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Tax system as a factor of tourism competitiveness: The case of Croatia

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Abstract

The main purpose of the paper is to determine the connection and mutual causality of the tax and hidden tax burden and their influence on the development of tourism sector and its competitiveness in Croatia. In the part on taxes burden the attention is dedicated to the corporate income tax (CIT) and the value added tax (VAT). In comparison to other countries, CIT rate in Croatia is not so high, while the current reduced VAT rate of 10% is only applied to accommodation services. The Croatian fiscal system includes an extensive list of hidden fees, and neither the number of these different fees nor the way in which they are calculated is fully known.

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Key words: Tax system, tourism, competitiveness, hidden fees, Croatia

1. Introduction

Hotel industry and tourism are significant factors of competitiveness abilities and development of observed country. For example, only in European Union member states tourism today contributes to around 10 % of the gross domestic product (Gago et al, 2006), while in many countries, especially smaller and more dependent on tourism, tax revenues from tourism are considerably higher than 10% (McAleer, Shareef and Da Veiga, 2005). In that way taxing presents public policy that mostly directly or indirectly influences hotel industry and the whole sector of tourism, because due to the relative elasticity

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of demand^a easily twisted the behaviour of guests, in a way that due to the introduction or changes of taxes changed prices modify the behaviour of potential guests.

The Study of Deloitte and Touche (1998) showed that higher tax burden reduces hotels and tourism revenues, while the increase or decrease of tax rate significantly influences the decisions of the tourists regarding the destination of a voyage and the way and means of accommodation. In other words, because of mobility, information and sensitivities to prices, tourists very often select the destination having in mind the prices required by providers of accommodation and catering^b. Due to all mentioned, hotel industry in any observed country has an aim to achieve more favourable position in comparison to its competition, and one of the way how to achieve it is to provide encouraging taxing of tourist services and hotel industry. As a result, many countries in recent years introduced, reduced and/or redesigned a whole scope of tax forms that are intended for hotel industry and tourism (WTTC Taxation Policy Task Force Case Studies, 2004). In mentioned process Croatia is not the exception, because the reduction of the total tax and non-tax burden (hidden fees or parafiscal charges) for the hotel industry could help the preservation of the competitiveness abilities of tourism in respect to other tourist destinations.

In the further text the main aim of the paper will be explained, and succinctly will be shown how taxes influence the tourist sector. Furthermore, basic forms of fiscal and parafiscal fees that influence the tourism will be presented, with particular attention to the situation in special in Croatia.

2. How the taxation influences tourism and hotel business?

Gooroochurn and Sinclair (2005) identified around 45 various taxes that are collected in tourism, where around 30 are born by tourist guests, while 15 are born by hotel firms, although shifting^c can be different depending on demand and supply price elasticity (Fish, 1982). The impact of introduced tax on the hotel room price will mostly depend on demand price elasticity. If the demand is sufficiently elastic, hotels will not be able to increase the accommodation price and shift the tax to guests, but they will have to bear it by themselves and reduce the profit. If, on the other side, the demand is inelastic, hotels will be able to increase the accommodation price and guests will have to bear the newly introduced or increased tax through increased accommodation price. Where there is high price elasticity for the hotel sector, as is the case in Croatia, in the conditions of possible increased of accommodation prices due to increased tax and non-tax burden, in final there could be a huge redirection of guests to other cheap and more competitive destinations.

The World Tourism Organisation (WTO, 1998) quotes the existence of many groups of taxes and fees related to the tourist activity. These are for travelling (visa fees, entry and exit charge); air and ship transport (airport and harbour charges and fees, charges on travel tickets, contributions and taxes on the fuel, tax on the transit, allowance for the safety); hotel and other accommodation (overall 15 different taxes and fees); restaurant (the value added tax, excises on the alcohol); road traffic (the toll and excise on

^a Price elasticity of demand measures the sensitivity of quantity of demand regarding the changes in prices, and shows how much in percentage it changes the quantity of demand of some good if its price grows for 1%.

^b A good example is the experience of American federal state New York, where in 1990 with other state and local taxes 5% tourist tax on hotel rooms was introduced so the price of hotel accommodation increased for around 5%. The Survey conducted after 4 years showed that mentioned price increase caused 2.5% reduction in demand for hotel accommodation, so the mentioned tax was soon abolished (International Hotel & Restaurant Association, 1996).

