Executive summary

This report analyzes the potential economic impacts related to proposed tax changes on the tourism sector in the Bahamas. The report estimates the change in VAT and other taxes that would be paid by the tourism sector under the Government's proposed VAT and selected alternative tax policy options.[1] The Government's proposal imposes a VAT rate of 10% on hotels and 15% on other tourism sales. This tax increase is partially offset by the elimination of the current 10% hotel occupancy tax and a reduction in import duties.

Key findings of the study include:

- **The Government's proposed VAT would increase the price tourists pay in the Bahamas by 9%.** The Government's proposed VAT would increase the net tax burden on the tourism sector by an estimated approximately $320 million in 2015 levels. This includes the combined impact of the new direct and indirect VAT taxes and reductions in current-law taxes.[2] The tax increase would raise the total price of tourism in the Bahamas by 9%, assuming all of the tax increase is passed forward to tourists in higher prices.

- **A 9% increase in tourism prices would reduce tourism consumption by 11%.** As tourists respond to increased prices resulting from the VAT, they would reduce the number of visits and consume fewer goods and services in the Bahamas. The analysis estimates that this response would reduce tourism sales by $380 million in 2015 levels.

- **A $380 million reduction in tourism sales in 2015 would result in the elimination of 9,000 tourism and related jobs across the Bahamian economy.** It would result in a loss of nearly 4,700 direct tourism sector jobs, relative to the baseline in 2015 (11% reduction). The total domestic job loss would increase to 9,000 jobs when considering jobs supported by the tourism industry's supply chain and employee spending (the "multiplier" effect). By 2017, the economy-wide job loss would increase to nearly 13,200 jobs, of which 6,800 would be from within the tourism industry.

- **By 2017, the Government's proposed VAT would reduce tourism's contribution to GDP by more than $350 million (or -15%).** Under current law, tourism's contribution to GDP (the most comprehensive measure of the industry's current economic activity) would reach an estimated $2.3 billion in 2017.[3] As shown in Figure ES-2, the imposition of the proposed VAT would reduce tourism sector GDP by $353 million by 2017, a 15% reduction.[4]

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[1] This report does not estimate the total taxes that would be collected economy-wide or the economic impacts on the entire Bahamian economy. Rather, this report estimates only those related to changes in the tourism industry (including tourism's domestic supply chain and spending by tourism and related industry employees).

[2] Direct taxes include the VAT paid on tourism industry sales and the unrecovered VAT paid on input purchases by VAT-exempt businesses. As used in this study, indirect VAT is the VAT paid by tourism businesses as higher prices from exempt suppliers, such as financial services and insurance. For example, since financial services are VAT-exempt under the Government's proposal, these businesses would pass forward the VAT paid on their inputs as higher prices to their customers (tourism businesses).

[3] Based on a 4.6% annual growth rate from 2014 as projected in World Travel & Tourism Council (WTTC) *Economic impact of tourism in the Bahamas 2014.* Ratios of GDP, wages, and jobs to sales were held constant over the projection period, Therefore, growth rates are the same for all indicators.

[4] The reductions in tourism sector GDP are relative to the current-law baseline in the year of comparison. For example, in 2017 GDP would be $353 million lower than the level in 2017 without the proposed changes.

- **The three-year cumulative loss in GDP from the impact of the Government's proposed VAT on the tourism industry is an estimated $890 million, relative to current law.** Over the three-year period, the tourism industry is estimated to contribute a total of $6.5 billion to GDP under current-law growth projections. If the Government's proposed VAT is enacted, the tourism industry would produce a total of nearly $5.7 billion of GDP in three years, $890 million below current law – a 15% reduction.

