NATIONAL CENTER FOR POLICY ANALYSIS

Travel Taxes: The Hidden Trifecta

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In recent years, in a drive toward more revenue, officials at every level of government have raised a trifecta of travel-based taxes dramatically. As a result, travelers bear large effective tax burdens that can amount to 30 percent higher costs in high-demand areas like New York City or Chicago.

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Hotel Occupancy Taxes. As of 2012, the most recent year for which complete data is available, about 22 states levy a specific statewide tax on lodging, ranging from as low as 3 percent to as high as 13 percent of the price of a night's stay at a hotel or motel.[1] They are often accompanied by local lodging taxes, which are popular in such metropolitan areas as Chicago and Los Angeles, where the hotel tax is 4.5 percent and 14 percent, respectively.[2]

Rates vary, but the structure of the occupancy tax tends to be similar, with a minimum stay threshold determining if a rental is transient or residential, and a minimum price threshold determining if the rental is taxed. For example, according to the Texas Comptroller of Public Accounts, hotel occupancy in Texas is taxed if the bill at a hotel, motel, condominium, or bed and breakfast totals more than $15. Local taxes also apply to any room rental that totals more than $2 per night for stays of less than 31 days. This means that in some Texas cities, even the rental of a personal residence for a short stay is taxable.[3]

Car Rental Taxes. Car rental taxes are widespread but less universal than hotel occupancy taxes — 38 states levied a car rental tax as of 2006.[4] The tax burden is often higher when the car is rented at an airport, where a surcharge is added by the local airport authority.[5] Research suggests that this has resulted in nearly 25 percent more expensive rentals within the geographic areas where the surcharge is levied.[6] Car rentals are also subject to sales and use taxes, which can amount to as much as 10 percent. In some locations, like New York, there are special state and local taxes on rental cars in addition to the statewide sales tax.[7] New York City rental cars are subject to an effective tax rate of 20 percent, accounting for all general and special sales taxes.

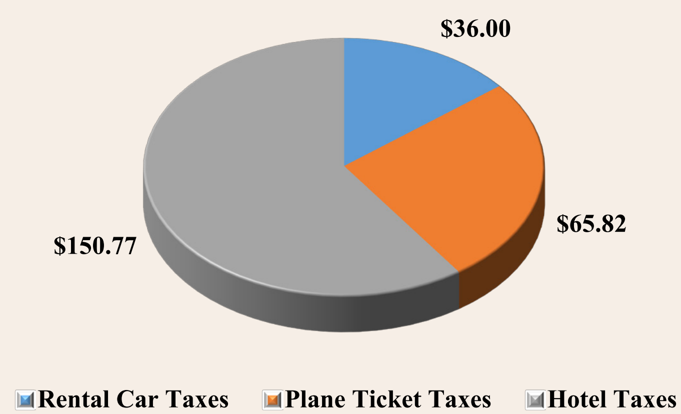
Airline Taxes and Fees. The public and high profile legislators alike complain about airplane ticket prices and fees. While prices have indeed risen, not all of this rise is the fault of the companies themselves. Taxes on air travel have also risen, especially since September 11, 2001. Many of the current taxes are flat fees and not rates, meaning that effective rates are especially high on short flights. Within the United States, the majority of taxes are issued by the federal government:

- The federal ticket tax is a 7.5 percent excise tax on every ticket purchased.
- A segment tax is a $3.70 fee charged per take-off and landing.
- The September 11 Security Fee doubled in 2014 from $2.50 to $5.60 per leg of each flight.[8]

Finally, a passenger facility charge is levied by local airport authorities but is coordinated federally; it can be as much as $4.50 per take-off and landing.[9] These four fees are just a small part of a much longer list of 17 taxes and fees.[10] Taken together, these airline taxes can amount to a 30 percent surcharge on some domestic flights.

