Global tax reboot:

Geopolitics, tax policy and society in flux

Takeaways for tax leaders

- Three interconnected trends are reshaping the global business landscape and creating uncertainty and risk:
  - After decades of ongoing globalization, the international order is splintering, and governments are now prioritizing safety and security over measures to promote prosperity and growth.
  - International tax is a rare area where multilateral collaboration continues, with consensus being forged over fairer, more efficient tax rules. The consensus is fragile, however, and significant divisions over some of the rules still need to be bridged.
  - Income inequality is worsening globally, leading to distrust of politicians and government and fueling populist and protectionist attitudes.
- To help businesses navigate these choppy waters, tax leaders should be seeking to understand how geopolitical trends might play out, what threats might arise and how exposure can be mitigated.

Cracks in the global order

- After decades marked by relative harmony and convergence, ongoing divergence and fragmentation are the hallmarks of the geopolitics today.
- Moves toward global consistency on economic dimensions, such as trade, business values and technology standards, have slowed as political and diplomatic relationships veer in the opposite direction.
- Among the factors that are now converging to disrupt the global order, five forces in particular are creating the most pervasive risks:
    - Climate change and the energy transition
    - Artificial intelligence
    - War in Ukraine and the Israel-Hamas conflict
    - China's domestic economy
    - China's changing role in the world
- In this unpredictable environment, some regimes are adopting more aggressive postures.
- Governments and businesses are shifting their approach to foreign trade and investment in response, reorienting their economies around national security and securing vital supplies.

Companies today can no longer count on globalization to drive efficiency and savings as they have for the past decades. Instead, they are operating in a business environment with more cost and complexity than at any time in the past 30 or 40 years.

Cooperation or competition?

The future of global tax

- While geopolitical forces are disrupting international relations, corporate tax is a bright spot where multilateral consensus and cooperation are being won.
- The Inclusive Framework now counts over 140 jurisdictions as members, collaborating as equals on a common approach toward improving the global tax environment. They also committed to refrain from adopting measures, such as digital services taxes (DST), that would be contrary to the agreed common approach.
- Following a July 2023 agreement among 138 members, the Inclusive Framework released the text of the multilateral convention (MLC) to establish new taxing rights for market jurisdictions in Amount A of Pillar One.
- It remains to be seen whether and when the MLC's text will be finalized and ratified by a sufficient proportion of Inclusive Framework members.
- Significant issues remain on the Inclusive Framework's agenda that could derail further success. For example:
  - Some developing nations do not think the framework is inclusive enough or that the two-pillar solution fully addresses their issues.
  - The tax treatment of incentives and how they can be deployed in developing countries under Pillar Two remains unresolved, as do some of the rules for sourcing revenues.
- The current consensus on Pillar Two is fragile and needs to be nurtured. Further delays could put smooth implementation of the rules in jeopardy, and this could lead more countries to introduce DSTs or take other unilateral steps to protect their tax revenue.

Once the global minimum tax becomes a reality, countries will have limited ability to compete for foreign investment with non-refundable tax incentives. While other forms of incentive might be offered outside the tax system, mechanisms will be in place to prevent simply shifting tax support to other means.

Eliminating income inequality

The promise and peril of AI

- Income inequality has been rising for decades, but after the pandemic, hyperinflation and supply chain insecurities of recent times, the citizens and nations of the world on the lower end of the income scale are increasingly resentful of the unequal distribution of wealth.
- As the income gaps widen, the loss of trust among societies is a powerful undercurrent running through the geopolitical forces discussed earlier in this publication, and the lack of faith extends to tax systems.
- Tax and transfer systems can be one of the most potent tools that governments can use to redistribute income and address inequality but most discussion in the area today remains mired around non-starters such as wealth taxes and taxes on banks.
- With more creative policy innovations, governments can rebalance the tax treatment of income and capital more equitably and start to close the broadening income gap.
- AI and other technologies will be an important element of this process. By applying AI and analytics across vast amounts of data, social benefit programs can be precisely targeted and their intended outcomes verified, tax compliance can be better monitored and enforced, and patterns of tax evasion can be more easily spotted.
- More broadly, AI could help raise citizens' prospects by breaking down language and accessibility barriers and opening new job opportunities.
- But like all disruptive technologies, AI holds both promise and peril. For example:
- It could be used to sow confusion and interfere in political processes by spreading highly credible misinformation.
- AI could aggravate existing inequality as gender, racial and other biases in the data that AI uses to learn are rewoven and embedded into generated products.
- Then again, AI could go a long way toward helping improve equality and living standards globally as part of greener, more sustainable economies, but only if:
    - the businesses that design and deploy AI keep control over the machines and their results, and they remain accountable to society at large
    - governments set the right regulatory frameworks to leverage the potential of AI for the common good, while governing risk through principles that promote safety, security and transparency.

AI can go a long way toward helping improve equality and living standards globally as part of greener, more sustainable economies. But this will depend on ensuring that the businesses that design and deploy AI keep control over the machines and their results, and that they remain accountable to society at large.

Managing through the reboot

- Topics like conflict in Europe and the Middle East, income inequality and AI governance may seem remote from the everyday concerns of tax functions.
- But as geopolitical forces develop and unfold, they drive change in global trade and investment flows, which in turn affect companies' value chains, tax profiles and long-term profitability.
- An emerging leading practice for managing geopolitical risk is to build robust risk governance frameworks. These frameworks include tools for management and boards that:
  - identify salient geopolitical risks
  - map them to actual drivers of revenue and cost
  - establish clear responsibilities for developing mitigation plans around each of these risks.
  - deliver robust internal and external reporting on current risks, future potential scenarios and crisis readiness.
- By taking a lead in designing and implementing such frameworks, tax leaders have exceptional opportunities to contribute to mainstream business strategy, build their team's profile, and contribute to the business's sustainability and success.

The key is to shift people's mindsets toward seeing scenario planning and strategic planning not as discrete activities but as one and the same. A geopolitical risk governance framework can help businesses produce an evergreen roadmap for achieving their goals across a range of possible futures.

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