^c Legal incidence shows who is responsible according the law to bear the tax, but as prices can be changed depending to the taxation, whole really pays the tax can be seen by economic incidence. It presents the changes in distribution of available private real income due to the introduction of taxes because of changes in prices. Fiscal theory analyses the factors that determine the differences between legal and economic tax incidence – the amount of tax shifting.

the gas); car rental (municipal and local taxes, other taxes, excises on the gas); tax and fees for visiting tourist attractions; and, finally, taxes on games of chance which pay the casino and gambling house.

In further text will be explained which tax and other parafiscal levies mostly burden business activities in hotel industry and in tourism. In the part on taxes the attention has been dedicated to the corporate income tax (CIT) and value added tax (VAT), while in the part on the hidden fees most important burdens, i.e. contributes and user allowance are explained.

2.1. Tax burden of tourism and hotel industry - corporate income tax and value added tax

Table 1. Rate of corporate income tax and value added tax in selected countries, 2011

Country	Corporate income tax	Standard VAT rate	Reduced VAT rate	Note on reduced (lower) VAT rate
Bulgaria	10	20	7	Reduced rate of 7% on hotel services that are part of organised touristic packet.
Cyprus	10	15	5 / 8	Reduced rate of 8% on all kind of accommodation, including hotels.
Montenegro	9	17	7	Reduced rate of 7% on hotel accommodation.
France	33.33	19,6	5,5	-
Greece	23	23	6.5/13	Reduced rate of 6.57% on hotel accommodation.
Croatia	20	23	10	Reduced rate of 10% on hotel accommodation.
Italy	27.5	20	10	-
Malta	35	18	5 / 7	Reduced rate of 7% on hotel accommodation.
Portugal	25	23	6 / 13	-
Slovenia	20	20	8.5	Reduced rate of 8.5% on food preparation.
Spain	30	18	8	Reduced rate of 8% on hotel accommodation.
Turkey	20	18	8	Reduced rate of 8% on touristic services.

Source: European Commission, Taxation and Customs Union, 2011; International Bureau for Fiscal Documentation, 2010.

Lower CIT rates Europe in comparison with Croatia (20%) only has Montenegro (9%) followed by Cyprus and Bulgaria (10%), while the highest is on Malta (35%). However, tax rate on CIT is not the only decisive factor, because tax burden depends also on how tax base is determined, i.e. items that increase or decrease tax base, (non)existence of tax deduction, allowance, incentives and subsidies.

It is quite common that for hotel accommodation and some services in tourism reduced VAT rate is applied. Currently in Croatia the reduced VAT rate of 10% is only applied to accommodation services or accommodation with breakfast, half board or full board in all kinds of commercial catering establishments as well as on the agency provision for related mentioned services. In comparison with other countries presented in Table 2.1, mentioned rate is among the highest, what without doubt reduces Croatian competitiveness, particularly having in mind that other changes in VAT in the last few years, like the cancelation of subsidies for reduction of organised transport costs, increase of VAT rate for touristic agency service from 0 to 22% and accommodation booked through agency from 0% to 10%, are not negligible.

In the following text main forms of parafiscal burden for tourism in selected countries, primarily contribution for social insurance and hidden fees, will be presented.

2.2. Parafiscal burden for tourism and hotel industry

From parafiscal burden contribution for social insurance and hidden fees that belong to the different levels of government are presented.

2.2.1. Contribution for social insurance

Large contribution for social insurance increases labour costs and lowers the competitiveness of firms and economy. In the long-term the burden of contributions, including those paid by employers, are shifted to employees in the form of lower wages and salaries. In Table 2 contribution rates for social insurance for selected countries in 2011 are presented.

Table 2. Contribution rates for social insurance in 2011

Country	Maximum contribution rate, %		
	Employee	Employer	Total rate, until
Bulgaria	12.9	18.6	31.5
Cyprus	6.8	8.5	15.3
Montenegro	24	9.8	33.8
Greece	16 -19.45	28.06	47.51
Croatia	20	17.20	37.2
Italy	10	40-45	50-55
Malta	10	10	20
Portugal	11 (9.3 for managers)	23.75 (20.3 for managers)	34.75 (for managers 29.6)
Slovenia	22.1	16.1	38.2
Spain	6.35	29.9 + injury (1-6.7)	36.25 + injury
Turkey	14	20.5 + injury and sickness (1-6.5)	34.5 + injury and sickness

Source: International Bureau for Fiscal Documentation, 2011

Contribution rate for social insurance in Croatia is relatively high, but with the exemption of Cyprus, not higher or different in comparison with other observed countries. Despite the mentioned and having in mind unfavourable relation between the number of active insured persons and pensioners and substantial outlays for health care in Croatia, mentioned rate is still insufficient for covering all costs and financing the system. Possible reduction of contribution rate for social insurance will without doubt aggravate payment of pensions and financing of health protection. That will with maintaining of the current high level of public spending require further need for borrowing on the financial market. At the end, that would also cause hard situation and problems for the public finance. Thus, the only solution is to reduce public expenditures because that is the only correct way to insure long-term fiscal sustainability and reduce total fiscal and parafiscal burden.

