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COVID-19: Credits and incentives as an economic stimulus

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Tax credits and incentives are set to be an essential part of stimulus as countries seek to recover from the economic impacts of COVID-19. Programs worldwide include myriad forms such as grants, tax credits and deductions, as well as tax holidays and deferrals, allowing companies to dramatically reduce running costs and growth expenditure.

Sometimes credits and incentives are aimed at job retention by providing relief on business income tax contributions. Elsewhere, credits and incentives support smaller businesses and sectors that may have been particularly badly harmed by the pandemic - or those that are projected to offer strong future expansion, such as digital and 'green' firms.

In addition, credits and incentives are a powerful mechanism for supporting training efforts, capital expenditure, the opening or modernization of facilities, and research and development processes. Many governments also use incentives to attract private capital into their infrastructure programs in the interests of faster development and risk diversification.

Moving from immediate to long-term targets

When the coronavirus pandemic began to spread in early 2020, government-led incentives had a strong focus on job retention, in countries as diverse as France, the UK, US, Canada, China and Australia, as well as many other nations[1]. In the US, tax credits have also been made available to firms maintaining health insurance for employees working reduced hours or for those made newly redundant[2]. Many such measures have been kept in place, as have others such as loss carryback policies introduced in Germany, Japan, Singapore, the US and beyond, with the aim being to improve cashflows at hard-hit companies[3].

As lockdowns are loosened worldwide, many of these early incentives - and emergency sector help such as hospitality VAT cuts in the UK[4] and Germany[5], or civil aviation tax deferral in France[6]—may be tapered off gradually. This will be in favor of newer schemes with fresh targets, including longer term tax reductions such as in Singapore where several exemptions will aim to boost the attractiveness of the financial sector.[7] Small business support is also a priority, as in China, where VAT reductions for small firms continue and there are new tax breaks in ecommerce zones[8], Japan, where small companies can receive several tax credits or exemptions around assets[9], and the US where the Biden administration has planned credits for small businesses establishing staff retirement plans[10].

Employee skills upgrades will also be firmly in focus, with programs addressing digital and management training. Alongside this are incentives to support the availability and diversity of employment: in the US, the work opportunity tax credit provides a reduction in income taxes for any business hiring military veterans, those on welfare, those with disabilities, or people who have been unemployed for six months or more[11]. While the country's corporate tax rates will potentially rise again under President Biden, campaign pledges have promised companies redomesticating jobs an advanced credit, as well as credits for investments in communities affected by large-scale manufacturing job losses[12].

A regional emphasis is expected in many nations, aimed at areas viewed as requiring investment[13], as well as in reflection of where people are now working. In Ireland, for example, tax breaks will be offered for individuals and for companies that support home working in rural towns, in a bid to bridge the rural-urban divide and rejuvenate smaller towns[14]. In Canada, the province of British Columbia is providing tax credits to employers that have increased their employment of low-to-middle income workers[15]. In the UK, meanwhile, eight freeports are being created in a bid to incentivize activity in deprived coastal areas[16].

Capital investment incentives will be critical to motivating business spending, including around sustainable energy and durable operations. The UK government, for example, is now enabling corporations to apply for tax 'super deductions' on expenditure for machinery with long lifespans.[17] In the US, President Biden's $2 trillion infrastructure plan includes large credits for clean energy generation and storage.[18] Meanwhile, research and development is also receiving a boost, with the most frequent reform being to increase the availability and scope of related incentives[19], such as in Germany where an annual credit of up to €1 million per business will be available, with additional amounts for development around artificial intelligence and green hydrogen[20]. Spain and Denmark have increased R&D tax allowance rates[21], while Japan also plans to expand technology development allowances[22].

Turning credits and incentives into successful stimulus

Credits and incentives in all forms are critical to getting national economies back on track and functioning at high capacity, and it is clear that countries will increasingly modernize and tailor their efforts as they emerge from the pandemic. Alongside other stimulus from infrastructure investments, regulatory simplification and monetary policy adjustment, credits and incentives will be essential to delivering strong support for the growth of businesses and wider economies, increasing productivity and catalyzing spending.

For such incentives to succeed, however, careful design, appropriate targeting and smart delivery is vital, as we examine in this paper. Countries will need to establish proper program integrity and transparent reporting, backed by consistent administration and guarantees for participants. Equally critical to success will be a focus on the new work locations of many business employees, and a careful tailoring of particular schemes to draw in private capital.

Key considerations for governments

There are several key success factors that governments should consider when designing and operating post-COVID credits and incentives:

Program integrity

Smart government programs are reliant upon a clear understanding of where there is most need to provide stimulus, and how credits and incentives can fit in. Heat maps, in combination with dialog with industry, help identify sectors most affected, as well as the types of employees, self-employed and startup leaders most impacted. Meanwhile, predictive risk analytics can support better program design[23].