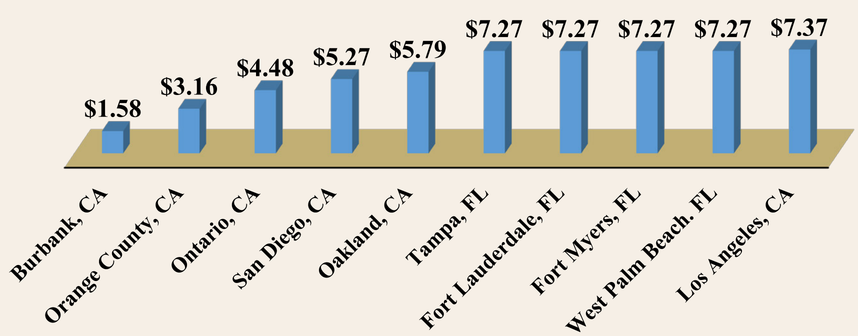
Average Trip Tax Burden Calculation. Based on U.S. Department of Transportation data, the most common coast to coast trip is from Los Angeles to New York City. Assuming an average-priced roundtrip plane ticket ($381.50), an average-priced three day hotel stay (3 x $317= $951), and an average-priced small rental car (3 x $60.06 = $180.18), an L.A. to N.Y.C. trip costs a total of $1,512.68 before taxes.[11] Using conservative estimates of the various taxes imposed, the minimum tax collected is about $252.59, for an effective tax burden of about 17 percent. [See appendix for details of the calculation.] Some $149.51 of this tax burden consists of taxes that discriminate against travel, meaning that those who travel to New York City pay nearly 10 percent in travel taxes in addition to the normal taxes paid by all residents [see Figure I].[12]

Figure I
Taxes on a $1,500 Trip from L.A. to N.Y.C.



Source: Author's calculations. See footnote 14 for detailed source data.

Figure II
Top Ten Cities with Lowest Travel Taxes



Source: Author's calculations. Data is from the Global Business Travel Association, December 10, 2013. Available at http://www.gbta.org/PressReleases/Pages/rls_121013.aspx.

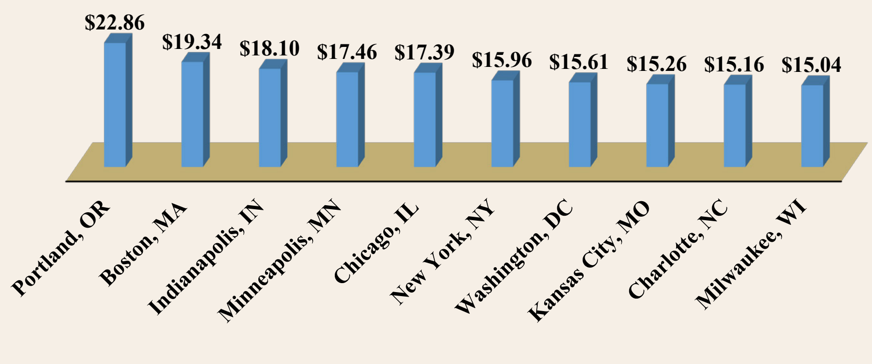
Variation Across States. Airline taxes are federally controlled, but state and local hotel occupancy and rental car taxes vary widely from state to state. According to the Global Business Travel Association [see Figures II and III]:[13]

- Portland, Oregon, has the highest discriminatory travel tax burden.
- Burbank, California, has the lowest discriminatory tax burden.
- California and Florida cities tend to have lower discriminatory tax burdens than cities in other states.

Travel taxes are politically popular revenue tools because of the simple fact that politicians are not generally accountable to travelers or tourists. Additionally, it is possible that there has been little opposition from the business world because many aspects of travel are tax deductible as business expenses.[14]

The Effect of Travel Taxation on Economic Activity. Travel taxes directly and indirectly affect economic activity. The most obvious way is by discouraging travel altogether. A direct effect of this kind would most negatively affect airlines, and it would only occur if the demand for air travel is relatively elastic. (Elastic means that for a given percentage increase in price per ticket, the quantity of tickets demanded decreases by a greater percentage.)

Figure III
Top Ten Cities with Highest Travel Taxes



Source: Author's calculations. Data is from the Global Business Travel Association, December 10, 2013. Available at http://www.gbta.org/PressReleases/Pages/rls_121013.aspx.

