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Challenges and opportunities for revenue mobilisation during and after the COVID-19 pandemic

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Contents

Our talk with cover broadly three areas:

- Impacts of COVID-19 on domestic revenues
- Role of taxation in government responses
- Domestic revenue mobilization: timing, opportunities and challenges

Impacts of COVID-19 on domestic revenues

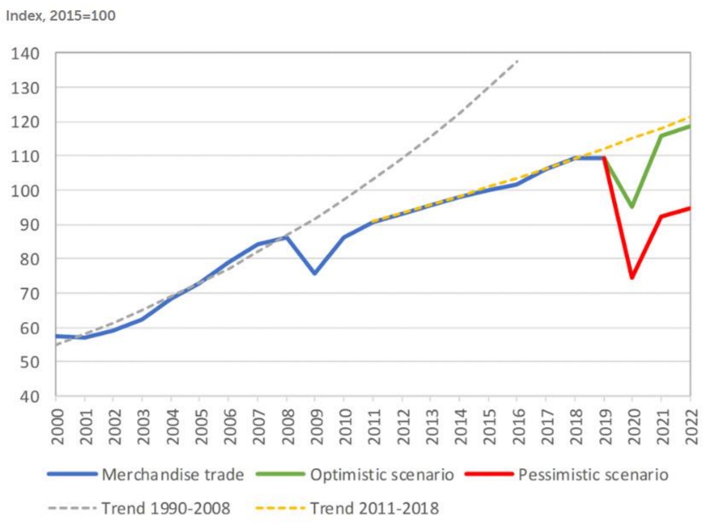
Historically deep global economic shock

Global: Reduced flows of goods, capital and labour, falling commodity prices

Domestic: Lockdowns and social distancing measures

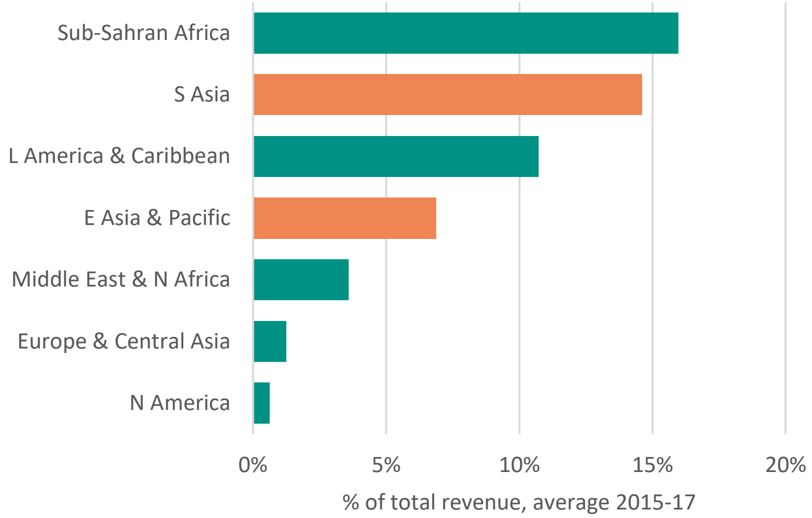
Declining global trade reducing trade taxes

World merchandise trade volume, 2000-2022



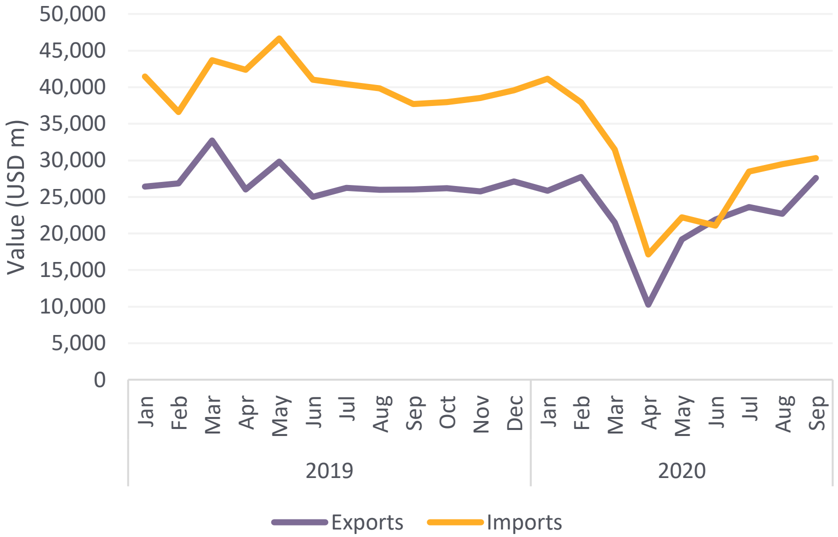
Source: WTO Secretariat.

