SUBMISSION

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International Visitor Conservation and Tourism Levy

A submission to the Minister of Tourism from Local Government New Zealand

20 July 2018

Contents

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Local Government New Zealand (LGNZ) is the national organisation of local authorities in New Zealand. All 78 councils are members. We represent the national interests of councils and lead best practice in the local government sector. LGNZ provides advocacy and policy services, business support, advice and training to our members to assist them to build successful communities throughout New Zealand. Our purpose is to deliver our sector's Vision: "Local democracy powering community and national success."

Summary

LGNZ congratulates the Government for accepting the principle that the beneficiaries of tourism infrastructure should contribute to the costs of building and maintaining that infrastructure. This is a significant step forward from the position held by previous governments and is warmly welcomed by LGNZ.

The debate now has moved on to how best to achieve a fair apportionment of costs and the mechanisms to raise the funds to meet those costs.

In this regard, LGNZ supports the introduction of the International Visitor Conservation and Tourism Levy ("IVCTL") but notes that this will only partially address the issue of funding mixed-use infrastructure used by tourists and which benefit the tourism industry. LGNZ's submission addresses a number of the questions raised in the consultation document in the body of this submission.

In addition to the IVCTL, a clear case exists to introduce a local tax regime that would allow territorial authorities that wish to do so to introduce a Local Tourist Levy.

A package of funding options that includes a Local Tourist Levy would assist councils to alleviate the burden on local ratepayers from continuing to subsidise the tourism industry. This would allow councils to allocate scarce ratepayer funds to projects of more direct benefit to local citizens. A package of tourism funding options including an ability for councils to levy a local tax on tourism is required because Crown run grant schemes cannot provide a secure and continuing revenue scheme to allow councils to fund both the capital and operational costs[i] of infrastructure used by tourists.

A reliable and durable combination of funding tools for local government will achieve the following outcomes:

- Future visitors to New Zealand will get an improved customer experience;
- The "social license" for the tourism industry to operate in New Zealand will be preserved; presently it is in peril; and
- By creating a new and durable revenue stream, a Local Tourist Levy will create a strong incentive on councils to both grow the visitor value proposition by locality and incentivise councils to facilitate investment in accommodation options. These incentives are created because success in achieving both outcomes would direct benefit councils financially. Such a regime is commonplace throughout the world and is consistent with a localist approach to local government funding options. The tourism industry would benefit, local councils would directly benefit, and most particularly local ratepayers would benefit thus enhancing the industry's social licence.
- It will allow for all visitors to New Zealand to contribute to the costs of the infrastructure they use. The current IVCTL excludes a substantial percentage of our visitors including the growing Australian market evidenced in the graph below.

Figure 1: Australian visitors will reach nearly 2 million by 2024. Source: MBIE 2018 Forecast

Introduction

Tourism is New Zealand's largest export earning industry. That success is welcome but success also creates issues. At a local level the growth in tourism is straining the ability of local ratepayers to fund infrastructure that is both primarily used by tourists and infrastructure which is used by both locals and tourists but which has to be built to specifications beyond the needs of locals in order to accommodate peak demand (driven by tourism numbers). A classic example of this latter type of infrastructure are wastewater plants which for environmental and health reasons must be able to accommodate the demand created by tourist numbers. Funding infrastructure that has significant capital and operational expenditure is difficult when the ratepayer base is smaller (and in some cases significantly smaller) than the tourist numbers that exist. Grant schemes alone cannot fund such infrastructure because they do not address operational expenditure. Financing such infrastructure requires a durable and secure revenue stream.

LGNZ wishes to preserve and enhance the ongoing success of the tourism industry. But to achieve that goal a more equitable solution for infrastructure funding must be found if ordinary New Zealanders are to continue to support the growth of the tourism industry. A strategically astute sector ought to recognise this too.

The combined investment of LGNZ's 78 member councils on infrastructure that is used by visitors make the local government sector the largest contributor to the tourism industry in New Zealand. Total operating activity to the year ended 30 June 2016 was $9.2 billion and 44 per cent or $4.1 billion of that expenditure was on the critical mixed-use infrastructure that supports the tourism industry. This includes investment in local roads, local transport, drinking water supply, wastewater services and solid waste refuse.

