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Studying the Impact of the Value Added Tax on Profitability and Survival of the Companies in Tourism Industry (Case study: Hotels in Tehran)

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Abstract

Objective: The present study aimed to trace Studying the Impact of the Value Added Tax on Profitability and Survival of the Companies in Tourism Industry (Case study: Hotels in Tehran)

Methodology: According to the value added tax law and activities of tourism industry that are subject to value added tax exemptions, this study examines the impact of value added tax on the profitability and survival of the companies in the tourism industry in Tehran hotels. The research method is quasi-experimental and retrospective conducted by using retrospective data in the accounting research scope based on real data. The analysis of the data was done in two sections; before and after the valued added tax increase: descriptive statistics included 30 sample hotels during a period of 12 years (2007 to 2019) and the number of year- hotel (360).

Results: The results showed that increase of value added tax has a significant inverse effect on the profitability of the hotels in the country implementing this law.

Innovation: Considering the importance of the tourism sector in promoting the economic growth of developing and developed countries, several empirical studies have been conducted on factors affecting tourism demand in recent years. In this regard, the relationship between the tax rates as one of the government's financial instruments and the profitability of the tourism industry has been less considered in tourism studies.

Keywords: Value Added Tax, Profitability and Survival of the Company, Tourism Industry.

1. Introduction

Taxation is one of the most important and stable sources of income for governments in most countries. Among the types of taxes, the best way to collect taxes is value added tax. This tax was not very famous in early 1970s; however in recent years, the main focus of the tax system reform program, in almost all countries in the world, is value added tax. So that this tax was adopted by the majority of developed and developing countries in the last half century and on average a quarter of the government's income is provided by these economies (Azizi & Mansouri, 2019). In fact, value added tax is one of the most progressive tax systems in the world that has been converted to the most common ones in the world. The implementation of this type of tax causes transparency in economic exchanges and avoiding the phenomenon of the underground economy, reducing tax evasion, preventing goods smuggling, economic corruption, encouraging investment or improving economic conditions, business environment and production and establishing justice economy (Kolahi and Noor, 2016). Hence, it is expected that value added tax influences different sectors of an economy.

The complexity of implementing the value added tax, such as need for specialized personnel and administrative costs, regular registration of accounts, understanding the value added tax, multiplicity of tax rates and exemptions have caused issues regarding non-realization of this goal. This problem is significant especially in developing countries more than developed countries. In addition, some inadequacies and practical problems of the value added tax system including its impact on inflation, decreasing nature, relating this tax with the financial services sector, how to impose the tax on public sector institutions, etc. are the concerns of the government in some countries that have not introduced this tax. Some countries have experienced income reduction by using the value added tax system. Perhaps one of the other important reasons for not applying value added tax in some countries is worry about the issue of income reduction. The importance of the government's role in the economy is determined according to the impact of the budget and financial policy on economic activities. Since adoption of financial policies has a significant impact on the main variables of the economy, examining the government's revenues and expenses are very important as fundamental tools. For this reason, in investigating the most important reasons for reforming the tax system in Iran, it can be mentioned that revenues from oil sales and tax revenues are two important components of the government revenues (Jaafari Samimi et al., 2018).

Excessive reliance on the oil revenues due to the fluctuation of its price in the world markets has caused very severe instability in the government revenues. In other words, tax revenues are influenced indirectly by the foreign exchange flow resulted from the sale of oil, since decrease in foreign exchange earnings leads to a decrease in imports and indirect tax (import tax). Given that tax revenues, as a major item of government revenues, can be used as an effective financial tool to provide financial resources for necessary government expenses, adjusting distribution of income and wealth and directing the economic activities of the society are considered and therefore, according to this important necessity using an efficient tax system seems essential in Iran economy (Kia et al., 2021). Tax policies and the reforms of tax rates in the tourism sector are among the measures that have been taken by the countries with tourism destinations in the last two decades. In the past, the aim of the taxation policy was to establish a source of income for the governments and the management of the tourism industry, but during the last two decades, generally, the countries implements the policy of tax exemption aiming at tourism development. Various countries take into account the tax issues and prices in the tourism industry seriously. Introducing new taxes, choosing the tax target community and the method of taxation deserve to be discussed under separated titles, but tax exemptions have been recognized as a tool for the prosperity of the tourism sector in countries. For instance, many European countries consider an

exemption varying between 40 and 50 percent for the value added tax of hotels (Barati & Rasulzadeh, 2022).

