policy brief
november 2015

Impact of the 15% Value Added Tax (VAT) On Accommodation For Foreign Tourists in Zimbabwe

Background

As a strategy to promote the tourism sector based on its contribution to the economy in Zimbabwe, Government decided to exempt accommodation services for tourists from Value Added Tax (VAT). This was intended to ensure that accommodation services offered by Zimbabwean hotels, lodges and other providers would have some competitive edge over what is charged in neighbouring countries. However, as the tax base continues to shrink owing to economic challenges, Government became constrained, forcing it to continue to explore other mechanisms of enhancing fiscal space.

Among the revenue raising strategies in the 2014 National Budget Statement was a proposal to remove the exemption of VAT on accommodation services for non-residents. However, through the Ministry of Tourism and Hospitality, stakeholders lobbied for the postponement in applying the VAT while the industry grows. Thus, instead of the effective date being 01 January 2014, this was postponed to the 16th of January 2015, when the Value Added Tax (General) (Amendment) Regulations, 2015 (No. 38) were introduced. The regulations removed accommodation services from the services offered to tourists that are zero rated.

The Zimbabwe Council for Tourism (ZCT), the apex organization which represents actors in the tourism sector, commissioned the Zimbabwe Economic Policy Analysis and Research Unit (ZEPARU) to conduct a study on the possible implications of this policy measure to the tourism industry and the economy in general. This policy brief was prepared to highlight the key findings, messages and recommendations from the study.

The Importance & Policy Relevance of the Issue

The assessment of this policy decision is critical at this juncture when tourism has become a key pillar for the recovery of the Zimbabwean economy, as both agriculture and mining having slowed down while the manufacturing sector continues to struggle. The tourism sector remains one of the main avenues through which the economy can increase foreign earnings, as the exports of goods has been declining. It is therefore critical to assess whether the policy issue would have an impact on this current tourism sector trajectory.

The issue needs to be assessed from three possible contexts. The first is the regional perspective. The exemption was being used by the tourism players as a competitive advantage compared to the other regional countries which do not have the exemption. Removing the exemption would virtually put Zimbabwean players in the same category as neighbouring countries, who could also market some tourist resort areas in Zimbabwe. The appreciation of the

US$ has also made the Zimbabwean Tourist product uncompetitive relative to regional counterparts. Furthermore, Zimbabwe has not yet fully recovered from the negative perception that characterised the hyperinflationary period. It is therefore critical to assess the removal of the exemption within the overall context of the factors inhibiting/ promoting the competitiveness of the sector with the regional context.

Second is the international perspective. Examples can be found on the impact that similar measures had in other economies around the world. This would also give an indication concerning the likely effect that the removal of the exemption can have on the Zimbabwe economy.

Thirdly, the policy measure can see tourists coming into the country facing higher costs of accommodation. Understanding the reaction of tourists to the increase in cost of accommodation will provide insights into the intended/ unintended policy impacts. For example, tourists may opt to stay in other regional countries where accommodation costs are cheaper and fly in on a day trip to enjoy tourism products in Zimbabwe, particularly around the Victoria Falls area with direct flights from regional airports. The decision of the tourist on accommodation services would generally depend on the elasticity of demand for accommodation services in Zimbabwe. While the tourism products in Zimbabwe can be inelastic, the same cannot be said of accommodation services. If the same tourism products can be accessed while staying in neighbouring countries, tourists could relocate and the country would only gain from the payments that they make to see the facilities, which is lower compared to what they would have paid if they stayed inside the country. Thus, accommodation services can be elastic, even though tourism attraction sites can be inelastic. It is in this regard that it is important to get the tourist perspective on the cost of accommodation.

