

# COVID-19: The impact on VAT/GST systems

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## In brief

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The COVID-19 pandemic has elicited a very different response when compared to previous financial crises. For example, governments cannot lean on policies that might increase demand, the standard fiscal stimulus for a regular economic downturn. Many governments are adjusting VAT/GST systems as a rapid response measure to assist with financial liquidity. In this Bulletin, we look at three specific areas:

- How the COVID-19 crisis is impacting VAT/GST systems
- Measures governments have announced in response to the crisis
- Looking beyond the crisis - a time for change.

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## In detail

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### Background

Globally, governments are taking action to control the spread of the COVID-19 virus whilst trying to mitigate the adverse impacts on their citizens and economies of drastic health-related measures, such as social distancing, self-isolation and lockdowns. In particular, governments are employing a wide range of fiscal reliefs and support to help households and businesses through the immediate storm. Governments will need to remain flexible in responding to the evolving health and economic challenges. In the long term, governments will need to consider how best to restore public finances without further damaging economic recovery as countries emerge from some of the stricter aspects of the current containment phase.

During the 2007 - 2009 financial crisis, tax revenues from all sources fell dramatically. However, revenues from consumption taxes were typically less affected than revenues from other bases such as corporate income tax, as highlighted in the OECD's report '[What drives consumption tax revenues? Disentangling policy and macroeconomic drivers](#)'. As such, VAT/GST historically has been seen as a more reliable and less volatile form of tax revenue both in good times and bad. In addition, it is relatively easy for governments to administer. However, the nature of the current circumstances is very different from that of the financial crisis - in particular, governments cannot lean on policies that might increase demand, the standard fiscal stimulus for an economic downturn.

### Some immediate impacts of the COVID-19 crisis on VAT/GST systems

As a result of the sudden imposition of strict containment measures, businesses have seen their revenue decrease or in some cases disappear completely overnight, whilst still incurring fixed running costs and trying to operate remotely from 'home offices' in many cases. This has led to a number of significant VAT/GST impacts, including:

- **Reduction in business** - with fewer sales and less output tax, some businesses have suddenly found that their VAT/GST status has changed from being a payment trader to a repayment trader – i.e., pre-crisis they regularly paid VAT/GST over to the government, and now with expenses outweighing income the government owes them VAT/GST. The cashflow impact may be more pronounced in countries with input tax carry forward regimes that only offer refunds by netting off against output tax; where import VAT/GST must be paid at the border rather than postponed to the VAT/GST return; and where return filing periods are on a quarterly (or longer) basis rather than monthly.
- **Customer default** - when a tax invoice is issued this creates a liability for the supplier to pay the related VAT/GST to the government, regardless of whether the customer ever pays. Given current circumstances, delayed or defaulted customer payments are creating cashflow issues for suppliers. Here, tools such as cash accounting (particularly important for SMEs), bad debt relief, assignment procedures, and other measures (e.g., VAT-free transfer of a going concern ('TOGC') treatment, exporter scheme reliefs, VAT/GST grouping, etc.) may assist, where available. Unfortunately, at present, the use of such instruments is not uniform and is often ineffective due to complexity or difficulty in satisfying the rules. However, there are a host of measures that businesses can take to ensure they are maximising their cashflow - this can be as simple as recovering VAT on expenses at the earliest opportunity or undertaking data analytics to identify accounting errors.
- **Practical challenges of operating in lockdown** - thanks to modern technology many business functions can continue to operate remotely during lockdown. However, there are challenges when it comes to certain aspects that are set up to operate in a more physical and less virtual world, such as the use of paper-based documentation to achieve legal formalities – e.g., issuing and receipting invoices, obtaining transport documentation, corresponding with tax authorities, making VAT/GST elections, participating in court procedures, etc.
- **Repurposing** - many businesses are repurposing their production lines to produce items such as hand sanitizer, disinfecting alcohol, facemasks, or medical devices such as ventilators. However, such changes can come with unexpected VAT/GST issues if goods are donated rather than sold - giving items away can create a 'deemed' supply for VAT/GST purposes, requiring the payment of output tax on the deemed value of the goods, or resulting in an input tax restriction on the basis of making a 'non-business' supply. Some reliefs do exist for donations. However, good intentions can prove costly if the VAT/GST position is not clearly considered in advance.

### Measures that governments have announced in response to the crisis

With assistance from institutions such as the OECD and EU, many governments have introduced the following types of measures to ameliorate the impacts of the crisis:

- deferral of VAT/GST, customs and excise duty payments
- accelerated input tax refund procedures
- more flexible time to pay procedures
- simplifying procedures for claiming relief from VAT/GST on bad debts
- extension of filing deadlines
- remitting or delaying the payment of VAT/GST penalties and interest
- postponement of regular tax authority audit and control activities
- enhanced provision of remote services, including relaxation of some of the more formal rules around tax authority correspondence and procedures

- additional guidance and open communication.

