

AMERICAN UNIVERSITY OF ARMENIA

IMPACT OF THE INTRODUCTION OF HOTEL TAX ON LOCAL GOVERNMENT
AND THE HOTEL INDUSTRY IN ARMENIA

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LIST OF ABBREVIATIONS

CFOA- Community Finance Officers Association

AHA- Armenian Hotel Association

MTA- Ministry of Territorial Administration

LG- Local Government

ETC- Europe Travel Commission

CAPS –Competitive Armenian Private Sector

YSU- Yerevan State University

VAT- Value Added Tax

CIS- Commonwealth of Independent States

TOA- Tour Operators Association

Abstract

The hotel tax is applied in many countries under different names. Following the requirements of the European Charter on Local Self-Governance, RA Constitutional provisions, amendments made to the Law “On Taxes” and other RA laws, the government of Armenia initiated the introduction of a hotel tax in Armenia for the purpose of strengthening local governments’ institutional, fiscal capacities as well as diversifying their own source revenues.

The purpose of this Master’s Essay is to analyze the impact of hotel tax introduction on local government budgets and the hotel industry in Armenia.

Firstly, the paper gives an overview of the necessity to introduce a hotel tax in Armenia followed by the analysis of the main provisions of the draft “Law on Hotel Tax”. The paper next reviews the European experience of hotel tax application for the purpose of drawing conclusions and making recommendations for the case of Armenia.

Afterwards, the paper presents the main opportunities and challenges of hotel tax introduction for local governments and the hotel industry of Armenia followed by a review of the perspectives of public and private sector representatives related to the topic.

Next, the paper focuses on the case of Tsakhkadzor, summarizes the results of the survey and interviews conducted with hotel managers and city mayor of Tsakhkadzor.

In the final part, the paper analyzes different approaches to hotel taxation in Armenia, makes conclusions, gives a set of recommendations and provides with the limitations of the study and proposals for further research.

Introduction

Local governments in many countries are assigned diverse sets of taxes as major sources of their own-source revenues. While traditionally local taxes always included property tax (property in the broader sense, including any type of real estate), other types of taxes are also included, among them vehicle tax, sales tax, income tax, hotel tax, etc.

The logic of the hotel tax is to apply the tax on tourists because they enjoy all the services that residents of that specific city receive as taxpayers. But introduction of the hotel tax is not only a fiscal tool aimed at generating additional financial revenues and diversifying own source revenues, but also means to strengthen institutional capacity of local governments. It also stems from the provisions of the RA Constitution, RA Laws and European Charter of Local Government. However, the introduction of the hotel tax needs economic justification and a deliberate study of its implications on hotel and tourism industries of Armenia as well. Thus the purpose of the paper is to study the impact of introducing a hotel tax on local government budgets and hotel industry in Armenia.

General Review of Hotel Tax and International Practice

The Republic of Armenia Constitution and RA Laws' Implications

Following the requirements of the Republic of Armenia constitutional provisions, RA laws and European Charter of Local-Self-Government, the Government of Armenia has initiated the process of introducing hotel tax in Armenia, viewing it as an additional source of local government revenues. According to Article 106 of the RA Constitution, “The community shall generate its budget independently...the communities shall establish local taxes and duties within the scope defined by law...Communities can set forth fees for their services.” Article 107 of the RA Constitution states:

“The community shall exercise its right of self-government through the bodies of local self-government – the Council of Aldermen¹ and the Head of Community...

The Council of Aldermen of the community shall in conformity with the procedure defined by the law... (manage the community property, approve the community budget upon the submission of the Head of Community, oversee the community budget execution) envisage local taxes, duties and fees in conformity with the procedure defined by the law...(and adopt legal acts subject to observance in the territory of the community.)”

The amendments of April 27th, 2010 to the law “On Taxes” classify the taxes into two categories: state and local taxes. The Hotel tax is enlisted as a local tax among others: property tax, land tax, and tax on parking of transportation means. The law also prescribes that while the application of land tax and property tax is mandatory for each community, the application of two other local taxes is discretionary and their rates are established by the community council.

The Law on the Local Self-Government prescribes the power of the Community Council to “define the rates of local duties and fees set by the legislation” (Article 16). Article 34 specifies the activities of the Head of Community in the sphere of finances to include the submission of the draft decision on setting the rates and types of local taxes, duties and charges established by the legislation for the approval of Council. In addition, the Head of Community is obligated to carry out the “collection, oversight of property tax, land tax...local duties and fees...within the boundaries of the community.”

European Charter of Local Self-Government Implications

Local and regional democracy is one of the major fields of activity for the Council of Europe and a fundamental component of 21st century democracy in Europe. The aim of the Council of Europe is to reinforce and consolidate local and regional democracy in member states, to draw up and implement a framework of standards for the functioning of the State,

¹ We used here the original language of the English translation of the Constitution of Armenia. Elsewhere in the text the term council or community council will be used.

its institutions and its intermediate structures, such as municipal, provincial and regional authorities and to encourage the sharing of experience and best practice (Council of Europe 1985).

The European Charter on Local Self-Government, which entered into force in 1988, is one of the most important legal instruments of the Council of Europe and has been ratified to date by 38 member states, including Armenia in May of 2002 (Union of Communities of Armenia 2004). The purpose of the European Charter is to reinforce common European standards for “measuring and safeguarding” the rights of the local authorities, which stand the closest to the citizen as well as give him “the opportunity of participating effectively in the making of decisions affecting his everyday environment.” The Charter commits the parties to applying basic rules guaranteeing “the political, administrative and financial independence” of local authorities, which acting within the limits of the law, are to be able to regulate and manage “a substantial share of public affairs” under their own responsibility in the interests of local population (Council of Europe 1985). It is, thus, a demonstration at the European level, of a political will to the safeguarding and reinforcement of local self-government in the different European countries as an important contribution to the construction of a Europe based on the principles of democracy and decentralization of power.

The Charter sets out the principles concerning the protection of local authority boundaries, the adequacy of administrative structures and resources for the tasks of local authorities, the conditions under which responsibilities at local level are exercised, administrative supervision of local authorities’ activities, the financial resources of local authorities and legal protection of local self-government (Union of Communities of Armenia 2004).

The Article 4.2 of the Charter stipulates that “Local authorities shall, within the limits of the law, have full discretion to exercise their initiative with regard to any matter which is not

excluded from their competence nor assigned to any other authority.” In other words, Article 4 emphasizes the importance of local authorities as political entities to act in their own right to promote the general welfare of their inhabitants as well as the right to exercise their initiative in the scope of their authority.

To be able to carry out the responsibilities assigned by the constitution and the law, local authorities should be provided with adequate financial resources. According to Article 9.3 of the Charter, “Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.” Local authorities, thus, shall be provided by financial resources of their own as well as be responsible for setting the tax rate i.e. weighing the benefit of services provided against the cost to the local taxpayer. It is accepted that central or regional statutes may set overall limits to local authorities’ powers of taxation; however, they must not prevent the effective functioning of the process of local accountability (Council of Europe 1985).

According to Article 9.4 of the Charter, “The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.” Certain taxes or sources of local authority finance are, by their nature or for practical reasons, relatively unresponsive to the effects of inflation and other economic factors. Excessive reliance on such taxes or sources can bring local authorities into difficulties since the costs of providing services are directly influenced by the evolution of economic factors. The imposition of the hotel tax, thus, will ensure the diversification of the community financial resources which is currently lacking in the community (Council of Europe 1985).

Becoming a signatory to the European Charter on Local Self-government on May 1st, 2002, Armenia is now bound by the provisions of the Charter and obligated to decide upon

the introduction of the hotel tax as a local tax as well as establish the tax rates. The Hotel tax will strengthen the power of the local self-government bodies in administering and managing a substantial part of economic and public affairs under their own responsibility. In other words, the introduction of the hotel tax will emphasize the importance of the local authorities as political entities in exercising initiatives in regard to the economic and public life of their communities within the scope of their authority.

European Experience of Applying the Hotel Tax

The hotel tax is applied in many countries under different names such as hotel tax, accommodation tax or luxury tax. The tax rates differ from country to country while the purpose of the tax is usually the generation of financial revenues for the improvement of public facilities.

It is important to study the European experience of hotel tax introduction for the purpose of drawing lesson from their practice and making conclusions for the Armenian case. Within the framework of this study we will look at the hotel tax rates of 5 European countries, which are amongst the world's top 10 tourism destinations by arrivals and seven by receipts: Italy, United Kingdom, Spain, France and Germany (Center for European Studies 2010).

Italy

On 28th of July 2010 Rome City Council gave its approval, in accordance with Article 14, Paragraph 16, Letter e), of the Decree Law No.78 dated 2010, as converted by Law No. 122 dated 2010, to the introduction of an overnight accommodation tax on tourist services in the city (Municipal Council Resolution No. 67 dated 28th/29th July 2010). The fee is intended to financially assist the city's efforts in organizing urban services aimed at ensuring the standard

of the tourists' stay is both highly efficient and of the best quality (ETN Global Travel Industry News 2010).

