Tax Expenditures: A post-pandemic bond in social contracts

By:

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Introduction

The start of 2020 brought with it very perilous times in which countries around the world were forced to close their borders in a concerted effort to contain the deadly COVID-19 which claimed over 7 million lives around the world in the first half of the year. Tax bases dwindled due to job losses and a correspondent decrease in income and sales taxes. As many governments scramble to come up with inventive policies to rebalance the economy and raise tax revenue, this is a call to revisit the relevance of existing tax expenditure policies as they may become redundant in a post-pandemic era.

Tax Policies and the Social Contract

Tax economists and tax lawyers sometimes argue that tax policies are a “poor vehicle for social policy”,(Mumford 2010) yet every major tax law contains a provision for tax expenditures. These tax expenditures can come in various

forms including incentives, special exclusion, special credit, a preferential rate of tax, a deferral of tax liability, exemption, or deduction from gross income (Li 2007). They are commonly used to influence economic behavior and attract investment into various parts of the economy. The US Department of Treasury also describes tax expenditures as "revenue losses" which are attributable to provisions of the tax laws.

Describing tax expenditures as "revenue losses" implies that they bring about only negative results; almost likening them to a willful waste of revenue, when that is not always the case. Just as other government expenses are incurred on the development of the state, tax expenditures are also geared towards the same purpose; to promote agriculture, research, healthcare and technology, among others. Such government expenses are not defined as "revenue losses". The reference to revenue losses may be as a result of the fact that this revenue is never actually received by the government and is allowed to be deducted or exempt during tax collection, but the end goal is the same.

In China, tax incentives were initially backed by the cultural perspective that offering generous taxes and granting honors to foreigners without calculating the value was a part of cultural hospitality and would encourage foreigners to participate in Chinese civilization. Revenue loss was unofficially estimated at CNY50 per year or up to 10% of local tax revenue in certain places (Li 2007). As Yaobin Shi, Chinese Vice-Minister of Finance pointed out; it is the overly broad objectives, overly simplified methods and loose administration, among other things that result in actual revenue loss.

In the United Kingdom, the National Audits Office released its Tax Expenditure Spend Report for 2019, which detailed the various tax expenditures available in the UK and the social policies they were created to tackle. The report revealed that the cost of tax expenditures in 2018-2019 was an estimated £155Billion from 111 tax incentives. This is £155Billion in state funds that were used as tax concessions and were applied in a non-uniform basis without adequate scrutiny from the tax authorities. Case studies were carried out, and it was discovered that the 10 largest tax expenditures had not been evaluated by the tax authorities, neither were frameworks or principles applied in guiding the administration of the tax reliefs. The committee was left to conclude that HMRC

did not even know whether a large number of tax reliefs were delivering value for money.

On the other hand, some countries like Nigeria have it embedded in statutory provisions that prior evaluations must be conducted by the sector Minister to determine the budgetary and financial implications of the tax expenditures. Nigeria's Fiscal Responsibility Act 2007 even goes further to state that granting of tax expenditures is only on the condition that they are "accompanied by countervailing measures" during the period mentioned through revenue increasing measures such as tax raises and expansion of the tax base.

The 2020 Pandemic[1] and the New Direction for Tax Expenditures

It goes without saying that contactless services would thrive over and above others during the lockdown. For example; Amazonrecorded a 26% increase in revenue than the same period in 2019 without the outbreak of the virus, while in-person service companies like Six Flags, United and Delta Airlines suffered as much as 50% to 60% reduction in market capital. It is possible that in some countries, companies in these thriving sectors may still enjoy tax incentives.

In April of 2020, it was recorded that 20.5 million jobs were lost in the United States of America alone in the month of April, thereby taking the unemployment rate to an all-time high of 14.7% (CBC News). It is forecasted that this rate may go up to 20% at the end of June 2020 (Bartash 2020). This is more than the post-world war unemployment rate of 10.8%. A lot of developing countries like Nigeria already suffer a low tax to GDP ratio, and the highest revenue from taxes are sourced from income taxes. In 2017, the highest share of tax revenues in Nigeria was contributed by corporate income tax (45%) and the second-highest share from personal income tax (16%) (OECD 2019). With the loss of jobs and businesses, it is only expected that the largest contributor to Nigeria's taxes will reduce as well without a corresponding reduction in the already existing financial obligations on the government. In addition, in June 2020, Nigeria's federal government made an upward revision to the 2020 budget by ₦300billion, with ₦186billion of those funds allocated to the healthcare sector alone.

Mckinsey's COVID-19 Briefing Note has posed an important question: 'Is the money directed in the best possible way?' [2]Although the question is focused specifically at new COVID relief funds being introduced by various governments, this question should be applied to all tax expenditures used by the governments pre-pandemic as well. Without disregard for the already existing needs in the society, optimizing or building new infrastructure and policies to meet the needs of the post-pandemic economy may be expensive to manage without a corresponding rise in taxable income or a change in tax expenditure policies. For example, Nigeria recently increased its federal budget by ₦300billion and created a COVID intervention fund of ₦500billion. Also, in Kenya, the PAYE tax bands, turn over tax and companies income taxes have been strategically reduced as a means to keep money in the hands of Kenyans during the pandemic (KPMG 2020). While both governments are providing some form of relief to their citizens, these do nothing to increase revenue income.

Rather than creating new incentives to add on to existing tax expenditure policies, there is a pressing need for governments to look back at existing tax expenditures and question the relevance of those policies in this season and the degree to which they can be suspended or modified. For example; in the case of the 3 to 5 years' tax holiday granted to the pioneer industries in Nigeria, can the scope of these grants also be enhanced by mandating stricter local content engagement in their businesses to create more work opportunities for indigenous companies? This way, existing legal framework can be maximized by redirecting incentive funds to the pandemic battered local companies, thereby keeping money in the hands of citizens and raising income revenue for the state.

Conclusion

The one that pours water into a leaking basket and expects the water to remain is only setting themselves up for disappointment. So far, we have discussed tax expenditures and how useful they can be for growing sectors of the economy. However, it would be counter-productive to introduce new tax policies as COVID reliefs without considering that existing pre-pandemic policies may have become redundant and a source of revenue loss during this period. It cannot, therefore, be over-emphasized that if tax expenditures are redirected or even

suspended, this has a chance of greatly enhancing many governments' COVID relief efforts and kick-starting various parts of their economies.

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[1] In December of 2019, China reported its first cases of the COVID-19 outbreak in the city of Wuhan. As the rate of infection spread across China and subsequently across the world, infection numbers and death tolls began to rise and many countries were pressed to implement containment measures which resulted in a historic halt of majority of the world's economies by the end of March 2020. To ensure business continuity amidst the lockdown, many companies had to develop and implement digital business continuity plans, and for some, to totally reinvent the wheel on how they do business in order to survive.

[2] June 18, 2020 COVID-19 Briefing Notes.

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