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Tax and natural disasters

Carolyn Palmer, October 2014

Tax and natural disasters

Presentation outline

- **The research**. A comparative case study of tax responses to natural disasters (New Zealand, Australia and Japan).

- **Do countries follow good tax policy when responding to a disaster?**
- The role of tax in responding to a disaster.
- Tax responses to natural disasters
    - New Zealand
    - Australia
    - Japan

- **Tax policy lessons.**
- Administrative responses.
- Role of the existing policy framework and process.
- To levy or not?

Natural disasters place significant strain on economies, which has implications for tax policy

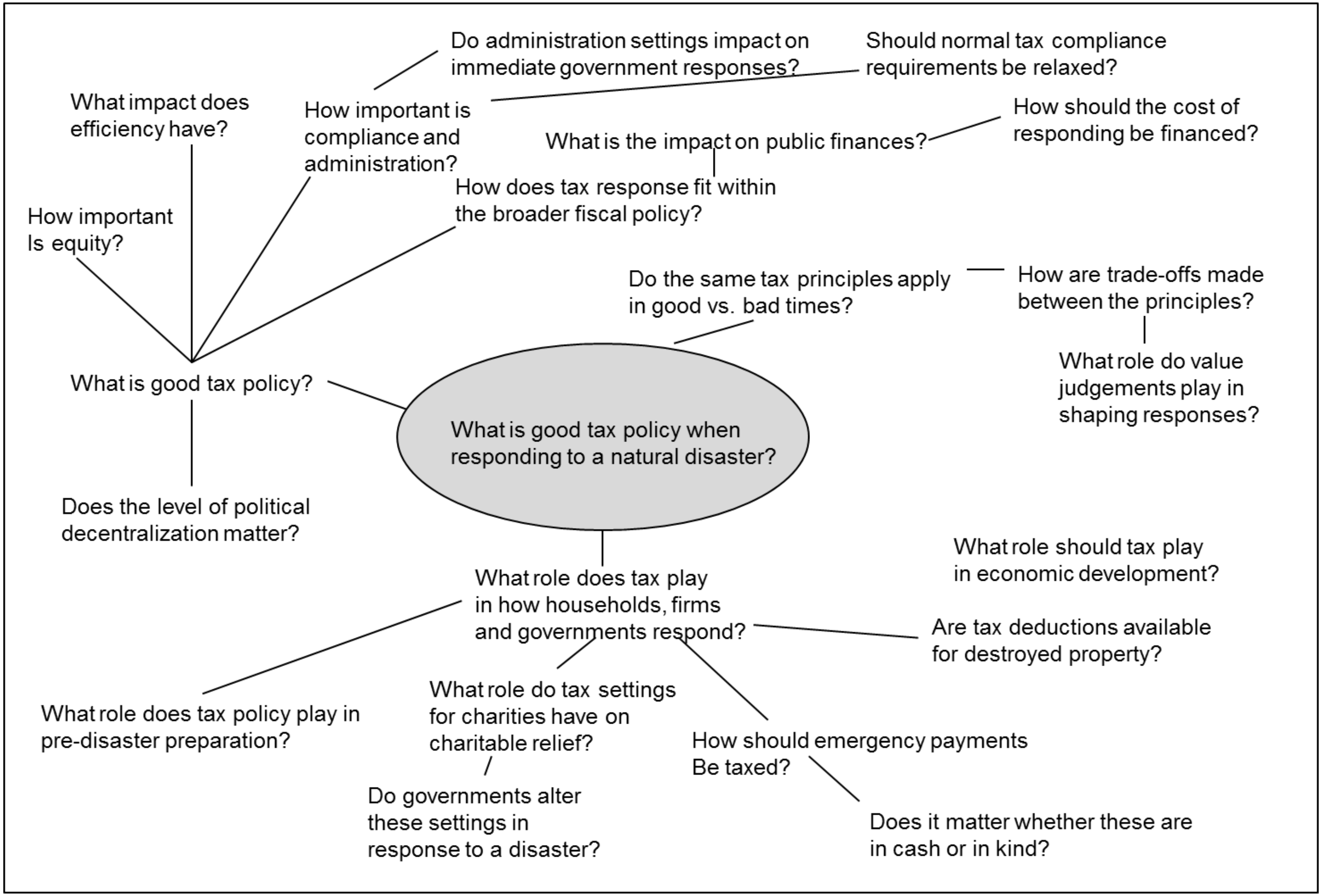
Fiscal cost of recent natural disasters
Percentage of GDP

Date	Country	Event	Fiscal cost
2011	NZ	Christchurch earthquakes	8%[1]
2011	Japan	Tohoku tsunami	6%[2]
2011	Australia	Queensland floods	1%[3]

- Disasters are an unplanned but critical stress test of fiscal policy.
- Disasters challenge countries to re-examine settled doctrines (Schick, 2012).

