Taxation and the Social Contract in a Post-Pandemic Era: Domestic and International Dimensions

By:

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"*The world is my country, all mankind are my brethren, and to do good is my religion*" *– Thomas Paine, American revolutionary (1776)*

Introduction

We are all witnesses of the effect of major upheavals or events in the world; such as the terrorist attacks of 2001; the global economic crisis of 2008; the climate change and environment threats. As with such global events, Covid-19, which started as a local health threat in Wuhan, in China, quickly developed into a global pandemic, disrupting the life and businesses of people. Aside from the fact that these global events do not respect boundaries since the entire world is so connected, the absence of consensus or agreement amongst nation-states on how to address the issues arising from technology, the digital economy and globalization, as well as regulations and system for harmonious resolution of issues present peculiar challenges for taxation. Moreover, what I choose to refer to as 'conspiracy or alignment of influence and leadership in the international world order', perhaps places some nation-states at a disadvantage, thus eroding the social contract basis for relationships.

The Global World economy and relationships

The dynamics of the relationship of the individual and corporates with the nation-state, and by extension, the relationship of states in international law and international taxation, have occupied the attention of individual taxpayers, tax authorities, governments and multilateral organizations and agencies such as the OECD, the United Nations. The relationship between natural persons and the state, and the legal rights and relationship between them, remains the subject of social contract theory[i]. How this gets translated into the basis for a relationship in international law and taxation will certainly engage the attention of all and require further research and interrogation.

Social Contract and Taxation

Social contract theory essentially states that people live together in society in accordance with an '*agreement*' that establishes moral and political rules of behaviour. Some believe that if we live according to a social contract, we can live morally by our own choice and not because a divine being requires it. The social contract arguments therefore typically posit that individuals have '*consented*', either explicitly or tacitly, to surrender some of their freedoms and submit to the authority (of the ruler, or to the decision of a majority) in exchange for protection of their remaining rights or maintenance of the social order. Consequently, this explains the concerns over the legitimacy of the authority of the state to impose taxes on individual citizens and corporate entities connected to the state.

The degree to which the social contract argument maybe extended to international law and international taxation would seem to align with the thinking and understanding, that state sovereignty exercised over its citizens with the imposition of taxes, may result in states surrendering some autonomy by signing bilateral and multilateral treaties, for the mutual benefit of states, peoples and businesses.

Whether this reinforces or dispels the underlying principle of social relationships and legitimacy and the exercise of lawful authority, both at the individual and state levels, demands further interrogation, especially in the light of recent happenings and the overall global eco-system. Building consensus around key themes and developments such as technological advancement, the continual weakening of boundaries between states, cross border trade, easy movement of goods and services, and digital transactions remains a challenge, in the face of socio-cultural differences and the growth of populist movements etc.

The response to Covid-19 pandemic requires that in the light of the connectedness of the global economy, that states and the international tax system are reset to adequately address the disruption of the lockdown and its effect on domestic and the international economy. In the next section, we explore the domestic and international dimensions of social contract with people and taxation, especially in the light of tax policy, tax law, tax planning and tax compliance, in the era of technological and digital changes, the new normal virtual working and the absence of consensus in leadership and divergent priorities of nation-states and businesses

Domestic dimensions It has been argued that the National tax policy of a country is one product of the classic Lockean social contract between individuals and government. Tax policy creates and reflects relationships between the market, the citizen, and the state. As a result, traditional tax policy discourse centers around the premise that decisions about taxation should be made exclusively within nations, independent of outside concern and interference. But this view of sovereign autonomy over taxation is increasingly inconsistent with a global economic reality in which market and regulatory relationships have been and are being fundamentally reformulated.

The national tax policy of countries are essentially guidelines that inform the development of tax legislation and administration of taxation in the country. With respect to tax policy translating into tax law, and the level of tax compliance, the experience of Nigeria, perhaps demonstrates more the failure of tax policy translating into tax law and effective tax compliance. The principles and guidelines articulated in the Nigerian National tax policy[ii] document, has until recently, not experienced a structured attempt to guide the formulation and reform of the tax laws and tax administration in the country. It is often argued in some quarters, that, concerning tax compliance, taxpayer resistance to pay taxes is generally dictated by the fact that every economic sacrifice must give economic benefit as a return. When paying the taxes, a taxpayer will not get a direct return for the tax payment, but the benefits will be provided in the form of public service, good facilities and infrastructure built by the government as results of tax payments. However, experience and studies[iii] indicate that the low gross domestic product (GDP) to tax ratio in many developing or emerging economies may be ascribed to the fact of absence of or perception of an absence of benefit from paying taxes, as much as it is due to corruption and administrative leakages.

