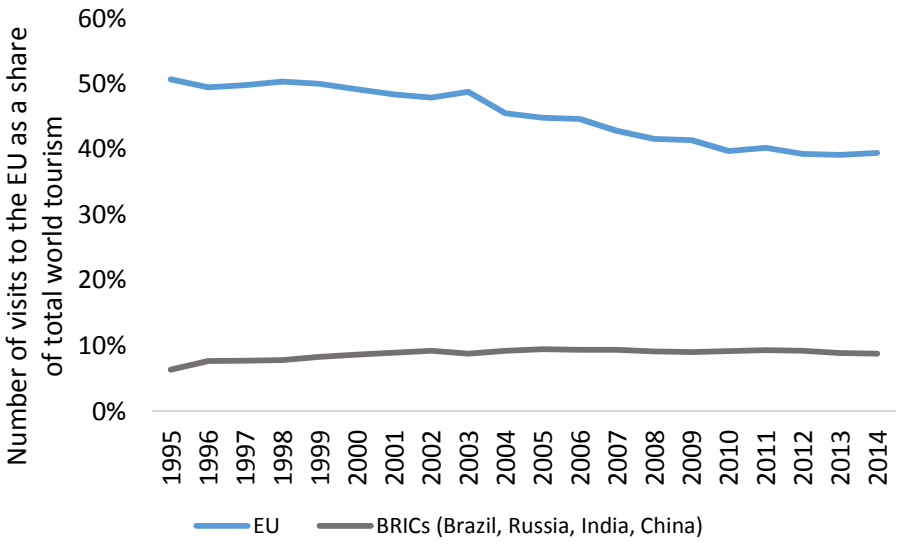
Regulators have a key role to play to help maintain competitiveness in the tourism industry. This is particularly true in light of increasing global competition with emerging and developing economies attracting more and more tourists annually. While the absolute number of international arrivals in the EU has increased, as the figure below illustrates, the total number of visits to the EU as a share of total visits across the world fell from 51% to 39% between 1995 and 2014. This relative decrease is due to the faster growth of tourism in emerging markets; in the BRIC economies for example, the number of international tourists increased by 197% between 1995 and 2014, while over the same

[151] Eurostat, 2015a

period the number of visitors to the EU grew by only 67%.

A large share of tourism expenditure in the EU is also domestic; the WTTC estimates that of total tourist expenditure within the EU in 2016, 69.2% was by domestic tourists and only 30.8% was from foreign visitors.[152] There is a risk that expenditure even by domestic tourists will begin to fall if regions outside the EU are able to attract EU tourists. Hence, not only do MS need to maintain their own competitiveness in attracting tourists from within the EU, the EU as a whole needs to maintain its competitiveness in order to compete with the rest of the world for tourists, both foreign and domestic. In June 2010 a communication by the European Commission[153] set out a new strategy for EU tourism along with strategic priorities; of these, one priority was identified as being "to stimulate competitiveness in the European tourism sector".[154] Below we discuss the key drivers of competition in the tourism industry.

Figure 12: EU tourism as a share of global tourism



Source: World Bank[155]

Tourism demand depends to a large extent on the preferences of tourists in terms of the type of holiday they are looking for, for example in terms of budget (luxury or low budget) or experience (beach holidays, skiing holidays, city breaks). Indeed, as highlighted in the case studies presented above, most major tourist destinations offer a variety of packages of varying quality and price to cater to the diverse needs of consumers. Nevertheless, holidays of a certain level of luxury or type of experience in one jurisdiction will compete with similar holidays in other jurisdictions, and consumers' choice on their travel destination will then be driven by other factors. Price is a key factor affecting the competitiveness of similar locations, but several other factors (such as quality) also contribute to tourist flows. These are discussed in Box 1 below.

[152] World Travel and Tourism Council, 2017
[153] European Commission, 2010
[154] Ibid.
[155] World Bank, World Development Indicators, 2017

Box 1: Is price the only factor driving tourism flows?

The price of one tourist destination vis-a-vis another similar destination has a strong influence on tourism patterns, and the importance of price in driving competitiveness in the tourism industry has been studied by several academics.

Tourism academics Gooroochurn and Sugiyarto, for example, wrote a paper detailing the key competitiveness indicators in the travel and tourism industry.[156] While their list includes a broad array of variables including infrastructure, social development and many other factors, the research emphasised the importance of the prices of the main services consumed by tourists, such as hotels, car rental and entertainment.

Prideaux conducted a similar piece of analysis into the factors affecting bilateral tourism flows and came to similar conclusions regarding the important drivers.[157] The paper also specifically discusses indirect tax, citing the imposition of a general sales tax of 10% in Australia in July 2000 which the research indicates can "discourage international arrivals because of the increase in price and encourage the substitution of domestic for international tourism to cheaper foreign destinations."

In addition, Culiuc (2014) used a gravity model to explain bilateral tourism flows. The paper found that tourism flows respond strongly to changes in the destination country's real exchange rate along both the extensive (number of tourist arrivals) and intensive (duration of stay) margins, illustrating the influence of price on tourism demand.

However, while price has a clear influence on tourism demand, it is not the only determining factor. In addition to the importance of prices on tourism flows, academic literature also discusses the important caveat of quality, and how price cannot be considered in isolation. This is particularly evident in Dwyer and Kim (2010), who argue that "perception of value", as a combination of price and quality, is the key determinant. According to a recent Eurobarometer survey, while tourists cited price as one of the top reasons for returning to the same holiday destination, other factors cited included natural features (landscape, weather), the quality of accommodation, and cultural and historical attractions.[158]

Culiuc's (2014) gravity model also found that in addition to the impact of the real exchange rate, other factors also influence tourist flows; the distance between two countries, for example, has a negative impact, while language ties have a strong positive effect.

Overall, therefore, the literature suggests that price and quality factors jointly contribute to tourism demand. In recent years, price and quality have become more important than ever in driving competition in the sector. With the development of price

[156] Gooroochurn and Sugiyarto, 2005
[157] Prideaux, B. 2005
[158] European Commission, 2014

comparison sites and the availability of online ratings which provide better information about quality, consumers have become far better informed about the price and quality of competing destinations, influencing their decisions on holiday destinations. However, as many aspects of the 'quality' of a destination are fixed, for example the historical and cultural attractions on offer and the natural landscape, at the margin, price is the key driver of demand.

The literature outlined above indicates that price is an important factor in determining tourism flows and expenditure between countries, though the heterogeneity of tourist services means that it should not be considered in isolation. In the following section, we discuss the channels through which taxes, by affecting the price competitiveness of one destination vis-a-vis another, can impact tourist flows and ultimately on the wider economy.

4.3. The impact of taxes on tourism

The section above identified price as one important driver of tourism demand. Alongside its other uses, taxation policy is a fundamental tool that policy-makers have to drive price competitiveness in the tourism industry.

Under certain forms of enhanced flexibility, MS might choose to increase their price competitiveness against competitor jurisdictions offering similar holiday experiences by reducing taxes on tourists. Indeed, the tourism industry is diverse and caters to a wide range of consumers, which drives variability in the quality and price of holiday packages. However for similar holidays in different jurisdictions, consumers looking for a certain type of holiday experience will often be relatively indifferent between locations and therefore price will be a major factor driving consumer choice.

Empirical studies have found that the income elasticity and price elasticity of demand for tourist services is high; relative to other industries, the goods and services produced by tourism industries can be seen as a form of 'luxury' consumption with close substitutes (for example, alternative destinations offering packages of similar price and quality). Therefore, a small change in taxes and other levies could have a disproportionate impact on tourism levels if the reduction or increase in taxes is passed onto consumers in the form of lower or higher prices. Furthermore, the tourism sector is characterised by a large number of small- and micro-sized businesses that operate at low profit margins and which often lack significant capital buffers, meaning small changes in the tax system can mean the difference between viability and bankruptcy. These businesses, particularly in the accommodation sector, also face significant disruption through the rise of the sharing economy, which has introduced a greater degree of competition and which is not always treated equally for taxation purposes. The industry as a whole is therefore very vulnerable to changes in taxes.

However, at the same time tourist taxes lack the same level of political accountability within a jurisdiction as other forms of taxes which generate greater public scrutiny. Gooroochurn (2004), for example, notes that taxing tourism-related sectors is relatively

more efficient than taxing other sectors, as reducing the consumer surplus of international tourists does not affect social welfare nationally. As a result, the tourism sector is often seen as an easy target for governments seeking to raise revenue; Forsyth and Dwyer (2002) argue that tourism taxes are an exertion of market power by governments to extract maximum rent from tourists. In doing so, there is a risk that politicians will choose to increase short-run public revenues at the expense of long-run growth.

In this section we first present a theoretical framework for the impact of tourist taxes. We then present the findings of a literature review to understand the implications of tourism taxes on the competitiveness of EU states and on wider macroeconomic variables. In general, while tourism taxes are often justified by governments as a means of addressing the negative externalities associated with tourism, academic literature and empirical evidence suggests that the impacts on businesses in the industry and the wider economy are arguably disproportionately high.

Tourism is also perhaps unique in comparison to other industries in its tax implications given that most tourist services are consumed at the destination rather than where the consumer normally resides. As a result, a tourist tax levied at the destination can be seen as a form of export tax which, from an economic perspective, can be harmful to local producers and can lead to market distortions, inefficiencies and ultimately a loss in welfare. A pertinent example is an export tax levied by the Argentinian government on the exports of agricultural products, which was later reduced in 2015 on account of the negative impacts this had on local farmers.[159]

For the purposes of our analysis on the implications of tourism taxes we have considered two types of taxes borne by tourists:

(1) Value Added Tax (VAT): a general tax on consumption borne by tourists and residents alike, hence not specific to the tourism industry, but which will affect businesses operating within the industry, for example, accommodation providers, tour operators and travel agents; and
(2) Bed, or occupancy, taxes: specific charges targeted directly at tourists and levied on the rent of accommodation.

The way in which both of these taxes are applied across EU MS is outlined in Chapter 2. Below, following a discussion of the theoretical impact of tourist taxes, we consider the literature surrounding the impact of each of these taxes on tourism in turn. It should be noted however that tourists are affected by a range of general and specific taxes as discussed in previous chapters of this report and the impacts of these taxes need to be considered together rather than in isolation.

4.3.1. The theoretical framework of tourism taxes

In this subsection we explain the underlying economic principles of the effect of taxation.

[159] USDA Foreign Agricultural Service, 2015

By distorting price signals, taxes can reduce economic efficiency and welfare. This is explained with the use of a supply and demand framework as illustrated in Figure 13 below. The equilibrium price and quantity that prevails in the market for the product or service in question (for example, a hotel night or a meal) is determined by the intersection of the market demand and supply curves. Before the application of taxation, the quantity consumed in the market is represented by point Q_0.

Once the tax is applied, the market supply curve shifts upwards by the amount of the tax. The new equilibrium price, P_1 is higher than before and the quantity demanded therefore decreases to Q_1. As a result, consumer surplus (a measure of consumer welfare) falls from Areas 1, 2 and 3 to Area 1. At the same time, the price received by producers falls to P_1 - tax and therefore, producer surplus (a measure of producer welfare) falls from Areas 4, 5, and 6 to Area 6. The government captures a portion of the consumer and producer surplus through tax receipts (Areas 2 and 4). However, while some of the lost consumer and producer surplus is transferred to the government in the form of tax revenues, and is therefore not an economic loss, as a result of the price distortion the loss in consumer and producer surplus will generally exceed the additional revenue (except in the case where either demand or supply is perfectly inelastic, as explained below); this is the theoretical deadweight loss of taxation to society and is represented by Areas 3 and 5.

The size of the deadweight loss associated with a tax is influenced by both the absolute level of the tax imposed and the steepness of the demand and supply curves (otherwise known as their price elasticity).

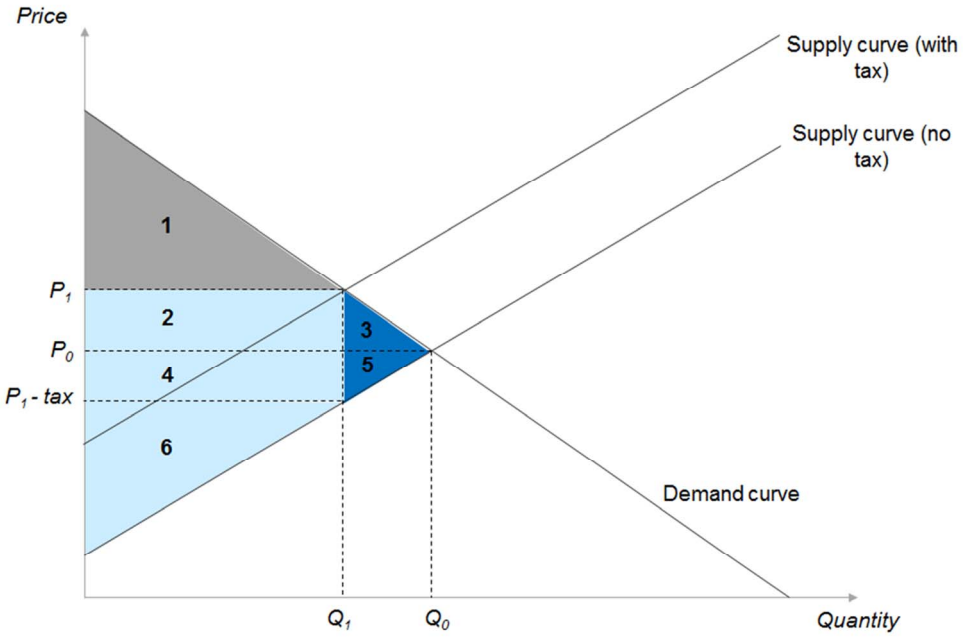
- **The absolute level of tax imposed:** The higher the rate applied in the figure above, the further the supply curve shifts up in response, and the larger the associated deadweight loss, all other things equal.

- **Elasticity of supply and demand:** The price elasticity of supply or demand measures the sensitivity of producers or consumers to a change in the price of an underlying product or service. Steeper supply and demand curves reflect more inelastic supply and demand conditions in the market. This means that supply or demand is relatively insensitive to changes in price. Therefore, the more inelastic supply or demand, the smaller the size of the deadweight loss; in the extreme scenario where either supply or demand is perfectly price inelastic (implying that a change in price has no impact on the quantity supplied or the quantity demanded), the size of the deadweight loss is zero. Conversely, when supply or demand are relatively elastic, the deadweight loss of a tax is large. We have conducted a review of the price elasticity of demand for tourism which is discussed in greater detail in the following sub-section. A key conclusion is that the sensitivity of tourism to prices varies by both the origin and destination of tourists as well as their purpose of travel.

In addition, the burden of the tax, or the share of loss in welfare, between producers and consumers is driven by the extent of pass-through; the larger the proportion of the tax

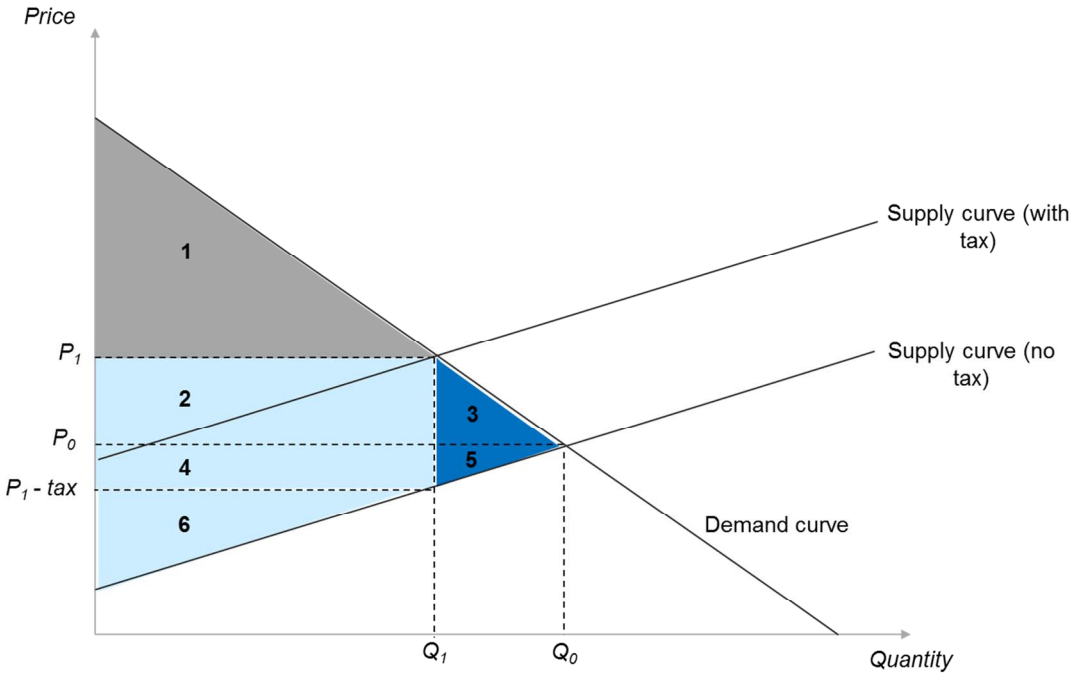
producers are able to pass on to consumers, the greater the loss in consumer welfare relative to producer welfare. The extent of pass-through is influenced by the relative elasticities of supply and demand. For example, where demand is relatively inelastic compared to supply, a change in price will have relatively little impact on demand, hence producers may be more likely to pass on taxes to consumers. Similarly, where the supply side is highly elastic to a change in price, the level of pass-through will be high and therefore consumers will bear a higher proportion of the burden of the tax. This is illustrated in Figures 14 and 15 which demonstrate that where supply is elastic, or where demand is inelastic, the share of burden on consumers (area 2) is greater than the share of burden on producers (area 4). On the other hand, when demand is elastic, or supply is inelastic, producers will tend to bear a greater share of the burden. Ultimately, the party with a relatively more inelastic response to a change in price will bear a greater share of the burden of a tax.

Figure 13: Deadweight loss of taxation



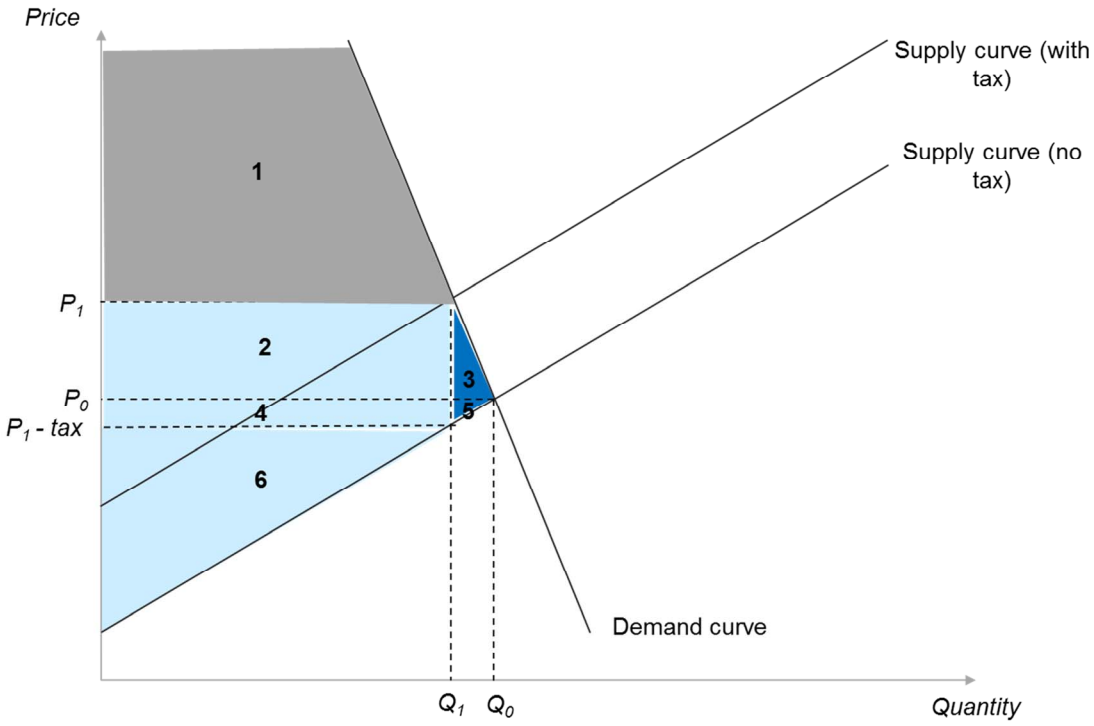
Source: Varian (2010), PwC analysis

Figure 14: Burden of tax (Elastic supply)



Source: Varian (2010), PwC analysis

Figure 15: Burden of tax (Inelastic demand)

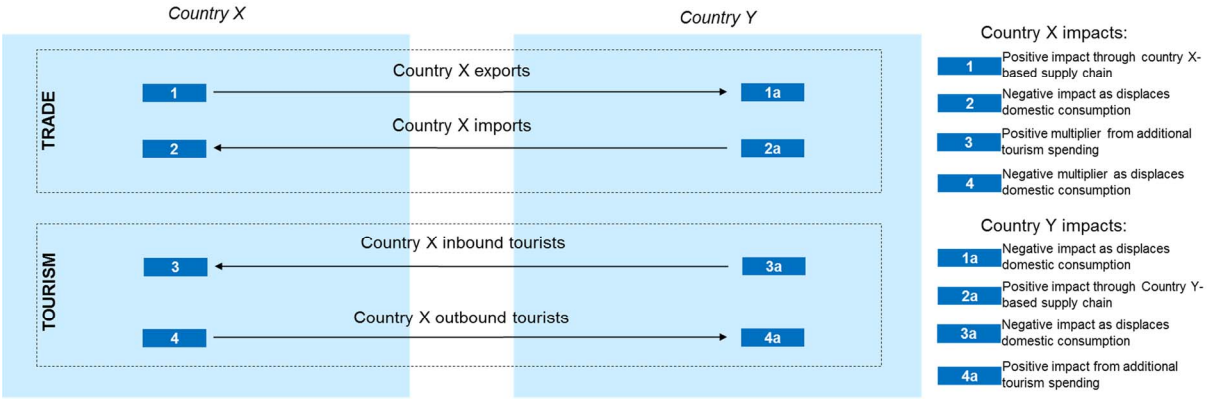


Source: Varian (2010), PwC analysis

In addition to the market inefficiencies generated by taxes, taxes levied on the tourism sector in particular impact demand from not only foreign tourists but also domestic tourists. For example, a tax levied in one country, Country X, not only deters tourists from another country, Country Y, but also deters local residents of Country X from domestic tourism who may now choose to travel to Country Y instead. As a result, instead of spending money on local tourism goods and services, residents of Country X will spend money in Country Y, resulting in a leakage from Country X. This is illustrated in Figure 16 below.

Figure 16 also illustrates the similarities between tourism and trade; tourism in a country can be likened to an export of that country as it is associated with spending by foreign consumers on domestic goods and services. Taxes on tourism are therefore a form of export tax, which can be harmful to local producers and which can lead to market distortions, inefficiencies and ultimately a loss in societal welfare, both at the source and the destination.

Figure 16: Impacts associated with inbound and outbound tourism



Source: PwC analysis

In the remainder of this section, we discuss two types of taxes on tourism and empirical findings on their economic impact in light of the economic theory discussed above.

