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COVID-19 Recovery Contributions

Alexander Klemm, Shafik Hebous, Geerten Michielse, and Narine Nersesyan

This note reviews the possible scope for and design of temporary "COVID-19 recovery contributions" raised on high incomes or wealth to help meet the extraordinary financing needs following the pandemic while also promoting social cohesion in difficult times. The easiest and quickest option is a surcharge to the personal income tax, perhaps restricted to the highest income levels. A tax on "excess profits" could also ensure a contribution from businesses that prosper during or after the crisis and could be crafted in the spirit of recent reform proposals. One-off capital levies, despite some theoretical appeal, would have severe drawbacks in practice. While recovery contributions are intended to be temporary, the crisis may provide momentum to permanently enhance tax progression in countries wherein it is desirable and/or to raise revenue from a less distortionary business tax.

Please direct any questions and comments on this note to cdsupport-revenue@imf.org.

I. INTRODUCTION

The large fiscal cost of the COVID-19 crisis[1] has raised interest in temporary recovery contributions as a possible source of finance in the pandemic aftermath. They are defined here as temporary additional levies aimed to fall particularly on the more affluent.[2] This note[3] first considers temporary additional charges on personal or corporate income, and then temporary or one-off taxes on wealth. The rationale for such charges is that:

[1] See the October 2020 *Fiscal Monitor* (IMF 2020).

[2] Broader definitions of recovery contributions are conceivable, with progressivity achieved in the use rather than levying of funds. While a VAT surcharge, for example, could not be easily targeted to better off people, it could still be part of a redistributive measure if proceeds are used to finance poverty-reducing spending. Excises, especially on luxury goods, are another option but unlikely to raise much.

[3] Several legal drafting issues related to the topics addressed here are considered in IMF (2021).

- The fiscal shock of the pandemic is of a temporary nature, which could be matched by a temporary levy.[4] These levies have been used in the past for other major temporary shocks, for example, to fund a natural catastrophe, a war, or the recovery from a war.[5] The temporary and targeted nature distinguishes recovery contributions from structural changes in the tax system.
- The recovery contribution targets the burden explicitly on those with high incomes or wealth or the most profitable businesses, that is, those with the greatest ability to pay. This recognizes the importance of social cohesion in coping with the crisis, with much of the burden of the response—exposure of essential workers to health risks, unemployment, short time working—falling on the less affluent.

As a temporary recovery contribution does not address the structural efficiency, fairness, or revenue-raising capacity of a tax system, countries requiring such improvements should consider broader, permanent reforms. A tax system that is generally fit for purpose can be temporarily complemented by a recovery contribution. However, a weak system will need structural reforms. For example, where progressivity of the income tax system is weak, strengthening tax progression through taxes on high incomes and wealth might be a structural improvement—though the exact degree of progressivity will vary depending on a country's circumstances and preferences.[6] "Excess profit taxes"—taxes intended to bear on economic rents—might also be introduced as a structural measure, raising revenue from the most profitable businesses while causing no or little distortion.

To increase the likelihood of acceptance of it would be important to explain the rationale of any newly introduced taxes. Recent survey evidence (Klemm and Mauro 2021) shows that in a sample of US respondents, about two-thirds would support a progressive temporary levy explicitly introduced to finance the costs related to the pandemic. Naming of the charge may also matter, tempering to cultural sensitivities: that survey also revealed that support is higher when it is explicitly called "COVID-19 Recovery Contribution" than when labeled by other terms, such as simply tax or contribution. It found too that support is higher among people who lost employment or fell seriously ill, or who know someone who did. This suggests that demand for redistributive policies might be high post pandemic, although trust would likely be lost rapidly if policies are not seen as addressing people's needs.

