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Recovery from the COVID-19 crisis

What role will tax policy play?

RECOVERY FROM THE COVID-19 CRISIS

WHAT ROLE WILL TAX POLICY PLAY IN SUPPORTING RECOVERY?

While government actions around the world will vary, there are some common themes in how different countries have responded to the global health crisis and what has likely become a global recession as a result. Many governments reacted to the COVID-19 crisis quickly—and in a significant way. Unlike prior recessions, the nascent recession is, to a large degree, due to the actions taken by governments in response to the pandemic. The significant reduction in business activity was a direct consequence of the closures that governments adopted to help contain the transmission of the virus. Alongside these necessary measures, governments had to deploy monetary and fiscal policy to sustain individuals, health care providers, businesses and their employees, charities, and others during the temporary pause in economic activity.

Once the immediate crisis subsides, policy makers will need to set the stage for business to rebound quickly and sow the seeds that ultimately will allow them to thrive.

In the short-to-medium term, we are likely to see continuing uncertainty as to when and how the economy will re-open and what economic recovery will look like. The current thinking from leading global economists is that we'll more likely see a U-shaped or W-shaped rather than a V-shaped curve,[1] particularly while any ongoing outbreaks of COVID-19 still require careful management and containment. While there is an expectation (and a hope) that a vaccine or treatment will be available, there is no guarantee. Policy makers will need to plan for each scenario.

Emergency response measures

While the specific short-term emergency responses vary country-by-country, tax policy has generally been at the center of these measures. The most common tax policy measures include initiatives such as:

- Deferral of tax payments to create liquidity for businesses and individuals.
- Wage subsidy programs and measures to support the self-employed (including the growing number of gig economy workers).
- The relaxation of certain existing restrictions such as expanding the ability to carry back losses.[2,3]

These measures have contributed to dramatic increases in government deficits and corresponding increases in the levels of national debt in countries around the world.[4]

Some sectors have visibly sustained less damage than others. This pattern will continue in the recovery stage, where some sectors will likely rebound faster than others. It is equally likely that many companies will not survive the pandemic at all—and others will only be able to survive through consolidation. In this environment, it seems more likely that the recovery will be somewhat gradual and not akin to simply turning on a light switch.

During the economic recovery phase, tax policy will likely play a key role.

While different countries will make different choices on a short-to-medium-term basis, tax incentive regimes providing stimulus to certain sectors will be an option to encourage investment and spending and to create jobs. Measures introduced during this gradual recovery period are likely to be more targeted than those that were deployed during the initial emergency response phase. However, this will not be an easy task to calibrate as certain regions within a country may be able to ease the containment restrictions more quickly than others. Longer term, though, ever-increasing amounts of government debt would appear to be unsustainable, as would the continued reliance on monetary policy to keep interest rates at historically low levels. Tax policy therefore will be one of the longer-term levers that governments can use to generate revenue to manage increased levels of national debt.

The COVID-19 crisis has put a spotlight on the fragility of the global economy and the interdependencies of the countries and supply-chains within it.

While it is uncertain if the crisis will result in long-term changes to existing paradigms, it is certain that policy makers will be considering their medium-term options to maintain economic stability.

None of the five major issues that we are about to explore are new. However, we expect a renewed interest in assessing the options that these issues present. It is essential to understand the associated role of tax policy in the decision-making process as governments and their advisors plot a path toward economic recovery.

1

INDUSTRIAL NATIONALISM VS. GLOBALIZATION

Globalization has resulted in increased trade between nations, which has been credited with bringing about increased efficiency, productivity, and innovation, as well as generating higher standards of living and reduced prices for consumers.[5] Tax treaties have had a part to play by limiting double taxation, while trade agreements that reduce duties and tariffs have promoted cross-border trade.