Armed with this information, governments can create a combination of tax credits and deductions, or tax holidays and deferrals, and grants—addressing training, capital expenditure, R&D, sustainability, opening or modernization of sites, technology advancement, innovation including patent boxes, and attraction of private capital. Proper program integrity (see our separate paper), meaning the effective design, delivery and oversight of schemes, will always be essential to successful implementation. Programs should be well targeted, as clearly communicated as possible, and straightforward to apply for.

Transparency and fraud prevention

Beyond proper initial design and consistent administration, effective delivery of programs requires stringent examination and consistent transparency. Governments need to establish monitoring mechanisms and independent reporting on incentive programs, led by dedicated and well-resourced bodies committed to assessing stimulus effectiveness. They must also be willing to adapt programs as needs evolve, while adhering to any guarantees made.

As a core part of transparency efforts, governments must also focus on preventing losses through fraud, waste and abuse. Combining the skills of monitoring and investigation staff with machine learning algorithms that analyze vast data sources means risks can be identified before they become problems, which ultimately helps to secure maximum program value[24].

Stability and guarantees for participants

Governments will need to meet business expectations around program stability and duration. For credits and incentives to achieve strong take-up, companies need to know how long specific options will last or when reviews will take place. It is also important that businesses are clear what would happen in the event of a change of government or an update to tax policies—incentives can be protected either by front-loading the benefits or guaranteeing their continuation for existing participants to a certain date.

Equally, governments must address total cost of compliance for businesses, as companies will only apply for benefits that are worth having once all requirements are met. This means the desire for robust regulations, which prevent program abuse, must be balanced with making access realistic for businesses that are interested and eligible. For success, credits and incentives will need to be affordable to access, stable over time and administratively consistent.

New work locations

The shift to home working that has happened for huge numbers of formerly office-based staff has profound consequences for taxation. Many employees live in different districts or regions from their offices, rendering irrelevant many current incentives that are tied to office locations and that aim to encourage employees to spend in nearby stores, gyms and restaurants. When staff work from home much of their spending moves with them, and given that remote operation is expected to become a norm for many people, incentives will need to adapt accordingly.

Governments need to consider, therefore, the economic multiplier effect of tax incentives, where it is now realized, and if this is in line with their goals. Simultaneously, they will need to approach the wider question of how to generate activity in districts currently filled with offices, and consider whether different incentives will now be needed there to create stimulus.

Attraction of private capital

Private capital involvement in infrastructure, in the form of dedicated private equity, pension funds, debt investors and public-private partnerships (PPPs), will continue to be essential to successful projects. Infrastructure funded, created or operated by effective partners - including well-managed consortia - can offer efficient delivery and risk sharing. This means there must be consideration of how best to establish incentives and credits to draw in such parties.

Efforts can include structuring tax credits to encourage longer term participation from corporations, private equity funds or debt investors. Governments may seek to tie these credits to project completion and duration of ongoing service provided, in order to help secure the desired results. When looking to raise funding, countries may also issue new municipal bonds that are entirely tax exempt to the holders, enabling somewhat reduced borrowing costs as a result.[25]

In practice

Tax credits and incentives have long played an important role in economic stimulus, but their targeted usage will be ever more essential as countries seek to recover from COVID-19.

When different nations around the world exit lockdowns, they may gradually taper off emergency job support, loss carryback policies and VAT reductions. As they do so, they will enter a new phase of targeted stimulus around inclusive and regional growth, corporate capital investment, research and development, skills, sustainability and digitization, and the attraction of private capital.

To ensure these credits and incentives work, countries will recognize some clear considerations:

Programs need to be well targeted and designed, with careful selection of incentive types. Transparent monitoring and proactive fraud prevention help secure value

Businesses will need easy application processes, affordable compliance, consistent administration and clear guarantees on program duration if they are to participate

Credits and incentives should reflect the new work locations of former office staff, with separate consideration of how to generate activity in existing business districts

Private capital will be essential to recovery, so credits and incentives should help attract high quality investment, supporting infrastructure creation and management

Governments will face important questions as they seek to develop highly effective credits and incentives, as a long term response to the economic damage of the coronavirus pandemic. Getting these programs right will play an essential role in generating powerful stimulus, enabling countries to begin to recover and thrive again.

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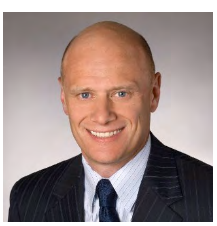

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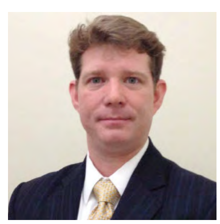

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