ACCOUNTANCY EUROPE.

LONG-TERM TAX POLICY CHANGES FOR A SUSTAINABLE RECOVERY

Discussion paper

IDEAS.

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HIGHLIGHTS

The coronavirus crisis has given us an exceptional opportunity to make large changes to tax systems to produce a more sustainable economy. All parties must work together to build sustainable tax systems - an essential component to sustainable economic growth. This publication proposes recommendations for business and governments to achieve this objective:

Businesses and their advisors should be prepared to play their part in the recovery, acknowledging governments' roles in their survival and adapting their tax policy to new societal expectations. These include enhanced transparency, forsaking abusive tax practices, and working with tax authorities in a cooperative manner.

Governments should consider the adequacy of their current tax systems and, after a thorough analysis, consider whether they should broaden their tax base, put increasing emphasis on certain forms of taxation or introduce new taxes.

Next to these more long-term measures, our accompanying paper Short-term tax measures: Supporting businesses through the Coronacrisis, highlights direct and indirect tax measures that governments should consider in the short term.

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LOOKING TO THE FUTURE

The recovery from the coronavirus crisis provides an opportunity to refocus the economy, creating jobs and a providing a working environment fit for the future. Governments should also consider effective tax measures to promote investment by the private sector in the circular economy, and in such areas as sustainable energy and green transport. This must be supported by public sector investment in sustainable infrastructure projects.

A lot has been, and will continue to be, asked from governments, lawmakers, and tax administrations. But businesses, and their advisors, must also contribute to the recovery of the economy and social fabric of society. Citizens expect everyone to play their part and there is increased intolerance of aggressive tax planning.

We call upon businesses to examine their current tax policies and relationships with tax authorities to ensure that they are suitable for a period of fiscal shortage, and the increased societal expectations for businesses to play their role in the recovery.

The paper examines options that may help put us on the path to building modern, robust, and fair tax systems fit for Europe's future. In the longer term, society needs a simple, robust, and transparent tax infrastructure that will support governments and the EU to achieve its climate, social and financial objectives

We have also published the accompanying paper Short-term tax measures: Supporting businesses through the Coronacrisis, where we highlight measures for both direct and indirect tax that governments to support struggling businesses in the short term.

Some 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.

THE ACCOUNTANCY PROFESSION'S ROLE

The accountancy profession has a vital role to play in developing sustainable tax systems and accountants' roles will change with increasing automation. Accountants will continue to apply their technical expertise to help evaluate and systematise changes to the tax system, to explain these changes to taxpayers and ease their transition to the new rules.

As tax systems adapt to deal with new challenges and trends, such as reducing carbon emissions and increased transparency, the breadth of skills that the profession has in other areas, such as in financial and non-financial reporting, assurance, and system design, will also be invaluable.

RECOMMENDATIONS - LONG TERM TAX POLICY MEASURES

RECOMMENDATIONS FOR BUSINESSES: CORPORATE RESPONSIBILITY - TRUST, TRANSPARENCY & EFFICIENCY

UNWINDING OPAQUE STRUCTURES

If companies do not take action to withdraw from potentially abusive arrangements, they should not expect to have access to support packages paid for by other taxpayers. We have seen countries such as Canada, France, Denmark, and Poland link the provision of support packages to businesses to their good tax governance and/or greening their business model.

Businesses using opaque structures and/or holding companies based in non-compliant jurisdictions should be given time to unwind such structures before access to support packages is denied. Otherwise, lower paid employees could suffer. Senior management could commit to unwind the structures, within a predetermined timeframe. The management would be personally liable should the business fail to take the promised actions, and support payments already made would be recovered.

Companies also realise the potential for good messages in this space. Those that have remained profitable during the crisis are handing back support package payments and property tax rebates. By September 2020, the UK government estimated that over 80 000 businesses (including household names such as Ikea and Bunzl) returned support payments. Others, such as Primark, announced that they would not draw on such support measures, despite being eligible.