Fourthly, the operators of tourist facilities could opt to absorb the cost of the tax after a cost benefit analysis reveals that passing on the additional costs to the tourist would result in them losing business. In that case, the additional VAT cost would simply reduce the revenues and profits of operators of tourist facilities If this happens, while Government would receive revenue from the additional VAT, they would also be losing out through the reduction in corporate tax that is collected from the players. The net impact on Government would depend on whether the additional VAT collected is not lower than the foregone corporate tax earnings. In this regard imposing VAT of tourist accommodation could result in a net increase or net loss in revenue from the sector.

This policy brief provides an overview of these four perspectives before highlighting the recommendations emanating from the findings of the broader study.

Regional Perspective

African countries such as Tanzania, Uganda and Zambia have experienced similar situations to Zimbabwe as far as removing the exemption of accommodation for foreign tourists is concerned. During the fiscal year 2013/2014 the Tanzanian government indicated intentions to abolish the VAT exemption on tourist services, as a way of raising revenue. Stakeholders in the tourism industry, however, successfully lobbied against the measure, which had to be postponed to allow for more consultations. In July 2013, the Ugandan government eliminated VAT exemption on hotel accommodation and introduced VAT of 18% on all accommodation facilities. In December 2013, however, the government reinstated exemption of VAT on accommodation after the move had reduced competitiveness of Ugandan hotels. As the fiscal pressures persisted, the government made a further u-turn and reinstated the VAT on supply of hotel accommodation in tourist lodges and hotels outside Kampala District in July 2014.

As of 1 January 2014, all tourism products in Zambia previously zero rated products (activities and tour packages) were standardized for VAT at 16%. Other countries in the region which charge VAT on accommodation services include:

South Africa 14% **Botswana 12%** **Namibia 15%**

Kenya
(a reduced rate of 14% when the standard rate is 16%)

Thus, the policy measure in Zimbabwe has generally placed Zimbabwe in the same line with other countries in the region. The payment of taxes for accommodation services is therefore not something unique to Zimbabwe.

International Context

Studies have also been done to assess the impact of such policy measures at the international level. The results, which were based on a number of studies,[1] are given in Box 1. These studies all point to the fact that the introduction of the VAT can have negative impact in terms of the development of the tourism industry as well as on job creation opportunities in the sector.

Box 1: International Experience On Effect of VAT Measures in the Tourism Industry

In France reducing the VAT rate on restaurant services from 19.6% to 5.5% in July 2009 saw about 50,000 new jobs being created only in the restaurant sector by 2011 when other sectors cut over 30,000 jobs over the same period.

In Germany, reducing the VAT rate on accommodation services from 19% to 7% from January 2010 saw an annual increase of 2.4% and 2.9% in the number of jobs in hotels in 2010 and 2011.

In Luxembourg, the low level of VAT saw the hospitality industry creating 1,650 new jobs in 2011 and over 1,800 in 2012.

In Latvia, increasing the VAT rate on accommodation in January 2009 from 5% to 21% reduced employment in the sector by 12,000 resulting in losses for the government in social and income taxes of around 14 million EURO.

In Croatia, increasing VAT for accommodation services from 0% to 10% in 2006 saw the average number of nights a tourist stayed in hotel declining by 22% compared to 2005 the number of foreign tourists coming from Croatia through travel agencies being 2.1% lower than in 2006.

The Irish Government announced a reduction in the rate of VAT on tourism-related goods and services including restaurant services and hotel accommodation from 13.5% to 9% in May 2011.

The reduced 9% rate of VAT created an extra 23,000 jobs between mid-2011 and 2014.

Tourist Perspective

Based on interviews with about 145 tourists in Victoria Falls, the tourists are very sensitive to price increases, including the costs of accommodation. On average, increasing accommodation costs by more than 5% would see about 75% of the tourists visiting Victoria Falls deciding either not to visit Zimbabwe again or reducing their length of stay from the average stay of 2-3 days. Currently, a typical tourist visiting Victoria Falls spends about $1900 in the country. Any measure that changes the tourist's stay would also deny the economy from enjoying this full tourist budget, which is widely enjoyed in different sections of the value chain. Thus, it is not correct that the tourist is only interested in tourist resort services, such that an increase in accommodation services would not matter. In order to avoid disrupting the tourist arrival statistics, hotels and tour operators need to ensure that they absorb at least 95% of the additional accommodation costs. This obviously have cost implications, which can best be understood from the tourism players' perspective.

