Taxation of tourism activities: evidence from Portugal

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DRAFT VERSION

Abstract

The paper will discuss whether the increase or introduction of tourism taxation should be addressed through specific or general indirect taxation. With this objective, the paper will describes the concept of tourism taxes and will present different reasons that are in its bases of adoption. The paper also offers some numerical exercises comparing the effects of specific and general tourism taxation in Portugal, a developed country with a sizeable tourism industry.

Keywords: Taxation, Tourism, CGE models, Fiscal Policy

Introduction

Tourism activities are usually subject to indirect taxation. For example, tourists must pay general taxes when they consume different goods and services in the destination country. In some countries there are also specific taxes on tourism, this case of taxation have gained acceptance over the years, whith currently more than 40 different applications around the world (WTO…). The wide use of tourism taxation can be explained for several reasons: (i) the magnitude of revenue potential, that could represent more than 10% of the tax receipts collected by some developed countries, approaching 100% in certain small tourist economies (McAleer, Shareef & Da Veiga 2005); (ii) the low distortionary effects to taxation and the exportability of the fiscal burden, mainly in countries where tourism is an important economic activity; (iii) the

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ability to act as a price substitute for the public goods and services consumed by tourists; and (iv) the corrective role that could be played by these taxes.

For this reasons, grow the academic interest for analyzing the design and effects of indirect taxation on tourism activities, which (according to Gago et al. 2009) began in the late seventies. Most of the studies has dealt with specific levies on hotels (e.g. Bonham, Fuji, Im & Mak 1992; Bonham & Gangnes 1996; Combs & Elledge 1979; Fuji, Khaled & Mak 1985, 1988; Hiemstra & Ismail 1992, 1993; Im & Sakai 1996; Mak 1988; Mak & Nishimura 1979; Spengler & Uysal 1989). However, the effects of other taxes have attracted less attention until recent years (e.g. Blake, 2000; Gooroochurn & Milner 2004; Gooroochurn & Sinclair 2005; Wanhill 1995).

**Indirect taxation of tourism activities**

The receipts who came from indirect tax generated by tourism come from two different types of indirect taxes; specific tourist taxes, in accordance with a wide range of formulas and circumstances (usually hotel room taxes and airport entry/exit taxes; see WTO, 1998, for details), and from general taxation on consumption. But, none of these formulas can be described strictly as tourism taxes, because almost all goods and services used by tourists (hotels, restaurants, flights, car renting, etc.) are also used by non-tourists. Consequently, the taxable item is not the tourism itself but rather a tax base generally linked to it, so that any fiscal measure addressed to tourism activities also has effects on non-tourists. Therefore, when we refer to tourism taxation in this paper, we really mean indirect taxes affecting tourist activities.

When we made a reflection about foundations of tourism, indirect tourism taxes can be justified on mainly three arguments: (i) revenue-raising objectives; (ii) coverage of conventional costs of public services; and (iii) internalization of external costs.

In first place, the tourism sector is a natural candidate not only for, at least, average fiscal pressure, but also for higher-than-average pressure when tourism represents a significant share of economic activity. Habitually, it has been considered that many tourist destinations have no clear substitutes (because of particular geographical or climatic reasons, distance, quality, etc.). This phenomenon creates monopoly power on the supply side (Gooroochurn & Sinclair, 2005), whereas on the demande side it means
that price alterations may bring minor behavioral changes (low elasticities of substitution). That situation appeals for the use of tourism taxes as a means of an efficient collection of revenues, following the well-know prescriptions of public economics. By other way, when tax incidence falls mainly on non-resident tourists, the excess burden or efficiency distortion disappears in the minds of the policy makers (Gooroochurn & Sinclair, 2003). As a result, tourism taxation becomes a highly attractive instrument for fiscal reform (Fujii et al., 1985) or to obtain extra revenues for funding new public expenditures. But, this only applies when tourists are not residents in the jurisdiction that levies the tax.

Concerning the second reason for tourism taxation, it could be used as a specific instrument for funding tourism-related extra costs brought about by a higher provision of public goods and services. For example, a intensive tourist activity may lead to the need for a larger supply of services or infrastructures, such as medical services, road maintenance, garbage collection systems, safety, water supply, sewage sanitation services, whose costs may not be covered by the taxes already paid by tourists. Furthermore, local constituencies must provide adequate infrastructures to meet the demand in high seasons, investing in facilities underused during the rest of the year. For instance, in the case of the Algarve (Portugal), there is a seasonal pattern, with around 70% of the total arrivals in the May-September period (WTTC, 2003)

At last, the external costs resulting from tourism may be sizenable (Green, Hunter, & Moore, 1990) and, among other things, negatively affect tourist activity. Basically, this area includes congestion and environmental costs (pollution, unpleasant aesthetic effects and other factors contributing to a decrease of the quality of life for local citizens) which are not only a by-product of the tourism sector but also an input for this sector.
For example, mass tourism may reduce the quality of the tourist experience through congested and overcrowded streets and other facilities, psychological stress on local users and visitors, and faster deterioration of natural resources and public services, resulting in higher maintenance costs, and the loss of aesthetic value as a result of building developments (Briassoulis, 2002; Ryan, 2002).