Share of revenues from trade taxes, 2015-17



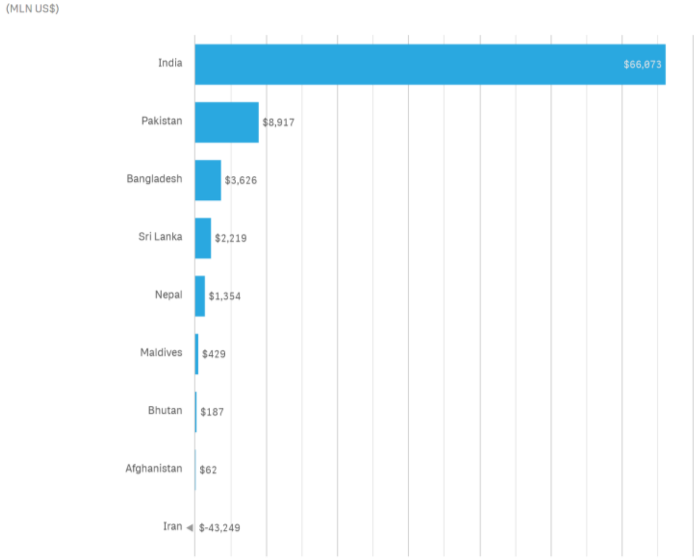
Source: ICTD/UNU-WIDER

India’s exports have recovered, but imports lag behind



Source: UN Comtrade

Petroleum (refined + crude) net imports, 2019



Source: UN Comtrade

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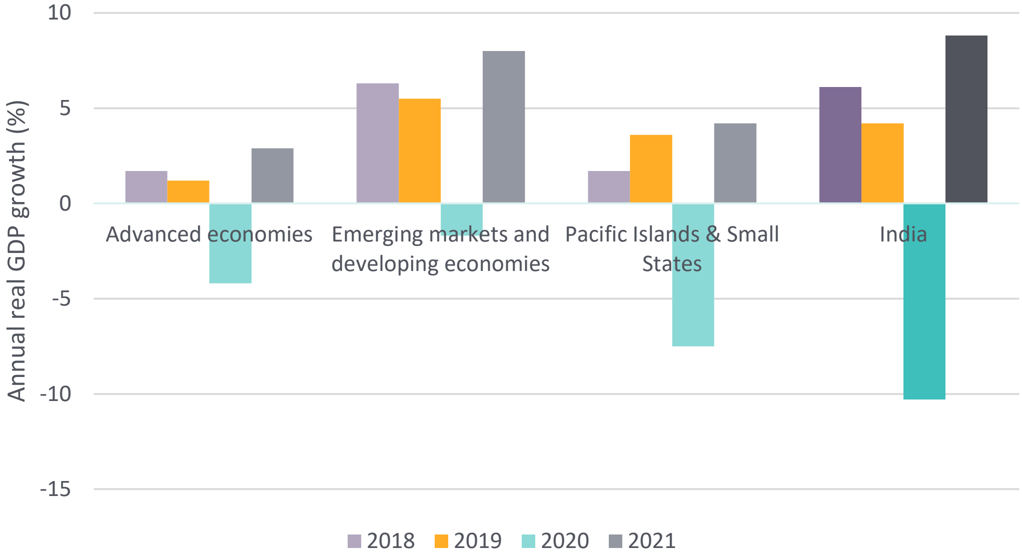
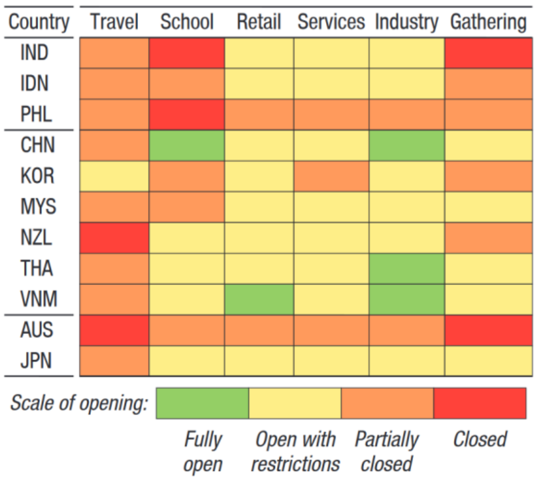
India more negatively affected than most of Asia-Pacific region



Source: IMF Regional Economic Outlook Asia and Pacific, Oct 2020

Figure 2.1.3. Status of Containment Measures



Source: IMF staff estimates.
Note: As of September 8, 2020. Country abbreviations are International Organization for Standardization country codes.

