Could uncertainty be your best opportunity for growth?

The growth agenda
SMOOTH SEAS DO NOT MAKE SKILLFUL SAILORS.

Swahili proverb
One piece in the puzzle

Countries today are locked in a race to retain existing capital and attract more inbound investment. This is no easy feat amid a global landscape marked by political uncertainty and uneven economic growth.

A nation’s tax policies can certainly make a critical contribution to long-term economic growth. As taxes are one of the largest expense and liability items in many organizations’ financial statements, CEOs, CFOs and other decision-makers closely review a country’s tax policies when looking for a destination for their capital. They may ask: Is the rate competitive? Are business costs treated fairly? Are there attractive incentives? Is the approach to collection, enforcement, taxpayer rights and dispute resolution sound?

Governments know tax policy is only one ingredient for optimal growth. Others include sound infrastructure, stable social and fiscal policies, fair and effective legal systems and an educated and competitive workforce.

Tax matters

When it comes to the global tax environment, governments’ current mantra is a low headline rate, but with a typically broader base.

In order to attract investors, some countries are opting to cut corporate income tax (CIT) rates and/or roll out innovation incentives such as patent boxes. In EY’s outlook for global tax policy in 2017, 8 of 50 countries surveyed planned to reduce their CIT rates in 2017. Of the remainder, 40 planned no change to their tax rates, while just 2 nations forecast rate increases. Eleven of the 50 respondents said they plan to introduce more “generous” R&D incentives in 2017.

While such moves are helpful to business, governments need to recognize that organizations will look beyond tax rates or incentive packages and consider the entire tax environment. Businesses want assurance that a country will treat taxpayers fairly. It’s one matter to qualify for some form of tax incentive, but what happens if an investor fails to get the proper stamp on a form or misses a deadline and the incentive disappears?

Similarly, business will assess if taxpayers are given the following: fair treatment in the examination process; access to an appeals process, including unfettered access to courts; and the opportunity to avail themselves of dispute resolution procedures or competent authority processes under international tax treaties without repercussion.

Businesses and government policymakers are typically aligned in the objective of growth – for their company and their country, respectively – but neither are willing to take on undue risk in exchange. Government policy coupled with fair enforcement is a critical balance to achieve the growth desired by all.

Solid foundation

Businesses want to invest in stable and growing economies. This means destinations where governments are investing in their infrastructure, education and health care systems to support the flow of goods and a competitive workforce. And where there is stability in leadership and transparent legislative and legal processes, there is a basis for solid, long-term growth.

The United States is one country currently debating its tax system. The US policy of taxing US-based businesses on their global earnings (instead of a territorial approach) leaves the US as the only G7 country with this system. When coupled with a corporate tax rate that exceeds all other developed nations, reform is a real possibility. Despite these perceived negatives, the US has been able to avoid undue capital flight. How? In general the country’s trade and immigration policies have been viewed as positive for encouraging US investment.

Balancing act

In order to attract steady, long-term investment, a country must evaluate the whole of its tax, fiscal and legal systems, along with its physical infrastructure and labor resources. Achieving the right mix is a balancing act that countries are attempting all around the world. While tax policy is certainly a key factor in choosing where to invest, when viewed in isolation it is rarely sufficient to change the economic behavior of a business or investor. For most businesses, it is about finding the right mix between the tax environment and other growth and value drivers.

As policymakers seek new ways to drive economic growth, they want and need to hear from companies about what that mix would be and how potential changes would affect business decisions.

The economy can only grow when all the right pieces are in place.
“The consensus has been that, for income taxes, low rates plus a broad base favor economic growth.”

Victoria Perry
Assistant Director, Fiscal Affairs Department
International Monetary Fund (IMF)

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Globalization has been a powerful force in recent decades, dismantling trade barriers, increasing the movement of people and flow of goods and services across borders and creating multinational businesses. Recent political events have reflected a shift in some attitudes about globalization amid concerns about rising inequality and environmental damage, among other issues. While it’s hard to imagine our interconnected world severing ties overnight, the globalization of the past may not be that of the future.
Integration or isolation: the path forward

- Increased trade
- Lower tariffs
- Economic growth
- Global collaboration
- Harmonization of regulations
- Creation of good jobs
- Technological advancement
- Falling poverty
- Cultural exchange
- Inclusive growth
- Tolerance
- Clean environment
- Rising tariffs
- Collapse of trade
- Economic slowdown
- Income inequality
- Trade protectionism
- Patchwork of laws
- Unemployment
- Environmental destruction
- Xenophobia
- Rising poverty

“Entrepreneurship is culture, and it needs to be nurtured.”

Turki Al Yahya
Founder/Managing Partner, GHC (WHITES Health & Beauty),
EY Entrepreneur
Of The Year™ 2016 Saudi Arabia

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Tax thought leadership online

Future of Tax: the transformation of a core business function
Blockchain, data analytics and robotic process automation. Watch the Future of Tax video series to understand how emerging technologies and growing global transparency are remaking the tax function. Is your business ready?

2017 Task Risk and Controversy Survey Series: Tax steps into the light
EY surveyed tax and finance executives about the current state of tax planning, provision, compliance and reporting. Their feedback is clear: new transparency and reporting initiatives are transforming tax. The report provides six steps organizations can take to adapt to this new environment.

Worldwide Indirect Tax Developments Map
Much change is afoot in indirect tax today. Stay informed with the new Worldwide Indirect Tax Developments Map with updates on valued-added tax and goods and services tax (VAT/GST), along with global trade, insurance premium tax and excise and environmental taxes.

EY leaders featured in this issue:

Chris Sanger
EY Global Tax Policy Leader
+44 20 7951 0150

Marlies de Ruiter
EY Global ITS Tax Policy Leader
+31 88 407 7887

Bridget Walsh
EY Global Head of Transaction Tax
+44 20 7951 4176
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The tax & growth paradox
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Expansion prospects
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The great trade reset
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IMF/OECD deliver report addressing tax certainty
Changing tax legislation and drawn-out court decisions: these are among the sources of tax uncertainty today, according to a report by the Organisation for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF).

US tax reform outlook has potential global effects
The report provides an overview of the current state of the US tax reform debate, including possible elements of the reform and key issues for stakeholders.

Governments are prolific in creating excise taxes
Tobacco, alcohol and fuel are traditional excise taxes, but governments are now targeting other products to raise additional tax revenue and shape consumer behavior.

Start-up tales
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Growing green
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Here come the robots
48  Technology may soon put many people out of work. A tax on robots and the introduction of a basic universal income are among the possible responses being discussed today.
Don’t let uncertainty disrupt growth

Nearly a century ago, EY’s original founders Alwin Ernst and Arthur Young were running separate US firms but shared a common goal – growth. In 1924, both took their first steps toward internationalization, setting up alliances with UK firms.

What they did not – and could not – know was that these were the first steps on a journey of global expansion, one that would eventually bring the two firms together.

These expansion initiatives came during a period of uncertainty. A time when many countries were imposing trade and exchange restrictions to protect their domestic markets. But both men recognized that to grow they needed to look beyond their home market.

Today’s world is also an uncertain one: economic growth is patchy, while income inequality is on the rise. As governments look for solutions, we’re once again seeing an increase in protectionist measures. But rather than close doors, governments should seek to unlock opportunities for more inclusive and sustainable growth, focusing on opening up markets, leveling competition and reforming and updating tax systems in recognition of the changing digital and global nature of commerce.

Era of expansion

There are clear economic benefits to our interconnected global economy. Increased global trade has reduced the cost of goods and services in developed countries, for example. People can buy more with their money, be it washing machines, airplane tickets or the latest smartphones.

Developing countries also have benefited from greater international trade and foreign direct investment. As these economies flourished, new start-up companies emerged and existing businesses expanded. Many of the world’s largest companies are now based in developing markets, accounting for 147 of the Fortune Global 500 in 2016.

Global growth has helped significantly lower poverty around the world, allowing millions of people to join the middle classes. At the same time, the number of people living in extreme poverty declined from 836 million in 2015 from 1.9 billion in 1990, according to the United Nations. Almost half of the population in developing countries had less than $1.25 a day to live on in 1990. By 2015, this figure had declined significantly to 14%.

A wary world

But an interconnected world brings complexity, and sometimes contagion. The subprime mortgage disaster in the US rapidly evolved into the 2008 global financial crisis and subsequent economic slowdown – events from which the world has yet to fully recover.

Growing inequality, within both developed and developing countries, is an important issue today. Across the Organisation for Economic Co-operation and Development (OECD), the gap in incomes between the richest and poorest is at a 30-year high, and technological and demographic changes only threaten to further widen this divide.

In response, globalization – in particular, trade and migration – have increasingly become targets of criticism. 2016 was a year of profound change – certainly in the UK and the US, among other countries – where many voters registered their dissatisfaction with the status quo.

Free trade and open borders are under increasing challenge. The UK’s Brexit referendum last year abruptly interrupted the European Union’s decades-long quest toward political and economic integration, while the US this year decided to withdraw from the Trans-Pacific Partnership (TPP). Recently, members of the International Monetary Fund (IMF) dropped a pledge to “resist all forms of protectionism.”

In the US, many workers blame international trade for job losses, but technological disruption has played a significant – if less recognized – role. A 2015 Ball State University study, The Myth and the Reality of Manufacturing in America, found that the US manufacturing sector lost 5.65 million jobs between 2000 and 2010, with productivity gains accounting for 88% of those losses. And it’s a trend that’s showing no signs of slowing down.

While factory workers were the first to feel the impact of increasing automation, technological advancements
have since disrupted whole sectors: tourism, publishing and postal industries, to name just a few. Professions as diverse as law and teaching are likely next.