A review of studies by InterVistas Consulting Inc., which specializes in travel and tourism for public and private clients, found:[15]

- The demand for short plane trips is more sensitive to price changes than that of long routes, due to the ability of people to choose other types of travel.
- The demand for business flights is much more inelastic than the demand for vacation flights, likely because business travel is less flexible and is more likely to be reimbursed.
- The demand for air travel is income elastic. In other words, wealthier people are more likely to fly, and the effect on the poor of any tax or fee on airfares is greater than on the rich.
- The elasticity of demand for individual carriers and for smaller geographic areas is greater than for large areas and the market as a whole. In other words, people are more sensitive to price changes on individual carrier flights and on shorter flights. This is mainly a function of a competitive market and other travel options (car, bus or train) when traveling shorter distances.

Thus, any action resulting in a price increase will definitely reduce air travel. This effect will be especially large when the price increase is confined to specific geographic areas.[16]

Effect on Tourism. Nationwide service fees and taxes are levied at the federal level, meaning that the effect on travel will be minimal. However, the InterVistas study concludes tax and fee hikes discourage air travel by poor individuals more than most other demographic groups. For most travelers, airlines are the only option for cross-country trips, implying that taxes on air travel likely stop some poor individuals from traveling at all. Because travel allows more access to job opportunities, lower income individuals suffer larger negative effects.

Hotel taxes and car rental taxes indirectly influence tourism and travel decisions, especially with the rise of websites like Expedia, which book lodging, car rentals and airplane travel as a package. The InterVista study mentions that when prices of tickets rise in narrow geographic areas, demand is relatively price elastic. It is possible that the lodging component has become wedded to some extent to the travel destination choice. If that is the case, the geographically specific nature of hotel occupancy taxes and car rental taxes should drive tourists away from areas were the tax rates are excessive.

Hotel occupancy taxes also appear to eat into the budget tourists set for their vacation trips. Such an effect was empirically observed in Hawaii in 2013, when a hike in the transient occupancy tax raised the cost of hotels for all tourists. The result was a nearly 3.4 percent fall in general excise tax revenue, as tourists appeared to spend less money on other attractions and gifts.[17] Such a result follows from the fact that travel often requires incurring lodging expenses, while consumption of souvenirs is optional.

Finally, a very recent cross-country study of the European Union revealed that taxes affecting essential tourist services have a dramatic impact on the level of tourism. Specifically, the study found that a hike in the Value Added Tax (or VAT, similar to a sales tax) on hospitality services in Latvia from 5 percent to 21 percent resulted in the loss of nearly 12,000 jobs and a nearly €14 million (euros) in tax revenue.[18] In France, a cut in the VAT from 20 percent to 5 percent resulted in a windfall of 50,000 new jobs. The results were similar over many periods in several other European countries.

Policy Recommendations. In general, higher taxes in an area will discourage travel to that area, but the magnitude of this effect is not uniform. In other words, some areas have unique characteristics such that there are no close substitutes.

Take New York City and Washington, D.C., for instance. No other place in the continental United States has the same monuments and history as Washington, D.C., and no other city has the same iconic attractions as New York. In addition, New York City and D.C. are centers of business and politics. Due to this competitive advantage, they can tax tourists more without fear that tourism will decline so much as to offset the hoped for increase in revenue.

These factors could explain some of the variations in tax rates throughout the country, and suggests that cities that rely mainly on generic tourism or business travel should avoid raising travel taxes. They should not follow the tax formula of cities like New York, as their situations are economically different.

Conclusion. While travel taxes may seem politically attractive, it is clear that they have an economic cost. Whether that cost comes in the form of lower sales tax revenue or less tourism, it can be quite large especially in areas where tourism is a staple of the local economy. If metropolitan areas wish to compete for travelers, they should take note of how the taxes stack up.