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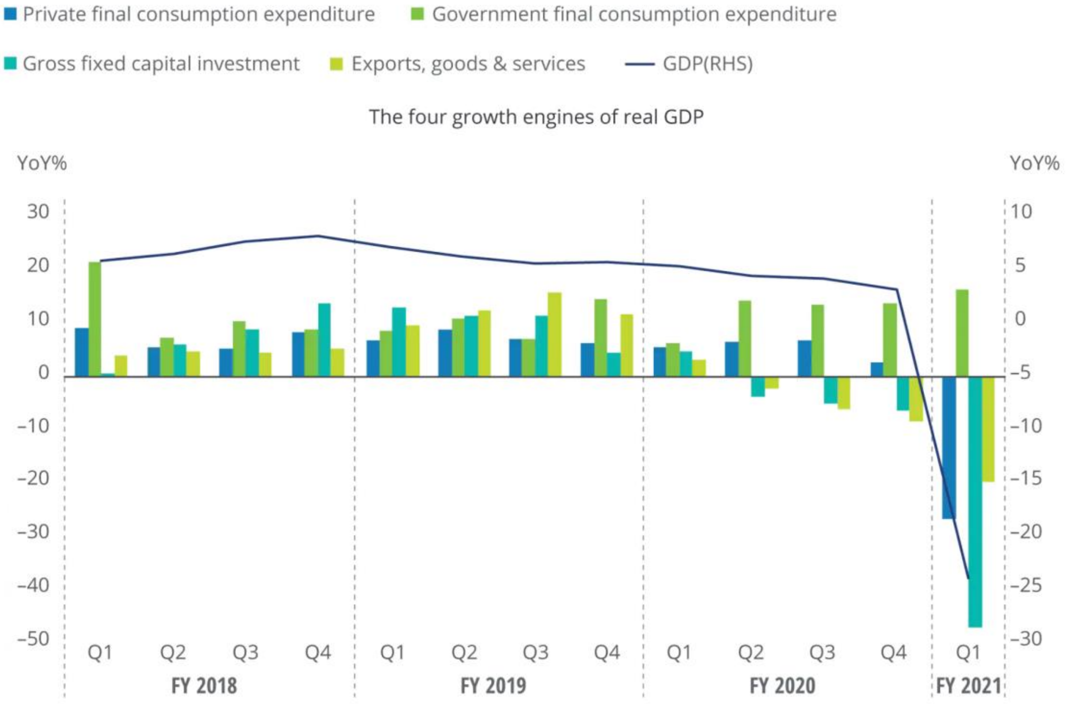
India's economy contracted at a record pace in Q1 FY2021

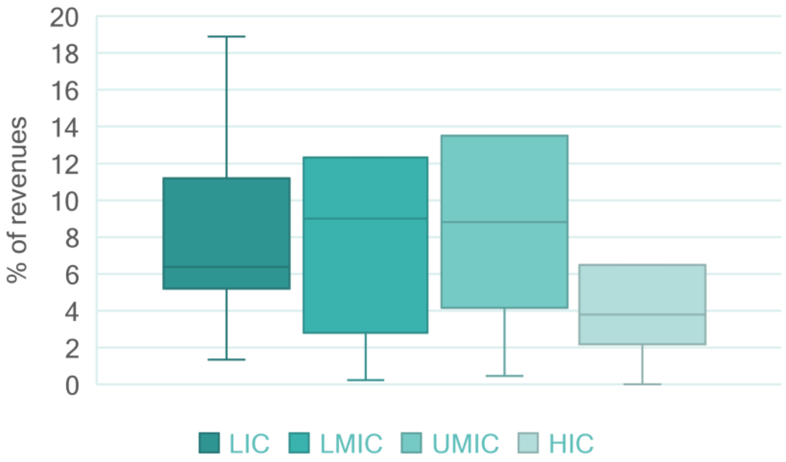


Source: Ministry of Statistics and Programme Implementation, Government of India, August 2020.