Consequently, may be necessary a public intervention to restore economic efficiency, with indirect taxes as a powerful tool to incorporate all those external costs in the final price paid by tourists (Clarke & Ng, 1993). Besides, tourism taxes could have significant direct effects on the quality of tourism demand and the magnitude of the added value generated by the sector through reduced congestion and an increased willingness to pay by tourists. In addition, the tax might be used with a variable time profile to avoid congestion peaks and de-seasonalize tourist activities, contributing to a better economic performance. Despite, the strong rejection of this proposal from local authorities (see e.g. Burns, 2010), some of them recognize that needs further future exploration, it is concluded that this may still be a “live” issue.

Some Main Features of the Portuguese Tax System

The VAT is the main indirect tax that levies touristic activities. However, there are other general indirect taxes who may charge tourists and non-tourists.

VAT and excise duties

After increases of two percentage points in 2002 (to 19%) and 2005 (to 21%), the standard VAT rate was cut by one percentage point to 20%, and again increases of one percentage point in 2010 (to 21%) and 2011 to 23%, effective as of 1 January 2011.

Portugal applies three VAT rates: besides the standard 23% rate, a intermediate 13% rate (on restaurants, some wines, some foodstuffs, fuel oil and coloured diesel) and a reduced 6% rate (mainly on basic foodstuffs, books, periodicals and newspapers, water and electricity. In Azores and Madeira the standard rate is 16%, whereas the intermediate rate is 9% and the reduced rate is 4%. Excise duties revenues are in line with the EU-27 average.

Wealth and transaction taxes
In December 2003 and January 2004 respectively, the local tax on real estate and the transfer tax were replaced by new municipal taxes. Currently, two taxes on wealth are in force: the municipal real estate tax (IMI) and the municipal real state transfer tax (IMT). There is no net wealth tax. The gift and inheritance tax was abolished in 2004. A stamp tax is levied on transfers of property on death or gift only if the donor and the beneficiary are not next of kin.

Local taxes

In addition to the taxes already mentioned, taxation at the local level also comprises a municipal tax on vehicles.

Social contributions

Employees pay contributions equal to 11% of their gross salary without any ceiling (10% for members of the corporate board, but up to a ceiling). The employers’ contribution rate is 23.75% (21.25%). Social security contributions are deductible from the PIT and the CIT.

Modeling approach and Methodology

The expected significant effects of tourism taxation in countries where tourist activities represent a major economic sector require the use of modern methodologies to evaluate them, such as CGE models. According several authors these techniques offer important advantages compared to traditional partial equilibrium approaches, since they capture intersectoral and macroeconomic links.

CGE models are used in economic research to simulate the macroeconomic conditions of a country, region or the world. The use of CGE models to analyzing tourism policies and activities has increased considerably in the last ten years. Most CGE models deal with the impact of tourism in different countries, as in Adams and Parmenter (1995) for Australia; Zhou et al. (1997) for Hawaii; Blake (2000) for Spain; Alavalapati and Adamowicz (2000) for Canada; Kweka (2004) for Tanzania; Sugiyarto, Blake, and Sinclair (2003) for Indonesia; Blake, Sinclair and Sugiyarto (2003) for Cyprus and Malta; Blake, Durbarry, Sinclair and Sugiyarto (2001) for the USA; and Sinclair, Blake and Gooroochurn (2005) for Cyprus, Malta and Mauritius, Gago et al. (2009) for Spain.
However, the pieces of research interested in the impacts of tourism taxation are much less common. Exceptions are the aforementioned cases of Blake (2000), who analyzes the level of taxation of tourist activity in Spain, Gooroochurn and Milner (2004) and Gooroochurn and Sinclair (2005), who study the effects of changes in sales taxes in Mauritius and pay special attention to the tourist sector, and Gago et al. who studied the impact on Spanish economy for different types of taxation direct and indirect for tourist activities.

**Expected results**

The research we are developing will try to prove if both specific and general taxes on tourism would be able to yield improvements in terms of revenues and internalization of costs without obstructing the economy.

**References**


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