The funding required to pay for this infrastructure predominantly comes from local ratepayers through their property tax (rates). In addition, the distribution of visitors to New Zealand is extremely uneven across the country. Therefore, large numbers of visitors are putting pressure on communities that do not currently have the rates-based funding ability to meet this demand and so maintain the visitor experience.

A report on infrastructure cited by MBIE[1] states that local government mixed-use infrastructure is integral to creating an outstanding visitor experience[2]. "To achieve our long-term growth targets and maintain our international competiveness we need to develop and maintain New Zealand's mixed-use infrastructure." The World Economic Forum's *Travel and Tourism Competitiveness Report 2015*[3] ranked New Zealand as the 16th most competitive destination in the world overall but 21st on infrastructure. TIA's Tourism 2025 in 2016 recorded this as an issue. Where it was acknowledged that, "quality infrastructure is needed to support the range of activities visitors enjoy"[4].

Accordingly, LGNZ congratulates the Government for accepting the principle that tourists as beneficiaries of infrastructure should contribute to the costs of providing and maintaining that infrastructure. LGNZ is pleased to provide its' views on the IVCTL and on necessary extra increments to achieve a more effective and sustainable funding regime.

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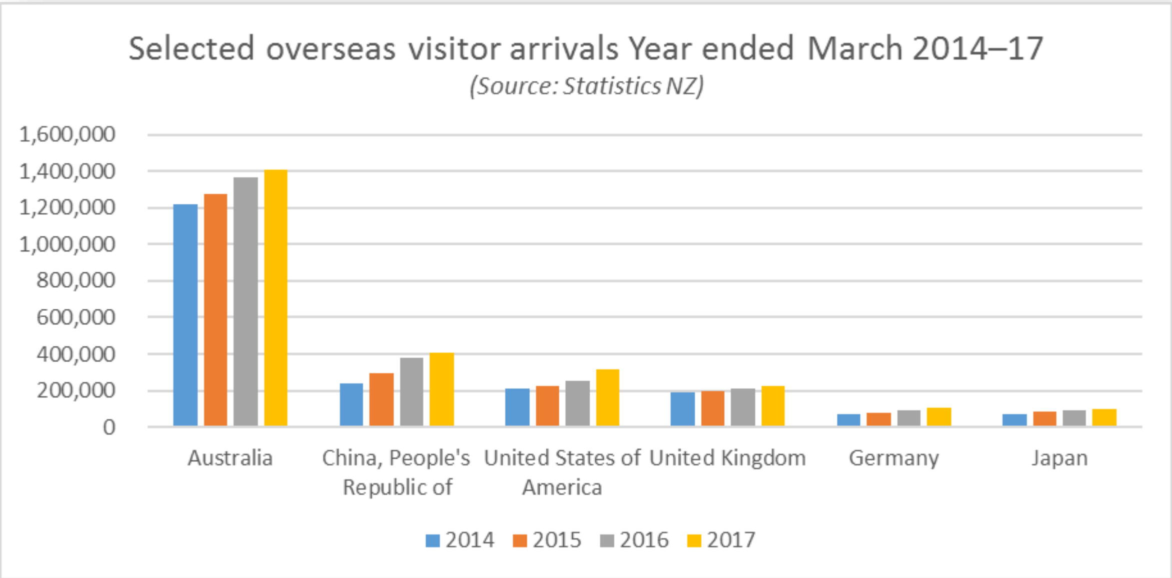
1 MBIE, Tourism Infrastructure incite series, 2016, P.9
2 MBIE, Tourism infrastructure incite series, 2016, p.10
3 World Economic Forum. (2015). the travel and tourism competitiveness report 2015: Growth through shocks. Retrieved from http://www3.weforum.org/docs/TT15/WEF_Global_Travel&Tourism_Report_2015.pdf
4 Tourism 2025

The problem

The current system is inequitable because a significant proportion of users of mixed-use infrastructure are not paying to use it. International and domestic visitors are accessing for free local mixed-use infrastructure when they travel around New Zealand. The burden on local communities to meet the costs is particularly acute at tourism destinations supported by a small number of ratepayers such as Queenstown Lakes District, communities on the West Coast of the South Island, the McKenzie basin, Fiordland and Rotorua.