It is estimated that automation, artificial intelligence (AI) and other disruptive changes could displace 7.1 million jobs by 2020, according to a report from the World Economic Forum covering 15 major developed and emerging economies. Already, it’s been reported that a Japanese insurance firm began replacing employees this year with an AI system that promises to be cheaper and more productive.

**Come together**

Organizations today rely on global supply chains and markets – as does the world economy. Turning away from globalization would mean lower efficiency and economic growth. The world instead needs to find a way to keep trading and growing together.

Business and government leaders must support an environment of inclusive growth to ensure the long-term benefits reach the broadest group possible. This includes employees, customers and communities, as well as shareholders. If the broader population – not just the top earners – sees an increase in their income, then consumption will expand and fuel greater economic growth.

The leaders of the G20 recently put inclusive growth on their agenda as they seek to kick-start a new era of global economic growth. In doing so, they acknowledged the need to create better jobs, address inequalities and reduce poverty going forward.

There are different ways to accomplish these ambitious but critical goals. Governments need business to create new jobs and to invest and drive growth. One way is by incentivizing businesses and institutions to deliver training and apprenticeship programs for young people and displaced workers.

Business, in turn, needs government to put strong, pro-growth policies in place. Governments must seek to conclude additional trade deals, even if they are only on a regional basis. More work must also be done to liberalize trade in services around the world, and to address non-tariff issues that companies face when doing business internationally, including different regulations and local laws.

Furthermore, changes to tax policy and structural reforms could lift economic growth and reduce inequality. Governments can spur growth by levying corporate tax on a broader base at lower rates and introducing or expanding innovation tax incentives.

The use of digital technologies also promises to make tax collection and administration more effective and improve compliance. The current G20 agenda, focused on tax certainty and growth, is driving discussions on how digitalization will impact tax and what measures can be taken to better deal with the global digital value chain and the future collection and allocation of taxes.

Governments may also consider reevaluating the structure of long-established tax systems, creating new approaches to the taxation of wealth and capital.

An inclusive and expanding global economy will allow companies to continue expanding and create new jobs both in their home markets as well as abroad. This outward-looking mindset is one that EY has followed for almost 100 years and will continue to do so as we go forward – in both the good times, and the tough.

By Mark A. Weinberger,
EY Global Chairman and Chief Executive Officer
The cross section of a tree reveals the growth rings inside. The tree expands in size as new cells grow, creating ring after ring. Depending on the conditions, for example the amount of rainfall in a year, the rings can be larger or smaller in size. Whether it's trees or the economy, growth depends on external factors.
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While taxation may be an imperfect exercise, it is a fundamental function of governments, used to raise adequate revenue to provide services and meet other obligations, as well as support the quest for sustained economic growth.

Taxation “is the most difficult function of government, and that against which their citizens are most apt to be refractory. The general aim is, therefore, to adopt the mode most consonant with the circumstances and sentiments of the country.”

These words written two centuries ago by Thomas Jefferson, the third US president, still ring true for governments today.

What taxes will taxpayers consider palatable? At what level? How to balance that with revenue needs and the desire for economic growth? How do specific taxes and tax levels affect growth? Are there “right” tax policies for specific growth problems? How do short-term solutions affect long-term growth? The questions are almost endless — and the answers not always clear.

Making the exercise even more complicated is the fact that tax policies are shaped in part by political rather than economic considerations and can be the product of negotiations among opposing views and political parties. As European Commission President Jean-Claude Juncker once quipped about certain Eurozone economic policies: “We all know what to do, we just don’t know how to get re-elected after we’ve done it.”

However imperfect and difficult the process, developing tax policy is a fundamental function of governments, used not only to raise adequate revenue to provide services and meet other obligations, but also in the quest for the sustained economic growth that will support high employment and production and better quality of life for their citizens. Given the low global economic growth of recent years, governments around the world have been looking hard at how taxes might help.

Distortions
Almost all taxes are considered economically distortive. However, some impede growth more than others. In 2008, the Organisation for Economic Co-operation and Development (OECD) issued a report ranking major groups of taxes in terms of their negative impact on long-term economic growth. The report concluded that corporate/capital income taxes have the most damaging potential effect, followed by personal income taxes, consumption taxes such as value-added taxes (VAT), then recurrent real property taxes.

“Whenever an economic choice is driven by something other than pure market forces, it distorts the decision and distortions generally impede growth by making the economy less efficient,” says Michael Mundaca, National Tax Co-Director, Ernst & Young LLP, United States, based in Washington, DC and a former Assistant Secretary for Tax Policy for the US Treasury Department. In theory, the best strategy for growth is to remove the distortions.

But designing a tax system that will encourage growth is anything but simple. A nation cannot simply choose only taxes that are thought to be least distortive. “Real property taxes and excise taxes may be the least harmful to growth, but of course you can’t run a whole government on them alone,” says Victoria Perry, Assistant Director, Fiscal Affairs Department, International Monetary Fund (IMF).

“The consensus has been that, for income taxes, low rates plus a broad base favor economic growth,” says Perry.

Finding the right mix of taxes to balance national revenue needs and growth-friendly tax structures is not easy. “One of the toughest problems is how to tax household income and residential property in the same way as business assets,” says Dale Jorgenson, Samuel W. Morris University Professor in Harvard University’s Department of Economics and pioneer of several aspects of modern economic analysis of tax policy.
“Without it you’re not going to gain very much from tax reform,” Jorgenson says. “A pro-growth tax strategy goes beyond national borders as well. “Tax structures that create as few hurdles as possible for foreign direct investment support economic growth,” says Marlies de Ruiter, EY Global ITS Tax Policy Leader, based in Rotterdam, the Netherlands. “It is also important to be sure that source taxation is as low as possible so that the tax environment in domestic markets is the same for everyone who wants to invest there,” adds de Ruiter, the former Head of the OECD’s Tax Treaty, Transfer Pricing and Financial Transactions Division.

Despite the influence of tax on growth, there is no firm agreement about exactly how important it is or the potential economic growth impact of specific taxes or incentives. “It can be difficult to isolate and quantify the effect of a tax,” says Perry. “Tax affects outputs, which can also lead back to revenues and spending, which leads back again to outputs.”

**State of uncertainty**
If taxes are a drag on growth, so is uncertainty about those taxes, since it undermines the ability of businesses to estimate risks or project long-term returns, thereby reducing their willingness to make investments.

“A tax structure that brings certainty and stability to business is critical for business growth, for employment, for economic growth across the board,” says David Lewis, Vice President – Global Taxes & Assistant Treasurer for pharmaceutical giant Eli Lilly and Company.

“Every size company needs to know that, when we make economic decisions based upon the information we have today, we can reasonably rely on the conclusion that those economic circumstances will remain in place.”

Some uncertainty today arises from OECD recommendations to address base erosion and profit shifting (BEPS). “While the desire was to create more certainty across governments and tax policies, I think we all fear that there will be greater uncertainty,” Lewis says.

The OECD is well aware of these concerns. “It was right to do the work on transparency and base erosion and profit shifting first because that was about fixing broken rules,” says Pascal Saint-Amans, Director of the OECD’s Centre for Tax Policy and Administration. “But we always need to get the balance right and we know it is also important to make sure that investments are not subject to hurdles from tax policies or tax administrations.”

Toward that end, the OECD and the IMF published a report in March 2017 on tax certainty that had been requested by G20 leaders. The report provides recommendations for practical measures for enhancing tax certainty, including tools for both dispute prevention and resolution, according to Saint-Amans. (For prior coverage of tax certainty, see Tax Insights Nº 18, available at taxinsights.ey.com.)

The OECD’s ongoing work on tax certainty will remain in the spotlight for the foreseeable future. The G7 Finance Ministers and Central Bank Governors issued a communiqué at the conclusion of their May 2017 meeting indicating that financial (including tax), economic and political uncertainties are currently significant barriers to growth. And in July 2017, the G20 leaders said they welcomed international cooperation on pro-growth tax policies and work on improving tax certainty following their meeting in Hamburg, Germany.

**Low-growth trap**
By all measures, the global economy has been limping along in recent years and only modest global growth is projected through 2018 because investment, trade, productivity and wage growth all remain weak, in what many have called a low-growth trap. When growth remains slow, businesses become cautious and invest less and consumers become pessimistic and spend less, in turn increasing business restraint even more. And economic uncertainty causes banks to be less willing to lend to businesses, reducing their ability to finance investment.

A parallel problem is that, while growth remains subdued, income and wealth at the top of the economic ladder have steadily increased, causing a huge gap between rich and poor: across the OECD countries, the richest 10% of the population now earn almost 10 times more than the poorest 10%, up from 7 times in the mid-1980s.

And the middle has shrunk. The growth of median incomes has slowed and, in some OECD countries, real median incomes have not grown in decades. This further
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Credit: Stephen Voss

impedes economic growth, because middle classes help drive economies.

These inequalities undermine social cohesion, in turn making it even harder to implement policies that would promote growth for the most affected groups.

All these trends together have led the G20 and the OECD to push hard for economic growth policies, but ones that will also promote inclusive growth.

Beyond the drawing board

Countries continue to pursue lowering their income tax rates while broadening their tax base, according to the EY report, *The outlook for global tax policy in 2017*. Of the 50 countries surveyed for the report, 8 countries reported that laws are now in place that will result in lower corporate income tax (CIT) rates in 2017. Several of the countries have begun or are about to begin significant multiyear rate reductions, including India, Japan and the UK.

