ACCOUNTANCY EUROPE.

SHORT-TERM TAX MEASURES: SUPPORTING BUSINESSES THROUGH THE CORONACRISIS

Discussion paper

IDEAS.

TAX
APRIL 2021

HIGHLIGHTS

The coronavirus crisis continues to negatively impact many labour-intensive business sectors that are key to European employment. It is important that viable businesses in these sectors are supported by national governments to ensure Europe's social stability and economic health.

The tax system has an important role to play in providing this support that is cost effective for governments as it uses existing data and systems. In this paper we highlight measures for both direct and indirect tax that governments should consider.

Some of these measures have cross-border impacts so we also highlight the role of the European Commission and international organisations in sharing best practice and coordinating efforts.

Our accompanying paper, Long-term tax policy changes for a sustainable recovery, examines options for building a modern, robust and fair tax infrastructure fit for Europe's future.

CONTENTS

INTRODUCTION

EU Member States are mitigating some of the most negative financial effects of the coronavirus crisis. This is thanks to early and decisive state intervention, together with the relentless drive and commitment of public healthcare employees, civil servants, business, and civil society at large.

However, many businesses, particularly in key sectors of heavy employment such as tourism and leisure, are still in a perilous financial position and will require continuing government support to survive. In this paper we propose measures that governments should consider supporting the sectors suffering the most from the coronavirus crisis - to ensure their survival, increase employment and plan for a sustainable future.

Our accompanying paper, Long-term tax policy changes for a sustainable recovery, examines options for building a modern, robust and fair tax infrastructure fit for Europe's future.

SHORT-TERM SUPPORT TAX MEASURES

Tax systems could be an effective way to target support measures, as tax authorities already possess a great deal of data about businesses and their pre-crisis profitability. This will help target measures towards those sectors worst hit by the crisis and towards businesses that have the best chances of contributing to a sustainable recovery.

Using tax systems could also improve support measures' efficiency and effectiveness and reduce their susceptibility to abuse. Governments have struggled to ensure that the first wave of support measures went to legitimate businesses in genuine need. The accountancy profession, building on its professional principles, in particular integrity, and its commitment to the public interest, could assist in this - as discussed in our paper Coronacrisis: actions for the public sector (May 2020).

Businesses should also be aware of the cost of support measures to national governments and of citizens' concerns as to how increased government debt is to be financed in the future. Businesses should only use support measures when it is critical to their survival. We further consider how businesses can contribute to a sustainable recovery in the accompanying paper.

In this paper we will look at some tax measures that could help businesses survive the coronavirus epidemic. Governments should thoroughly examine the measures proposed before considering their introduction, to assess the:

- effectiveness of the measures in directly achieving the stated policy objective – i.e. the elasticity of the measures on the economy and the sectors specifically targeted
- ease of introduction and withdrawal of the measures – both in respect of administrative burdens and the financial effect on both public sector and private sector bodies
- procedures necessary to ensure that all businesses targeted by the measures can benefit from them, as well as controls implemented to prevent their misuse
- alternative approaches that may produce a better result for the stated policy objectives
- strength of monitoring procedures to assess the efficacy and efficiency, and correct use of funds and incentives
- effectiveness of communication strategies to inform citizens on the correct use of the funds and incentives, and the progress made - to build public trust in the system

Some or all of the measures mentioned below may already have been implemented in some Member States. Equally, some of the measures may not be appropriate for individual Member States, depending on their existing tax systems and local economic specificities.

Below we will first deal with measures the EU and national governments can take via direct business taxes, and then those via indirect taxes.

DIRECT BUSINESS TAXES

Most direct taxes on businesses are based on profits, so many businesses will likely have significantly reduced income taxes to pay for the 2020 and 2021 calendar years.

Many previously profitable businesses may still have paid business income tax in 2020 in respect of prior years' profits even though they are likely to generate reduced profits in 2020 and beyond. This could put a heavy burden on businesses that have suffered severe reductions in revenue and cashflow since the start of the crisis.

We recommend governments consider the following measures, to the extent not already applied:

LOSS RELIEF AND REDUCING PAYMENTS ON ACCOUNT

Businesses should be permitted to offset losses made in the coronavirus period as soon as possible against taxable profits made in prior periods. There may be insufficient profits made in the preceding year to fully utilise the losses from the accounting period(s) affected by the crisis.