- **Reducing the proposed VAT rate on tourism industry businesses would reduce the negative economic impact of the VAT.** Table ES-1 compares the estimated 2015 change in tax collections (the "static" tax impact) of the Government's proposal and three selected policy alternatives with single VAT tax rates of 7.5%, 5%, and 0% applied to all tourism businesses. Net new taxes (reported in Section I) paid by the tourism sector would be an estimated $117 million under a 7.5% VAT applied to all tourism industry sales and 0.75% employer payroll tax (Alternative 1).[5] Zero-rating the tourism sector (Alternative 3) results in a slight net decrease in current-law taxes paid by tourism, even with a 2.5% employer payroll tax, primarily due to the elimination of the hotel occupancy tax.[6]

  Figures ES-2 and ES-3 show the negative economic impacts of the policy alternatives compared to the Government's proposal. As shown in Figure ES-2.2, the three alternative tax policy options would reduce the negative impact on GDP in 2017 from $353 million under the Government's proposed VAT to $159 million under Alternative 1 and $88 million under Alternative 2; Alternative 3, the zero-rated VAT option, would have only a minimal negative impact on the tourism industry.

- **Alternative revenue sources could replace the expected tax revenue from the Government's proposed VAT.** As shown in Sections II and III of Table ES-1 and in Figure ES-1, alternative taxes, including employee payroll taxes, increased taxes on cruise lines departures, and other tax increases, could raise as much as $261 million annually, roughly the same amount collected from the Government's proposed VAT.

[5] Alternative 1 includes a 1.5% payroll tax (0.75% on employers), Alternative 2 includes a 3% payroll tax (1.5% on employers), and Alternative 3 includes a 5% payroll tax (2.5% on employers). The portion of the payroll taxes paid by tourism businesses is included in the estimate of net new taxes paid by the tourism sector.

[6] A zero-rated VAT tax on the tourism industry would not tax the final sales to tourists under the VAT, but would provide a credit to businesses in the tourism industry for any VAT taxes they pay on input purchases. The effect of this treatment would be to eliminate the VAT on the sales of the tourism sector.

Table ES-1. Estimated taxes from policy alternatives to the Government's proposed VAT, 2015 static tax estimates

Millions of 2015 B$

		Single rate alternatives[1]		
		Alternative 1; 7.5%[2]	Alternative 2; 5%[3]	Alternative 3; 0%[4]
I	Direct tourism business taxes			
	VAT collected on sales	$206	$137	$0
	Hotels	92	62	--
	All other	114	76	--
	Input VAT paid by exempt businesses[5]	14	14	14
	VAT refund delay or denial	--	--	--
	Payroll tax, employer portion, tourism	5	9	15
	Subtotal: New taxes (VAT & Payroll)	224	160	29
	Less: Import duty reduction[6]	-62	-59	-6
	Less: Elimination of hotel occupancy tax	-45	-45	-45
	Net new taxes paid by tourism sector	117	56	-22
II	Taxes connected to tourism			
	Payroll tax, employee portion, tourism	5	9	15
	Cruise line passenger tax increase	13	13	13
	Connected taxes (employee & cruise lines)	17	22	28
III	Taxes paid by other sectors			
	Payroll taxes, employer portion, other sectors	19	38	63
	Payroll taxes, employee portion, other sectors	19	38	63
	Customs duty exemption elimination	16	16	16
	Legalization of numbers/lotteries & gaming bill 2013[7]	60	60	60
	Enforced charter boat/foreign dive operators[7]	6	6	6
	Enhanced tax compliance of 5%[7]	25	25	25
	Net new taxes, other sectors	145	183	233
	Net new tax collections, proposed policy	$279	$260	$239

[1] The policy alternatives shown in Table ES-1 correspond to the following policy alternatives in the full report: Alternative 1 = Policy Option 4 (7.5% single rate on tourism), Alternative 2 = Policy Option 5 (5% single rate on tourism), and Alternative 3 = Policy Option 7 (tourism businesses zero-rated)

[2] VAT rate on tourism of 7.5%; Employer payroll tax of 0.75%; general VAT rate of 15%

[3] VAT rate on tourism of 5%; Employer payroll tax of 1.5%; general VAT rate of 15%