The fee is set to be applied as of January 1, 2011 and will be asked of anyone staying in every overnight accommodation inside Rome's boundaries at the end of each stay, with the sole exception of hostels. Thus, from January 1, 2011 all visitors to the Italian capital must pay an extra 2 Euros per person per night to stay in hotels rated up to three stars and 3 Euros per person per night for four and five star accommodation (ETN Global Travel Industry News 2010).

It is worth noting that the fee is also levied on anyone who has booked or paid for the trip through a travel agency or tour operator and therefore pays by presenting a voucher at the reception desk. In the same way, as the grounds for the tax are not the general services provided by, for example, a hotel, but for overnight accommodation in the city, the fee is asked of anyone even where agreements stipulate exemption from payment of hotel bills (for example: group guides, CITI tourist coach drivers, etc) (The Telegraph 2011).

Tour operators and hotel owners have bemoaned the new levy. Hoteliers fear it will have drastic repercussions on the industry's profits: increasing costs; generating controversy with tour operators; affecting employment levels; and threatening tourist visits. The question of who will pay the tax is not easily answered as well. Hotels have already signed the contracts with the tour operators for 2011 and it would be problematic to change the rates in the catalogues already printed (Pasquini 2010).

According to Mauro Cutrufo, Rome's deputy mayor, who is also in charge of the municipality's tourism policy, the hotel tax doesn't "hit the hoteliers" because it will be paid by the tourists, not by the hoteliers "as a contribution for the services they use" (Pasquini 2010).

On the other side, however, hoteliers are sure that there is no other option left than to absorb the tax. The hoteliers would be forced to keep down the expenses and the risk is a reduction of the services which may damage the Italian offer. The absorption of the tax in turn will significantly reduce the hotel turnover harming hotel industry. Besides, the tax could also give rise to distortions of competition between the properties located in the territory of Rome and in neighboring cities. Since the tax is applied in Rome only, it may shift the preferences of tourists to stay in hotels of other cities to avoid paying the tax (Pasquini 2010).

Concerning the earmarking of the tax receipts, it is important to note that the tax receipts will not necessarily be invested in the tourist services or be directed to actions promoting tourism. There is no law that binds the city to use the revenues for a specific purpose. Thus hoteliers fear that the tax receipts will be used in areas other than promotion of tourism in Rome (Pasquini 2010).

United Kingdom

Starting from January 2011, the value added tax rate in UK rose to its highest level of 20% from 17.5%. The coalition government hopes the rise will address the budget deficit estimated to reach £155 billion (US\$240.4 billion) by the end of the year. In real terms this means an extra 2.13p added to each pound spent or, for an average middle class family, an estimated £600 (US\$931.18) more a year (Nand 2011).

In fact, with the VAT rate increase UK has now the third highest rate of VAT in the European Union; the only countries that have higher rates are Denmark and Lithuania. Opposition to the VAT increase claims it will discourage spending, thereby slowing the rate of recovery and potentially costing thousands of jobs. In terms of tourism, hotels and hospitality the concern is it will also deter overseas visitors and UK-based guests (Nand 2011).

According to recent research by TripAdvisor polling more than 3,200 people across Europe, 24% of respondents thought the increase would make the U.K. too expensive with an additional 26% undecided as to whether this might affect their decision to visit (Nand 2011).

Martin Couchman, deputy chief executive of the British Hospitality Association (BHA) said it is difficult to say what effect the rise will have on individual properties, but the BHA estimated that “the gross cost to the industry - and that’s hotel, restaurants and so on, is about a billion pounds (US\$1.6 billion) which will have to come from customers as well as from hotels and restaurants simply absorbing the costs” (Nand 2011).

France

France is considering taxing luxury hotels to fund restoration work for hundreds of aging historic buildings. Culture Minister Christine Albanel said a two-euro (£1.50; \$3) tax on four- and five-star hotels could be an "interesting" way to solve the problem (BBC News 2008).

The standard VAT tax rate in France is 19.6% since the year of 2000, however there is reduced rate of 5.5% for hotels and restaurants, food & drink; books; passenger transport; and some other goods and services. There is also a 2.1% VAT rate for goods from chemists and some newspapers (TMF Group 2011).

The French buildings which need repair and attention are scattered throughout the country. A recent study of such buildings was done and the ministry of culture found that 41 per cent of these buildings were in serious condition or risk being endangered beyond repair (Property Wire 2008).

The Culture Minister said the proposed tax could generate some 50 million Euros a year to top up the 300 million Euros of state funds allocated annually for restoration work. Ms. Albanel justified the plan by saying 70% of luxury hotel guests were foreign nationals, "who are often visiting in connection with our heritage"(BBC News 2008).

In response to the tax initiative, the hotel industry has concerns. Though in comparison to the costs of such rooms, which range from € 180 to € 220 per night, two additional Euros does not seem like much. According to hotel industry representatives, though, it is not about the additional cost as much as it is about tarnishing the tourism industry here in the world's eye. The tax would not hit locals, but tourists mainly, who are traditionally visiting the city to see many of these buildings anyway (Property Wire 2008).

Much of France's economy is based on tourism. The country is consistently one of the top rated tourism destinations worldwide. Some 75 million people visit France each year. There are over 18,800 hotels in France, about one third would be affected, and though it is unclear if additional bed and breakfast or tourists' residence of other styles would be affected by such a tax (BBC News 2008).

Spain

The IVA/VAT is a general consumption tax which is levied on all commercial activities involving the production and distribution of goods and the provision of services. It is a consumption tax because it is borne by the final consumer (Financial Services VAT Alert 2011).

IVA is calculated at a rate between 7% and 16%. On accommodation and restaurants the flat rate is 7%, but for retail goods, alcohol and electrical appliances IVA is 16%. So, if the room rate in Spain is 100 Euro, the visitor must pay 107 Euro per night for his stay (Financial Services VAT Alert 2011).

Germany

The German government announced plans to assist the struggling accommodation industry by reducing the VAT on hotel rooms from 19% to just 7% from the 1st of January 2010 (Financial Services VAT Alert 2011).

Like in the rest of the European countries German hotel industry had suffered during the economic downturn: in the first seven months of 2009, the average occupancy at German hotels was just 57.8, one of the lowest figures ever reported in Europe. By this announcement the government tends to encourage tourism to Germany and make the visitors stay longer (Financial Services VAT Alert 2011).

Summary

To summarize the European experience of hotel tax introduction it is important to note that the taxable services in European countries do not include services other than accommodation. In fact, the accommodation tax, in majority of countries, is assumed to be born by tourists rather than hoteliers. However in some cases hoteliers prefer to absorb the tax since they have previously signed contracts with tour operators for certain accommodation prices and published catalogues. In the latter case, the fear is that the hotel tax will greatly harm hotel industry and tourism development.

It is also important to differentiate between countries that have apply reduced VAT rate to support hotel industries to which a hotel tax is applied and those countries that have increased the VAT rate for hotel services for the purpose of generating financial resources to improve public facilities and promote tourism. The countries that apply a reduced VAT rate for hotel services are Italy, France, Spain and Germany. A fixed rate of two to three Euro accommodation tax is applied in Italy and Germany. France is considering an accommodation tax of two Euros to generate financial resources for the purpose of

conducting a restoration work. The only country that does not consider a hotel tax is United Kingdom that has instead increased the VAT rate that applies to hotel services up to 20% from 17.5%.

Table 1: Hotel/ Accommodation Tax and VAT rates for the year of 2011

Country	Hotel Tax Rate	Standard VAT Rate	Reduced VAT Rate
Italy	2-3 Euro	20%	10%
France	0.2-1.5 Euro	19.60%	5.50%
Germany	2-3 Euro	19%	7%
Spain	0%	16%	7%
United Kingdom	0%	20%	-
Romania	3%	24%	9%
Czech Republic	0.57 Euro	20%	10%
Malta	7%	18%	5%

The hotel tax and VAT rates of the countries included in Table 1 are retrieved from Tourism Department of RA Ministry of Economy showing that in majority of cases when a hotel or accommodation tax is applied, the hotels are eligible to pay a reduced VAT rate instead of a standard VAT rate so that the sum total of hotel tax rate and VAT rate does not exceed 20%. The application of a reduced VAT rate for hotel facilities that pay hotel taxes is done for the purpose of supporting hotel industry and mitigating the financial burden of the hotel tax. While in case of Armenia, if the draft law on hotel tax was adopted the sum total of hotel tax and VAT rate would exceed 20% reaching 22-25%.

Research Questions and Hypotheses

The following research questions have been addressed in this study:

1. How will the introduction of the “Law on Hotel Tax” initiated by the Ministry of Territorial Administration impact the local community budgets? Is the tax going to be only fiscal or also an economic instrument?
2. What will the consequences of introducing the hotel tax be on the facilities delivering hotel services? In particular how it may impact hotels’ sales strategies and amount of customers they serve?
3. How efficient will the hotel tax be in terms of generating enough financial resources for the development of tourism in the communities? Do the expected tax revenues significantly exceed the cost of administrating the tax?
4. What are other benefits of introducing this type of local tax in Armenia?