Duties and taxes paid by the economic operators of the tourism sector are factors that changes the price and the cost of providing services to tourists. Tax exemption on tourism facilities has been implemented for several years and the tourism activists and the agents have been supported, however, the government seeks to eliminate these exemptions from its the work plan. Of course, these exemptions are not applied to all tourism businesses and the trustees of the tourism industry seek to extend these tax exemptions to all businesses in the tourism industry. Currently, based on the value added tax law and the resolution of the Islamic Council of Ministers, the value added tax exemption is being implemented for the suburban, rail and air transportation sector (both freight and passenger). While municipal fees, airport fees, and passenger safety monitoring fees are collected. Travel agencies are also exempted from value added tax (for tours entering the country). While the ticket sales fee is charged by the travel agencies from the passengers and the added value of this fee is also received. The tax exemption for inbound tours or domestic tours is different, so that exemption is between 50 and 100 percent. Restaurants and sales centers and supply goods to tourists have no tax exemption and they have to pay it completely. Also hotels (except hotels with four and five stars) are exempt from paying value added tax. Regardless of the issues related to the type and amount tax that restaurants receive from tourists, it is worth mentioning that different departments providing services to tourists generally receive taxes or fees in some form from tourists, mainly as value-added tax. In few cases, other types of taxes or duties can be added to it. However, taxes have been collected from tourism economic operators in different ways, but essential measures have been established to apply wider tax exemptions to the tourism industry since 2021 in order to promote the prosperity of tourism sector (Islamic Council, 2020).

Value added tax in Iran has been taken into account due to the favorable characteristics of this type of tax in the fields of expanding the tax base, reduction of relying on oil revenues, increasing the systematization of the tax system, improving the efficiency of the tax system, improving individuals participation in tax payment, the issue of tax revenues and the imbalance in government budget expenditures and revenues. Value added tax has a high power to generate income for the government, so that experts consider it as a money machine. Therefore, value added tax should be considered in analyzing the profitability of the tourism industry. This type of tax is an economic tool for tourism management, in the sense that it is ultimately a tax that has an impact on the customer behavior. According to the above mentioned, applying and increasing the value added tax on the tourism industry provides the possibility that the operators of this industry, such as hotels and restaurants, cannot receive the increased costs from the final consumers because of the intense pressure of competition. Therefore, these changes increase the risk of sustainability of some industries including tourism industry significantly. One percent increase in prices due to increase in value added tax rate can lead to a drop in the number of tourists entering and ultimately affecting the number of visitors will also reduce the total tourism income. Higher value added tax causes some smaller businesses to give up since they are currently operating with limited profits and unable to receive the cost from the customers under intense competitive pressure (Mateus & Mateus, 2021).

Considering the importance of the tourism sector in promoting the economic growth of developing and developed countries, several empirical studies have been conducted on factors affecting tourism demand in recent years. In this regard, the relationship between the tax rates as one of the government's financial instruments and the profitability of the tourism industry has been less considered in tourism studies. Therefore, in this research, it has been tried to answer this question, whether the practices and the increase in the value added tax rate affect the profitability of the tourism industry (Tehran hotels)? Suggestions should be presented to managers and tax officials in the Tax

Affairs Organization based on the results and findings of the research.