[4] VAT rate on tourism of 0%; Employer payroll tax of 2.5%; general VAT rate of 15%

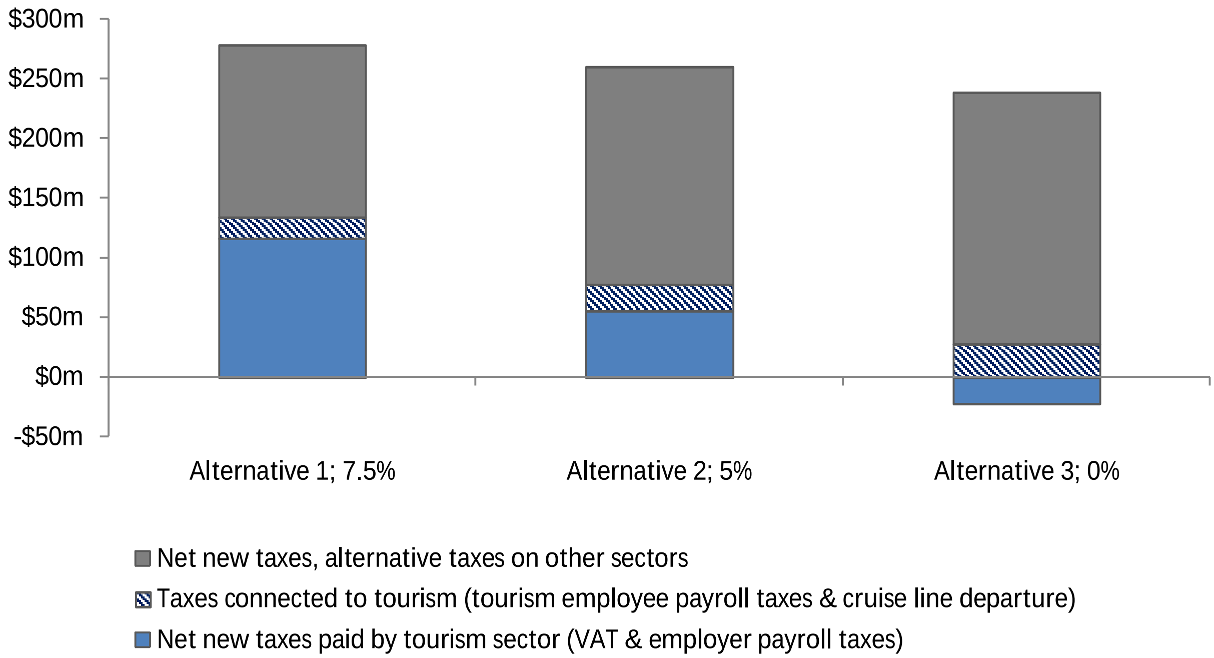
[5] Casino revenues are zero-rated in all three of the policy alternatives.

[6] The analysis assumes that the customs duty reduction would be less than or equal to the VAT collected on industry sales.

[7] Revenue estimates provided by the tourism industry.

Figure ES-1. Composition of Government revenues, under three VAT policy alternatives, by source, 2015 static tax estimates

Millions of 2015 B$



Note: Sums shown in the figure are the total taxes from Box 1 and Box 3 as shown in the "Analysis Roadmap."
Source: EY analysis.