The prominence and economic dominance of some countries, for instance, the United States and its peer countries, results in these countries implicitly drafting a transnational social contract that potentially constrains national tax policy bargaining[iv]. Unfortunately, this appears to affect emerging economies, who lack the ability and financial bargaining power to influence the development of these policies. These emerging economies fail to come to the international tax policy debate early. The concerns and issues affecting emerging economies may not receive sufficient attention. Also, the absence of competency and lack of capacity to effectively articulate emerging economies issues is a major problem. This state of affairs invariably affects building consensus and agreement towards the evolving social contract between nations.

The COVID-19 impact on the economies of these countries cuts across the formal and informal sectors. Nigeria, with its mono-economy, which is heavily dependent on the oil and gas industry, has suffered severely, with the collapse of oil price and the effect of the pandemic. So, also is the case with other emerging economies which are either dependent on tourism or the export of agricultural products etc. which are negatively impacted due to the constriction of demand and market for their raw materials. The relative weakness of these economies means that they are not able to respond adequately to address the needs of the populace in the social contract with the state and effectively participate in building consensus on policy and taxation issues in the international arena.

International Dimensions Countries are now so economically interdependent that one nation's tax policies can profoundly undermine another's attempts to implement the bargain. Developments in the global tax landscape, especially where championed by institutions like the UN, OECD etc. can inform and influence tax policy and tax law development in most countries. More recently, developments and discussion on subjects such as BEPS, Transfer Pricing and Double taxation treaties (DTT) are shaping the debate and development of domestic and international systems.

With technological advancement, free movement of persons and goods, globalization and the digital age, the boundaries between states, peoples and institutions are disappearing. Major theoretical developments in tax policy are now arising not through solely national political and legal processes but through the interactions of non-governmental actors in transnational settings. Working together in networks, especially the Organization for Economic Cooperation and Development (OECD), these transnational actors are gradually redefining the connection of taxation to sovereignty[v].

Covid-19 has significantly affected the international trade, the aviation industry, tourism, health and manufacturing sectors with the lockdown of economies, resulting in reduced government revenues and severe cases of unemployment. These, in turn, impact revenue from taxation. The response by countries and regional blocs such as the EU/ OECD/G20 etc. all demonstrate the connectedness of economies, and the social contract between individuals and state authorities, and between states.

Conclusion

The technological developments, the disruption caused by the digital age, cross border transactions, and the effect of free movement of persons, goods and services in a vastly connected world has meant that no economy is spared the effect of the COVID-19 pandemic. The failure of traditional systems and regulations for dealing with taxation is placing serious demands on domestic and international taxing systems. How States proceed with building consensus to create a social contract that facilitates effective taxation, especially in the light of the massive disruptions caused by the pandemic will require continuous engagement by all parties. Success will perhaps depend on how proactively and quickly countries and the international taxation system unlearn old habits and begin to ascribe to the new normal way of doing things.

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[i] Emergence of social contract theory is pioneered by several well-known scientists as Thomas Hobbes and Jean Jacques Rousseau.

[ii] National Tax Policy documents 2012 & 2016

[iii] The problems exist if return from tax payment cannot be felt by taxpayer. For example, Russia had a bad experience when taxpayer compliance level reached the lowest figure of 26%. Low tax compliance in Russia was happened because of taxpayer distrust to government in relation with accountability of tax revenue management. Taxpayer criticized the government's performance because of high and massive corruption and government failure to provide public services; it makes taxpayer refuse to pay taxes (Rothstein, 2000)

[iv] Allisons Christians, Sovereignty, Taxation, and Social Contract, *Minnesota Journal of International Law, Vol. 18* *Univ. of Wisconsin Legal Studies Research Paper No. 1063* [v] Thirty of the worlds‟s largest economies, including the United States, Japan, Germany, and the United Kingdom, but not China or India, are OECD members. *See* OECD, RATIFICATION OF THE CONVENTION ON THE OECD AND OECD MEMBER COUNTRIES, *available at* http://www.oecd.org/document/58/0,2340,en_2649_201185 (last visited June 11, 2008).

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