Hypotheses:

1. The introduction of the hotel tax initiated by the Ministry of Territorial Administration will enhance the financial capacity of and promote tourism development in selected communities, which have a developed tourism infrastructure.
2. Introduction of the hotel tax will have a negligible impact on the local government budgets in most of other communities. The cost of hotel tax administration by a single local government may be high enough to diminish the benefit of applying the tax.
3. Moderate rates of hotel tax 2-5% will not have a visible negative impact on the hotel industry, while higher rates will have a negative impact on the facilities delivering hotel services by decreasing the number of customers and ultimately leading to a decline of hotel income.

Methodology

The primary method used in this exploratory research was a case study, which included a face to face in depth interviews of 11 hotels in Tsakhkadzor and a face to face semi-structured interview with the city mayor of Tsakhkadzor Garun Mirzoyan.

The sample of hotels that was used for the survey conducted in Tsakhkadzor was created by a quota sampling method. Quota sampling allowed for a homogenous and representative sample of all the hotels of Tsakhkadzor. The sampling frame included 22 hotels enlisted by the following classes: five “five star” hotels, nine “four star” hotels and eight “three star” hotels or pensions. The final sample included 11 hotels of all classes of hotel facilities. The response rate was 91%, which means that ten out of eleven hotels agreed to take part in the survey. The observation units thus became mainly the general managers or managers of the hotels that were in the sample. The unit of analysis became the perspective of the interviewees concerning the hotel tax implications.

For the purpose of acquiring the perspective of the local government of Tsakhkadzor on the issue of hotel taxation, a face to face semi-structured interview was conducted with the city mayor of Tsakhkadzor.

Two other semi-structured face to face interviews were conducted with public and private sector representatives who have vested interest in the issue of hotel taxation in Armenia. The representative of the public sector was Mr. Mekhak Apresyan, the head of tourism department, RA Ministry of Economy and the private sector representative was Mr. Hakob Hakobyan, the president of Armenian Hotel Association.

This research is also based on primary data such as legislative acts, constitutional provisions, as well secondary data collection and analysis, such as analysis of international best practice of hotel taxation and other.

Results

Analysis of the draft Law on Hotel Tax

In 2010 Government of Armenia made an attempt to draft the “Law on Hotel Tax” and put it into circulation. Ministry of Territorial Administration (MTA) requested Community Finance Officers Association (CFOA) to develop the initial draft and send to the Ministry for their subsequent review. Besides the motive of generating own source financial resources for local governments, RA Government intended to design a local tax that could partially compensate for the reduction of subsidies that will take place when a new draft “Law on Financial Equalization”² is passed at the National Assembly. The draft “Law on Financial Equalization”, which is going to replace the acting one, may greatly reduce the amount of subsidies allocated to budgets of large communities for the benefit of smaller ones. Since the majority of large communities have developed hotel industry, the revenues generated from the hotel tax can potentially compensate for the reduction of subsidies allocated by State Government.

After drafting the “Law on Hotel Tax” in October of 2009, several public discussions were conducted with the representatives of public and private sector aimed at finding out their perspectives on hotel tax introduction for local government budgets and hotel industry in Armenia. This draft was posted on CFOA website (www.cfoa.am) after it was prepared. It was this version that became available to us and was analyzed in this paper.

Later, the draft “Law on Hotel Tax” was circulated in the Government for review, however in April of 2011, it was removed from circulation with a written comment made by Armen Gevorgyan, deputy prime minister saying that “ the law will not be circulated without an in depth discussion with the parties that have a vested interest in the issue³.”

² The draft “Law on Financial Equalization” has passed first reading at the NA on April 29th, 2009. It is available at the NA website: http://www.parliament.am/reading1_docs4/K-353.pdf

³ The information was received by Mekhak Apresyan, head of Tourism Department of Ministry of Economy.

According to the Law, the hotel tax “is a local tax, which is regulated in the framework of the Law on Taxes and the draft law.” The hotel tax is called for “enhancing financial capacity of and promoting tourism development in communities.” The tax payers defined in the law are “the facilities delivering hotel services in the Republic of Armenia.”(Article 4).

According to the “Law on Tourism and Tourism Activities”, which defines the hotel services delivered by the hotel facilities, hotel services include: accommodation, overnight stay, meal provision as well as other paid services connected to the accommodation. The hotel facilities are defined in the following way: hotels, motels, hotel type facilities, spa resorts, recreation and specialized camps, boarding houses, bed and breakfast facilities, youth and camping facilities (complexes) and guesthouses.

Article 6 of the “Law on Hotel Tax” defines the facilities liable to pay the hotel tax to include:

- a) hotel facilities, for which tax liabilities have been established in accordance with general procedures (value added tax and profit/income tax);
- b) hotel facilities, for which tax liabilities have been established in accordance with the presumptive taxation procedures.

Article 7 states the tax base for hotel tax to include;

- a) Actual receipts generated per delivery of hotel services by the tax payers established in the Clause a), Article 6 of this law;
- b) the space of hotel facilities deployed by the taxpayers established in the Clause a), Article 6 of this law (including the total space of fixed assets used for delivery of hotel services estimated in square meters).

The rates of hotel tax are established by relevant community councils within the limits established in Article 8 of the law (article 7). The rate of hotel tax will be the product of the base value of the tax defined in the Article 7 of this Law and the rates below:

a) 2-5 percent of actual receipts generated against delivery of hotel services by the tax payers established in the Clause b), Article 6 of the law on hotel tax;

b) 150-600 drams per quarter per square meter of the hotel facilities deployed by the tax payers established in the Clause b), Article 6 of the law on hotel tax.

Article 10 of the law on hotel tax stipulates that “the rate of hotel tax applicable in the community will be unified for all hotels operating in that particular community and will not be changed within the given budget year.” If the community council will not have established other rate for the next planned budget year, hotel tax rates will remain unchanged for the subsequent budget.

The hotel tax also defines the assessment and payment procedures in Articles 11-12 in the following way: “Hotel tax is assessed and paid to the relevant community budget by the taxpayer independently and in accordance with the procedures established by this Law. The reporting period for the hotel tax is the quarter.” Payers of hotel tax may pay tax obligations in installments to the community budget concurrently with the actual revenues generated on delivery of hotel services (taxpayers defined in the Clause a), Article 6 of this Law) or in quarterly installments equal to quarterly obligations (tax payers defined in the Clause b), Article 6 of this Law).

The draft law on hotel tax has several drawbacks in terms of lacking precise definitions of taxable objects, services, taxpayers, taxation procedure, taxation purpose, etc. Besides, the draft law is mostly written in a declarative mode than resembles a proper and detailed legal act.

The draft law defines the taxpayers to be “facilities delivering hotel services” in order to define the object of taxation; however the hotel tax is not necessarily born by the hoteliers. The question of who bears the hotel tax depends on elasticity of supply and demand for the named services and on the sales strategy of the hotel facilities. If the hoteliers are raising the

prices for the hotel services and showing the local tax by a separate line in the total bill, then the tourist will have to pay the tax. If the hotelier decides to keep the prices the same and absorb the tax, then the hotel tax will be paid by the hotelier at the expense of the profit. The demand for the hotel facilities that will raise the prices will be lower than the demand for competitive hotel facilities that decide to keep the prices for hotel services unchanged. However, it is important to consider that the demand for lower class hotels is relatively elastic to price changes while the demand for luxury hotels is relatively inelastic to prices. This means that if the lower class hotels raise their prices, the demand for hotel service will be greatly affected while the demand for higher class hotels will only slightly decrease at higher prices.

The draft law defines the taxable services to include “hotel services delivered by hotel facilities as defined in the Law of Armenia on Tourism and Tourism Activities.” Besides accommodation, hotel facilities have a variety of other services like restaurants, saunas, swimming pools, sightseeing tours, conference halls, etc. The list of taxable hotel services is not defined by the law on hotel tax, instead the law refers us to another law on “Tourism and Tourism activities”, which still does not provide the reader with specific definitions of types of hotel services.

Many European countries apply accommodation tax rather than a hotel tax, which means that a tourist pays a tax only for the accommodation service he receives. While the draft law on Hotel Tax envisages the tax to apply to “facilities delivering hotel services” in the Republic of Armenia. This means that a tourist will pay 2-5% tax on each of services provided at the hotel: accommodation, restaurant, pool, gym, movie theatre, etc. If all the services are taxable in the hotel, the hoteliers will face a difficult dilemma, whether to raise the prices for all the services, absorb the tax or diversify the prices for hotel services. The absorption of the hotel tax from all services will significantly reduce the profit of the hotelier,

while raising prices for all services can reduce the demand for the hotel. In either case, hoteliers will try to find ways to deviate from paying a hotel tax that applies to all hotel services. A solution would be either to reduce the list of taxable hotel services to a few in order to avoid deviant behavior or only tax the accommodation service similar to other European countries.