4.3.2. The impact of VAT on tourism

Several academics have investigated the potential impacts of VAT on tourism, both positive and negative. VAT is charged on the supply of relevant goods and services made in the course of business by a taxable entity, unless the suppliers are subject to specific reliefs. All businesses must register for VAT if their turnover of taxable goods and/or services exceed a minimum threshold, which varies by MS (see Chapter 2 for thresholds by MS). VAT accrues on the additional value of each transaction, and is collected at each stage of production and distribution; a business therefore incurs VAT on its purchases (input VAT) and charges VAT on its sales (output VAT). In most circumstances, VAT registered businesses can recover the input VAT incurred on purchases. Therefore the value of VAT collected and paid over on a net basis by any party in the supply chain is that which relates to the value added to the supply by that party.

The European Commission sets the regulations on VAT rates for MS - the standard minimum VAT rate is set at 15%, but MS are free to set their own standard VAT at a rate equal to or greater than this. In addition, the regulations permit a maximum of two reduced rates, the lowest of which must be at least 5%. In practice, various derogations allow for super-reduced rates in some instances. The Commission's action plan of April 2016 also sets out options for giving MS greater autonomy on their VAT rate policy.[160]

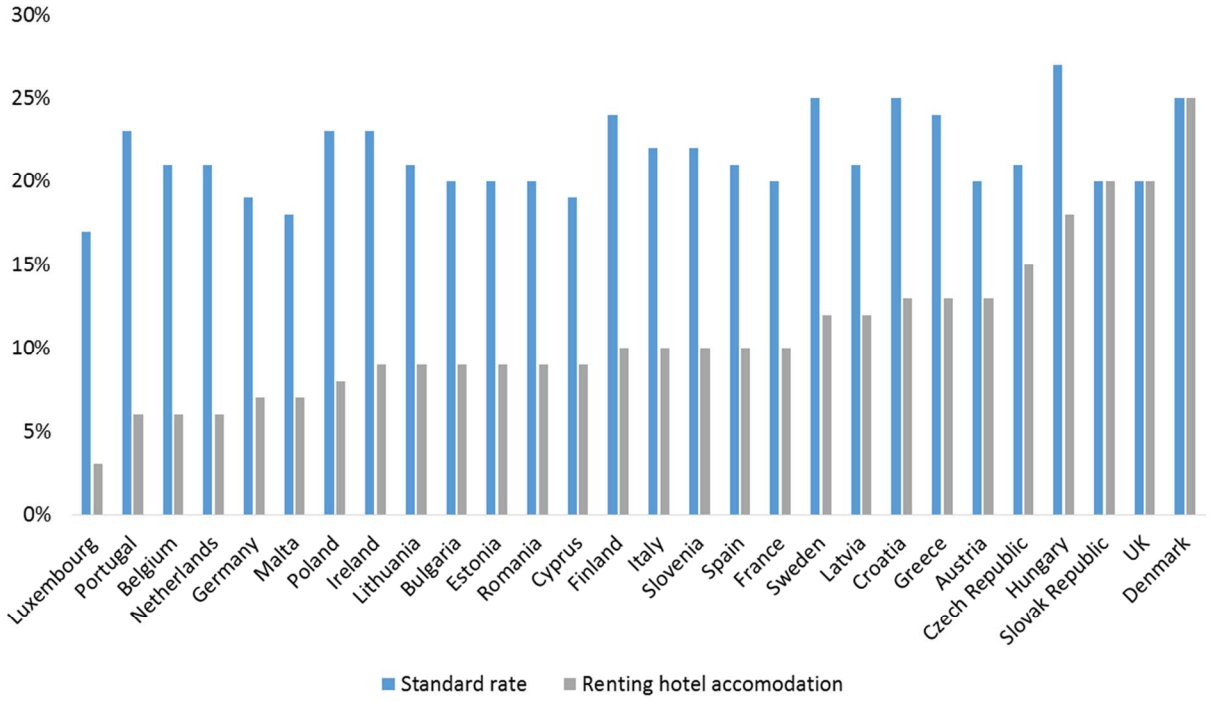
VAT on tourism-related activities is often regarded as highly distortive and damaging to the price competitiveness of tourism destinations. As a result, many EU countries apply reduced rates to tourist services, where permitted under the present EU VAT regime. This is in part due to the perceived mobility of the tax base and the elasticity of demand for tourist services, as well as a conscious decision by some MS governments to promote the industry. The extent to which businesses pass on reduced VAT rates to consumers as reduced prices depends on the relative elasticities of demand and supply, as discussed in Section 4.3.1 above. Sectors within the tourism industry with relatively more inelastic

[160] European Commission, 2016

demand or elastic supply and therefore likely to see higher rates of pass-through.

The chart below illustrates, as an example, the standard VAT rate across EU MS compared with the VAT rate on rented hotel accommodation. As illustrated, the vast majority of EU MS (with the exception of Slovakia, the UK and Denmark) have applied reduced VAT rates on hotel accommodation.

Figure 17: Standard VAT rates and rates on hotel accommodation in the EU-28



Source: PwC WWTS

Economic theory would suggest a strong case for setting reduced VAT rates on accommodation, and other tourism-related industries, in order to promote tourism and, as a result, economic growth. Tourism contributes significantly to the economy, as discussed in Section 4.1 above, and hence reducing tourist taxes, if it increases tourist flows, is likely to generate positive effects on the sector and on the wider economy.

On the other hand, some academics[161] treat tourism taxes as a means of correcting the negative externalities associated with tourism, for example the environmental repercussions of increasing levels of tourism, both on the part of consumers (for example, littering by tourists) and producers (for example, environmental degradation to develop tourist attractions). The existence of negative externalities results in over-consumption and over-production of tourism goods and services, as tourists and producers do not take into account the external costs of their activity (and only consider their private benefits and costs) in their consumption or production decisions. In doing so, they consume or produce more than they otherwise would if they were required to pay the full social cost of their actions (the sum of their private and external costs). An

[161] See for example Chang, J., Lu, L. and Hu, S. (2011)

environmental tax can help correct for this by reducing the private benefits to tourists or increasing the private costs to producers such that they also reflect the negative external consequences of their activities.

While the negative externalities generated by tourism should not be ignored, there are also positive externalities associated with tourism which are also not accounted for in the decisions of producers and consumers. For example, tourism provides domestic residents with exposure to other nationalities and cultures, and a favourable tourism experience in a country can generate goodwill that can influence international relations. There are also clear wider economic benefits of tourism, reflected by the contribution of the industry to providing employment and stimulating growth.

There is therefore a strong case for reducing tourist taxes to increase the price competitiveness of a destination and, as a result, tourism demand. The benefits of increased tourism however need to be balanced against a loss in government revenues from reducing tourist taxes. The impact of reducing tourist taxes also ultimately depends on two key factors:

- *The price elasticity of tourism demand:* if tourism demand is relatively price elastic, demand is sensitive to changes in price and a reduction in the VAT rate on tourism-related goods and services can have a substantial impact on tourism demand; and

- *The extent to which producers pass on reduced costs to consumers in the form of reduced prices:* the greater the extent to which producers can pass on taxes, the greater the impact on the prices paid by consumers, and the greater the potential impact on demand. Evidence suggests that any cut in VAT on tourism-related activities is likely to be passed on to the consumer.

Below we discuss these considerations in greater detail, focusing particularly on the potential economic and fiscal impacts associated with potential changes in VAT rates on tourism, for example from the standard VAT rate to a reduced VAT rate in certain sectors.

4.3.2.1. The economic impact of VAT in tourism sectors

Economic theory suggests that if tourism demand is relatively elastic, a reduction in the VAT rate on tourism-related goods and services such as hotels and restaurants will lead to an increase in overall expenditure by tourists, and vice versa. However, this relies on the cost or cost-saving of the change in VAT being "passed-through" to the consumer, affecting the price that they face. The level of pass-through depends on the relative elasticities of supply and demand. Theoretically, the intensity of competition in the sector should increase the probability of pass-through over the medium-term.

Two key factors therefore jointly determine the impact of a change in taxes on tourism demand, spending in the sector and producer revenues:

(1) The rate of pass-through of a change in VAT to prices; and
(2) The sensitivity of tourism demand to a change in price (the price elasticity of demand).

The overall economic impact associated with a change in VAT (3) will then be driven by the linkages between the tourism industry and other sectors in the economy.

In light of the importance of the tourist industry for many governments, there have been a number of studies commissioned that have explored the role of taxes and prices in influencing tourism flows and the specific impact of changes in VAT in tourism sectors in various countries. The discussion which follows addresses (1), (2) and (3) above, based on a review of literature.

1. The impact of a change in VAT on consumer prices

The impact of reduced VAT on tourism and the wider economy depends crucially on the extent to which reduced VAT is passed on by businesses to the final consumer. We refer to this mechanism as "pass-through"; this is the percentage of a change in a tax that is reflected in consumer prices via a reduction or increase in prices. For example, if the average hotel price for one night is €120 including a 20% tax (implying a before tax price of €100), a 40% reduction in tax (to 12%), with 75% pass-through would reduce the average hotel price to €114, ceteris paribus.[162] We discuss the impact of pass-through on prices in detail in Section 4.4.

As discussed above in Section 4.3.1, the level of pass-through is influenced by the relative elasticities of supply and demand, which determines which party bears the burden of a tax, or which party benefits more from a reduction in tax. For example, where demand is relatively price elastic, an increase in prices will lead to a disproportionately large change in demand. Therefore, the pass-through of increased levels of taxation may be lower. Similarly, the level of pass-through will also be driven by factors which influence the elasticity of supply, such as the degree of competition in the market. As discussed in Section 4.2, the European tourism industry is highly competitive therefore businesses are likely to have limited scope to hold back reduced tax rates as additional revenue as competitive pressures will drive down prices. Equally, with a relatively high elasticity of supply, producers can pass on increased taxes and adjust levels of supply in response to any resulting changes in demand.

Most evidence suggests that a significant proportion of a cut in VAT is likely to be passed through to lower prices. However, research on the level of pass-through has found strikingly different results depending on various factors such as the sector, region and the length of time over which the pass-through is measured. We have reviewed the literature most relevant to the EU and the tourism sector and outline the main findings below.

[162] Calculated as: €120*(€20*40%*75%) =€114. This example also implies an increase in the before tax price (the price received by producers) to €114/(1+12%)=€101.79. Tax revenue per unit would decrease from €20 to €114-€101.79=€12.21.

In 2015, the IMF conducted a study estimating the pass-through of VAT changes to consumer prices for 67 consumption categories across seventeen countries that were part of the Eurozone between 1990 and 2013.[163] The study refers to "cumulative pass-through" which is the total pass-through over a two-year window from one year prior to the reform to one year post the reform. The main conclusions from the study are summarised below:

- The cumulative pass-through from a change in the standard rate VAT was estimated to be 139%.[164] Half of the pass-through was achieved in the year prior to the reform as a result of businesses anticipating the change and smoothing their prices over time (rather than introducing a sudden price hike or discount on the date of the reform).

- The pass-through from a change in the reduced rate was 36% in the month of the VAT reform, with no significant results for the cumulative pass-through one year after the tax change.[165]

- The pass-through from a reclassification (the movement of an item between rate categories) was 10% in the month of the VAT reform with no significant results for the cumulative pass-through one year after the tax change.[166]

- Combined, the above conclusions provide evidence that the level of pass-through increases as the coverage of the consumption base affected increases. However, the study also finds some evidence that the relationship is flat or even decreases at the highest levels of coverage. Both these results are consistent with theory.

- There was no evidence of a disparity in the level of pass-through from an increase in VAT or decrease in VAT, with pass-through of 40% and 24% estimated respectively (with sufficiently large standard errors to be able to conclude that the levels of pass-through are not significantly different).[167]

- The study recognises potential bias in the estimated results as a result of omitted variables including data on VAT announcement dates, non-monetary union countries, exchange rates, monetary policy, business cycle, market structure, trade intensity and the degree of compliance.

- Possibly, the two most important conclusions were that significant levels of pass-

[163] IMF (2015), the IMF used monthly price data taken from the Harmonized Index of Consumer Prices (HICP) published by Eurostat.
[164] Econometric test significance at the 1% level, with a standard error of ±36pp, based on 972 observations
[165] Econometric test significance at the 1% level, with a standard error of ±13pp, based on 191 observations
[166] Econometric test significance at the 1% level, with a standard error of ±3pp, based on 68 observations.
[167] Econometric test significance at the 1% level for both the increase and decrease in VAT, with standard errors of ±15pp and ±8pp respectively, based on 1,009 and 222 observations respectively.

through occur in anticipation to proposed VAT changes, and that the assumption of full or close to full cumulative pass-through is not valid in all cases.

The IMF study provides useful evidence on pass-through but does not estimate the level of pass-through specifically in the tourism industry. Of the EU-28, only three MS do not apply a reduced rate of VAT for accommodation, with eleven not applying the reduced rate for restaurants.[168] Particularly in the case of accommodation, the IMF study would therefore imply that pass-through of super reduced VAT rates in the sector reduced from the current reduced rates may be closer to 36% than to 139%. Furthermore, the IMF sheds light on the different rates of pass-through for different goods and services; specifically, it finds that non-durable goods tend to have a lower rate of pass-through than durable goods. However, as the study examines a range of consumption categories without isolating the effect on tourism sectors, the extent to which the results from the study would apply directly to the tourism industry is unclear.

More specifically in the tourism industry, the Cut Tourism VAT campaign commissioned a piece of work from Deloitte, Graham Wason from Tourism Respect and Michael Nevin from Nevin Associates to assess the impact of reduced VAT rates on the tourism sector in Britain. As part of this work, a survey was conducted of members of the British Hospitality Association, providing more direct evidence of pass-through in the tourism sector. 95% of members responding to the survey reported that if a 5% VAT rate was established in the UK, some or all of the VAT change would be passed on to consumers. In addition to a reduction in retail prices, other potential impacts of a VAT reduction reported included increased investment, increased employment, enhanced training and higher wages. The authors conclude that about 60% of a VAT reduction would feed through to lower prices, although it would take approximately four years for the full effect to occur.[169]

More widely across the EU, a report by Copenhagen Economics for the European Commission in 2007 noted that "permanently lowering the VAT rate on a particular good (or service) sooner or later will lead to a reduction in the price of the good more or less corresponding to the monetary equivalent of the lower VAT rate".[170] This suggests a rate of pass-through of close to 100% in the long-run. The researchers found that pass-through for restaurants ranges from 25% in Portugal to 100% in Finland. However, empirical evidence from France suggests a lower rate of pass-through; the French Court of Auditors note that only 20% of a reduction in the VAT rate on restaurant services from 19.6% to 5.5% in July 2009 was reflected in prices.[171]

The paper by Copenhagen Economics (2007) also suggests that pass-through can vary as a result of supply-side factors. For example, where there is limited scope to expand capacity, supply will be relatively inelastic and a smaller share of a reduction in VAT will be passed on to consumers. A larger share will instead be held back by businesses to increase profit margins. The accommodation sector in particular requires considerable

[168] HOTREC, 2017
[169] Cut Tourism VAT, 2012
[170] Copenhagen Economics, 2007
[171] Les Echos news article, 2015

time to react to a change in demand resulting from a change in prices and pass-through may therefore be slower. For example, investment decisions such as increasing or decreasing capacity in response to a change in demand can take a long time to be enacted, due to extensive planning processes before construction can even begin. On the other hand, airlines are quickly able to adapt to a change in demand resulting from a change in price, for example by leasing fewer or more planes.

Both hotels and airlines however, are increasingly selling less services directly, using third party websites that have sophisticated pricing strategies, more closely matching supply with demand. These complicated pricing strategies make it more difficult to estimate pass-through in the industry.

In the case of travel agents and tour operators, there are two layers through which any tax change must filter. For example, where a reduction in a VAT rate occurs, in order for it to flow through into prices faced by end-consumers, it must first be reflected in the prices charged by suppliers (e.g. hoteliers) and then also by the travel agent or tour operator. This may mean greater delays in the pass-through of tax changes, especially given that many traditional tour operators, (with printed travel material), set their prices 18-24 months in advance.

Overall, literature suggests that factors influencing the elasticity of supply and the elasticity of demand will contribute to the rate of pass-through. Factors which will increase the elasticity of supply, and as a result the rate of pass-through, include, amongst others: (1) high local, national and international competition (with low barriers to entry and businesses operating near to marginal cost); (2) available capacity, allowing producers to adjust supply in response to a change in demand; and (3) limited differentiation in the goods and services provided by the sector (as highly differentiated businesses can command higher prices, and thereby more easily retain tax reductions). Factors which will influence the elasticity of demand are discussed in greater detail below but could include, for example, the ease of obtaining pricing information (which will increase the elasticity of demand and reduce the rate of pass-through). The relative elasticities of supply and demand will ultimately influence the rate of pass-through. As discussed in detail below, the elasticity of tourism demand tends to be high, which would reduce the rate of pass-through, however, the high level of competition in the industry implies a high elasticity of supply. As a result, most literature indicates that a change in taxes is likely to be passed on to consumers.

Literature also suggests that the level of pass-through can increase over time and can be influenced by context-specific factors such as the stability of economic conditions (for example, inflation rates, exchange rates, government policy and national security) and the degree of tax compliance.

As a result of the wide range of factors which drive the rate of pass-through, it is difficult to estimate the rate for a given change in tax. Thus, as discussed in Section 4.4, our occupancy tax data tool is designed to allow the user to select an appropriate level of pass-through for each EU-28 MS.

The impact of pass-through on consumer prices, producer prices and sector-specific government tax intake, assuming all else is held constant, is discussed in detail in Section 4.4 where we describe the methodology for our data tool.

2. The impact of a change in prices of tourism products on demand

If reduced VAT rates on tourism-related activities are passed through to consumers in the form of lower prices, the impact on demand then depends on how responsive tourism demand is to a change in price levels. By making tourism at the destination relatively cheaper, lower prices are likely to both promote exports and reduce imports by incentivising increased inbound tourism from abroad and decreased outbound tourism (encouraging residents who might otherwise choose to travel abroad to choose domestic over foreign travel). High local VAT on tourism activity is therefore distortive not only because it affects inbound tourism but also because it affects the relative prices of different holiday destinations for local residents.

Academic studies have demonstrated a high elasticity of demand for tourism; in other words they have found that tourist demand is highly sensitive to changes in prices. Peng et al (2015), for example, conducted a meta-analysis of international tourism demand elasticity studies. Across all studies, they found an average price elasticity of tourism demand in Europe of -1.291 for inbound tourism; this suggests that a 1% increase in price would lead to a 1.291% fall in tourism demand in Europe on average.

Other academics have also found that the price elasticity of demand for a given destination depends on the country of origin of the tourists; tourists from some countries are found to be more sensitive to changes in price than tourists from others. Morley (1998) for example found that the price elasticity of inbound tourism demand in Australia ranges from -2.87 for Japanese tourists to -0.08 for tourists from the UK who appear to be less sensitive to changes in the price of a visit to Australia. Similarly, considering outbound tourism, the elasticity of demand also varies by destination. Researchers at Nottingham University for example developed an Almost Ideal Demand System model to examine the impact of various factors on demand by residents of France for tourism in other selected EU countries. Their model found that a 1% increase in prices in the UK, Italy and Spain reduced the demand for tourism of tourists from France in those countries by 2.2%, 1.75% and 1.8% respectively.[172] The research does not examine the specific impact of VAT changes but states that changes in the rate of value added tax may have an impact on price competitiveness.

As we discuss in detail in Section 4.4.1.3, not only does the effect of price on demand depend on the source and destination of tourists, the price elasticity of demand varies also by purpose of travel. Business travellers, for example, are likely to be much less sensitive to a change in price of travel than leisure tourists who have greater flexibility in choosing alternative destinations or lengths of stay. This is supported by Peng et al (2015)'s meta-analysis of international tourism demand elasticity studies; they find an average price elasticity of business travellers across the world of -0.35. This suggests that a 1% increase in the price at the destination only reduces business travel on

[172] Durbarry and Sinclair, 2003

average by 0.35%. It should also be noted that in some countries, businesses are allowed to deduct VAT payments. As a result, in this case business tourists will be completely price inelastic to a change in price resulting from a change in tax; in other words, a change in price which is generated by a change in tax will have no impact on demand from business tourists.

There is also a significant degree of heterogeneity in tourists whose purpose of tourism is for leisure which has a bearing on the price elasticity of demand. Sauran (1978), for example, suggested that "sunlust" or coastal destinations are likely to be more elastic than "wanderlust" or non-coastal destinations. As coastal destinations have closer substitutes, tourists visiting these destinations are therefore likely to be more sensitive to changes in price.

A key point to note is that while studies have generally estimated a high price elasticity of demand for tourism products and services, taxes, even if passed through to prices, will only have the same effect on demand as any other price change if they are visible to the consumer. In the case of VAT, changes in rates will be reflected in the price that is visible to consumers, for example when they make hotel reservations, and hence will induce a behavioural response. However, this is not always the case; occupancy taxes, for example, are typically only charged on departure, as discussed below.

Academics have also found that the adjustment in demand is not immediate and it can take time for the impact on demand of a price change to be fully realised.

Overall, as with the rate of pass-through, the literature suggests that the price elasticity of demand for tourism is driven by a number of different factors. Location factors, including both the origin country of tourists and the destination country, affect how tourists respond to a change in price. In addition, tourists with different purposes of travel are found to respond differently.

It should also be noted that not only does a change in price in one destination affect tourism demand in that destination, it also affects demand in competing destinations; this is the cross-price elasticity of demand. An increase in holiday prices in one destination, resulting for example from an increase in VAT at that destination, is likely to increase demand for tourism in competing destinations. The extent to which demand in competing destinations is affected will be determined by the cross-price elasticity of demand which depends on a number of factors including the substitutability of tourism at one destination for another. Hence, in changing tax levels, as well as the price elasticity of demand for tourism, jurisdictions also need to be aware of tax rates in other locations, particularly in competing locations, which will also affect how demand responds to price changes.

3. The impact of a change in VAT on the wider economy

The literature outlined above suggests that changes in prices, through for example a change in taxes, can have a significant impact on tourist flows, at least over the medium- to long-run once prices have adjusted and demand has responded. While the UK, unlike

many other EU countries, opted not to apply reduced VAT rates on tourism activities, a study by Cut Tourism VAT[173] showed that a cut in VAT on tourist activities from the current rate of 20% to 5% could increase spending by foreign tourists in the UK by as much as £10bn. Increased tourism flows and higher revenues generated by the industry as a result of a lower VAT rate can impact the economy through direct, indirect and induced channels by:

- Generating higher levels of employment in tourism and related services;
- Increasing income tax receipts and reducing social security payments as a result of higher levels of employment;
- Increasing profits for businesses in the sector, as well as those indirectly affected by tourism;
- Generating an increase in corporation tax payments and shareholder dividends from higher business profits; and,
- Increasing spending in other sectors of the economy from the induced effects of higher employment.

All of the above will contribute positively to GDP in the economy. Furthermore, higher profits for businesses in the sector can be expected to lead to increased investment in the industry. This will further improve quality and the competitiveness of the destination as discussed in Section 4.2 above.

