Abstract: A significant but controversial source of tourism tax revenues is the hotel occupancy tax. This study investigates the use of occupancy taxes in the state of South Carolina, with the purpose of exploring whether local governments use these revenues for tourism related purposes. Results yielded from a classification instrument for accommodations tax expenditures involving two teams of researchers independently classifying 385 expenditures for 34 county and municipal governments, revealed that 13 per cent of expenditures were not complying with state rules on spending of local occupancy taxes. Recommendations for policy makers are discussed as well as the need for further research.

Keywords: Accommodation tax, tax compliance.

Introduction

Many state and local governments promote tourism with funds generated by taxing travelers. Most states and local governments have removed destination marketing organizations from their budgets and instead fund those organizations directly through tourism tax receipts. Local occupancy taxes – or bed taxes – are supplementary sales taxes added to the base price of a hotel room that properties must charge to their guests. Such taxes are controversial (Spengler and Uysal 1989).

Some critics claim that state and local governments often see these taxes as a “free” source of revenue, because the local government believes the burden of these taxes falls on tourists rather than local citizens Hiemstra and Ismail (1993). Lodging owners and operators who are responsible for collecting and remitting these taxes often point out that imposing the tax has adverse impact on lodging demand and is therefore not a free benefit to the community. Hiemstra and Ismail (1992), for example, have reported a price elasticity in the range of -.44.
In their analysis, the adverse impacts of room taxes on lodging sales, measured in terms of number of rooms sold, were considerable for all major segments of the lodging industry. State and local governments as well as the destination marketing organizations that they support often counter that there are offsetting positive benefits for the lodging industry from the use made of the tax receipts, but the magnitude of these benefits has not been analyzed (Mak 1988).

Lodging and tourism interests have often had a role in the formulation of tax policies at the state level where such taxes have been imposed. One result of this influence has been to limit the use of such revenues by local governments. Often the law requires a proportion of occupancy tax revenues to be used solely for tourism related expenditures. A rationale for such forced expenditure is that the money spent promoting tourism helps to grow future tourism demand and therefore helps to offset the negative impacts of the lodging tax. The question then becomes: Are tax revenues collected at the local level being used to promote tourism?

The purpose of this study is to analyze local government use of local occupancy taxes in the state of South Carolina, USA. More specifically, the questions to be explored are (1) to what extent do county and municipal governments attempt to game the rules associated with how such sales tax revenues are expected to be used; and (2) what are the most frequently used tactics being employed by those government entities that appear not to be in compliance with the rules.

The South Carolina Accommodations Tax

South Carolina has a statewide accommodations tax, which is similar to other US states. Local governments (municipal or county) collect and remit the tax to the South Carolina Department of Revenue (SCDOR). Those funds are returned to the local government, which then spends the money according to the following rules:

- The first twenty-five thousand dollars is allocated to the general fund of the municipality or county government. This money may be spent in any manner the local government sees fit.

- Five percent of the balance is allocated to the general fund of the municipality or county government. This money also may be spent however the local government desires.

- Thirty percent of the balance must be allocated to a special fund and used for advertising and promotion of tourism.

- The remaining balance must be allocated to a special fund and used for tourism-related expenditures.

According to the South Carolina statute, tourism-related expenditures include:
- Advertising and promotion of tourism
- Promotion of the arts and cultural events
- Construction, maintenance, and operation of facilities for civic and cultural activities
- The criminal justice system, law enforcement, fire protection, solid waste collection, and health facilities when required to serve tourists and tourist facilities
- Public facilities such as restrooms, dressing rooms, parks and parking lots
- Tourist shuttle transportation
- Control and repair of waterfront erosion
- Operating visitor information centers

Municipalities and counties are required to submit annually to the South Carolina Department of Revenue (SCDOR) and the South Carolina Accommodations Tax Oversight Committee (SCATOC) an Accommodations Tax Reporting Form that details how their funds from the accommodation tax have been spent. The SCATOC is charged with monitoring local governments' use of the accommodations tax. The committee has the power to judge expenditures non-compliant, and in such cases may request that the SCDOR withhold equivalent funds from subsequent disbursements of the accommodations tax to the local government. The committee does not have the power to impose any punitive actions against local governments for non-compliant uses of the accommodations tax, other than such future withholding of funds.

Research Methods

In accordance with State law, each local government receiving funds from the accommodations tax must file an Accommodations Tax Reporting Form with the SCDOR that is reviewed by the SCATOC. This form shows the disbursement of the tourism tax revenue, with each local government indicating all the activities funded by State accommodation tax revenues, the organization to whom the money was dispersed, and the nature of the expenditure. We gained access to the forms submitted to the SCATOC for fiscal year 2001/02 through a written request invoking the Freedom of Information Act.