Accountants should also consider the suitability of the tax advice that they give their clients in light of increased public expectations and scrutiny. We refer tax practitioners to our publication Accountants & Tax, (February 2020), which sets out some basic principles covering tax planning advice.

WORKING TOGETHER AND COOPERATIVE COMPLIANCE

Business and tax authorities should work more closely to improve the trust in and efficiency of the tax system.

We support the introduction of a pan-EU cooperative compliance system. Cooperative compliance should be available to all compliant businesses, irrespective of size, that are willing to provide enhanced transparency in return for more tax certainty and a better relationship with tax authorities. Voluntary compliance saves costs and increases capacity for business and tax administrations. We strongly support the European Commission's (EC) work to develop a pan-European cooperative compliance framework, supported by an EU Taxpayers' Charter.

BUILDING TRUST

We recommend that all large businesses voluntarily adopt a code of conduct for their tax practices (for example, the tax code of conduct published by PensionDanmark). Where large businesses wish to benefit from further support measures or tax incentives, governments should consider requiring that they endorse a statement that they will abstain from artificial tax planning activities (where businesses lower their tax bill outside normal economic activities).

To improve trust, companies should voluntarily adopt tax transparency measures, such as the Global Reporting Initiative's GRI 207, to the degree relevant for the size and complexity of their business. As with the tax code of conduct, access to support packages and /or tax incentives could be made conditional on such enhanced public tax transparency - particularly for larger businesses.

DIGITALISING TAX SYSTEMS

We would also recommend that business plays its part in helping governments to modernise tax administrations and boost their digital capacity. This will bring long-lasting benefits to both business and to citizens, and create a more robust, green, and efficient tax system.

RECOMMENDATIONS FOR GOVERNMENTS

FIGHTING FRAUD AND CORRUPTION

Governments must do their part to restore trust in the tax system, which is crucial for its acceptance and effectiveness. Trust leads to voluntary compliance. Businesses have a fiduciary responsibility when it comes to tax behaviour. However, EU citizens, who contribute most of the taxes (collected through income and payroll taxes, social charges, and VAT) are not only looking at large enterprises' tax behaviour. They also look at how their tax money is spent and whether criminals who misuse public funds are brought to justice.

The EC should be innovative in breaking down barriers between tax administrations in the fight against tax fraud – whether they arise though legislation, audit methodologies or pure self-interest. Tax fraud, especially in respect of VAT, is still possible on a large scale. This is due to non-alignment between tax administrations when it comes to cross-border exchanges of information, and non-standardised tax audit practices. Initiatives to improve information exchange or cross border audits are often met with bureaucratic or (perceived) legal obstacles.

The latest amendment to the EU Directive on Administrative Cooperation in the field of taxation in the EU ('DAC 7'), which provides for the automatic exchange of annual information to digital platforms, is an important step in the right direction.

OVERSIGHT OF EUROPEAN FUNDING

Recent fraud and corruption cases involving European funds and subsidies have eroded EU citizens' trust in the European institutions. Anti-fraud and anti-corruption activities must be strengthened, especially as the EC is considering introducing new taxes for its own funding (such as a digital levy and the Carbon Border Adjustment Mechanism).

We urge the Commission to strengthen its audit and anti-fraud framework in respect of the use of European funds, and to enhance the transparency of these measures for the wider public. The Covid-19 support packages will see an unprecedented flow of money from the EU towards Member States. If these funds are not used in an appropriate manner it could destroy the very fabric of the European Union.

The accountancy profession is willing to assist with the design of such a framework.

SUSTAINABLE TAX SYSTEMS

As highlighted in our Sustainable Tax Systems project (March 2020), sustainable tax is a fundamental element to support the shift to a sustainable economy, whereby progressive tax systems promote sustainable investment, help reduce inequality, and take account of new business models and societal developments.

Current tax systems are rooted in the world of bricks and mortar businesses that had low mobility and whose business model relied on the constant consumption of resources. Tax systems are ad-hoc, complex and largely opaque to citizens.