An analysis of previous changes in VAT rates provides some evidence of the impact of changes in prices through changes in taxes on the tourism sector and the wider economy:

- In **France**, Hysi and Kociu (2015) show some correlation between VAT and employment; they note that a reduction in the VAT rate on restaurant services from 19.6% to 5.5% in July 2009 was followed by the creation of around 50,000 jobs in the restaurant sector between 2009 and 2011. While this is not conclusive of a causal relationship and there could be a number of factors driving the increase in employment aside from the fall in VAT rates, the researchers note that this increase in employment came at a time when in general, employment rates were falling across the rest of the economy (for example, they cite a 30,000 job cut in the construction sector). However, a report by the French Court of Auditors notes that the impact of the reduction in VAT on employment was lower than expected and cost the State an average of EUR2.6 billion a year.[174]

- In **Germany,** a reduced VAT rate on hotels was introduced in 2010, reducing the rate from the standard rate of 19% to 7%. Analysis by Deloitte, Wason and Nevin (2011) showed that performance by Accor, the largest hotel group in the EU, in the first 6 months following the change improved by 11.6% for upscale and midscale hotels in Germany and by 10.5% for economy hotels. This compares to an increase of 4.8% and 5.5% for upscale/midscale and economy hotels in the UK. In addition, the report cites a survey conducted by Hotelverbandd

[173] Cut Tourism VAT, 2012
[174] Les Echos article, 2015

Deutschland (IHA), which represents approximately 20% of hotels in Germany, on their members' response to the VAT cut; 89% of respondents noted that they had commenced (or planned for) new investments, 32% had taken on (or planned to take on) more staff, and 32% had reduced their prices, all in the first year following the change in policy.

- In **Croatia,** an increase in the VAT rate on accommodation from 0% to 10% on 1 January 2006 contributed to a 2.2% reduction in the number of overnight stays between 2005 and 2006.[175]

Academic research also provides empirical evidence which shows an econometric relationship between tourism expansion and GDP growth. Cortes-Jimenez et al (2009) for example show that for Spain and Italy tourism is a significant contributor towards long-run growth. However, the paper does not explore the channels through which growth might occur. We would expect it would be through the direct, indirect and induced channels discussed above.

Other academics have used macroeconomic models to estimate the net impact of changes in the VAT rate on growth and employment. In the UK, for example, the Cut Tourism VAT campaign and HM Treasury have commissioned several studies to assess the impact of reduced VAT rates on British tourism and the wider economy using Dynamic Partial Equilibrium (DPE) and Computable General Equilibrium (CGE) models. Analysis by Deloitte, Wason and Nevin (2011), for example, used a DPE model to estimate the economic impact of reducing VAT on visitor accommodation and attractions from 20% to 5%; their analysis estimates the creation of 78,000 jobs as a result (64,000 in accommodation and 14,000 in visitor attractions).[176] Similarly, in 2012, analysis conducted by the Cut Tourism VAT campaign for HM Treasury using a CGE model suggested that reducing VAT on accommodation and visitor attractions from 20% to 5% could generate over £19bn over 9 years in discounted terms.[177]

It should also be noted that even if changes in VAT are not fully passed on to consumers, it is likely that a VAT reduction will generate positive effects on the wider economy. Firstly, given the high elasticity of demand for tourism observed and estimated by academics, even a small change in prices is likely to have a large impact on tourist flows. This will stimulate wider impacts through the channels discussed above. Secondly, any VAT reduction not passed onto consumers will instead contribute to higher profits for businesses. Investment of higher profits will have further multiplier effects on the economy.

4.3.2.2. The fiscal impact of VAT in tourism sectors

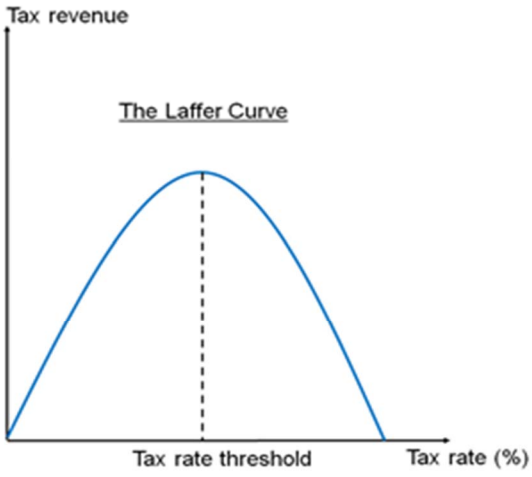
An important concern for politicians in reducing the VAT rate on tourism is the loss in VAT revenues to the government. This is clearly a valid concern; in the UK for example, the hospitality industry is estimated to have contributed £41 billion to the Exchequer in 2014,

[175] Dombrovski, 2010
[176] Deloitte, Wason & Nevin, 2011
[177] Cut Tourism VAT, 2012

51% of which arose from VAT sales.[178]

The expected immediate impact of cutting VAT on tourism-related activities would be a loss of VAT revenue. However, there may be a lag between a reduction in the VAT rate in tourism sectors, and a change in the prices of tourist goods and services and a consequent change in tourism demand. In France, for example, restaurants faced heavy criticism for not passing on a reduction in the VAT rates on restaurants from 19.6% to 5.5% to consumers in the form of lower prices and instead keeping benefits as increased profits.[179] However, pass-through of the cut in VAT to prices is taking place gradually, particularly with increasing competitive pressures. In addition, the low profit margins at which businesses in the sector operate may explain the lag in pass-through in order for these businesses to remain viable. As demand begins to respond to lower prices, the negative impact on tax revenues could potentially be partially offset.

Research by Copenhagen Economics (2007) suggests that it can take up to two years after a change in tax rate for the full effect to be realised. Other researchers have used more conservative assumptions on the rate of pass-through as discussed previously; in their work for the Cut Tourism VAT campaign (2012), Deloitte, Wason & Nevin for example, assumed a pass-through rate of only 60% which they assumed would take four years to come unto full effect.



There is also an argument that a VAT rate which is set too high could be damaging for both the competitiveness of the tourism sector and for fiscal revenues. Theoretically, the Laffer curve (illustrated on the diagram on the left) suggests that while tax revenues will be increasing in the tax rate up to a certain point, after a threshold is reached, the negative effect of taxes on demand will mean that tax revenue begin to fall as taxes continue to rise. Therefore, although it is unlikely to be the case, where the existing tax rate is at or beyond this threshold, reducing the tax rate could in fact increase tax revenues by increasing demand.

Analysis conducted as part of the Cut Tourism VAT campaign in the UK illustrates the potential fiscal impacts of a cut in taxes. The findings suggest that over time, the immediate loss in tax revenues can be fully or partially offset by a boost to tax revenues. Using a DPE model, Nevin Associates Ltd. (2015) show that reducing VAT in the UK on accommodation and visitor attractions from 20% to 5% could generate a direct loss in VAT receipts of £1.5bn and £1.4bn in the first two years but a net loss of only £560m and £36m respectively. Furthermore, after the first two years, the VAT reduction is expected to generate a positive net fiscal impact. The same tax cut modelled using a CGE model is estimated to generate a net fiscal gain in the first three years but a small net

[178] Oxford Economics, 2015
[179] Deloitte, Wason & Nevin, 2011

fiscal loss from then onwards.[180] Therefore, the results from the CGE model suggest that the loss in tax revenues can be partially offset.

There are several reasons why the loss in tax revenues from reducing VAT can be partially or fully offset. Firstly, over the medium- to long-term, the base on which VAT is levied will not remain constant, and is likely to have the following direct effects:

- Lower VAT will increase the price competitiveness of the destination and hence is likely to stimulate higher demand (as a result of a high price elasticity of tourism demand, as discussed above). Therefore, the total tourism revenue base on which VAT is levied will increase;
- Not only will lower VAT in tourism sectors increase price competitiveness and help attract foreign tourists, it could also provide incentives to local residents to choose domestic holidays over foreign travel, further expanding the tax base;[181] and
- Lower VAT rates can help reduce the size of the shadow economy (the part of the economy which does not contribute VAT payments either because it is deliberately unreported or because businesses, particularly those close to the VAT threshold, maintain turnover below the threshold to avoid the cost of VAT payments). The share of businesses inside the VAT regime is therefore likely to increase as, with a reduced VAT rate, the disincentive to VAT registration for businesses in the tourism industry below the VAT registration threshold will be reduced. Evidence suggests that the shadow component of the tourism sector may, in some cases, be significant.[182]

Secondly, the indirect effects of reduced VAT could lead to further gains in the fiscal balance. For example:

- Increased employment both in tourism industries and related industries will lead to increased income tax revenues and national insurance payments and savings in social security payments;
- Higher profits earned by firms in tourism and related industries will lead to increased corporation tax collections; and,
- Higher profits will also result in increased dividend payments, and increased income tax collected on these earnings.

Therefore, while the literature is inconclusive on the net fiscal impact of a reduction in VAT, the loss in revenues may be offset to a large extent as a result of the wider direct and indirect impacts on the tax base, employment and business profits.

4.3.2.3. Summary of the impact of reducing VAT in tourism sectors

The tourism industry contributes significantly to the EU economy and, as such, a

[180] Cut Tourism VAT, 2016
[181] However, it should also be noted that lower VAT could also result in an increase in the disposable income for residents who may then use this to increase their budget on overseas holidays.
[182] F. Schneider and C. Williams, IEA, 2013

reduction in VAT in tourism sectors (for example, from the standard VAT rate to a reduced VAT rate in certain sectors) is expected to stimulate economic growth through direct, indirect and induced channels. The extent to which a reduction is expected to flow through to the wider economy, however, depends crucially on: (1) the level of pass-through of reduced VAT rates to consumer prices; and (2) the elasticity of demand with respect to prices. Academic research suggests both a high degree of pass-through and a high elasticity of demand, particularly in competitive tourist destinations. This implies that a reduction in VAT in tourism sectors is likely to have a disproportionately large positive impact on tourism flows and, as a result, on the wider economy. This may explain the prevalence of reduced rates for tourism-related goods and services observable across the EU-28.

While increased tourist flows are expected to generate jobs and, through this, stimulate growth, these benefits from a reduction in VAT rates in tourism sectors need to be balanced against the resulting loss of fiscal revenues. Economic analysis however finds that, while revenues may fall in the immediate term, this will be partially or fully offset over the medium- to long-term. This is because of increased revenues from: increased VAT receipts as a result of increased demand; increased income tax receipts as a result of increased employment; and, increased corporation tax receipts as a result of increased business profits.

In addition, the negative impacts of tourism, and of increasing tourism by reducing VAT in tourism sectors, also need to be considered. Increased tourism raises some concerns, for example, with regards to the environment, and often taxes are considered to be an efficient means of addressing this. However, again academic literature suggests that while negative environmental externalities could be corrected using taxes, this should be through targeted rather than general taxes to avoid distortionary effects. Furthermore, while tourism taxes could, to a certain extent, offset negative externalities associated with tourism that affect local residents, by reducing the sale of tourism services, they also have a negative impact on local producers and residents.

Overall, therefore, economic theory, backed by academic research, indicates that changes in VAT rates are likely to be passed on to consumers in the form of changes in prices which are likely to stimulate a change in demand. Therefore, there is a case for reducing VAT rates where reduced rates are not already applied in tourism sectors, particularly where demand for tourism is highly elastic, for example coastal tourism destinations. In changing taxes, however, jurisdictions also need to be aware of other factors which influence demand, particularly the tax rates in other competing tourist destinations.

4.3.3. The impact of occupancy taxes on tourism

As we outlined in Chapter 2, several governments also levy an additional charge, or "tourist tax" on the rental of accommodation in order to directly target tourists. A tax of this type is often known as an occupancy tax (or equivalently, a bed tax, or a lodging tax). It is levied on the total price of rental, over and above any other taxes (for example, VAT on accommodation) and is often charged either as a percentage of the

accommodation cost (an ad valorem tax) or on a per person, per night basis (a per diem tax). In some jurisdictions, where occupation taxes are levied, there are exemptions included for long-term stays over a certain number of nights in order to avoid disincentivising longer stays. In Spain, for example, tourists are charged a per night levy up to a maximum of seven nights, beyond which there is no occupancy charge.[183]

Occupancy tax rates vary by country, although not all governments choose to levy them. Tax rates can also vary within a country, for example by location or by accommodation type. In Germany, for example, occupancy taxes vary between €0.25 and €5.00 depending on location, while in France, a €0.20 tax per night is levied for camping and 1-star hotels and a €1.50 per tax per night is levied for 4-5-star hotels.[184] Table 5 in Chapter 2 summarises the occupancy charges levied across EU MS.

While occupancy taxes are by no means a recently introduced charge in the tourism industry, until now they have mainly been used in the United States. Recently, however, they have been becoming increasingly popular in Europe. This has largely been driven by fiscal pressures on governments and the need to generate revenue, combined with the political perception that such a tax is predominantly borne by tourists who have little influence over local elections (hence, the tax can be 'exported'). However, by adding an additional burden on the European tourism industry, occupancy taxes, like other forms of tourism taxation, can have a significant negative impact on the price competitiveness of the destination. Furthermore, with several jurisdictions introducing reduced VAT rates on accommodation and other tourism goods and services, the trend towards occupancy taxes threatens to reverse the benefits generated from reduced VAT rates.

Generally, accommodation providers are legally responsible for collecting occupancy taxes and for transferring receipts to the government. However, accommodation providers may reduce some of the burden on consumers by changing the underlying price of hotel rooms. As discussed above, the extent to which accommodation providers can pass on the burden of the tax onto consumers depends on the relatively elasticities of demand and supply. Hotels and other accommodation providers then have to optimise between allowing consumers to bear the entire burden of the tax and risking a reduction in their demand and revenues, or reducing underlying prices to reduce the burden on consumers but, by doing so, reducing their profit margins. For this reason, occupancy taxes are often vigorously opposed by the accommodation sector.

The channels through which occupancy taxes affect tourist flows and the wider economy are the same as discussed above in relation to VAT charges in tourism sectors. By increasing the relative price of accommodation in a given location, they affect the price competitiveness of that location and hence can impact tourist flows. This then has a knock-on impact on the wider economy through the direct, indirect and induced effects of reduced tourism. However, occupancy taxes, by their nature, are very low. Therefore, they make up a small percentage of the budget of a tourist compared to other forms of taxes including VAT. This might mean, for example, that the predicted consumer behaviour would not be the same as a wholesale price change for a hotel or a change in

[183] Ernst & Young, 2013
[184] Ibid.

more significant taxes.

A difference between occupancy taxes and general VAT in tourism sectors is in the extent to which these taxes are visible to the consumer. While VAT is directly reflected in the prices paid by consumers, for example when they make holiday reservations, occupancy taxes are typically only paid on departure. As a result, occupancy taxes may be likely to have a more moderate impact on tourism demand. Nevertheless, they are likely to induce a psychological impact on tourists and can affect repeat tourism.

In addition, an occupancy tax also differs from general VAT in tourism sectors by directly targeting a particular segment of the tourism industry - accommodation services. As a result, this sector is the most directly affected by these taxes. Other sectors within the tourism industry can, however, be indirectly affected if, for example, tourists respond to the increased total cost of accommodation by reducing expenditure on other tourism activities or by reducing travel altogether either by choosing not to travel (the extensive margin) or by choosing to travel for fewer days (the intensive margin). Again, however, this will depend on the extent to which tourists are aware of these occupancy charges and hence can adjust their behaviours in response.

Below we summarise existing research on the specific impacts of occupancy taxes on the tourism industry and the arguments for and against levying such charges. In particular, we focus on the impact on accommodation providers and the wider economy, and the impact on fiscal revenues. Given that, until recently, occupancy taxes were largely only used in the United States, the vast majority of existing literature is based on research on the levies imposed across American states.

4.3.3.1. The impact of occupancy taxes on accommodation providers and the wider economy

Whilst levying a charge on the renting of accommodation is an effective means of directly targeting tourist activities without imposing a direct cost on residents (other than domestic tourists), occupancy taxes are often regarded as placing a disproportionate burden on the accommodation sector and as being welfare-reducing for tourists.

HOTREC, an organisation representing the hotel, restaurant and cafe industry at the European level, issued a position paper on the emergence of occupancy taxes across Europe in 2012 outlining the key concerns of the sector with regards to these taxes. The paper argued that occupancy taxes, like other tourist taxes, can distort the competitiveness of Europe as a tourist destination, impacting tourism both from within and from outside European borders. Furthermore, the way in which these taxes is often levied is considered to penalise tourists who stay for longer (and who therefore spend more at the destination), particularly where the tax is levied as a fixed charge per night. This concern is however mitigated to some extent in jurisdictions which only levy a charge for a certain number of days after which the charge is dropped. The paper also notes that often the level of tax increases with the star ratings of hotels. It is argued that this provides negative incentives to hotels to abandon their star rating system (which in many countries is voluntary) and results in the loss of a key source of information for

tourists in selecting a place to stay. It should however be noted that as an industry group representing the accommodation sector, HOTREC is likely to take a particular view on the emergence of occupancy taxes.

Occupancy taxes can be seen as particularly discriminatory towards the accommodation sector in comparison to other tourism sectors. For businesses operating in this sector, they could mean either a loss in profit margins if businesses are unable to sufficiently pass on the cost to guests, or a reduction in revenues if consumers reduce demand in response to an increase in price (for example, by spending fewer nights or by choosing alternative forms of accommodation which are not subject to an occupancy tax or which are taxed less heavily). Furthermore, the burden is not borne equally by the sector. For example, a significant proportion of tourists may choose accommodation not provided by the sector and may choose instead to stay with friends or family who will not be subject to the levy. The sector has also seen a rise in peer-to-peer platforms through the sharing economy, which may or may not be subject to the same charges.

As with VAT in tourism sectors, the impact on businesses of an occupancy tax depends firstly on whether businesses are able to pass on the cost to consumers, and secondly on whether consumers respond in a significant way to a change in price. On the first point, Bonham and Gangnes (1996) used time series analysis to assess the impact of an occupancy tax levied in Hawaii and found that the tax was almost entirely shifted onto consumers. This is in line with the findings on VAT in tourism sectors discussed above which suggests that over time the burden of the tax will increasingly be passed on, suggesting that the supply is relatively more elastic than demand.

In terms of the impact of increased accommodation costs on demand, however, the literature is inconclusive. In their analysis of the charge levied in Hawaii, Bonham and Gangnes (1996) found that the impact on net hotel revenues is minimal. This suggests inelastic demand for tourist accommodation. On the other hand, analysis by the American Economics Group in 2004 found, using an econometric model supplemented with an economic impact model based on input-output modelling, that a 2% increase in the combined tax on hotel and motel rooms could reduce room sales by 2.4%. The researchers, however, did not outline their precise methodology.

On their somewhat counter-intuitive findings, Bonham and Gangnes (1996) noted that there could be several factors driving their results. For example, they claim that the 5% increase in lodging costs from the tax would only increase the total cost of a typical holiday in Hawaii by less than 1.5%. Hence, the change may not be large enough to trigger a substantial change in demand. It could be argued that, as occupancy taxes make up only a small percentage of the budget of a tourist compared to other forms of taxes including VAT, this could mean that the predicted consumer behaviour would not be the same as a wholesale price change for a hotel or a change in more significant taxes. Additionally, another argument is that visitors may not be aware of the tax as it is only levied on check out, and as a result they may not have responded in the expected way. This raises a further issue with regards to the transparency of occupancy taxes; consumers may not always be aware of their existence and therefore do not factor the additional cost into their decisions. This can, however, be harmful for repeat tourism.

In addition to the damaging effects on the accommodation sub-sector, occupancy taxes can have a negative impact on the wider tourism industry and the economy as a whole. Tourists could, for example, respond to the increased costs of accommodation by reducing the number of days they spend on holiday, or by spending less on other tourist services such as meals or entertainment. Bonham and Gangnes (1996) recognise that even though their analysis does not find a reduction in room revenues from the introduction of an occupancy tax in Hawaii, this does not preclude adverse effects on the wider tourism industry through this channel. As discussed in relation to VAT in tourism sectors, the negative direct impacts on the tourism industry will also impact on the wider economy through indirect and induced effects. The American Economics Group (2004) estimate that a 2% increase in room tax in the US, in addition to reducing room sales, would also have a ripple effect on the economy, costing the nation 317,112 jobs, $8,527 million in wages and $26,994 million in sales.

It could be argued that as occupancy taxes only directly impact the accommodation sub-sector, unlike general VAT in tourism sectors which negatively affects the entire tourism industry in a direct way, it would make political sense for governments to reduce VAT in tourism sectors but to introduce occupancy taxes on tourists instead. This argument is however weakened by research which suggests that both types of taxes have a similar effect. As an example, Labendeira et al. (2006) use a general equilibrium model of the Spanish economy to examine the impact of VAT on tourism expenditure, comparing it to a specific tourist tax. They find that a 10% *ad valorem* tax on lodging for non-residents versus a VAT increase on tourism goods and services from 7% to 12% (which, although a smaller change, will affect a wider base as a general tax on all sectors) will have similar impacts on non-resident expenditure (-3.1% and -3.2% respectively). This therefore suggests that introducing occupancy taxes is likely to simply reduce any benefits generated from policies to reduce VAT in tourism sectors.

4.3.3.2. The impact of occupancy taxes on fiscal revenues

Often, occupancy taxes are seen as a politically preferable means of raising additional tax revenues. Although in general this could be seen as unfair to tourists and an example of 'taxation without representation', some academics have argued that these taxes, even if they do increase government revenue and contribute to a reduced budget deficit, are justified because of the negative impacts of tourism. As discussed in relation to VAT in tourism sectors, taxes, general or specific, can be seen as an effective way of correcting the negative externality that arises as a result of increased tourism by allowing tourists to 'internalise' their externalities on, for example, the environment. Palmer and Riera (2002) conducted a detailed review of the 'Balearic ecotax' when it was first proposed, which was designed to reduce the negative environmental impact of tourism. The tax was however proposed to be levied as an occupancy tax on tourist stays and hence was argued by the authors to not be suitably targeted. Therefore, while there may be an argument in favour of some form of tax to reduce the externalities which arise from tourism, occupancy taxes, while more targeted on tourism than general VAT, do not appear to be the most appropriate way of addressing the issue.

While occupancy taxes can increase government fiscal revenues, as is the case with general VAT, these could also be offset to an extent by a reduction in demand and a reduction in other sources of revenue (such as income tax, if jobs in the tourism sector are negatively affected).

A key question in establishing how 'fair' an occupancy tax is, is what the revenue generated will be used for. It is often the case that the additional revenue will simply be used to reduce budget deficits. However, if occupancy tax revenues were to be hypothecated for tourism purposes and invested back into the tourism industry, they could potentially be more justifiable. For example, in Malta a per person per night charge of €0.50 is levied on tourists but the revenues generated are exclusively used to improve local infrastructure in touristic areas. The American Economics Group (2004) argue that, despite the negative impacts they estimated on the sector and the economy of an occupancy tax, the net impacts could be positive if revenues raised from the tax are used to promote tourism.

4.3.3.3. Summary of the impact of occupancy taxes

Specific taxes on tourism, such as occupancy taxes, are more directed at tourists than other forms of taxation which directly affect both tourists and local residents. However, they can place a disproportionate burden on the accommodation sector and can be welfare-reducing for tourists.

While literature does not suggest a clear effect on hotel stays as a result of occupancy taxes, this does not imply no impact. As discussed above, several academics have demonstrated that tourism is particularly price elastic. Therefore, any tax that increases prices in a way that is visible to consumers will affect the overall level of tourism on both the intensive and extensive margins. By increasing the cost of accommodation, these taxes can also divert tourism expenditure from other parts of the industry, for example food or entertainment. This will have a knock-on impact, not only on the wider tourism industry but also on the economy as a whole through indirect effects on other industries and through the induced effects of reduced employment.

Indeed, although veiled as a tax designed to reduce the negative externalities arising from tourism, occupancy taxes can be seen, and are often used, as a means of increasing government revenues and reducing budget deficits. However there is a question over whether this should be the purpose of a tourist tax. Unlike general VAT, one potential argument in favour of occupancy taxes on tourists is that the revenues are directly attributable to tourism and hence can be used to invest in the industry. In this case, by promoting tourism, it is possible that the net effects are positive. However, more research would be required to assess the extent to, and conditions under, which this would be the case.