II. RECOVERY CONTRIBUTIONS ON INCOME

Recovery contributions on income are relatively straightforward to implement. They can be levied either as a surcharge or surtax on an existing tax base,[7] (perhaps applying on or at higher rate(s) to the more prosperous) or as a new tax on a new base. Surcharges on personal income taxes have been used without facing major difficulties in several countries (see Appendix) and are probably the quickest option to pursue, given that most countries already have income taxes. The ability to introduce such a tax rapidly depends more on the existence of the tax than levels of per capita income, so developing economies that already have a reasonably well-enforced income tax would not face major additional difficulties in implementing at least a modest surcharge. Focusing such a surcharge on the highest incomes makes it more progressive but reduces its revenue potential. In many low-income countries, the narrow reach of the personal income tax especially

[4] Temporary measures differ from one-off levies in that they can distort on the margins of timing (for example, by leading taxpayers to push receipts beyond the end date). Timing effects can sometimes be used on purpose, for example, to bring investment forward (see IMF (2020a)).

[5] Strong governance, ensuring that resources are used transparently, efficiently, and effectively, would support tax morale. See, for example, IMF (2020b).

[6] See IMF (2020c).

[7] There is a subtle difference between "surcharges" (which augment an existing tax rate, that is, by multiplying it by 1 plus the surcharge) and "surtaxes" (which add an additional tax to the existing rate). For example, if the tax rate is 10 percent, a 5 percent surcharge will raise the tax from 10 to 10.5 percent; a 5 percent surtax will raise it from 10 to 15 percent.

limits its effectiveness in relation to the highest earners. A new tax on a new base might take more time to implement but can enable a more efficient and effective design if the current tax base is problematic.

Temporary taxes should be subject to evaluation, as they have a habit of becoming permanent. A solidarity levy on high incomes will distort behavior such as the existing income tax, although as a temporary additional charge it is unlikely to have a strong impact on structural choices such as participation or schooling—unless tax rates are extremely high. Solidarity levies on income usually apply for more than one year. They may lose their credibility, however, if they become (semi-)permanent, as taxpayers may then wonder why the purpose of the levy has not been fulfilled. It would then be more transparent to make the levy part of the general tax system rather than a temporary levy. Of course, permanence can be a merit if the solidarity levy has desirable structural features. That might be true, for example, of an income tax surcharge that enables an increase in progressivity which is in normal times hard to achieve. In this sense, a crisis is also an opportunity to experiment with changes that may prove a permanent improvement, although this requires them to be introduced as subject to future evaluation rather than with a promise of expiration.

Recovery contributions on corporate income can target the most profitable businesses by being designed to tax economic rents. The current crisis is affecting sectors very differently. However, targeting recovery contributions to specific sectors is problematic because (1) sectors are often difficult to define, (2) firms may operate in various sectors, and (3) windfalls or unusual losses may also occur in unexpected sectors. It would be better to target the solidarity levy on economic rents—the excess of returns over the minimum investors require—wherever they arise. This has the attraction of raising revenue in a way that is potentially non-distorting.[8] And it would automatically ensure that companies that did not prosper during the pandemic will pay no tax on this account. Excess profits taxes have been used by several countries (including the United Kingdom and the United States) during the two world wars, typically designed along the lines of an allowance for corporate capital.[9]

Rent taxes can be crafted in line with recent reform proposals, including those under discussion in the OECD Inclusive Framework.[10] This envisages separate taxation of “residual profits,” defined as those in excess of a “routine return”—which, very broadly, is a base similar to that of a traditional excess profits tax. Adopted multilaterally, such a tax would also address the difficulty that transfer pricing and other techniques enable the shifting of profits to lower tax jurisdictions. More generally, even if crafted as an addition to the regular corporate income tax, an excess profits tax (under whatever name) could ultimately serve to shift the corporate tax system in a desirable direction.

III. RECOVERY CONTRIBUTIONS ON WEALTH

Unanticipated, unavoidable, one-off levies on wealth would be non-distortionary—but are unlikely to be achievable in practice. If unanticipated, they do not distort behavior, including avoidance activity, before their enactment—but not necessarily after. And if credibly deemed as one-off levies, they will not affect future decisions—except to the extent that they enable lower future taxes, which would likely raise savings. With no distortions, the revenue potential of a one-off or temporary capital levy is high.[11] However, the difficulty lies in

[8] To prevent discouraging high-risk, high-return activities, all relevant costs, including those from failed attempts, should be deductible.