Another 40 reported no anticipated or known change to their national headline CIT rate in 2017, while the change was small for the two countries reporting an increase.

At the same time, tax bases are getting broader. Transfer pricing changes were the leading causes of tax base broadening in the survey (32%), followed by less ability to deduct interest/business expenses (31%) and tax enforcement changes (21%).

Governments are also increasingly using tax policy as a tool to incentivize pro-growth behavior, such as innovation and patent boxes and incentives for both research and development and broader business investment, according to London-based Chris Sanger, EY Global Head of Tax Policy.

In the view of many economists, a key feature of a good tax system is that taxes should fall on consumers rather than producers, according to London-based Nick Catton, Assistant Director, Economic Advisory, Ernst & Young LLP, United Kingdom, and former senior economist for the UK’s HM Revenue & Customs. “If you tax something that’s part of the production chain, you introduce a distortion both into how goods and services are produced and also into what’s consumed, whereas if a tax just falls on consumption, there’s only the one distortion,” Catton says.

It’s not surprising then that consumption taxes (such as VAT and sales taxes) were ranked low in damaging effect on

“Real property taxes and excise taxes may be the least harmful to growth, but of course you can’t run a whole government on them alone.”

**Victoria Perry**

Assistant Director, Fiscal Affairs Department
International Monetary Fund
growth by the OECD. Those levies have taken an increasing share of tax across the developed world in recent decades.

“We’ve seen a significant increase both in terms of rate increases and the adoption of VAT or a goods and services tax (GST),” says EY’s Sanger. “For example, China is replacing its business services tax with a VAT and India is fundamentally reforming its multi-state GST.”

The Bahamas, China, Egypt, Malaysia and Tanzania have all adopted VAT/GST in recent years, and in 2018 Member States of the Middle East’s Gulf Cooperation Council (GCC) are due to adopt a VAT.

Wait and see
Just as the OECD’s BEPS project has increased tax uncertainty for the foreseeable future, forcing businesses to wait and see how the recommendations will be implemented around the world, the use of taxes to improve economic growth will add another layer of uncertainty as policies shift.

The US is one of many nations rethinking its tax laws in the search for growth. Any tax reform by a major trading nation would change the business and economic landscape, and many countries are modeling these potential effects and assessing how they might shape their tax policies in response.

To a certain degree, businesses can address this uncertainty through monitoring and modeling to assess the impact of any tax reform. Organizations also need to engage with local and global leaders about possible tax policy changes and the impact on their businesses.

Those leaders are listening, since both businesses and countries have a major stake in the outcome.

“We have an extraordinary opportunity today to achieve transformational tax reform that could be a legacy to our children and grandchildren,” Lewis says with regard to US tax reform proposals. “It’s important to get it right.”

In a world searching for growth, it’s true for tax policy everywhere.
“There has been a backlash against tax rulings. But rulings can be an important part of how a company delivers tax certainty. In light of the latest developments, we have to regain trust between the companies concerned and the tax authorities through strengthening this relevant instrument.”

Klaus von Brocke
EU Direct Tax Services Leader**

“The leading countries demonstrate a strong link between tax policy and tax administration – in terms of forming, operating and improving a country’s tax laws. Indeed, tax certainty through a stable, predictable and consistent administration of tax policies is a key element of international attractiveness.”

Jean-Pierre Lieb
EY EMEIA Tax Policy & Controversy Leader

“Recently we have heard about the potential for income taxation of robotics given the anticipated impact of this trend on the global workforce and concerns about lost revenue. As with many other technological revolutions coming before this one, technology tends to increase production and expand economies, thus creating new, more advanced skill jobs. Therefore, countries should consider promoting and encouraging (through policy) emerging technologies that increase productivity vs. seeking to immediately tax them.”

Channing Flynn
EY Tax Technology Sector and Global Digital Tax Leader

“In the past, reducing inequality was seen mainly as a question of achieving a fair society, but over the last three years organizations such as the OECD and IMF have made a strong economic case that action to curtail highly unequal distribution of income and wealth can promote sustainable growth by improving social cohesion, which in turn helps government’s introduction of growth-promoting structural reforms.”

Jeffrey Owens
Senior Policy Advisor*

* Ernst & Young LLP, United Kingdom
** Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Germany
“M&A remains very much rooted in our corporate culture and is a key driver of our growth.”

Pierluigi Longo
M&A Director
Luxottica Group S.p.A.
Growing uncertainty caused by shifting tax rates and rules isn’t stunting worldwide mergers and acquisitions today, but it is making matters more complicated.

By Bill Millar

For many businesses, mergers and acquisitions (M&A) drive growth. Consider the history of Luxottica Group S.p.A. in the eyewear industry. The Milan, Italy-based company, founded in 1961, has assembled much of its portfolio of branded eyewear, retail networks and eyewear distributors through acquisitions.

“M&A has always been a crucial activity for the group,” says Luxottica M&A Director Pierluigi Longo. “It remains very much rooted in our corporate culture and is a key driver of our growth.”

Over the past two decades, Luxottica has expanded globally through regular, strategic purchases starting with the acquisition of the LensCrafters retail chain and Persol eyewear brand in 1995 through the pending combination with France’s Essilor International SA, announced this year. Along the way, Luxottica acquired global brands including Ray-Ban sunglasses, the Sunglass Hut retail chain and Oakley, the maker of athletic eyewear. It has also bought additional retail chains and brands in Australia, Asia, Europe and North and Latin America.

While strategic business goals are the catalyst for Luxottica’s acquisitions, tax is nevertheless an important issue that should always be addressed, according to Luxottica Tax Director Giacomo Soldani. In every country there is a different tax regime and some are more cumbersome than others; the company depends on advice from its tax team to ensure that it is proceeding in an appropriate way.

Tax becomes even more critical in large deals, as there are many issues that can impact valuation and risk. “We get involved early and work very closely with the M&A team,” Soldani says. “If you get things wrong or overlook something early in the process, it can create significant problems later on.”

Despite growing complexity and uncertainty, respondents in an EY survey had predicted that dealmaking would remain robust in 2017. EY Global Capital Confidence Barometer, a survey conducted earlier this year of more than 2,300 executives in 43 countries, found that 56% of executives surveyed planned to make an acquisition within the next year.

“Geographical expansion to secure supply chains and increase customer reach will accelerate cross-border M&A,” Steve Krouskos, EY Global Vice Chair Transaction Advisory Services, wrote in the report. “Private equity is returning to replenishing mode. Lastly, corporates are increasingly reassessing and reshaping their portfolios, creating a natural pipeline of deal opportunities.”

Tax is among the risks that companies must address today when making acquisitions. The EY M&A survey found that 76% of respondents had failed to complete or had cancelled an acquisition over the past year, and tax implications was cited as the primary reason by 33% – behind issues discovered during due diligence, and concerns about cybersecurity and regulatory or antitrust reviews, but ahead of economic and political instability.

Amid widespread change in the tax world, “there is no time in memory where pricing the risk and cost of taxation within M&A deals has been so challenging,” says Bridget Walsh, EY Global Head of Transaction Tax, who is based in London. The changes begin with a global tax reform plan, developed by the Organisation for Economic Co-operation and Development (OECD), aimed at increasing transparency and consistency.

“Nations have access to vastly more information about each company doing business within their borders stemming from expanded reporting requirements [e.g., country-by-country reporting],” Walsh says. “The information is being used to reevaluate transfer pricing – essentially where profits can be taxed – and that creates uncertainty within M&A.”
Changing rules

Another new guideline stemming from the OECD initiative limits the amount of interest businesses can deduct, reducing the degree to which companies can use leverage within transactions. The objective of the guidelines and regulation is to prevent profit shifting from jurisdiction to jurisdiction by financial means.

This has particular implications for the private equity (PE) industry, which often uses substantial leverage within its transaction financing structures.

“Private equity investors are having to rethink their approach to the M&A marketplace,” says Erica Lawee, EY Global Development Leader, Transaction Tax, who is based in London. For the most part, this means looking for ways to generate value through less leveraged dealmaking.

Certain aspects of M&A transactions may be dramatically affected by other changes in the tax environment. Tax rates are changing as are rules related to grants and incentives as well as the transferability of loss carryforwards. And tougher enforcement actions and uncertainty about tax rates make the modelling of deals much more difficult.

Yet another source of uncertainty arises from the many unknowns associated with US tax reform. Tax can have a dramatic impact on asset valuations. With companies not certain of how and when US tax rates and policies will change, deal assumptions become less reliable.

“Not knowing when or how the rules will evolve complicates any transaction involving the US,” Lawee says. “It’s a challenge both for existing portfolios and future deals.”

The global-based nature of today’s business environment poses yet another challenge in terms of accurately assessing and determining a deal’s tax implications. “M&A has become increasingly global and competitive in nature,” Walsh says.

“For example, we see an attractive asset in France being chased by a China-based fund that is in turn, largely financed by US investors as well as PE bidders from the UK and Canadian pension funds. These types of combinations have now become typical.”

Mind the gap

Marc Demuth, the Paris-based Managing Director of Corporate Finance in charge of Advisory for listed companies, EMEA
The growth agenda

assets and liabilities, whereas an asset purchase carries fewer tax attributes for the buyer to assume."

Still, asset-based transactions can be more difficult to execute. There are more legal considerations and greater cooperation is required from the seller who must carve out such assets from its ownership structure, according to Lv.

