IMPACT OF THE COVID-19 CRISIS ON TAX TRANSPARENCY

- A GLOBAL LOOK AT THE ISSUE -

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World Economic Impact

In the June 2020 "Global Economic Prospects" report, the World Bank indicates that "COVID-19 has triggered a global crisis like no other - a global health crisis that, in addition to its enormous human impact, is leading to the deepest recession since the Second World War. "

It later adds: "the base forecast envisions a 5.2 percent contraction on global GDP in 2020 --- the deepest recession in eight decades."

It further interests us in citing the following, from the same report: "The global recession would be greater, if controlling the pandemic takes longer than expected or if financial stress triggers a cascading default situation."

In short: this is a massive crisis and the forecasts remain uncertain, because the projections are based on an estimated date of control of the pandemic, which could vary.

Economic Impact in Panama and its tax revenues

On the economy of Panama, let's use as a

reference what was published by INDESA Capital in its LinkedIn account, on July 3, 2020: “According to the figures of the Monthly Rate of Economic Activity (IMAE) published by the INEC today, on April the Panamanian economy contracted 34.7% and from January to April, 7.4%; reflecting the impact of the health emergency caused by COVID-19”. And this does not include the months of May and June.

As for the Tax Collection of Panama is concerned, let's quickly review two data information, prior to the outbreak of the pandemic crisis in Panama:

On March 27, 2020, the International Monetary Fund published the “Article IV Consultation” with Panama, that is, an annual report that is made, after a visit to the country and based fundamentally on the situation of the previous year (2019). In that report, the IMF said:

“It is imperative to realign tax revenues and expenditures to sustain growth. Furthermore, to improve the capacity of both, the tax and customs administrations, it is necessary to review Panama's complex tax exemptions that continually erode the tax base." (The underlining is ours).

On the other hand, on March 4, 2020, FitchRatings released the Panama Risk Rating report, which is also fundamentally based on the performance of 2019. Under the "Key Rating Drivers" section ("Key elements that guide the Rating"), said report states the following:

“Confirmed Rating: Panama's BBB rating is supported by a robust and stable macroeconomic performance. This has as an offset, a relatively narrow government revenue base and an odd record of achieving fiscal consolidation targets. The Government revenue has consistently fallen short relative to economic activity.” (The underlining is ours)

In the “Rating Sensitivities” section, the report later adds:

“Fiscal Predictability, Revenue Improvement: An increase in the credibility and predictability of the fiscal strategy would be positive for the rating, leading to an improvement in debt dynamics in the medium-term and sustained improvements in tax collection which broadens the flexibility of fiscal policy. " (The underlining is ours).

Furthermore, in the “Rating Factors” section, under the “Weaknesses” subsection, FitchRatings included the following two items:
“The tax revenue base is relatively narrow relative to that of its peers.

Government revenue growth has consistently fallen short relative to economic activity. ”

"The poor performance of income could reflect structural issues in the tax agency and issues relating to tax evasion."

In conclusion, we have that for IMF and FitchRatings, the Panamanian State, before the COVID-19 crisis, had a weak income that was already the weak link of the government's fiscal performance.

As we mentioned, both reports were made bearing in mind, the preliminary figures of 2019 Current Income that had already been published by the General Directorate of Income (DGI). These Current Income are made up of 3 items: Tax Income, Non-Tax Income and Other Income.

Preliminarily, it turned out that the Current Revenues for 2019 totaled an amount of US$ 8,099 million, meaning: US$645 million less than in 2018. In particular, Tax Revenues totaled the majority of Current Revenues, for an amount of US $ 5,345 million in 2019, that is: US $ 333 million less than in 2018. [1]

This is what the scenario looked like when the pandemic and its devastating effects arrived.

By May 2020, the accumulated Current Revenues, in preliminary figures, were already 24% under, for the same period in 2019. And in the specific case of the accumulated Tax Revenues for that same date, these were already 29% below the same period on 2019.