4.4. Estimating the impacts of a change in tourism taxes

In this section, we discuss our methodology for calculating the effects of a change in tourism taxation on the tourism sector and on the wider economy. Based on this

methodology, we have developed a spreadsheet-based data tool that provides a method for using taxation as a lever to assess the economic impacts of a change under different assumptions.

It should be noted that our methodology does not directly model the channels of impact from a change in tax through to sectoral Gross-value Added[185] (GVA), economy-wide GDP and sectoral and economy-wide employment. Instead, we rely on existing research which model these impacts and apply their findings to a proposed change in tax.

Our data tool focuses on the impact of a change in occupancy taxes on the accommodation sector and the wider economy. As legal constraints limit the scope to reduce VAT rates in tourism sectors, and as the majority of EU Members States with the exception of three already apply reduced rates on accommodation services, we do not assess the impact of a change in VAT rates in tourism sectors. Furthermore, VAT is a general consumption tax therefore it is impossible to reduce the tourism VAT in isolation as the reduced rate would apply to a range of goods and services.

The data tool therefore focuses on the effects of a specific tourism tax on the accommodation sector. It does not capture the direct effects on other tourism services such as tour operators or travel agents. As the tourism product provided by tour operators and travel agents is often a package of other services (including, for example, accommodation, food, transport and others) which may each be treated differently for the purposes of taxation, the direct effects are more difficult to isolate. Furthermore, it does not account for the cross-border effects of a change in tax, for example, the change in tourism demand in one jurisdiction resulting from a change in tax in another. More complex macro-economic modelling would be required to capture these effects.

The tool captures the impacts on all EU MS using simplifying assumptions, as we discuss below. We have also extended our methodology for our three case studies locations discussed in Chapter 3) to provide more detailed and location-specific insight. The extent to which each MS and case study location is affected by a hypothetical change in tax depends crucially on the type of tourism each destination attracts, and the elasticity of demand for each type.

A spreadsheet-based version of our data tool is made available for use by the Commission. In section 4.4.2 we provide results by EU MS for a hypothetical change in and occupancy taxes and with sensitivity checks on assumptions on the level of pass-through to price and on the elasticity of tourism demand to a change in price, along with explanatory text.

Below we provide a detailed discussion of our methodology and findings from our analysis.

[185] Gross Value Added is a measure of the value of goods and services produced by a given industry or sector of the economy. The sum of GVA across sectors plus net taxes on products is the Gross Domestic Product (GDP) of a country.

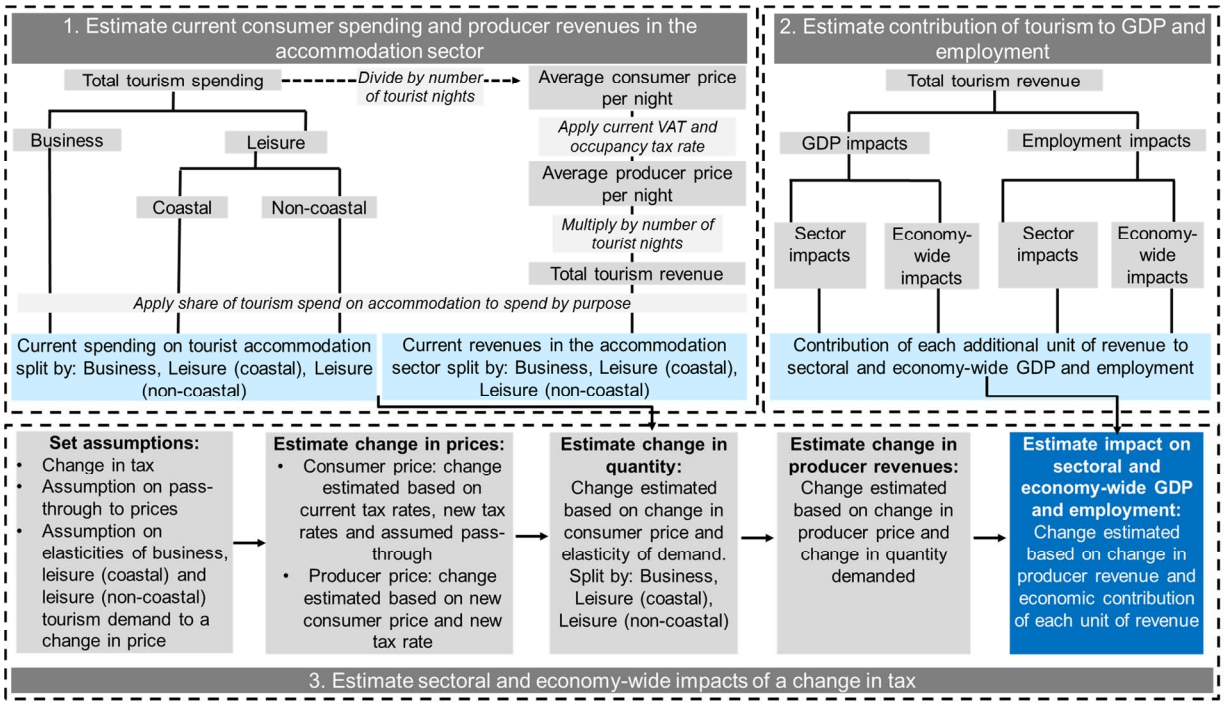
4.4.1. Methodology

We have developed a methodology and built a simple, flexible tool for each MS, which draws on existing models of the economic contribution of tourism. The tool assesses the national impact of a change in occupancy taxes on the accommodation sector and the wider economy. Our approach is summarised in the diagram below and involves three key stages:

1) Estimation of the current spending on accommodation by tourists and current producer revenues in the sector.
2) Estimation of the contribution of tourism spending on accommodation to GDP and employment, both on the accommodation sector and at the economy-wide level.
3) Using (1) and (2) above, combined with assumptions on pass-through and price elasticities of demand, estimation of the impacts of a change in occupancy taxes on consumer spending and producer revenues, and the resulting impact on the accommodation sector and wider economy.

Below we discuss our methodology for conducting each stage in detail.

Figure 18: Overview of our methodology



Source: PwC

4.4.1.1. (1) Estimating current consumer spending and producer revenues in the accommodation sector

The first stage of our approach establishes current spending on tourism and the associated producer revenues. This provides us with a baseline against which we can assess any potential change generated by a change in tax. Below we discuss our approach to estimating each.

In addition to total spending and revenues, it is important to understand the share of spending and revenues generated by different tourist groups. Different groups of tourists respond differently to changes in prices. For example, when the purpose of a visit is for business, a change in price is likely to have a more suppressed impact on demand compared to when the purpose of a visit is for leisure. One reason for this is that the average business traveller has less flexibility in their decision to travel or not to travel because of a change in price. Therefore, we have split tourism spend and producer revenues by purpose of travel, to allow us to assess the differential impact of a change in taxes on different groups of tourists. We have then applied different price elasticities to each group of tourists, based on empirical research, as discussed below.

(a) Estimating current tourism spending

The World Travel and Tourism Council conducts annual research on the tourism industry across countries. As part of this research, it publishes data on internal tourism consumption, defined as the total revenues generated by tourism sectors within a country, split by purpose of travel (business and leisure). Our methodology uses this data to establish total tourist spending by business and leisure tourists for each MS.

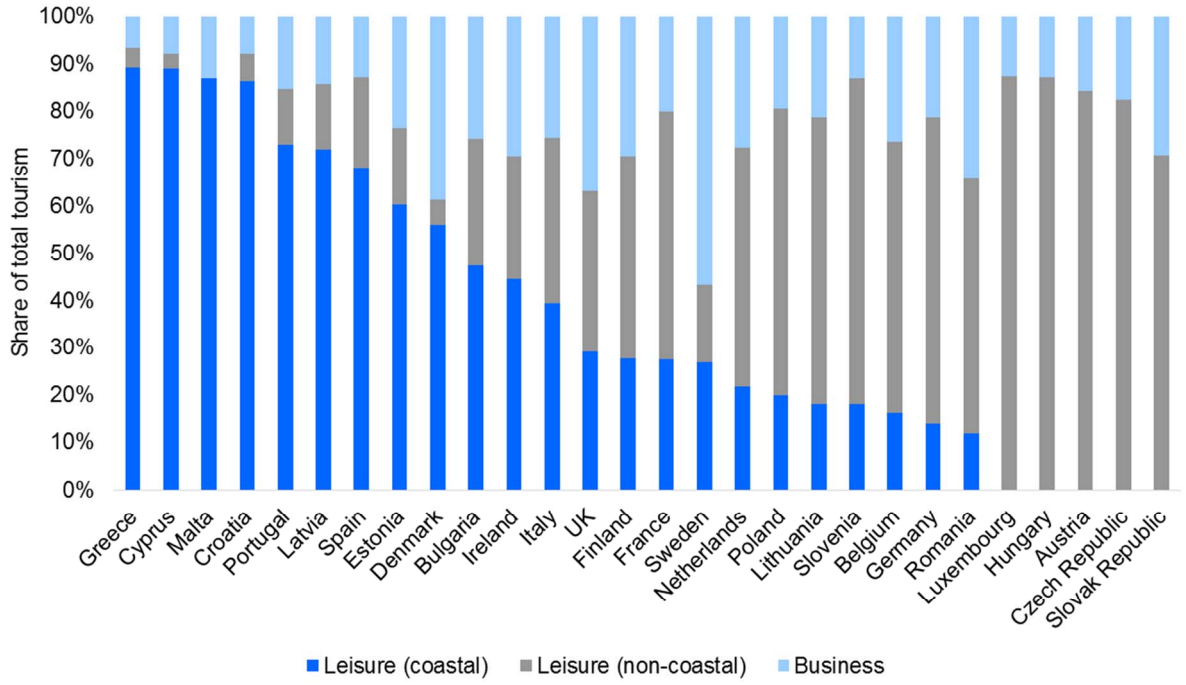
In addition, there is likely to be significant heterogeneity amongst tourists whose purpose of travel is leisure. Again, these different groups of leisure tourists are likely to respond differently to a change in price. There are several different ways in which leisure tourists can be grouped, for example by income level or by holiday type; we split leisure tourists into two groups: tourists visiting the beach (coastal tourism) and tourists visiting cities (non-coastal tourism). Sauran (1978), for example indicated that "sunlust" destinations are likely to be more elastic than "wanderlust" destinations. Empirical evidence supports this and we therefore apply higher price elasticity to coastal tourism. The high price elasticity for coastal locations could be driven by the fact that tourists visiting the coast are likely to have a choice of multiple alternative locations and hence are more influenced by the price at a given location, compared to tourists visiting cities who may choose to travel to a given city to visit a specific tourist attraction, for which there are no (or very limited) close alternatives.

In order to disaggregate leisure tourism spending into spending on coastal and non-coastal tourism, we use Eurostat (2015b) data on the number of nights spent at tourist accommodation establishments by coastal and non-coastal areas at the NUTS2 level. The share of nights spent in coastal and non-coastal accommodation could be used as a proxy for the share of leisure tourism spending on coastal and non-coastal tourism and can be aggregated from the NUTS2 level data provided by Eurostat to the country level.

The chart below illustrates the share of tourism spending across MS, split by purpose of travel: business, leisure (coastal) and leisure (non-coastal). As shown, a large proportion

of tourist spending in southern Europe is on coastal holidays compared to central Europe where countries are landlocked and hence non-coastal tourism dominates. Overall, there is significant variation across MS in terms of the types of tourists they attract. This suggests that if different groups of tourists respond differently to changes in price, each MS will be affected by a change in tax to a different extent, depending on their share of business, leisure (coastal) and leisure (non-coastal) tourists. For example, if coastal tourism is more responsive to changes in prices, southern European countries which have a greater share of coastal tourism will be relatively more affected.

Figure 19: Share of leisure (coastal), leisure (non-coastal) and business tourism by Member State

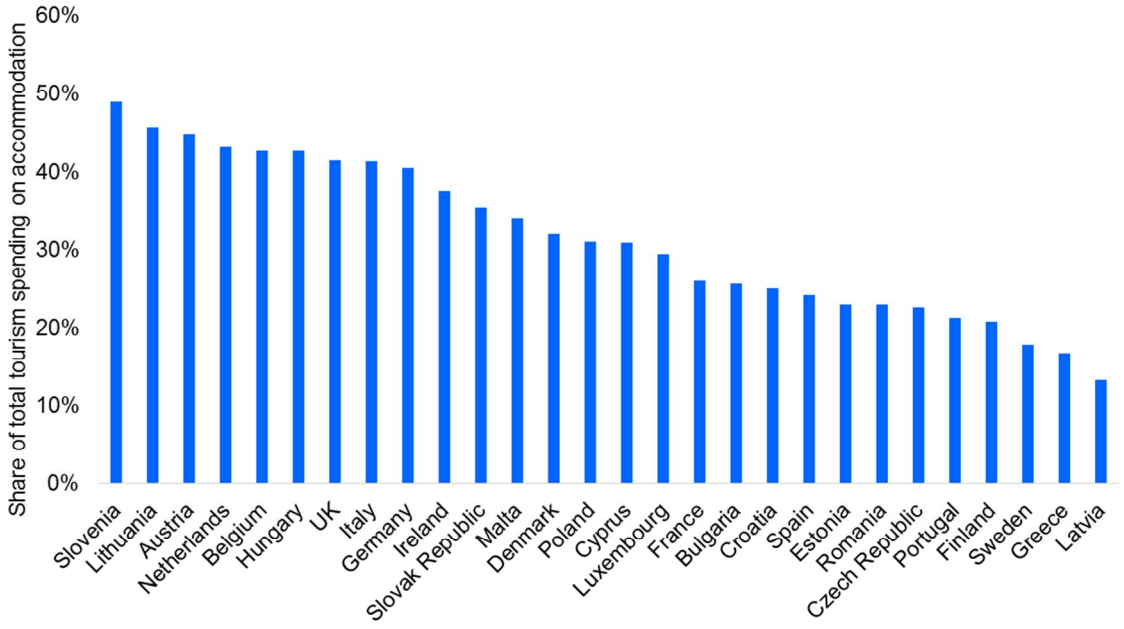


Source: PwC using WTTC[186] and Eurostat data[187]

As occupancy taxes are specifically levied on the accommodation sector, the direct impact of a change in taxes is on this sector. Therefore, the impact of a change in price needs to be assessed on demand for the accommodation sector, rather than the tourism sector more broadly, which would result in an overestimate of the impact of a change in taxes on total spending. Eurostat (2015c) provides data on the average expenditure per night by tourists in different tourism sectors, including accommodation. The chart below illustrates the significant variation in the share of tourism spending on accommodation by MS.

Figure 20: Share of tourism spending on accommodation by Member State

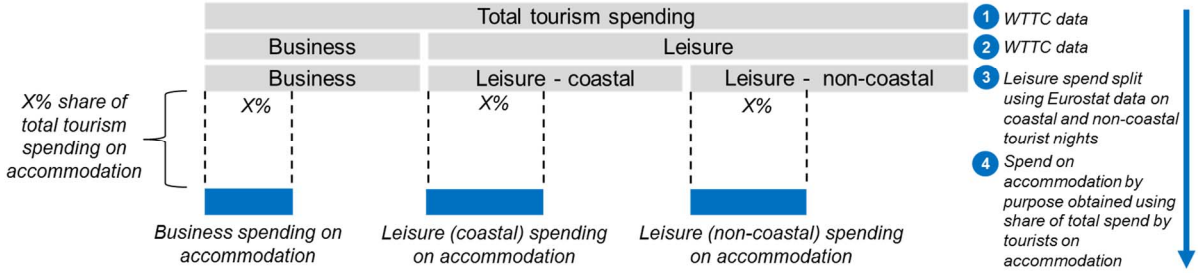
[186] World Travel and Tourism Council, 2016b
[187] Eurostat, 2015b



Source: Eurostat (2015c) for all countries apart from Sweden (2011)[188]

To obtain estimates of tourist spending in the accommodation sector by purpose of visit, we apply the share of total tourism spending in the accommodation sector by MS to our estimates of spending by purpose, as shown in the diagram below. This approach assumes that each group of tourists (business, leisure (coastal) and leisure (non-coastal)) spends the same proportion of their total spending on accommodation. This is a simplifying assumption based on data availability. It is plausible that business tourists spend a greater share of their total spending on accommodation, while leisure tourists spend a greater share towards food and entertainment. However, we have not explored this caveat in our tool, due to a lack of publicly available data on tourism spending by sector and by different groups of tourists.

Figure 21: Methodology for estimating tourism spending on accommodation by tourism purpose



Source: PwC

(b) Estimating current tourism revenues

[188] Swedish Agency for Economic and Regional Growth, 2011

In order to estimate current tourism revenues, we first have to estimate the quantity demanded and the average producer price per unit. We use Eurostat (2015b) data on the number of nights spent at tourist accommodation establishments as our estimate of quantity demanded.

To estimate the average producer price per night, we first estimate the average consumer price per night. As discussed above, the World Travel and Tourism Council[189] publishes data on internal tourism consumption which we have used above to estimate tourist spending. Using this data on tourist spending and data on the number of nights spent at tourist accommodation establishments (which we use as our estimate of demand), we can estimate the average consumer price per night as the total tourist spending divided by the number of nights. Applying the current VAT rate on accommodation and the estimated ad valorem occupancy tax rate (discussed in Section 4.4.1.3 below), we can then estimate the producer price per night. This approach assumes that the only taxes levied on the accommodation sector include VAT and occupancy taxes; in reality, the accommodation sector is likely to bear additional taxes including, for example, corporate taxes, as discussed in Chapter 2. Under this assumption, the difference between our estimates of consumer price and producer price per night provides an estimate of the tax per tourist per night received by the government.

Combining the estimated number of nights (quantity demanded) with the producer price per night, we then estimate total producer revenues. As above with consumer spending, we then split total producer revenues into revenues in the accommodation sector generated by business and leisure (coastal and non-coastal) tourists using the same approach described above.

4.4.1.2. (2) Estimating the contribution of tourism spending to GDP and employment

The first stage in our approach described above provides us with the baseline tourism spending and producer revenues in the accommodation sector. To assess the impact of a change in taxes, our approach relies on previous research on the contribution of producer revenues to the accommodation sector and wider economy.

The World Travel and Tourism Council assesses the direct and indirect contribution of tourism activity on GDP and employment. The impacts are defined as follows:

1) Direct contribution to GDP: the total spending by tourists in tourism sectors less purchases made by these sectors

2) Total contribution to GDP: the sum of the direct, indirect and induced impacts on the economy from spending in tourism sectors

3) Direct contribution to employment: the total number of employees in tourism

[189] World Travel and Tourism Council, 2016b

sectors

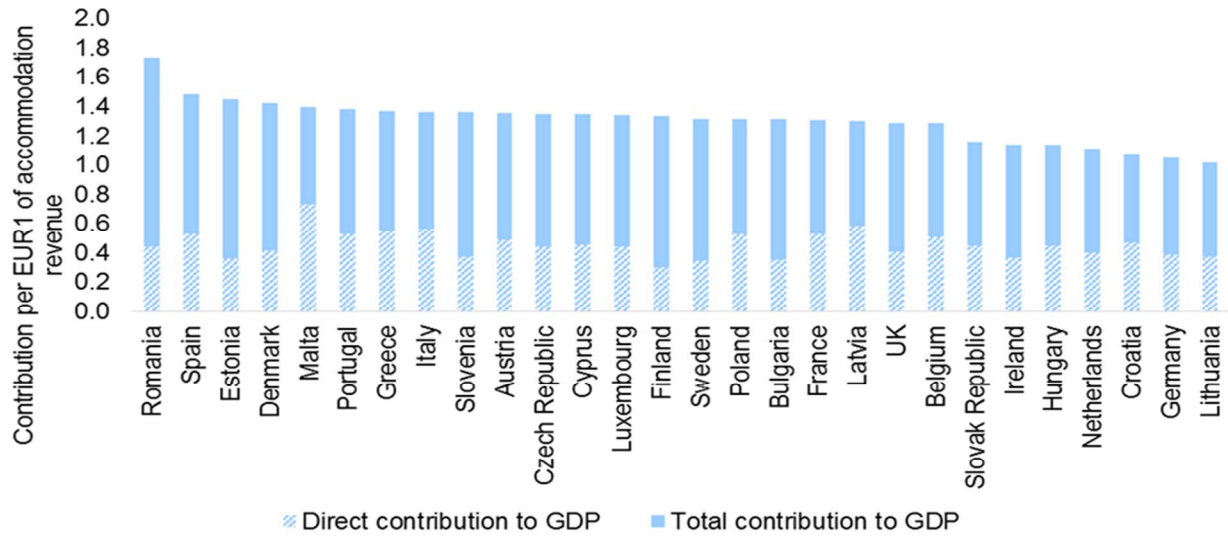
4) Total contribution to employment: the total number of employees in tourism sectors plus additional jobs generated through indirect and induced channels

We use this framework to estimate the contributions to GDP and employment for every unit of revenue generated in the tourism sector. Once we have established the change in revenue in the accommodation sector in stage 3 below, we can then use these contributions of additional units of revenue to assess the impacts on the sector and the economy. It should be noted that this assumes that every unit of revenue contributes equally to employment and GDP regardless of the tourism sector to which the revenue can be attributed to.

Figure 22 below illustrates the contribution to direct GDP (at the sectoral level) and total GDP (at the economy level) of every EUR 1 of tourism revenue in the accommodation sector across MS. As illustrated, every EUR 1 of revenue in the accommodation sector generates the largest contribution to GDP in Romania of EUR 1.7. Interestingly, while in Romania tourism spending has the highest total impact on GDP, the direct impact is relatively low compared to other MS. This suggests strong linkages between the accommodation sector and other sectors in the economy in Romania.

Similarly, Figure 23 illustrates the contribution to direct and total employment of every EUR 1m of revenue in the accommodation sector. Again, the contribution to employment is greatest in Romania where every EUR 1m of revenue in the accommodation sector generates 39 jobs in the accommodation sector, and 102 jobs across the economy.

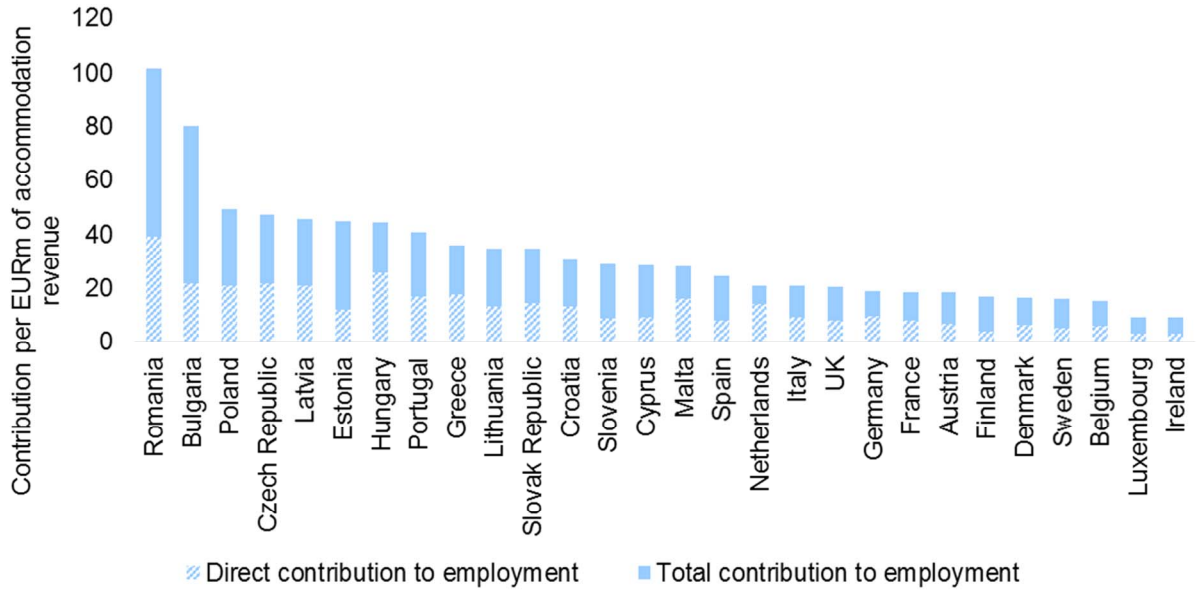
Figure 22: Direct and total contribution of every EUR 1 of tourism revenue in the accommodation sector to GDP (Euros)



Source: PwC using WTTC[190]

[190] World Travel and Tourism Council, 2016b

Figure 23: Direct and total contribution of every EUR1m of tourism spending to employment (number of jobs)



Source: PwC using WTTC[191]

4.4.1.3. (3) Estimating the sectoral and economy-wide impacts of a change in tourism taxes

The final stage in our methodology estimates the impact of a change in tax on the accommodation sector and the economy as a whole.