2. Review of Literature and Theoretical Background

If we consider the tourism industry as an export sector in a country with many tourists, it will be introduced as a foreign sector of the economy. Trade is one of the most important factors in the foreign sector of the economy and is one of the main components of development. In today's economy, countries are aware of the need for strengthening and paying attention to trade as one of their main goals in policies making since in addition to driving the production sector, it transfers knowledge and establishes economic and cultural interaction and it is important in the era of globalization. For this purpose, important steps are taken in order to eliminate the commercial obstacles in order to join The World Trade Organization and trade liberalization. One of these steps is decreasing direct commercial taxes and the customs tariffs that have caused the reduction of the government's income from this point of view. On the one hand, it has been tried to improve trade and resources for preventing lose of income with replacing other internal taxes. Due to the favorable characteristics of the value added tax, most countries uses it. The issue that should be considered whether this movement has been able to improve the statue of the foreign trade or this type of tax will also indirectly limit trade. The consequences of implementing value added tax can be strongly influenced by the business structure and the way of implementation in countries. If tax to be applied to the added value of goods and services produced inside a country, the tax system will be based on the principles of the origin. In this case, the import of goods and services is outside the scope of value added tax. In contrast, if value added tax to be imposed on goods and services used within a country, the tax will be based on the principle of destination and in this case, export will be outside its scope (Ernst and Yang, 2012).

Research related to the value added tax and profitability and survival in the tourism industry are as follows: Cheharghani and Zaranejad (2019) investigated the effect of value added tax on Iran's economic growth using the CGE equilibrium model and the analysis has been done in the form of nine scenarios, which include imposition of value added tax with applicable rates in all scenarios and the value added tax rate in the agricultural sector is assumed to be zero. Azizi and Mansouri Kasvai (2021) studied the effect of value added tax on trade and compared this effect in countries exporters and non-exporters of oil, their results indicated that value added tax has a significant negative effect on trade and export in each group of the studied countries and there was a significant negative effect on trade and export in each of the studied country. However, its negative effect is more in oil exporting countries than in non-exporting countries. Kia et al (2021) identified the criteria and metrics for evaluating the value added tax policy. The results of the sampling adequacy test fulfilled the objective of the factor analysis. Next, confirmatory factor analysis was used. The results of the confirmatory factor analysis confirmed the compatibility between the theoretical structure and the experimental structure of the research model. Lambi (2017) assessed the impacts of a major tax reform and the effects of tax reforms including value added tax in Uruguay using the computable general balance method. The result showed that in order to maintain the neutrality of the budget after tax reforms, the value added tax rate should be reduced. Timmermans and Achten (2018) investigated the value-added tax to a damage and value-added tax partially based on life cycle assessment: principles and feasibility that aimed to examine the argument in favor of changing from value added tax or sales tax to loss value added tax mainly based on the assessment of the life cycle of goods and services. With this change, goods and services that damage the environment seriously and are harmful to health will be expensive. Mariscal and Werner (2018) studied the effects of the value-added tax on income distribution. They relied on two tax

conditions in Mexico increasing the tax rate for a group of cities and exempting another. Zou and Jingxian (2019) studied the effect of value added tax on tax leverage: taken from the reform of China's value added tax and stated that they have used the revised China's value added tax in 2007, which aims to attract fixed investment, as a natural experiment to find out the effect of financial leverage. According to Dang et al (2019), the evidence showed that maintaining transparency and economic stability will effectively reduce the tax burden. Hosseini and Briand (2020) studied the effect of replacing sales tax with value added tax on production efficiency and informality in Indian states. Using scalable anomaly detection techniques, Jellis van Hooyveld, David Martens, Bruno Peters (2020) stated that the range of tax fraud detection with a very small number of known labeled data (legal fraud/legal case) is representative for the population due to sample selection bias. Kisanga et al. (2021), in a research entitled the evaluation of the distributional impact of reduced VAT rate on the standard rate items in Tanzania and options for refunds income loss stated that these results are sustainable development solutions to strengthen Tanzania's research to achieve development goals. In research to analyze the impact of the tourism industry, Mateus and Mateus (2021) investigated the consequences of a significant increase in value added tax in the tourism industry regarding estimation of profitability and survival of related Food and Beverage companies' service providing activities. Analysis of this research is divided into three periods of before the value added tax, after the increase of the value added tax and during the financial crisis. The results showed that a significant increase in value added tax significantly affects the profitability of the companies in the country implementing value added tax more impressive than the financial crisis.