Luxottica’s Soldani sees the company’s M&A and tax teams as partners – and not only in dealmaking. With so much change taking place in areas such as transfer pricing, the company increasingly needs to update its valuations for tax purposes – with valuation being a specialty within the M&A practice. “So very much so, what we have is a partnership between M&A and tax,” Soldani says. ■

Key action points

- In response to today’s high and still-rising tax uncertainty, it is advisable to engage tax expertise early on in deal development to assess potential tax challenges, risks and synergies. While tax should never be a driver of M&A, it can have a significant impact on transaction valuation and outcome.

- Various elements within a transaction, such as the tax rate in the target country or whether grants, incentives or loss carryforwards are transferable, can be an important factor in deal valuation.

- Shifting from the purchase of a target’s shares to instead acquiring a target’s carved-out assets can sometimes improve the tax effectiveness of an acquisition.

- With so many regulations and tax rates in flux and with enforcement action on the rise worldwide, companies need to make certain their transactions take tax costs, compliance and risks into full account.

Reach out to your EY Tax advisor to learn how our Transaction Tax Services can help with the above.
When it comes to trade, the mood has shifted perceptibly over the course of a year. Brexit and the election of US President Donald Trump are set to lead to upheaval in the areas of trade and tax going forward. Global businesses have entered an era of uncertainty.
A year ago, leaders of the G20 countries issued a statement defending global trade after a meeting in China.

“The choices we make together will determine the effectiveness of our response to the challenges of today and help to shape the world economy of the future,” the G20 leaders said at the time. “We will work harder to build an open world economy, reject protectionism, promote global trade and investment, including through further strengthening the multilateral trading system, and ensure broad-based opportunities through and public support for expanded growth in a globalized economy.”

Just half a year later, the mood among G20 members had shifted perceptibly. At a meeting in Germany in March, the group’s finance ministers reached an “impasse” when it came to the free trade issue, and were only willing to comment on efforts to “strengthen the contribution of trade to our economies” in their statement. In July, G20 leaders spoke about “mutually advantageous trade” and the need to fight protectionism, including unfair trade practices.

The landscape is changing fast for multinational businesses. The UK vote to leave the European Union (EU) and the election of US President Donald Trump, who ran a campaign that criticized trade deals such as the North American Free Trade Agreement (NAFTA) and the Trans-Pacific Partnership (TPP), are symbolic of a new anti-globalization philosophy that is threatening to overturn international trade norms and dampen economic growth.

Tariffs, which came down across the world in recent decades, are suddenly once again near the top of the list of risks that companies must monitor today. The potential is clear – less openness. What’s uncertain is whether this change will lead to the disruptions many fear.

“The world of trade has been flipped on its head,” says Adrian Ball, EY Asia-Pacific Leader for Indirect Tax, who describes businesses in that region as cautious.

Multinationals can take a closer look at their risks through supply chain mapping and financial modeling, monitoring exposed elements in their supply chain, considering priority supply chain lanes, and evaluating alternative sourcing, according to Bill Methenitis, a Dallas-based EY Global Trade professional.

“Change may occur quite rapidly, and businesses will benefit from being nimble in this environment,” says Methenitis.

Cracks in the foundation

For now, the twin pillars underpinning global political, economic and investment uncertainty are Brexit – the UK’s pending departure from the EU – and a recast of US trade policy under President Trump.

UK Prime Minister Theresa May formally started the official Brexit process in March when she sent a letter to the EU that triggered Article 50 of the Lisbon Treaty. The prior year, a majority of UK voters who participated in the referendum – 52% – unexpectedly opted to leave the 28-member bloc, which has become the world’s largest economy via its single market.

The journey ahead for the UK and the EU is long, precarious and complex. The UK position, presented in a white paper to Parliament in February 2017, confirmed that the UK then was aiming to reach long-term solutions within a two-year time frame rather than opting for interim solutions. Since then, the UK has had a general election that has resulted in a minority Conservative government, and there has been more discussion about transition agreements.

“Entire industries are now reliant on global supply chains, and countries want to be a part of them rather than on the sidelines.”

Douglas Peterson
Chief Executive Officer, S&P Global

56% of foreign investors plan to invest in Europe in the next three years, a sign of investor optimism despite an uncertain political and business climate.

European instability is the boardroom’s number-one cause of risk. Global economic volatility and the fragmentation of Europe are the biggest worries for investors.

Brexit is a much bigger worry for foreign companies established in the UK (cited by 33% of respondents) than for those that are not (15%).
The goal is to sign a free trade agreement (FTA) and a new customs agreement, rather than to join the European single market like Iceland, Norway and Liechtenstein.

In the absence of a transitional agreement, new trade and customs agreements, either permanent or temporary, must be in place by March 2019 for UK trade with the EU to carry on without the sudden impact of tariffs.

The alternative is considered a “cliff’s edge”: the loss of FTAs would send the cost of imported intermediate goods soaring, and tariffs and customs processes would sever supply chains. Companies in both the UK and the remaining EU countries would suddenly face a loss of zero-tariff access to each other’s markets, driving up costs in both places. The UK, which up to now has applied the EU’s Common Customs Tariff to goods originating from outside the EU, would need to legislate a domestic tariff system.

“Brexit is really unknown,” said Douglas Peterson, Chief Executive Officer of S&P Global. “It’s going to be very difficult to renegotiate the treaties and manage this in two years.”

This difficulty is therefore leading to more calls for a transitional agreement, to enable trade to continue while the new regulatory framework is formulated and agreed.

Stay or go

Some multinational organizations with UK operations aren’t waiting around to see if the plan works. Driven by concerns that businesses may have to forfeit their seamless access to the single market, they are looking at reshaping, transferring, downsizing or moving their UK or even European operations, according to the EY European Attractiveness survey, Plan B … for Brexit.

According to the EY survey of 254 business executives with foreign investments in Europe, 14% of global businesses operating in the UK said they will transfer some or all of their activities elsewhere, while the remaining 86% plan to stay put.

Financial services in particular is a sector in which companies are considering leaving because they already know that Brexit will end their ability to offer services in the EU without suffering an increased regulatory burden.

A study from the Brussels-based think tank Bruegel estimated the change could cause €1.8 trillion in banking assets to depart Britain, and lead to the transfer of up to 30,000 banking, consultancy, legal and accounting jobs to the EU.

Brexit could also have an effect on manufacturers’ supply chains. The aerospace and automotive industries are increasingly vulnerable, for example, in terms of the various parts that are gathered for assembly from different places. Moving from zero tariffs to a 10% rate for entry into European markets could severely damage the UK auto industry’s competitiveness and increase the price of cars imported from the EU by an average of £1,500, according to the UK’s Society of Motor Manufacturers and Traders.

Tariffs wouldn’t be the only problem. Leaving the customs union means goods will be subject to proof-of-origin checks as they cross borders. Research suggests this process adds 8% extra cost on average to the underlying value of the goods, according to Nikhil Datta, a researcher at the London School of Economics’ Centre for Economic Performance.

Tax implications

If the UK fails to reach an FTA with the EU, UK exporters will look to address changes in customs duties and value-added tax (VAT) by adjusting their business structure in order to find the “least disruptive point of entry into the EU in terms of certainty on custom duties, custom procedures, import quotas and payment of VAT, and route most of their trade through this point (rather than selling directly to the individual countries),” according to Plan B … for Brexit.

The UK government may be open to using tax competition as a solution to these problems, the EY report suggests. If free trade deals prove hard to negotiate, it could...
reduce corporate income tax rates further in an attempt to retain companies in the UK, for example, according to one Sunday Times report. But that would make it harder to balance the budget, Datta says.

“The government says again and again that it’s going to balance the budget, and cutting corporate tax rates would obviously make that very difficult,” Datta says.

**The growth agenda**
The Brexit referendum and potential consequences will affect organizations, especially those in three business areas: financial services, high technology and medium-sized organizations.

When the UK leaves the European single market, foreign investors will need to consider the short-term consequences for their supply chain and growth perspectives.

Just 4% of senior executives said they were well-prepared for Brexit, while 1 in 10 organizations currently have no plans.

“The president has tremendous power to restrict trade – almost unlimited.”

Gary Hufbauer
Senior Fellow, Peterson Institute for International Economics

Trump’s two days of talks with Chinese President Xi Jinping in early April did not generate any developments in this area, with the two leaders agreeing to meet again this year. US Trade Representative Robert Lighthizer has said that the WTO was not set up to deal effectively with a country like China and its industrial policy, according to a Bloomberg report.

In terms of trade policy, Trump does have more room to maneuver than in other areas. Multiple laws give the US President the ability to impose tariffs or halt the negotiated access to the US market for goods from certain countries. The 1974 Trade Act, for example, allows the president to retaliate for large balance-of-payment deficits or unfair trade practiced abroad, and Trump could use that law or others to impose tariffs, duties or import restrictions, according to a report from the Peterson Institute for International Economics.
“When you consider how important these multinationals are, you see that the US is still very much integrated with the rest of the global economy.”

Ayhan Kose
Director, World Bank Group’s Development Prospects Group

“The president has tremendous power to restrict trade—almost unlimited,” says Gary Hufbauer, a Senior Fellow at the Peterson Institute for International Economics in Washington. “But he cannot liberalize trade without Congressional assent.”

Once in a generation tax reform
Tax reform could be another way for Trump to address trade concerns. US House of Representatives Speaker Paul Ryan has vowed that tax reform will be completed by the end of this year. And in late July the Trump administration and key Republican senators issued a statement indicating their joint commitment to reform.

“Tax reform could be valuable to the US in remaining competitive against other countries,” said Peterson of S&P Global. “But it needs to be permanent. Knowing that something is permanent gives you the ability to plan.”

Overhauling the tax code however is considered extremely difficult in the US, so much so that it is often considered a once-in-a-generation event.