The ongoing expectation by the New Zealand tourism industry that local citizens should pay the full cost of the required capital and operating expenditure to meet infrastructure demand is not sustainable. This is strategically ill-advised if that industry wishes the communities of New Zealand to continue to be welcoming to tourism. The situation has been steadily getting worse over the past four years as the numbers of international visitors have steadily risen.

Figure 2: Visitor arrivals from Australia, China, United States, United Kingdom, Germany and Japan have been steadily increasing since 2014.



The issue now is so bad that it threatens the social license of the tourism industry in New Zealand. This poses substantive risks to the New Zealand economy because tourism is New Zealand's biggest export industry, contributing 20.7 per cent of New Zealand's foreign exchange earnings[ii].

Local government and central government need to work collaboratively to develop a lasting solution. New Zealand's demographic trends heighten the long-term concerns.[iii] Not only is the population getting older and predominantly on fixed incomes, there is considerable growth in international and domestic migration per capita. These changes affect individual council's abilities to raise finances for their core business let alone deal with an influx of visitors.

Looking to the future the issue is set to get a lot worse. The latest forecasts reveal a significant increase in pressure on local mixed-used infrastructure from greater international visitation. The latest forecasts for the 2018 - 2024 period show that visitor arrivals to New Zealand will grow 4.6 per cent a year, reaching 5.1 million visitors in 2024. The total international spend is expected to reach $14.8 billion in 2024, up 40 per cent from 2017.

McKinsey and Deloitte research supports the need for a Government response

The tourism industry provided initial estimates in 2016 on the size of the infrastructure need if New Zealand is to remain internationally competitive. McKinsey reported a funding requirement of NZ$100 million across 20 priority councils where visitor growth has outpaced local mixed-use infrastructure provision[5]. They went on to conclude that $100 - $150 million per annum was needed over the next ten years to ensure New Zealand was future ready for the forecast increase in visitor numbers.

Alongside the McKinsey research, Deloitte conducted a national assessment of tourism infrastructure to understand the size of the problem. The report[6] prioritised seven types of infrastructure that have the greatest impact on tourism activity overall. Councils provide five of these including drinking water and wastewater systems, public toilets, road transport and car parking.

Car parking infrastructure as an example ranked the seventh highest tourism impact related infrastructure. The report confirmed that if this type of mixed-used infrastructure is not available, travellers might bypass towns, sites or attractions. The result is a loss of revenue for the district and a poor and declining visitor experience.

Investment required to meet forecast requirements

As part of the study in 2017, Deloitte compiled a list of "actionable" local government mixed-use infrastructure projects. The research provided a better understanding of the scale and depth of the need. A survey of 78 councils identified an initial long list of 673 local and mixed-use infrastructure projects[7].

Although the project pipeline was developed for illustrative purposes only, it did reveal a very large problem. Overall a rough order cost for 525 (78 per cent) of the 673 local and mixed-use projects was established. Some of significant value including wastewater systems. The total value of costed local and mixed-use projects calculated using this approach was $1.46 billion.

LGNZ is pleased that the government now is recognising the scale of the problem and the need for new approaches to meet the funding need.

Project Shotover – $25 million upgrade of Queenstown's sewage treatment system illustrates the scale of some projects to meet rising demand from visitors.

5 McKinsey Report, Addressing New Zealand's most pressing local tourism infrastructure needs, Tourism Infrastructure Study, 2016, p.10