[1] The studies include Dombrovski R and Hodžić, S (2010), 'Impact of Value Added Tax on Tourism', International Business & Economics Research Journal Volume 9, Number 10– October 2010; Ahearne, A (2015), Restoring Competitiveness to Ireland's Tourism Industry: The Role of Reduced VAT, February 2015; and Hysi A and Koçiu L (2015), 'The Impact of the Reduction of The VAT in Tourism: The Case of Albania', International Journal of Economics, Commerce and Management, United Kingdom Vol. III, Issue 4, April 2015

Hotels, Lodges & Tour Operator Perspective

Hotels, lodges and tour operators have already felt the heat as far as the full impact of the VAT policy decision is concerned. This was mainly because they rightfully felt that passing on the additional increase in accommodation due to the VAT to the tourist would discourage them from coming into the country. Although profitability could also be affected by other economic challenges, there was a noticeable decrease in profitability by those who absorbed the costs of the VAT increase during the first six months of 2015 compared to the same period in 2014.

The decrease in profitability due to absorbing the costs by the tour operators is estimated to range between 10% and 15%, depending on whether the operator absorbed all the additional costs, or only 50% of the additional costs.Hotels and lodgeson average, registered a decline in profit by about 27% compared to the same period in 2014, which they attribute to absorbing the additional costs.

The general impact has been to reduce profitability, which has implications on corporate tax revenues. Hotels and lodges that absorbed the costs have engaged in various schemes to increase arrivals by engaging in promotions, reducing rates and generally offering discounts. This has increased their costs, which also reduce their profits and their corporate tax obligations.

Conclusion

Just like telecommunications, tobacco and fuel which have all faced new tax regimes, the tourism sector cannot be expected to be an exception, especially given that other countries in the region are also taxing the service. There is need for flexibility, however, to ensure that the viability of firms, which is the main source of tax revenues, is not compromised by revenue boosting measures that do not take into account the sector wide effects. This is particularly within the current context where Zimbabwe players are at a disadvantage compared to their neighbouring country counterparts.

There has been a minimal effect on tourism arrivals to date due to the fact that players decided to absorb the additional costs due to VAT than pass them on to the tourist. If the full costs had been passed on to the tourist, this would have had a negative impact on the economy. For example, during the first half of 2015, Zimbabwe received a total of 87,138 tourists from Europe and America. Given that on average, a tourist budgets about $1,900 to spend in Zimbabwe, this means that about $165.6 million was enjoyed from these arrivals. Government announced that VAT collected during the first quarter of the year from accommodation was about $1.65 million, which can be estimated at about $3-4 million during the first half. If the hotels had passed on more than 5% of the additional costs to the tourist, the economy would have lost about $124 million of the tourist expenditure (assuming that 75% of the tourists would have decided not to visit Zimbabwe). However, while tourist arrivals were maintained, the players are now worse off due to the need to meet the VAT costs from their own revenues.