Deloitte Insights | deloitte.com/insights

Fiscal impacts more acute in low and middle-income countries

General government debt interest payments as a percentage of revenue by income, 2019

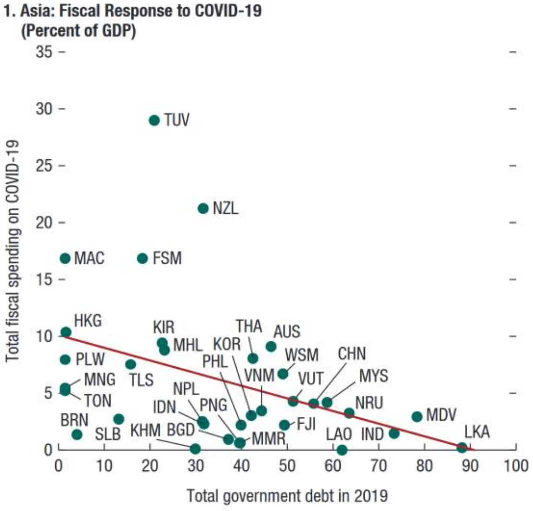


Source: World Bank World Development Indicators

- More limited access to capital markets, widespread and simultaneous calls on external finance, less scope for temporary central bank financing

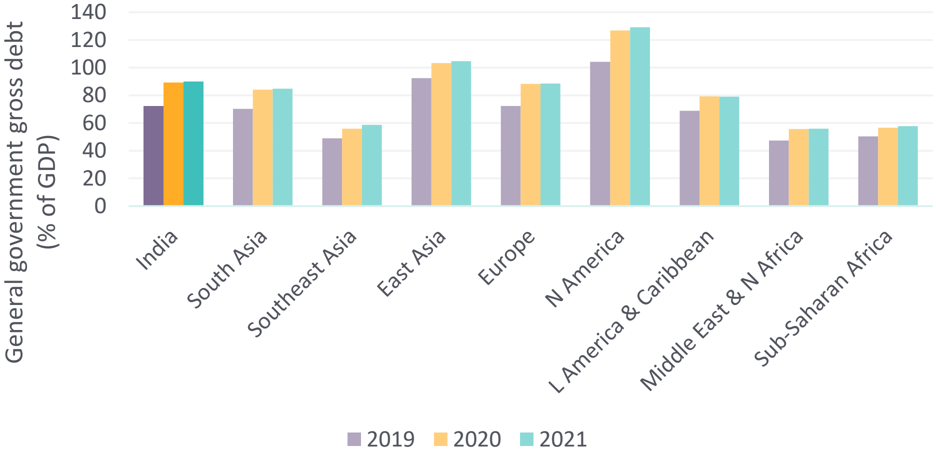
Shrinking fiscal space to finance recovery

Figure 4.4. Asia's Policy Responses



Sources: IMF World Economic Outlook database; and IMF survey of policy responses to COVID-19.
Note: COVID-19 = coronavirus disease. Country abbreviations are International Organization for Standardization country codes.

Source: IMF Regional Economic Outlook Asia and Pacific, Oct 2020



Source: IMF World Economic Outlook, Oct 2020

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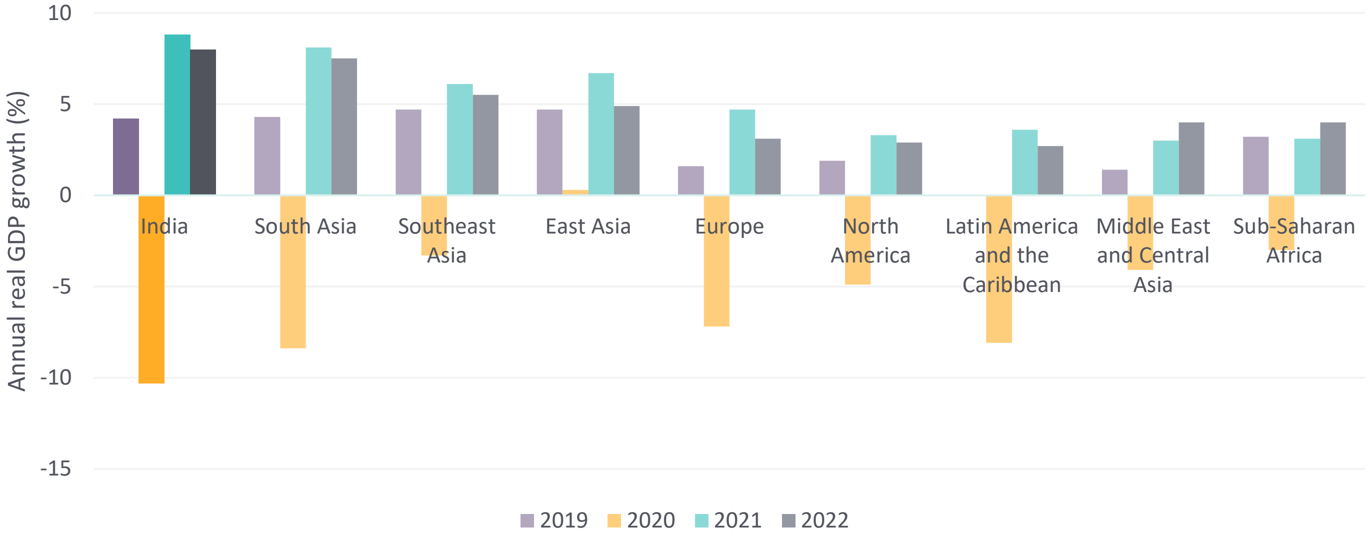
But Indian economy expected to lead recovery