Mateus and Mateus (2021) in the article entitled "Does the increase in value added tax harm the tourism industry, evidences from Portuguese", investigated the mentioned topic since 2003 to 2013. The analysis was done based on a sample of 23388 Portuguese companies and 4969 Greek companies, which annual observations for each company were on average 5.1 and 6.9 for Portugal and Greece, respectively. Portugal and Greece are the closest countries in southern Europe with similar population, GDP per capita, cultural dimensions and tourism indicators. The findings of this research depicted that demand for tourism is flexible and sensitive to price changes. Therefore, a 1% increase in the tourists cost leads to a 2% decrease in the number of tourists arriving to the country.

3. Research Methodology

The method for conducting this quasi-experimental and retrospective research is using past information in the scope of accounting research based on real information. In this type of research, the purpose is investigating the relationships between the variables and the data collected from the environment existed naturally or were past events analyzed without direct intervention of the researcher. Data review method is in the form of mixed data analysis of year-on-year review using multivariate regression. The data were collected using the financial statements of Tehran hotels for a period of 12 years (2007-2018).

Research Model and Variables

The regression model of this research is as follows:

$$PROFIT_{i,t} = \beta_{0,i} + \beta_{i,j} VAT_{i,j,1} + \sum_{k=1}^{k} \beta_{1,k} Y_{i,k,t} + \sum_{k=1}^{k} \beta_{2,l} Z_{l,t-1} + \varepsilon_{i,t}$$

The dependent variable

Profitability (PROFIT) has a special place and is the main axis as a dependent variable in this research. If this variable is not calculated accurately, the accuracy in calculating the independent variables will be useless. In this research Profitability is measured by the ratio of profit before interest and tax to total assets.

Independent variables

In addition to value added tax, two groups of factors affect profitability, a series of the factors are related to the company itself, which are: size, financial leverage, and we considered these factors in the form of ΣY. And a series of the factors related to macroeconomics are: exchange rate, inflation and economic growth, which we considered in the form of ΣY.

Value Added Tax: (VAT) is application and stability of the criterion, and imaginary variables of zero and one are used.

Size: Small businesses are often considered as innovators and job creators. Small businesses have a significant contribution in the tourism sector. Jobs, production growth and contribution to the economy of this group of companies are often compared with large businesses. Size should affect profitability. Economy of scale, diversity of business and its scope means that a large company will generally be more profitable than a smaller company. Besides, they probably will have easier access to bank financial resources, generally face lower borrowing costs and likely to go bankrupt because, unlike small companies, they can absorb higher costs easily. Here we measure firm size by the natural logarithm of total firm assets (Mateus and Mateus, 2021).

Financial leverage: (LEV) is a type of financial tool to increase the return in an investment. In fact, the use of financial leverage means using debt in a specific investment. A company or investor can increase his capital and financial activities apart from assets and capital, without adding new investors, through borrowing (creating debt) capital. Financial leverage is calculated by dividing total liabilities by total assets.

Inflation rate: The inflation rate is a decreasing function of the real exchange rate and the nominal exchange rate that directly increases the price. Compared to domestic goods, foreign goods increase the demand for domestic goods and wages and production costs and it leads to an increase in the price of domestic goods until the real exchange rate reaches the equilibrium rate. Exchange rate can act as a monetary policy variable. Inflation rate is equal to the logarithm of the inflation rate announced by the central bank.

Economic growth rate is simply a ratio in percentage that shows the changes of value added of economy established by the country in a period, which is usually a year, compared to the previous period or the previous year. In economists' point of view, it depicts how much the GDP of a year has decreased or increased compared to the previous year. Economic growth equals to the GDP of the current period minus the GDP of the previous period divided by the gross output of the previous period.

Exchange rate is a number that shows the value of a country's currency in terms of exchange currency in a certain time, which is measured through the increase in the general level of the dollar and the dollar rate in this research is considered for its standardization and natural logarithm was taken (Varharami & Abbasgholinejad Asbaghi, 2018).

4. Research Findings

Descriptive Findings

In order to examine the general characteristics of the variables and their detailed analysis, familiarity with the descriptive statistics related to the variables is necessary. Table (1) shows the descriptive statistics of the data related to the variables used in the research. Descriptive statistics is related to 30 sample hotels during a period of 12 years (2007 to 2018) or the number of (360) hotel years.