First, the parameters, or choice variables, of the tool need to be set. These include:

(a) The current and proposed change in occupancy taxes
(b) Assumptions on the rate of pass-through of taxes to prices and the elasticity of tourism demand to a change in price.

Using these parameters along with the current level of producer revenues and the economic contribution of every additional unit of revenues, we estimate the impact of a change in tax.

(a) The current and proposed change in occupancy taxes

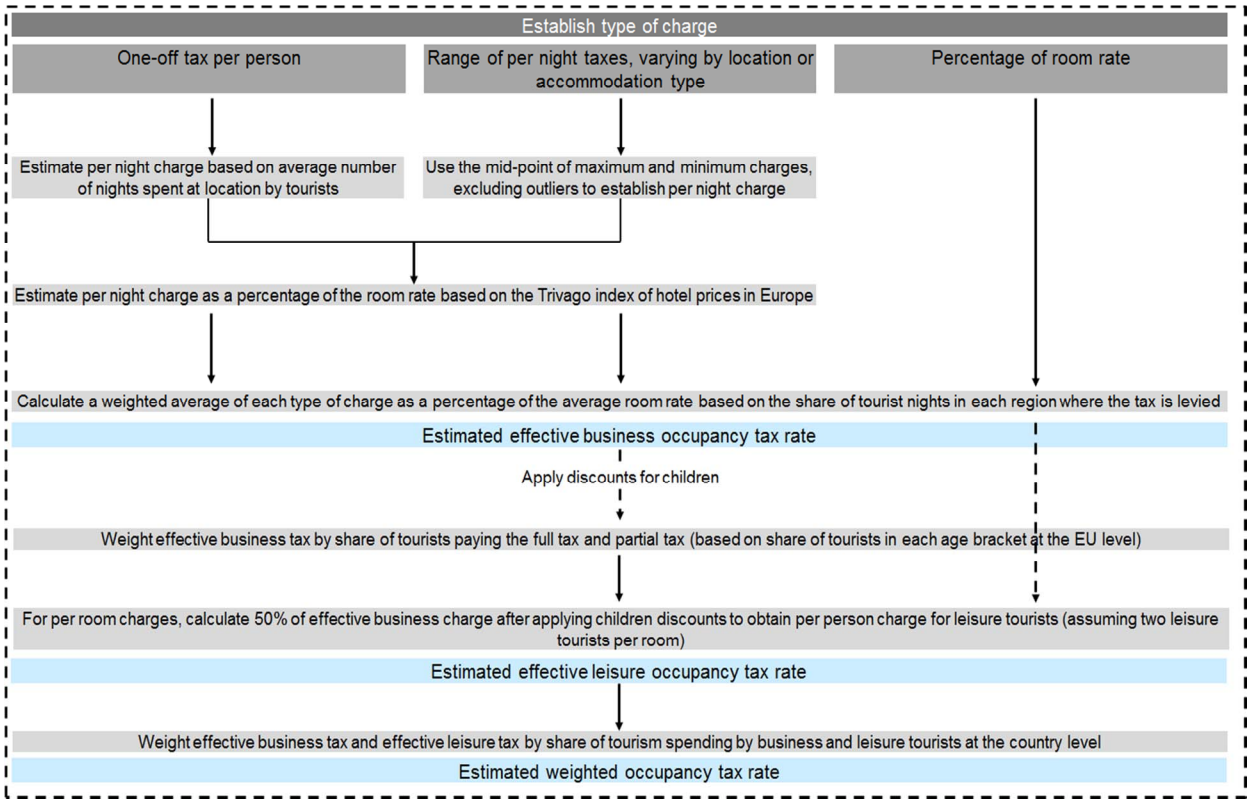
As discussed in Section 4.3.3, occupancy taxes vary considerably in how they are levied across MS. Some MS charge on the basis of a percentage of the accommodation cost, while others charge per person and/or on a per night basis. Adding further complexity, the level of the charge often also varies by type of accommodation and/or by region (for example, some popular tourist cities command higher charges), while some MS also

[191] Ibid.

charge lower rates for children.

Therefore, in order to design a tool allowing the user to measure the impact of a change in occupancy tax across all MS, we developed a composite index for the charge, converting the charges within a jurisdiction to an "average" percentage of total spending which is comparable across states. Our methodology for developing this index is presented in Figure 24 and discussed in further detail below. Our tool enables the user to adjust key parameters of this index (for example, the way in which the occupancy tax is levied, regions it is levied on and any discounts applied for children) to generate a change in the composite index for the occupancy tax and the resulting change in price, tourist spending, producer revenues and economic impact.

Figure 24: Methodology for developing a composite index for occupancy taxes



Source: PwC

Of the 28 MS, ten states do not levy any occupancy taxes (as identified in Table 5 of Chapter 2). For the remainder, the first stage of creating a comparable composite index for occupancy taxes was forming a simpler index of each MS's occupancy tax as an individual charge per night, or a room charge per night (as these are assumed to be equivalent in the case of business tourists). This charge is then divided by the average cost per night for the relevant MS to achieve a rate as a percentage of the cost of accommodation per night. For Romania and Lithuania, the charge is already levied as a percentage of accommodation cost, and hence the second stage of this calculation is not required.

Our approach to estimating the charge per night for an individual, or charge per room per night, as described above, varies by country, depending on the way in which the tax is levied. Of the eighteen MS which levy occupancy taxes, sixteen levy the charge as a varying fee per person per night. The varying charges depend on factors such as accommodation type, location and the total number of nights stayed. As numerous factors determine the charge, the mid-point of the maximum and minimum charge in the jurisdiction was selected as an appropriate average estimate for these states, after removing any outlier charges. One example of an outlier is a charge of €4.40 for staying in a palace in France, when the 5-star hotel charge is only €1.50. To convert the charges into a percentage of total spending, the charges were divided by the average cost per night for each relevant MS.

To find the average cost per night for each relevant MS, we used the 2015 Trivago Hotel Price EU Index[192], which is an index of the average monthly hotel prices for the 50 most popular EU cities in 2015. Using this index, we took the average annual hotel price for the most popular city of each relevant MS, and used this as a proxy for the average hotel price for each relevant MS. As the index units were in British Pounds, we applied the average 2015 European Central Bank EUR:GBP rate (see Appendix II) to ensure our calculations were matched in the same currency, in the same year.[193]

Eight MS did not have cities featuring on the Trivago index. As such, we conducted a Trivago hotel search for these MS for a one week stay in the middle of August. We took the median price from the selection and seasonally adjusted the price, based on the 50 cities' average monthly price differences in the Trivago index. As these prices were also in British Pounds, we applied the same European Central Bank EUR:GBP rate instead, to ensure our calculations were matched in the same currency, in the same time period as before.

Calculating the composite occupancy taxes for Portugal, Lithuania and Bulgaria required a more nuanced approach:

- For Portugal, an occupancy tax is only levied in Lisbon. Therefore, applying the tax uniformly across Portugal would overstate the average tax paid by tourists. As such, we used NUTS2 data on the share of total national tourist nights spent in Lisbon, to create a weighted average of the occupancy tax for the entire country.[194] This weighted average was then divided by the average cost per night, as with the calculations for the other MS.

- Similarly, Lithuania only charges occupancy taxes for two specific touristic regions, namely Palanga and Druskininkai. As these regions are more granular than the available NUTS2 data, alternative sources were used to perform a similar calculation, based on the number of tourists, rather than tourist nights.[195] [196]

[192] Trivago, 2015
[193] European Central Bank, 2017
[194] Eurostat, 2015b
[195] OECD, 2017b
[196] Lithuania State Department of Tourism, 2017

- Bulgaria has specific regional taxes for littoral (seaside) resorts, as well as separate country-level occupancy taxes. We applied the county-level tax as described above for other MS levying a varying charge. However, the additional resort tax was treated differently. We calculated a weighted average for the share of tourist nights at coastal areas relative to the entire country and applied the littoral tax to this percentage of tourists. The littoral tax is also levied as a one-off per person charge per stay and therefore adding it the country-level charge would overstate the actual charge paid by tourists. As a result, we divided the one-off charge by the average number of nights stayed by tourists in the country[197] to obtain an approximate per night charge. This figure was then added to the country-level tax before dividing by the average cost per night, just like the calculation process for other MS.

This approach described above allowed us to estimate, for all MS, an occupancy tax in the form of a percentage of accommodation spending for one person/room per night. We use this rate as representative of the per night charge incurred by a business traveller.

In the case of leisure tourism, however, tourists also include children, who attract a lower rate in some jurisdictions. In addition, often leisure tourists will travel together and share a room, and thereby are required to pay a lower charge where the tax is levied on a per room basis. We dealt with both of these problems by constructing a separate leisure adjusted occupancy tax as a percentage of accommodation spending, as outlined below.

Firstly, with regards to lower rates for children, several countries offer discounts of varying amounts for children of varying ages. To take these discounts into account, we used Eurostat data[198] to estimate the proportion of total leisure tourists across all MS under the age of 15; this was estimated at approximately 15% of total leisure tourists. We then assumed a uniform distribution to estimate the proportion of children aged 0-1 years, 1-2 years etc. In addition, we extrapolated this distribution up to 17-18 years old, so we could also capture discounts applicable to 16 to 18 year olds. This enabled us to weight the representative charge for a business traveller (equivalent to the charge for 1 adult) to develop an "average" charge per person (adults and children) for leisure tourists.

Hence, using this approach we were able to estimate an approximate average occupancy tax in the form of a percentage of accommodation spending for one person/room per night for leisure travellers. This was sufficient to represent leisure tourist occupancy taxes for most countries, as most levy their taxes by person, rather than per room. However, this rate was an overstatement for Romania and Lithuania, where the tax is levied per room. We assumed an average of two leisure travellers per room, and thus halved the percentage taxes for these countries for leisure tourists.

The approach described above enabled us to estimate an ad valorem charge per business traveller and per "average" leisure traveller charge, accounting for variations in the

[197] UNCTAD Handbook of Statistics, 2007
[198] Eurostat, 2015d

charges by region, type of accommodation and age of traveller. The next stage in our approach was to create a single composite index combining the charge for business and leisure travellers. In order to do this, we created a weighted average of our business occupancy tax rate and leisure occupancy tax rate, based on the share of total tourism spending in each MS by business and leisure travellers.[199] The effective composite occupancy tax rate for each MS is summarised in the table below.

Table 19: Estimated composite index of occupancy taxes

Member State	Effective business charge	Effective leisure charge	Weighted composite charge
Austria	0.92%	0.79%	0.81%
Belgium	3.38%	2.99%	3.09%
Bulgaria	2.83%	2.50%	2.59%
Croatia	0.54%	0.47%	0.47%
Cyprus		No tax	
Czech Republic	0.46%	0.46%	0.46%
Denmark		No tax	
Estonia		No tax	
Finland		No tax	
France	1.04%	0.86%	0.89%
Germany	2.42%	2.42%	2.42%
Greece		No tax	
Hungary	4.00%	2.00%	2.26%
Ireland		No tax	
Italy	2.50%	2.26%	2.32%
Latvia		No tax	
Lithuania	0.15%	0.15%	0.15%
Luxembourg		No tax	
Malta	0.30%	0.30%	0.30%
Netherlands	1.87%	1.64%	1.70%
Poland	0.79%	0.79%	0.79%
Portugal	0.23%	0.20%	0.20%
Romania	1.00%	0.41%	0.61%
Slovak Republic	1.89%	1.89%	1.89%
Slovenia	0.96%	0.85%	0.86%
Spain	0.97%	0.82%	0.83%
Sweden		No tax	
United Kingdom		No tax	

Source: PwC analysis using ETOA, Ernst & Young (2013) and various sources

The composite occupancy tax rates by country that we have developed are synthetic and while they allow us to standardise the varied occupancy taxes across countries to compare the impacts of changing taxes, they are restricted in their use as a policy tool. In addition, the index does not pick up additional nuances in the occupancy tax structure, for example where rates are reduced or capped for longer stays.

We have developed our tool such that policy makers can adjust key parameters which

[199] World Travel and Tourism Council, 2016b

form part of the occupancy tax, for example, the upper and lower limits on charges by accommodation type, or the discounts applied to different age groups, to understand the impact of changing these levers.

(b) Assumptions on the rate of pass-through and the elasticity of tourism demand

In addition to choosing the change in the structure of the occupancy tax rate, our tool is also designed to enable the user to set other key assumptions which drive the results on the impact of change in taxation. As discussed in Section 4.3, the impact of a change in tax crucially depends on: (1) the extent of pass-through to prices; and, (2) the elasticity of tourism demand to a change in price. While we have set these assumptions based on literature, they can be adjusted by the user to assess the sensitivity of the estimated GDP and employment impacts to changes in assumptions on pass-through and elasticity.

With regards to the extent of pass-through, as discussed previously, while most literature suggests that over time a change in tax will largely be entirely passed onto consumers as a change in price, there may be a lag in the short-run. A fuller discussion of estimates of the rate of pass-through is provided in Section 4.3.2.1. For the purposes of the tool, we have used a conservative assumption of an initial pass-through rate of 60%, however users of the tool are able to adjust this assumption. Based on the change in tax under consideration, we can then estimate the change in the consumer price if there were 100% pass-through, and the change in price using our assumed level of pass-through, calculated as follows:

$$\%\ \text{change in consumer price with 100\% pass through} = ((1+\text{new tax rate}) - (1+\text{old tax rate}))/((1 + \text{old tax rate}))\times 100$$

$$\%\ \text{change in consumer price with assumed pass through} = \%\ \text{change in price with 100\% pass through} \times \text{assumed rate of pass through}$$

Using the new estimated consumer price we can then also estimate the change in producer price as the consumer price less the new level of tax applied to the accommodation sector (including the existing VAT rate on accommodation and the new occupancy tax rate, as set by the user).

Our proposed assumptions on the elasticity of tourism demand by tourist group to a 1% change in price is summarised in the table below. Again, these assumptions are flexible and can be varied to assess the impact. Furthermore, for our case study locations discussed in Chapter 3, we have obtained location-specific elasticities, where existing research is available in order to better proxy the potential response of tourists to a change in price at these locations.

It should be noted that our elasticities are for the impact on tourism demand to a change in price, rather than more specifically the impact on accommodation demand to a change in price which is limited to a share of total tourism demand. For the purposes of our analysis, we assume that accommodation demand responds in the same way to a change in price as general tourism demand; it could however be argued, for example, that

tourists respond to a change in accommodation prices by switching to alternative forms of accommodation. Users of the tool are however able to vary the assumed elasticities in the tool to account for this possibility.

For the price elasticity of demand for business travellers, we use estimates from Peng et al (2015)'s meta-analysis of international tourism demand elasticity studies; they find an average price elasticity of business travellers across the world of -0.35. This suggests that a 1% increase in the price at the destination only reduces business travel on average by 0.35%. This supports the view that business tourists are likely to be less sensitive to a change in price as they have fewer alternatives as compared to leisure tourists.

To obtain assumptions on the elasticity for coastal and non-coastal leisure tourism, we have used country-specific estimates in Smeral (1994); the estimated elasticity for Spain of -1.39 is used as representative of the elasticity for coastal holidays while the estimated elasticity of -0.43 for Germany is used for non-coastal holidays. This is in line with our estimates for the split of tourism spend by purpose discussed above whereby a relatively large proportion of tourism spending in Spain (78%) is derived from coastal holidays and a relatively large proportion of tourism spending in Germany (82%) is derived from non-coastal holidays. The elasticities also support the views of Sauran (1978) who suggested that "sunlust" or coastal destinations are likely to be more elastic than "wanderlust" or non-coastal destinations. We have applied a weighted average of these elasticities to each MS based on their proportions of tourism spend by purpose (business, coastal leisure and non-coastal leisure).

Table 20: Estimated elasticity of tourism demand by purpose of travel

Tourism purpose	Assumed price elasticity of demand
Business	-0.35
Leisure (coastal)	-1.39
Leisure (non-coastal)	-0.43

Source: Peng et al. (2015), Smeral (1994)

While it could be argued that the elasticities used from Smeral (1994) are outdated, they are supported by the findings from Peng et al (2015)'s more recent meta-analysis which suggests an average price elasticity for European tourism of -1.29 which lies in between our estimates for the elasticities for coastal and non-coastal leisure tourism.

A limitation of the elasticities used in the tool is that they only account for the own price elasticity of demand, and not the cross-price elasticity. Tourism demand will also be influenced by the price of tourism in other jurisdictions, particularly those which are nearby or which offer similar packages. A more sophisticated model would be required to assess the impact on tourism in one country from a change in price in another.

Using the assumptions on the pass-through of a change in tax to price and on the

elasticities of different types of tourist demand to a change in price, we can estimate the percentage change in tourism demand, or the change in tourist nights (as the percentage change in price, determined by the change in tax and the level of pass-through, multiplied by the elasticity of demand). The percentage change in the consumer price of accommodation and the percentage change in tourism demand can then be combined to estimate the change in tourism spending on accommodation.

Next, we apply the estimated percentage change in accommodation spending to the current levels of spending established in stage 1 (see Section 4.4.1.1) to estimate the absolute change in spending. Similarly, we also estimate the change in producer revenues using the new producer price, driven by the level of pass-through, and the new quantity demanded, driven by the elasticity of tourism demand to a change in price.

Finally, using the contribution to sectoral and economy-wide GDP and employment of every unit of revenue in the accommodation sector established in stage 2 (see Section 4.4.1.2), we can estimate the impact of the resulting change in revenue from the hypothetical change in tax. This is calculated as the estimated change in revenue multiplied by the contribution of every unit of producer revenue to sectoral and economy-wider GDP and employment.

4.4.1.4. Case studies

In Chapter 3, we present three case studies for highly popular tourist destinations in Europe including the Spanish Balearic Islands, Cyprus and Paris. In addition to estimating the impacts of a change in occupancy taxes for each MS, we have also designed our tool to enable us to conduct specific analysis on these locations. The results of this analysis are discussed in Chapter 3. Here, we describe our methodology. The methodology used is similar to that described above for each MS, however we have made slight adjustments to allow us to capture location-specific impacts.

As with the approach described above for MS, the first stage was to establish tourism spending in the accommodation sector for each case study location. We achieved this by breaking down tourism spending at the national level to the level of the case study location using the share of total national tourist nights spent in each.[200] For Cyprus, as our case-study location is the country as a whole, we used the total spend by tourists on accommodation as estimated above. For Paris, we used the share of tourism nights in France in the NUTS2 region of Ile de France, which includes Paris, while for the Balearic Islands, we used the share of tourism nights in the NUTS2 region of Illes Balears.

In the second stage above, we estimated the contribution of tourism revenues to sectoral and economy-wide GDP and employment. For our case study locations, we have assumed that the contribution is the same as the contribution at the national level (i.e. the contribution of each unit of revenue in Paris is the same as the contribution of each unit in France, and similarly for the Balearic Islands and the national contribution for Spain.)

[200] Eurostat, 2015b

Finally, we estimated the parameters of the tool including: the occupancy tax rates, the assumed level of pass-through and the price elasticity of tourism demand.

In terms of the occupancy tax rate, we used the same occupancy tax rates for Cyprus and for Paris as used above for the respective MS. For the Balearic Islands, however, more specific information is available on the occupancy tax rates levied hence we used the following approach to estimate the occupancy tax rate:

1. The occupancy tax in the Balearic Islands is a fixed charge between €0.50 and €2.00 depending on the type of accommodation.[201] In addition, a 50% discount is applied to the rate during the off-peak season. We therefore weighted the minimum and maximum charges in the range by the share of travel in the off-peak season. This was achieved by sourcing data on the total number of tourists arriving throughout the year[202] and assigning the six least popular months as the off-peak period. Using this approach, we estimated that 84% of travel to the Balearic Islands is during the peak season, while the remainder is off-peak. We therefore estimated a weighted charge ranging between €0.46 and €1.84. As discussed above for other MS levying a fixed charge, we then selected the mid-point of the range of €1.15 as the weighted average occupancy charge.

2. The next step was to estimate this charge as a percentage of the average room cost per night in the Balearic Islands. Our approach used was similar to that described above for the eight MS not featured in the Trivago (2015) index; we conducted Trivago searches for each of the Balearic Island's four main islands; Majorca, Ibiza, Menorca and Formentera and then calculated a weighted average cost per night based on each island's population.[203] Next, we converted the prices, that were in British Pounds, to Euros using the European Central Bank GBP:EUR spot rate for 2015, and divided our weighted occupancy charge by our weighted average cost per night to obtain an average percentage charge. As above, we use this estimated tax as a percentage of the room rate as representative of the average charge borne by a business traveller.

3. To find the appropriate rate for leisure tourists, we accounted for the fact that under 16 year olds are exempt from the tax, using the same method discussed above for MS. We then weighted the business tourist rate and leisure tourist rate, based on the levels of business and leisure spending in the Balearic Islands, to arrive at our composite percentage rate.

The final stage in our approach is to set assumptions on the pass-through of taxes to prices and the price elasticity of tourism demand. For the pass-through rate, we assumed the same level of pass-through (60%) as before. In terms of the price elasticity of tourism demand, however, we used more specific elasticities based on empirical research on our case study locations. For the case studies therefore, instead of splitting elasticity

[201] Government of the Balearic Islands, 2017
[202] caib.es, 2015
[203] Statista, 2016

by tourism type as above in Table 21, we instead use a single elasticity for all tourism.

In the case of our Cyprus case study, we applied a country-specific price elasticity of tourism demand of -0.2[204], instead of applying our general elasticity assumptions, described in the previous subsection. Given the high share of coastal tourism in Cyprus, our estimated elasticity for Cyprus in our national-level analysis was relatively high suggesting elastic demand. However, specific research on Cyprus in fact finds inelastic demand in Cyprus suggesting that, despite high competition for coastal tourism, tourism demand is not as sensitive to a change in price of a holiday in Cyprus.

Similarly for Paris, a country specific price elasticity of tourism demand of -1.17 was applied, based on the long run elasticity of UK visitors to France.[205] This suggests relatively elastic demand for tourism in Paris, suggesting that a small change in price is likely to have a disproportionately large impact on demand. It could, however, be the case that the elasticity we have assumed is relatively higher than the average elasticity of demand for tourism in Paris. Our assumption is based on the responsiveness of British tourists to a change in price in France; given the relatively small distance between France and the UK, British tourists may be more sensitive than an average tourist to a change in price in France, for example compared to tourists who are traveling from further away. Therefore, in our discussion of our case study on Paris, we discuss the implications of assuming more inelastic demand.

