

Tax Implications of Natural Disasters and Pollution

*Massimo Basilavecchia, Lorenzo del Federico
& Pietro Mastellone*



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Law & Business

EUCOTAX Series on European Taxation

**Tax Implications of Natural
Disasters and Pollution**

Edited by

Massimo Basilavecchia
Lorenzo del Federico
Pietro Mastellone



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Tax Implications of Natural Disasters and Pollution

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Introduction

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Contents/Subjects

The EUCOTAX series covers a wide range of topics in European tax law. For example tax treaties, EC case law, tax planning, exchange of information and VAT. The series is well-known for its high-quality research and practical solutions.

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Practitioners and academics dealing with European tax law.

Frequency of Publication

2-3 new volumes published each year.

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Foreword Written By
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Foreword*

While seemingly technical, the theme of this important new volume raises some key social, economic and even philosophical dilemmas facing governments today.

This is so firstly because of the importance of disasters as a threat, not only to the lives and well-being of citizens, but also to the health of societies and economies as a whole. For example, the earthquake that struck Port-au-Prince, Haiti in January 2010 killed more than twice as many people in a single day (over 220,000)¹ than those who died in that country of all causes in the preceding year.² When the Eyjafjallajökull volcano choked Europe's airspace with ash later that year, losses to airline companies exceeded USD 1.7 billion,³ and the overall economic impact was estimated at USD 5 billion.⁴ More recently, in 2013, Typhoon Haiyan uprooted some 4 million Filipinos, 4% of the country's population.⁵ While not capturing as many headlines, 'small' disasters cumulatively wreak even more economic damage than the 'mega-disasters' and kill comparable numbers of people.⁶

Reducing the risk of such calamities should surely be a high-level priority. But how can this be achieved? The answer is not as simple as it first appears. Psychological studies have demonstrated that individuals have an unfortunate tendency to discount

* The views expressed in this Foreword are the author's own and do not necessarily represent the position of the IFRC or of its members.

1. IFRC, *Haiti Earthquake. Five-year progress report*, Geneva, 2015, available at www.ifrc.org/Global/Publications/general/1287600-IFRC-Haiti%205-year%20progress%20report-EN-LR.pdf, p. 2.
2. RURAL POVERTY PORTAL, *Statistics (crude death rate)*, available at www.ruralpovertyportal.org/country/statistics/tags/haiti.
3. See THE ECONOMIST, *The fire next time*, 14 April 2011, available at www.economist.com/node/18558053?zid=313&ah=fe2aac0b11adef572d67aed9273b6e55.
4. DER SPIEGEL ONLINE INTERNATIONAL, *Ash Sensor in Testing: European Airline Prepares for Next Volcano*, 2 January 2012, available at www.spiegel.de/international/europe/ash-sensor-in-testing-european-airline-prepares-for-next-volcano-a-806670.html.
5. IDMC, *The evolving picture of displacement in the wake of Typhoon Haiyan. An evidence-based overview*, Geneva, May 2014, p. 2.
6. See, e.g., UNISDR, *The silent disaster of local losses*, 27 November 2013, available at www.preventionweb.net/english/professional/news/v.php?id=35669&utm_source=pw_search&utm_medium=search&utm_campaign=search.

the risk of disasters in irrational ways.⁷ While major events certainly raise public fears, their impact on behaviour is often short-lived. For example, a survey of Atlantic and Gulf Coast residents conducted a year after Hurricane Katrina dealt historic levels of death and damage in the United States found that less than 20% had taken any steps to strengthen their homes in the face of future storms.⁸ This irrationality carries over even into the private sector, whose sensitivity to business-specific investment risks does not always extend to risks from natural hazards.⁹

Certainly, one crucial way for governments to correct this imbalance is through direct regulation. For example, urban planning regulations and building codes can and generally do insist on attention to safety in the placement and construction of dwellings in light of future hazards.¹⁰ However, it must be recognized that administrative rules like these can impose significant costs on individuals and companies, as well as on the governmental agencies charged with enforcing them. The very poor, in particular, are often not in a position to bear these costs. Thus, rules designed with their general well-being in mind might end up leaving them worse off, for instance, by making adequate housing less accessible and/or forcing them to distance themselves from livelihood opportunities. Moreover, whereas a ‘compliance culture’ is quite strong in some countries, in many others, both obedience to, and enforcement of, key safety-related rules is extremely poor.