From a business perspective, the disruption of the supply of a single key component has a direct impact on the overall global supply chain. This result stems from the independencies between geographic locations within the chain. COVID-19 has highlighted these dependencies. In the early stages of the crisis, some countries found themselves reliant on imports for critical goods such as medical equipment (e.g., ventilators and personal protection equipment for health care workers).[6] There were instances of countries blocking outgoing shipments to prioritize local needs.[7] In some cases, countries resorted to rarely used measures to compel local companies to retool and produce essential supplies. Some remain concerned about their continued reliance on importing crucial commodities such as food and medical supplies.

The memory of the COVID-19 crisis will not fade quickly.

Governments will want to be better prepared for the next 'black swan' event. However, a balanced response is necessary to avoid further global economic disruption. Local sourcing of essential supplies during the crisis has been problematic for many nations. Confronting supply chain gaps will be one of the lasting consequences of the pandemic. However, this will need careful management. Even prior to the crisis there were populist movements promoting the benefits of local purchasing. The crisis may fuel this type of national focus. Steps to promote local priorities will not erode the benefits of globalization. At the same time, applying an overly nationalistic approach across the board should be weighed against the impact on cross-border trade and the global economy. There may also be an impact on the role to be played in promoting investment, innovation, and growth.

The principles governing international tax have displayed a long track record of supporting international trade through bilateral and multilateral approaches to income tax and customs duties. The recent G20/OECD Base Erosion and Profit Shifting (BEPS) project,[8] which has been expanded to include the 137 countries, is a recent example of nations deciding to adopt a multilateral approach rather than taking unilateral actions that could impede trade through increased complexity, increased disputes, and double taxation. The current Pillar One/Pillar Two project on tax policy measures for a digitalized world economy[9] is another example of an attempt to achieve a global solution and curtail unilateral actions.

2

BIG GOVERNMENT VS. SMALL GOVERNMENT

There are a range of differing ideological and political views regarding how expansive or how limited a role government should play in regulating the affairs of individuals and businesses, and different countries and their voters have landed at different spots along the spectrum.

The crisis has caused many countries around the world to embrace the notion of "big government"—regardless of previously held ideologies. Many governments have needed to take actions that would have been unthinkable only a few months ago. The implemented measures that severely limit what individuals and businesses are and are not allowed to do, putting their economies into a temporary "coma" in order to mitigate the spread of COVID-19. In many cases, governments are spending and borrowing much more than would have seemed possible prior to this crisis. Current estimates would suggest that many now face the most significant economic contraction since the Great Depression.[10] Governments have needed to provide financial support to individuals who have lost their income, and to businesses whose operations have come to a halt or have experienced severe disruption. Policy makers are hoping that their actions will allow most businesses to survive the crisis, and that individuals will therefore have jobs to return to. However, the cost of these emergency measures and the loss of revenue that governments have experienced have brought about deficits. The corresponding levels of debt are of historical significance.

The initial shock of the pandemic prompted many governments to respond aggressively and quickly in terms of both fiscal policy and monetary policy. There is no playbook or easy comparison for these current global events. Unlike the Great Depression in the 1930s and the Global Financial Crisis in 2008, the root cause of this recession is not a financial crisis, but a global health crisis. The containment measures that governments have enacted as a response, has created a simultaneous supply and demand shock. In many jurisdictions, monetary policy alone will not begin to address these shocks: both fiscal stimulus and monetary stimulus are required.

As countries and their economies move from their initial response into a recovery phase and beyond—policy makers will face big decisions around key questions.

Is the existing social safety net enough?

In response, some have advocated for a form of universal basic income,[11] however, a discussion of the social safety net extends into other areas, such as access to affordable housing and health care.

A universal income regime could be implemented through tax policy or through separate programs. As countries begin to recover from the pandemic, will the social safety net go back to what it was pre-crisis, or will there be permanent changes—and if so, to what degree? Investment in this area would need to be financed, thereby adding to existing deficits and debt, and policy makers having to balance between competing priorities.

What role should government play going forward?