Finally, for the Balearic Islands, based on literature we have assumed a price elasticity of tourism demand of -1.65[206], which suggests that demand for tourism in the Balearic Islands is highly sensitive to changes in price. This is in line with our findings that most coastal destinations tend to have demand which is relatively price elastic.

The price elasticities of tourism demand, and effective business, leisure and weighted average occupancy tax rates are given in the table below:

Table 21: Estimated price elasticity of tourism demand and effective tax rates for case study locations

	Price elasticity of demand	Effective occupancy tax rate		
Case study location	**Assumed elasticity**	**Effective occupancy tax on business travel**	**Effective occupancy tax on leisure travel**	**Weighted average occupancy tax**
Cyprus	-0.2	0.00%	0.00%	0.00%
Paris	-1.17	0.50%	0.41%	0.43%
Balearic Islands	-1.65	0.66%	0.56%	0.57%

Source: PwC using multiple sources

[204] Cleanthous,P., 2008
[205] Li, G., H. Song and S.F. Witt, 2006
[206] Garin-Munoz, T., Montero-Martin, L., 2007

4.4.1.5. Summary of inputs and outputs of the data tool

The table below summarises the inputs and outputs of the data tool discussed in detail in Sections 4.4.1.1-4.4.1.4 above. The data tool uses the inputs listed in the table below and reports the estimated impact of a change in occupancy taxes on sectoral and economy-wide GVA and employment.

Table 22: Inputs and outputs of the occupancy tax data tool

		Variables	Notation	Notes and derivations
Inputs	**Fixed inputs**	Occupancy tax rate, ad valorem standardised (%)	τ_t	Standardised figure derived from occupancy tax data collection and methodological assumptions that are outlined in detail in Section 4.4.1.3.
		VAT on accommodation	VAT_t	The current VAT rate on accommodation is used to estimate producer revenues in the sector (see below).
		Quantity demanded (tourist nights)	q_t	Data from Eurostat (2015b)
		Current consumer spending in accommodation (€)	$p_t^c q_t$	Data from the World Travel and Tourism Council (2016c) on total consumer spending with data on accommodation shares obtained from Eurostat (2015c). Note: p_t^c is the consumer price, which we can approximate by dividing total consumer spending by tourist nights (q_t)
		Producer prices (€)	p_t^p	$p_t^p = \left[p_t^c / (1 + (\tau_t + VAT_t))\right]$. Note: p_t^p is the producer price or pre-tax price per unit
		Producer revenues (€)	$p_t^p q_t$	Total producer revenues are estimated as the producer price multiplied by the number of tourist nights
		Sectoral employment per unit of revenue (jobs)	$emp_t^s / p_t^p q_t$	Data collected from the World Travel and Tourism Council (2016c) for the impact of the tourism industry, approximated for the accommodation sector using with data on accommodation shares obtained from Eurostat (2015c).

Impacts		Economy employment per unit of revenue (jobs)	$emp_t^e / p_t^p q_t$	Data collected from the World Travel and Tourism Council (2016c) for the impact of the tourism industry, approximated for the accommodation sector using with data on accommodation shares obtained from Eurostat (2015c).
		Sectoral GVA per unit of revenue (€)	$GVA_t^s / p_t^p q_t$	Data collected from the World Travel and Tourism Council (2016c) for the impact of the tourism industry, approximated for the accommodation sector using with data on accommodation shares obtained from Eurostat (2015c).
		Economy GVA per unit of revenue (€)	$GVA_t^e / p_t^p q_t$	Data collected from the World Travel and Tourism Council (2016c) for the impact of the tourism industry, approximated for the accommodation sector using with data on accommodation shares obtained from Eurostat (2015c).
	Variable inputs	Pass through	r	Restricted to $0 \leq r \leq 1$ (100%)
		Price elasticity of demand	ε	Based on literature, but flexible and can be set by the user
		New occupancy tax rate, ad valorem standardised (%)	τ_{t+1}	User chooses changes to parameters of the occupancy tax rate enabling the tool to estimate τ_{t+1}. The standardised rate is derived in the same way as for τ_t
	Consumers	New consumer price (€)	p_{t+1}^c	$p_{t+1}^c = f\left(p_t^c, r, \tau_t, \tau_{t+1}\right) = p_t^c[1 + r\,(\tau_{t+1} - \tau_t)/(1 + \tau_t)]$
		New quantity demanded (tourist nights)	q_{t+1}	$q_{t+1} = f\left(p_t^c, r, \tau_t, \tau_{t+1}, \varepsilon, q_t\right) = q_t\left[1 + \varepsilon\left(p_{t+1}^c - p_t^c\right)/p_t^c\right]$ Note: This is the same new quantity for producers
		Impact on consumer spending (€)	$\Delta(p_t^c q_t)$	$\Delta(p_t^c q_t) = p_{t+1}^c q_{t+1} - p_t^c q_t$
	Producers	New producer price (€)	p_{t+1}^p	$p_{t+1}^p = p_{t+1}^c / \left(1 + (\tau_{t+1} + VAT_t)\right)\big)$
		Impact on producer revenues (€)	$\Delta\left(p_t^p q_t\right)$	$\Delta\left(p_t^p q_t\right) = p_{t+1}^p q_{t+1} - p_t^p q_t$
	Government	Impact on total sectoral government revenue (€)	$\Delta\left(\tau_t p_t^p q_t\right)$	$\Delta\left(\tau_t p_t^p q_t\right) = \tau_{t+1} p_{t+1}^p q_{t+1} - \tau_t p_t^p q_t$

Outputs	**Reported outputs**	Impact on sectoral employment (jobs)	Δemp_t^s	$\Delta emp_t^s = \Delta(p_t^p q_t) * emp_t^s$
		Impact on total economy employment (jobs)	Δemp_t^e	$\Delta emp_t^e = \Delta(p_t^p q_t) * emp_t^e$
		Impact on sectoral GVA (€)	ΔGVA_t^s	$\Delta GVA_t^s = \Delta(p_t^p q_t) * GVA_t^s$
		Impact on total economy GVA	ΔGVA_t^e	$\Delta GVA_t^e = \Delta(p_t^p q_t) * GVA_t^e$

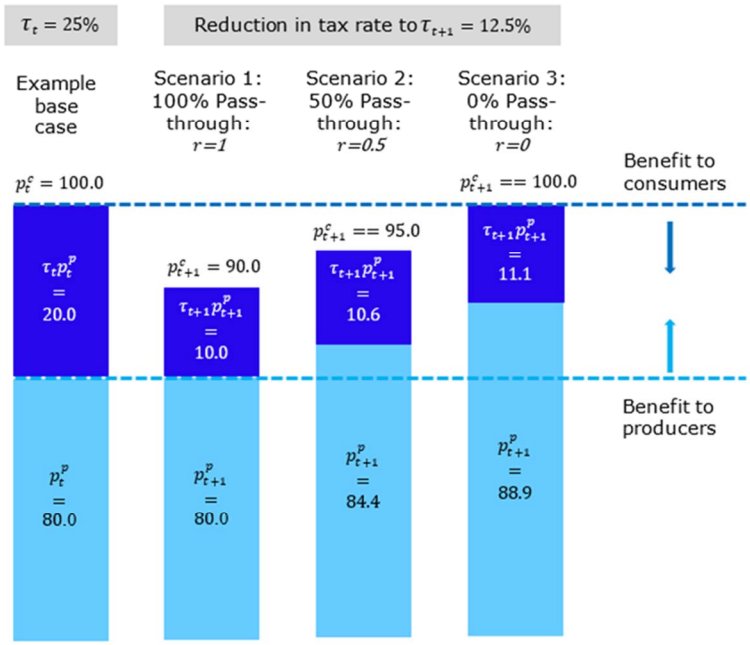
Source: PwC using multiple sources

The diagrams below provide an illustration of the impacts of a reduction in occupancy taxes under different assumptions on pass-through and elasticity, demonstrating the reliance of the results on these assumptions. As shown in Figure 25, the higher the rate of pass-through of a reduction in a tax, the greater the benefit to consumers from a reduction in consumer price, and the lower the benefit to producers through an increase in producer price.

Similarly, Figure 26 illustrates the sensitivity of the results to a change in elasticity. As illustrated, the impact of a reduction in occupancy taxes on consumer spending can be positive or negative depending on the relative increase in consumer demand to the fall in price. Under assumptions of elastic demand, consumer demand increases relatively more than the fall in price, particularly when pass-through is high, therefore total consumer spending is more likely to increase. The impact on producer revenues from a reduction in tax, on the other hand, is always positive. This is because producer revenues are a function of the producer price and quantity demanded; as demonstrated in Figure 25, the impact on producer price from a reduction in tax is always greater or equal to 0, while at the same time, assuming the elasticity of demand is always negative (i.e. demand curves are downward-sloping and a reduction in price will always increase demand), the impact on quantity demanded will also always be positive. The extent to which producer revenues increase as a result of a reduction in tax depends on the rate of pass-through, which determines the price received by producers, and the elasticity of demand, which determines the impact on quantity.

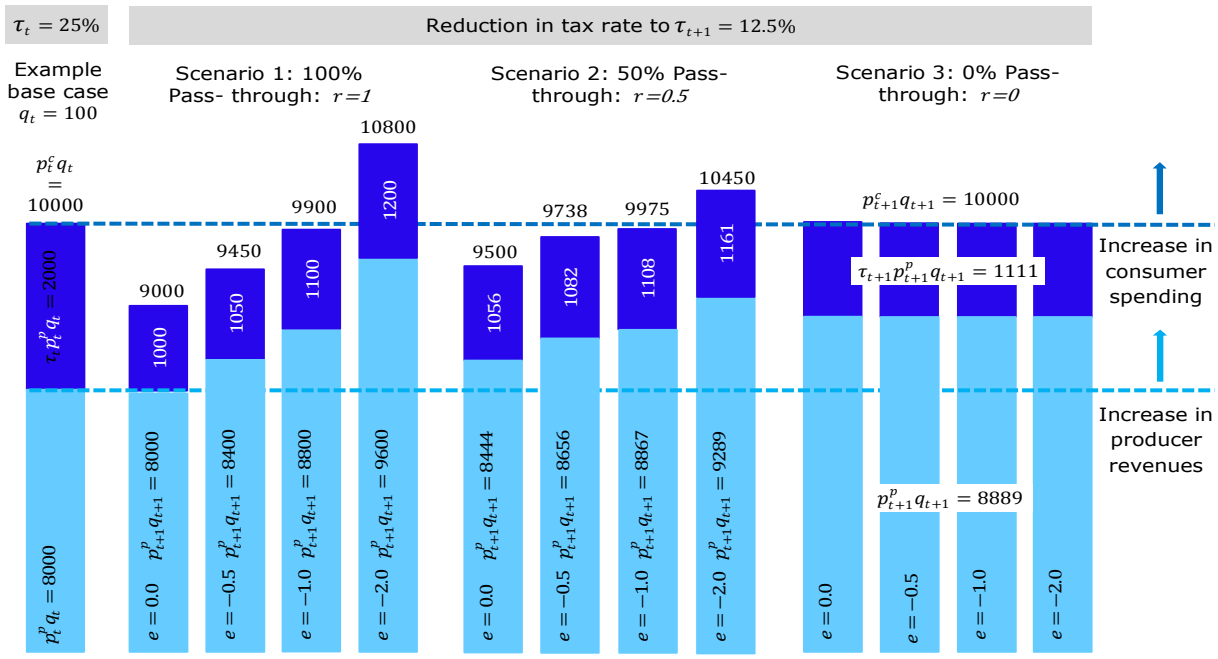
The diagrams below are illustrative and assume no VAT in the sector which would widen the gap between the consumer price (p^c) and the producer price (p^p). In Section 4.4.2, we present estimated impacts for each MS of a hypothetical change in occupancy taxes, under assumptions on pass-through and the price elasticity of tourism demand.

Figure 25: Illustration of the effect on price of a reduction in occupancy taxes under different assumptions on pass-through



Source: PwC analysis

Figure 26: Illustration of the effect on consumer spending, producer revenue and tax revenue of a reduction in occupancy taxes under different assumptions on the price elasticity of tourism demand



Source: PwC analysis

4.4.1.6. Caveats

The data tool estimates the impacts of a change in tourism taxes levied on the accommodation sector on GVA and jobs in the sector and on the wider economy. The tool is also flexible in allowing the user to change assumptions on the level of pass-through, the elasticity of tourism demand to a change in price, and MS specific taxes. It draws on existing research by the WTTC on the contribution of tourism and does not directly model the effects of a change in tax and the channels through which this would flow through the sector and the economy.

One limitation of the tool is that it does not have the capability to capture the interactive effects of different types of taxes, nor does it allow us to assess how an increase in tax in one MS affects the competitiveness of another. The impacts captured are also gross, rather than net (i.e. they do not account for the jobs or economic activity that the tourism sector may displace from other parts of the economy if taxes on the sector are reduced). A more sophisticated model, such as a Computable General Equilibrium (CGE) model, would be needed to capture these effects.

Given the static, partial equilibrium nature of the tool, the tool should only be used to assess the potential impact of marginal changes in occupancy taxes. With significant changes in policy, there will be large macroeconomic general equilibrium impacts over time which are not captured. Again, more sophisticated models would be needed to capture these impacts.

Furthermore, our approach looks specifically at the direct impact on the accommodation sector. In doing so, it does not account for the fact that a change in spending by tourists in accommodation could impact on spending by tourists in other tourism sectors such as transport or food and beverages. Further assumptions will be required to estimate these impacts and they are therefore not included in our proposed approach.

Our composite index for occupancy taxes is also developed on the basis of a number of simplifying assumptions, as discussed above. For example, it seeks to capture the average charge paid by a representative tourist on a per night basis. However, our index does not pick up additional nuances in the occupancy tax structure, for example where rates are reduced or capped for longer stays.

Overall, the tool is designed to provide an assessment of the potential direction and magnitude of impacts of a marginal change in occupancy taxes. The results are only indicative and more sophisticated modelling approaches should be used to fully evaluate the impact of a proposed change in policy, accounting for cross-sector and cross-border effects in a general equilibrium framework.

4.4.2. Findings for the EU-28

In this section, we discuss key findings from our analysis for EU MS. Our analysis on the three specific case study locations is provided in the respective sections of Chapter 3.

As discussed, with occupancy taxes, there are a number of levers we could alter to assess the resulting economic impact. As a number of MS do not currently levy occupancy taxes, for comparable analysis we have considered the potential impacts from increasing the levy (or introducing a levy, where applicable). The magnitude of the results would remain the same for the same proportional decrease in tax, but the direction of impact will be reversed.

For simplicity, we have assessed the impact leaving the structure of the tax the same (for example, the regions to which the tax applies and discounts offered to children) and changing only the level of charge as follows:

- For countries with no existing charge, we have introduced a 3% room charge;
- For countries with a charge levied as a percentage of the room rate (Hungary and Romania), we have increased the charge by 1 percentage point;
- For countries with a fixed charge which does not vary by accommodation type, we have increased the charge by €0.5; and
- For all remaining countries with a fixed charge which varies by accommodation type, we have increased the minimum and maximum charges by €0.5.

In addition, for Bulgaria where there is an additional one-off charge in Sofia, we assume this remains the same.

The estimated economic impacts from the above changes in the occupancy tax rate are shown in Table 23 and Table 24 below. Users of the tool are able to change other parameters of the occupancy tax structure to assess the impact.

As a result of the differences in the ways in which occupancy taxes are levied, it is difficult to compare the impacts of a change across MS. However, we can consider countries which levy the tax in a similar way to assess some of the differential impacts. For example, considering countries which levy a fixed charge which varies by accommodation type, we can see that countries such as Malta with a high share of coastal tourism are more affected by a change in tax than, for example, Austria where non-coastal and business tourism dominate. As a result, a similar increase in tax (in percentage points) results in a smaller negative impact on producer revenues in Austria than in Malta. A similar comparison between Cyprus and Luxembourg reveals the same findings; both countries currently do not levy occupancy charges but the introduction of a 3% charge has a large negative impact in Cyprus on producer revenues given the higher share of coastal tourists.

In terms of the impact on tourism spending, the findings illustrate that the impact on total spending from an increase in tax can be positive or negative, depending on the relative shares of different groups of tourists. In countries with a large share of coastal tourism, for example Cyprus, Greece and Spain, our hypothetical increase in occupancy taxes is expected to decrease tourism spending. This is because the increase in price is offset by a substantial decrease in quantity demanded due to the high elasticity of demand for coastal tourism. On the other hand, for countries with a larger share of non-

coastal or business tourism, the findings are somewhat counterintuitive as an increase in taxes is expected to increase total spending. In the case of these countries, the decrease in demand as a result of the higher price is not enough to offset the impact of the higher price paid per unit. Therefore, the impact on total spending is positive, despite the fall in demand.

However, regardless of whether the impact on tourism spending is positive or negative, the impact on producer revenues is always negative in response to an increase in tax (and vice versa), as discussed in Section 4.4.1.1. The relative impact on producer revenues depends on the relative shares of business, coastal and non-coastal tourism and the rate of pass-through.

Table 24 presents the estimated absolute impact on GVA and employment at the sectoral and economy-wide level as a result of the hypothetical change in occupancy taxes. By construction, the percentage impact on producer revenue is equivalent to the percentage impact on GVA and employment. The absolute impact depends on the current contribution of each unit of revenue in the accommodation sector to GVA and employment, as discussed above. Therefore, larger economies with a large tourism industry in absolute terms, for example the United Kingdom, are estimated to have a larger absolute effect from the hypothetical change in tax.

Table 23: Estimated impacts on sectoral spending and revenues from a change in occupancy taxes

Member State	Change in tax			Impacts	
	Current occupancy tax	New occupancy tax	Change in effective tax rate (% points)	Change in tourism spending in accommodation (%)	Change in producer revenues in accommodation (%)*
Austria	€0.15-€2.18	€0.65-€2.68	0.35	0.11%	-0.20%
Belgium	€0.53-€7.50	€1.03-€8.00	0.39	0.09%	-0.26%
Bulgaria	€0.27-€0.94	€0.60-€2.03	0.71	0.05%	-0.58%
Croatia	€0.53-€7.52	€0.77-€1.44	0.39	-0.05%	-0.40%
Cyprus	No tax	3%	1.62	-0.26%	-1.72%
Czech Republic	Up to €1	€0.00-€1.50	0.23	0.07%	-0.13%
Denmark	No tax	3%	2.08	0.06%	-1.58%
Estonia	No tax	3%	1.85	0.00%	-1.67%
Finland	No tax	3%	1.94	0.34%	-1.40%
France	€0.22-€3.30	€0.72-€3.80	0.25	0.04%	-0.18%
Germany	€0.25-€5.00	€0.75-€5.50	0.46	0.11%	-0.31%
Greece	No tax	3%	1.60	-0.25%	-1.64%
Hungary	4%	5%	1.00	0.28%	-0.53%
Ireland	No tax	3%	1.94	0.17%	-1.59%
Italy	€0.50-€7.00	€1.00-€7.50	0.31	0.03%	-0.24%
Latvia	No tax	3%	1.71	-0.11%	-1.61%
Lithuania	€0.30-€0.60	€0.80-€11.10	0.10	0.02%	-0.07%
Luxembourg	No tax	3%	1.69	0.57%	-1.06%
Malta	€0.50	€1.00	0.30	-0.04%	-0.32%
Netherlands	€0.55-€5.75	€1.05-€6.25	0.27	0.06%	-0.19%
Poland	€0.37-€0.92	€0.87-€1.42	0.62	0.13%	-0.43%

Portugal	€1.00	€1.50	0.10	-0.01%	-0.10%
Romania	1%	2%	0.61	0.16%	-0.40%
Slovak Republic	€0.50-€1.65	€1.00-€2.15	0.88	0.26%	-0.46%
Slovenia	€0.60-€1.25	€1.10-€1.75	0.47	0.10%	-0.32%
Spain	€0.45-€2.25	€0.95-€2.75	0.31	-0.01%	-0.29%
Sweden	No tax	3%	2.35	0.44%	-1.63%
United Kingdom	No tax	3%	2.05	0.32%	-1.37%

Source: PwC, using various sources
Note: By construction, the percentage change in producer revenues in the accommodation sector is equivalent to the percentage change in GDP and employment at the sectoral and economy-wide levels

Table 24: Estimated economic impacts from a change in occupancy taxes

Member State	Sectoral impact on the accommodation sector		Economy-wide impact	
	GDP impact (Local currency, millions)	Employment impact (number of jobs)	GDP impact (Local currency, millions)	Employment impact (number of jobs)
Austria	-17	-240	-48	-650
Belgium	-10	-120	-27	-310
Bulgaria	-5	-150	-17	-540
Croatia	-37	-140	-85	-320
Cyprus	-7	-140	-20	-430
Czech Republic	-35	-60	-107	-140
Denmark	-236	-480	-809	-1,250
Estonia	-3	-100	-13	-400
Finland	-12	-140	-55	-690
France	-39	-570	-95	-1,340
Germany	-154	-3,830	419	-7,550
Greece	-36	-1,160	-90	-2,350
Hungary	-3,271	-600	-8,330	-1,050
Ireland	-29	-230	-90	-710
Italy	-77	-1,230	-184	-2,840
Latvia	-2	-80	-5	-170
Lithuania	-0.2	-10	-0.6	-20
Luxembourg	-3	-20	-8	-60
Malta	-1	-30	-3	-50
Netherlands	-11	-370	-30	-560
Poland	-45	-410	-111	-950
Portugal	-3	-80	-7	-200
Romania	-9	-180	-36	-470
Slovak Republic	-3	-100	-8	-240
Slovenia	-2	-50	-8	-160
Spain	-40	-610	-112	-1,870
Sweden	-319	-500	-1,217	-1,570
United Kingdom	-376	-9,010	-1,185	-23,140

Source: PwC, using various sources
Note: By construction, the percentage change in producer revenues in the accommodation sector is

equivalent to the percentage change in GDP and employment at the sectoral and economy-wide levels

Table 25 below presents a sensitivity analysis on assumptions on the level of pass-through and the price elasticity of tourism demand. We assume the same increase in occupancy taxes as above and assess the impact on tourism revenues under different assumptions.

Increasing the level of pass-through from 60% to 100%, results in a lower percentage change in the price received by producers. However, at the same time, the price paid by consumers increases by a higher percentage with an increase in tax. As a result, the quantity demanded decreases to a greater extent. The overall impact of a higher pass-through rate on producer revenues depends on the relative impact on producer price and quantity. In countries with elastic demand, for example, countries with a high share of leisure tourism such as Cyprus, the relatively lower impact on producer price is offset by the larger impact on demand. Therefore, the negative impact on producer revenues is larger with a higher rate of pass-through.

Changing the assumptions on elasticity also has a varying impact on MS depending on the extent to which they rely on different types of tourism. Decreasing the price elasticity of business tourism demand from -0.35 to -0.1, for example, reduces the economic impact of countries which have a large share of business tourism. By assuming that business tourists are less responsive to a change in price, countries such as Sweden are estimated to be less impacted where the purpose of travel for the majority of tourists is business. On the other hand, for countries such as Greece where only 7% of tourists are business travellers, the estimated impact from changing the elasticity of business tourism is marginal.