Governments should consider implementing the following:

- permitting offset for up to 5 fiscal years prior to the loss-making period(s)
- where the relief for losses is restricted, removing temporarily the restriction to allow full utilisation of all profits for a particular financial year as quickly as possible
- both processing loss relief claims and repaying the resulting overpaid tax promptly
- temporarily permitting offsetting trading losses against other forms of income and gains, both in the loss-making period(s) and in the three prior fiscal years. This could be particularly useful for unincorporated businesses who support their business with income from other sources or from capital gains made on personally held assets
- permitting indefinite carry-forward of otherwise unutilised losses. These losses should be immediately and entirely offset against future profits, with the tax credit amount being off-settable against other taxes due by the business

Many tax systems require taxpayers to make payments on account of the current year's liability, frequently based on the preceding financial year's liability. It is therefore possible that some businesses are required to make income tax payments on account despite making losses in the year in question.

Governments should consider implementing a fast relief system by which payments on account can be reduced or halted as soon as the business is able to provide evidence that business profitability has reduced.

TEMPORARY EASING OF THE INTEREST LIMITATION RULE

The EU Anti-Tax Avoidance Directive (ATAD) limits the amount of interest expense that can be deducted by relevant corporations to a maximum of 30% of earnings before interest, tax, depreciation and amortisation.

Very large companies have seen their earnings fall dramatically since the start of the crisis, yet their financing requirements remain (or have increased), as does the obligation to service their debt. Companies that would have normally been able to offset their external interest costs against their profits may not be able to do so during the crisis due to the 30% capping provision.

We call on the European Commission (EC) and Member States to consider until the crisis has passed:

- temporary lifting the interest limitation, in respect of external interest charges at a consolidated group level
- temporarily raising the € 3 million threshold for automatic deductibility of interest
- Member States permitting the carry back and carry forward of 'exceeding borrowing costs', where they have not already done so

- applying the option for interest deduction to be based on the consolidated group rather than just on the standalone company, for those Member States that have not already done so

GROUP TAXATION RULES

Some Member States do not have a tax consolidation regime, or only have a limited one – especially for groups with overseas entities. This means that if a group company makes taxable losses, these losses cannot be offset against taxable profits made elsewhere in the group.

This could introduce another financial burden for groups suffering during the crisis where tax must be paid by individual entities even though the group as a whole has substantially lower profits, or even losses. Member States should introduce relief for losses made by group entities against other profits made in the group, even if only on a temporary basis.

There is also a good argument to permit tax free transfers of assets within the group, as this may facilitate the repatriation of business assets back into the EU, as discussed in the following section.

TAX CREDIT FOR EXIT TAX SUFFERED

The coronavirus crisis highlighted issues with relying on globalised supply chains. Some businesses will likely seek to repatriate means of production from third countries back into the EU to ensure greater security of their European supply chains. This could have long-term benefits for the EU economy and job creation – and environmental benefits.

However, an exit tax charge could be imposed by the third country when the assets or activities are removed to the EU. Such exit taxes are normally not off-settable against corporate income taxes or other common business taxes. This represents a barrier to bringing such assets into the EU. We encourage Member States to consider an offset of third country exit taxes against corporate income tax due in the Member State.

Where no corporate income tax is due, refunding the foreign exit taxes through a domestic tax credit mechanism should be considered. This could be achieved by allowing it as a deductible cost against profits. Governments should consider the measure's overall economic benefit. This means weighing the cost of the tax relief granted against potential tax revenues obtained from, for example, payroll taxes and social security payments arising from the additional employment created.

The measure should be time limited. However, Member States should consider allowing businesses up to two years to relocate activities once the decision has been taken, as significant changes to a business' supply chain take time to plan and implement.

Such measures should take into consideration state aid rules and the possibility of provoking retaliatory action by countries suffering business activities exit. In that respect, and to ensure long-term economic benefit for the country offering the tax relief, these measures should be restricted to transactions that include transfers of physical assets and tangible economic activities. In the past, certain similar measures have been deemed to be abusive and have caused friction with other countries, when limited to the transfer of solely intangible assets.

Governments could also consider allowing relief for any capital gains tax charged when the assets exit the country against capital gains tax due in the destination country if the assets are subsequently sold.