The range of 2-5% of the hotel tax rate is an obscure range. In fact, public discussions of this draft⁴ showed that no comprehensive economic analysis was made to justify these rates. It is also obvious that there are no clearly defined criteria based on which the rate of the hotel tax should be established. The obscurity and ambiguity of the tax rate establishment procedure may create in the future rooms for bargaining on behalf of taxpayers and discretion on behalf on taxing authorities.

According to the draft law, the purpose of the hotel tax is to “enhance the financial capacity and promote tourism development in communities”, however the draft law does not specify the essence of tourism development and the means to achieve it. In other words it must be clearly stated the spending strategy of tourism development and the priorities of that spending.

Divide between the Hotel Industry and Government on Imposition of Hotel Tax

Initiated by Counterpart International and USAID a public discussion of the draft Law on Hotel tax was held on January 26, 2011. The list of participants of the public discussion included number of representatives of public and private sectors: representatives of Ministry of Economy, Ministry of Finance and Ministry of Territorial Administration; representatives of hotel businesses, Armenian Hotel Association, Armenian Tourism institute as well as NGO's of the CFOA and Protection of Consumer Rights.

⁴ A public discussion of the draft law was organized by Counterpart International and USAID on January 26, 2011 in Golden Tulip Hotel Yerevan.

The CFOA introduced the draft law of the hotel tax and raised many questions of vital importance for the stakeholders of the issue. One of the most controversial questions was whether the hotel tax will benefit local communities to such an extent that it will outweigh the additional burden incurred by tourism industry.

The Armenian Hotel Association stance was quite negative and critical on the issue. They were strongly against the introduction of the hotel tax claiming that it will be an additional burden on hotel industry. The concern is that since the tax will be born by the tourists, the hotel tax threatens to reduce number of tourists. In face of high competitiveness among tour packages the additional hotel tax will raise the prices for Armenian tour packages and thus harm Armenian tourism industry. Their stance on the issue was so unalterable that when they were informed about the fact that the draft law on the hotel tax was sent to Government for a review, they made it clear that any further discussion of the hotel tax is meaningless and left the discussion table.

The Tour Operators Association's perspective on the Hotel Tax introduction was also critical in terms of the issue of selling the tour packages in advance. In case when the hotel tax is imposed the concern is that the tax will be born either by tour operators or by hoteliers. The president of the TOA proposed to make a pilot imposition of the tax in one community and closely follow up on the impact.

The participants of the discussion shared the perspective on the need for more expertise and a careful study of the implications of the hotel tax. It is essential for each tax initiative to pass through an evaluation in terms of the impact of the tax on the economy, hotel industry and tourism development before a draft law is sent to the Government to be reviewed. Most importantly, the hotel tax introduction should be done taken into account the peculiarities of Armenian hotel and tourism industries and within a complex approach based on the characteristics of the community.

Benefits and Challenges of Hotel Tax Introduction

The introduction of the hotel tax is not a simple and straightforward task neither for the initiating party, The Government, (the Ministry of the Territorial Administration) nor for National Assembly that reviews and votes on the adoption, not to mention the parties to whom does the tax directly apply. The parties involved have differing and even to say adverse positions on the matter. The local communities are meant to be the beneficiaries of hotel tax introduction in that the tax will generate new and diversified financial resources to the communities to be spent on tourism development. The main resistance comes from hotel facilities (objects of taxation) and the Hotel Association of Armenia in that the additional tax burden will harm hotel and tourism industry by raising prices on hotel services. Especially in view of high competitiveness in international tourism market, Armenian tourism industry will be highly affected by increased hotel service rates.

The hotel tax has several peculiarities:

- One of the peculiarities is that it is a non compulsory tax and each community decides upon its introduction and tax rate on a voluntary basis (within the rate scope)
- Another feature of the hotel tax is that the impact of the tax will be seen in a long run. It will take time for businesses to see the positive impact of local government expenses directed to support taxpaying units in serving better the tourists.
- Also, the hotel tax is unique due to the fact that it will be the first tax to be established by communities themselves. Rates of other local taxes such as property and land taxes are set so far by the law.

Benefits of the Hotel Tax

The main benefits of the hotel tax are as followed:

- Firstly, the introduction of the hotel tax will grant communities with greater financial independence in managing their own financial resources generated by the tax and exercising an independent financial strategy under their full discretion within the scope of their authority and limited by the purpose of the tax.
- Secondly, the hotel tax is a fiscal tool allowing for a diversification of community budget revenues and an additional source of financial means.
- Thirdly, the hotel tax will initiate an enhanced cooperation between the private sector and community.
- Next, the revenues generated by the hotel tax will potentially help the community to improve the quality of public services provided to the visitors of the community and ultimately improve their satisfaction.
- Although the tax burden is born by tourists or visitors rather than local residents, the primary beneficiaries will be community residents.
- Finally, the revenues from the hotel tax will be spent on the improvement of the community infrastructure which will in turn promote tourism development and benefit hotel facilities in the first place.

The Main Challenges of Introduction of Hotel Tax

One of the main challenges is the limitations of the scope of the hotel tax implications. In fact, a limited number of communities: approximately 70-90 communities out of 915 have hotel facilities where the hotel tax can be applied. It might not be efficient to introduce the hotel tax in communities with few hotel facilities, thus the hotel tax will not cover all communities in Armenia.

Another challenge for community authorities is the obligation of the community council to establish the optimal rate of the hotel tax which will not harm the hotel industry of the

community. In other word, it can be a challenge for local authorities to find an optimal tax rate that will be mutually beneficial both for the community and for the hotel facilities. It is also possible that some of the local authorities have vested interest in the hotel business in their home towns which is another factor potentially affecting introduction of that tax in cities.

A consequence of the challenge mentioned above can be strained relationship between the hotel owners and community authorities in case they don't find a common approach to the hotel tax rate and administration issues.

If the hotel tax rate is established too high, it will most probably increase hotel service costs and decrease the number of visitors and tourists, thus hurting hotel industry and tourism development in that specific community where the tax is to be introduced.

Any tax introduction is not only an additional financial burden but also a challenge in terms of administration of the tax. The benefit that comes from the tax should highly outweigh the costs of tax administration and oversight; otherwise the administration of the tax will be too costly and inefficient for the community.

The tax doesn't specify whether it will be applied only to tourists or the local citizens or nationals of Armenia as well. If the tax is applied solely to tourists, non residents of RA, then hoteliers will need ID documents as a proof for tax liabilities the need for which will be complex to explain to each tourist.

Balancing Tourism Promotion and Hotel Tax Burden

The analysis of the hotel tax in terms of its impact on the Armenian economy, tourism industry and hotel business is not complete without the consideration of perspectives of public and private sectors' representatives on the subject. Interviews with Mekhak Apresyan, Head of Department of Tourism and Territorial Economic Development, RA Ministry of Economy and

Hakob Hakobyan, President of Armenian Hotel Association and General Manager of Tufenkian Heritage Hotels shed light into many details of great importance on the implications of hotel tax introduction in Armenia.

Interview with Mekhak Apresyan

When presenting the details of the hotel tax and asking about what it is aimed at Mekhak Apresyan said that the purpose of the initiative is to promote community development and ensure financial means to resolve community-level tourism development issues by replenishing the local budgets.

Mr. Apresyan said that although the idea is good in itself, in order to reach the best results and not to have a negative impact on tourism development in Armenia and the competitiveness of the Armenian tourism product in the international market, it needs to be implemented by holding discussions with the interested parties and jointly finding the best solutions.

According to Mr. Apresyan, the principle of not increasing the tax should be adopted so as to avoid inappropriate price increases of hotel services, and as a consequence, travel packages. One option to discuss here is the application of the hotel tax at the expense of a decreased VAT rate for hotel services.

Interview with Hakob Hakobyan

A face to face semi-structured interview with Hakob Hakobyan, president of Armenian Hotel Association and General Manager of Tufenkian Heritage Hotels was conducted on April 27, 2011 for the purpose of getting familiar with some of the issues related to the hotel tax which Mr. Hakobyan is mostly concerned about.

According to Mr. Hakobyan, “In the current conditions of social-economic development of Armenia, an introduction of any additional tax will negatively impact Armenian economy. Since the hotel tax assumes additional tax burden, it cannot positively affect economic and tourism development in Armenia.”

His main concern is that the introduction of the tax will automatically increase the prices of hotel services. Currently the Armenian tourism product is in the range of middle to high prices, and is comprised of several components: airfare, hotel accommodation, meals, tours, taxes, etc. In view of high competitiveness in international tourism market, a hotel tax introduction will lead to an increase of prices for the Armenian tourism product, which will have negative consequences for tourism development in Armenia.

Mr. Hakobian is concerned about the potential of Armenian hotel business to absorb the additional tax burden. Currently Armenian hotels do not have the capacity to raise prices for services in most of cases. In communities where there are 2 or 3 hotels, the additional burden will not generate significant financial means, meantime greatly harming hotel businesses. An example of such a community is Goris, where there are 2 hotels with a capacity of 60 rooms each. The annual turnover in Goris is around 100 mln AMD, a hotel tax of 3-5% will generate around 3-5 mln AMD per year, around 250- 416 thousand AMD monthly, which can be spent on asphaltting approximately 15 sq meters of road per month.

