Tax implications of Covid-19

A fundamental transformation of tax systems is needed in the wake of Covid-19

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The current crisis is showing once more the importance of efficient and well governed states when it comes to finding collective solutions to elementary problems. Tax systems will play a key role in absorbing the social and economic impact of the Covid-19 pandemic in developing countries and promoting a rapid and sustainable economic recovery afterwards.

The additional financial requirements for public budgets will be enormous, especially in poorer countries. Key sources of revenue, such as natural resource exports and tourism, have collapsed and it is not known for how long. The World Bank estimates, for instance, that Africa will see a 12 to 16 per cent fall in state revenues, depending on the extent of the crisis. Budget deficits are forecast to increase by 3.5 percentage points of GDP on average for 2020.

Many developing countries are still in the lockdown phase of the pandemic, where the emphasis is on tax relief measures, such as the deferral of tax payments to create short-term liquidity for businesses. This is followed by an easing phase, in which tax relief measures can be used to incentivise consumer spending and investment in order to get the economy moving again. Many industrialised nations currently find themselves in this phase, struggling to find a balance between providing effective tax incentives for the private sector and securing sufficient state revenue to finance the increased spending. By the end of the pandemic, if not before, it is also necessary to consider long-term measures for making public finance systems resilient and fit for the future.

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But what options do governments have for providing short-term tax incentives for investment and emergency economic programmes without jeopardising their ability to cover rising state expenditure in the medium and long term? Poorer countries in particular often lack financial leeway for stimulus packages.

On the one hand, tax bases must be broadened, with more effective taxation of wealthy private households and assets. For instance, many states generate barely any revenue from property tax or personal income tax. But these are precisely the kind of taxes that promote progressiveness and fairness within tax systems, as they take greater account of the potential of wealthy taxpayers.

On the other hand, the international community must be resolute in tackling tax evasion and avoidance, which cost billions in lost tax revenue around the world each year. To this end, it is important for tax authorities to improve the quality of the tax data and tax registers they hold, as well as to enhance their tax auditing capacity. The digitalisation and automation of registers, accounting procedures and information-sharing processes, both between authorities within a single country and between nations, is a key starting point.

Nonetheless, the poorer developing countries are unable to implement the necessary measures on their own. When it comes to tackling tax evasion and avoidance by large companies especially, these nations are reliant on international cooperation. There is a particular need to put an end to the opaque business practices of tax havens and to the global race to the bottom regarding corporate tax rates. As far as the latter is concerned, options are being discussed for introducing a global minimum tax. Such a tax is presently the subject of negotiations within the OECD framework and should be implemented swiftly.

However, developing countries will also require additional finance, only some of which they will be able to obtain in loan form. The much discussed financial transaction taxes could provide another source of revenue for states. More funding could also be mobilised by levying taxes on large assets and inheritances, especially if the G20 countries can be persuaded to take concerted action in this area. An internationally agreed tax on digital services, such as those offered by the large technology companies, could provide an additional boost to state tax revenues. The US withdrawal from the OECD’s digital tax talks does not bode well in this regard. However, this should not be taken as the final nail in the coffin for multilateral solutions, but rather as a warning and an encouragement to the other countries to step up their efforts to find common solutions.

While the 2008/2009 global economic crisis had many negative consequences, one positive effect was that it massively accelerated international cooperation on tax matters. This is the kind of impetus that we also need for tackling the Covid-19 pandemic. The focus is not on generating more revenues, but rather primarily on achieving greater equity in the way that revenues are generated. This requires more public discussion of fair taxation. After all, the way that resources are mobilised and deployed to tackle the crisis will also have an impact on state legitimacy and social cohesion.

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