Table ES-2. Direct tourism industry dynamic economic impacts of Government's proposed VAT and policy alternatives

Millions of nominal B$; thousands of jobs

	Government's proposed VAT	Alternative 1; 7.5%[1]	Alternative 2; 5%[2]	Alternative 3; 0%[3]
Tourism prices, % increase				
2015	9.2%	4.2%	2.4%	0.1%
2016	9.2%	4.2%	2.4%	0.1%
2017	9.2%	4.2%	2.4%	0.1%
Sales				
2015	-$380	-$172	-$99	-$5
2016	-$464	-$209	-$120	-$5
2017	-$554	-$250	-$142	-$5
GDP				
2015	-$242	-$110	-$62	-$4
2016	-$295	-$133	-$75	-$3
2017	-$353	-$159	-$88	-$1
Wages & salaries				
2015	-$57	-$22	-$10	$4
2016	-$69	-$27	-$12	$5
2017	-$83	-$31	-$13	$6
Jobs				
2015	-4.7	-2.0	-1.1	0.0
2016	-5.7	-2.4	-1.3	0.0
2017	-6.8	-2.9	-1.5	0.0

[1] VAT rate on tourism of 7.5%; Employer payroll tax of 0.75%; general VAT rate of 15%
[2] VAT rate on tourism of 5%; Employer payroll tax of 1.5%; general VAT rate of 15%
[3] VAT rate on tourism of 0%; Employer payroll tax of 2.5%; general VAT rate of 15%
Note: Differences shown in the table are the annual difference under each policy scenario, relative to the current-law baseline in that year. Assumed current-law growth of the tourism sector is 4.6% in 2016 and 2017. The price elasticity of demand is -1.2 in 2015, -1.4 in 2016, and -1.6 in 2017. Estimated increases in wages and salaries and jobs under Alternative 3 are due to a net reduction in taxes for hotels from the hotel occupancy tax elimination.
Source: EY analysis. Current-law baseline industry growth is based on the WTTC 2014 study of the economic impact of travel and tourism in the Bahamas, projected annual growth 2014-2024.

Figure ES-2. Direct tourism industry GDP impacts of Government's proposed VAT and policy alternatives, 2015-2017

Figure ES-2.1 Tourism GDP v. baseline
Baseline tourism sector GDP =100%

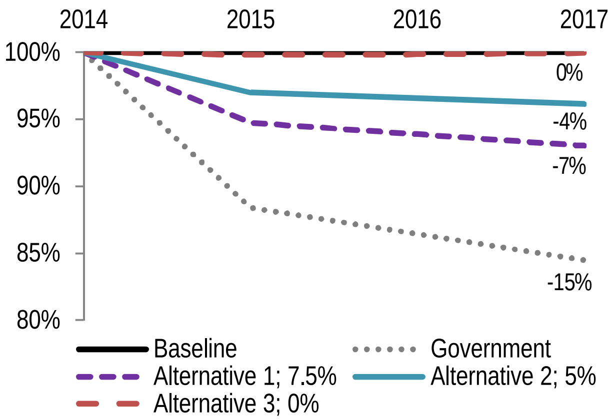


Figure ES-2.2 Tourism GDP v. baseline
Millions of nominal B$

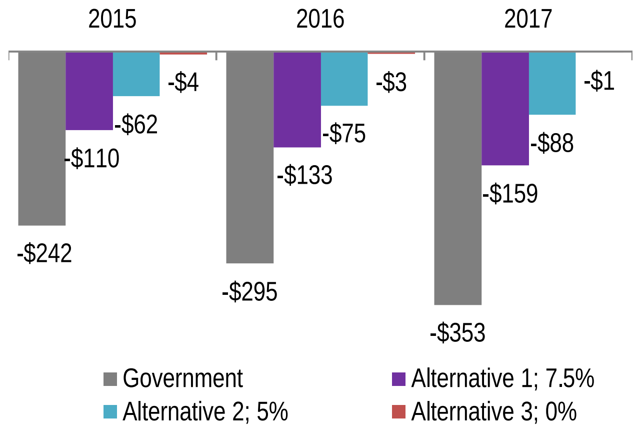


Figure ES-3. Direct tourism industry job impacts of Government's proposed VAT and policy alternatives, 2015-2017