RELIEF FOR HOME OFFICE COSTS AND TEMPORARY BUSINESS RESIDENCE

Travel restrictions and social distancing measures have resulted in many more people working remotely and not always in their normal country of employment or residence. Consequences can be:

- home workers may incur additional costs for which they may not be able to claim tax relief
- where compensation is given for home working, this may be taxable on the employee
- the employee may be working in a different country for a long period of time, raising the possibility of taxation in the country of temporary residence as well as in the source country

- if an individual is a key member of the company's senior management, it is possible that the place of effective management of a company for tax purposes changes to the country of temporary residence of the manager concerned. This could lead to double taxation of the company

These issues require a short-term solution to avoid double taxation and undue hardship for employees. The Irish government has recognised some of these issues and has introduced measures to provide relief and improve clarity. The Organisation for Economic Co-operation and Development (OECD) has also identified this matter and issued guidance illustrating good practice.

Remedies in relation to income tax and social charges must be sought at a European Union level (with international agreement being the longer-term objective). This is necessary to prevent double taxation (and double non-taxation), whilst ensuring that employees continue to have access to health and other services that they pay for.

There is a real possibility that the Coronavirus crisis will lead to long-term changes in the work pattern for many employees. Governments should assess their domestic tax systems' adequacy for dealing with these problems and collaborate to produce an international framework that deals with the taxation of increasingly mobile businesses and employees.

TAX DEDUCTIBLE DEPRECIATION

Governments should consider accelerating the rate at which depreciation of capital assets and research and development expenditure can be offset against taxable profits to accelerate private sector investment. Several countries already allow 100% write-off of capital costs (or super-deductions exceeding 100%) in the year of acquisition for certain types of assets.

This could support investment in sectors especially hard hit by the crisis, such as transport, tourism, and construction. It could also support investment in those areas where the crisis has shown a severe need, such as medical services and drug research.

We also believe that enhanced depreciation or allowances should be focused on promoting investment and development in such areas as information technology, promoting use and production of green energy, and energy saving products and green transport.

EMPLOYMENT TAXES / SOCIAL SECURITY PAYMENTS

In many jurisdictions, taxes on labour and indirect taxes represent over 50% of fiscal budgets. Tax measures implemented to relaunch the economy post coronavirus should aim at preserving or even creating jobs.

As a short-term measure, governments should consider whether a temporary reduction in employer's social security charges could help protect jobs, particularly in such sectors as travel, hospitality, and leisure.

Additional central funding will be required in Member States where employers' social security payments are directly linked to the benefits ultimately received by employees. This will ensure that employees do not suffer financial hardship later in life because of the reduced contributions during the crisis period.

FILING DEADLINE AND TAX PAYMENT DEFERRAL

Many national governments already permit delayed filing of business tax returns and delayed payment of business tax liabilities. However, the obligations remain to file and pay taxes – which businesses should do once they have the capability and funds to do so. Existing deferment measures should be reviewed to determine whether they need to be further extended.

Some businesses will be temporarily unable to comply with their filing obligations and pay any taxes due. We recommend that tax authorities establish procedures (preferably telephone or internet based) so that affected businesses can inform the tax authority as soon as possible about possible breaches. Where promptly notified, the tax authority should take a sympathetic view and not impose penalties or interest where genuine hardship is proven. In such cases, enforcement and debt recovery processes should be temporarily suspended.

Deferment of tax liabilities will undoubtedly save some businesses. For others it is also merely deferring the problem and will result in them having to pay several years' debts in a short interval. Tax authorities should establish instalment payment plans for businesses in financial distress at a preferential rate of interest so that cash flow can be properly managed, and businesses supported.

This would be equivalent to granting support loans to businesses, which many governments have already done. However, the risks to the government of fraudulent applications for, or default on, the loans would be reduced compared to business support loans, due to the amount of information revenue authorities have about their taxpayers.

INTERNATIONAL TAX DISPUTES RESOLUTION

Taxpayers with cross-border activities too often face international tax disputes that lead to double taxation and lack of certainty - for both direct and indirect taxes. During the crisis period these disputes put even more stress on businesses struggling to survive. In the long-term, they increase inefficiency and harm investment.

Improving the systems both to prevent and solve tax disputes will assist some businesses in surviving in the short-term and lead to a more sustainable tax system in the long term.