2.2.2. Users' fees

Next to the taxes, in other countries and in Croatia there is a whole scope of public revenues in form of hidden fees. Neither the number of these different fees nor the way in which they are calculated is fully known. Parafiscal burden shows the share of personal income or corporate income that is paid for various types of administrative and communal fees, levies and charges.

Usually these fees are not in the centre of political discussion and/or public attention of those that mostly deal with tax burden and tax rates. These „hidden fees and other non-fiscal revenues are heavy burden for economic activity and a serious threat to international competitiveness, and simultaneously very weakly explored area of public revenues“ (Charron, Chow, Halbesma, 2008). Organisation for Economic Cooperation and Development (OECD) classifies all charges paid by users that are linked to the costs of service provision as non-tax revenues, but simultaneously a part of charges and fees (for example, licences for allowing the performance of economic activities, fishing and hunting, lotteries,

betting and entertainment) is included in category of tax revenues^d, what limits comparisons between the countries.

User charges or fees are intended for covering the expenses which emerge by the usage of public resources and most often present the most important autonomous source of non-tax incomes of local units with beforehand earmarked purpose. In that way they are reimbursements for service done to users by state and local self-government bodies or non-capital goods which are not of the industrial nature. Charge payment obligation usually arises after the user personally has initiated the activity of the state or the quasi-state body. In doing so, in majority of the cases there is no competition because there is only one (or low number of) provider(s). These are most often the state bodies or the companies in the public ownership, so it is easily to acquire monopoly (or oligopoly^e) position. Furthermore, because of the lack of competition, provider can demand and obtain higher prices than those at economic level (Bird, 1992). User fees are usually charged for distribution of electric currency, gas, water, sewage, canalisation, water collection and purification, for services of airports and harbour, public libraries, parks, recreational centres, road and bridge maintenance, fire protection and a whole range of other services. An advantage characteristic of user charges is that they are not limited only to the citizens of a country that introduces such fee, but the territorial principle is applied to its payment.

User charges or fees are most often divided in the following groups:

- *Service fees* – compensation to the expenditures of public sector for various licences and permissions (for example, for marring and divorcing, work, house pets, motor vehicle) and small fees for particular services (confirmation of copies, issuing of registration) for users that can easily be identified.
- *Public prices* – revenues that local government units achieve by selling goods and services where private user can easily be identified. These are, for example, compensation for using public goods and entrance tickets for recreational centre and parks.
- *Specific benefit taxes* – compensations related to particular benefits used by exact population groups, for example, because of improving life circumstances in their area. Usually they are charged either to assess values of assets or on some traits of these assets (location, size, facade).

On the basis of available OECD data (despite mentioned problems with comparability) and EUROSTAT on GDP in current prices (in EUR), *Table 3* presents shares of non-tax revenues in selected EU members and Croatia.

Table 3. Non-tax revenues in selected EU members and Croatia, 2002-2007, in % GDP

Country	2000	2001	2002	2003	2004	2005	2006	2007	Average
France	4.8	4.9	4.9	4.7	4.7	5.2	4.8	4.8	4.9
Greece	6.5	5.9	4.8	5.1	4.7	4.6	5.8		4.7
Italy	3.5	3.6	3.6	3.3	3.3	3.1	3.1	3.1	3.3
Portugal	4.8	3.6	3.7	4.8			3.3	4.5	3.1
Croatia			3.4	3.5	4.3	4.3	4.0	5.0	4.1

Source: for non-tax revenues not consolidated general budget: *OECD (2009: 269-287)*; for GDP: Eurostat (2010:98); for Croatia: www.mfin.hr other revenues of consolidate central government and the Ministry of Finance (Ministarstvo financija, 2008). For the reasons of comparison included are concessions that are part of this Registry, but of the Registry of concessions. Calculation by authors.