A proposal from the House of Representatives contained a border adjustment tax (BAT) that would have exempted exports from taxation while subjecting imports (including components) to tax but key tax writers and the administration in July indicated the BAT would not be pursued as part of tax reform.

Link in the chain
More protectionism would add to what already is a relatively protected economy: trade accounted for about 30% of US gross domestic product (GDP) as of 2015, less than the average of 70% in other advanced economies, according to the Global Economic Prospects report from the World Bank Group in January.

American multinationals are a core element of the American economy—they account for more than a quarter of sales of US companies, nearly 20% of exports and 10% of jobs, according to Ayhan Kose, Director of the World Bank Group’s Development Prospects Group.

“When you consider how important these multinationals are, you see that the US is still very much integrated with the rest of the global economy,” Kose says.

The impact from any changes will be profound for the global economy as well. “Trade is a formidable force as a vehicle for promoting growth and helping reduce poverty,” Kose says. “A number of countries have escaped the low-income trap and become middle-income by embracing trade openness.”

Staying the course
Amid this great global questioning of global connectivity, some countries remain committed. Canada and the EU recently signed a free trade agreement. In Latin America, Brexit and Trump could provide the impetus for the Latin American Mercosur block to finally complete an FTA with the EU, and push for a deal with the UK as well.

While the US may have abandoned TPP, the 11 remaining countries involved are still casting about for free trade-friendly alternatives and invited China and South Korea to their March meeting.

“Trade is not going away,” says Peterson. “Entire industries are now reliant on global supply chains, and countries want to be a part of them rather than on the sidelines.”

After Canada signed its Comprehensive Economic and Trade Agreement (CETA) with the EU in February, Prime Minister Justin Trudeau’s speech to the European Parliament was both a celebration as well as warning of what could happen if voters’ skepticism of trade and a globalized economy deepens.

“Now we need to make it work,” Trudeau said. “If we are successful, CETA will become the blueprint for all ambitious, future trade deals. If we are not, this could well be one of the last.”

Key action points
• Tax and trade risks are converging. Managing these risks means gathering expertise in both areas in order to build accurate forecasting models and plan tactics and strategies.
• Brexit presents short-term risks, such as the return of tariffs, potential supply chain disruptions, and the potential need to shift some operations out of the UK and into the EU. The unclear outcomes narrow corporate options for immediate responses, but where businesses have been able to take decisive actions, such as in the financial services sector, the trend is toward other European locations.
• US trade policy presents similar risks, including a loss of tariff-free access, but also potential opportunities if a tax reform package lowers the corporate income tax rate.
• While new trade barriers are likely in the US, most countries remain committed to free trade. There will be new agreements and rules coming that present fresh opportunities as well as compliance challenges.

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All information in this article was current as of the print deadline of August 15, 2017.
These are uncertain times. Economic growth is proving elusive in many countries around the world. Populism and protectionism weigh on some countries, while others battle to negate isolationism and foster new global trade ties. Shifting tax policies add complexity.

And over everything loom the pressing issues of today and tomorrow: climate change, rising economic inequality, and the advent of a new era dominated by artificial intelligence and automation in which many jobs are disappearing.

As Chief Executive Officer of the Anglo-Dutch consumer goods giant Unilever, Paul Polman grapples with these complex challenges every day. The company behind Ben & Jerry’s ice cream, Hellmann’s mayonnaise and Dove soap last year implemented a major savings program aimed at making the business more agile and competitive, helping deliver a 22% profit increase in the first half of 2017.

In an interview with Tax Insights, Polman stressed that Unilever’s strategy will need to evolve further in the future. How can Unilever marry profitability with sustainability? How can the company identify and implement innovative solutions to respond to weak global economic growth?

“The biggest overarching challenge we face – governments and business alike – is to move to more inclusive and equitable forms of growth,” says Polman, current chair of the World Business Council for Sustainable Development, who has sat on climate change panels and the

“...A business has more confidence to make significant investments for the future if the tax environment is stable.”

Paul Polman
Chief Executive Officer, Unilever
high-level panel developing the Sustainable Development Goals (SDGs) at the United Nations. “Any system where too many people get left behind is sowing the seeds of its own destruction.”

“This means, for instance, facing up to the consequences of climate change,” Polman says. “It is key now that governments and business work together in new forms of partnerships to implement these agreements and deliver this new model of sustainable and equitable growth.”

The big rethink
The Dutch businessman, who rose through the ranks at Procter & Gamble and Nestlé, was named Unilever CEO in 2009. He believes there needs to be a shift in focus in order to achieve a practical and equitable approach to sustainable growth.

“There is no business case for enduring poverty and runaway climate change,” Polman says on Unilever’s website.

Polman introduced the Unilever Sustainable Living Plan in 2010, aimed at improving wellbeing (with its food and hygiene products), reducing the corporation’s environmental footprint and enhancing livelihoods (through increased incomes for farmers and small retailers, for example).

In 2016, Polman created the Global Commission on Business and Sustainable Development with former UN Deputy Secretary General Mark Malloch-Brown with the goal of articulating the economic case for the 17 key SDGs identified by the UN. Finding solutions to these challenges, which range from good health and gender equality to climate change and decent work, is vital to unlocking new future sources of economic growth, Polman says.

He points to a report from the Business and Sustainable Development Commission that identifies at least US$ 12 trillion of commercial opportunities for firms investing in sectors closely associated with hitting each of the UN’s 17 goals.

“Doing business well and sustainably means end-to-end thinking, including the whole supply chain,” Polman says. “It means rethinking the purpose of business, its role and impact in society. We need to create more jobs and use fewer materials – and we have to rethink our tax system, which currently often encourages the opposite.”

Get the tax balance right
Polman believes there is a direct line of causation between taxation and economic growth. He says governments should strive to set taxes at levels that ensure high-quality public services, but do not hobble business activity.

“As with everything, there is the right balance to be struck – if the tax burden is too high or if it falls in the wrong place, then the full potential impact of the business contribution may not be maximized,” Polman says.
“Tax policies that support innovation and R&D, and which invest in people, will underpin future growth. Similarly, the importance of certainty in the tax environment should not be underplayed. A business has more confidence to make significant investments for the future if the tax environment is stable.”

This kind of certainty is paramount to businesses such as Unilever, a truly global player that generates 57% of its business in developing markets. Constantly changing tax policies are an unwelcome distraction, delaying investment and eating into profits, he says.

Double taxation is another source of contention that causes significant concern, both in terms of money as well as time that it takes to resolve any tax authority concerns. It is a major barrier to cross-border trade and investment, according to Polman.

A sustainable base
In developing markets, authorities face the challenge of building a more sustainable tax base. Globalization has helped lift many out of grinding poverty. But these countries often lack institutional depth, meaning that governments can struggle to build a big enough tax base to finance a sustainable growth agenda. Increasing transparency, tackling corruption, and ensuring broader tax compliance by the many and not just the few is needed, Polman says.

It is here that governments and business leaders can really work together and make a difference. Businesses, of course, have a clear obligation to comply with local tax laws and to interpret them in a responsible way, according to Polman. It is in his firm’s best interests “to help develop good governance, and to ensure that tax levels are fairly assessed and properly collected.”

But governments are the ones that make tax laws, and they must take responsibility for making changes where required, Polman says. As part of this process, Polman says Unilever – as one of a number of interested stakeholders – can provide input on proposed tax reforms, as well as the company’s practical experience and insights.

Pointing to recent legislative changes in India, Polman says: “I am watching with interest to see whether the introduction of the new goods and services tax there will bring more businesses and individuals into tax compliance.”

New world order
Shifting views on global trade pose another challenge in the years ahead. The election of a US president who has criticized trade deals as harming American businesses and UK voters’ decision to leave the European Union have suddenly thrown the spread of globalization into question.

In Unilever’s view, the main Brexit-related challenges going forward are likely to be operational, Polman says: Will businesses be able to hire the human capital they need at every level of the organization, particularly in the UK? Will Brexit lead to new tariffs on goods leaving or entering the country? Are new customs forms or changes to sales taxes likely to crimp efficiency or affect flows of working capital?

“A long transitional period would create the least risk for businesses and consumers, as there would be more time to plan and clarity over the exact changes needed,” notes Polman, who says he shared these thoughts during meetings with UK Prime Minister Theresa May.

When it comes to the US president’s plans to reshape America’s tax structure, Polman is adopting a “wait-and-see” approach. “It would be good for international tax stability if there were more consistency in approach across countries.”

But Polman is also quick to note that the UK and US are just two of the world’s many trading nations, albeit important ones historically wedded to the notion of internationalism and the free flow of capital. Within three decades, 80% of the world’s population will live outside the US and Europe, Polman points out. “Those firms well positioned with products and services that meet the needs of these emerging economies will be those best placed to capture growth.”
Among globalization’s biggest success stories is the European Union’s single market, a territory where goods, services, capital and people move freely across borders. By dismantling hundreds of barriers to trade within the region, the EU catapulted itself to become the world’s largest economy. But the path forward for this project is no longer as clear as it once was. Europe is struggling to deal with migration inflows, weak economic growth and the pending departure of the UK from the EU.
For his project Übergang, photographer Josef Schulz captured border stations across Europe that have fallen out of use. While Europe’s internal physical borders may no longer be visible, he believes that the mental barriers of the EU’s 500 million residents have proven much more difficult to dismantle. “The border posts resemble abandoned sentinels or faded monuments of past partition,” Schulz writes on his website. “They will remind us of what has yet to be achieved, recalling that they could one day easily be returned to their previous function.”
The single market is still very much a work in progress.