The main central index is average, which indicates the balance point and the center of gravity of the distribution, and is a good index for the centrality of the data. For instance, the average value for the financial leverage variable equals to 0.09, which shows most of the data are concentrated around this point. In general, dispersion parameters is a measure to determine the amount of dispersion from each other or their dispersion relative to the mean. One of the most important dispersion parameters is the standard deviation. The value of this parameter for the economic growth variable equals to 2.66 and the financial leverage variable is equal to 0.12 percent,

which shows that these two variables have the highest and lowest standard deviation, respectively. The minimum and maximum also shows the lowest and highest amount in each variable.

Table 1): Descriptive statistics of research variables

Variable	Abbreviation	No.	Mean	Median	Max.	Min.	SD
Profitability	Profit	360	0.12	0.048	1.57	-0.022	0.27
Value added tax	VAT	360	0.66	1.00	1.00	0.00	0.47
Hotel size	SIZE	360	19.98	19.98	20.71	17.87	0.38
Leverage	LEV	360	0.097	0.082	1.24	0.035	0.12
Inflation rate	Inflation	360	1.13	1.05	1.54	0.95	0.19
Economic growth	GDP	360	-0.81	0.12	9.58	-0.89	2.66
Exchange currency	EXCH	360	4.24	4.24	4.62	3.90	0.26

Variance Heterogeneity Test

The results in table (2) show that the significance level of the test in the research model is less than 5% and indicates presence of heterogeneity of variance in disturbance sentences and this problem has been solved in the final estimation of models by executing the *gls* command and also using the features of the standard powerful tool fixed in Eviews 10software.

According to the results of table (3), it can be seen that the significance level of the serial autocorrelation test of the research model is less than 5% and indicates the existence of serial autocorrelation in the models. This issue has been resolved with addition of the first order break in the model (Aflatoni, 2018).

The unit root test of variables

To check the presence of unit root in panel data, Levin, Lin and Chu test can be used, the results are summarized in Table (4).

Serial Autocorrelation Test

According to the results obtained in table (4), it can be seen that the significance level of the variables in the unit root test is less than 5% percentage and indicates the significance of the variables.

Table 2) The results of the heterogeneity of variance test

Test model	Statistics	Sig	Result
Research hypothesis	353.21	0.0000	Variance Heterogeneity

Table 3) Results of serial autocorrelation test

Test model	Statistics	Sig	Result
Research hypothesis	280.8	0.0000	Serial Autocorrelation

Table 4): Unit root test (Levin, Lin and Chu) quantitative research variables

Variables	Abbreviation	Statistics	sig	Result
Profitability	Profit	- 7.28619	0.0000	Stationary
Hotel size	SIZE	- 3.89671	0.0000	Stationary
Leverage	LEV	- 14.9500	0.0000	Stationary
Inflation	Inflation rate	- 3.90373	0.0000	Stationary
Economic growth	GDP	- 3.18738	0.0000	Stationary
Exchange currency	EXCH	- 4.50764	0.0000	Stationary

Hypothesis Test Results

F-limer test (Chu)

According to the results obtained in table (5), it can be seen that the level of significance of the Chu test for the hypothesis of the research is less than 5% and it indicates the acceptance of panel data model which needs to be assured. Hausman's test is presented below (Aflatoni, 2018).

Hausman test

According to the results obtained in table (6), it can be seen that the significance level of the test in the research hypothesis test model is less than 5% and indicates the acceptance of constant effects.

Hypothesis Test Results

Research hypothesis: increasing the value added tax has a negative and significant effect on the profitability of the tourism industry.

The results of table (7) show that the value added tax increase variable with a negative coefficient (0.045) and a significance level below 5% (0.0001) has a negative effect on profitability; therefore, the research hypothesis is not rejected at 5% error level.

The internal variables of hotels, including size and financial leverage, have a significant relationship with profitability with a significance level below 5%. Also, external variables affecting hotels include inflation rate, exchange rate and economic growth with a significant level below 5% have a significant relationship with profitability. The coefficient of determination equals 81%, which shows independent and control variables in the model, and they were able to explain 81% of the changes in the dependent variable. Also, the value of the Durbin Watson (DW) is equal to 1.99 and since our number is between 1.50 and 2.50, it shows that there is no strong autocorrelation between the sentences of the disturbance model. The test statistic with a significance level below 5% depicts that the research model is suitable. The co-linearity statistic below is 5, which shows there is no strong correlation between the research variables.

