

Tax policy considerations in dealing with COVID-19 impacts

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In brief

Alongside public health and economic measures, governments have been activating in-country tax relief measures to reduce or delay taxpayers' tax liabilities and administrative burdens as a result of the COVID-19 pandemic. Tax authorities have been providing guidance and taxpayers have been deciding, where relief measures are not automatically applied, whether and how to avail themselves of such measures in appropriate situations. Looking ahead to a recovery phase, we consider in this Bulletin:

- how different the post-COVID-19 economy may look
- if unilateralism may overtake multilateralism or regionalisation
- new expectations on solidarity and tax transparency
- paying for the crisis: a short-term trade-off between stimulus and competition
- different perspectives on taxing the economy of the future as a practical matter

In detail

The post-COVID-19 economy may look very different

The COVID-19 pandemic has led to a downturn in the global economy and in many, if not most, domestic economies. Some territories have been and will continue to be more affected than others. But some commentators feel that this downturn will be different from previous experiences, including the most recent financial crisis of the early 21st century.

Preceding any post-COVID tax policy design issues is the question: what are the costs of the crisis? High government debt in many countries may mean a drag on future investment. The way to, and speed of, debt reduction predominantly will be determined by interest and inflation rates and economic growth.

The starting points for the direction of future tax policy may look different around the world.

The case for multilateralism or regionalisation may have changed

Apart from the different starting points, the apparently limitless push for globalisation may not be as clear an objective in the coming months and years. This potentially could apply to both taxpayers and tax administrations and could also affect the roles of the relevant international organisations.

Globally-focused supply chains and people-heavy processes have been stressed and are being reconsidered. The balance between debt and equity funding may be re-assessed and the tax treatment debate refueled. Automation and robotisation may increase and/or accelerate, with effects on employee-based taxes. Locating production and other business resources closer to home rather than in lower-cost territories to protect the value chain would mean substantial changes in the instruments and transactions needed to reflect the new intra-group relationships and consequent corporate income tax profit allocations. These could be catalysts for a more active discussion with any government involving new types of tax and with the tax administration about tax governance frameworks and a more collaborative or horizontal monitoring approach going forward.

Differently organised supply chains and increasingly automated processes will impact how and where value is created in multinational companies and may give rise to new transfer pricing challenges. There will be heightened uncertainty and concerns about liquidity and profitability that will affect pricing and comparables generally. But, just as people are trying to get to grips with recent OECD guidance on financial transactions, there will be new issues to consider regarding extraordinary expenses and who bears them; shifts in functions, assets and risk because of workforce constraints or structural changes; and focused tax audit activity.

The OECD may wish to consider analysing the impact of changing business models on the scope of its work on Pillar One of the 'Tax Challenges of the Digitalisation of the Economy'. Amid falling tax revenues, turnover taxes (including digital services taxes) and other measures outside of the double tax treaty purview may start to look more attractive to governments. The future direction of these treaties would then also seem less certain.

Governments may have a greater focus on items that are vital to their citizens. A state may also devote less resources to discussions involving other territories that may result in little incremental revenue or growth for that state [not sure what the preceding sentence means]. Incentives, including tax incentives, for locating particular activities may change from a competitiveness perspective. Some countries may be innovative in their approaches. Particular regions may see the opportunity to act together or in a more aligned manner.

All things considered, multilateralism doesn't look as secure as it is now and some have questioned whether it is as certain now as it was in recent years anyway. Increased unilateralism will however hamper countries' ability to recover from the crisis in the longer term when businesses are confronted with unilateral taxes and levies for which treaties do not provide double taxation relief.

New expectations on solidarity and tax transparency

There has been greater scrutiny lately of whether certain taxpayers or categories of taxpayers should be able to benefit from specific tax reliefs or incentives, regardless of whether they meet the criteria. This takes the debate about tax avoidance, lawmakers' intent, and things like 'any principal purpose' test to a different level. Territories may take into account when they design a particular tax, including any feature of or relief from that tax, the scope of the measure and build in anti-avoidance rules. Even then, they will have to be wary of certain kinds of discriminatory treatment, because of, for example, treaty agreements and, in the European Union, State Aid rules. Where specific treatment or options have to be claimed or notified, some taxpayers may consider the wider impacts alongside the different tax effects of doing so. However, clarity over purpose and criteria should be key principles for lawmakers.

