ACCOUNTING AND TAX COMPLEXITIES IN MANAGING TOURISM BUSINESSES

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ABSTRACT

The purpose of this study is to analyze how accounting and tax changes recently introduced in Portugal affect the particular situation of tourism and hospitality management sectors. Firms operating in such areas of economic activity have important specific characteristics, such as a high proportion of tangible assets (buildings, land, leisure facilities) and also intangibles (goodwill derived from acquisitions, trade marks). The new accounting and tax environment significantly increased challenges managers have to face when making decisions and reporting their results.

KEYWORDS

Accounting and Tax, Tourism Businesses, Management Complexity.

1. INTRODUCTION

Financial performance analysis and tax planning are relevant factors in managing any company. Tourism related businesses are no exception. Be they big or small, firms in the tourism and hospitality sector are under the scrutiny of many stakeholders. Employees, shareholders, banks, customers, governments and others, are all of them interested in the financial and tax position of these companies.

Recently, the accounting and tax environment these companies face in Portugal was quite changed. The introduction of an international financial reporting standards (IFRS) based accounting system, and the consequent adaptation of the corporate income tax (CIT), induced deep modifications in financial and tax reporting.

The purpose of this study is to analyze how these accounting and tax changes influence the particular situation of tourism and hospitality management sectors. Firms belonging to these areas of economic activity have important specific characteristics, such as a high proportion of tangible assets (buildings, land, leisure facilities) and also intangibles (goodwill derived from acquisitions, trade marks).

2. LITERATURE REVIEW

There are strong forces pushing for more relevant accounting information in terms of revenues, expenses, assets and liabilities. In particular, fair value accounting has moved to the forefront of financial reporting. (BREALEY AND MYERS, 2003).

But, at the same time, the conditions that should be present in the economic environment are not always available to use this fair value model of accounting recognition. For example, buildings, investment properties, or financial assets, are natural candidates to be recognized at fair value. However, in many cases no active market exists upon which to base such computation. And when the use value (based on discounted cash flows) is a potential alternative, it can produce significant swings in accounting values, creating volatility in the main balance sheet aggregates. (MARTINS, 2010)

On the other hand, many of the specific strengths of tourism firms (brand recognition, skilled labor force, good location of facilities, satisfied customer base) cannot be recognized as internally generated immaterial assets. To sum up, in the new accounting model many of the particular features of tourism businesses can generate a certain degree of complexity in producing reliable and consistent financial information. (GU AND LEV, 2008)

Tax changes have moved to a conceptual and legal approach that is based on a non-automatic acceptance as deductible costs of many expenses recognized for accounting purposes. Examples are: impairment charges, provisions, amortizations, or changes in fair value. Thus companies having assets that can be (for financial reporting purposes) recognized using fair value, face a tax environment, in the CIT, that is not attuned to this new accounting paradigm.

A high degree of book-tax divergence is certainly another factor of complexity in managing a sector that has enough operating elements generating uncertainty, like international crisis, volatility of demand or heavy price competition. (DESAI AND DHARMAPALA, 2009).

What management implications have this potential disconnection between financial reporting and tax rules faced by the tourism sector firms? What are the particular problems that the typical asset composition of tourism businesses induces in the new accounting and tax environment? These are the questions that the paper will explore.

3. METHODOLOGY

The methodology is based on a description of the financial accounting options open to a typical tourism firm, and an analytical discussion of the pros and cons of using fair value versus the historical cost method. The quality of financial information will be discussed, and although fair value is gaining a high degree of visibility and a broad base of adepts, its complexities will be highlighted. In the tourism sector, as in many other activities, fair value *versus* historical cost is a topic being hotly discussed. The quality of financial information is an important management responsibility, and accounting choice is not neutral regarding the level of such quality.

Then, the tax implications of using different methods are discussed, highlighting the potential impact in the effective tax burden suffered by firms.

4. MAIN RESULTS AND CONCLUSIONS

Main findings of the analysis are:

- the introduction of the fair value in the new accounting system (SNC) has been a move in the direction of producing a financial reporting that delivers information considered more relevant to assess the economic performance and asset values of firms;
- however, its application is fraught with obstacles, especially in areas where market values or use values are difficult to compute;
- the tourism sector faces significant swings in market values of tangible assets, mainly related to economic cycles that influence the sector;

- in certain specific areas – e.g., goodwill impairment tests – the process is plagued with uncertainty about future cash flows, the risk premium to include in the discount rates, or the length of time that future benefits will accrue;

- the tax treatment of many revenues and costs is quite divergent from its accounting treatment, therefore introducing an additional element of complexity in managing the overall performance of tourism companies, given their particular characteristics in terms of asset composition, valuation methods and tax environment.

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