^d For example, VAT and various fees and charges are included in the category tax on sales of goods and services.

^e The existence of small number of service providers on the market what enables them to collude and achieve a monopoly position.

In selected analysed countries where data are available, non-tax revenues have been in the range from 3 to 6% of GDP. In the whole observed period from 2000 to 2007 the lowest average share of non-tax revenues in GDP has been recorded in Portugal (3.1%), and the highest in France (4.9%).

2.3. Users fees in Croatia

The most important revenues of local self-government in Croatia are various fees, primarily communal contribution and communal fee or charge. On the level of local units (municipalities and cities) there are at least 20 various fees, charges and contributions that are introduced by own decision or responsible body. The differences between their number and size of particular municipality and city are significant.

By the Registry of non-tax revenues in Croatia established in 2008, for the first time 245 court and administrative duties, compensations, charges and fees, penal fees, fees and duties for various certificate exams, membership fees etc have been incorporated. Despite the mentioned, in the general public there have been neither a discussion on prices and quality of public services, nor about the way how to recognise 50 to 60 hidden fees and charges that in the most cases have the characteristics of taxes (Bajo, 2006).

According to the Survey by the Institute of Public Finance (Institut za javne financije, 2008), for the hotel industry the most important are the following non-tax duties^f: monument fee (2 types in percentage to revenues and respecting to the size of the object), utility service payment for the use of the town estate, utility contribution, water allowance for using and protecting of water and water contribution), concession on maritime good, parking and harbours of particular purpose, and fee for woods. As stated by the mentioned Survey „four firstly mentioned main contributions and fees (compensation for using and protection of water, but not water contribution) present more than three fourth of fifth of all outlays of hotel industry for various hidden fees. Significant burden to hotels presents also compensations for using protected copyrights in the field of music and Croatian public television subscription“.

The collection of non-tax revenues is performed by local units (mainly communal utility companies). Just therefore tax authorities cannot easily determine the payer and amount of payment or tax debts according to the revenues by special regulations or hidden fees or allowances, because they have neither insight in types, nor the names of payer of numerous fees and allowances.

The problem of non-tax revenues is directly linked to the quality of life and the quality of communal infrastructure. Especially are important low allowance level and small number of the fees with clear established payment rules. The hidden fees and allowances present the invisible burden of financial transaction for hotel companies and tourist visiting. Therefore, it is necessary to work systematically on the simplification and reduction of the non-tax burden in order to alleviate the picture of Croatia as the paradise of hidden fees.

^f From other charges there is a need to mention: communal contribution or fee for the connecting to the communal infrastructure; graveyard fee, fee for registration of the firm, contribution for collecting crude garbage; fee for exploitation of mineral raw materials, oil and gas; concession for performance of communal services; concession for using agriculture land; concession for extracting mineral and thermal water; concession for using water from public sources; water conservation charge, water use charge, charge or fee for changing purpose of agricultural land; charge for lease of state agricultural land; fee for concession of using agricultural land; revenues of selling state agricultural land; forest contribution; sojourn tourist tax; fee for announcement and promotion; fee on betting store; parking fee; hunting lease and hunting rights concession charge; administrative charges.

3. Conclusion

Tax burden for hotel industry and the tourist sector in general is significant in all observed countries, but because of large government expenditures the space for its bigger decrease is narrowed. Next to the tax, there is also non-tax parafiscal burden of various hidden fees and allowances. The activity for the improvement of positions of hotel industry should primarily be directed in conceiving and decrease this form of financial burden. Non-tax revenues in majority of observed countries as well as in Croatia present important sources of budget revenues. However, their administration is not simple and smooth because for various allowances are responsible different bodies and/or levels of governmental power, and often they are not efficient and fair.

From touristic sector in observed countries increased competition will demand strengthened efforts in retaining the existing and attracting new visitors. In all this, almost decisive issue is quality and a price of the touristic product. The biggest part of the price is cost of hotel accommodation which is in significant measure determined by the level of the tax and non-tax burden.

Although in 2008 the Registry of non-tax revenues has been established for the first time, in Croatia there is still a need to perform additional organized activity on the rationalisation, adjustment and simplifying in the system and regulation of non-tax revenues as well as to examine, cancel and decrease particular forms of imposed non-tax fees, especially on local level. Furthermore, it is important to define clear rule of their distribution. It is necessary to keep in mind particular specific quality of Croatian tourism, and also of the tourism in general, like its season character and occupancy of accommodation capacities.

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