1 (Burgess, 2011).
2 (Hayashi, 2012).
3 (Smart, 2012).

Determining the appropriate tax response requires multiple complex decisions under time pressure with limited information



The topic of natural disasters and tax policy is neglected in the literature

Economics and political science literature

- Scarce attention is paid to natural disasters in the economic and political science literature (Cavallo and Noy, 2011).

Impact on government policy

- The literature discusses the impact on government policy more generally (Freeman, Michael and Muthukumara, 2003; Todd and Todd, 2011; World Bank, 2010).

Impact on tax policy

- The existing literature is focused on individual natural disasters.

The research

Methodology.

- A comparative case study of tax responses to natural disasters.
- 70 interviews with tax policy makers in New Zealand, Australia and Japan.
- Funding from the Robin Oliver Tax Policy Scholarship.

Aim.

- Provide a narrative of different tax policy responses.
- Assess whether countries follow good tax policy when responding to a disaster
- Assess how responses relate to the strength of the existing policy framework and process.

Tax and natural disasters

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A framework for thinking about tax and natural disasters

Do the principles of good tax policy get applied in a disaster situation?

How important is revenue adequacy?

- What is the impact on public finances?
- How does tax fit within broader fiscal policy?
- How should the response be financed?

How important is equity?

- Those in the affected area vs other citizens
- Intergenerational issues

How important is compliance & administration?

- Do administration settings impact the immediate response?
- Should normal compliance rules be relaxed?
- Speed of response

How important is efficiency?

What influence do outside factors have?

- Political influence?
- Impact of a well articulated and agreed framework?
- Does political decentralization matter?

What is good tax policy when responding to a natural disaster?

Do the same principles apply in good vs. bad times?

- Is a different trade-off made between the principles?
- Optimal theory, BBLR?
- What role do value judgements play in shaping responses?

How does tax impact how agents respond?

Pre-disaster preparation?

- What role does tax play in risk reduction (impact on property markets, funding for mitigation) and risk transfer (insurance)?

Immediate response?

- How should emergency payments (in cash and kind) be taxed?
- What role does tax have on charitable relief and are settings altered in response to a disaster?

Post-disaster?

- Are tax deductions available for destroyed property?
- What role should tax play in economic development?

Do countries follow good tax policy when responding to a disaster?

- **What is good tax policy?**

- **Principles of good tax policy**. Revenue adequacy, equity, efficiency and ease of compliance and administration (Musgrave and Musgrave, 1989).

- **Political influences**. Economic theory does not consider the policy process, including political factors (Hansen, 1983; Bird and Zolt, 2003).

- **Practical limitations**. The design of a tax system must take into account practical limitations and administrative capacity (Kay, 1990).

- **Intent**. Tax policy design is influenced by the purpose of a particular tax.

Is good tax policy the same in good and bad times?

Do the general principles apply?

- Public finance – standard policy responses to the GFC may not be appropriate (Schick, 2012).
- War financing – unusual macroeconomic conditions prevail (Caplan, 2002).