Bearing in mind the problem of communities with few hotels, Mr. Hakobian proposes an analysis of the potential of all communities, hotel business revenues, tourism flows, etc. The cluster approach to the hotel tax will allow for an individual analysis of communities and their capacity to bear an additional tax. A hotel tax can be imposed only in communities with many developed hotel businesses, like Yerevan, Tsakhkadzor, Jermuk and Dilijan. In the rest of the communities with few hotels and underdeveloped tourism infrastructure, it is pointless to introduce such tax.

Concerning the question of earmarking of the hotel tax receipts to the development of tourism infrastructure in communities, Mr. Hakobian said that the development of the infrastructure should not be carried out to the detriment of hotel revenues. The price increase of the Armenian tourism product should not proceed but follow the development of tourism infrastructure. It makes sense to improve the Armenian tourism product first, and then raise the price of that product not vice versa.

Moreover, the earmarking of the hotel tax receipts to tourism development assumes drafting of concrete business plans. Most of the community councils do not have the appropriate skills to be able to draft literate business plans of tourism development.

Hotels are already improving the quality of community life by providing employment, improving roads, placing garbage cans, etc. The Tufenkian hotels in Dzoraget and Tsapatagh provide jobs for more than 100 families. The cost of installment of drinking water system, electricity, street lighting, gas system and sewage disposal system in these communities was incurred by the Tufenkian hotels. The installment of sewage disposal system alone cost 40 thousand USD to the Tufenkian hotel. The drinking water system of Dzoraget Tufenkian hotel provides purified drinking water for the village population as well.

Concerning AHA's involvement in drafting the law on hotel tax, Mr. Hakobyan said that the perspective of the Armenian Hotel Association was not considered in the drafting process. The AHA learnt about the hotel tax after the amendment to the law on "Taxes" was adopted by the National Assembly. Afterwards, the AHA took part in a public discussion of the hotel tax at the Ministry of Economy, where the management expressed a negative standpoint on the issue. The only positive feedback was received from local government representatives. According to Mr. Hakobian, the "Law on hotel tax" should be drafted jointly with all interested parties involved, with the purpose of finding mutually beneficial approach of the tax. Adoption of a hotel tax law that will apply to all Armenian communities with the same

tax range is a wrong approach. It is important to consider the characteristics of the communities, the flow of tourists and hotel facilities of all communities and many other factors, and create a law which will have a cluster approach.

Before the adoption of the law, however, it would be wise to make a pilot in several communities with different levels of tourism and hotel activity, and analyze the impact of the hotel tax on tourism and hotel business in these communities.

It is important to note that as the president of Armenian Hotel Association Mr. Hakobian's perspective on the hotel tax introduction can be considered as representative of most of the hotel businesses in Armenia. The main concern is how to modify the sales strategy when an additional tax is introduced. The question becomes whether to cut expenses, to raise prices or to absorb the tax. When the hotel tax is introduced, Mr. Hakobyan projects to absorb the tax at the expense of his business revenues received from the tourist groups which have already made the pre-payment. The latter approach will most probably be the common approach for most of the hotel businesses in Armenia.

A Case Study of Tsakhkadzor City

Overview

Tsakhkadzor is one of the main tourism and leisure centers of Armenia. It is famous for its ski resorts as well as cultural and historical monuments. Tsakhkadzor is located on an altitude of 1840 m from the sea level, on the eastern slope of Mount Teghenis. Lofty mountains and deep forests surround the city. Tsakhkadzor has a soft salubrious climate; the average air temperature in August is +18 Celsius degrees and in January is -6 Celsius degrees. The average annual precipitation is 600-700 mm with 2500 sunny hours annually. There are 1700 people living in the community, who are mainly occupied in service industry (Armenian Development Agency 2006).

There are 22 hotel facilities in Tsakhkadzor today, with a total number of 1206 rooms and 2548 beds⁵. Tsakhkadzor is visited by around 8500 tourists annually⁶.

Tsakhkadzor city has been famous for hosting the Main Winter Sports Olympic Centre of the Soviet Union. It became even more popular as a mountain ski resort after well-known LEITNER Company constructed a new ropeway on the slope of Mount Teghenis (2900 m) in 2004 (Armenian Development Agency 2006).

On June 9, 2005 the government of Armenia drew up a project of making Tsakhkadzor an international tourism center by the year of 2007. According to Ara Petrosyan, the former deputy minister of economy the project which cost around 1.6 billion AMD aims at achieving two goals: to promote tourism to Tsakhkadzor and Armenia taken as a whole and to prolong the tourist season in Armenia⁷ (Martirosyan 2005).

Competition with Other Ski resorts

Today there are ski resorts in almost all European countries: approximately 150 ski resorts in 25 countries. To be able to compare the accommodation rate of Tsakhkadzor hotels with other European ski resorts an example can be brought: the accommodation rate for a group of 5 people in January in Meribel resort of France is 605 EUR for 7 days, which makes up 18 USD per person per night. While the accommodation rate in Tsakhkadzor for the same period of time in the same type of hotel would cost twice expensive. Of course, the prices for ropeway are quite cheaper in Armenia compared to Europe; however Armenia abates in prices for airfare and the availability of a diverse transportation system (ROA Government Decree # 948 2005).

⁵ The data is taken from Tourism Department of Ministry of Economy.

⁶ The estimate of tourism flow is taken from Garun Mirzoyan, city mayor of Tsakhkadzor.

⁷ Since Armenia has been known to the international market as a country of 3 seasons (spring, autumn, summer), once Tsakhkadzor is developed Armenia was to become all-year-around tourism country.

Competitiveness is quite tough in the region as well. Winter resorts operate in Lebanon, Turkey, Iran and Israel. Among CIS countries winter sport tourism is developed in Ukraine, Russia, Georgia and Kazakhstan. The most developed winter resorts in the region are Turkish resorts, which are relatively new and actively emerging into the International market. Those resorts are Paklanduke, Sarighamish and Erzurum (ROA Government Decree # 948 2005).

All of the above mentioned resorts are equipped with ropeways that meet international standards. Those resorts have better infrastructures, cheaper prices and provide better service than Tsakhkadzor. However it is important to note that Tsakhkadzor has several advantages in CIS market in terms of a relaxed visa regime and the nostalgic psychological factor related to the former Olympic Center. The advantages of Tsakhkadzor resort for the international market include the prospects of discovering a new resort; hospitality and safety and the possibility to combine skiing with cultural historical, religious and other tourism types (ROA Government Decree # 948 2005).

Survey of Hotel facilities of Tsakhkadzor City

For the purpose of familiarization with the perspective of management of hotel facilities concerning the hotel tax introduction face-to-face interviews were conducted with the General Managers and Managers of 11 hotel facilities of Tsakhkadzor city. The sample frame was retrieved from www.armhotels.am website, which provided contacts of 22 hotel facilities of Tsakhkadzor city. Then the hotel facilities were enlisted by categories⁸ (five star, four star, three star pensions) and the sample was created by a quota sampling method for the purpose of achieving a homogeneous sample. The final sample included 11 hotels of different categories.

⁸ Majority of hotels in Tsakhkadzor do not have official categorization. However for the purpose of research the mentioned categories were taken from www.armhotels.am site which best describes the hotels and their classes.

The response rate of the survey was 91%: out of 11 hotels only one five star hotel refused to participate in the survey⁹. In fact, the tax liabilities for all ten hotels have been established in accordance with general procedures; the tax liabilities of only two restaurants have been established in accordance with the presumptive taxation procedures. Two out of ten hotels interviewed had ‘five star’ rating (Rossia and Vosku Ashkarh hotels) , a capacity of hosting 100 visitors in average, with high season occupation rate of 60% and an average room rate on full board of 48,000 AMD.

Three ‘four star’ hotels that were interviewed had an average capacity of hosting 200 visitors, an average high season occupation rate of 70-75% and an average room rate of 25,000 AMD (full board and high season prices).

Out of five remaining three star hotel facilities, three were pensions and two were hotels. The 3 pensions in average have a capacity to host 65 visitors, with average occupation rate (high season) of 60% and average room rate of 17,000 AMD. The two three star hotels had an average capacity to host 185 visitors, with average high season occupation rate of 35% and average full board room rate of 10,000 AMD.

The interviewees of the survey were mainly general managers with only two exceptions: one manager (Sport Complex) and one financial director (Vosku Ashxarh).

The main questions of the interviews aimed at finding out the awareness of the hotel Management about the amendment made to the “Law on taxes” and the establishment of hotel tax as a local tax type in Armenia as well as the familiarization with the concerns about hotel tax implications, possible solutions and the areas which need improvement in their community.

⁹ Fifty percent of the overall hotel facilities in Tsakhkadzor were interviewed.

Only three out of ten respondents were aware about the amendment made to the “Law on Taxes” and were familiar with the draft law on “Hotel Tax”¹⁰. Sixty percent of the respondents think that their community council will approve the hotel tax if the law is established; twenty percent said that they don’t think that the community council will apply the tax and twenty percent of respondents said they can’t say for sure.