6 National Tourism Infrastructure assessment, TIA, Deloitte, 2017

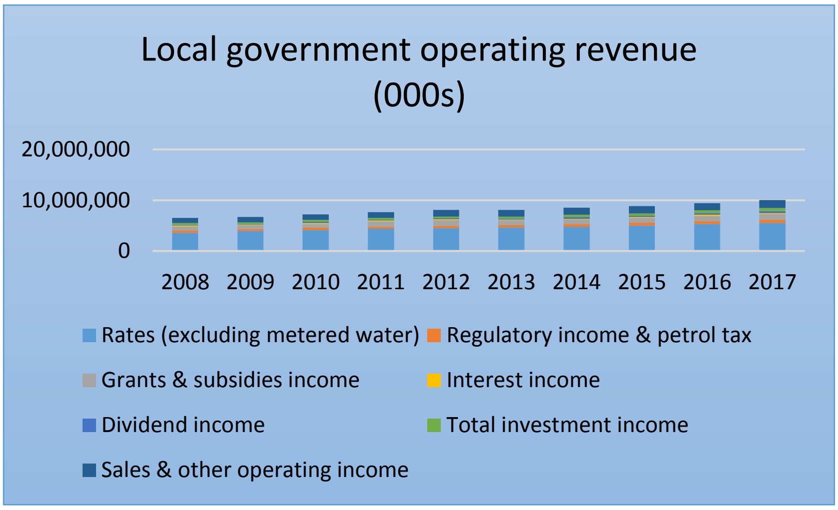
7 Deloitte, Estimate of Scale of Need for Local and Mixed Use' Tourism Infrastructure, 2017, p.6

Current funding arrangements

Local government funding tools

Councils' current property tax based funding and financing options do not enable them to deal with the tourism infrastructure funding issues effectively. The tools available to councils are limiting their ability to provide the required tourism mixed-use infrastructure for growing visitor demand. The graph below highlights that the majority of council revenue is generated through rates shown in light blue. (All figures in $000s, as at year ended 30 June 2008 – 2017).

Figure 3: Local government operating revenue. (Source Local Authority Financial Statistics, Statistics New Zealand)



In the table below, we highlight the limitations of the funding options available to councils.

Table one: Local Government funding tools, limitations for dealing with mixed-use infrastructure need

Local Government funding tools	Limitations for dealing with mixed-use infrastructure need
Property Tax	Property values do not reflect the burden on facilities and services imposed by visitors[iv]. The rating mechanism can mean that activities, which have a lower impact on facilities and services, may pay more than activities, which impose a higher demand on facilities and services.
Targeted rates and differentials	The targeted rates-based approach is a blunt tool distorting investment over time in ways that lower the economic benefit of tourism to New Zealand. Neither differential rates nor "per pan" charge reflects the costs driven by the tourism industry. These do not properly align the charges on accommodation providers with the impact of tourism. The charges are unlikely to encourage efficient behavioural responses from visitors (especially since the charges are not visible to visitors). Instead, they are likely to distort decisions by accommodation providers (and visitors) in ways that reduce economic welfare.
User charges	Not all the costs of infrastructure provision are covered through user charges. It also is not practical to charge user fees for much of the tourism mixed-use infrastructure such as signage, parks and trails.

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Tourism Infrastructure Fund (TIF) has limitations

The previous government launched the Tourism Infrastructure Fund (TIF) in 2017 in response to the issues raised by the McKinsey and Deloitte research. An amount of $25 million per annum is available through a grants scheme administered by MBIE.

The local government sector welcomed the limited contribution made by the TIF but repeatedly raised concerns about the Fund's ability to deal adequately with the scale of the issue – primarily the limited amount of money and the time-limited duration of the TIF. A grants model also can be overly bureaucratic and does not address the need to fund ongoing operational costs. A time-limited grants based model also does not meet the funding certainty test for councils needed for many types of infrastructure investment.

Presently, LGNZ has reviewed the TIF in partnership with MBIE and has provided recommendations to the Minister of Tourism on how to resolve the issues to help improve performance. It is proposed that many of these improvements such as inclusion of capital and operating costs, new allocation criteria and local government input on the decision making panel could also be used for the new IVCTL.

GST

Tourism generated $3.3 billion in GST for the year ended March 2017. All GST collected goes to central government; none goes to local government. That money is only indirectly returned to the districts that generated it and then only in part. It is certainly not returned in the form of financing for infrastructure projects.

Local government perspective

The proposal to introduce an IVCTL collected at the border will provide a much-needed durable and sustainable revenue stream for some tourism infrastructure projects. But the model has its limitations.

LGNZ agrees that no single funding tool will meet all objectives of a sustainable funding model and that a package of funding tools is required. The IVCTL is one part of the solution.