[9] This system is discussed in IMF (2016).

[10] See also discussion in IMF (2019).

[11] Recent estimates—which do not account for behavioral responses—suggest that a hypothetical capital levy of 10 percent on personal net wealth in Germany (based on 2007) would raise about 9 percent of GDP (Bach 2012).

meeting these three conditions: it is very hard to avoid anticipation, evasion and avoidance opportunities are hard to preclude, and it is very hard to credibly claim that a levy will be repeated (see also Keen (2013)).[12] Experience provides ample illustrations.

Historical examples of one-off capital levies show only a few successful cases, and those were implemented under exceptional circumstances (see Appendix). Many one-off capital levies have been unsuccessful as their revenue was either eaten up by economic instability, such as hyperinflation, or they were introduced slowly, giving affected people time for evasive action. The more successful examples in terms of revenue-raising were introduced under very specific circumstances. The Japanese levy, for instance, was introduced while occupation forces were exercising governance control, with international links largely severed in the aftermath of World War II. The Japanese levy also had strong anti-avoidance features, such as a provision in the law that allowed for an immediate purchase of the property by the authorities at the self-assessed value, reducing incentives for under assessment.

Surcharges to existing wealth taxes may be a more suitable form of recovery contribution, although their potential is modest. Whatever the case for doing so as a structural measure, introducing a wealth tax where one does not exist is likely to be time-consuming and subject to significant practical (and sometimes legal) [13] implementation problems.[14] Where wealth taxes already exist, the revenue they raise is generally quite limited—and they are often vulnerable to avoidance and evasion by the very wealthiest.[15] Although the social tolerance to avoidance and evasion has diminished in recent years, enforcement is still difficult for wealth taxes, so the international trend has been for countries to abolish them. The potential for a substantial recovery contribution from wealth taxes in the near term thus appears modest. Increasing real estate taxes with a solidarity supplement, perhaps on the most valuable properties, may be more widely and more rapidly feasible, although it would be less progressive, as the share of housing wealth declines with the level of wealth.

IV. CONCLUSION

A strong case can be made for recovery contributions on the better off to meet the extraordinary financing needs following the COVID-19 crisis. A surcharge or surtax to the personal income tax for higher incomes is the easiest and quickest option; a tax on "excess profits" could also ensure a contribution from businesses that prosper during or after the crisis. One-off capital levies would have severe drawbacks in practice. The crisis may provide momentum to permanently enhance tax progression in countries where it is desirable and/or to raise revenue from a less distortionary business tax.

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[12] The one-off nature may be credible only if a capital levy is adopted following a truly exceptional event, both in terms of frequency and extent. Whether the pandemic meets these criteria is yet unknown.

[13] See IMF (2021).

[14] Landais, Saez, and Zucman (2020) propose a wealth tax for the EU that is raised for 10 years at rates of 10 percent for the top 1 percent, 20 percent for the top 0.1 percent, and 30 percent on billionaires. They estimate that this would yield 10 percent of GDP in revenues over 10 years.

[15] See IMF (2020c).

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APPENDIX 1. Country Experiences with Temporary Contributions

Capital levies[16] have been applied at least since Ancient Greece[17] and implemented mostly in exceptional circumstances. Table 1 presents some prominent examples and summarizes their impact.