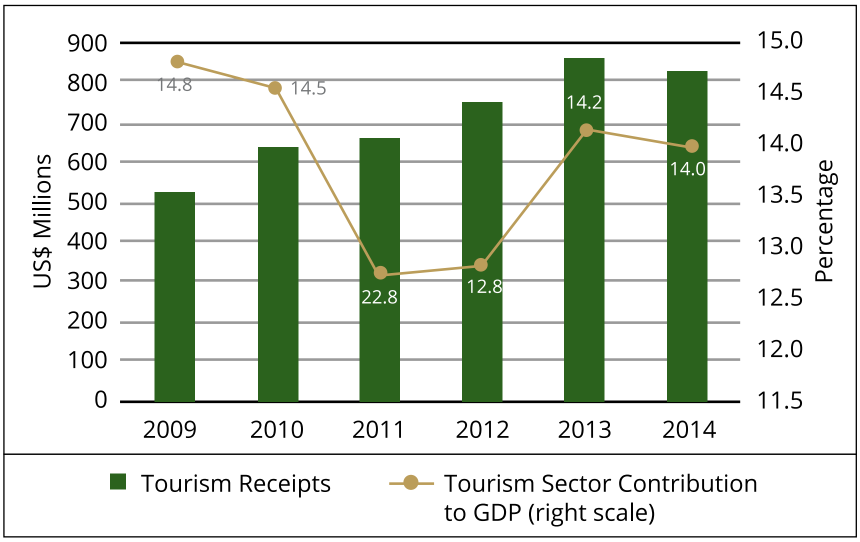
Policy Recommendation

Recommendations for striking a balance between revenue collection and industry viability include the following:

- There is need to revise downwards the VAT chargeable for accommodation purposes from the standard 15% to a reduced rate for the sector (as in Kenya) which is below 15%;
- To ensure that the tourism sector also contributes to VAT like all other sectors, there is need to incrementally introduce VAT, starting with about 5% (acceptable to tourists) before gradually getting to the reduced rate within two years. This would recognise their vulnerability to competition, while at the same time giving them time to play a role in contribution to government revenue.

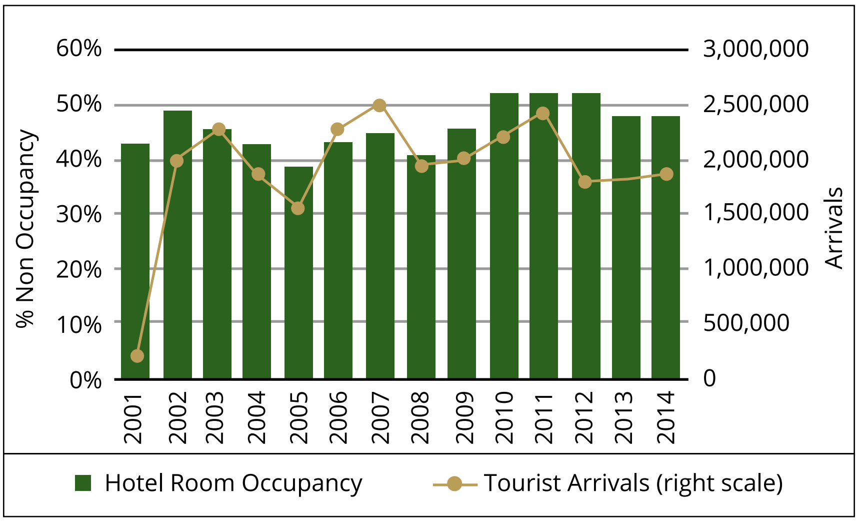
Appendix Findings From This Study In Graphs

Figure 1: Tourism Sector Contribution to the Zimbabwean Economy (2009-2014)



Source: Zimbabwe Tourism Authority, ZIMSTAT

Figure 2: Tourist Arrivals and Hotel Room Occupancy



Source: Zimbabwe Tourism Authority (ZTA)

Figure 3: VAT Collection on Domestic goods and services (February 2009-July 2015)