LGNZ does not believe the proposed package meets the following criteria:

- Scale of revenue to enable strategic investment in New Zealand's key attractions, networks, and/or seed funding for other revenue generating initiatives. (The size of the funding gap is addressed earlier in the submission);
- Fair distribution of costs, aligning those who benefit from publicly provided infrastructure with those who are paying as closely as possible; and
- Support regions to realise their tourism potential, and enjoy the subsequent social and economic benefits.

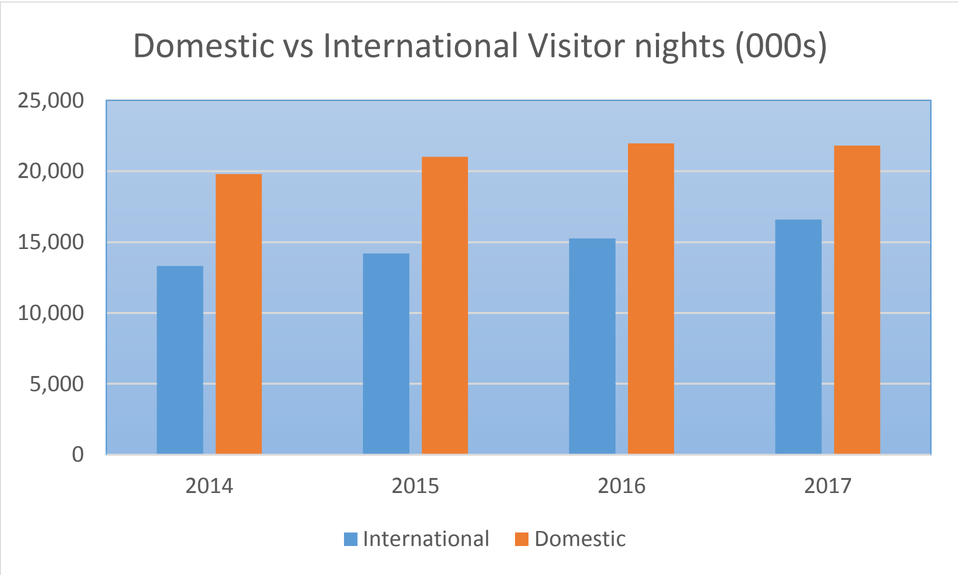
The issue of equity is not dealt with adequately in the proposed package. Our concern is the inability to secure funding contributions from domestic, Australian, Pacific Island and business visitors. Tourists create the need for the infrastructure. Their point of origin is immaterial to meeting that funding need.

The numbers of Australians visiting New Zealand is growing and for the year ended March 2017 there were 1,406,256 arrivals[v]. (refer Figure 1 on page 4)

While understanding the drivers for the exclusion of Australian tourists it does mean that the amount of money to be raised by the IVCTL is necessarily constrained. By definition, that limits the value of the IVCTL.

Excluding particular classes of tourists (including domestic tourisms – comprising approximately 50 percent of visitor nights) from any funding model perpetuates and does not solve the free-rider problem. The graph below shows domestic visitor nights compared with international visitor nights for 2014 to 2017 inclusive. For all of these years domestic visitor nights exceed international visitor nights putting pressure on local government mixed-use infrastructure.

Figure 4: NZ Domestic vs International visitor nights 2014-2017. (Source, Tourism Satellite account)



Local Tourist Levy

Throughout the world local tourist levies are a common way of meeting the costs that tourism creates in local communities, with, for example, accommodation levies used commonly throughout Europe, the United States and Canada.[8] Currently New Zealand is an outlier in respect of local tourism funding.

LGNZ supports the introduction of enabling legislation to provide councils with a discretionary authority to introduce a Local Tourist Levy in order to raise additional revenue necessary to meet the additional demand for services and infrastructure resulting from growth in the tourism sector. The proposed levy will apply to the number of bed nights occupied by tourists in all forms of commercial accommodation – a form of "bed tax" via a flat rate per night or percentage of accommodation bill. The purpose, criteria and suggested legislative changes to enable this to proceed are outlined below.

Purpose

The purpose of introducing a levy on visitors is to ensure that the cost of providing facilities and services is met by those who benefit. These levies fund the cost of providing mixed-use facilities and infrastructure used by tourists. That cost is almost fully met by local citizens through rates, a situation that is not fair and disincentives local investment in such services. Ideally, the resulting allocation of cost between local ratepayers and visitors should (approximately) reflect the degrees to which each drive the costs of those facilities and services.