Table 5): F-limer test results (Chu)

Test model	Statistics	Sig	Result
First secondary hypothesis	8.500	0.0000	Accepting data panel model

Table 6): Hausman test results

Test model	Statistics	Sig	Result
Research hypothesis	63.337	0.0000	Fixed impact of y-intercept

Table 7): The result of the research hypothesis test
Dependent variable: profitability

Variables	Abbreviation	Coefficients	SD	t statistics	Sig	VIF
Value added tax	VAT	-0.045	0.011	-3.97	0.0001	2.33
Hotel size	SIZE	-0.025	0.007	-3.41	0.0007	1.63
Leverage	LEV	0.48	0.067	7.21	0.0000	1.15
Inflation rate	Inflation	0.21	0.058	3.56	0.0004	2.80
Economic growth	GDP	-0.10	0.026	-3.75	0.0002	2.26
Exchange currency	EXCH	-0.11	0.026	4.20	0.0000	1.27
y-intercept		- 0.008	0.23	- 0.037	0.96	
Coefficient of determination		0.81				
Durbin Watson		1.99				
Statistics F		35.854				
Sig		0.0000				

5. Discussion and Conclusion:

Change in tax policies and use of value added tax system in tourism industry is one of the demands that has recently been raised by private sector activists and studies have been conducted regarding it. In the experts' opinions, one of the factors affecting the tourists' decisions to choose a destination is its price. According to the World Economic Forum, Iran ranked first in 2015 in terms of cheap travel destinations. While, Iran considered this feature (cheap travel) as one of its advantages to compete in the global tourism market, the application of value added tax imposed on tourists can make this travel destination more expensive and have a negative effect on its competitiveness. However, it depends on the rate of value added tax that can be received from tourists. It also depends on the facilities, but it should be noted that almost one third of Iran's tourists are Iraqi who mainly come to Iran with pilgrimage intention, and in these cases, such a tax reduces the number of tourists visiting Iran besides other consequences. Meanwhile, some experts believe that instead of relying on the cheap index for Iran's competition with competing destinations, it can be measured in other strengthened competitiveness indices. However, it seems that if the rate of value added tax is to be collected from the tourists there will be a need for serious and deep discussions and the rate that is determined will be very important. How can it be established? By a reasonable and rational rate the tax from industry activists can be transferred to mostly foreign tourists and providing profitability for the businesses related to the field of tourism can improve the related infrastructures directly and indirectly. On the other hand, Iran has not lose the advantage of being competitive in the price of travel destinations in a situation where it has big competitors which have been marginalized to some extent only due to security conditions and may enter the tourism market of the region at any moment. In this regard, different experiences have been recorded in other countries, which can be helpful for Iran. Great Britain, The United Arab Emirates and Tanzania have had different experiences before and after establishment of value added tax gaining experiences from three continents and with different economic systems.

Finally, some suggestions are recommended:

1) It is suggested that the level of value added tax coverage to include a wider range of hotel services with a significant impact on the change in demand and the resulting impact on the accommodation sector, direct benefits for the government and interests and indirect demand for tourists. This expansion should be based on the type of tourists and the purpose of the policy maker should be considered and should not make a broad policy regardless of the type of beneficiary society.
2) In terms of price and tax policies, travel service offices should be supported because they are influenced by the tourism industry price policies. On the other hand, transportation services are important due to the extent of inter-sectorial relations and any policies that have price effects on the tourism economy should be implemented with more consideration. Also, depending on the type of tourists and the policymaker's goal of applying taxes, analyses should also be done in this regard
3) Taxes on agency services and tour operators have significant direct effects and any tax on this group of activists in the tourism industry (due to the very low level of domestic and national tourist demand) to use this type of service and also, the low share of foreign tourists from the entire country's tourism industry influence the development of travel agency services. Therefore, value added tax coverage is not recommended for this group of tourism industry activists.

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