Sustainable tax systems are transparent to their citizens. Changes are clearly communicated to explain the reasons behind the changes, their likely consequences and what measures are being undertaken to deal with negative impacts on society's vulnerable sectors. Only with this transparency will the necessary changes to tax systems be socially acceptable.

DIGITALISING TAX SYSTEMS

Sustainable tax systems also deploy information technology to provide a better user and customer experience, fight abuse and help ensure the adequate funding of public services.

The coronavirus crisis has highlighted the importance of investment in information technology in both the public and private sectors. It has facilitated remote working by many staff and been instrumental in the successful roll-out of rapid response assistance measures. Along with private sector investment in IT systems, we also call for further government investment in tax authorities, to improve the efficiency and resilience of tax systems and build the tax authorities of the future.

In the short-term:

- tax authorities should accelerate the digitalisation of their guidance and their processes. Information and guidance should be freely available online, with more complex guidance provided by interactive tools. Access to filing and reporting should be online, with a streamlined registration process for taxpayers. Tax returns should be pre-filled based on information received from other sources and from real time reporting
- governments should offer a single, interactive, business registration portal that allows new business to register with all relevant government departments, thereby reducing administrative burdens for all parties, improving compliance and reducing errors.

In the longer-term:

- tax authorities should adopt 'real time' reporting of business transactions - with additional safeguards that ensure that the other party to the transaction has recorded the same amount. This will reduce the opportunity for mistakes and fraud, simplify reporting and tax audits, and ultimately reduce costs for all stakeholders. This process should start with larger businesses and then filter down to smaller entities once the systems have proven effective
- tax authorities should develop a secure digital 'fingerprint'. This will facilitate access to the services mentioned above, reduce fraud, facilitate know your client checks and improve access to banking services. Developing and promoting a European standard could help facilitate cross-border trade
- governments should improve the interconnectivity of their various systems. This, with the digital portal mentioned above, would reduce the need for taxpayers to submit the same information to multiple departments and avoid unnecessary duplication of work by government departments. It will also improve the efficiency of anti-fraud tools based on data mining
- governments should develop effective tools based on big data mining and artificial intelligence to identify risks of tax leakage and to identify those taxpayers that may require assistance in complying with their tax affairs
- taxation authorities should review their existing processes to assess the degree to which they can be digitalised. For example, the repayment of withholding tax could be made far more efficient by digitalising the process, particularly in conjunction with a legal digital fingerprint

The EC's VAT in the Digital Age project details how effective digitalisation of tax systems requires investment in staff, including retraining, to make best use of new IT tools and focus resources where most needed. This would facilitate, for example, the fight against misuse of support measures and tax evasion.

Governments should also review how well their tax systems have performed during the crisis and how sustainable they are for the future. There should be a broad review of how the tax systems could be simplified and improved. It should be examined how resources can be moved from unnecessary administrative functions to where they are needed – such as the fight against fraud.

As part of this review, the relationship with taxpayers should be examined - moving towards a more trust-based system for compliant taxpayers, incorporating such features as co-operative compliance, tax assurance (as set out in our paper Providing support in tax controls and assurance (May 2018)), good tax governance and voluntary tax transparency. We will consider how governments could review their tax systems later in the paper.

STIMULATING SUSTAINABLE ECONOMICS

Current low interest rates reduce the urgency to repay government debt but, for intergenerational equity, governments will have to reduce historically high levels of government debt. Tax policy has a big role to play in the recovery by encouraging growth and by boosting tax revenues, as recognised by the OECD.

Effective incentive measures to foster investment

To stimulate recovery, the OECD has highlighted that the second phase of aid packages and tax incentives should be more targeted and that inefficient incentives should be withdrawn.

Governments should properly design and implement support measures and incentives. Such measures should promote additional investment. Poorly designed measures may only influence the timing of behaviour - a particular issue with time-limited incentives or where there is a long interval between announcement and implementation of incentives.