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[8] Examples of countries which have accommodation-related levies include: Austria, British Virgin Islands, Canada, Croatia, Fiji, France, Germany, Greece, Italy, Japan, Kenya, Maldives, Netherlands, Spain, Slovenia, Sri Lanka, Trinadad and Tobago, United States, Vanuatu. The City of Toronto is the most recent place to see an accommodation levy, and this provides a detailed look at design components and the analysis that underpinned it.

The range of funding options available influences the willingness of councils to invest and raise revenue as well the behaviour of the individuals who ultimately bear the burden of the payment; often in unhelpful ways. The challenge is to provide options for local government to fund the facilities and services utilised by visitors while limiting welfare-reducing side effects.[9] To meet these twin objectives, enabling legislation should allow a council to introduce a levy on short-stay accommodation in commercial dwellings including Airbnb.[10]

Neither the Local Government Act 2002 or the Local Government (Rating) Act 2002 allow councils to apply such a levy. Such a levy would require new legislative authority.

Enabling legislation

LGNZ is seeking legislation to enable councils to "levy" commercial dwellings (as defined in the GST Act 1985) based on the number of nights a visitor[11] stays in accommodation. This authority, which might perhaps be part of a stand-alone "Local Government Revenue Act" will include the following:

- A transparent and consultative process, similar to that used to adopt a development contribution policy, to adopt a Local Tourist Levy and its rate;
- Specification of the mechanism to enable the levy to be charged and collected, including any critical requirements on design (eg a limit on the nightly amount to align with international visitor expectations, whether the rate should be a fixed dollar amount or a percentage etc.) and the establishment of any centralised reconciliation and settlement office if required (see below);
- A requirement to specify the activity (eg promotional services, infrastructure etc.) that the levy might fund;
- Identify specific considerations, such as principles and other matters, that should be considered when deciding whether to adopt a Local Tourist Levy over and above that which a council is already required to do by law;
- A period in which the levy should be reviewed, e.g. 15-20 years; and
- Specify an appeal process (the processes applying to development contributions in the LGA 2002 may be applicable).

Any Local Tourist Levy should be subject to the reporting and accountability requirements as required by the Local Government Act 2002.

To avoid duplication the regulations to the Local Government Revenue Act should include templates that set out the process by which the Local Tourist Levy will be applied and collected. This should be designed jointly and with the active participation of Treasury and IRD officials. Both agencies should be directed to provide advice to councils on the design of a Local Tourist Levy if requested.

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[9] From a tax efficiency perspective, a first best solution might be an allocation to local government of a portion of the revenue collected by central government from the additional GST and income tax generated from tourism, given the comparative efficiency of these taxes. That option is not available to local government.

[10] The levy would apply to commercial dwelling services as defined in the Goods and Services Act 1985 – this includes hotel, motel, homestay, farmstay, hostel, inn, boarding house, camping grounds etc – but excludes situations where a person is renting property as their place to live. Our understanding is that this definition would capture holiday homes. For the avoidance of doubt, the alignment with the GST Act is not related to the $60,000 *de minimis*, but rather the definition of "commercial dwelling".

[11] As in the case of the Stewart Island levy, this amendment may introduce a definition of a "visitor", which has the option of excluding, for example, people who are ratepayers in the region. We note that excluding people from the definition of visitor increases the transaction costs associated with exempting those people, the materiality of which needs to be weighed against the prospect that local ratepayers will use local accommodation.

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Applicable criteria

When deciding whether to establish a Local Tourist Levy, and if so at what rate, the following criteria might apply, and could be specified as part of the decision-making process in the appropriate statute:[12]

- **Efficiency**: minimise impediments to economic growth and avoid distortions (biases) to the use of resources.
- **Equity and fairness**: achieve fairness including through "horizontal equity" (the same treatment for people in the same circumstances) and "vertical equity" (higher tax obligations on those with greater economic capacity to pay); this criteria would involve assessing who bears the economic incidence of the levy.
- **Revenue integrity:** minimise opportunities for tax avoidance and arbitrage.
- **Fiscal adequacy:** (in combination with other funding mechanisms) raise sufficient revenue for the region's requirements.
- **Compliance and administration costs:** minimise the costs of compliance and administration, and give taxpayers as much certainty as possible.
- **Coherence:** The levy should make sense as part of the overall tax system (both local and central government taxes).