A number of countries have specified criteria about businesses not being based in so-called 'tax havens,' when claiming the benefit of COVID-19 measures. Some also have talked about crisis loans made to companies being repaid before dividends can be distributed to shareholders, potentially irrespective of where those companies and shareholders are based. These kinds of conditions are being woven into the calls from non-governmental organizations and other stakeholders, like the European Parliament, for greater transparency, particularly as part of a more responsible and sustainable business approach to tax behaviour and tax strategies.

A wider group of corporate stakeholders is interested in companies' tax strategies. Such stakeholders include institutional investors, trade unions, financial supervisors, and regulators, as well as clients, business partners, employees and boards. In parallel, tax not only has a financial impact on corporations, but also involves reputational and commercial risks. We expect COVID-19 to accelerate this development.

A group's approach to tax, internal controls, sustainability and reporting will be more relevant than ever. For this, companies need a long-term tax strategy, with clear (board) tasks and responsibilities, effective tax risk management and auditable tax transparency. You can read more about this in our publication [Corporate tax governance: Creating a sustainable and transparent tax approach in times of fundamental change](#).

Paying for the crisis may mean a short term trade-off between stimulus and competition

Given the need to pay back the debt borrowed by territories, various countries will see political pressure to raise taxes and possibly cut spending. Levels of tax to GDP historically have risen post crises but a number of factors could impact this. Enacting austerity measures too soon could depress a possible economic recovery, so timing will be critical - the same issues probably apply to taxes that can be levied quickly, like consumption taxes, as to immediate government spending.

Governments may need to consider the extent to which they need to spend to support particular activities even after the peak of the virus, including spending to support social benefits and pensions (such needs may be increased to the extent businesses are unable to meet pension fund deficits). A range of obligations will impact businesses' ability to pay higher taxes, including potentially larger pension contributions, either by regulation or practicality. Corporate tax take will be lower because of the crisis, and this may reignite the paying fair share of tax debate (and perceived tax avoidance) but also a focus on total tax contribution (TTC) or total impact management for a business.

Internationally, protections for discriminatory treatment of foreign businesses and individuals may come under pressure. It is also still difficult to tell whether some developing countries will be in a similar position to more developed countries, whether appropriate solutions will be the same and whether this is an opportunity or a threat in relation to narrowing divergences between them.

Perspectives on taxing the economy of the future as a practical matter

In deciding how to levy additional taxes, how immediately governments' exchequers can feel the impact is one consideration. But there are other considerations. An [OECD working paper of 18 July 2016](#), put growth and equity considerations on an equal footing, going beyond the traditional growth focus of the seminal 2008 OECD Tax and Economic Growth report. It emphasised the need to look not just at the ranking of taxes in terms of their negative impact on long-run GDP per capita but at both:

- tax and benefit systems as a whole including things like taxpayer reactions to tax changes or whether tax rules are properly enforced, as well as on factors beyond the tax system such as a country's stage of development, social preferences for redistribution, and the existence of compensation mechanisms, and
- the hierarchy that recurrent taxes on immovable property had been found the least harmful for economic growth individually, followed by consumption taxes including environmentally-related taxes, and then personal income taxes and corporate income tax.

Both taxpayers and governments will have a desire for a more robust safety net in the future. The sustainability of particular types of tax revenue, amid different crises and tensions will probably be a greater factor.

Looking more to the future, the role of tax in driving climate goals could be a factor. Other factors may include the scarcity of human resources for tax matters and the ability of data analytics and how businesses may adapt in the post COVID-19 era, with technology potentially affecting compliance, tax behaviour, transparency and tax governance.

The takeaway

The international tax system has been evolving to reflect changing circumstances, but major shifts in the paradigm have been few and far between. We are seeing stress resulting from discussions about the taxation of the digital economy that

have morphed into heated debate about the impacts of the digitalisation of the economy as a whole and the globalisation of virtually everything, including business.

Unilateral digital tax measures are being introduced and existing legislation broadened to capture more foreign businesses. Technology is constantly changing what is possible, as well as how things can be done more efficiently, and the tax system itself is an object of review. As people have started to question more of the fundamental building blocks of direct and indirect taxation, the COVID-19 pandemic could be the catalyst for more radical change.

See also

- [PwC's navigator on Tax, Legal and Economic Measures in response to COVID-19](#)

Let's talk

For a deeper discussion of how these issues might affect your business, please call your usual PwC contact. If you don't have one or would otherwise prefer to speak to one of our global specialists, please see the contact details below:

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