Source: IMF World Economic Outlook, Oct 2020

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Surviving/Thriving sectors?

<u>UK/US</u>
Pharmaceuticals
Groceries
Tech (remote working, operational efficiency)

<u>Japan</u>
Personal/household goods
Pharmaceuticals
Groceries
Digital payments

<u>China</u>
Digital: payments, entertainment, publishing, information
Health providers, plans
Pharma, MedTech

<u>India</u>
Life Sciences
Professional Services
Manufacturing

Source: Deloitte heatmaps (June 2020); Kroll heatmaps (Aug 2020)

Evolving impacts require frequent assessment

- Use of taxpayer data for monitoring, e.g.:
    - Falling receipts could indicate whether social distancing is effective and feed into modelling of virus spread
    - Customs data to anticipate shortfalls in essentials and identify trade dependencies
    - Sector or region analysis to identify worst-affected for targeting
    - Weekly or monthly data shows how activity is changing or early signs of recovery and potential bottlenecks

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Role of taxation in government responses

Three phases of (tax) policy response

Phase	**Support**	**Stimulus**	**Consolidation**
When?	Immediate but temporary	After social-distancing measures have been eased or lifted	After economic recovery has properly taken hold
Why?	Help business and household survival	Boost demand to support economic recovery (if needed)	Restore fiscal sustainability (if needed)
Examples	Tax payment deferrals, expedited refunds, targeted help for affected sectors	Temporary reduction to VAT or increase in capital allowances	Revenue-raising measures consistent with MTRS: role for green taxes?

Support phase principles and practice

- **Role of tax is limited in informal setting**
- Spending/cash transfers may be more effective – target most affected
- Tax levers need to provide relief but protect revenue cash flow and jobs e.g. deferred payments, faster refunds, wage subsidy
- Reduce transactions costs: money transfer, tariffs on relief items
- Limit admin burdens, including new reforms

India

- Extension of income tax filing deadline (3 months); reduction of penalty for late payments; date for filing fiscal year 18/19 GST tax liability extended (3 months); other miscellaneous relaxation of tax regulatory/administrative requirements.
- Reduction in up-front tax deductions for workers;
- Plus social protection, healthcare, wage support

Source: IMF Fiscal Monitor: Database of Country Fiscal Measures in Response to the COVID-19 Pandemic, Sep 2020

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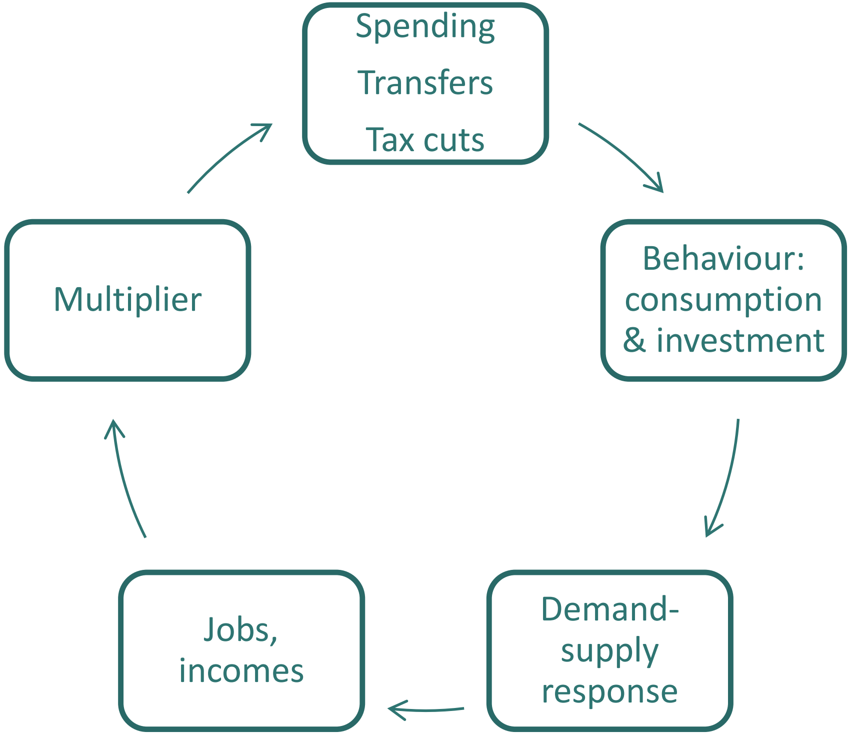
Economic stimulus design considerations