Sustainable economics are essential to fund the recovery. Simply raising taxes in a depressed economy will not raise sufficient funds to reduce government debt and may hamper growth. Policies are needed to foster investments, reduce unemployment and promote the creation of skill sets and jobs suitable for a digitalised economy.

Incentivising a sustainable economy

However, it is not necessarily the case that economic growth will be, or should be, a return to business as usual. It is possible that the coronavirus crisis could produce long-term changes in behaviour, such as reduced business and personal travel, increased working from home, and acceleration of the development of e-commerce in all its forms.

We believe that such changes will have long-term benefits for a sustainable economy. Incentives should be focused towards stimulating developments in digitalisation (including the digital infrastructure) and green technology. An example of such investment can be found in the German stimulus package. This may not be the norm. For example, the OECD has reported that 'over 50% of policy support for energy in recovery packages is going to 'brown' fossil fuels'.

In the short-term, governments should introduce measures to support the circular economy. In the long-term society should move towards a more sustainable business model - where businesses are not expected to maximise profits irrespective of externalities, but rather work with society to help deal with the pressing issues of the 21st Century. This may reduce tax yields (as profitability would be reduced) but this would be offset by the costs saved in having to deal with negative externalities.

CONSIDERING ADDITIONAL FUNDING FROM TAX SYSTEMS

It is likely that national tax yields will remain depressed for some time due to:

- reduced consumer confidence, which both reduces overall consumer spending and means a greater proportion of spending is on essentials that often carry reduced rates of VAT
- longer recovery time for profits taxes (for example, until losses are fully utilised)

Governments will probably need to examine whether additional tax revenues can be raised that don't hamper the economic recovery. This could be done through a combination of broadening existing tax bases and introducing new taxes.

BROADENING THE TAX BASE

Governments could broaden the tax base by plugging gaps in the existing tax systems that allow some incomes and gains to be untaxed or easily avoided. Governments could also examine underused tax bases, which could also be linked to other policy objectives.

Depending on a country's existing tax system and tax culture, governments could review:

- **existing reduced rates of tax** (especially in respect of VAT). Quite often, reduced rates are costly, complicate tax systems and fail to achieve the policy objectives that led to their introduction. In many circumstances, the objective of making VAT more progressive for lower income families could be achieved in a more cost-effective way by direct grants
- **tax exemptions**. Some of these, for example VAT on financial services, result from legacy difficulties in establishing an effective tax base - which modern developments in information technology have reduced or eliminated. The EC has launched a public consultation on the current exemption for financial services and some individual countries are also examining this issue
- **alignment of the tax treatment of capital gains with the taxation of income**. This measure could address some of the increasing concerns about the growing level of inequality
- **taxes on inheritance**, to ensure that they properly integrate with other taxes, are progressive, do not contain unnecessary exemptions, and are not easy to avoid
- **the equity and effectiveness** of differential rates of taxation between earned income and savings income (often subject to lower taxation), which may also help with income inequality issues
- **increasing tax revenues from real estate taxes**, which are also relatively undertaxed compared to other taxes on income or consumption and are difficult to avoid or evade. Depending on the existing tax system, this could include taxing income from property at the same rates as other income. It could also involve, for example, applying the normal rates of VAT to residential property acquisition

INTRODUCING NEW TAXES

Many countries are already considering introducing new temporary or long-term taxes. Introducing new taxes should not be rushed. Their effectiveness in raising revenue, the economic distortions they cause, and the ease of implementation and compliance should be considered.

The tax system neutrality should be reviewed to ascertain whether new taxes are intended to solely provide additional revenue or could be used for other positive outcomes (e.g.: using new environmental taxes to reduce employment taxes with the aim of increasing employment).

On the introduction of new taxes, it would be beneficial to have a formal review provision incorporated on drafting, so that the effectiveness of the tax, and any negative consequences, are reviewed after, for example, 2 years following their introduction.

The following are examples of measures taken globally rather than specific recommendations for all countries.