During the crisis most jurisdictions felt that very significant government intervention was needed. As regions around the globe move through recovery—and are restored to pre-pandemic trading conditions, what will be the role of government in relation to the market?

Again, views vary across or along the spectrum. From a competitiveness perspective, many countries have been streamlining government regulation with a view to improving efficiencies. A "big government" system requires increased revenue from taxes, which will have a significant impact on tax policy.

An increased role for government could also result in changes to incentive regimes. Currently, some incentive regimes are business and market-driven, while in others the government effectively picks the potential "winners." Will we see a shift towards more government intervention in this area?

Some countries are also linking COVID-19 crisis-related tax relief to other tax initiatives. A new COVID-19 relief program in Canada, for example, is not available to corporations that have engaged in tax fraud in the past and will require businesses that are receiving benefits to comply with certain climate change initiatives.[12] Likewise, France, Denmark, and Poland have excluded companies that are registered in tax havens from eligibility for their respective COVID-19 tax relief measures.[13]

If increased tax revenue is the goal, when should new measures be introduced and what form should they take?

There is no single answer. The most sustainable source of increased tax revenue, during recovery, should come from growth through increased business activity, profits, and increased employment. Business growth will also help address the spiking ratios of debt to GDP.

Different countries will approach this in different ways. While most countries are presently focused solely on implementing emergency measures, some countries are already implementing new revenue-raising initiatives in tandem. For example, India's new two percent tax levy took effect in April of 2020[14], Hungary introduced a sales tax on large retailers in conjunction with its emergency measures[15] and Poland introduced a video streaming tax during the crisis. As always, it's a fine balance between raising revenue and adding perceived tax burdens that can impede investment and growth.

Countries may consider some type of measured tax stimulus as an alternative to raising taxes. This would encourage consumer spending and drive businesses to get back to where they were prior to the pandemic as soon as possible. Thus, in due course, leading to increased revenue for governments.

Potential stimulus could include temporary reductions in VAT and sales tax rates to encourage consumer spending. Tax incentives could also encourage private sector investment in infrastructure, and targeted incentives for private sector investment in the health sector.

Potential sources of tax revenue

If the goal is to increase tax revenue in the longer term, then what potential sources could countries tap into?

Some have called (before and post-crisis) for targeting specific groups of individual and large corporations through increased income tax rates and/or base broadening measures, new minimum taxes, wealth taxes, new estate taxes, new capital taxes for corporations, new carbon taxes, new taxes on super-profits, increased sales taxes, and increased VAT and other indirect taxes such as Digital Services Taxes (DSTs).

In April of 2020, the OECD issued a report entitled "Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience".[16] The OECD's observations on the role of tax policy in the current environment are set out in the appendix for this article.

There is no doubt that an increased fiscal balance, whether through spending reductions, enhanced tax revenue or both, will be needed as a result of the increased debt associated with the COVID-19 crisis. Each country will respond differently. Those that went into the crisis with stronger balance sheets will have greater flexibility in how they respond. As countries compete for investment and jobs, tax is one of the competitive levers to attract employers and this will continue to be the case.

Tax rate increases may not be the only option explored by jurisdictions to increase tax revenue.

Depending on the regime, there may be opportunities to adjust rates and broaden the tax base or the mix of taxes. For example, regimes that have relatively high-income tax rates but relatively lower VAT rates may see indirect taxes play an increasing role. Each country will do its own assessment. Some have suggested that this could be an opportunity for the US to introduce a federal VAT as a revenue raiser.

In an April 9, 2020 keynote address,[17] German Finance Minister Olaf Scholz discussed the crisis and the need to have fiscal firepower and robust national budgets in all countries along with the need to avoid a race to the bottom on corporate tax rates. In reference to Pillar Two of the OECD Inclusive Framework project he said: "This is where my proposal for a minimum global tax rate comes in. Last year, the G20 tasked the OECD with presenting, in 2020, a plan for a corporate tax reform. There are 137 nations and jurisdictions currently working on this task within the OECD Inclusive Framework on BEPS."

