



# Hospitality or Lodging Taxes as a Source of Revenue for Tourism Economic Development Efforts

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Rural areas and small towns are searching for new sources of jobs and income as they have experienced declining economic competitiveness. One potential source of economic activity is the tourism industry. The U.S. Travel Data Center reports spending on travel service in the U.S. reached approximately \$350 billion in 1989. Americans spent an estimated \$316 billion, while foreign visitors spent \$34 billion on travel in the United States. The same report notes that Americans spent 5.2 billion nights away from home for an average trip length of four nights. Herein, tourism is defined to include all travel related expenditures.

Community leaders are asking if capturing some of these tourism expenditures represents a potential strategy for economic development. Potential benefits include new job creation, the capture of outside income for the local economy, and growth in local tax revenue. Potential drawbacks cited include the concern that tourism growth can bring "strangers" to town and possibly impact the current social structure. Also, tourism can sometimes be seasonal, with slow periods for local businesses. Finally, the threat of environmental deterioration sometimes concerns local residents. Most of these concerns can be addressed with sound local planning. Ultimately, each community will have to decide if tourism is a viable option. The experts do note that one cannot "play" with a tourism strategy. The market is highly competitive and communities must have commitment to sound product development and a marketing plan.

The first step for a community interested in the tourism and travel industry is to establish clearly defined goals the entire community can support. Common goals include attracting and stopping visitors in your area; extending their stay to maximize expenditures; and finally, extending your season so a steady flow of tourists exists. Wide citizen involvement and community awareness are critical. Groups involved should include city and county officials, civic organizations, business persons, educational institutions, and religious leaders.

An effective community-wide effort can include the formation of several subcommittees, including **promotion** to centralize and coordinate the targeted market effort for tourism attractions; **special events** to develop and carry out events such as festivals, fairs, downtown sales, homecomings, etc.; **hospitality** to create awareness of the importance of good customer service for out-of-town visitors; **visitor information**

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**center** to provide a one-stop center for tourist information in the community in order to make it easier for out-of-town guests to enjoy their stay and spend more money; and **finance** to focus on fund-raising since the effort will not succeed without adequate resources.

Several community groups have recently expressed interest in the hospitality tax option to help finance tourism efforts. The main purpose of this fact sheet is to discuss the use of a lodging tax as part of a tourism effort.

## Financing Tourism Efforts

Financial planning is very important if tourism programs and projects are going to be successful. A sustainable and long term funding base is necessary if a community or region desires to make a meaningful commitment to tourism efforts. There are several options a community can consider as a funding source and the best choice will depend upon local conditions and the intended use of the funds (for example, a major project or tourism effort versus a small scale festival or event). Each source has unique characteristics and might be appropriate depending upon the specific need for funding.

The types of funding sources employed will depend partly on the community's desired level of tourism activity. Getting a program "off-the-ground and rolling" will usually require local donations. Gifts may be solicited and local fund raising activities organized by a core group of citizens. Once the community has shown willingness and ability to raise funds, state and federal matching funds will be easier to obtain. Likewise, grants from foundations and development organizations may be within reach. General revenue bonds may also be needed, at some point, for major capital investments.

For annual or seasonal events, funds may be raised through avenues like gate receipts, vendor fees, organization fees, retail sales, donations, and advertising sales. These funds, combined with sufficient volunteer efforts, may be adequate to support several periodic events. But an on-going tourism effort will probably require more substantial and continuous funding.

An on-going tourism effort requires a reliable flow of funds. Although a city may choose to add tourism promotion to their operating budget, additional funds will probably have to be raised. Perhaps the two most common methods of fund-raising are: (1) increasing the general sales tax and (2) implementing a lodging tax. The lodging tax is often chosen because it is

paid, not by local citizens, but by travelers passing through the community.

## Lodging Tax

A hotel/motel or lodging tax is essentially a sales tax levied by an incorporated city against the room rental rate of local hotels, motels, bed and breakfasts, and similar lodging enterprises. Oklahoma lodging taxes are in the range of 2 to 5 percent of the base room rate (cost of the room excluding the cost of phone calls, room services, and such) and apply only to businesses having five or more rooms for rent. A lodging tax is instituted after a proposed city ordinance is adopted by a majority vote of the citizens. Such an ordinance will state the tax rate, how the funds are to be used, and how the tax revenues are to be collected and managed. (The Appendix outlines the key elements of a city lodging tax ordinance.) Often, the logic for adopting a lodging tax is that the money collected will be used to promote economic development. Economic development, in turn, will result in additional business for the lodging industry.

The form of economic development that directly benefits the lodging industry is tourism. "Tourism" encompasses more than just vacationers; it includes a wide variety of visitors who stay overnight for trade shows, conventions, special events, and various other reasons for which a person may be spending one or more nights away from home. If lodging tax dollars are used to promote economic activity benefitting the lodging industry, it is a positive situation for the city. Visitors, rather than local citizens, pay the tax and lodging enterprises, as well as other local businesses, may experience economic benefits.