In addition, we had the South Carolina Council of Municipalities and County Governments survey local governments' disbursement of the local option tourism tax. These local option tax revenues must be spent according to the same rules as above, but fall outside the purview of the SCATOC. However, no completed questionnaires were returned to the researchers forcing the researchers to abandon this aspect of the research project. Initially two of the researchers-Team 1-examined all the forms provided by SCATOC. The forms were reviewed
by the researchers to gain a sense of the types of expenditures made and the level of reporting detail. After an initial review, these two researchers then created the following measurement instrument:

Using this review instrument, these two researchers then re-evaluated the thirty-four forms containing 385 expenditure items that had been received from SCATOC. The two other researchers involved with this project – Team 2 – subsequently used the instrument to evaluate the same thirty-four forms. This process resulted in two sets of independent evaluations, which allows for a check of the reliability of the non-compliance measures.

### Results

Team 1 deemed that 63.4% of the 385 items reported by local governments as compliant as compared to 70.4% for Team 2 (See Table 2). When the two sets of evaluations were matched, it was found that the two sets of reviewers agreed on 70.1% of the items. As discussed in the conclusion, a major cause of the lack of consistency is attributed to the Accommodation Tax Reporting Form, which requires little detail from the local government, thus leaving many items open for a wide range of interpretation.

---

**Table 1**

Instrument for Describing Items on the South Carolina Accommodations Tax Reporting Form

| Compliance | 1 = Compliant, in the spirit of law (if 1, proceed to next expenditure item)  
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2 = Questionable compliance; Questionable in the spirit or not enough information making it worthy of an audit (if 2, proceed to tactics section)</td>
<td>---</td>
</tr>
</tbody>
</table>
| Tactics     | 1 = Under documentation (if 1, proceed to next expenditure item)  
|             | 2 = Mis-appropriation of funds to local resident use (if 2, classify reason for misuse) | --- |
| Misuses     | LS - Local Services, normally provided by local government for residents  
|             | LI - Local Infrastructure (not a building), primarily for use by local residents  
|             | LF - Local Facilities (buildings), primarily for use by local residents  
|             | LE - Local Event, primarily serves local residents with either a low absolute number of tourists or a low percentage of tourists  
|             | AD - Advertising (non-tourism)  
|             | MT - Mis-appropriated travel, not related to tourism  
|             | LED - Local Educational Programs, primarily for benefits of residents  
|             | BUS - Business Recruitment/Direct Business Support, of non-tourism entities | --- |
Of the 385 items reviewed, 43.4% were classified as non-compliant (or questionable) by at least one of the two rating teams. On the other hand, the rating teams agreed that 13.6% of the items were potentially non-compliant.

Further analysis summed the total amount of accommodation tax revenues being appropriately (and inappropriately) used as deemed by both groups. Of the $12,896,436, between $4,703,042 and $4,787,104 were deemed non-compliant (or questionable) use of funds, or 36.4% and 37.1% of the total allocated funds respectively. In the 13.6% of the cases where both review teams concluded non-compliant use of funds, these funds summed to $2,439,000 or 18.9% of total accommodation tax revenues.

Table 2

<table>
<thead>
<tr>
<th>Compliant?</th>
<th>Team 1</th>
<th>Team 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>63.4%</td>
<td>70.4%</td>
</tr>
<tr>
<td>No/Uncertain</td>
<td>36.6%</td>
<td>29.6%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Total Tax Revenue</th>
<th>$12,896,434</th>
<th>$12,896,434</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount Compliant</td>
<td>$8,193,392</td>
<td>$8,109,330</td>
</tr>
<tr>
<td>Amount Non-Compliant</td>
<td>$4,703,042 (36.4%)</td>
<td>$4,787,104 (37.1%)</td>
</tr>
</tbody>
</table>

Asked what tactics were seemingly being used to game the rules associated with the tax uses, Team 1 reported that 53.3% of the deemed questionable uses of the tax revenues were employing an under-reporting strategy while 46.7% were using the funds for resident purposes. Conversely, Team 2 reported that local governments were employing under-reporting tactics in 26.6% of the cases of questionable usages; 73.4% using funds for resident purposes. Obviously, the lack of inter-judge reliability in tactics being employed was due to differences in which expenditures were deemed compliant in the first stage of the analysis.

Table 3 summarizes the categories of the misuses of the accommodation tax revenues for both research teams. Significant differences do exist between the teams of evaluators. Tax revenues used to support events serving primarily local residents was the most frequently deemed misuse, followed by local government services to residents and infrastructure serving primarily residents.
**LOCAL GOVERNMENT**

Table 3
Most Frequently Deemed Misuses of Tax Revenues (Percentages)

<table>
<thead>
<tr>
<th>Misuse</th>
<th>Team 1</th>
<th>Team 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Support for events serving residents not tourists</td>
<td>40.6%</td>
<td>59.7%</td>
</tr>
<tr>
<td>Infrastructure serving residents not tourists</td>
<td>18.7</td>
<td>16.8</td>
</tr>
<tr>
<td>Services to residents not tourists</td>
<td>25.0</td>
<td>15.6</td>
</tr>
<tr>
<td>Support of an individual business</td>
<td>3.2</td>
<td>1.3</td>
</tr>
<tr>
<td>Not enough Information</td>
<td>12.5</td>
<td>6.6</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>100%</strong></td>
<td><strong>100.0%</strong></td>
</tr>
<tr>
<td><strong>Cases</strong></td>
<td>64 cases</td>
<td>77 cases</td>
</tr>
</tbody>
</table>