For these and other reasons, governments cannot rely solely on prohibitions and restrictions but must also look to incentives for disaster risk reduction. As pointed out in this volume, tax policy can play a role here. Several examples are described here related to insurance, such as rendering policies less expensive via corresponding tax deductions, as in the case of Austria and Germany or, on the contrary, by adding a surcharge to private premiums to allow for public coverage of ‘uninsurable’ disaster types, as in the case of fire insurance in Denmark. The *ex ante* use of tax incentives is also fairly common with regard to private infrastructure investments to support ‘green development’ and reduce pollution, as noted in this volume with respect to Japan. Unfortunately, however, similar tax incentives for investments in activities such as retrofitting of unsafe dwellings, revitalization of natural barriers (such as forests, mangrove swamps and wetlands), or voluntarily moving to areas less exposed to natural hazards remain the exception rather than the rule.

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7. See, e.g., E.U. WEBER, *Experience-based and description-based perceptions of long-term risk: why global warming does not scare us (yet)*, in *Climatic Change*, vol. 77, no. 1/2006, p. 103 et seq.; G. LOEWENSTEIN – E.U. WEBER – C.K. HSEE – N. WELCH, *Risk as feelings*, in *Psychological Bulletin*, vol. 127, no. 2/2001, p. 267 et seq.
 8. See H. KUNREUTHER – E. MICHEL-KERIAN – M. PAULY, *Making America more resilient toward natural disasters: a call for action*, in *Environment*, vol. 7, no. 4/2013, available at www.environmentmagazine.org/Archives/Back%20Issues/2013/July-August%202013/making-america-full.html.
 9. See UNISDR, *From Shared Risk to Shared Value – The Business Case for Disaster Risk Reduction. Global Assessment Report on Disaster Risk Reduction*, Geneva, 2013, available at www.preventionweb.net/english/hyogo/gar/2013/en/gar-pdf/GAR2013_EN.pdf, pp. 194-197.
 10. See IFRC-UNDP, *Effective law and regulation for disaster risk reduction: a multi-country report*, Geneva, June 2014, available at www.undp.org/content/dam/undp/library/crisis%20prevention/UNDP_CPR_DRR_fullreport2014.pdf, pp. 45-71.

Likewise, tax policy is not generally thought of as a tool for supporting immediate post-disaster relief. This is perhaps more understandable, as tax incentives are generally slow to be felt. However, in his chapter, Werner Haslechner points out a fascinating counter-example from Germany, which allows employees to exclude a portion of their salary from taxable income (and immediately reduce the amount of tax withholding), if they voluntarily forego it in favour of a disaster-struck co-worker. In many countries, there are laws allowing for tax deductions related to charitable donations, and several have specific rules with regard to donations to be used for the purpose of disasters; however, there is quite a range as to the amounts allowed to be claimed and the organizations that may receive them.¹¹ Countries that do not allow such deductions or that restrict them by amount should consider that such mechanisms not only support affected persons but also indirectly save them money they might otherwise spend on public disaster relief (though the latter will never be completely ruled out by private efforts).

For the most part, as described by the authors in this volume, tax policy is used to support recovery, for instance, by defraying some of the disaster-related expenses borne by affected persons and companies or stimulating reinvestment in affected areas. Tax mechanisms have some distinct comparative advantages in meeting these objectives – Including an already established mechanism for ‘distribution’ of the support as well as institutional capacity and experience in making targeted and nuanced decisions about whom to support and how. This built-in system of reporting and oversight may make it easier to guard against discrimination and fraud, which are a particular risk in the often chaotic and politically-urgent task of reconstruction.

