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The Impact of the Coronavirus Pandemic Crisis on the VAT Framework

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In these unprecedented times of the Coronavirus pandemic, governments all around the world are striving to sustain their health systems while managing, as far as possible, the economic damages caused by the pandemic crisis. One of the most compelling economic objectives of every government during this crisis is to keep businesses in operation while preserving, at the same time, employment levels.

Such a new economic reality has forced most countries to deploy unprecedented support packages for businesses. Although the implementation of those support packages was a necessary step for the survival of many businesses, one cannot oversee the potential adverse effects that will arise from their enactment, which may have manifold effects also on the VAT framework.

That being said, this contribution focuses on the VAT implications arising from the decision of governments to defer VAT payments as well as to introduce financial assistance measures based on a business' decline in turnover.

Deferred VAT Payments

One relatively common measure implemented by several countries, such as, *inter alia*, Brazil, Cyprus, Greece, Italy, Sweden, and the United Kingdom, is the possibility for businesses to defer their VAT payments.

The prime aim of this measure is to inject liquidity into the economy to help businesses carry on. This measure is expected to affect the revenues of national governments in the short-term, but it will eventually allow those governments to collect the tax due in the future.

It is true that the above measure will, at least in the short-term, provide some breathing space to businesses in order to cope with the devastating effects of the pandemic. However, a question arises in relation to the long-term impact of such a deferment strategy, which will eventually evaporate once the payment of VAT becomes due. Namely, will businesses be able to pay the deferred VAT once it will become due or, instead, will they struggle with such an obligation, with further financial complications for them?

The answer to the above question would indeed depend on several elements, such as the economic recovery rate, the VAT deferral time-period, as well as the magnitude of the financial aid. In addition, it is more accurate to assume that the baseline scenario above will apply, mostly, to small-medium businesses, i.e. taxpayers that have a tendency to evade taxes due to the lack of separation in ownership and control as well as their peculiar structure and limited resources to cope with their VAT obligations.[1]

In order to avert a scenario where businesses are in default of their VAT obligations, on the one hand, there is a need for businesses to understand that their VAT obligations towards the government are ultimately destined to remain unchanged and, thus, carefully plan and put resources aside to make the VAT payments timely and as required. On the other hand, governments should consider the possibility of granting businesses some flexibility in the payment of VAT, for instance by allowing payment of VAT in instalments.

Financial Aid

Alternatively, or in addition to a deferral of VAT payments, several governments have decided to provide financial assistance to businesses that have reported a decline in their turnover due to the COVID-19 outbreak. Although financial aids may vary greatly across countries in terms of thresholds and methods for liquidity assistance, all these financial aids have taken turnover levels as a determinative factor.[2]

Although not directly related to VAT, this type of measure may indeed have an indirect impact on the VAT framework and, in particular, on VAT evasion levels. More specifically, the implementation of the above measures may give businesses an opportunity to intentionally enter into tax evasion strategies in order to falsely report a reduction in their turnover. The ultimate goal of a cheating business will be to enter into the scheme and receive the financial aid granted by the government. A commonly used strategy to evade the VAT due relates to under-reporting of sales. In other words, the opportunity to receive assistance from the government may drive businesses to employ strategies in order to be eligible for the financial aid. In this context, taxpayers' behaviours will be driven by the uncertainty in the market and economic instability as a result of the pandemic.

Also in the case of financial aid, worries relating to an abuse of this measure seem more applicable to small-medium businesses, which appear to be more prone to engage in VAT evasion[3], as well as to businesses that find themselves at the last stage of the transaction chain, i.e. before the end consumer. It might also occur that the effects on tax evasion will vary across countries depending on other factors such as the level of tax morality within a country.

In light of the above, governments may consider introducing stricter conditions for the granting of financial aid aimed at addressing the possibility for businesses to engage in such evasion strategies. For instance, a possible condition would be to allow the imposition of targeted and severe penalties on businesses that have intentionally reported a reduction in the turnover in order to receive an otherwise undue financial aid. Despite the practical difficulty of detecting non-compliant businesses, the fear of punishment might in fact disincentivize those businesses to engage in tax evasion practises in order to report a decline in their turnover levels.[4]

Conclusion

To conclude, the implementation of measures to assist businesses during these difficult times will be a crucial aspect for the global economy and its recovery after the COVID-19 crisis. Despite this, it is equally important to take into consideration that the implementation of rapid measures might create undue effects as those measures risk distorting the VAT framework as currently established. Yet, the above analysis does not aim to disregard the importance of the measures in question.

Rather, it suggests that adjustments need to be made in order to ensure that the system is not abused or leads to adverse outcomes.

[1] As a matter of fact, shareholders in large companies are not directly accountable for the company's tax strategy, making them not directly concerned about the company's strategy to influence tax policy. For this reason, owners of SMEs are more sensitive to any changes in the financial situation and they are more tempted by tax evasion opportunities. On the influence of separation of ownership and control on tax compliance, *see*, e.g., K. Yiallourou, *The Limitations of the VAT Gap Measurement*, 28(4) EC Tax Review, 196 (2019); Y. Keinan, *Corporate Governance and Professional Responsibility in Tax Law*, 17(1), J. Tax'n & Reg. Fin. Inst., 10 (2003).

[2] Notably, countries that have currently implemented a financial aid scheme granted based on a business' turnover include Cyprus, Denmark, France, Ireland, New Zealand and Spain.

[3] On the tendency of small-medium enterprises to evade VAT, *see*, e.g., D. Joulfaian & M. Rider, *Differential Taxation and Tax Evasion by Small Business*, 51(4) Nat'l Tax J. 676 (1998); A. Swistak, *Tax Penalties in SME Tax Compliance*, 40(1) Fin. Theory & Prac. 130 (2015).

[4] On the effects of tax penalties on tax evasion levels, *see*, e.g., L. Lederman, *Report for the European Association of Tax Law Professors 2015 Congress: Tax Penalties as Instruments of Cooperative Tax Compliance Regimes*, Indiana Legal Studies Research Paper No. 320 (2015).

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