3

UNILATERAL ACTION VS. COORDINATED RESPONSE

An April 15, 2020 communication released following a virtual meeting of the G20 Finance Ministers and Central Bank Governors included this statement:

"We stand ready to act promptly and take any further action that may be required. We reiterate our commitment to use all available policy tools to safeguard against downside risks, ensure a swift recovery and achieve strong, sustainable, balanced and inclusive growth, while continuing to tackle the global challenges, notably those related to addressing the tax challenges arising from the digitalization of the economy and enhancing access to opportunities."

The fact that the Pillar One/Pillar Two tax project remains high on the list of priorities of the G20 during a global pandemic demonstrates a desire by this body for a coordinated response—as does the fact that the OECD Secretariat and others have continued work on the project throughout the crisis. They are adhering to their goal of reaching political agreement by the end of this year. The OECD view is that a coordinated multilateral solution is needed to curtail deployment of unilateral Digital Services Taxes (DSTs) which could result in increased complexity, double taxation, and the hindrance of cross-border trade. The project should also result in needed improvements in dispute mechanisms.

Pillar One addresses a reallocation of taxing rights for certain digital products and services and the sale of some consumer goods, while Pillar Two introduces a minimum tax. Achieving consensus among the 137 nations of the Inclusive Framework understandably has been challenging.

There has been a lot of global tax cooperation since the 2008 global financial crisis and the resulting recession. This includes the BEPS project to curtail international tax planning and to increase transparency, as well as the introduction of the Automatic Exchange of Information and Common Reporting Standard to address tax evasion. Within the EU, the Anti-Tax Avoidance Directives I and II have resulted in a common approach in this area. Whether or not broader consensus can be achieved in other areas of tax remains to be seen.

An area where the COVID-19 crisis can be expected to require cooperation (in tax and other areas) is in the developing world. The virus does not respect borders. It is in everyone's interest that developing countries get the support that they need to respond, recover, and thrive.

4

DIGITAL IMPERATIVE

This may be the area that causes, or at least accelerates, the most permanent changes post-crisis. It quickly became very clear that governments and government agencies (including tax authorities), businesses, not-for-profit organizations and households that could operate digitally would fare better during the crisis.

The compelling need for access to strong digital bandwidth nationally and around the world was very evident. Those that have already digitized had a significant head start.

Directionally, this movement towards digital was already afoot: the crisis made it an imperative. And now having successfully moved to digital platforms, it is unlikely that governments or businesses will simply return their operations to where they were before—particularly while social distancing remains necessary, until (and if) a vaccine or treatment of the virus is found, and while the threat of returning to lock-down measures remains. More likely, it is a combination of digital and non-digital operations but with an increased focus on digital. This has very significant implications for business and governments.

The future of digital platforms

- **Will digital meetings become the new business travel?** While business travel will continue, to what extent will it be reduced and replaced with the digital meetings many have now become very accustomed to?
- **Will virtual working become more mainstream when possible?** With many businesses now not only embracing, but requiring employees to work from home and finding that they were able accomplish this successfully, will it result in a reduced need for office space? If so, that will have implications for businesses that are in or near office buildings.
- **Is there going to be a permanent shift to shopping online?** As shoppers have become increasingly adept at ordering online, will less space be needed in brick and mortar shopping malls? This also has implications for policy makers and related decision making around infrastructure spending. In the health sector there will likely be an increased use of tele-health services. Again, this trend will have implications for policy makers.

Tax policy can play a role here: policies that incentivize digital infrastructure and operations can assist in encouraging investments in these areas. The trend towards digital infrastructure should help to make individuals, businesses, and governments to become more resilient.

Many tax administrations had already started down the path towards digital. Now the crisis has forced them to accelerate what they were doing.