The rapid response by governments is providing relief to many affected businesses, and whilst some governments are doing more than others, all governments must balance between the objective of supporting households and businesses through the crisis and the longer-term requirement to raise revenue in the face of expanding fiscal deficits. There are two additional important points to note:

- Keeping up with the sheer volume and pace of new measures is challenging for both businesses and policymakers. In order to support businesses and governments in navigating the complex landscape, the Global PwC network has compiled, by territory, an extensive database of COVID-19 measures announced by governments around the world for VAT/GST ([link](#)), and for broader tax, legal and economic purposes ([link](#)).
- Whilst there may be VAT/GST reliefs available in many territories, the devil is (as always) in the detail. In particular, it is important to understand the detail and scope of the measures as to when they apply and who can benefit from them, as well as to consider issues of corporate responsibility and reputation prior to applying for or taking any relief. Looking ahead, there may be keen interest in how and on whom government money was ultimately spent.

### Looking beyond the crisis - a time for change

In their report 'Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience', the OECD focuses on how tax policy can aid governments in dealing with the COVID-19 crisis, looking at different policies and their sequencing to address different phases of the crisis ([link](#)). All the focus is currently on the immediate response measures required to manage the emergency and mitigation phases of the crisis. However, it is likely that attention will soon shift to measures to stimulate recovery and, beyond that, to mechanisms to balance the books in the longer term. These developments could provide the impetus for governments to take hitherto politically difficult steps to positively reform, simplify and improve global VAT/GST systems. We set out below some of the more important VAT/GST aspects that we expect could be up for consideration to foster future growth as well as to generate revenue for governments, taking into consideration both the design features and the technological aspects of VAT/GST systems.

- **Broadening the VAT/GST base** - often cited as an inherent problem in many VAT/GST systems, serious consideration is likely to be given to removing any exemptions and reduced rates that may be regarded as inefficient and which create complexity, legal uncertainty, increased costs of collection and administration, and diminished overall effectiveness of the system. However, it is clear that such a move could only be envisaged as part of a long-term strategy of reform including, where required, support for businesses and individuals using other, and better targeted, financial measures outside the VAT/GST system.
- **Remove unnecessary limitations to the right to recover input tax** - VAT/GST neutrality is a cornerstone of the system, and in principle the right to recover input tax should not be restricted. VAT/GST is intended as a tax on private consumption, but it has increasingly become a tax on business as well. Fast and efficient VAT/GST refund mechanisms are critical, as is ensuring that VAT/GST is not charged or paid to the government when it doesn't need to be. Changes to watch for in this area could include re-examination of areas such as cash accounting, bad debt relief, assignment procedures, TOGC treatment, exporter scheme reliefs, postponed import VAT/GST accounting, VAT/GST grouping, etc.
- **Efficient VAT/GST collection** – problem areas in VAT/GST are less related to the allocation of taxing rights (now reasonably settled in line with the destination principle) than poor systems design features. Improvements are needed in collection mechanisms based on a simple and consistently applied international VAT/GST framework, together with the efficient use of modern technology and expanded availability of cooperative compliance procedures.
- **Technology** - Clearly, technology alone will not suffice to ensure a fully functioning VAT/GST system in the future. Nevertheless, it is important to analyse and evaluate what kind of impacts technological developments (e.g., data analytics, real-time reporting, pre-filled returns, split payments, AI, etc.) could have on the design and operation of future VAT/GST systems, keeping in mind that technology: (1) is continually evolving at pace; (2) needs to converge (there currently are too many competing technological solutions); and (3) could address a fundamental question as to whether the staged collection process is still fit for purpose or could be replaced by enhanced digital accounting and

reporting processes. Importantly, in order to deliver effective solutions, there needs to be greater interaction between tax and technology stakeholders throughout the policymaking process (from inception to conclusion). Technology will continue to impact the structure and operational strength of tax administrations, where effective digitisation can increase compliance and reduce taxpayers' administrative burden.

- **Looking back and learning lessons** - finally, it will be important to look back on how VAT/GST emergency response measures were implemented in practice, to analyse their overall effectiveness, and to learn appropriate lessons considering both best practices for future emergencies and any underlying weaknesses inherent in current VAT/GST systems that need to be fixed.

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## The takeaway

For now, governments will continue to focus efforts on fighting the spread of COVID-19 whilst keeping their economies afloat. As we look to the future, it is clear that, whilst the crisis has produced both profound suffering and enormous anxiety, it has also resulted in a fundamental re-thinking of many aspects of the daily lives of people around the world. In that respect, the crisis can be an action-forcing event for both policymakers and businesses to promote beneficial change throughout society.

Taxation has a part to play in this complex puzzle, and, from a VAT/GST perspective, governments may have an opportunity to improve the neutrality, proportionality, practical administrability and security of the tax to better deliver for their citizens. With respect to VAT/GST and in numerous other areas, the weeks and months ahead will reveal how governments, businesses, and citizens respond to the moment.

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## Let's talk

For a deeper discussion of how these issues might affect your business, please call your usual PwC contact. If you don't have one or would otherwise prefer to speak to one of our global specialists, please contact one of the people whose details are set out below:

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