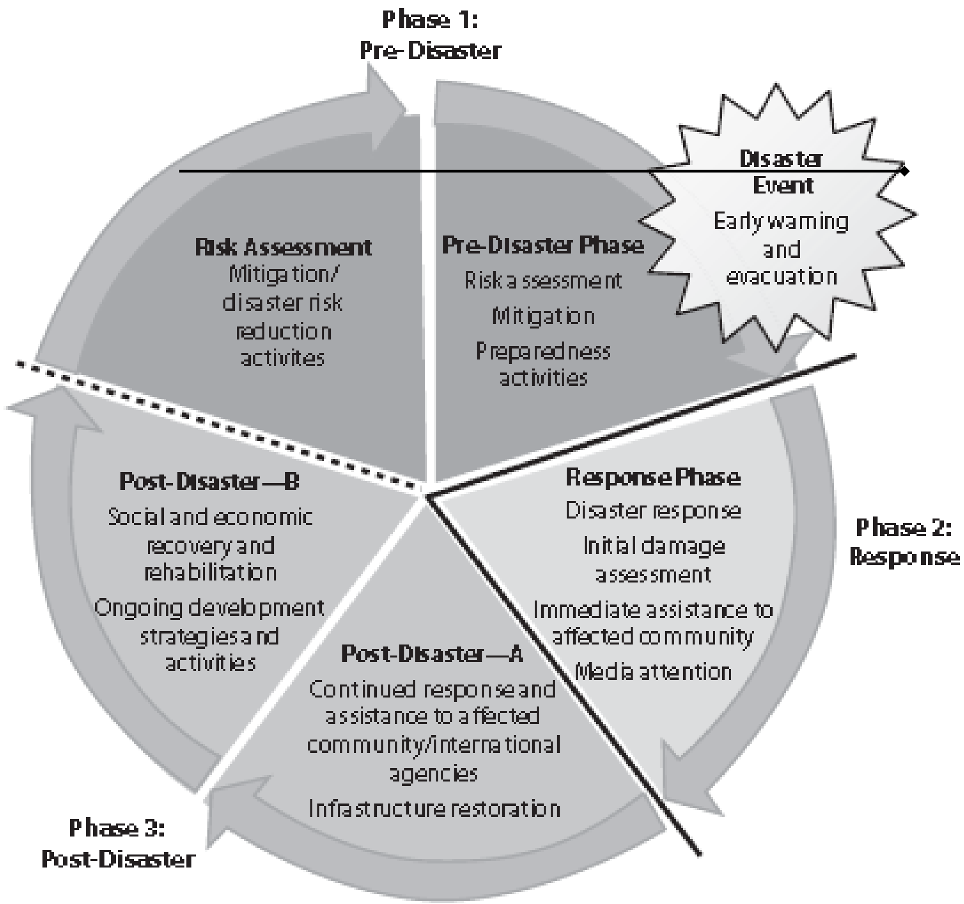
How to make trade-offs between the principles?

- Trade-offs will be required (Musgrave and Musgrave, 1989).
- Continued lack of clear guidance in recent tax reviews (Kay, 1990).
- Mirrlees (2011) applied optimal tax theory. However, complex and practical conclusions cannot readily be drawn (Creedy, 2011).
- TWG adopted rational policy analysis (Creedy, 2010). Choosing between reform options will depend on value judgements.

- May be a case to depart from standard tax policy.
- Different weighting (value judgement) may be placed on principles.

What is the role of taxation in responding to a disaster?

Figure 1: Phases of the Disaster Management Cycle



Source: Based on work of Ian Davis, Cranfield University, Bedford, United Kingdom.

- Pre-disaster preparation involves risk identification, reduction and transfer. Role of tax policy is on risk reduction, funding and risk transfer (insurance).
- Immediate responses are focused on fast effective relief. Role of tax policy is to fund relief and to have a well-operating system.
- Post-disaster involves recovery, rebuilding and reconstruction activities. Role of tax policy is to finance these activities.

Tax responses to natural disasters: New Zealand

Pre-disaster

- Limited experience of large scale events. Early responses privately funded.
- *Napier 1931*.
- *National Disaster Fund and EQCover*.
- *1976 Act* – relief for agricultural businesses affected by disasters.
- *Cyclone Bola 1988*.
- *2004 floods*.