The EU itself admits that many barriers remain, including in the areas of e-commerce, financial services, energy, transport and services, as well as tax systems. According to a working paper released last year by the Organisation for Economic Co-operation and Development (OECD), potential double-taxation issues in connection with pensions and income act as a brake on the mobility of labor within the single market.
Germany—Austria (Hörbranz)
Europe’s single market is facing what could very well be existential tests. Some countries have introduced temporary internal border controls in response to a wave of migration in recent years, a move that has impacted local economies. Some EU nations are also erecting fences on their borders with both EU and non-EU members, while the UK could leave the single market. There’s a lot at stake for the EU if permanent border controls are reintroduced. Trade between European countries could decline, reducing the area’s gross domestic product (GDP). What does the future hold in store for Europe’s borders?
The growth agenda


Credit: Josef Schulz
The growth agenda

Start-up tales

By Karen Lynch

Tax Insights spoke with the EY World Entrepreneur Of The Year™ 2017 Award winner, as well as some national award winners. The entrepreneurs – from Australia, Canada and Saudi Arabia – run very different businesses and have their own distinct strategies and visions. In separate interviews, they discuss what governments can do to foster enterprise growth and innovation, including the design of tax systems. And they draw on their own experiences for advice to other budding entrepreneurs. Lesson No. 1: businesses facing cash management issues in the early stages still need to think about optimizing their investment in tax strategies.
Middle East trailblazer

Entrepreneurs are a small but growing breed in Saudi Arabia. The Saudi government employs 70% of workers, but a policy blueprint called Saudi Vision 2030 aims to grow the private sector and diversify beyond the oil industry.

Turki Al Yahya, Founder and Managing Partner of GHC (WHITES Health & Beauty), is ahead of the curve. Nine years ago, he launched the first chain of health and beauty stores in Saudi Arabia called WHITES Health & Beauty. Since then, Al Yahya has continued to experiment with combining different aspects of retail in a single shop, for example, stocking high-end brands along with mass-market brands in a unique shopping experience.

Today, GHC’s business has grown to include six subsidiaries, including the original WHITES chain, the more recently acquired Kunooz Drugstores and the National Distribution Company – totaling 250 retail outlets and distribution to another 2,000 points of sale in the kingdom. “Growing that big in nine years is quite fast, in our part of the world,” Al Yahya says.

Seeds of entrepreneurship

Al Yahya embraces innovation – in his own business, his country and his industry. “We’ve positioned ourselves as a fashionable, trendy retailer. That keeps us moving and creating and innovating continuously, when it comes to services, categories, brands, products, shopping experience and all aspects of retail,” he says.

And there’s more change ahead. He plans to expand the company regionally and globally, even as Saudi Vision 2030 seeks to attract more, potentially competitive foreign business into GHC’s home market. Amid all the change, “we need to be flexible and able to move faster than others,” he says.

If Saudi Vision 2030 succeeds, Al Yahya could soon be in good company as the ranks of Saudi entrepreneurs expand. The blueprint includes many initiatives to incentivize and support entrepreneurs and young companies, including the establishment of the General Authority for Small and Medium Enterprises, favorable access to funding and a greater share of national procurement. “Entrepreneurship is culture, and it needs to be nurtured,” Al Yahya says. “I’m glad to see this culture starting here.”

Navigating tax

Today, GHC and other Saudi companies are not subject to taxation, per se. Rather the focus is on zakat, the obligatory payment of 2.5% on net assets that is required under the Islamic system and collected by the government to support the poor and needy. Also contributing to the cost of doing business are various government fees, such as business licenses and real estate development applications. “They are not as high as taxation, but we have been experiencing increasing costs for the past three to four years,” Al Yahya says.

Early this year, however, value-added tax (VAT) was approved for some goods and services in Saudi Arabia, seen by some observers as a way to help finance Saudi Vision 2030 amid declining oil revenues. GHC is assessing the potential impact of the new tax’s implementation in January 2018. “The VAT will definitely have an impact on sales and consumer behavior, but I’m not frustrated about that,” he says. “I believe that any business model should be flexible enough to cater to market changes.”

Going forward, as GHC expands internationally, the company will also have to maneuver the complexities of various and changing tax policies from one country to the next. Internationally, Al Yahya concedes that taxation is not only complicated but can even be employed as a form of market protectionism. Still, he sees it mainly as a cost of doing business. “Taxation should never be the obstacle,” he says. Market opportunity should always be the primary consideration, though some countries’ tax environments will be more attractive than others – especially those with clear and transparent tax rules, he adds.
Extreme health care

Aspen Medical takes health care to extremes. That much is clear from the moment that Co-executive Chairman Andrew Walker picks up the phone in Iraq, where the company has been contracted to help rebuild and run trauma and maternity units on the outskirts of the war-torn city of Mosul.

Iraq may represent one of the more extreme examples of Aspen Medical’s innovative health care outsourcing services, but it is not the only difficult case. In 2017, the company also remains on the frontline of efforts to fight Ebola in West Africa, adds co-founder Glenn Keys, joining the interview from company headquarters in Australia.

Aspen Medical was launched by the longtime friends in 2003, driven by a belief that businesses should use their expertise and capital to help bring about positive change. The company provides high-quality health care in remote, challenging or underresourced areas where there is high demand. That could be providing clinical staff in an indigenous Australian community, an ambulance service in West Texas or an aeromedical evacuation service supporting an oil rig.

Wherever it is, Aspen Medical provides complete health care solutions, including people, equipment, consumables, ambulances, pharmaceuticals — “whatever is required,” Keys says.

Aspen Medical’s performance as a company is not always measured in dollars. In Mosul, for example, “children are being born with great success under the most amazingly difficult circumstances,” Walker says. Nevertheless, Aspen Medical’s co-chairmen are extremely focused on the business side, as well.

“We’re a for-profit company; that allows us to deliver against what our purpose is, and it makes us very efficient at what we do,” Keys says. In Mosul, for instance, Aspen Medical is working under contracts from the World Health Organization and United Nations Population Fund.

Blind spot

When it comes to taxation, Keys and Walker stress the high cost of tax to any enterprise and the importance of managing it efficiently. “The more money you can keep in your business, the more you have available for growth,” Walker says, whether for capital expenses, hiring or building technology platforms.

The alternatives include raising equity from investors, whose patience or vision may diverge, or taking on debt and all its covenants. Even a grant can carry with it red tape and compliance requirements that can distract a start-up.

Many entrepreneurs neglect tax strategy in the early days of their business, Walker says. One reason is the simple fact that they don’t yet turn a profit. “The last thing on their minds is tax, and that’s a big trap.” Once successful, entrepreneurs may realize they have made errors and by then it may be too late.

Another reason some entrepreneurs put off tax strategy is that they may not see tax as a cost, because it is paid after profit is calculated. “Tax is absolutely one of our biggest costs and needs to be carefully considered,” Walker says. When going into an international market, one of his first questions is about the local tax regime. For example, lacking a bilateral agreement between the government of any one country and Aspen Medical’s home base in Australia, “we could end up running a job at a loss, simply because we hadn’t thought about tax properly.”

“As entrepreneurs, we benefit from the infrastructure and business environment that governments, in the main, create: a stable workforce, laws, police, roads, electricity, water.”

Dr. Andrew Walker
Co-executive Chairman, Aspen Medical
Keep it simple
Aspen Medical’s co-founders’ advice to governments would be to keep tax policy simple. For most goods and services, they say, a lower overall tax rate would serve their country better than complicated tax incentives aimed at moving markets one way or another. “Having said that, taxes can be used by government to drive innovation that brings entirely new goods and services to market,” Walker says. Examples include R&D (research and development) grants, tax breaks on wages paid to scientists or software developers and intellectual property regimes that assess a lower tax on the product of new patents.

Keys and Walker speak from experience. In its early years, Aspen Medical benefited greatly from an Australian export market development grant. “That was absolutely critical to growing our business overseas,” Keys says. “It led to us getting very significant business as export and allowed us to take our innovative service model into a lot of different international settings.”

Aspen Medical also has a cautionary tale to tell. In an early engagement in a Pacific island nation, Aspen Medical left it up to its contractors to handle their own payroll taxes. When some of them neglected to follow through, Aspen Medical was presented two years into the job with a significant tax bill. “It threatened to sink the company,” Keys says. Aspen Medical negotiated payment and settled with the government, then dealt with every contractor to recoup the money. But the damage was already done in opportunity costs and other setbacks. Aspen Medical kept that lesson in mind as it expanded across Australia, the Pacific, Africa, the Gulf region, the UK and the US. The company now employs more than 2,500 professionals.

Along the way, Aspen Medical has followed the advice it gives other entrepreneurs: seek to be tax effective — paying the correct amount of tax. After all, businesses also benefit from government spending that is derived from tax revenue. “As entrepreneurs, we benefit from the infrastructure and business environment that governments, in the main, create: a stable workforce, laws, police, roads, electricity, water — the whole gamut,” says Walker.
Protein from the prairies

Consider the tiny lentil. As AGT Food and Ingredients Inc. Chief Executive Officer Murad Al-Katib sees it, this low-key legume is a veritable engine of innovation and growth. In a world that faces increasing health, food security and water scarcity issues, lentils provide a high-fiber, high-protein staple that can be grown without irrigation and can actually help fertilize the soil in which it is planted.

In the late 1990s and early 2000s, the University of Saskatchewan developed natural breeding and seeding techniques suitable for Western Canada’s short growing season and limited rainfall. Suddenly, the tiny lentil became a big deal for Canada, which now produces 65% of the world’s supply.