Figure 1 provides a selected national perspective on existing lodging taxes. Although most lodging taxes are assessed by cities, some counties and states also levy a tax. Figure 1 indicates that Oklahoma lodging taxes are among the smallest. Even after adding the general sales tax to the lodging tax, the total tax on an overnight visitor in Oklahoma compares favorably with the other cities.

## Oklahoma Cities Collecting a Lodging

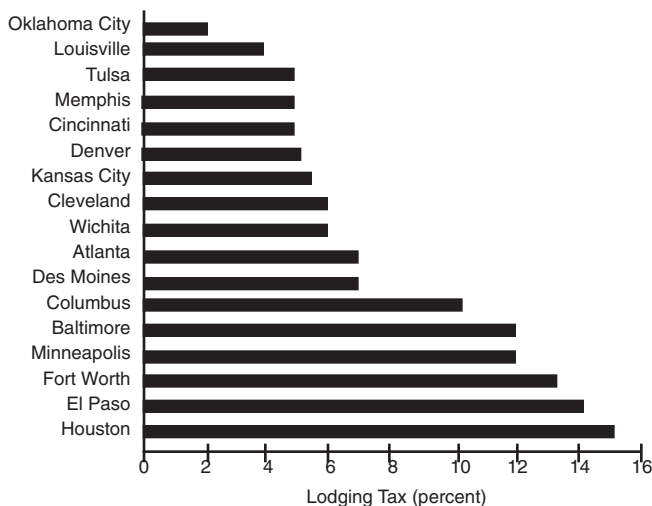


Figure 1. Hotel Tax in Selected Major Cities.

## Tax

Fifteen Oklahoma cities have a lodging tax (Table 1) and collect more than \$4 million annually. The lodging tax rate ranges from 2 to 5 percent with the average being 3.63 percent. Some ordinances are more specific than others regarding uses of the funds. The Guymon, Stillwater, Ponca City, and Muskogee ordinances specify that 100 percent of the funds be used for tourism promotion. Some cities, such as Altus, provide for precise allocation of the funds. Lawton and Enid, on the other hand, state that funds are to be used for tourism, economic development, and so forth but do not specify the allocation. Likewise, for Del City "economic development" is the stated purpose but this is broadly defined such that it encompasses tourism. Finally, note that Moore uses all its lodging tax funds on acquisition and capital improvement of local parks. Clearly, there are a variety of purposes and an even greater variety of specifications for the use of lodging funds.

When a city adopts a lodging tax and determines the purpose or purposes for its use, the city must also specify who will do the work. Some cities set up their own tourism department or convention and visitor center but many cities contract tourism and economic development work to the local chamber of commerce or economic development foundation. Most cities appropriate the funds annually but Guthrie does so semi-annually. Cities often assign an appointed committee or commission to act as an oversight and approval body for proposed projects and programs. Sometimes these oversight bodies include representatives from several groups including the hotel/motel industry. In addition to regular review of specific uses of funds, some cities' ordinances call for periodic vote of the people to continue the lodging tax. Lawton, for example, votes every five years to renew or abolish their lodging tax. Hence, each city may customize its ordinance to local needs and interests.

## Consequences of a Hospitality Tax

There are perceived advantages and disadvantages to a local lodging tax. A key advantage often cited is that the tax is levied on travelers rather than on local citizens. Local voters may find this very appealing. Taken at face value, the lodging tax seems to be ideal since it taxes people from outside the community for the benefit of people within the community. One possible disadvantage, however, is a reduction in visitors. Hotel and motel operators often voice concern that they will see a reduction in overnight guests. A study by Hiemstra and Ismail for the American Hotel and Motel Association found a 4.4 percent decline in the number of rooms rented for a 10 percent room tax. However, for smaller room tax rates, they found a smaller decline in rentals.

Proponents of lodging taxes argue that the revenue generated should be used to promote tourism, hence increasing hotel/motel business. Several Oklahoma cities report that their promotional activities have indeed increased the level of hotel and motel rentals in their cities. Successful tourism promotion also increases the number of day visitors. Even if visitors do not spend a night in the community, spending money to attend a local event, buy a meal, and perhaps fill the gas tank are all ways in which the local economy is stimulated.

On the other hand, if a community is not large enough (does not have enough hotel and motel rooms), the community

**Table 1. Lodging Tax Rates and Allocation of Tax Revenues for Oklahoma cities Levying a Lodging Tax.**

	Rate (%)	Tourism (%)	Econ. Dev. (%)	Parks & Rec (%)	Conv. & Visitors (%)	Arts & Humanities (%)
Altus	5	20	80			
Bartlesville*	2	x	70		x	
Del City**	3.5		100			
Enid	5	x	x		x	
Guthrie	3.5		67		33	
Guymon	3	100				
Lawton	5	x	x			
Midwest City	3.5		80	20		
Moore	3			100		
Muskogee	3	100				
Norman	4			25	50	25
Oklahoma City	2				100	
Ponca City	3	100				
Stillwater	4	100				
Tulsa	5		40		50	10

\* The lodging tax provides a small percentage of Bartlesville's total tourism and development budget. A .25% general sales tax raises the vast majority of funds.