Tax responses to natural disasters: New Zealand

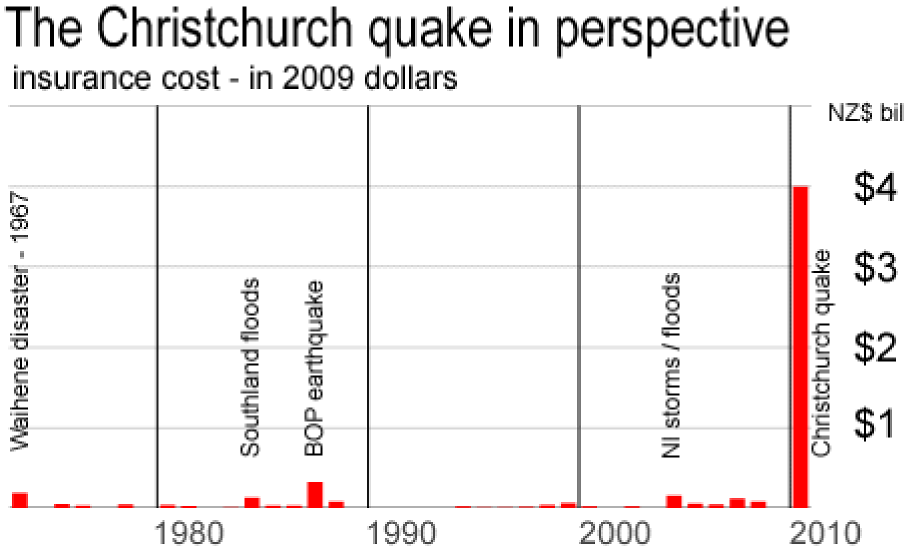
Immediate response

- *Administrative responses*: waive UOMI, allow information sharing, filing and payment extensions, relieve interest payable by overseas workers.
- *Emergency support*: tax free employer welfare contributions, tax exemption for donated trading stock, WFF exemption and GST exemption for earthquake support subsidy payments.
- *Charitable relief*: Earthquake Appeal Fund.
- *Extend existing treatment*: Disposal and demolition costs treated as part of deductible loss, limit depreciation recovery, extend losses on buildings, depreciation where access restricted, and extend redundancy tax credit.
- *Correct existing treatment*: Matching rules for losses on disposal and insurance proceeds, GST exemption for reinsurers, red-zone revenue account property exclusion, and amendments to thin capitalisation.

Tax responses to natural disasters: New Zealand

Post-disaster

- *Funding*: increase in the EQC levy.
- *Rebuilding*: roll-over relief for depreciation recovered for Canterbury property owners, extended time limits for tax-free earthquake recovery employee allowances.



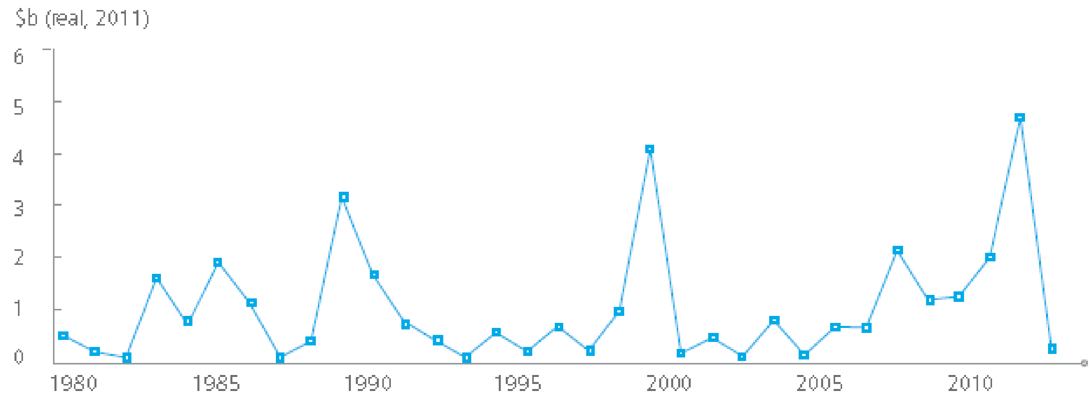
Source: ICNZ (www.interest.co.nz)

Tax responses to natural disasters: Australia

Pre-disaster

- Exposed to frequent and large natural disasters, with cost rising over time:

Chart 2.1: Insured costs of natural disasters, 1980–2012



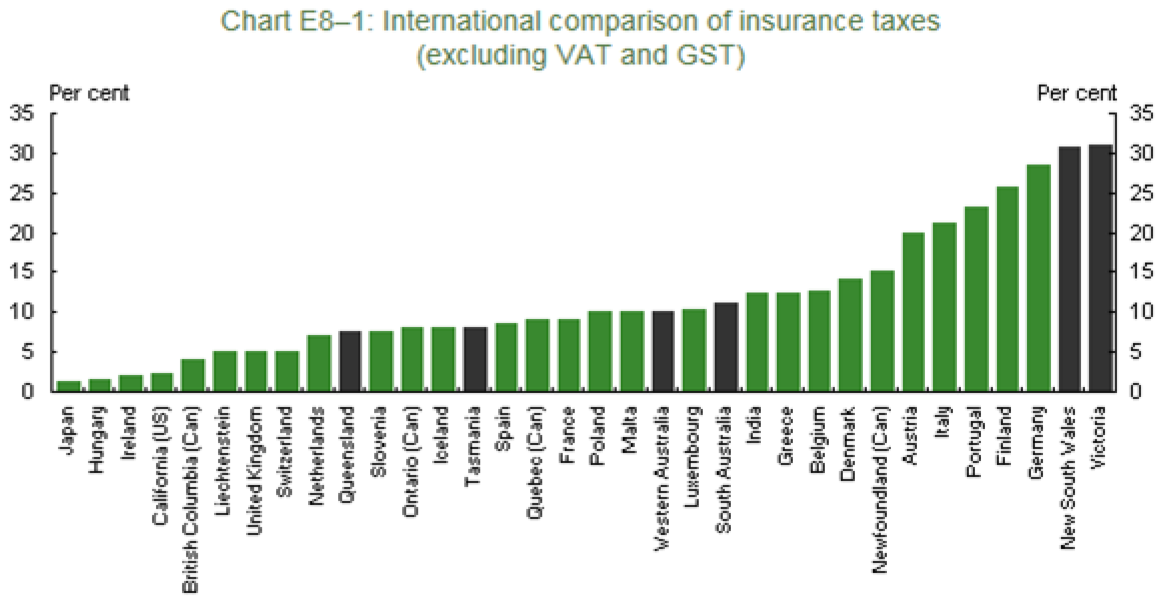
Source: Insurance Council of Australia (2013)

- No formal natural disaster insurance scheme.
- Natural Disaster Relief and Recovery Arrangements (NDRRA).
- Australian Government Disaster Recovery Payment.