Digital taxes

Not all sectors of business have suffered equally during the crisis - with digitalised businesses often having been seen to benefit from the crisis. This has led to an increased focus on increasing the tax burden on the digitised economy.

For example, Poland has introduced a tax on Video on Demand platforms to support local film makers hit by social distancing measures.

Many countries are considering, or accelerating, the introduction of less specific digital taxes, particularly in the form of a levy on income from digital services. The OECD has suggested that this could hasten acceptance of their Pillar One proposals for taxing highly digitalised companies.

Wealth taxes / taxes on capital

Other countries are considering extraordinary wealth taxes to help fund national support and recovery programmes. For example, Argentina has introduced an extraordinary wealth tax on those with assets worth more than 200 million pesos (€2 million) – at rates of 3.5% on wealth in the country and 5.25% on wealth abroad. Spain is also considering a wealth tax, with wealth over €10 million taxed at an extra 1% and income over €200 000 at an extra 3%.

Such measures will bring in additional revenue in the short-term, but their longer-term impact is hard to measure. They may introduce market distortions that change taxpayers' behaviour and provide more incentives for avoidance and evasion. A more fundamental review is desirable for the longer-term sustainability of tax systems. It should consider filling gaps in the tax system, expanding and simplifying tax bases, and more effectively taxing economic rents rather than specific business sectors or taxpayers.

Although taxation's role is primarily to raise revenue for governments, it can be effective in changing behaviour. Governments should consider the benefits of introducing new taxes, or placing more emphasis, on taxing activities with undesirable externalities.

Environmental taxes

Environmental taxes currently only provide a small proportion of total tax revenues in most countries. Governments should consider placing more emphasis on 'green taxes' to help reduce carbon emissions (and pollution and waste). This is already a focus of the EC, with its work on revising the Energy Tax Directive, reviewing VAT rates on fuel and the taxation of passenger transport, and considering the introduction of a comprehensive Carbon Border Adjustment Mechanism to bolster its Emissions Trading System.

It is always difficult to make significant changes to tax systems and, especially, to introduce new taxes. We now have a rare opportunity when many citizens will accept that there is a need for decisive and forward-looking action. Significant changes should be more acceptable to citizens. For example, both Canada and Iceland conducted a gender fairness review of their coronavirus support measures. These reviews are important because women have been disproportionately negatively affected by anti-coronavirus confinement measures.

The EC should also press ahead with its work in making the European VAT system more sustainable, removing aspects that are detrimental to the wider development of the circular economy.

There is also the potential for a 'double dividend' in respect of taxes that change behaviour – i.e. the main benefit of some taxes may not be the additional revenues that they raise but rather the reduced costs to society that come with a reduction in externalities. For example, reducing pollution may save more money through reduced healthcare costs and premature mortality than is raised by the introduction of the tax.

COORDINATING INTERNATIONALLY

Many of these proposed new taxes have international consequences, particularly on who has taxing rights to certain income, and on transfer pricing issues.

There should be international coordination of national recovery measures to increase the effectiveness of such taxes, and to reduce potential trade wars, or a race to the bottom. Even increased cooperation will not prevent disputes. Governments must work together to build a better dispute resolution process, building on the OECD's International Compliance Assurance Programme.

Action is also required at EU level. Tax must be better coordinated in Europe beyond a simple harmonisation of legislation. For example, although there is significant exchange of tax information between Member States, the quality of such information, and the degree to which it is used successfully, varies significantly. There are still many differences in Directives' transpositions and unified guidance is lacking when the legislation is implemented.

We recommend that existing directives and regulations are reviewed, streamlined, and further harmonised. Common guidelines should be issued that are applicable across the EU to achieve the same tax treatment in all Member States, with the same interpretation of the rules.

Taxpayers' protection and their rights in the EU should be improved to reduce cross-border tax controversies and double taxation, and to provide greater tax certainty. Policymakers should introduce a comprehensive dispute avoidance and resolution system in the EU. It should be obligatory for Member States to negotiate together and come up with a solution to problematic cross-border transactions and disputes on taxing rights.

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