The countries described here have tried to calibrate their tax support to avoid undermining private insurance markets and straying into the moral hazard of promoting private risk-taking on the basis of expected government bail-outs. They have also grappled with the question of how much help is enough help, in light of the potential for market distortions and the provision of unfair advantages. In this respect, it is striking that the European Union (in its limited exceptions from ‘State aid’ prohibitions related to disaster recovery) and most of the countries described are careful to avoid ‘over-compensation’. The notion that beneficiaries of public support should not be any better off than before the disaster has struck them, however, contradicts the growing consensus among disaster management experts that communities should be ‘built back better’ after disasters, not just restored to the same precarious state they may had before.

As pointed out by Professor Kawabata, moreover, recovery support focused on tax deductions will only help those with sufficient income and assets to owe tax in the first place. Thus, poor families – particularly those that do not own their own homes and who are therefore often unable to claim benefits for repair or rebuilding – will only benefit if there is a possibility of an affirmative tax credit. This segment of the

11. See K. SIMON – L. IRISH, *Tax preferences for non-governmental organizations*, in P. BATER – F. HONDIUS – P. KESSLER LIEBER (eds), *The tax treatment of NGO's. Legal, ethical and fiscal frameworks for promoting NGOs and their activities*, Kluwer Law International, The Hague, 2004, pp. 315-316.

population is often the most forgotten as time moves on after a major disaster and headlines shift to other issues. A tax-related (longer term) approach may thus be of particular help to them, if well designed.

In general, States have tended not to legislate extensively with regard to disaster recovery, electing instead an ad hoc approach. This may lead to very different (and sometimes unfair) approaches as between disasters depending on the level of political attention they receive. Learning from the examples described here will surely help, both in how best to balance the social interests at play and to avoid inequities. It is also to be hoped that this volume will stimulate additional scholarship in this neglected but important area of public policy.

David Fisher

Preface

Natural disasters are physiological in the life of planet Earth; they are unpredictable and frequently cause human casualties and destruction. Nowadays, the depletion of natural resources caused by an excessive level of industrialization and the development of cross-border trade have increased the number of disasters caused by human activities, whose extraordinary pollution need to be neutralized through specific measures. Despite their undoubted importance, public finance profiles and tax implications are often neglected.

The present volume has been conceived to fill this gap and, therefore, it analyses the measures of public finance and 'compensatory' taxation for geographical areas struck by natural disasters and disasters due to human error or environmental pollution. More precisely, the research focuses primarily on EU commitments and policies, with particular regard to State aid regulations laid down by Article 107 TFEU, the CJEU's case law and the European Commission's approach.

The study then analyses several significant experiences of EU Member States and makes an important comparative analysis of the Japanese tax regime, whose interest is traditionally based on the earthquakes response law and it is nowadays highly increased by the recent Fukushima nuclear disaster. In relation to each national tax system, scholars and distinguished experts examine the instruments aimed at facing the damage provoked by natural calamities and environmental disasters: public finance schemes, tax measures and, if existent, compulsory insurance mechanisms alternative to tax measures.

This comparative assessment will clearly permit to highlight the different reactions that States have after calamitous events: in fact, a State may merely adopt 'recovery measures' (i.e., measures aimed at restoring the damage suffered by taxpayers) or introduce also 'development measures' (i.e., measures aimed at creating new and different opportunities for income production).

The volume aims at achieving several goals: investigate the efficiency of EU and Member States' response law, outline the framework of financial subsidies and tax

reliefs, address victims of disasters to the most appropriate aid instruments and highlight the business opportunities.

Massimo Basilavecchia
Lorenzo del Federico
Pietro Mastellone

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CHAPTER 1

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