Only twenty percent of the respondents said that prices for hotel services would rise in case a hotel tax of 2-5% rate is applied in their community (Spendor and Viardo ‘three star’ pensions). They were concerned that the increase in prices would negatively impact the number of visitors of their hotels as well as ruin their long-term relationship with the customers. The rest of the respondents said if the hotel tax is applied they would absorb the tax and keep the prices of hotel services at the same level at the expense of their profit. Twenty percent of the respondents (hotel Russia and Sport Complex) said that their sales strategy might as well include the diversification of hotel services.

Forty percent of the respondents said that if given the opportunity they would be very willing to negotiate the tax rate with the community council, forty percent said they would be somewhat willing to negotiate and twenty percent said that it will be impossible to negotiate the tax rate with the community council.

The main concern of the 90 percent of the respondents was that in conditions of high competitiveness with tour packages of other ski and spa resorts, Tsakhkadzor tour packages are not very attractive due to expensive airfare and high hotel prices. The average accommodation rate per person in high season on the basis of full board differs from 9000 AMD in a ‘three star’ hotel per night to 47,000 AMD in a five star hotel. The increased cost for public utilities and food as well as the Federal and local taxes have already increased the net cost of hotel services. An additional hotel tax would further increase the cost for most of

¹⁰ General Managers of Kecharis and Splendor had previously participated in a discussion concerning the hotel tax organized by the ministry of economy. Manager of YSU Guesthouse is a relative of the city mayor from whom he learnt about the hotel tax.

the hotels. Since the sales strategy for most of the hotels is to sustain the same prices due to competitiveness the hotel tax will mostly be absorbed by the hoteliers at the expense of their profit.

Interestingly enough, participants of the survey proposed several different solutions concerning the hotel tax imposition. One of the solutions was to decrease the VAT by the same rate as the hotel tax will be established or to give hotels other privileges like exemption from other local or federal taxes. The General Manager of Kecharis hotel proposed to apply the hotel tax only in case if the number of tourists exceeds certain threshold. The General Managers of Alva and YSU Guesthouse proposed a hotel tax of a fixed amount of 200-300 AMD per tourist per night to avoid complications with tax calculations. The hoteliers who were prone to increasing the prices in case the hotel tax is applied said they would show the hotel tax by a separate line like the VAT for the tourist to understand that the price increase is due to an additional tax.

Besides the issue of tax implications for hotel and tourism industries, the respondents were greatly concerned about how the revenues generated from the hotel tax will be spent.

Concerning the question on how they would like the local government to spend the revenues generated from the tax, respondents gave priority to the building of roads, street lighting, garbage removal, public toilet installations and amusement centers. According to several hoteliers after several days of stay in Tsakhkadzor tourists get bored since there are no amusement centers like movie theatres, concert halls, museums, open air festivals etc (the only bowling hall is in Kecharis hotel in Tsakhkadzor). Although most of the hotels have mini movie halls, pools and saunas, there are no public amusement centers and a very limited number of public parks and restaurants. Several respondents mentioned the great need for installing signboards in different languages as well as establishing a medical centre and fire station. Several hoteliers proposed that the revenues generated from the hotel tax be spent on

presenting the hotels of Tsakhkadzor in tourism exhibitions abroad as well as printing informative brochures about the services hotels provide. Several respondents mentioned the need for organization of trainings for the hotel staff to raise the level of services to meet high standards. The Manager of Sport Complex said that it would be sensible for the community council to present an Action Plan with a fixed amount of finances based on which the tax rate could be established. One expensive project proposed was to install a snow blow system to extend the ski season and attract more tourists to the community¹¹.

Face to Face Interview with Tsakhkadzor City Mayor

The Case study of Tsakhkadzor is not complete without the consideration of the perspective of Garun Mirzoyan, the city mayor of Tsakhkadzor concerning the impact of hotel tax introduction on local government budgets and hotels of Tsakhkadzor. For this purpose a face to face interview was conducted on May 13th with Garun Mirzoyan. It is interesting to mention that Mr. Mirzoyan is simultaneously the president of the Hotel Association of Tsakhkadzor. Eight out of 22 hotels are members of the Hotel Association and pay annual membership fee of 50 thousand AMD for the operation of Hotel Association. The main activities of the Association include the publication of informative catalogues of the Association member hotels, group discussions of a variety of issues related to hotel industry and tourism promotion and the representation of Tsakhkadzor tourism product in international exhibitions.

During previous seven years, hotels of Tsakhkadzor were annually being presented at the International Tourism Exhibition in Moscow within the framework of “Skiing” and “Recreation” resorts. Financed by city municipality and Tsakhkadzor Hotel Association an exhibition hall of 9-12 sq. meters is rented annually for the representation of Tsakhkadzor

¹¹ The season for skiing is very short a few months in winter only.

city as a ski and recreation resort during the Tourism Exhibition in Moscow. Around 5000 EURO is spent by the city municipality on publications and for renting the exhibition hall annually. However due to limited financial resources the municipality couldn't afford to represent Tsakhkadzor city in the framework of "Recreation" resorts on March 2011. In this view, the tax receipts could be spent on renting a larger exhibition hall in International Tourism Exhibitions, making more publications so as to represent Tsakhkadzor city in a better way.

Being familiar with the practice of hotel taxation in several Alpine ski resorts, Mr. Mirzoyan pointed to the importance of making it clear for the hoteliers that the hotel tax should be borne by the tourist rather than at the expense of the hotel profit.

In view of the fact that the population of Tsakhkadzor city is 1700 people, which becomes 5 times more during high touristic season a tourist who enters the community is provided by community level services for which s/he does not pay. A tourist who pays the hotel bill for the services provided at the hotel should also pay for the services provided by community where the hotel is situated. Such services include the developed infrastructure, solid waste removal, street lighting, public toilets, public parks, etc. Since tourists equally benefit from the community services as the local citizens who pay taxes to the local government, it would be wise to tax the tourist with a fixed rate of 200-300 AMD per tourist.

The law on the "Hotel Tax" should be written so as to define the taxable objects, services as well as taxation procedure accurately in order to avoid ambiguity. Mr. Mirzoyan mentioned the importance of the city municipality to have power over the administration and collection of the hotel tax or share the power with the State Tax Service¹². The base of the

¹² In fact the power of local tax collection is mandatory over the head of community: Law on Local Self-government, Article 34 stipulates that the head of community has the following obligatory competencies in the financial sphere: He/She organizes the collection and control of local taxes, fees and charges as well as the rents of community and state owned lands within the community administrative borders and the rents of community owned property.

taxable objects could be provided by the State Tax service but the collection and oversight of payment should be within the jurisdiction of the local community.

As Mr. Mirzoyan stated that earlier experience with property and land taxation administration proves that it should be executed within the jurisdiction of local community rather than by the State Tax Service. When the collection of property and land tax was exercised within the jurisdiction of State Tax Service, it suffered efficiency since the collection rate of those taxes did not effect the performance assessment of the State Tax Service employees. As soon as administration and collection of those taxes was transferred to communities, the collection rates went up significantly.

Concerning the question of a presumable resistance by hoteliers concerning the hotel tax introduction, Mr. Mirzoyan said that if the rate is established as a fixed tax per tourist, he does not foresee any resistance by them. According to him, hotels of Tsakhkadzor are in need for much advertisement abroad, however it is easier to represent those hotels as part of Tsakhkadzor resort than individually. In this regards, Mr. Mirzoyan proposes that the financial means generated from the hotel tax be directed into 2 major projects: the promotion of Tsakhkadzor resort abroad and the creation of a Tourism Service Center in Tsakhkadzor.

The second project proposed by Tsakhkadzor city mayor is to open a Tourist Service Center under the authority of Tsakhkadzor city municipality. This center will not only be an information facility, but a center which will organize the leisure of the tourists as well. The center will deal with the following main tasks:

- Provide information on the hotels of Tsakhkadzor and other facilities
- Organize tours for tourists upon their request
- Organize cultural and sport events
- Train hotel staff
- Make publications of hotels and distribute during exhibitions

This centre will be totally financed by the receipts generated from the hotel tax and will be financed according to a business plan approved by Tsakhkadzor City municipality.

Analysis of Potential Revenues from Hotel Tax Receipts in Tsakhkadzor city

The available data on hotel average room rates, occupation rates and number of rooms in Tsakhkadzor city allowed for a crude calculation of the potential revenues generated from the introduction of an accommodation tax in Tsakhkadzor city incorporated in Table 2.

The data that was collected during the interview survey conducted with 10 hotels of Tsakhkadzor. Since the occupation rates and average room rates vary depending on the season, the estimation is carried out upon three seasons: high season, low season and Christmas time. It is also important to note that the occupation rates mentioned in Table 2 are approximate since majority of the hoteliers do not keep track of tourism flows and occupation rates. The data representing the amount of city administrative budget, property and land tax receipts are retrieved from Armenian Statistical Service and allow comparing the tax receipts with other local taxes.