For Deloitte's views on how tax administrations can go about becoming more digital see, "The Revenue Agency of the Future—Seven keys to digital transformation".[18]

The global focus on tax policy and taxing rights related to the digitalization of the economy was already present with Action 1 of BEPS and the Pillar One/Pillar Two project. As the economy moves even more in this direction this focus will only increase.

It is not going unnoticed that companies that were already providing digital services were better able to thrive during the crisis. This adds pressure to reach global consensus in this area but also provides a temptation for unilateral action.

5

TAX DISPUTES AND TAX ADMINISTRATION

There is already a trend towards an increase in tax disputes around the world, particularly in the area of transfer pricing, where the dispute is often between two tax administrations over which one has the right to tax certain income. This is consistently borne out in Deloitte's annual global survey regarding BEPS and the Global Tax Reset[19] in which only a relatively small percentage of respondents anticipate that tax administrations will interpret the OECD Transfer Pricing Guidelines in a consistent manner.

There is a risk that the increased needs of governments to address deficits and debt stemming from the pandemic will fuel more disputes with tax authorities.

This speaks to the need to have robust dispute resolution processes in place, and to the extent possible, dispute prevention mechanisms such as the International Compliance Assurance Programme (ICAP)[20] are being explored. These may be a favorable way forward. While ICAP itself is very labor-intensive for both business and tax administrations and therefore may not be scalable to smaller businesses, there may be best practices from ICAP that are. Similarly part of the Pillar One/Pillar Two project is the development of enhanced dispute resolution processes with binding results and deadlines to achieve them. The need for this will be even more compelling in the post-crisis world. It is also now perhaps more likely that such processes could be administered using a digital platform rather than completely relying on physical meetings.

CONCLUSION

While tax policy is not the only lever that governments have in addressing issues that have been brought to the foreground as a result of the COVID-19 crisis, it is an important one.

Policy makers will likely be reassessing some fundamental issues as a result of the crisis, including basic questions around big government vs. small government and about multilateral vs. unilateral action. It is too early to say where this will land and it will likely land in different places in different countries; however, it will be interesting to see how the next stages of these fundamental updates will unfold around the world. Keeping up with these tax policy developments is critical as we move to the "next normal" during economic recovery and reopening efforts in both individual countries and across regions.

APPENDIX
5.3. TOWARDS FISCAL POLICY IN THE AFTERMATH OF THE CRISIS[21]

EXPLORING OPTIONS FOR TAX POLICY REFORM

Tax policy will contribute to covering the costs of the crisis and policy responses to it. As countries look to restore their public finances, tax will have a key role to play, both in terms of revenue levels and of the tax structure, which may need to be adapted to a post-COVID era. However, policy makers should consider that the best way to boost tax revenue is to support solid growth, including through sufficiently strong and sustained stimulus, as this will expand tax revenues. This can occur in tandem with other policies to smooth costs over time, e.g., central banks keeping government bonds on their balance sheets indefinitely.

It is clearly too early to develop advice on tax policies for the longer term, but the debate is starting. The unprecedented nature of the crisis is, for example, prompting reflection on whether some exceptional measures could be contemplated, as has been the case after major wars or major fiscal crises (Aidt and Jensen, 2009[41]; Seelkopf, Lierse and Schmitt, 2016[42]; Scheve and Stasavage, 2012[43]). This involves suggestions for new sources of revenue or modifying the tax mix in existing systems.

Some academics and other stakeholders have recommended extraordinary revenue raising measures, e.g. (Guvenen et al., 2019[44]; Landais, Saez and Zucman, 2020[45]). Suggestions to use the tax system to tax back additional income earned during the crisis (Marron, 2020[26]; Mankiw, 2020[27]) are being floated. Some are also mentioning carbon pricing tax measures as a way to combine revenue raising objectives with a more fundamental, long term structural reform. While recognizing the significant political economy challenges of such measures, there is evidence that introducing new taxes is less difficult at a time of major policy reforms, as it allows for the impacts of a wide range of policy measures to be balanced. Even though not all countries may be willing to move in these directions, a growing number are, for example, introducing or strengthening carbon pricing, and this could be further facilitated by international cooperation and coordination.