What about the other countries? We have discussed the case of Panama, as an example, because it is the one we know. However, regardless of the background of the income behavior of the other countries of the world, the published reports coincide in indicating that it is a fact that the double shock of the economic crisis of the pandemic is giving an unforeseen and brutal blow to the public income of all Taxes, national and/or territorial entities.

Many developing and emerging countries will be facing similar scenarios to that of Panama, others with better levels will also be hit hard. The rich alike, without a doubt.

The solutions will require restructuring the tax systems and fighting tax evasion.

The pandemic is still fully active. We are still in the middle of the storm, especially in the American continent. It is only logic to think that the States are more concentrated on the economic reactivation and stimulating growth, however, no matter how indulgent we want to be, it is clear that the social

[1] See news from the Panama City newspaper La Prensa, February 12, 2020: "Revenues fall $645 million."

spending and public investment that must be put into play to manage, to say the least, if the situation is reverted to the pre-pandemic state, it will be colossal.

Where will the money come from in the next few years? Of the debt? With regards to this issue, the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) issued a press release on July 6, 2020, regarding the publication of its 2020 Economic Outlook report. On said publication, it states that in our region:

"... the currently management of fiscal policy is complicated by an unfavorable and highly uncertain macroeconomic environment. In addition to the increases in public debt observed during the last decade, the fact that due to the pandemic, countries face the falling of tax collection as a consequence of the contraction in economic activity and lower prices of basic products (commodities), while expenses needs are rapidly increasing to mitigate the social and economic effects of the pandemic. "

In our opinion, the largely paralyzed economies cannot be squeezed with more taxes initially. Putting the gear to work again, with minimum obstacles and with the stimulus of the State, is the main goal.

Eventually however, the overwhelming social needs, the fact that the crisis has hit the entire world, reducing the space to get loans and the ever-increasing strengthening of the concept that the signs of true mobilization of domestic resources, is a precondition for foreign aid, it will force, at some point, to take a look at what can be done on the tax side.

The discussion has already begun. For starters, with the debate on the taxation of the digital economy and the "Google tax", which had already been on the table before the crisis, due to unilateral approaches and laws, but also through multilateral channels towards dialogues for Action 1 of the BEPS Plan.

But there are many other options on the table, from environmental taxes, with their dual role, to increases in VAT (known in Panama as ITBMS), wealth taxes, review of exemptions and progressively of Income Tax.

We are a long way from reaching conclusions. The truth is, that it seems as if the redistributive element of wealth that taxes also have, will raise its profile in the Fiscal and Economic Policy post COVID-19. Each country has its own reality and time will tell what the results will be.

That said, the best collection does not only come from increasing or creating taxes. Reducing the evasion of existing taxes is a fundamental way. In fact, as I have said on previous occasions; reducing evasion, prior or parallel to the increase in tax pressure, is an ethical imperative: because increasing the tax burden of those who generate wealth, without reasonably combating and controlling tax evasion, is a reward for evaders, because those who have always paid would still pay more and those who don't pay will continue to do the same.

In this regard, let us once again quote the already mentioned statement from ECLAC:

"ECLAC estimates that the region lost 325,000 million dollars - equivalent to 6.1% of GDP - in 2018 due to tax non-compliance. Evasion of corporate income tax in the region is especially acute. Tax systems in some countries generate less than 50% of the income from this tax that in theory they should generate, resulting in tax gaps of between 0.7% of GDP and 5.3% of GDP. Faced with this challenge, countries of the region are developing a series of actions and innovations to limit the spaces for evasion and thus promote the mobilization of internal resources to finance the Sustainable Development Goals of the 2030 Agenda."