Binding arbitration between taxpayers and tax authorities (and between tax authorities themselves) is essential. Governments should also promote tools that increase early tax certainty, such as Advance Price Agreements or the OECD's International Compliance Assurance Programme (ICAP) for both direct and indirect taxes.

INDIRECT TAXES

VAT RATE REDUCTIONS TO SUPPORT SPECIFIC SECTORS AND STIMULATE DEMAND

As indicated by the OECD report Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience (May 2020), VAT rate reductions are not always the most effective way of supporting businesses, particularly in times of low demand. Governments should carefully consider the cost effectiveness of such VAT measures. Governments should also examine whether the policy objectives cannot be more efficiently achieved by other means – such as support grants or voucher schemes (although voucher schemes introduce VAT complexities).

Experience has shown that VAT cuts are not always cost effective when used to stimulate consumer demand, as VAT cuts tend to be retained by businesses to increase their profits. In the current context, this may be beneficial, as increasing businesses profitability may assist businesses survive and thereby protect jobs.

Despite their limitations, temporary cuts in VAT rates that focus on the most affected sectors could be a useful tool for business support where governments have not already introduced them. Sectors such as leisure, hospitality, and travel are highly labour intensive and have suffered, and will continue to suffer, the most from social distancing measures, the closure of borders and outright travel bans.

FILING DEADLINE AND TAX PAYMENT DEFERRAL

Broadly the same considerations apply to indirect taxation as they do with direct taxation, as discussed above.

FLEXIBILITY IN THE VAT SYSTEM TO DEAL WITH CRISES

Member States' governments have limited flexibility in making rapid changes to their VAT system because VAT legislation is essentially adopted at an EU level. This is especially the case when applying reduced rates of VAT, zero rating and exempting supplies - to limit unfair VAT rate competition between Member States.

This lack of flexibility has caused issues during the coronavirus crisis, for example:

- preventing Member States exempting (or zero rating) supplies of personal protective equipment, as many items do not currently meet the definition of hospital or medical care under Article 132.1(b) of the VAT Directive
- imposing a VAT charge (or alternatively, a recovery of input tax already deducted) on businesses that have excess stock that they are unable to sell and wish to dispose of, on a voluntary basis, to the circular economy
- limiting the ability to accelerate VAT bad debt relief, which should be harmonised across the EU
- restricting the Member States' individual capability to extend existing time limits to make claims for VAT recovery (e.g. under Directive 2008/9/EC) where access to documents and records was not possible during the confinement period

Many of these restrictions are in place to prevent unfair cross-border VAT competition and, as regards refunds, to ensure that there is one single EU-wide system. However, government aid packages are focused on boosting the domestic economy, so the risk of unfair competition across borders from allowing Member States to unilaterally reduce VAT rates remains limited.

Member States urgently need to have greater flexibility on VAT to deal with emerging crises. Such flexibility will also facilitate long-term economic changes – for example, the growth of the circular economy and sharing economy included in the EC's Action Plan of 15 July 2020.

This is not something achievable in a short time. A post-crisis review could indicate areas where Member States could be granted flexibility in applying the VAT system to respond rapidly to unforeseen crises.

The EC is aware of this and has proposed a directive to give Member States greater flexibility in setting VAT rates, but this has not yet been agreed in Council. We call on the EC to examine how the legislative framework (or the current system of limited derogations) can be amended to permit quick responses using the VAT system, at least on a temporary basis. We also call on Member States to accelerate their work on the proposed changes to the VAT Directive in respect of VAT rates. To achieve this, they should consider separating the proposal on VAT rates from the proposals for the definitive VAT regime.

To improve the ability of the EU VAT system to deal with urgent issues, we believe that Member States should support the EC's proposal to change the status of the VAT Committee to that of a regulatory committee. This would reduce the need to apply to the European Court of Justice for interpretations of the VAT Directive, thereby improving the VAT system's responsiveness when dealing with crises.

Avenue d‘Auderghem 22-28, 1040 Brussels

+32(0)2 893 33 60

www.accountancyeurope.eu

@AccountancyEU

Accountancy Europe

ABOUT ACCOUNTANCY EUROPE

Accountancy Europe unites 50 professional organisations from 35 countries that represent close to **1 million** professional accountants, auditors and advisors. They make numbers work for people. Accountancy Europe translates their daily experience to inform the public policy debate in Europe and beyond.

Accountancy Europe is in the EU Transparency Register (No 4713568401-18).