**Conclusions And Recommendations**

For academics, the study makes two contributions. First, it may guide the research agenda for researchers attempting to assess the degree of non-compliance in local government use of local occupancy taxes. Second, it adds to a growing body of literature on the adverse impacts of room taxes on the lodging industry. State and local governments often justify the creation or increases in such taxes in terms of their offsetting positive benefits to the lodging properties that must collect them. However, seldom is there an assessment of governments’ compliance to the rules in which the tax revenues can be used.

Before summarizing this study’s findings, it is important to re-iterate its limitations. First, though all four members are trained as researchers and employed a considerable amount of due diligence, none of the researchers are professional accommodation tax auditors. Second, the law’s vagueness allows for multiple and conflicting judgments regarding the appropriateness of any particular item. Third, local governments are required to provide very little information to the Oversight Board, meaning that the researchers (and auditors) have very little information on which to base their judgments. Therefore, the results should be treated as approximate indicators of the amount and degree of non-compliance for the year in question.

We estimate that between $2.4 million and $4.7 million of the $12.9 million state accommodation taxes that were returned to local governments in fiscal year 2001/02 for tourism development purposes were potentially misused and/or merit an audit by the SCDOR. Stated another way, between one-fifth to one-
third of these tax revenues potentially may have been misappropriated. The tactics being employed by local governments to seemingly skirt the rules varied between the research teams but centered on under documentation of tax usages to oversight authorities, and using the funds for resident – as opposed to tourism purposes. The most frequently deemed misuses of the tax revenues went to support events serving primarily local residents - not tourists- followed by support for local government services to residents, and infrastructure serving primarily residents.

Also of note was the lack of oversight in local option accommodation tax usages even though they are governed by the same legislation as to their appropriate uses. The fact that no local government elected to complete and return our survey raises questions as to how these funds are used. This issue should be investigated further.

Given that prior research has shown that lodging firms are harmed by accommodation taxes and that the State has attempted to compensate these businesses by insuring that a portion of the revenue is used to grow future tourism demand, we recommend the following:

- The simplest solutions to help avoid controversy would be to provide more space on the annual documentation form and require local governments to more fully document, explain, and justify their use of these funds.
- Provide local governments with a document that more clearly interprets the current legislation and which provides detailed examples of appropriate and inappropriate usage of the tax revenues.
- Create a more objective definition of a tourist so that the spirit of the law can be clearly discerned in cases where appropriate uses are in question.
- Create stronger oversight of tax usage by SCDOR with stronger sanctions for those entities found noncompliant.

Future Research

Tax compliance research is an important but nevertheless neglected area of research in the hospitality and tourism field (Crotts and McGill 1994). Most of the research has focused on the impact such taxes has on lodging demand. It is our hope that this research will stimulate discussion and additional research in new and equally useful directions. An area of research that begs for analysis is to explain why some local governments attempt to game the rules associated with how accommodation tax are used while others remain in compliance. The research methods employed in this study are a means to generate dependent variables useful in such analysis (e.g., percentage of accommodation taxes deemed non compliant, use of tactics in non compliance, etc.). Potential explanatory variables available in most communities could include measures of local
government financial flexibility, dependence of the local economy on tourism, as well as financial penalties for non compliance.

References


About the Authors

Alan K. Styles graduated with a Ph.D. in Accounting from the University of North Texas in 1998 and he is currently an Assistant Professor of Accounting at the College of Charleston. His publications and research addresses issues of public interest accounting, accounting ethics, international accounting regulation and accounting history.

Steve Litvin earned doctorate is from the International Graduate School of Management of the University of South Australia and is currently an Associate Professor of the School of Business and Economics at the College of Charleston. He has taught hospitality and tourism subjects for the past eight years most recently in Singapore. Prior to joining academia, he had fifteen years travel management industry experience, having worked in senior positions with two major USA travel management companies. Steve a CPA, has also practiced with two of the Big Five CPA firms.

John C. Crotts graduated with a Ph.D. in Leisure Studies and Services from the University of Oregon in 1989 and is currently a Professor and Director of the Hospitality and Tourism Management Program of the School of Business and Economics at the College of Charleston. Prior to this position, he lectured in the Advanced Business Programme on tourism subjects at Otago University, Dunedin, New Zealand and was Director of the Center for Tourism Research and Development at the University of Florida. His research encompasses the areas of economic psychology, tourism marketing strategy, and management of cooperative alliances.

Calvin Blackwell earned his Ph.D. in Economics from the University of New Mexico in 2000. He is currently an Assistant Professor in the Department of Economics and Finance at the College of Charleston. His research interests include experimental economics, public economics and tax compliance.