Timely
- In downturn
- …but limit virus transmission

Targeted
- Lowest incomes, most affected
- More complex, rent-seeking risk
- Constraints in government control?

Temporary
- Lower cost, brings forward spending
- Limits avoidance behaviour
- Appropriate timeframe in pandemic?

Stimulus packages - tax options and implications

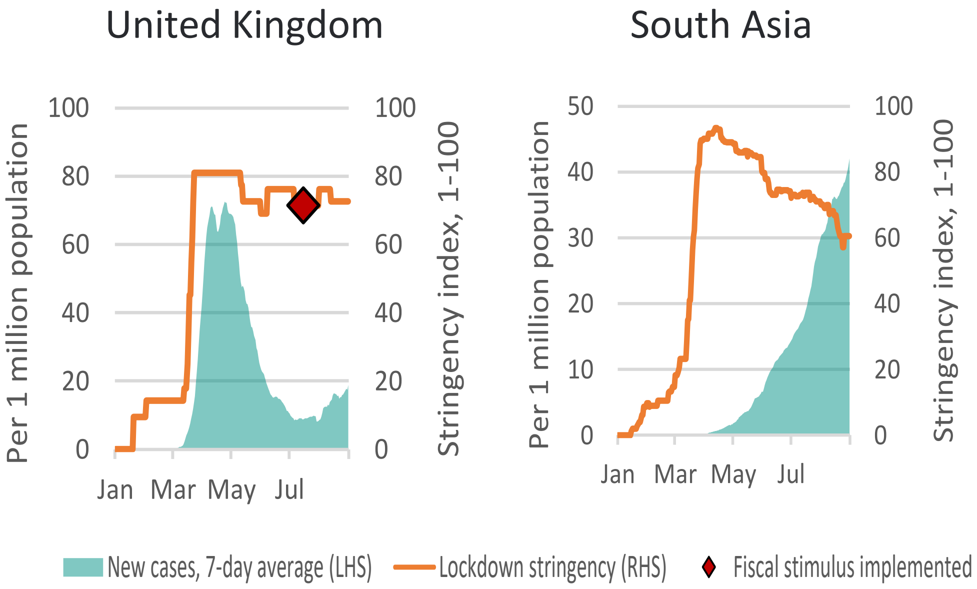
Stimulus options	Impact
Public spending	Fastest boost to demand through consumption (O&M)
Cash transfers	Fast increase in consumption (poorest, low saving)
Temporary tax relief – individual	Brings forward spending - less effective if informality (narrow base), more effective if target to low incomes e.g. necessities, property tax, local taxes
Temporary tax relief – business	Brings forward investment – more effective if cost-based incentives, not profit-based or FDI
Public investment	Higher multipliers in L-MICs, builds future tax base e.g. green tech, infrastructure, human capital

Revenue mobilization at each stage

1) Limit losses (temporary reliefs/loans, job retention), maintain cash flow

2) Some catch-up from boost to consumption etc; investments build future tax base; new measures on pockets of wealth

3) New revenue measures, 're-payment' and reform



Source: World Health Organisation, Coronavirus Disease (COVID-19) Dashboard (data up to 31 August 2020), Hale et. al. Oxford COVID-19 Government Response Tracker (data up to 31 August 2020), and OECD Tax Policy Tracker (data up to 31 July 2020).

