KPMG Private Enterprise

Carving a new path

How private companies can contribute to future economic stability

KPMG International

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Executive summary

Despite the upheaval of the pandemic, many private companies globally managed to sustain their businesses, often thanks to the support of targeted government programs, which were urgently needed and welcomed.

In many cases, government wage subsidies meant that companies were able to keep their staff employed. Special grants, low-rate loans and incentives helped many businesses to introduce much-needed new technologies to serve their customers and pivot their businesses toward online sales and service. Those in sectors that were hardest hit by the pandemic worked tirelessly to rejuvenate their businesses.

But governments and companies across the world are now facing even more new challenges. How to close the gap on the pandemic debt that has been accumulated is only one of many. Under similar urgent economic circumstances in the past, policymakers have often turned their attention to taxation as one option for restoring their treasury's coffers and getting their economies back on track.

As a tax professional, however, I don't believe that the world can, in fact, tax its way out of debt. KPMG Private Enterprise tax advisors across the world are in agreement. It's our view that the best way forward is to eventually put energy back into the economy with incentives that encourage innovation, R&D, green energy and other essential priorities that can help bring people back to work and boost productivity in the future.

We recognize that privately owned companies fully understand what needs to be done. As the engines of innovation and economic growth in most countries for decades, it's our view that private businesses can, in fact, contribute to greater economic stability if their potential impact is acknowledged and they are supported in a tangible and targeted way.

As KPMG Private Enterprise tax professionals, we believe we have a role to play in this process by helping governments understand and recognize the extraordinary social and economic impact of privately owned businesses. We believe we also have a responsibility to propose long-term options that support their continued contributions through targeted government policies and programs that are developed through a fresh entrepreneurial lens.

In the current state, government policymakers throughout the world are having to assess a multitude of economic options. We are taking this opportunity to add to the discussion by sharing our global perspective on the economic role and impact of private companies, with suggested actions for governments to consider in supporting the sustainability of these resilient companies.

We welcome your feedback on our observations and proposals. I encourage you to join our dialogue and contribute more new ideas for helping to stabilize the world's economies.

Mike Linter

Global Head of KPMG Private Enterprise Tax,
Tax and Legal
KPMG International,
Partner,
KPMG in the UK

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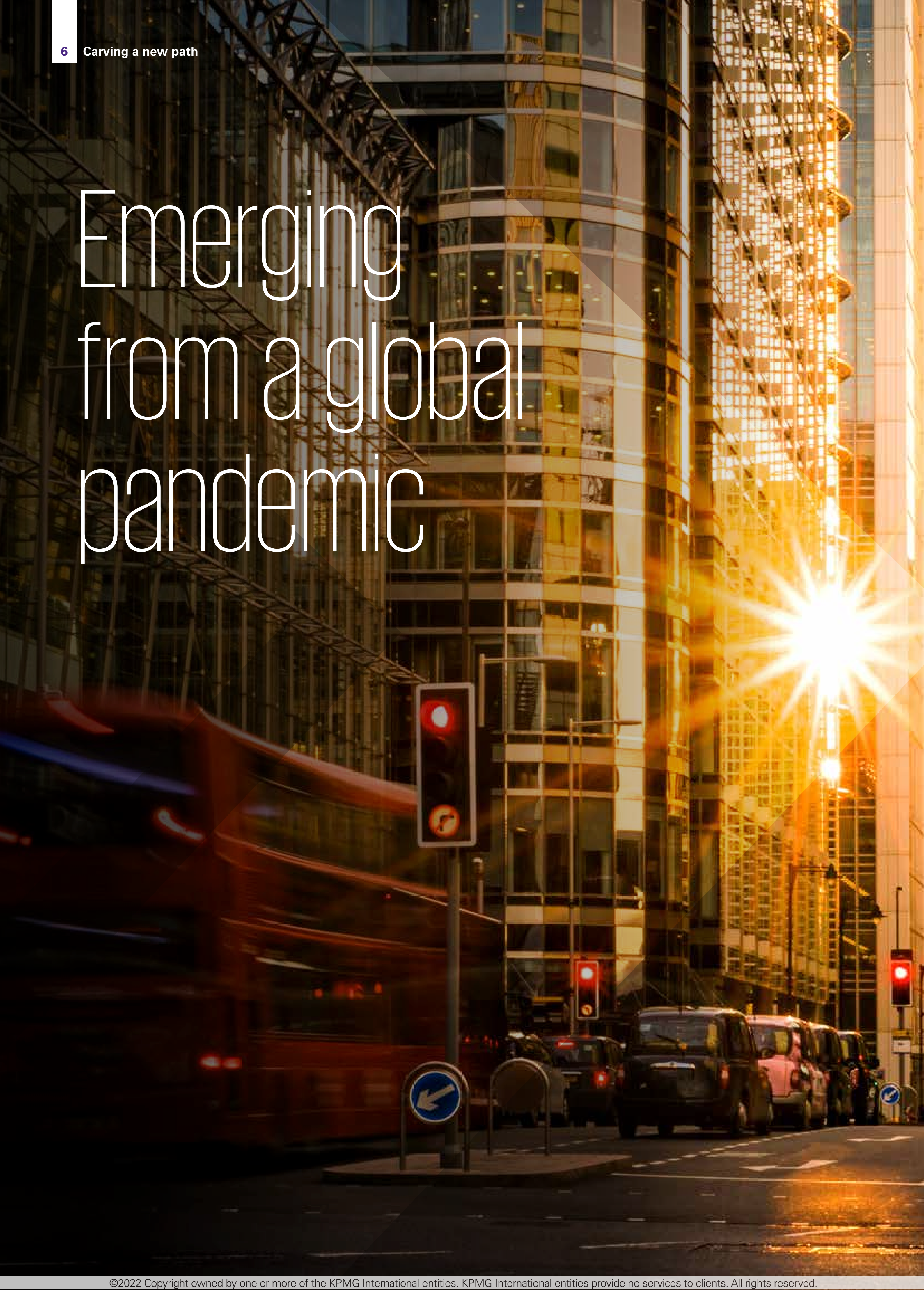
Emerging from a global pandemic