TABLE 1. Examples of Capital Levies

State and Period	Tax Type and Size	Objectives	Outcomes
Germany, 1913 (Defense contribution, "Wehrbeitrag")	One-off levy on higher wealth (and income), collected over three years. Assets above 10,000 marks taxed progressively at 0.15–1.5 percent.	To finance high military spending	Yielded 1.7 percent of GDP in 1913.
Austria, 1920	Progressive capital levy on owners of monetary and real assets at 3–65 percent. Flat rate for companies at 15 percent. Payment terms depending on liquidity of assets.	To fund post-war reconstruction	Introduction delayed by long debate, allowing significant avoidance. The resulting capital flight contributed to macroeconomic instability.
Italy, 1920	Levy on capital stock at 4.5–50 percent, payable over 20 years.	To alleviate debt burden following extraordinary wartime spending. To finance new social programs.	Contributed to public sector revenue. Nontransparent, with temporary increase in rates in 1921.
Germany, 1919 (National emergency levy, "Reichsnotopfer")	Progressive capital levy on net assets at rates of 10–65 percent above a threshold, payable over 30 years.	To rein in gross national debt (at 180 percent of GDP at the time)	Eaten up by hyperinflation (not indexed). Replaced by a permanent levy on wealth in 1923.
Czechoslovakia, 1920	Three tax types adopted, collected over a three-year period: (1) progressive capital levy on property values at 3–30 percent, (2) surcharge on property value increments at 0–40 percent, and (3) capital levy on corporate property at 3–20 percent.	To cover special expenditures of building the newly-independent Czechoslovak State.	Significant revenue in 1922–23 (majority of direct tax revenue) then declining. Minimal capital flight in the immediate aftermath of the war.
Japan, 1946	Progressive levy on property values, from 10–90 percent, with threshold allowance.	To reduce debt burden, provide finance for economic revival initiatives, and reduce income inequality.	Limited evasion in the aftermath of war. Rapid and effective implementation under allied occupation.
Germany (West), 1949	Capital levy of 50 percent on property and business assets, with significant threshold for financial assets, payable over 30 years.	To mobilize resources for reconstruction and integration of misplaced persons and refuges.	Total revenue equivalent to 60 percent of 1952 GDP.

Source: Bach (2012), Eichengreen (1989), and Rostas (1940).

[16] Narrower bank levies on deposits provide another historical example of one-off taxes on a stock and were suggested, but rarely implemented, in times of financial crises. Italy introduced a one-off tax on bank and postal deposits at a rate of 0.6 percent in 1992 while facing foreign-exchange and financial sector pressures. It was challenged on grounds of unequal treatment of different types of savings but upheld by the Constitutional Court.

[17] Two wealth levies (*Eisphorá* and *Liturgy*), at rates from 1 to 4 percent, levied as needed, often in times of war, or in the case of Liturgy also for public works, see McCannon (2017).

Various countries have used surcharges on personal or corporate income, or both. A non-exhaustive list is provided in Table 2.

TABLE 2. Examples of Surcharges on Income

State and Period	Tax Type and Size	Objectives
Germany, 1991	Solidarity surcharge on personal and corporate income—currently at 5.5 percent of income tax—has applied since 1995 (and in a previous iteration from 1991 to 1992).	Originally meant to cover the costs of the Gulf War, reunification, and eastern European reconstruction. It is currently foreseen to be reduced for some taxpayers from 2021. The surcharge accrues entirely to the federation, while income tax revenues are shared with states and municipalities.
Hungary, 1991	A solidarity tax on corporate income was levied between 1991 and 2009 (then at 4 percent), when it was folded into a higher main corporate income tax rate (increased from 16 to 19 percent).	
Japan, 2012	On corporate income tax, the surcharge was 10 percent and applied for two years. On personal income tax, the rate is 2.1 percent and it will apply till 2037.	Following the Tohoku earthquake a solidarity surcharge was introduced to finance the recovery.
Australia, 2011	A levy implemented as a surtax of 0.5 to 1 percent of personal income.	A flood levy to finance the reconstruction of infrastructure in areas affected by the Queensland floods.
United States, 1920s, 40s, 50s, and 60s	Excess profit taxes applied during both world wars and the Korean war. The most recent tax was levied at a rate of 30 percent on excess profits (above a normal rate of return). In 1968 a 10 percent surcharge on both personal and corporate income taxes was introduced, later prolonged to mid-1970.	For the examples during world wars and the Korean war the intention was war finance with a focus on firms benefiting. Several other countries have also used excess profits taxes during both world wars.