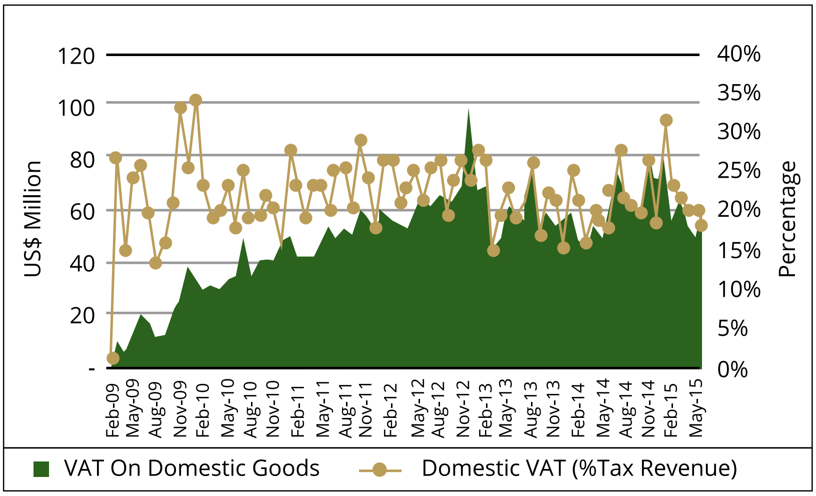


Figure 4: Distribution of destination countries for tourists interviewed

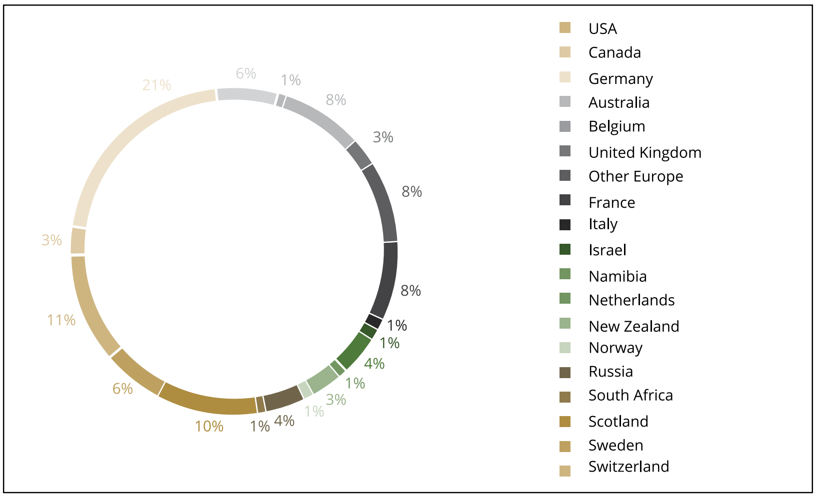


Figure 5: Average budget for Zimbabwe visit

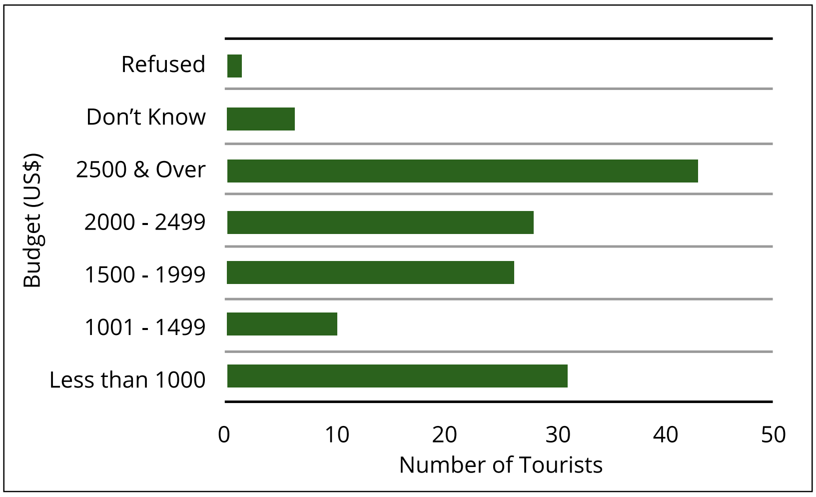


Figure 6: Likely reaction to an increase in accommodations costs in Zimbabwe

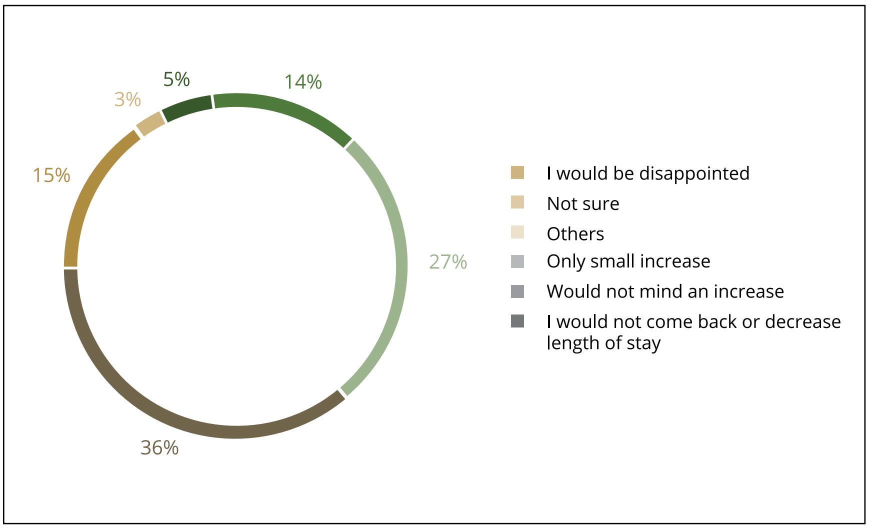
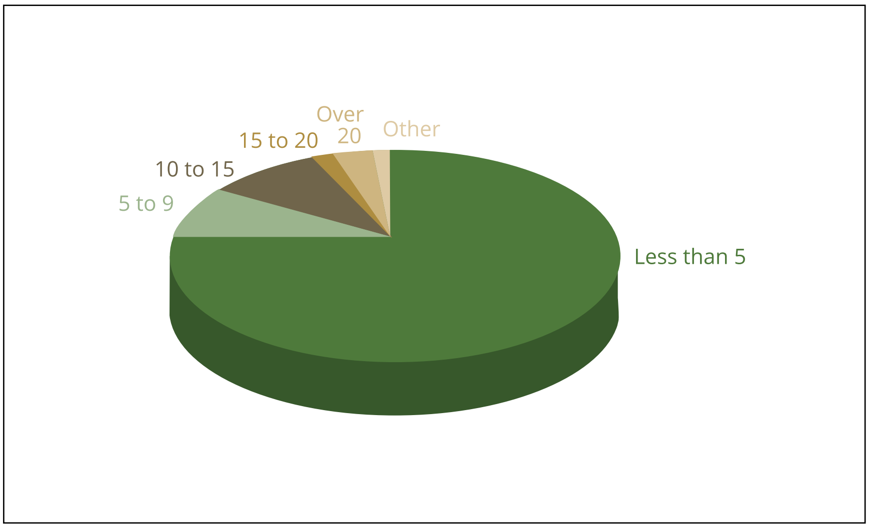


Figure 7: Maximum percentage increase in accommodation costs that the tourist would tolerate



About ZCT

The ZCT was formed in 1988, with the objective of speaking with one voice for the interests of Tourism private sector players throughout the country. ZCT works to ensure the creation of an environment in which it is possible for operators to maintain and grow their business, with consequent benefit to the economy as a whole.

Key activities include representation of the tourism sector at all levels of society, including with Government and its agencies. Other core activity is influencing opinions, policies, and planning and working for the creation of a favourable legislative, fiscal and physical environment for tourism operators.

Paper prepared for

The Zimbabwe Council of Tourism (ZCT)
No. 129 Baines Avenue
Corner 4th Street/Baines Avenue
Harare, Zimbabwe
Email: ceozct@gmail.com
Phone: +263-4-250 246

by

Zimbabwe Economic Policy Analysis & Research Unit (ZEPARU)
55 Mull Road Belvedere Harare
Email: chigumirag@zeparu.co.zw
Phone: +263-4-778423

and

Global Development Solutions, LLC (GDS
11921 Freedom Drive
Suite 550
Reston, Virginia 20190
USA
Email
Phone: +1 703 904 4373