The estimate of potential hotel tax receipts show that the receipts of 2-5% hotel tax comprise the share of 35-87% of city administrative budget. At the rate of 2% only the hotel tax receipts can be comparable with the amount of property tax receipts while a 5% hotel tax can generate a triple of the property tax amount collected in 2010. Thus the estimate shows that the hotel tax at even the lowest rate can generate significant financial resources for Tsakhkadzor's budget and can be comparable with other local taxes.

Table 2: Estimate of Potential Annual Revenues from Hotel Tax for Tsakhkadzor city (2011)

	High Season	Low Season	Christmas	Year Around
Average Room Rate (AMD)	23,200	18,600	26,000	22,600
Number of Rooms	1206	1206	1206	1206
Occupation rate (Percentage)	59	10	100	56
Season period (days)	98	254	13	365
Gross Receipts (AMD thousand)	1,606,006	569,762	407,628	258,339
Hotel Tax Receipts at 2% (AMD thousand)				51,667
Hotel Tax Receipts at 5% (AMD thousand)				129,169
Administrative Budget Revenues of Tsakhkadzor (AMD thousand)				148,261
Share of 2-5% Hotel tax in budget revenues				35-87%
Property tax receipts in 2010 (AMD thousands)				50,561
Land tax receipts for 2010 (AMD thousands)				2,550

Findings of the Case Study

- The awareness of the draft “Law on Hotel Tax” among the hoteliers surveyed was quite low (30%).
- Survey results show that a 2-5% hotel tax will have a negligible effect on hotel service prices. According to eighty percent of respondents, due to high competitiveness and the desire to keep prices as low as possible, the main sales strategy for hotels would be the absorption of the hotel tax. However, the absorption of the hotel tax will reduce hotel profits which can be a discouraging factor for investment in hotel business.

- Due to the fact that the city mayor of Tsakhkadzor is also the president of the Hotel Association of Tsakhkadzor, he will greatly contribute to the establishment of the optimal hotel tax rate that would generate significant financial resources without harming hotel industry and tourism development in the community. It is possible that in other cities municipal authorities will have similar vested interests that will contribute to establishing the tax rates at the minimum level possible.
- The annual revenues from a 2-5% hotel tax would generate around 51-129 million AMD annually for Tsakhkadzor city which comprises 35-87% of the administrative budget revenues. The minimum tax rate is comparable with the property tax receipts for Tsakhkadzor city for the year of 2010.

Analysis

In this section the paper will analyze some alternative approaches to hotel taxation which may generate significant financial resources without creating additional tax burden on the hoteliers.

1. One of the approaches is to apply a 2-5% hotel tax as a deductible expense from gross revenues charged with the objective to assess profit tax. This way the tax will be considered as an expense which will be deducted from the hotel revenues thus reducing the payable profit tax.
2. Another approach is to tax a 2-5% hotel tax at the expense of a decreased VAT, which means that the hotels will continue to pay 20% VAT of which 15-18% will be a central government tax, and 2-5% will be a local tax. This will mean that the central government will share some portion of its VAT receipts with the local governments similar to subsidies that local governments receive from the state budget. Of course this approach

will most probably receive strong resistance from the central government which will object against any legislative provision that may reduce its budget receipts.

3. Third approach to the hotel tax is to apply a 2-5% tax only on accommodation service rather than all services provided by hotel facilities. Since hotels provide a wide range of services, including accommodation, catering, laundry, spa centers, movie halls, sightseeing tours, etc. it will be a great financial burden for a hotelier to absorb the hotel tax on all of the services provided. It may ultimately be meaningless to operate a hotel business being overburdened by state and local taxes.
4. Next approach can be to introduce an accommodation tax at a fixed rate of 200-300 AMD per single tourist or for the first 3 nights spent in the hotel. The number of international tourists visiting Armenia for the year of 2010 was 683,979¹³ out of which 70,209 people stayed at the hotels or hotel facilities (the rest of the tourists were renting apartments/houses or staying with their relatives), and the indoor tourists made up to 456,432 people for the same year. If an accommodation tax at a fixed rate of 250 AMD is applied in hotels singly, taking the tourists' data for the year of 2010, an approximate amount of 131,660 thousand AMD will be generated from the accommodation tax (approximately 351 thousand USD per year) taxed singly and approximately 394,980 thousand AMD (a mln and fifty three thousand USD) for an accommodation tax being taxed for the first three nights. An accommodation tax of a 250 AMD per tourist singly or for three nights (1-2 USD) will be a great burden neither for the tourist nor for the hotelier, while the financial resources generated from that tax can be used for the purpose of developing community infrastructures or touristic facilities. In Tsakhkadzor city, an accommodation tax of 250 AMD will generate around 2,125,000 AMD, equaling to 5700

¹³ The data on number of outdoor and indoor tourists is taken from the report on the Socio-Economic Situation of RA, January-April 2011 available in the website of Armenian National Statistics office (www.Armstat.am).

USD if charged singly and around 6,375,000 (17 thousand USD) if charged for the first 3 nights spent in the hotel facilities¹⁴.

5. A final approach is to decide upon the rate of the hotel tax based on the fiscal needs estimated by municipal staff and presented for Council review. The tax rate can be defined on the basis of the amount of financial resources necessary to implement a tourism development project, which is considered a priority by the city population and businesses. It is important to design such project by holding discussions with the hoteliers so as to consider their ideas in the process of designing and implementing the project.

Conclusion & Recommendations

Becoming a signatory to the European Charter of Local Self-Governance in May 2002, as well as following the requirement of the Constitutional provisions, RA laws and regulations Armenia is now bound by the commitment to enhance fiscal and institutional capacities of local governments as well as diversifying their own source revenues.” In spite of the fact that the draft “Law on Hotel Tax” is currently removed from circulation in the Government, the process of legislative reform is irreversible and its progress is just a matter of time.

It is important to note that if adopted the hotel tax will have a limited scope of application, since according to our estimates approximately 70-90 communities out of 915 have hotel facilities which can be taxed. However we do not exclude the possibility of a wider applicability of the hotel tax due to the potential growth of hotel facilities in the coming years. Thus, given the perspectives for development of tourism business in Armenia, the hotel tax can gradually become a growing source of revenues for local governments. This will strengthen their capacity to execute assigned powers and even allow expanding the scope to other responsibilities currently under state authorities.

¹⁴ Considering that the number of tourists reaches 8500 in high season in Tsakhkadzor as informed by Garun Mirzoyan.

The estimates of the hotel tax revenues for Tsakhkadzor that has 22 hotel facilities and Goris that has only 2 hotels demonstrate the diverse implications of the hotel tax for local government budgets. In case of Tsakhkadzor, hotel tax receipts would generate significant financial resources: at its minimum rate of 2% it generates receipts comparable to property tax receipts in 2010. While in case of Goris, the hotel tax receipts will have a negligible impact on the local budget and the administration of the tax may even exceed the amount of collected tax.

These conclusions support the first and second hypotheses and draw conclusions that a hotel tax is meaningful to apply in communities with developed tourism infrastructure.

The third hypothesis was partially supported by the case study, which showed that the sales strategies of most of the hoteliers would be to absorb the hotel tax. Since the respondents claimed they would choose to maintain the same prices for hotel services and pay the hotel tax at the expense of the profit, it means that the majority of the hoteliers have the capacity to absorb the tax. Thus the hypothesis stating that “the introduction of a 2-5% hotel tax will not have a visible negative effect on hotel industry” is partially supported with the case study. However, we should be cautious with this conclusion, since the case study of Tsakhkadzor is not sufficient for the extrapolation of the findings for all communities of Armenia.

Concerning the estimates of potential revenues from hotel tax the estimates of hotel tax receipts for Tsakhkadzor city cannot be used for the purpose of generalization of the results for all of Armenia for the following reasons:

1. The sales strategies of other communities may differ from the sales strategies of hoteliers of Tsakhkadzor.
2. The estimates of the receipts from hotel tax can differ from community to community due to different tourism flows, occupation rates and hotel prices.

Recommendations

- Defining the hotel tax as a tax type in the RA law “On Taxes” should be followed by the adoption of the RA law “On Hotel Tax,” which must be preceded by a detailed analysis of the hotel tax implications for local governments’ budgets and hotel industry of Armenia.
- The law on hotel tax should clearly define the taxable object, the range of taxable services and the payment procedure, so as to avoid ambiguity. Specifically, it should be made clear whether the tax base include receipts from all services provided by hotel or only accommodation services.
- Drawing upon the international experience of hotel taxation it is recommended to consider applying a reduced VAT rate for communities that apply hotel tax¹⁵. The international practice shows that the total sum of hotel tax and VAT tax rate does not exceed 20%; based on this experience VAT rate for hotels in Armenia should be reduced as well to support hotel industry and encourage investment in this sector.

Limitations and Further Research

There are a number of limitations to the research and proposals for improvement of further research.