Tax responses to natural disasters: Australia

Pre-disaster

- Number of references to natural disasters in the existing tax legislation.
- High state insurance taxes.



Source: Insurance Council of Australia

Tax responses to natural disasters: Australia

Immediate response

- *Administrative responses*:
  - Filing and payment extensions.
  - Emergency response information.
  - ATO contribution towards community services.
  - ATO support for tax agents.
  - Clarification of tax treatment.
  - Assistance with record reconstruction.

- *Emergency support*: income tax exemptions.

- *Charitable relief*.

Tax responses to natural disasters: Australia

Post-disaster

- *Funding*:
    - Flood levy.
    - 2014 Productivity Commission Review of natural disaster funding.
- *Rebuilding*:
    - Tax exemptions for grants to small business and primary producers.
    - Amendments announced to provide CGT relief for taxpayers that participate in Australian government replacement asset programs.
    - Amendments to allow farmers to access their farm management deposits.

Tax responses to natural disasters: Japan

Pre-disaster

- Japan is one of the countries most affected by natural disasters and the tax legislation provides for many disaster tax issues.
- Individuals who suffer disaster losses on their home or other property may claim disaster loss deductions or tax exemptions.

Income bracket	Tax reduction/exemption
5M yen or less	100% exemption
5M-7.5M yen.	50% exemption
7.5M-10M yen	25% exemption

- Corporations who acquire replacement assets may defer capital gains.
- Japanese Earthquake Insurance Scheme.

Tax responses to natural disasters: Japan

- **Immediate response**

- *Administrative responses*:
    - Filing and payment extensions
    - Special arrangements for tax certificates.
    - NTA ruling to exempt compensation for private property, mental or physical damage.

- *Emergency support*:
    - For individuals: Extended disaster loss deductions and exemptions and tax credits for housing loans.
    - For corporates: Extended tax loss carry-backs and withholding tax refunds.

- *Charitable relief*: Tax deductions for qualifying donations.

Tax responses to natural disasters: Japan

Post-disaster

- *Funding*:
  - Deferral of proposed 2011 tax reform, including 5% corporate tax cut.
  - Reconstruction bonds.
  - “Temporary” tax measures: individual inhabitants tax (1,000 ¥ per person for 10 years), personal surtax (2.1% of income tax for 25 years) and a corporation surtax (10% of corporate tax).

- *Rebuilding*:
  - Special depreciation (10% to 36%) for replacement assets or new assets placed in service in the affected area.
  - Increased CGT relief for corporations (to 100%).
  - Stamp duty and real estate tax exemption.
  - Special tax reductions and subsidies for companies with business plans in the disaster area.

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Tax policy lessons

Administrative responses

- Use of discretionary powers vs. legislation.
- When to stop?
- Information sharing.

Tax policy lessons

Role of the existing policy framework and process

- Link between existing framework and process and responses made.
- Australia - strong political influence and lack of collaboration over tax policy.
- Japan – Strong political and cultural influence. Focus on equity and incentivising investment.
- New Zealand – strong framework and process.

> "*New Zealand's tax framework and process constitute a strong investment in human capital. People understand the framework and regularly apply it*".

Tax policy lessons

To levy or not?

- Pre-disaster funding and insurance.
- Post-disaster funding.
    - Raise taxes.
    - Cut government expenditure.
    - Borrowing.
- ‘One-off’ levy.

Summary

- Natural disasters place significant strain on economies. Determining the appropriate tax response requires multiple complex decisions. Natural disasters and tax policy is neglected in the literature.

- A comparative case study (New Zealand, Australia and Japan) provides a narrative of different tax policy responses.

- What is good tax policy may differ in good vs bad times.
- Role of taxation. Pre-disaster, immediate response and post-disaster.

- Number of tax policy lessons.
  - Administrative responses.
  - Role of the existing policy framework and process.
  - To levy or not?

- **Questions?**

For further discussion of these issues refer to the working paper - ‘Flood and fire and famine’: Tax policy lessons from the Australian responses to natural disasters (VUW).