TAX LOSS CARRYBACKS AND TAX-RELATED CASH FLOW POLICIES IN PERIODS OF FINANCIAL RECESSIONS

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Abstract

The asymmetric treatment of tax losses is an attribute common to almost all corporate income tax systems. This is most evident in times of financial recession when the liquidity, financial health, and even the survival of the companies are threatened. Tax loss carrybacks have been repeatedly used in the United States as a fiscal stimulus measure during recessionary conditions. Specifically, during the 2001 recession and the 2007–2009 recession the United States extended the tax loss carry-back period from two years to five years in order to improve firms' financial position and lower bankruptcy risk. In a similar vein, during the COVID-19 pandemic, the European Commission issued Recommendation 2021/801 which recommended the carry-back of losses for the small and medium-sized enterprises that were hit by the pandemic (European Commission, 2021). The measure would lead to an increase in the cash flow helping healthy businesses to survive.

A number of European Union Member States adopted this recommendation whereas some countries had already allowed the carry back of losses before the outbreak of the COVID-19 crisis. Specifically, in response to the COVID-19 crisis, three countries introduced a temporary acceleration of corporation tax loss relief whereas one country increased the loss carry-back amount that can be offset. There are also four

countries that adopted a temporal measure only for the years affected by the pandemic whereas one country incorporated a permanent 2-year loss carry-back period in its Tax Code. Greece is among the countries that did not adopt the recommendation. Undoubtedly, these divergent rules for the treatment of losses created an uneven playing field.

The purpose of this paper is to examine the liquidity and the financial position of the Greek companies three years after the pandemic and try to estimate whether the application of Commission Recommendation 2021/801 would have affected their cash holdings and to what extent (European Commission, 2021). First, we present analytical data regarding the impact that a tax loss carryback would have both on the cash flows of the firms and on public revenue. Then, we examine whether firms were able to offset their losses with profits in the following years or whether they did not recover from the economic recession. We believe that our findings will provide significant insight into the impact of tax asymmetries under the current corporate income tax law.

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