The main limitation of the research was the lack of reliable data concerning hotel turnovers, occupation rates and accurate average room rates which made it challenging to make an accurate estimate of the potential hotel tax revenues for Tsakhkadzor and impossible to make an estimate for all of Armenia. The survey questionnaire included questions about the approximate profit margin rate of hotel facilities for the previous three years, however,

¹⁵ It is very important to keep the sum of the reduced VAT and hotel at the level of conventional VAT rate in order to retain the competitiveness of the hotels among the cities. Otherwise hotels in the communities, where hotel tax is not applied will benefit from the reduced VAT tax and gain advantage.

almost none of the hoteliers provided with the requested piece of information. Besides, the majority of the hoteliers does not keep track of tourist flows or differentiate between indoor and outdoor tourism flows. Thus, the estimate of hotel tax receipts conducted for Tsakhkadzor city is approximate and the results of the survey can not be extrapolated for all large communities of Armenia.

To be able to generalize the results of the survey and estimate the amount of potential financial receipts generated from hotel tax introduction, it is important to conduct a case study of a larger sample and also cooperate with State Tax Service to be able to attain information on hotel gross receipts.

It is also recommended to conduct an in depth comparative study of international hotel taxation practice to be able to draw valuable lessons for the Armenia. In fact, countries that need to be studied in depth must have common characteristics with Armenia in terms of provided tourism product, hotel service level, tourism flows, hotel service prices, etc.

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Appendix 1

Draft “Law on Hotel Tax”

Drafted by *Communities Finance Officers Association*

Republic of Armenia
Law

On Hotel Tax

Contents

- I. General provisions
- II. Tax Payers
- III. Tax Brackets
- IV. Rates
- V. Assessment and Payment Procedures
- VI. Liabilities of Tax Payers, Oversight and Responsibility for Breaches of this Law
- VII. Estimation of Tax Base

General Provisions

Article 1: This law regulates assessment and payment of hotel tax in the Republic of Armenia, defines the tax brackets, payers, the taxation objects and base, as well as rates, schedule and procedures of assessment of the hotel tax.

Article 2: The hotel tax is called for enhancing financial capacity of and promotes tourism development in communities. The hotel tax is a local tax, which is regulated in the framework of the Law on Taxes and this law.

Article 3: The amount of payable hotel tax, as applied to the hotel tax payers defined in the Clause a), Article 6 of this Law, is established as a non-deductible expense from gross revenues charged with the objective to assess profit tax.

I. Tax Payers

Article 4: Hotel tax is paid by the facilities delivering hotel services in the Republic of Armenia.

II. Tax Brackets

Article 5: The tax brackets encompass hotel services delivered by hotel facilities as defined in the Law of Armenia on Tourism and Tourism Activities.

Article 6: The facilities liable to pay hotel tax include:

- a) hotel facilities, for which tax liabilities have been established in accordance with general procedures (value added tax and profit/income tax);

b) hotel facilities, for which tax liabilities have been established in accordance with the presumptive taxation procedures.

Article 7: The tax base for hotel tax includes:

- a) actual receipts generated on delivery of hotel services by the tax payers established in the Clause a), Article 6 of this law;
- b) the space of hotel facilities deployed by the tax payers established in the Clause a), Article 6 of this law (including the total space of fixed assets used for delivery of hotel services estimated in square metres).

III. Tax Rates

Article 8: The rate of hotel tax will be the multiple of the base value of the tax defined in the Article 7 of this Law and the below rates:

- a) 2-10 percent of actual receipts generated against delivery of hotel services by the tax payers established in the Clause b), Article 6 of this law;
- b) 150-600 drams per quarter per square metre of the hotel facilities deployed by the tax payers established in the Clause b), Article 6 of this law.

Article 9: Rates of hotel tax are established by the relevant community councils within the limits established in the Article 8 of this law.

Article 10: The rate of hotel tax applicable in a community will be unified for all hotel operating in that particular community and will not be changed within the given budget year. Hotel tax rates will remain unchanged for the subsequent budget year if the community council will not have established other rate for the next planned budget year.

IV. Assessment and Payment Procedures

Article 11: Hotel tax is assessed and paid to the relevant community budget by the tax payer independently and in accordance with the procedures established by this Law. The reporting period for hotel tax is the quarter.

Article 12: Payers of hotel tax may pay tax obligations in instalments to the community budget concurrently with the actual revenues generated on delivery of hotel services (tax payers defined in the Clause a), Article 6 of this Law) or in quarterly instalments equal to quarterly obligations (tax payers defined in the Clause b), Article 6 of this Law).

Article 13: The hotel tax will be paid into the relevant community budget on a quarterly basis before the 5th day (inclusive) of the month successive to the end of the reported quarter.

Article 14: Hotel tax payers will submit quarterly tax report to the community tax department on accrual basis in accordance with the pro forma in the Annex 1 to this Law. The deadline for submission of hotel tax reports is the 10th day of the month successive to the end of the reported period.

Article 15: The rate of the hotel tax payable in the reported period is established taking into consideration the amounts paid prior to and during the current reported periods.

Article 16: Based on the results of the reports, the hotel tax amount may be over and above the aggregate sum of the previous payments, in which case the payable difference will be paid into the community budget on the last working day of the first month after the end of the reported quarter. In cases when the actual payments are over and above the hotel tax obligations, the difference (over-payments) are considered advance tax payments for the next reported period or reimbursed to the tax payer within 10 days after the written application of the tax payer.

Article 17: The deadline for payment of hotel tax is the last day of the first month after the end of the reported quarter, after which fines and penalties will be applied on the delinquent tax obligation as specified in the Law of Armenia on Taxes.

V. Liabilities of Tax Payers, Oversight and Responsibility for Breaches of this Law

Article 18: The tax payers are liable for timely and full performance of hotel tax obligations and submission of tax reports.

Article 19: Oversight of performance on hotel taxation is regulated in accordance with the Law of Armenia on Taxes.

Article 20: The tax payers, who will have breached this law, as well as persons, who will have submitted inaccurate assessment or information on hotel tax, will be liable in accordance with legal procedures of Armenia.

Article 21: In cases of hotel tax delinquencies in excess of one year, the head of communities may sue the delinquent tax payers in order to charge the tax obligation (including tax arrears, fines and penalties) according to judicial procedures. Moreover, in cases when tax obligations are over and above 500.000 (five hundred thousand) drams, the head of community will be obliged to sue the relevant tax payer.

VIII. Estimation of Tax Base

Article 22: Estimation and recording to hotel tax payers will be implemented in accordance with the procedures defined by the community councils.

Article 23: This Law shall enter into legal force from January 1, 2010.

Appendix 2

Questionnaire for Interviewing Representatives of Hotels in Tsakhkadzor
May 2011

Interviewer: _____

Interview date: _____ **Interview start:** _____ **/End** _____

Interviewee Name: _____

Position: _____

Hotel: _____

Please make sure to record responses completely -- even if it does not seem related to the question itself. Please make sure to interview a responsible for finances.

1. For how many years does your facility operate?
2. Does it operate in winter?
____ Yes (*ask: for how many months?* _____)
____ No
3. During the year of 2010 how much VAT tax did you pay?
4. During the year of 2010 how much profit tax did you pay?
5. What is the hotel profit margin for the last three years? (*Don't read the list.*)
____ 0-2%
____ 3-5%
____ 6-9%
____ 10% and above
6. What type of services does your hotel provide except accommodation? (*Don't read the list. Multiple answers permitted.*)
____ Conference hall for organization of meetings, business forums and convocations
____ Swimming pool
____ Sauna
____ Sport room
____ Lounge bar
____ Medical treatment (sanatorium)

- _____ Restaurant/including organization of banquets and weddings
- _____ Cafeteria/outdoor café
- _____ Sightseeing tours
- _____ Car/bike rental
- _____ Space rental for other services, including souvenir shops, foreign exchange office etc.
- _____ Kids playground
- _____ Cinema hall
- _____ Renting of space for shops
- _____ Foreign exchange office
- _____ other (*please specify:* _____)

7. Are you aware of the amendment made to the “Law on Taxes” according to which the Hotel tax is introduced as a local tax type in Armenia?

_____ Yes (*Provide details about the provisions of the draft law, especially the base to which the tax will be applied.*)

_____ No (*Provide details about the provisions of the draft law, especially the base to which the tax will be applied.*)

What do you think about the introduction of this tax? (*probe for details.*)

8. I would like to ask about a possible scenario. Using your own personal opinion, what do you think how will the hotel tax with the rate of 2-5% impact the hotel business in terms of number of visitors of the hotel?

9. The nature of the imposition of the hotel tax is voluntary by the community council. In the case of your community council, what do you think will it impose the tax?

10. If the hotel tax is imposed, how willing will be to negotiate the tax rate and other aspects of the hotel tax with the community council? What would you say, very willing, somewhat willing, somewhat unwilling, or very unwilling?

- _____ Very willing
- _____ Somewhat willing
- _____ Somewhat unwilling
- _____ Very unwilling
- _____ Don't know/can't say

If the tax is imposed, how will your sales strategy modify? (*probe for: prices for accommodation will be increased, prices for services will be diversified, costs will be cut, the tax will be absorbed*)