Figure ES-3.1 Tourism jobs v. baseline
Baseline tourism sector jobs =100%

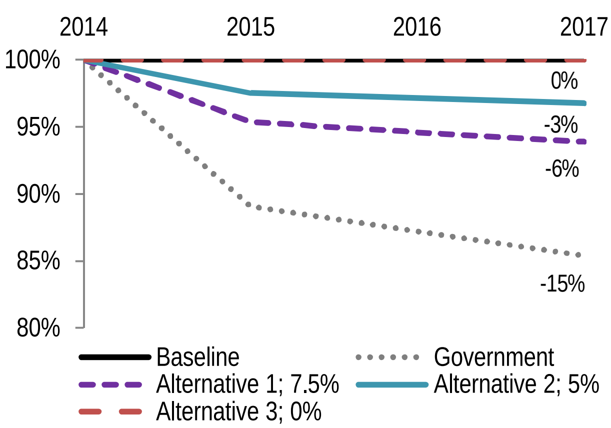
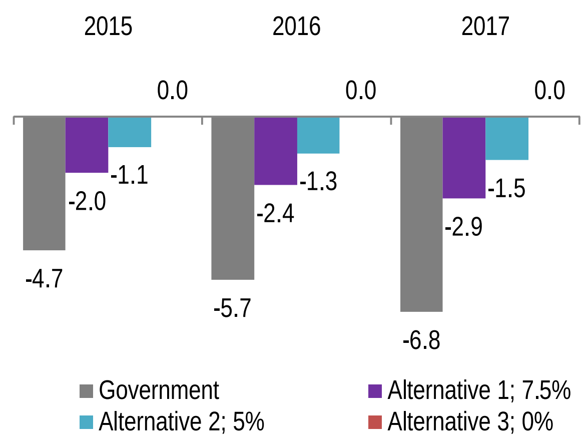


Figure ES-3.2 Tourism jobs v. baseline
Thousands of jobs



Note: Direct economic impacts shown in the figures are due to proposed tax changes on the tourism industry, estimated as the net increase (or decrease) in taxes, including VAT, employer payroll taxes (0.75% in Alternative 1, 1.5% in Alternative 2, and 2.5% in Alternative 3), and tax reductions (eliminations of hotel occupancy and import duty reductions).

Source: EY analysis based on publicly available economic data, the draft VAT bill and guide to VAT legislation published in November 2013 by the Bahamian Ministry of Finance, and policy option parameters specified by the tourism industry.

Table ES-3. Total direct, indirect, and induced dynamic economic impacts related to the tourism industry of the Government's proposed VAT and policy alternatives

Millions of nominal B$; thousands of jobs

	Government's proposed VAT	Alternative 1; 7.5%[1]	Alternative 2; 5%[2]	Alternative 3; 0%[3]
Sales				
2015	-$598	-$268	-$154	-$4
2016	-$729	-$326	-$187	-$4
2017	-$872	-$389	-$222	-$4
GDP				
2015	-$385	-$172	-$98	-$3
2016	-$469	-$209	-$118	-$2
2017	-$561	-$249	-$138	-$1
Wages & salaries				
2015	-$88	-$35	-$17	$7
2016	-$107	-$42	-$20	$8
2017	-$128	-$49	-$22	$10
Jobs				
2015	-9.0	-4.0	-2.4	-0.3
2016	-11.0	-4.9	-2.9	-0.3
2017	-13.2	-5.9	-3.4	-0.3

[1] VAT rate on tourism of 7.5%; Employer payroll tax of 0.75%; general VAT rate of 15%
[2] VAT rate on tourism of 5%; Employer payroll tax of 1.5%; general VAT rate of 15%
[3] VAT rate on tourism of 0%; Employer payroll tax of 2.5%; general VAT rate of 15%
Note: Differences shown in the table are the annual difference under each policy scenario, relative to the current-law baseline in that year. Assumed current-law economic impacts are the total direct, indirect, and induced economic impacts related to the tourism industry. The multipliers are held constant across all years. Therefore, the growth of the total impact is equivalent to the growth rate of the tourism industry (4.6%).
Source: EY analysis.