Along the way, the lentil provided a source of inspiration for Al-Katib to develop technology and process engineering systems in order to deliver the legumes (also known as “pulses”) in ready form to packers, canners, retailers, makers of snack chips and other links in the global food chain.

Al-Katib founded AGT in 2001 in partnership with the Arbel Group, a processor/exporter of grains and lentils in Turkey, the country from which his parents immigrated to Canada in 1965.

The company he launched represents the intersection of his passions for his home province of Saskatchewan, where agricultural constraints were limiting economic growth, and his experience as a public servant in international exports, where he saw the potential of lentils and other legumes to address growing food requirements in emerging markets.

AGT now processes 25% of the world trade in lentils (not to mention its business in peas, chickpeas, beans, pasta and more).

Enabling enterprise

Taxation has had a not-so-invisible hand in this story of growth. “As an entrepreneur, I believe that governments and government policy actually create the enabling environment for entrepreneurs to succeed,” says Al-Katib.

Many factors go into this mix, he says, such as small business incentives, R&D credits, and favorable rates for capital gains, dividends and stock-based compensation. “These are all things that have to be considered when putting in place taxation regimes that encourage small businesses and entrepreneurs as engines of growth for the economy,” he says.

“Some of this, in essence, is rewarding people for what I would call sweat equity,” Al-Katib says. Foregoing compensation for upside stock return is a foundation of entrepreneurial reward, he points out, since few entrepreneurs get paid well at the start. “If I look at the work I put in when I started my company, I’d have been getting paid three dollars an hour.”

AGT benefited from a small business preferential tax rate on its first CA$500,000 in net earnings, which encouraged initial investment of money and effort. “We were risking our own capital, and we didn’t want to pay not only a high corporate tax but also high personal tax rates on our salaries,” he says.

Growing the business

In return, Al-Katib has helped build what has become a multi-billion dollar legumes industry in Canada. AGT also contributes to other countries’ employment and treasuries through its 47 manufacturing facilities on five continents with exports to 120 countries worldwide. Major export markets include India, Turkey and Egypt and other countries where people rely on legumes as a source of protein.

As AGT expanded, Al-Katib recognized that “capital is mobile, people are mobile and technology allows us to locate in multiple jurisdictions worldwide, so tax strategy has been a very important part of our business strategy. We spend a lot of time understanding the regulatory regimes in which we operate.”
“As an entrepreneur, I believe that governments and government policy actually create the enabling environment for entrepreneurs to succeed.”

Murad Al-Katib
CEO, AGT Food and Ingredients Inc.

The 20% corporate tax rate in Turkey — one of AGT’s main markets today — compares favorably to other countries’ rates, he says. This, and the system’s transparency and predictability, have encouraged AGT to invest hundreds of millions there, including the 2009 acquisition of partner, the Arbel Group.

Fifteen years after Al-Katib founded his company, AGT’s consolidated revenue had grown to CA$1.97 billion (US$1.46 billion). But there is more to the story than growth for Al-Katib.

“The world population is growing at a pace where we’re facing a societal challenge to meet the demand for food,” says Al-Katib. “I’m a believer that entrepreneurs are not only a growth engine, but will also provide solutions to societal problems like food security,” he says.

His efforts were recognized by the Business for Peace Foundation, which presented Al-Katib with a 2017 Oslo Business for Peace Award for work with international agencies to streamline the delivery of food to Syrian refugees.
Tackling inequality

Tax policy design principles for inclusive growth (OECD)

The Organisation for Economic Co-operation and Development (OECD) believes there is an opportunity to achieve more inclusive growth through tax policy. Critics, however, are concerned that such policies could weigh on innovation and growth.

1. Broadening tax bases
   - Maintaining broad tax bases and low tax rates
   - Removing tax expenditures that are not well-targeted at redistributive goals
   - Broadening the social security base

2. Strengthening the overall progressivity of the fiscal system
   - Taxing capital and its returns in efficient and equitable ways
   - Introducing or strengthening progressivity beyond personal income tax
   - Strengthening horizontal equity to enhance vertical equity
   - Strengthening the link between taxes paid and benefits received across the life cycle
   - Providing adequate and targeted compensation or relief to the losers of pro-growth tax reforms

Poverty has plummeted in recent decades

Almost half the population of the developing world lived on less than this daily amount in 1990, compared with 14% in 2015.


Source: "8 things you need to know about China’s economy," World Economic Forum, 2016
Globalization has lifted millions out of poverty around the world; yet, the disparity between rich and poor within countries has grown. Tax policy is one way to help address this gap.

**Widening inequality gap**
Inequality between rich and poor is on the rise within OECD countries.

In 2013, the richest 10% of the population in OECD countries earned almost 10 times more than the poorest 10%, compared with seven times more in the 1980s.

Source: “In It Together: Why Less Inequality Benefits All,” OECD, 2015

The development of real disposable household income for the bottom, middle and top segments (OECD average), 1985=1

Source: “In It Together: Why Less Inequality Benefits All,” OECD, 2015
By Ross Tieman

Growing green

Future growth will depend on companies and governments tackling climate change. Carbon taxes provide a way ahead.
One might call it the Robin Hood approach to climate change. Earlier this year, some of America’s best-known political leaders, economists and business chiefs got together and called for a new tax. A tax on carbon emissions of US$40 a metric ton—gradually climbing further over time—is the best available way to combat climate change and provide insurance against its risks, former US Secretary of State James Baker and his colleagues wrote in a report from the Climate Leadership Council.

They suggested that the proceeds be redistributed to ordinary Americans at a rate of US$2,000 a year per family of four in the form of checks, direct deposits, or pension account contributions.

“The risk is sufficiently strong that we need an insurance policy and this is a damn good insurance policy,” Baker told the Washington Post earlier this year.

Coming around
It was an unusual proposal from a group whose public face was Baker, remembered for negotiating lower tax rates as part of the Tax Reform Act of 1986 while serving as US President Ronald Reagan’s Treasury Secretary.

The US has long struggled to find consensus on the need to fight global warming. Indeed, US President Donald Trump in June announced his country’s plans to exit the landmark Paris climate accord, saying it placed “draconian burdens” on US companies. The trigger was the Paris Agreement in December 2015, in which 195 nations agreed on actions designed to limit global warming to well below two degrees centigrade above temperatures prior to the Industrial Revolution. (Despite the US’s official exit from the agreement, a number of US states and cities remain committed to the accord.) The surprise is that it has taken so long. In May 1989, The Economist magazine predicted that within half a century many industrial countries would raise a fifth of their revenues from pollution taxes and charges.

Governments and the business world ignore climate change at their own peril. In a 700-page study in 2006, former World Bank chief economist Nicholas Stern called climate change a massive “market failure” that could wipe 5-20% off global Gross Domestic Product (GDP) each year, undermining prosperity. Stern’s analysis considered potentially devastating economic effects to humans and the environment, such as the impact of rising sea levels and falling crop yields.

In other words, global economic growth would become global decline.

Biding time
Fossil fuels are unduly cheap, economists say, because those who burn them do not pay for their adverse effects. Advocates argue that carbon pricing encourages fuel burners to release less carbon, and can help finance a switch to less harmful technologies and compensate those affected by the consequences of climate change.

Professor Roberton C. Williams III of the University of Maryland says there is widespread consensus today that “the most cost-effective way to control pollution is some sort of pricing.”

But getting policies implemented is tough. “It’s like roommates debating who is going to take the trash out,” says Williams.

“Everyone wants someone else to do it.”

58% of GHG emissions, including three of the world’s largest GHG emitters: China, India and Brazil. Carbon has a cost and pretty soon, it seems, most of the world will be paying at least part of it.

“We are at a tipping point now for carbon pricing,” says Mikael Skou Andersen, professor of environmental policy analysis at Aarhus University in Denmark.

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Countries, regions and states have tried three principal routes to containing GHG emissions: regulations, carbon taxes and cap-and-trade schemes, whereby energy-intensive plants, including power generators, must have tradable permits for the carbon they emit. Some use all three.

Market-based cap-and-trade schemes should theoretically focus on efforts to reduce carbon where they can do most good. But they haven’t always worked well. Take the European Union’s Emissions Trading System (ETS), the world’s largest trading system for GHG emission allowances. Critics say the carbon trading price is too low to encourage companies to cut their emissions and invest in new green technologies.

For businesses (especially those with an international footprint), different measures, in different countries, with different time frames, create complexity and uncertainty. “Companies are often not keen on cap-and-trade schemes because the market mechanism of these schemes leads to uncertainty in the price of carbon,” says Dominick Brook, US Leader of Global Sustainability Tax Services at EY.

The cure
Carbon taxes, by contrast, are simple, effective and quick to introduce. And because tax authorities collect them from a relatively small number of large companies (who simply raise their prices to their customers) they are cheap to collect and difficult to avoid.

In North America, it is often states, rather than national legislatures, that have pioneered carbon pricing. The Canadian province of British Columbia, for example, introduced a revenue-neutral carbon tax in 2008. Revenue from the carbon tax is redistributed through reductions in other taxes, including personal income and corporate income tax rates.

Though energy companies had to pay more tax, and were able to pass this on to their customers, citizens were aware that overall they were no worse off, says Jeff Saviano, EY Americas Tax Innovation Leader. Canada now plans a minimum nationwide carbon price floor of C$10/metric ton in 2018, rising to C$50/metric ton in 2022. Carbon taxes are attractive for governments facing deficits: Ireland, for example, introduced a carbon tax in 2010, in the wake of the financial crisis. Emerging economies such as South Africa hope GHG taxes can do good while compensating for a narrow tax base and weak revenue streams.