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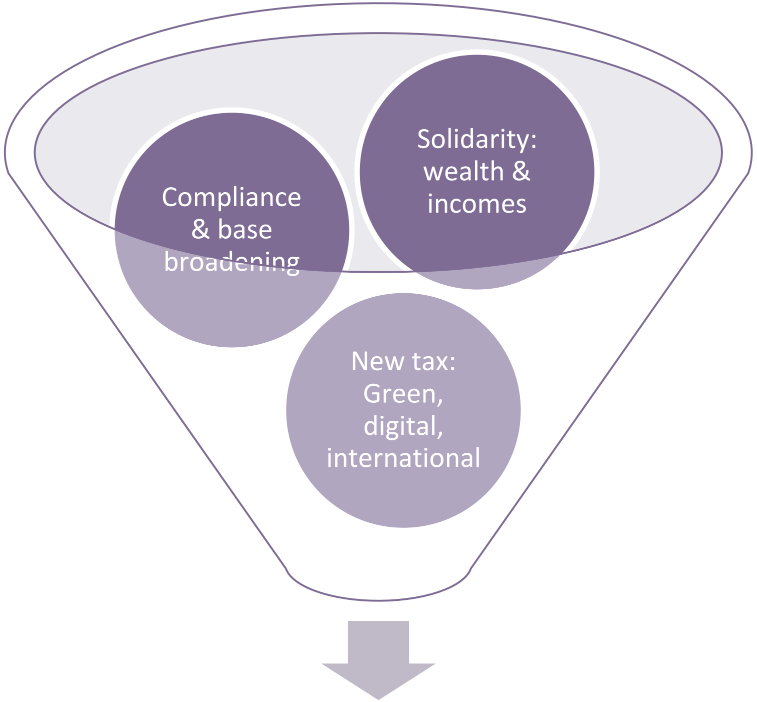
Domestic revenue mobilization: timing, opportunities and challenges

…No silver bullet!



Feasibility?

- Political support
- Administrative Capacity
- Ability to pay & burdens
- Wider impacts

Economic, Equity, Environment, Development Objectives

Short term (recovery onwards): targeted ‘solidarity’ levy

✓

- Pockets of wealth – profit-based, assets, high incomes, dividends
- Fairness - trust and compliance
- *Quid pro quo* for bailout sectors e.g. airlines
- Incentivises productive use of assets

✘

- Tax avoidance behaviour e.g. EU banking levy, OECD wealth taxes;
- Difficult to identify pockets of wealth
- Unfairness of wealth taxes, if assets not linked to ability to pay

…limit demand dampening (targeting); limit avoidance (one-off ‘surprise’ e.g. base on or before announcement date)

Short term (recovery onwards): targeted 'solidarity' levy

Examples:

- Germany post-war reconstruction and reunification in 1990s
- Ghana National Fiscal Stabilisation Levy (surcharge on CIT)
- European banking levy following bailouts after global financial crisis
- Uruguay Coronavirus 2-month levy on government service providers
- UK supermarkets after sales boost "*bowed to pressure and are repaying more than £850m in business rates relief they accepted from the UK government to help the supermarkets deal with the coronavirus pandemic*" (The Guardian, 2.12.2020)

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Taxes to support green economic recovery

Options:

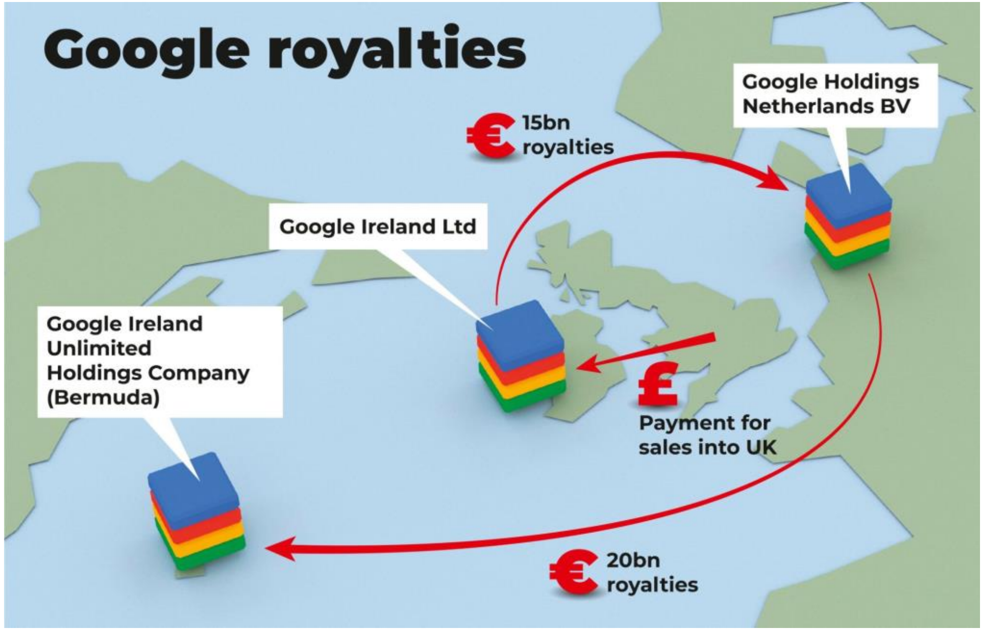
- Carbon pricing (tax, permits)
- Remove energy subsidies (equitable)
- Fossil fuel taxes (low oil price)
- Vehicle duty/levy and environmental levies (various)
- Incentives for renewables, adaptation etc.