Table 25: % change in producer revenues and GDP and employment at the sectoral and economy-wide levels from an increase in occupancy taxes under different assumptions

Member State	% change in producer revenues*			
	Original assumptions	Pass-through: 100% (previously 60%)	Elasticity of business tourism: -0.1 (previously -0.35)	Elasticity of leisure (coastal) tourism: -1.5 (previously -1.39)
Austria	-0.20%	-0.13%	-0.19%	-0.20%
Belgium	-0.26%	-0.20%	-0.25%	-0.26%
Bulgaria	-0.58%	-0.55%	-0.56%	-0.60%
Croatia	-0.40%	-0.43%	-0.39%	-0.42%
Cyprus	-1.72%	-1.90%	-1.70%	-1.80%
Czech Republic	-0.13%	-0.08%	-0.12%	-0.13%
Denmark	-1.58%	-1.56%	-1.49%	-1.64%
Estonia	-1.67%	-1.68%	-1.61%	-1.74%
Finland	-1.40%	-1.19%	-1.33%	-1.44%
France	-0.18%	-0.16%	-0.18%	-0.19%
Germany	-0.31%	-0.23%	-0.29%	-0.31%
Greece	-1.64%	-1.81%	-1.63%	-1.72%
Hungary	-0.53%	-0.34%	-0.52%	-0.53%
Ireland	-1.59%	-1.49%	-1.51%	-1.64%

Italy	-0.24%	-0.22%	-0.23%	-0.25%
Latvia	-1.61%	-1.70%	-1.58%	-1.69%
Lithuania	-0.07%	-0.05%	-0.07%	-0.07%
Luxembourg	-1.06%	-0.69%	-1.02%	-1.06%
Malta	-0.32%	-0.35%	-0.31%	-0.33%
Netherlands	-0.19%	-0.15%	-0.18%	-0.20%
Poland	-0.43%	-0.34%	-0.41%	-0.44%
Portugal	-0.10%	-0.11%	-0.10%	-0.11%
Romania	-0.40%	-0.29%	-0.37%	-0.40%
Slovak Republic	-0.46%	-0.29%	-0.43%	-0.46%
Slovenia	-0.32%	-0.25%	-0.31%	-0.32%
Spain	-0.29%	-0.30%	-0.29%	-0.30%
Sweden	-1.63%	-1.35%	-1.45%	-1.66%
United Kingdom	-1.37%	-1.16%	-1.27%	-1.40%

Source: PwC, using various sources
Note: By construction, the percentage change in producer revenues in the accommodation sector is equivalent to the percentage change in GDP and employment at the sectoral and economy-wide levels

4.5. Conclusions

The tourism industry contributes significantly to the EU economy and, as such, a reduction of general and/or specific taxes on tourism is expected to stimulate economic growth through direct, indirect and induced channels. While tourism taxes are often justified by governments as a means of addressing the negative externalities associated with tourism, academic literature and empirical evidence suggests that the impacts on businesses in the industry and the wider economy are arguably inordinately high. Tourism is also perhaps unique in comparison to other industries in its tax implications given that most tourist services are consumed at the destination rather than where the consumer normally resides. As a result, a tourist tax levied at the destination can be seen as a form of export tax which, from an economic perspective, can lead to market distortions, inefficiencies and ultimately a loss in consumer welfare.

The majority of EU MS already apply reduced VAT rates on consumption categories, therefore, the scope to reduce VAT rates is limited. In addition, there is a good case for not further reducing VAT rates from the current reduced levels to prevent distortionary cross-border effects. There is however greater scope for jurisdictions to adjust occupancy tax rates. We have therefore assessed the potential impacts of changing occupancy taxes using a simple data tool.

The extent to which a reduction in tourist taxes is expected to flow through to the wider economy, depends crucially on: (1) the level of pass-through of reduced taxes to consumer prices; and (2) the elasticity of demand with respect to prices. Academic research suggests both a high degree of pass-through, particularly in the long-run, and a high elasticity of demand, implying that a reduction in taxes levied on tourists is likely to have a disproportionately large positive impact on tourism flows and, as a result, on the

wider economy.

Findings from our analysis of a hypothetical change in the occupancy tax rate across MS indicate that countries are likely to be affected to different extents depending on the type of tourists they attract. Academic literature suggests that tourists are highly responsive to a change in price of a beach holiday, given the extensive competition and the wide range of alternative options. Countries in Southern Europe therefore which rely on coastal tourism are expected to be most adversely affected by an increase in tourist taxes, and, by the same token also stand to gain the most from a reduction in tourist taxes. On the other hand, countries which are frequently visited by business travellers are likely to be less affected by changes in taxes upwards or downwards.

Overall, literature and empirical analysis suggests that there is an economic case for reducing tourism taxes, particularly specific taxes such as occupancy taxes, in order to improve the competitiveness of tourist destinations. This is particularly the case where demand for tourism is elastic and therefore where a small change in price is likely to generate a substantial change in demand. However, a reduction in tourist taxes needs to be balanced against a short-term loss in fiscal revenues. Furthermore, although not explicitly measured in our quantitative analysis, cross-price elasticities (the impact on demand as prices change in competing destinations) are also important and emphasise the need for policy makers not to form their own tourism tax strategies in isolation.

5. RECOMMENDATIONS

In this chapter, we provide a set of recommendations emerging from our assessment of the tourism taxes levied by MS and our analysis of the economic impact of these taxes.

There are a number of reasons why governments introduce tourism taxes, both specific and general. Tourist taxes provide a significant source of revenue for many governments, particularly those which are heavily reliant on tourism. In addition, they can be seen as a means of correcting for the negative externalities associated with tourism. However, taxes introduce distortionary effects in markets and may negatively impact on the competitiveness of one tourist destination vis-a-vis another. Regulators have a key role to play in helping to maintain competitiveness in the tourism sector, and taxation policy is a core component of this. This is evident in the reduced rates of VAT on certain tourist sectors levied by several MS.

Taxation on tourism directly affects the price of visiting a destination, which is a key driver of tourism demand. However, there are other factors identified in the literature which also impact on demand, for example the quality of accommodation and other tourist activities offered.[207] Therefore, while from an economic perspective taxes are distortionary, revenues raised through taxes levied on tourists can be invested in improving the quality of tourism services as a means of increasing competitiveness, in turn benefiting the local tourism sector.

Overall, literature and empirical analysis suggests a strong case for reduced taxes on tourists in order to improve the competitiveness of tourist destinations and support the local tourism sector. Given the need to raise revenue on the one hand, and the need to maintain competitiveness on the other, policy makers need to carefully design the tax system so as to balance these conflicting objectives.

In this chapter we draw on the findings from our case studies and economic analysis to provide recommendations for EU MS on optimising the tax system in order to maintain the competitiveness of EU tourism. Section 5.1 briefly provides general considerations around optimising the system of taxation of the tourism sector, and Section 5.2 then provides more specific recommendations relating to tourism taxes.

5.1. Optimising the tax system for tourism

There are arguments for levying taxes on the tourism sector

There are a number of arguments put forward by academics and governments in favour of taxes on tourism, largely hinging on the use of taxes to correct for the negative externalities tourism can cause. For example, damage to the environment from tourist activity is not a cost fully borne by tourists, and hence is not factored into the decision-making process of tourists in choosing holiday destinations, which may result in more tourism being purchased than is socially optimal. Taxation is considered to be a potential

[207] See for example Dwyer and Kim (2010) and Culiuc (2014)

lever which policy makers can use to pass the environment cost of tourism back to tourists.

From a political perspective, taxes on tourism can be seen as ensuring that the sector contributes in a fair way to the burden placed by tourists on local infrastructure, including – in recent years – the dynamics in the housing market and the political pressure to maintain or improve housing affordability in large cities.

However the sector is particularly price sensitive, and it is important that the tax regime does not hamper its competitiveness

Economic theory suggests that taxes can have a distortionary effect on markets. In addition, taxes can have a destabilising effect on businesses operating in the tourism sector, which often operate on very low profit margins.

Tourism is also perhaps unique in comparison to other industries in its tax implications given that most tourist services are consumed at the destination rather than where the consumer normally resides. As a result, a tourist tax levied at the destination can be seen as a form of export tax which, from an economic perspective, could be seen as a form of anti-competitive behaviour which can lead to market distortions, inefficiencies and ultimately a loss in consumer welfare. In addition, a change in taxes on tourism affects not only tourism exports (i.e. visitors and associated revenue from abroad) but also the decisions of domestic tourists.

Furthermore, while the price sensitivity of tourists to a change in price is driven by a number of factors including location-specific factors and the purpose of travel of the tourists themselves, the price sensitivity of tourism in general has been increasing. With the development of price comparison sites and the availability of online ratings which provide better information about quality, consumers have become far better informed about the price and quality of competing destinations, influencing their decisions on holiday destinations. It is therefore becoming more important than ever for countries to maintain their price competitiveness in attracting tourists.

There is an argument for keeping taxes on the sector low, but general tax levers provide less scope for adjustment than tourism specific taxes

A common theme arising from the report is that the level of competitiveness of a country's tourism sector depends on both price related and non-price related factors, both of which are directly affected by taxation. Whilst tourism specific taxes directly affect the price of tourism, revenue from any tax base may be used to improve the non-price related factors such as infrastructure and cultural sites. Aside from VAT, general taxes are not used to promote tourism sector competitiveness.

Based on the principle of non-discrimination and fair competition policies, MS are generally not allowed to design tax policies in a way that may distort the market and

result in unfair economic advantages to a specific operator and sector.[208] MS therefore have very little scope to use general taxes as a lever for the promotion of the tourism sector, and this limitation is reflected in the rates we observe across the EU. Even in those cases where MS offer targeted support to particular businesses through tax incentives, limitations on resources and information tend to mean such support is targeted at criteria such as firm age and size, rather than a specific firms, sectors or technologies.[209]

For countries outside the EU where there are less restrictive tax design principles, we found no significant evidence to suggest that general taxes at their standard rates were used to target specific sector. It is worth noting, however, that when governments distinguish corporate income tax rates based on revenue/size criteria, this is likely to indirectly target the tourism sector. A disproportionate number of tourism operators may be classified as a small or medium sized enterprise (SME), so low corporate tax rates for SMEs are likely to have some positive impact on the sector, even where such policies are not intended to target tourism.

The one exception to this is VAT. However, as we have already outlined, most MS already apply a reduced rate of VAT to most goods and services closely associated with tourism activity, and as a result have very little scope to adjust these further given the legal constraints on VAT rates. For example, if MS wished to further reduce VAT rates on accommodation without any change to, or addition of new, reduced rates, only the following reduction options are possible in practice:

Table 26: Accommodation VAT rate reductions possible within existing rate structures

Member State	Current Rate	Possible reduced rate(s)	Member State	Current Rate	Possible reduced rate(s)
Austria	13%	**10%**	Italy	10%	**5%**
Belgium	6%	**-**	Latvia	12%	**-**
Bulgaria	9%	**-**	Lithuania	9%	**5%**
Croatia	13%	**5%**	Luxembourg	3%	**-**
Cyprus	9%	**5%**	Malta	7%	**5%**
Czech Rep.	15%	**10%**	Netherlands	6%	**-**
Denmark	25%	**-**	Poland	8%	**5%**
Estonia	9%	**-**	Portugal	6%	**-**
Finland	10%	**-**	Romania	9%	**5%**
France	10%	**5.5%**	Slovakia	20%	**-**
Germany	7%	**-**	Slovenia	9.5%	**-**
Greece	13%	**6%**	Spain	10%	**-**
Hungary	18%	**5%**	Sweden	12%	**6%**
Ireland	9%	**-**	UK	20%	**5%**

Overall, therefore, there is little scope for MS to consider encouraging greater

[208] EPRS, Tax Policy in the EU, 2015
[209] DG TAXUD, PwC, CASE and IHS, 2017

competitiveness of their tourism sector through the use of general taxes. Instead, they might consider tourism specific taxes – notably occupancy taxes – as a lever for adjusting the tax burden on the sector. Occupancy taxes provide much greater flexibility in adjusting the tax rates and base and are not subject to the same practical and legal constraints as general taxes. The following section outlines a number of specific recommendations that MS should consider when reforming or introducing tourism taxes.

5.2. Specific recommendations

5.2.1. Reduced taxes on tourism can increase the competitiveness of tourist destinations and bring wider economic benefits. However this needs to be balanced against a loss in short-term government revenues, and cross-sector and cross-border implications

The tourism industry contributes significantly to the EU economy and, as such, a reduction in general and/or specific taxes on tourism are expected to stimulate economic growth through direct, indirect and induced channels.

The majority of EU MS already apply reduced VAT rates on consumption categories, therefore, the scope to reduce VAT rates to stimulate tourism demand is limited. In addition, there is a good case for not further reducing VAT rates from the current reduced levels to prevent distortionary cross-border effects. As VAT is borne by residents and non-residents alike, it also constitutes a significant tax base, thus reducing rates can have a significant impact on tax revenues.

There is however greater scope for jurisdictions to adjust occupancy tax rates. In our analysis, we have assessed the potential impacts of changing occupancy taxes using a simple data tool. Our economic analysis indicates that the extent to which a reduction in tourist taxes is expected to flow through to the wider economy, depends crucially on: (1) the level of pass-through of reduced taxes to consumer prices; and (2) the elasticity of demand with respect to prices. Academic research suggests both a high degree of pass-through, particularly in the long-run, and a high elasticity of demand, particularly for coastal tourist destinations. This implies that a reduction in taxes levied on tourists is likely to have a disproportionately large positive impact on tourism flows and, as a result, on the wider economy.

Findings from our analysis of a hypothetical change in the occupancy tax rate across MS indicate that countries are likely to be affected to different extents depending on the type of tourists they attract. Academic literature suggests that tourists are highly responsive to a change in price of a beach holiday, given the extensive competition and the wide range of alternative options. Countries in Southern Europe therefore which rely on coastal tourism are expected to be most adversely affected by an increase in tourist taxes, and, by the same token also stand to gain the most from a reduction in tourist taxes. For these countries, a small reduction in tax is expected to have a disproportionate effect on demand and as a result, on producer revenues in the tourism industry and on the wider economy. On the other hand, countries which are frequently visited by business travellers are likely to be less affected by changes in taxes upwards or

downwards.

Therefore, our analysis suggests a strong economic case for countries which compete heavily for tourists to reduce specific taxes on the sector, increasing their competitiveness and allowing them to draw in more tourists. However, a reduction in tourist taxes needs to be balanced against a short-term loss in fiscal revenues. Where government revenues are invested in the tourism sector this is particularly important, as a reduction in revenues can impact quality. Our review of tourism literature finds that quality is another crucial factor influencing tourism demand in addition to price, therefore, a reduction in quality can have a similar negative effect on tourist flows as an increase in price.

Furthermore, while it may be economically beneficial for an individual country to reduce the tax rates in its tourism sector, to encourage increased tourism flows and wider benefits for the economy, this has cross-border implications for tourism. MS therefore need to be mindful of existing tax rates in competing destinations which also influence demand, and potentially consider coordinated tax policies to avoid a race to the bottom.

5.2.2. The perceived uniqueness of a location has a bearing on the effectiveness of its tax regime, and governments can influence this

A common theme throughout this study is that the perceived uniqueness of a destination plays an important role in determining how flexible leisure visitors are in choosing it as a holiday destination (the elasticity of demand for tourism in a location). Locations such as Paris, which offer well-known, highly unique landmarks and cultural attractions, are seen as having a relatively price inelastic demand from leisure visitors, whilst locations that may be considered as having substitutes, such as Mediterranean sun-and-sea destinations, are seen as having a relatively price elastic demand.

With the availability of online price comparison tools, holiday planners are increasingly sensitive to prices, as they are more able to readily compare holiday packages between similar destinations - heightening the impact of prices on location decisions. This is often referred to as the cross price elasticity of demand, which measures how much demand in one destination is affected by a price variation in a substitutable location.

Given the obvious distinction in uniqueness between the marketable elements of different destinations and the consequent impact on the price elasticity of that location, there are clear implications for the appropriateness of various taxes and tax levels. Policy makers should be cognisant of these factors when designing and implementing tourism taxes in their respective economies. To a degree this can already be observed, as locations which are considered to have a more unique tourism offering appear to apply more complex tax regimes on their tourism sector.

The perception of uniqueness is not a static phenomenon and it can evolve over time – either naturally, or with some intentional encouragement. The reality is that all destinations are unique in some way – be it in geography, history, culture or a combination of them all – but it is whether or not they are *perceived* by tourists to be

unique that has a bearing on how price sensitive tourists are to visiting. Governments can help positively shift this perception by supporting the promotion of the country's unique aspects, either through supportive regulation (e.g. opening up unique geographical attractions to sustainable tourism), distinctive international tourism marketing, or investment in the necessary infrastructure. Key to achieving this is a well-functioning tax system, which provides governments with the revenue they require to deliver this support.

Interestingly in the EU context, this uniqueness element is the main factor contributing to European countries' leading positions in the WEF tourism rankings, as opposed to price competitiveness.

5.2.3. How a tourist tax is introduced and administered has important implications for how the sector responds to it

In addition to the policy parameters (the base, rate, etc.) of a particular tax, we have seen from this study that the way a tax is both introduced and administered can have significant implications for the way in which the sector responds to it. This is perhaps particularly true for tourism taxes as changes to the industry are very widely publicised, there are many popular price comparison and review tools readily available to prospective tourists, and the taxes themselves are more visible to the general public than most taxes.

Drawing on the case of the natural experiment in the Balearic Islands and general principles for good tax policy, it is clear that governments can increase the public and sectoral support for a new tax through the way in which that tax is introduced. Measures to increase buy-in from the sector should include early notification of the government's intention to look at introducing such a tax - to allow the sector to plan ahead and inform customers as necessary - and a process of proper engagement with stakeholders. In addition to increasing buy-in, this also helps to ensure the tax that is eventually introduced is fit-for-purpose.

Such taxes may also be better received and accepted by the industry if the revenues raised are credibly set aside (hypothecated) to support the tourism sector. While on the one hand it may be argued that hypothecation artificially prevents government finance from being put to its best use (irrespective of which sector the revenue was generate from), on the other hand real political constraints may mean that without a promise of increased investment in the sector, policy makers could struggle to achieve the support they require to introduce such a tax in the first place. We see few examples of hypothecation in the data itself, however, suggesting that either it is not considered necessary for the introduction of tourism taxes or has not been utilised to its full potential.

Where hypothecation does occur, its benefits can be further strengthened by including key industry stakeholders in the actual decision-making process for the expenditure itself, as is the case for the Balearic Islands' new Sustainable Tourism Tax (which includes representatives of retail and employer's associations). Such transparency around

the tax and how it is spent can also help to build an understanding among consumers and reduce the frustration they may experience at being charged something they may not have been aware of or understood the purpose of.

Governments looking to introduce an occupancy tax should consider running a strong public consultation process well in advance of its introduction. Those designing or redesigning the process around how the tax is administered could consider measures such as those described above to increase support and buy-in from the industry, such as improved transparency around how the revenue is spent and potentially even include industry representatives in the decision-making process.

5.2.4. Compliance issues should also be considered to avoid occupancy taxes from becoming a burden on compliant businesses

As we outlined earlier, the rise of the sharing economy has led to individual and small-scale providers of accommodation playing an increasingly significant role in the tourism accommodation sector. In many cases these services are provided by individuals or families who do not use professional accounting services and who may not be fully aware of – or know how to comply with – their legal obligation to collect and remit occupancy taxes back to the relevant tax authorities.

Given the size and number of these providers, it can also be hard for the tax authorities to raise awareness of obligations, support providers to comply with them, and police non-compliance. This introduces a degree of inequity between the effective tax burden on compliant businesses and those who do not comply with the relevant tax obligations; distorting the market, reducing tax morale and leading to a loss of revenues for the government.

In response to this, tax authorities have begun to make use of the establishment of large shared platform providers (such as Airbnb and HomeAway) to facilitate the automated collection of occupancy taxes. This involves the platform provider collecting the appropriate taxes from the tourist at the time of payment and then remitting them back to the tax authority, without any direct involvement from the accommodation provider themselves. Airbnb, for example, now collects occupancy taxes on behalf of four EU MS (France, Italy, the Netherlands and Portugal).[210]

In addition to supporting compliance through automated processes such as these, tax authorities should also consider the effectiveness of measures to deter non-compliance and ensure non-compliant businesses are not generally favoured in practice by poor enforcement or inadequate punishment for active non-compliance.

The combination of supporting providers to comply with the tax regime through the automation of the tax collection procedure and effective measures to deter non-compliance will help to ensure the tax is perceived as fair and equitable, prevent compliant businesses from being unduly penalised, and ensure that the right revenues

[210] Airbnb website, 2017

are collected.

5.2.5. The visibility of occupancy taxes is not just an administrative issue, but may also have implications for consumer behaviour

One administrative element of occupancy taxes that we have covered elsewhere in this report is that they are typically due on checkout and cannot be pre-paid as part of room rates. It is not clear why this is the case, but it may be related to the prevalence of occupancy taxes in the U.S. and the standard practice of applying additional taxes/charges (e.g. sales tax, tips) at the time of payment there. This makes them unusual compared to other tourism-related taxes like departure tax and VAT, which are part of the overall price paid by a tourist at the time they book their travel. Although the overall cost to the tourist would be the same irrespective of whether the tax is paid upfront or on checkout, the *experience* of paying the tax is quite different. This may have consequences for tourist behaviour.

Although it is very difficult to test for this impact quantitatively, qualitative evidence suggests that this can have both a psychological and administrative impact on tourists, who can be frustrated by the 'hidden' charges they had not planned for, and who may not have retained enough local currency by the end of their stay to readily pay the tax. This makes it difficult for tourists to budget for their holidays in advance, and may be particularly frustrating for purchasers of all-inclusive package holidays who discover additional charges they had not planned for. This notion is reflected in numerous newspaper articles and discussions on travel website fora.[211]

For those who are first-time visitors to a location where an occupancy tax is charged - and who are not already aware of the tax - the total cost of accommodation will appear lower as they will not factor it into their travel decisions. For repeat travellers, however, we would expect to see both the total cost (including accommodation cost and accommodation tax) and the 'hassle factor' (associated with retaining enough local currency to pay the tax) factored into their travel decisions. This may deter marginal travellers from a particular location and, depending on the scale of this 'hassle factor', may even have an impact on the number of tourists visiting a location.

Although it may prolong the impacts of any change in occupancy taxes (to the extent that tourists book and pay for their holidays in advance), these negative impacts can be mitigated by incorporating the occupancy tax into the upfront payment taken by the accommodation provider. As noted in the previous recommendation, this is how the tax is administered in locations where it is collected by shared accommodation platforms like Airbnb while for hotels in these locations it is still payable on checkout.

MS looking to introduce an occupancy tax - or to make their existing taxes more tourist-friendly - should consider administering the tax in such a way as to improve transparency and avoid forcing tourists to make the payment at the end of their visit. Accommodation providers could be utilised to facilitate the collection of the tax at the time of sale rather

[211] See, for example: Trip Advisor forum, 2012

than the time of checkout.

5.2.6. Occupancy taxes inherently favour some tourists over others, and should therefore be designed or reformed with equity issues in mind

A notable element of most existing occupancy taxes is the way in which they favour certain groups of tourists over another, for example business tourists vs. leisure tourists, long-stay visitors vs. short-stay visitors, or younger guests vs. older guests. This may be a result of a specific exemption for a particular type of tourist or just inherent in the way the tax is levied, and demonstrates the flexibility that occupancy taxes provide in achieving various policy objectives.