\*\*Del City defines economic development broadly, thus tourism and other activities may be included.

cannot hope to raise a large amount of revenue from a lodging tax. This may imply that a lodging tax is either unsuitable for the community or that the lodging tax must be supplemented by other revenues in order to adequately fund a tourism program. Furthermore, if a community does not provide attractions and activities that draw guests from significant distances, a lodging tax may not be effective. To have a significant economic impact, visitors must stay in the community for a significant period of time and some of them must be far enough from home that they will want to spend one or more nights.

Another major advantage of a lodging tax is that it provides an on-going source of funds for tourism promotion. If a community is to have an effective tourism industry, it will probably require a steady stream of income for promotion of that industry. Donations and fundraisers are good and have their place, but may be unreliable and inefficient for an on-going program. On the other hand, communities report varying degrees of difficulty in collecting lodging taxes from the hotels and motels. However, collection of taxes need not be a significant problem if the tourism program is effectively increasing the number of over-night guests.

Finally, the lodging tax is a widely accepted instrument for raising money for tourism and can provide a system of accountability in its use. Cities throughout the United States levy this tax. The nation-wide study by Hiemstra and Ismail included data from 375 cities and several major cities are shown in Figure 1. Hotel and motel operators in cities levying the tax are directly impacted and it is relatively easy for them to measure the effectiveness of local tourism promotion programs over time. Collections and returns reported to the city by lodging operators provide information by which the city can measure tourism promotion effectiveness. At the same time,

the city ordinance authorizing the lodging tax may also contain provisions for strict accounting of expenditures. Accountability for expenditures may also be accompanied by measures of success of return. Agreements between chambers of commerce or development foundations, who actually carry out tourism promotion activities, often call for regular oral and/or written reports to account for expenditures and submit measures of program effectiveness.

## Summary

The hotel/motel or lodging tax is a widely used mechanism for raising funds to promote tourism, parks and recreation, convention centers, and other economic development activities. Effective management of these tax revenues may have the advantage of benefiting the local economy and placing the tax burden on non-local travelers. The primary disadvantage is that high lodging tax rates may reduce the number of potential overnight visitors, particularly when the rate is too high and the generated funds are not used to promote tourism. Compared to major cities across the United States, Oklahoma cities appear to be levying some of the lowest lodging tax rates. Ultimately, each community will have to analyze the potential consequences of a lodging tax and decide if this is a feasible step. To gain more information in implementing a lodging tax, you may wish to call one of the authors at the OSU Cooperative Extension Service. Other good sources of information are the Oklahoma Tourism and Recreation Department and each of the cities currently levying a lodging tax.

## Resources

Minnesota Extension Service. A Training Guide for Rural Tourism Development. University of Minnesota, CD-EP-5666, CD-MI-5668, 1991.

Hiemstra, S.J. and J.A. Ismail. Impacts of Room Taxes on the Lodging Industry. Report prepared for American Hotel and Motel Association by Restaurant, Hotel, and Institutional Management Institute, Purdue University, March 1991.

## Appendix

### “Hotel” Tax Ordinance Outline

- I. Citation and Codification
- II. Definitions
  - A. Director
  - B. Hotel
  - C. Occupancy
  - D. Occupant
  - E. Operator
  - F. Permanent Resident
  - G. Rent
  - H. Return
  - I. Room
  - J. Tax
- III. Tax Rate
- IV. Exemptions
  - A. Permanent Residents
  - B. Federal and State Government and Agencies
  - C. Nonprofit charitable, religious, philanthropic, and educational organizations

- V. Administration and Collection of Tax
  - A. Tax to be Separately Designated on Bills
  - B. Operator Responsible for Collection
  - C. Records to be Kept
  - D. Returns
  - E. Payment of Tax
  - F. Bond Required
  - G. Assessment and Determination of Tax
  - H. Refunds
  - I. Notices
  - J. Remedies Exclusive
  - K. General Powers of the Director
  - L. Administration of Oaths and Compelling Testimony
  - M. Certificates of Registration or Collection Permits
  - N. Interest and Penalty
  - O. Delinquent Taxes
  - P. Operator’s Discount
- VI. Use of Funds
- VII. Records Confidential
- VIII. Fraudulent Returns
- IX. Amendments
- X. Provisions Cumulative
- XI. Provisions Severable
- XII. Provision for Termination
- XIII. Collection Fee
- XIV. Effective Date

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