That is in the case of Latin America, but the issue is a global challenge: it happens in the United States, Asia, Africa, India, everywhere, in some places more than others. For example, let's read an excerpt from the March 5, 2020

speech by Paolo Gentilone, European Commissioner for the Economy, on the priorities of the European Commission in regard to the tax policy of the European Union:

"Tax fraud and evasion are a threat to the very foundation of our social model. They eat up the public revenue needed to invest in our people and infrastructure. They abruptly disrupt the level playing field for our businesses and erode public trust in our tax systems. And they interrupt the development of smarter, greener and more competitive economies, as Member States are pulled into a race to the bottom to attract highly mobile companies. Thus, the work to combat these abuses must continue with full force under this Commission. And allow me to assure you that it will continue. A great deal of work has been done over the past 5 years to strengthen our defenses against tax abuse. As a result, the UE has a strong fiscal transparency structure and rules to block some of the most prominent forms of aggressive tax planning. There are proposals on the Council table to modernize VAT and end cross-border VAT fraud that costs our Member States 50 billion euros per year. "

So far we have:

- The economic crisis derived from COVDI-19 is deep, it will be long and global.
- State revenues around the world will be hit hard.
- States need to improve their income to face the enormous public and social spending required to face the consequences of the crisis.
- Although in a first stage there is no increase or creation of taxes, it is a fact that in the long run it will not be possible or realistic to face the challenge in a sustainable way, based only on debt and commodity prices.
- Eventually the States will have to look towards restructuring their tax systems to mobilize domestic resources.
- While the long discussion about possible increases or tax creation progresses, it is a sure fact that the fight against tax evasion generates an important collection opportunity.

Now, what does Tax Transparency have to do with all of this?

Tax Transparency as a tool to combat tax evasion

It has already been specified: the fight against tax evasion will be a key element in the recovery of income of the States in the post COVID-19 economies, well, within this area, the tools of Tax Transparency, especially the exchange of information between States for tax purposes, are fundamental in the legitimate struggle of all countries to combat tax evasion.

The exchange of information for tax purposes works within the same logic of multilateral cooperation among States to face, as a team, problems that are transnational in nature. For example, States exchange information to combat violations of customs and agricultural quarantine regulations, to capture fleeing persons with an arrest warrant, to combat drug trafficking, trafficking in women, illegal trafficking of cultural heritage and animals, and protected plant species, pedophilia, illegal immigration, corruption, money laundering from serious crimes, arms trafficking and matters of a similar nature.

Tax evasion is also a transnational problem, because large evasions usually require operating structures and logics that involve more than one country.

The exchange of tax information is a system that may be useful for countries with a criterion of link with the tax authority by source of income, by tax residence or by nationality. Technically it has been proven.

The world of legal frameworks for information exchange is vast. In fact, there are several forms of information exchanges for tax purposes. The most evolved and generalized legal framework is the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, known as "MAC" promoted by the OECD Global Forum. Panama, a member of this compromise, has approved all the complementary legislation and has been executing it for 3 years.

The two main types of information exchange that exist are as follows:

1. Exchange of Information on Request (EOIR): By means of the corresponding legal framework, following protocols, the Tax Administration of one country requests that of another country to share information with tax relevance for the investigation of specific cases.
2. Automatic Exchange of Information (AEOI): Also following a pre-established protocol, by electronic means, each year the countries exchange financial information, which can be used for investigations with tax impact. Relevant examples are the Common Reporting Standard (CRS) system, under the MAC convention, and the agreements (IGA) that the United States has to implement FATCA.

There are other formats for the exchange of information between States, for example the country-by-country reporting scheme, in terms of Transfer Pricing or the spontaneous Exchange of Tax Information.

However, the concept of Tax Transparency does not only involve the exchange of information between States. The underlying idea is that, as the tax issue involves the general interest, reasonable access to information be allowed to the State that facilitates the work of making fair taxation effective, respecting Human Rights. Thus, for example, in the EU there is the DAC6 Directive, applicable according to the domestic law of transposition to each Member State, according to which it is established that tax-paying companies inform the Tax Administration about signs of aggressive tax planning, within their operations in the European level.

Final Comments

It may be possible that we do not agree in part or even in whole with the Tax Transparency instruments, however, as a relevant mechanism in the fight against tax evasion, and given the renewed need of the States to increase their income, I estimate that the presence of these ways of strengthening tax collection will be stronger in the post COVID-19 world.

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