For example, large groups sharing a room will find that a per-person per-night occupancy tax adds proportionately more to their overall room rate than a single business traveller. Of the 18 MS that levy occupancy taxes, 17 do this on a per-person per-night basis, and in the case of Berlin there is even an explicit exemption for business travellers. This means business and sole travellers pay less as a percentage of the room rate than families and groups.

If accommodation is being used as a mechanism for taxing tourism itself, it could be argued that this characteristic of occupancy taxes is more in line with their intended policy objectives. This is because in general more people exert more pressure on infrastructure, do more damage to the environment, and make more use of tourist related activities such as access to cultural sites and museums, which may justify a higher tax burden on larger groups.

While this may be the right outcome, governments looking to introduce or redesign an occupancy tax should explicitly consider these equity implications in the design of this tax. Although the occupancy tax rate may seem low, when administered on a per person per night basis, this can add up to a sizeable cost for leisure tourists who travel in larger groups (e.g. with family members).

There are examples of alternative tax structures that may be considered. Romania's occupancy tax, for example, is levied solely on basis of room rate rather than per person, per night. Many MS also offer some form of discount or exemption for children, with cut-off ages varying across MS.

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APPENDIX I: PRELIMINARY CASE STUDIES

As outlined in sections 3.1. and 3.2., a high-level literature review was initially conducted to identify Member States that stand out on the basis of their taxation of tourism, the strength of their tourism industry or recent improvements in the competitiveness of their tourism industry. On this basis we identified a shortlist of six potential best-practice locations to take forward for more detailed case study analysis (including desk research and interviews with local experts).

In addition to the final case studies presented in sections 3.3., 3.4. and 3.5., the following sections presents the other three case study locations that were selected for the shortlist: Austria, Berlin (Germany) and Croatia.

A. 1.1 Preliminary case study: Austria

Austria applies a broad range of taxes to the tourism sector, some of which are general and some of which are directly related to tourism. Austria makes for an interesting location in part due to its prominence as a European winter holiday destination.

Overview of tourism taxes in Austria						
Corporate Income Tax	Personal Income Tax	Property Tax	Value Added Tax	Occupancy Tax	Departure Tax	Other Taxes and Levies
25%	Up to 55% (42% at average income)	YES	20%, 13%, 10%	YES	YES	-

A.1.1.1. The tourism sector in Austria

Despite being one of the smaller countries in the EU by population size, Austria is the fifth most popular destination for tourists[212] and the fourth most tourism-intensive country in the EU.[213] The direct value added effect of tourism in Austria was estimated by the national statistics agency to be €17.59 billion in 2014, accounting for 5.3% of the country's GDP (with direct and indirect effects combined contributing 14.8% of GDP).[214] Austria's diverse offering of winter and summer tourism includes cultural cities, winter sports, mountaineering, wellness and spas, as well as holidays on its small scale farms. According to the Austrian National Tourist Office, while a slightly higher number of tourists visit Austria during the summer season (around 22 million, versus 18 million in the winter), revenues from tourism are higher during the winter season.[215]

The Austrian authorities keep extensive tourism statistics and according to these the total

[212] Eurostat, 2017a
[213] Eurostat, 2016a
[214] Statistik Austria, 2017
[215] Austrian National Tourist Office, 2016

number of overnight stays for tourists in Austria reached a record 141 million in 2016, comprised of 38 million resident visitor nights and 103 million international visitor nights. The majority of these international nights were from German tourists (53 million) - by far the most important tourist market for Austria and increasing at a rate of almost 5% per annum. The market for higher-end tourism continues to grow, with 36% of nights being spent at accommodation rated either four or five star.[216]

Vienna is the most popular city destination (followed by Salzburg and Innsbruck), with 15 million tourist nights in 2016 and a growing proportion of these being from the UK, Spain, France and China.[217] Winter tourism dominates in the mountainous regions, particularly in the western provinces. The province that receives the largest amount of tourism is Tyrol, where many of Austria's prestigious ski resorts are located, attracting around 35 million tourist nights alone (approximately a quarter of all tourist nights).[218] Tyrol has 36 local tourism associations and a coordinated Tyrolean Tourism Board, which actively promote and support tourism to the region.

Austria scores very well in the Tourism Competitiveness Index, ranked at 12th globally (6th in the EU). It is number one for tourist service infrastructure - which assesses the availability and quality of accommodation, resorts and entertainment facilities and the accessibility of services such as car rental and ATMs - and also scores particularly well on safety and security and environmental sustainability. It ranks relatively well on all other measures except for price competitiveness, for which Austria ranks just 132 out of 141 countries included in the index (although still ahead of Italy, Sweden, Denmark, France and the UK).

A.1.1.2. Taxes on tourism in Austria

As noted earlier, a fairly extensive range of general and tourism-specific taxes are applied to the tourism sector in Austria. These are outlined in further detail below.

Corporate and personal income taxes

Companies in Austria are taxed at a flat national rate of 25% on all profits. This rate has not changed in recent years and there are no local company taxes. Personal income is taxed at progressive rates up to a maximum of 55%, with a tax free threshold of €11,000. The 55% rate applies to income over €1 million per annum and is the second highest in the EU (falling just short of Sweden's combined 57% national and municipal rate). In line with this, the marginal rate facing an individual on the average wage faces the second highest marginal tax rate for average income earners, at 42%, which is higher than the top marginal rate levied in most MS.

Small companies (with annual sales of less than €255,000) can estimate their profits by a simplifying method, which reduces administrative costs significantly, but there are no

[216] Statistik Austria, 2017
[217] Vienna Tourist Board, 2017
[218] Eurostat, 2016b

special schemes or exemptions relating to tourism for either corporate or personal income tax.

Real estate tax

An annual levy tax is applied on all developed and undeveloped real estate. A nationally set base rate, varying from around 0.05% to 0.2% depending on the real estate type, is applied on an assessed value (which is typically substantially lower than market value), and municipalities then can apply a multiplier of up to 500% on this amount. For example, if the assessed value is €100,000 and a rate of 0.05% is applied, this yields €50 and, if increased by a 500% multiplier, would yield an annual tax of €250. Municipalities tend to apply the maximum rate.

Value-Added Tax (VAT)

Austria's standard rate for VAT is 20%. Like most MS, Austria applies a reduced rate to activities affecting the tourism sector; charging 13% for accommodation services and admission to amusement parks and sporting events, 10% for restaurant and catering services (excluding beverages, which attract the standard rate), and exempting admission to cultural services from VAT altogether.

Although the standard VAT rate has been stable in recent years, 2016 saw various changes to Austria's reduced rates, with a direct impact on the tourism sector. On 1 May 2016 the rate on accommodation rose from 10% to 13%, while the rate for restaurant and catering services (including hotel breakfasts) remained at the previous rate of 10%.[219]

Occupancy taxes

Various occupancy taxes apply across Austria, under different names and rates for each of Austria's nine provinces (e.g. Ortstaxe, Nächtigungstaxe, Tourismusabgabe, Aufenthaltsabgabe). These apply to all overnight accommodation, including caravans and campsites, with rates ranging from €0.15 to €2.18 per person, per night.[220] The revenues are used to support local tourism, including tourism infrastructure, financing events, and subsidising local amenities.

Energy-intensive hotels and restaurants can apply for a tax rebate on energy levies, which reduces their overall energy costs.

Air passenger duty/departure taxes

Travellers departing from Austrian airports are charged an air transport levy - a departure tax with revenues collected at the national level. This tax was introduced in 2011, with rates varying by flight distance. Short-haul passengers are charged €7 per trip, medium haul passengers €15 and long-haul passengers €35, with each country

[219] PricewaterhouseCoopers, 2015
[220] European Tour Operators Association, 2017

classified as either short- medium- or long-haul in legislation.[221]

Concluding remarks

Tourism in Austria is subject to a wide variety of taxes, and it is unsurprising that the country scores poorly in measures of tourism sector price competitiveness. It would be interesting to examine the aggregate impact of these taxes on the price competitiveness of the sector, and to explore the differences between the provincial occupancy taxes and their effects on each local tourism market.

A. 1.2 Preliminary case study: Berlin (Germany)

Like Paris, Berlin is a popular city-break destination, featuring in Eurostat's listing of the top 20 most popular EU destination regions. Unlike most of the other locations on that list, however, it has only become a major tourist destination relatively recently (following reunification) and thus has much in common with destinations in the newer MS.

Overview of tourism taxes in Berlin (Germany)						
Corporate Income Tax	Personal Income Tax	Property Tax	Value Added Tax	Occupancy Tax	Departure Tax	Other Taxes and Levies
30-33% (on average)	Up to 47.475% (40.5% at average income)	YES	19%, 7%	YES	YES	-

A.1.2.1. The tourism sector in Berlin

While large in absolute terms (€123.8bn), travel and tourism constitutes a relatively small proportion of the German economy as a whole (4.0%).[222] The relative significance of tourism to the economy of Berlin is higher than in Germany as a whole, estimated at 7% of the local economy in 2014.[223] This is unsurprising, given Berlin is one of the top tourist destinations in Europe. In 2016, over 12.7m tourist arrivals were recorded, purchasing over 31m nights' worth of tourist accommodation, with the bulk of this tourist traffic coming from elsewhere in Germany (7.7m arrivals and 16.9m nights). In terms of international tourist flows, the most common countries of origin for visits to Berlin were the UK (0.6m arrivals and 1.7m nights) and the USA (0.4m arrivals and 1.1m nights).

Berlin markets itself as a city-break destination, with a range of museums, galleries, and historical sites, coupled with a diverse nightlife scene.[224] The average duration of stay of 2.4 days in 2016 suggests a city that is popular as a short-break, weekend destination. This is facilitated by the high availability of low cost flights as well as integration into the domestic and international rail networks. Notably, of the 12.7m tourist arrivals in 2016,

[221] Federal Ministry of Finance of Austria, 2012
[222] World Travel and Tourism Council, 2017d
[223] Visit Berlin, 2015
[224] Visit Berlin, 2017

around 7.7m came from elsewhere in Germany, rather than internationally.[225] This contrasts to the predominantly international nature of inbound tourism to other popular European cities such as Paris, Barcelona, Venice and London.[226]

Germany as a whole scores very highly on the World Economic Forum's Travel and Tourism Competitiveness Index, ranking third overall behind Spain and France. The report highlights German infrastructure, cultural resources and attractiveness for international business meetings as key factors in its high competitiveness score. However, Germany scores poorly for price competitiveness (126 out of 141 countries surveyed).

In Berlin, a thriving tourism sector competes with other social and political priorities. Concern about short-term letting of flats through online agencies, and the impact that this is having on the availability of affordable long-term residential accommodation, led to the introduction of a law banning the letting of entire homes/apartments for short periods without prior governmental approval. The law came into effect in May 2016.[227] Some sources suggest that clamping down on avoidance of occupancy and other taxes by small-scale operators may be an additional motivation behind the legislation.

A.1.2.2. Taxes on tourism in Berlin

The tax regime applicable to tourism services in Germany is similar to that applicable to other sectors. Germany has a federal structure, permitting decentralised setting of tax rates on tax bases such as property and profits, and decentralised public spending decisions. As with Spain, this provides significant opportunities for individual regions and cities to determine their own policy stance towards the tourism sector.

Corporate and personal income taxes

Companies in Germany are taxed at a federal rate of 15% of profits, plus a "solidarity levy" of 5.5% of the federal rate (0.825%). An additional "trade tax" (*Gewerbesteuer*) is applied to corporate profits at the local level, comprised of a national rate of 3.5%, combined with a municipal multiplier,[228] which in Berlin has been set at 410% since 1999.[229] This equates to a tax rate of approximately 30.2% on corporate profits in Berlin, though there may be some variations in how taxable profits are defined between these two taxes.

Personal income is taxed at progressive rates up to a maximum of 45%, with a tax free threshold of €8,652 for 2016. A solidarity levy of 5.5% of the applicable rate is also charged. For personal income from a trade, the aforementioned local trade tax also applies, though a tax-free allowance of €24,500 applies to both individuals and

[225] Visit Berlin, 2016
[226] Eurostat, 2016b
[227] Oltermann, 2016
[228] Germany Trade and Invest, 2017
[229] State of Berlin, 2017. Note that there has been recent controversy regarding the deductibility for trade tax purposes of rental costs for accommodation purchased by German tour operators.

partnerships. In addition to having different tax brackets with fixed marginal rates like other countries, individuals who earn between €8,653 and €53,665 face geometrically progressive rates of between 14% and 42%. As a result, the marginal tax rate faced by an individual on the average income in Germany is approximately 40.5%.

There has been recent controversy regarding the trade tax treatment of hotel capacity purchased by tour operators for purposes of creating package holidays.[230]

Real estate tax

Annual property taxes are payable on the statutorily assessed value of a property, multiplied by a federally-determined property tax rate of between 0.26% and 1% (depending on type, location, and value of property), multiplied by a municipally-determined additional multiplier of 810%, giving tax rates for Berlin of between ~2.1% and 8.1%.[231] For businesses this is partly offset by an additional trade tax deduction.[232] Statutorily assessed property values are based on historical valuations that are usually significantly lower than current market values.

Value-Added Tax (VAT)

Germany only operates a single reduced rate of 7%, in addition to a standard rate of 19%. As with most EU MS, Germany applies this reduced VAT rate for tourism related activities including hotel accommodation and cultural activities (the latter supplies can even be exempt, where the supplier is a public body or otherwise recognised by the competent national authority). A reduced rate also applies to public transport and taxis within a municipality, or where the distance travelled is 50km or less. Restaurants and amusement parks are standard-rated, as are most sporting events.

Occupancy taxes

A "City Tax" of 5% of the accommodation cost (prior to application of VAT, and excluding ancillary charges for facilities, minibar, food, etc.) has applied to all bookings made after 1 January 2014. The tax is capped at 21 days' worth of charges, and business travel is exempt, meaning the tax is targeted exclusively to leisure tourism.

Air passenger duty/departure taxes

An aviation tax is levied on the purchase of aeroplane tickets, and becomes payable upon the departure of a passenger from a German airport. The tax is charged at €7.47 for departures to destinations within the EU/EFTA and some immediate neighbouring countries such as Morocco, Russia, and Turkey. Outside that band, flights are charged at €23.32 for departures to destinations within 6,000km, and €41.99 for departures to all

[230] Ruling: Justiz, 2016
Commentaries: Püttmann, F 2016. FVW Medien, 2016. FVW Medien, 2016a.
[231] State of Berlin, 2017a
[232] PricewaterhouseCoopers, 2016

other destinations[233]. The tax has been subject to some critique from the aviation industry.[234]

Concluding remarks

Berlin offers an interesting example of a city-break location that only began to develop its tourist offering relatively recently, but which already attracts significant volumes of tourists. Moreover, it is one of the first cities in Europe to introduce legislation limiting the short-term letting of private accommodation, a significant growth area in the tourist accommodation sector. This and other developments are highly contested, providing insight into the kind of political issues associated with tourist development and taxation.

A.1.3. Preliminary case study: Croatia

Croatia is a popular Mediterranean tourist destination and ranks very highly in measures of tourism activity. Two specific tourism-focussed taxes make it a particularly interesting location to include in our case studies.

Overview of tourism taxes in Croatia						
Corporate Income Tax	Personal Income Tax	Property Tax	Value Added Tax	Occupancy Tax	Departure Tax	Other Taxes and Levies
18%, 12%	Up to 42.48% (incl. local surtax) (24%-28.32% at average income)	-	25%, 13%, 5%	YES	YES	Tourism contribution income tax

A.1.3.1. The tourism sector in Croatia

Since the breakup of the former Yugoslavia in 1991, Croatia has developed a strong reputation as a European destination of choice for many tourists. With over 12 million international tourists visiting each year, revenues from the sector as a whole make up over 18% of the nation's GDP, and the hotel and restaurant sector alone employs just under 7% of the total workforce. The majority of tourists visit Croatia from within the EU, with over two million visitors from Germany and over one million from Slovenia, Italy and Austria each year,[235] and the government actively promotes the country's pleasant climate, extensive Mediterranean coastline and beaches to international tourists.[236]

According to Eurostat data, Croatia is the eighth most popular tourist destination[237] and has the highest number of tourists per capita of any continental European country.[238]Adriatic Croatia is the fourth most popular destination in the EU, after the

[233] Zoll, 2016
[234] German Aviation Association (BDL), 2015
[235] Ministry of Tourism, Republic of Croatia, 2016
[236] Croatian National Tourist Board, 2017
[237] Eurostat, 2017a
[238] Eurostat, 2016a

Balearic Islands, Paris and Catalonia.[239] Its reliance on tourism revenues is second-to-none, with receipts from travel services being equivalent to over 17% of GDP.[240]

Interestingly, Croatia's strong popularity among tourists does not translate into a particularly strong ranking on the World Economic Forum's Travel and Tourism Competitiveness Index, which puts it at number 33 globally (16th in the EU). The country is ranked fairly consistently across all elements of competitiveness, scoring slightly better in terms of tourism infrastructure, health and hygiene, and international openness. Price competitiveness and the business environment rank more poorly, although within this some measures of taxation (such as the total tax rate for a representative business) score relatively well.[241]

A.1.3.2. Taxes on tourism in Croatia

The Croatian government recently overhauled the Croatian tax system, including changes to many taxes relevant to the tourism sector. Most of these changes came into force on 1 January 2017, and were designed to simplify the tax system and reduce the national government deficit.[242]

Corporate and personal income taxes

Corporate income tax in Croatia is levied at one of two rates: a standard rate of 18%, and a low rate of 12% for farmers and taxpayers with annual revenues of less than HRK 3 million (approximately €400,000). Prior to 2017 a standard flat rate of 20% applied across almost all businesses, with no reduced rate. Enhanced deductions are available to businesses involved in certain activities, including some tourism services,[243] and certain businesses operating in areas designated as being of special state concern may be required to pay only 50% of the prescribed rate or be exempt from paying corporate income tax altogether.

Personal income tax is also levied according to two rates, which were reduced from the beginning of 2017. The higher rate, applying to income over HRK 17,500, was reduced from 40% to 36%, and the lower rate from 25% to 24%. In addition, cities and municipalities may choose to impose a surtax on personal income. The surtax ranges from 0% to 18% (in Zagreb) of an individual's state tax liability. At between 24%-28.32%, the marginal income tax rate facing the average income earner in Croatia is the median for the EU-28.

As described below, both companies and businesses operating in the tourism sector are subject to an additional income tax relating to membership of tourist boards.

Real estate tax

[239] Eurostat, 2016b
[240] Eurostat, 2017b
[241] World Economic Forum, 2015
[242] Government of the Republic of Croatia, 2016
[243] Deloitte, 2017

Although there is a real estate transfer tax applied to the transfer of property ownership, there are no real estate taxes in Croatia.

Value-Added Tax (VAT)

The standard VAT rate in Croatia is 25% - the second highest in the EU and only exceeded by Hungary (which has a standard rate of 27%). A reduced rate is applied to a number of tourism related activities, including a 13% rate for accommodation and restaurant and catering services. Unlike most other countries, a reduced rate is not applied to passenger transportation or admission to amusement parks, sporting events or most cultural services.

The recent tax reforms made only minor changes to the VAT system insofar as it relates to the tourism sector, with the standard and reduced rates remaining constant and a 30% increase in the registration threshold (up to approximately €40,000) taking effect from the start of 2018.

Occupancy taxes

Overnight stays are subject to the Sojourn Tax, which applies to all overnight stays in Croatian accommodation - including nautical vessels - for people aged 12 and above (subject to a few other exceptions). The level of the tax is set by the national government and depends on the nature of the accommodation and the time of year. Levels range from HRK 2 (~€0.27) to HRK 7 (~€0.94) per night, with an exemption for young children and a reduction for those aged 12-18. For some providers a flat annual rate is paid, based on the average number of overnight stays in the previous year for the specific category of accommodation.

Interestingly, all revenues from the Sojourn Tax are hypothecated for the purposes of tourism. Depending on the type of accommodation the revenue relates to, legislation requires that a fixed proportion of the revenue is transferred to either the Croatian National Tourist Board or the Local County, municipality or city tourist board, and even specifies the purposes for which the funding can be spent.[244]

Air passenger duty/departure taxes

Passengers must pay a civil aviation tax on departure from any Croatian airport, which air carriers are obligated to include in the ticket price. For travel within Croatia the charge is €0.68 per person, while for international travel the rate is fixed at €1.37 per person, both of which are at the low end of departure tax rates.

Other tourism-specific taxes and levies

A separate tax (described in law as a membership fee) is payable by a wide range of

[244] Croatian Parliament, 2008

businesses and individuals working in the tourism industry to help fund Croatia's tourism boards. This tax is applied to total income, with rates varying according to a business's location and the activities it undertakes. A total of 24 different rates apply, ranging from as low as 0.00646% to as high as 0.1615%.245

As with the accommodation tax, the law specifies the proportion of revenues generated by this tax that must be transferred to each layer of tourist board (municipal, city, county and national).

Concluding remarks

Croatia provides an interesting example of a highly popular tourist destination with dedicated tourism taxes, the revenues of which are hypothecated for use within the sector rather than to fund wider government expenditure. It would be interesting to explore the impact of these revenues on the quality of tourism infrastructure and the degree to which Croatia is actively marketed abroad.

[245] Ministry of Finance, Republic of Croatia, 2017

APPENDIX II: CURRENCY CONVERSION RATES

The table below summarises the currency exchange rates used in our analysis in this report. For consistency, we have used the official average annual exchange rates published by the European Central Bank (2017) for all currency conversions through this report.

The 2015 exchange rates has been used only to convert hotel prices from the Trivago Index, which was only available in 2015 prices. All other exchange rate conversions have used the 2016 exchange rates.

Member State	Local currency	2015		2016	
		US$ (Local currency per US$)	Euros (Local currency per Euro)	US$ (Local currency per US$)	Euros (Local currency per Euro)
Austria	EUR	0.90	1.00	0.90	1.00
Belgium	EUR	0.90	1.00	0.90	1.00
Bulgaria	BGN	1.76	1.96	1.77	1.96
Croatia	HRK	6.86	7.61	6.81	7.53
Cyprus	EUR	0.90	1.00	0.90	1.00
Czech Republic	CZK	24.59	27.28	24.42	27.03
Denmark	DKK	6.72	7.46	6.73	7.45
Estonia	EUR	0.90	1.00	0.90	1.00
Finland	EUR	0.90	1.00	0.90	1.00
France	EUR	0.90	1.00	0.90	1.00
Germany	EUR	0.90	1.00	0.90	1.00
Greece	EUR	0.90	1.00	0.90	1.00
Hungary	HUF	279.40	310.00	281.36	311.33
Ireland	EUR	0.90	1.00	0.90	1.00
Italy	EUR	0.90	1.00	0.90	1.00
Latvia	EUR	0.90	1.00	0.90	1.00
Lithuania	EUR	0.90	1.00	0.90	1.00
Luxembourg	EUR	0.90	1.00	0.90	1.00
Malta	EUR	0.90	1.00	0.90	1.00
Netherlands	EUR	0.90	1.00	0.90	1.00
Poland	PLN	3.77	4.18	3.94	4.36
Portugal	EUR	0.90	1.00	0.90	1.00
Romania	RON	4.01	4.45	4.06	4.49
Slovak Republic	EUR	0.90	1.00	0.90	1.00
Slovenia	EUR	0.90	1.00	0.90	1.00
Spain	EUR	0.90	1.00	0.90	1.00
Sweden	SEK	8.43	9.35	8.55	9.47
United Kingdom	GBP	0.65	0.73	0.74	0.82

Source: European Central Bank, 2017