Reforms of the prevailing tax landscape could be considered anew, such as base broadening measures and tackling inefficient tax expenditures, which could be easier to address in the context of a broad reconsideration of the tax system. Governments may also consider new and under-used tax bases. Where governments need to expand tax revenues, efforts can focus on raising revenues from tax bases that will be the least detrimental to growth, including recurrent taxes on immovable property and general consumption taxes. Further analytical work will be needed, recognizing that efforts to restore public finances have not begun and may be a while. This time window should be used to explore possible avenues for tax reform.

Consulting with member countries of the Inclusive Framework and other organizations, the OECD stands ready to explore and assess new ideas as well as more traditional ones.

Corporate income taxation and the international tax agenda

Since the last global crisis in 2008, international tax cooperation has advanced significantly with regard to tax transparency as well as fighting tax avoidance by multinational enterprises (MNEs). For example, in 2018 information relating to 47 million financial accounts was exchanged with a combined value of around EUR 4.9 trillion under the Standard on Automatic Exchange of Information. The international tax community, through the Inclusive Framework on BEPS, which includes 137 jurisdictions on an equal footing, has been mandated to address the tax challenges of the digitalization of the economy. Work has progressed well, focusing on two pillars: Pillar One concerning a reallocation of taxing rights and increased tax certainty while Pillar Two focuses on ensuring that the profits of MNEs are subject to a minimum level of tax. In spite of the disruption due to the health crisis, work has progressed. In a post-crisis environment, it is likely that addressing the tax challenges of the digitalization of the economy and ensuring that MNEs pay a minimum level of tax will be of even higher importance.

While many businesses are facing unprecedented difficulties during the crisis, some may see profits rise. The expansion of teleworking and the shift towards digital commerce observed during the crisis may prove sticky and more economic activity may move online. Companies that can continue, and possibly even expand, their operations during the crisis as well as those that are able to return to normal production quicker or adapt faster may earn economic rents. Governments could focus on incentivizing investment while strengthening the taxation of economic rents and boosting resilience.

APPENDIX (CONTINUED)

Increased use of digital services and the need to expand revenue raising could provide new impetus to efforts to reach agreement on Pillar One issues internationally. The focus of the work on companies with high levels of profitability should facilitate revenue raising without negatively impacting the recovery of companies that have suffered heavily from the crisis. A swift recovery will require smooth functioning of global supply chains. In this light, policy makers could work to avoid the risks of unilateral action in the digital taxation area and the disruption of the international tax and trade agenda that could result from failing to reach a consensus-based outcome on digital taxation. The focus of Amount A of Pillar One on high-profitability companies would mean that companies running losses would be less likely to be impacted, which would limit negative effects on growth or the recovery of these companies from the crisis.

Rising pressure on public finances may strengthen the push for effective minimum taxation of MNEs. Where some countries may need to engage in difficult fiscal choices after the crisis, the demand for effective global implementation of the GloBE proposal under Pillar Two will be higher, not least to ensure that there is a level playing field in the levels of effective taxation between major MNEs and SMEs who may suffer disproportionately from the crisis.

Overall, tax cooperation will be even more essential so tax disputes do not turn into trade wars which would harm recovery chances further. This also means that progress will have to be made on increasing tax certainty, notably by improving dispute resolution and prevention mechanisms.

Finally, increased revenue needs should prompt investments in strengthened tax administrations, through increased use of new technologies and digitalization. Models of highly digitalized tax administrations can increase compliance and reduce burdens on taxpayers from more seamless and frictionless taxation. The benefits of investment in better tax administration may be particularly high for developing countries. Simplifying taxation via both administrative and policy measures, including simplified taxes for microbusinesses, could also help to bring some informal workers into the formal sector in the longer term.

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