Relationship between LTL and IVCTL

A Local Tourist Levy would provide a durable and sustainable revenue stream allowing areas with high numbers of tourists to fund the capital and operational costs of tourism-related infrastructure. Clearly, areas with higher levels of visitor nights (and therefore accommodation options) would benefit more than areas with lower visitor nights. However as accommodation is a useful proxy for infrastructure need that is an appropriate outcome. Councils with lower visitor nights and accommodation options would still have access to IVCTL funds for proven infrastructure needs.

Councils who might wish to capture revenue from a Local Tourist Levy would have strong incentives to grow the local tourist attractions in a district together with the accommodation options that might attract a tourist to stay. This would occur because councils would participate in the financial rewards of success. Such an incentive would assist in continuing to raise the service level offering to tourists. Present funding arrangements achieve the exact opposite of that goal. Because councils face all of the costs but capture none of the revenue, they are not incentivised to welcome tourists. Indeed tourists in such areas are at risk of being seen as a burden rather than being welcomed as a benefit. It is for this reason the tourism industry's social license is at risk.

[12] These criteria are taken from "Future of Tax", Submissions Background Paper, NZ Government Tax Working Group, 2018.

IVCTL

LGNZ's advocacy for a Local Tourist Levy should not be misinterpreted as opposing the introduction of the IVCTL. LGNZ does support the introduction of the IVCTL as part of a broader package of funding options.

LGNZ's point is that in and of itself, the IVCTL as designed will not address all of the issues local government faces because of the tourism boom; it will simply address a subset of those issues. As outlined this is particularly so for significant tourism areas and outliers. The IVCTL will not work for all areas, such as Queenstown and Auckland and is unable to deliver the requirements as outlined on page 3 of the consultation document. However, an IVCTL introduced alongside a Local Tourist Levy would provide a comprehensive package and put the mixed-use infrastructure funding issue to bed once and for all.

The IVCTL rate

The main impact of the differing rates being proposed is the ability to raise sufficient additional revenue to fund the costs associated with an increasing mixed-use infrastructure need across New Zealand. A lower rate will raise less money than the higher rate. The higher rate such as a $35 IVCTL to support the large need now and in the future (McKinsey/Deloitte research) is preferred. At this level, the $80 million projected revenue still falls well short of what is required. The position is further undermined because not all of the funds are designed to go to local governments. While understanding the funding drivers on the Crown to meet conservation estate issues, diverting away from councils money raised by the IVCTL simply accentuates the limitations of the IVCTL for local government. The lesser the quantum of funds from the IVCTL for councils, then the greater the case for a Local Tourist Levy.

Types of projects to receive funding

LGNZ believes that the available funding should be primarily allocated to projects that include potable, waste and storm water projects, local roading networks including cycle ways, public transport, freedom camping facilities (public toilets and car parking), local parks (provision and maintenance), public sports facilities and rubbish disposal (dump stations and recycling facilities).

Allocation

LGNZ supports an allocation method similar to an amended TIF approach that includes the LGNZ suggestions for improving the TIF mechanism. In particular local government representation and knowledge on the panel assessing bids is a necessary minimum. People without local government knowledge and experience are not in the best position to determine the relative merits of competing bids from local authorities.

Conclusion

The LTL proposal is consistent with the principle of subsidiarity and the concept of localism. It is an incentive-based system where success is rewarded with revenue. A Local Tourist Levy would grow the overall tourism pie. Both the tourism industry and local communities would benefit. Let's get on with it.

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[i] Australian visitors are currently exempt from the IVCTL under the current proposal
[ii] TIA website - https://tia.org.nz/about-the-industry/quick-facts-and-figures/
[iii] Policy Quarterly – Volume 13, Supplementary Issue – June 2017 – Page 3
[iv] New ways of supporting growth in tourism in an iconic destination, Sapere, 2016
[v] Source: Statistics New Zealand Tourism Satellite Account