“Many finance ministries are behind this,” says Ian Parry, Principal Environmental Fiscal Policy Expert at the International Monetary Fund (IMF) in Washington. “A lot of countries are very excited about potential revenues from carbon pricing.”

Indeed, carbon taxes can offer intriguing choices to policymakers, says Professor Janet Milne, Director of the Environmental Tax Policy Institute at Vermont Law School. A US study of a possible carbon tax in Vermont, The Economic, Fiscal, Emissions, and Demographic Implications from a Carbon Price Policy in Vermont, estimated that a price of US$50/metric ton of CO₂ would generate up to nearly US$300 million a year of revenue, compared with a current state budget of about US$6 billion. But combating climate change effectively requires multiple policy tools, she says. “We are all learning from experience about the best ways to combine different instruments.” And Parry cautions that “we are currently an awful long way from where countries need to be to be consistent with their Paris pledges.”

Complex choices
Adele Morris, Senior Fellow and Policy Director for Brookings’ Climate and Energy Economics Project, acknowledges policy choices are complex and require careful study, because the knock-on effects on companies and economies can be great. “Different fossil fuels have different levels of carbon intensity per unit of energy they provide,” says Morris. Adding a carbon price changes their prices relative to each other, and to non-fossil alternatives. “So that instantly incentivizes a shift in production choices and technology choices.” For companies, the detail of each
carbon tax scheme can have far-reaching implications.

One of the reasons carbon prices around the world vary hugely in price per ton is that they also vary widely in scope. Sweden’s headline tax of US$131/metric ton of CO₂ applies to household fuels, says Parry, but not to large energy intensive plants, which are subject to the EU cap-and-trade scheme where recent prices have been below US$10 per ton. Carbon pricing in China or India, which rely heavily on coal use, would have a larger proportionate effect on reducing carbon emissions than in the US or Europe, according to Parry.

IMF studies suggest that some countries, like China, India and Indonesia, would easily meet their mitigation pledges for the Paris Agreement with carbon prices of US$70 per ton by 2030, while others like Australia, Canada and some EU countries will need much higher prices.

More and more companies, including US-based multinationals, are already adopting internal pricing for carbon. This helps avoid projects that would become loss-making if carbon pricing that impacts their operations is introduced in the future. Some “are allocating those dollars into a central fund and are then using those dollars to introduce greater use of green technology and taking other steps to mitigate climate change,” Saviano says.

For now, it is difficult for businesses faced with diverse and unpredictable climate mitigation policies across governments to evaluate potential investment projects in different countries, especially those that are energy intensive and involve long-lived assets. They are looking for greater transparency.

“Companies want a seat at the table,” says Saviano. In the US and elsewhere, they seek predictability and a view of what the future holds, he explained.

Being efficient

Brook, who advises companies on sustainability, points out that there’s a simple strategy open to many companies: minimize carbon usage. “Renewable energy is a great way to reduce your carbon footprint, but what I really encourage is investments in energy efficiency,” he says. This enables companies not only to reduce their carbon emissions, but also boosts their bottom line by reducing energy costs.

Increasingly, there are signs that large-scale carbon mitigation technologies are also at a tipping point. Wind and solar energy are now sometimes cheaper than fossil fuels according to the World Economic Forum, while energy storage devices are improving fast. As prices fall, sales of renewable power and electric vehicles are soaring, albeit from a modest base.

That doesn’t make the introduction of carbon taxes any less likely. But it does flag the possibility of an investment boom that will enable companies and consumers to mitigate some of their effects.

As the IMF’s Parry concludes: “Higher energy costs can negatively impact the economy. But if the revenues from carbon pricing are used to cut taxation burdens on business or labor, or fund socially productive investment, for example in infrastructure, there is a large offsetting benefit to the economy.”

Key action points

- Stay up-to-date with carbon pricing proposals in the jurisdictions where you – and your rivals – operate.
- Introduce carbon pricing across your business at a credible threshold so that investment projects are carbon-pricing proof.
- Invest in reducing carbon emissions in every aspect or your business, profiting from falling renewable prices.
- Make low-carbon strategies a mainstream part of your business, and share this commitment with employees, customers and the communities where you operate.

Reach out to your EY Tax advisor to learn how our Business Tax Services and Indirect Tax Services can help with the above.

A smooth start

Adele Morris, Senior Fellow and Policy Director for Brookings’ Climate and Energy Economics Project, suggests five ways to minimize unwanted shocks to corporate or national competitiveness from the introduction of carbon taxes.

1. Carbon pricing

Carbon pricing needs to be introduced modestly and gradually so that companies and households can anticipate the change in their investment decisions.

2. Supplant complex regulations

Taxes should substitute, where possible, for less efficient regulations.

3. Tax revenues for tax reform

Some carbon tax revenues can be used as part of a broader tax reform, to lift other tax burdens on companies or households. “Some models or scenarios suggest you might get a net gain in economic growth,” Morris says.

4. Diplomatic advantages

Policymakers can exploit the domestic policy through diplomacy to leverage similar action by trading partners.

5. Special measures

Special measures, such as border carbon adjustments, can mitigate impacts on the few energy-intensive sectors that are particularly affected, such as chemicals, cement and metals, as well as helping dislocated coal workers and their communities.
Here come the robots

By Gerri Chanel
Would you keep at the daily grind, if you won the lottery? For most of us, the answer is evidently yes: in survey after survey, more than half—and even up to 90%—of workers at every level respond that they would stay on the job if they won a fortune. It seems most of us humans just like to work.

A substantial body of research documents the positive effects of work on mental health, from less depression to greater life satisfaction and higher self-esteem. As *The Atlantic* magazine aptly put it: “The paradox of work is that many people hate their jobs, but they are considerably more miserable doing nothing.”
But it increasingly looks like many of us may be out of work someday anyway—thanks to technology.

As society moves into what World Economic Forum founder Klaus Schwab calls the Fourth Industrial Revolution, hardware and software bots will replace huge numbers of workers at an accelerated pace. A 2016 World Bank analysis estimated that roughly two-thirds of all jobs in developing nations are susceptible to automation, but large numbers of jobs in developed nations will be eliminated as well.

Are we really facing a future where huge swaths of humanity will be doing nothing and earning nothing, grinding the global economy to a halt? Not necessarily. The future may just be breathtakingly different than we imagine right now.

Already there are proposals to offset the societal impact of robots. Microsoft Co-founder Bill Gates recently floated the idea of taxing them and using the funds to retrain people who have lost their jobs to automation. Robots themselves, of course, can’t pay tax (at least not yet …) but the companies that prosper from them certainly could.

“Right now, the human worker who does, say, $50,000 worth of work in a factory, that income is taxed and you get income tax, social security tax, all those things,” Gates said in an interview this year with Quartz. “If a robot comes in to do the same thing, you’d think that we’d tax the robot at a similar level.”

Gates isn’t alone in this view. For example, in February 2017 a European Parliament proposal to tax robots was narrowly defeated.

Tesla and SpaceX founder Elon Musk and others go beyond the idea of a robot tax, arguing that society will need to give people a basic universal income to replace income lost due to technology. This is not a blue-sky idea; some jurisdictions are already running trials to see how it might work, among them Finland, three towns in Ontario, Canada and several cities in the Netherlands. The start-up incubator Y Combinator is running a privately funded pilot program in Oakland, California.

Most proponents seem to generally agree that the basic universal income would be a bare minimum needed to get by. But there is no agreement on what would fund it. A robot tax? A consumption tax? A wealth tax? Or what the tax levels would need to be, since funding would presumably come in part from transfers from existing programs.

At the February 2017 World Government Summit in Dubai, Musk spoke out about the future need for some kind of universal basic income. But he also pointed out, “The much harder challenge is, how are people going to have meaning? A lot of people derive their meaning from their employment. So if there’s no need for your labor, what’s your meaning? … That’s a much harder problem to deal with.”

Which brings us back to the misery of not working. What would motivate us to get going in the morning to seek meaning if not for work?

Martin Ford, author of the 2015 book Rise of the Robots: Technology and the Threat of a Jobless Future, told CNBC last year that along with taxing the owners of the technology and robots, other sources to fund universal basic income programs could come from taxes on capital wealth, consumption or carbon. The tax revenue, he has said in the past, would give consumers the buying power that would drive the economy.

And what would replace the satisfaction we now get from work? Ford has also said that self-worth and motivation for self-improvement would come in part from activities incentivized by extra basic income, such as education, volunteering, innovation and work still requiring human attributes.

“At some point we will get to a point where the cost of not doing this is greater than the cost of doing it,” Ford told CNBC. “And at that point maybe it becomes easier.”

Just 25 years ago, few people had heard of the internet, but in the interim it has transformed our lives. While nobody yet knows what the future will bring, we’d better start planning. The robots are ready to report for work. =
The growth agenda

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6 More London Place, London, SE1 2DA,
United Kingdom, (ey.com/taxinsights),
taxinsights@ey.com

Editor in Chief:
Jay Nibbe

Editorial Board:
Kenji Amino, Kate Barton, Jim Hunter,
York Zöllkau

Program Lead:
Ryan Donmoyer

Publishing House:
C3 Creative Code and Content (Switzerland) AG,
c3.co/switzerland,
c3ch@c3.co

Editor:
Catherine McLean

Art Director:
Michael Pfötsch

Editorial Designer:
Monika Häfliger

Project Manager:
Urs Voser

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Jay Nibbe
EY Global Vice Chair Tax

Kenji Amino
EY Japan Tax Leader

Kate Barton
EY Americas Vice Chair Tax

Jim Hunter
EY Asia-Pacific Tax Leader

York Zöllkau
EY EMEIA Tax Leader

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