EU VAT Laws Will Make Accession Countries a More Expensive Destination and Will Force Their Inbound Tour Operators Offshore

When the European Union accession countries of Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia, join the EU on 1 May 2004, they will be signing up for a new taxation regime that will make their destinations less competitive.

At present, travel to the accession countries is not subject to EU VAT law but it will become so and prices will need to rise to cover the new VAT element. In general, travel to the EU accession countries will become more expensive to visitors from EU countries and to visitors from outside the EU who travel with a tour operator based within the EU.

In addition, travel to the current member states of the EU will become more expensive from the accession countries if travelling with an operator based in the accession countries.

The relevant piece of legislation is the Tour Operators Margin Scheme (TOMS), which applies VAT to EU based tour operators who take visitors to countries within the EU. (Tour operators based outside the EU are not subject to TOMS.)

For many years, the European Tour Operators Association (ETOA) has been campaigning for reform of the way VAT is applied to Travel & Tourism on the following grounds:

VAT is being applied to exports

TOMS provides strong incentives for EU based operators selling Europe to visitors based outside the EU to relocate their business outside the EU and hence to move jobs offshore.

VAT on Exports

The business of bringing tourists into Europe from abroad is exporting, as inbound visitors arrive and spend foreign currency in Europe's theatres, hotels, restaurants and shops. In most industries, exports are exempt from VAT. However in the case of Tourism the situation is perverse; the current tax regime effectively discourages exports by applying VAT to inbound visitors.

TOMS Incentivises Inbound Tour Operators to Relocate Offshore

At present, the application of VAT to tour operating is dealt with under the Tour Operators Margin Scheme (TOMS), which is intended to simplify the application of VAT to businesses selling holidays in EU member states. VAT under the margin scheme is paid by the tour operator on the tour operator's gross profit (before overheads, sales, marketing and travel agent's commission) at the VAT rate prevailing in the country where the operator is based. If the operator is based in the UK, it must pay 17.5% VAT on its gross profit. If the operator is based outside the EU, under TOMS, it does not pay any VAT at all.

Consequently, EU based tour operators that take tourists to accession countries such as Hungary, Slovakia and Poland will, after accession, have to pay TOMS VAT on their margin. In effect this means that they will have a stark choice: either raise prices and become uncompetitive or relocate their businesses outside the EU.

Soon after the initial introduction of TOMS, several inbound tour operators previously based in existing member states, such as the UK, relocated offshore, owing to the substantial tax disadvantage of being based in the EU. The consequence was that jobs were lost and the tax policy backfired - because substantial tax revenues, which would have come in the form of corporation tax, National Insurance and employee income tax, were lost too.

In consultation with the industry, the European Parliament recognised the detrimental effect of VAT regulations on tourism exports and in 2002 recommended that sales to customers abroad should be exempt from VAT. If this were the situation, EU-based and Non EU-based operators would compete on an equal basis. This Parliamentary recommendation has been ignored.

ETOA calls on the Council of Ministers to adopt the recommendation by the European Parliament to create a level playing field between EU and non-EU tour operators by making sales to customers abroad exempt from VAT.

ETOA also calls on companies within the industry to lobby their governments to exert pressure for reform of TOMS along the lines ETOA is suggesting.

On the specific question of travel to the accession countries Tom Jenkins said: *"ETOA has campaigned long and hard for reform of the way VAT is applied to travel and tourism. When the accession countries appreciate the potentially detrimental impact of applying TOMS to their travel product, we would expect them to exert strong pressure for reform. New measures are urgently needed to stop Europe from pricing its new members out of the holiday market."*

On the broader question of EU Enlargement, Tom Jenkins said: *"To see states that were previously Communist dictatorships ending decades of isolation and joining the EU is very exciting moment in history. However, I doubt that they really appreciate what they are getting in to. The accession countries will have to move at tremendous speed to conform to EU protocols, such as indirect taxation. The recent action by the lower house of the Czech parliament to veto the requisite Finance Bill illustrates how hard it will be to make the new marriage work."*

Financial Illustration
Because net profit margins in the travel industry are small, the VAT impact is very substantial. An offshore operator would typically make a profit of $40 a head on a coach-touring holiday that sells for $1,000. For an EU-based operator to make the same profit on the same holiday, the selling price to the end customer would have to be $1,091.50, a premium of almost 10% for no added value! (The chart below explains this with realistic figures.)

	Non EU based operator	EU based operator	
Sale Price	1,000	1,000	1,091.50
Tour Cost (hotels, transport, etc inclusive of VAT)	600	600	600
Sales and Marketing	160	160	160
Travel Agency Commission @ 20%	200	200	218.30
TOMS VAT (sale price - tour cost)	**0**	**59.60**	**73.20**
Net Profit Margin (before overheads and corporation tax)	**40**	**-19.60**	**40**

For further information, including a photograph of Tom Jenkins, Executive Director, please contact ETOA on +44 (0) 20 7499 4412 or visit www.ETOA.org.