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Appendix

Calculations of Average Trip Tax Burden

Hotel Taxes

	Rate	Amount	Travel Discriminatory?
City Sales Tax	4.875%	$46.36	No
State Sales Tax	4%	$38.04	No
Occupancy Tax	5.875%	$61.87	Yes
Unit Fee	--	$2	Yes
Total	--	$150.77	

Airline Taxes

	Rate	Amount	Travel Discriminatory?
Federal Ticket Tax	7.5%	$28.61	Yes
Segment Tax	4%	$7.80	Yes
Security 9/11 Tax	$5.60 per Enplanement	$11.20	Yes
Passenger Facility Charges	$4.50 per Takeoff / Landing	$18	Yes
Total	--	$65.82	

Rental Car Taxes

	Rate	Amount	Travel Discriminatory?
City Sales Tax	4.875%	$8.78	No
State Sales Tax	4%	$7.21	No
Special State Sales Tax on Short-Term Passenger Rental Cars	6%	$10.81	Yes
Special Metropolitan Commuter Transportation District Local Sales Tax on Passenger Rental Cars	5%	$9.01	Yes
Total	--	$35.81	

Notes

1. "Specific Statewide Taxes on Lodging – By State," National Conference of State Legislatures, April 3, 2012. Available at http://www.ncsl.org/research/fiscal-policy/state-lodging-taxes.aspx.
2. "Hotel Accommodations Tax (7520)," City of Chicago. Available at https://www.cityofchicago.org/city/en/depts/fin/supp_info/revenue/tax_list/hotel_accommodationstax.html/.
3. "Hotel Occupancy Tax," Texas Comptroller of Public Accounts. Available at http://comptroller.texas.gov/taxinfo/hotel/.
4. William G. Gale and Kim Rueben, "Taken for a Ride: Economic Effects of Car Rental Excise Taxes," Enterprise Rent-A-Car, July 17, 2006, page 1. Available at http://rentalcartax.com/uploads/sites/410/Gale_Rueben_Study.pdf.
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6. Geoff Williams, "The Hidden Costs of Rental Cars," *U.S. News & World Report*, February 4, 2014. Available at http://money.usnews.com/money/personal-finance/articles/2014/02/04/the-hidden-costs-of-rental-cars.
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11. Jim Gorzelany, "Where It Costs The Most To Rent A Car (And How To Always Pay Less)," *Forbes*, March 26, 2013, available at http://www.forbes.com/sites/jimgorzelany/2013/03/26/where-it-costs-the-most-to-rent-a-car-and-how-to-save-money-at-the-counter-regardless-of-where-you-travel/; "Trivago Hotel Price Index," Trivago, July 2015, available at http://www.trivago.com/hotelprices; "Air Fares," Bureau of Transportation Statistics, 2014, available at http://www.rita.dot.gov/bts/airfares (Note: taxes were subtracted from the annual averages found here); and "TransStats," Bureau of Transportation Statistics, March 2015, available at http://www.transtats.bts.gov/.
12. For a comprehensive view of the calculations and rates, see the appendix.
13. Data identifies the amount of money paid in travel specific taxes above and beyond general sales and use taxes. The GBTA data uses a specific trip itinerary and basket of purchases to calculate the dollar burden.
14. "Business Related Travel Expenses Are Deductible," BizFilings, January 9, 2015. Available at http://www.bizfilings.com/toolkit/sbg/tax-info/fed-taxes/deducting-business-related-travel-expenses.aspx.
15. Elasticity refers to the percentage change in demand resulting from a 1% change in price or income.
16. "Estimating Air Travel Demand Elasticities," InterVistas Consulting Inc., December 28, 2007. Available at http://www.iata.org/whatwedo/documents/economics/intervistas_elasticity_study_2007.pdf.
17. Lowell L. Kalapa, "Taxing Tourists Politically Popular," Rental By Owner Awareness Association, December 29, 2013. Available at http://www.rboaa.org/taxing-tourists-politically-popular/.
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Because of the NCPA idea of Roth IRAs, $310 billion in savings has been taxed once and will never be taxed again.

Because of another NCPA idea, 78 million baby boomers will be able to work beyond age 65 without losing Social Security benefits.

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The TAC can identify the effects of proposed tax changes on representative individuals and families at various income levels and at various ages.

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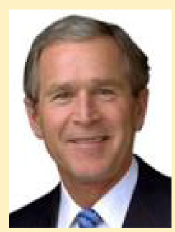

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Former President of the United States

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