Carbon Tax:

- 13% emissions covered by carbon pricing globally, across 40 countries, $30bn p.a.
- Evidence is patchy – some positive impacts on emissions and equity*
- Geographic variation for cities (e.g. Mexico sub-national surcharge)
- Not sufficient alone, but part of broader energy and climate mitigation/adaptation strategy

*Dorband, I., Jakob, M., Kalkuhl, M., Steckel, J.C. (2019), *Poverty and distributional effects of carbon pricing in low- and middle-income countries – A global comparative analysis*, World Development, Volume 115

Taxation of multinationals and digital economy



Source: https://www.taxwatchuk.org/taxing_uk_tech_royalties/

Multilateral (OECD, UN):

- Minimum tax of large MNEs
- Allocation by market presence and/or arms length standards

Unilateral:

- Digital Services Tax (e.g. UK)
- Expanded income tax (e.g. Kenya)
- Withholding tax on payments (e.g. Mexico)
- India Equalisation Levy

Taxation of multinationals and digital economy

✓

- Value = 4.5 - 15.5% World GDP in 2019 (UNCTAD)
- Boosted by COVID-19
- Global commitment and collaboration increasing e.g. OECD, UN, regional tax authorities, exchange of information
- Increased transparency and information sharing

✗

- Multilateral / treaty negotiations favour HICs
- Weaker enforcement of unilateral measures
- Behaviour change, unintended consequences;
- Inequities for vulnerable - access to finance, information, education

Rationalising ineffective tax expenditures

✓

- Opportunity to justify removal
- Tax expenditures can be expensive, ineffective and/or poorly targeted
- Alternative policies to achieve objectives at a lower cost
- Structural transformation towards certain services increases VAT policy gap.

✗

- May increase prices of sensitive products
- May not raise as much revenue as expected
- Potential deterrence to formalisation in affected sectors
- Generally difficult to remove politically, and may require counterbalancing proposals

Expanding taxation of income and wealth

✓

- Opportunity for progressivity and compliance
- High PIT liability in some advanced economies from top taxpayers
- Strengthen anti-avoidance provisions
  - reviewing transfer pricing regulations
  - revenue risks in DTAs
  - design of alternative minimum tax
- Taxes targeting wealth

✗

- Typically difficult in practice to apply taxes for wealthy individuals
- Demands on administration's resources and international coordination
- Political will to target taxation of wealth and time for sensitisation
- Possibility of deterring new investors

Consolidating administration efficiency and compliance

Compliance risks are likely to increase with coronavirus's impact:

- Increased VAT non-compliance in EU following 2008 financial crisis
- Relative size of compliance gap in countries with high informality
- Importance of developing trust with taxpayers for voluntary compliance

Options to reduce the cost of compliance for taxpayers:

- Pre-populated tax returns
- Validating GST credits using information from e-invoices (once introduced)
- Formalisation without creating tax burden for better future compliance
- Ease of use of e- and m-platforms
- Taxpayer communication strategies

Conclusions

- Fiscal policy levers very limited for recovery, all of which will hinder recovery of revenues
- Need for DRM now, but risks constraining recovery further, so options could be limited to targeted, temporary measures
- Can make preparations and consider messages now about longer-term DRM options after recovery e.g. tax compliance, solidarity, equity (taxing rich), green recovery etc.

Discussion

- *How much of this chimes with your experience?*
- *Where are India's tax 'gaps' and how has COVID-19 affected them?*
- *Are there opportunities from this experience e.g. politically difficult measures that may now gain more traction?*
- *How feasible might some of the options we presented be? At central and sub-national levels? Who could and should end up bearing the burden?*

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Thank you!