There is no question that the impact of COVID-19 has been vast and unpredictable. Fortunately, for many businesses, most governments sped to the rescue — especially in the early days of the pandemic — with social and financial lifeboats to buoy up their countries' businesses and citizens.

Support was wide-ranging and provided a financial safety net that some private businesses have referred to as, "a lifeboat in a sea of uncertainty".

For some, this support led to the very survival of their businesses. Others continued to trade relatively well, especially those in industries less affected by lockdowns and business interruptions. This, in turn, led to important decisions about whether they should take advantage of government support, especially if it wasn't needed right away.

As one leader of a privately owned business described, it was a chaotic and unpredictable time, and everyone was caught off guard. Even though some companies didn't need immediate help, they welcomed and accepted the government's support. For those in sectors that were particularly hard hit, however, government programs have truly been the lifeboats that helped them survive that crisis.

With access to new capital at highly attractive rates during the pandemic, many were able to invest in new technologies and make operational improvements to strengthen their organizations. For some, these improvements accelerated their growth in the short term. While a growth story amid a pandemic seems extraordinary, it wasn't a complete surprise given the widely recognized agility and adaptability of private companies.

"

For every business that had its challenges during the pandemic, it was easy to find one or two that did incredibly well. That's the beauty of privately owned businesses. They're generally more resilient and less affected by change because they look at their business with a long-term perspective,"

Mike Linter,
Global Head of KPMG Private Enterprise Tax,
Tax and Legal,
KPMG International,
Partner,
KPMG in the UK

He added that, "Equally, with their entrepreneurial spirit, they can find ways to take their existing business in a completely new direction. So, once they got over the initial impact of the pandemic on their normal operations, they showed once again just how resilient they and their businesses can be. "

The historical long-term view of privately owned businesses is based on the concept of patient capital. This approach to investment, combined with the agility and strength of the financial position of their companies, means that the private business segments have an important role to play in the world's economy going forward.

Their ability to invest now with the patience to achieve long-term results allows them to create jobs and new business opportunities in the communities where they operate. Patient capital is the hallmark of private companies — especially family businesses — and it's a critical ingredient in fostering the resilience that will be essential for an economic recovery.

As highlighted in the recent KPMG Private Enterprise report "*Mastering a comeback: How family businesses are triumphing over COVID-19*", family businesses that leveraged their patient capital by avoiding knee-jerk reactions in the early days of the pandemic were actually able to uncover untapped competitive opportunities. And these have become the origins of a longer-term strategy for taking their business in entirely new directions.

In our view, supporting the resilience, adaptability, innovation and long-term focus of private companies should be policy priorities for governments everywhere.

Key takeaways and considerations

- In most countries, there was a strong sentiment among privately owned companies that they should repay the benefits they received from government as quickly as possible, as conscientious, respected, social businesses, by covering their employees' leave and sick pay and minimizing the use of government furlough schemes.
- The company's financial performance in relation to the amount of government relief it received has been an important reputational consideration regarding the payment of dividends and executive bonuses and the ability to repay the government's support.
- Government support money does not belong to the companies that receives it. It belongs to the public, should be treated as such and returned to the public as quickly as possible. Governments are likely to put private companies under pressure to do the right thing.
- Reputation is affected negatively when work has been reduced and family businesses have accessed government furlough schemes to compensate employees while paying dividends to the family or bonuses to executives.
- Some politicians who were concerned about the dividends paid by listed companies suggested that these companies should pay a voluntary amount to their governments to support students, the retired poor, and other vulnerable groups of citizens.
- Questions remain regarding the responsibility of companies to repay the support they have received from government. If the company has been able to turn previous losses into profitability, is its pre-tax profit sufficient to repay the government relief it received? Does the company have sufficient cash flow to repay the relief it received, without taking into account a potential dividend payment?
- People care about how government's money is being deployed and expect businesses to do the right thing. The court of public opinion is expected

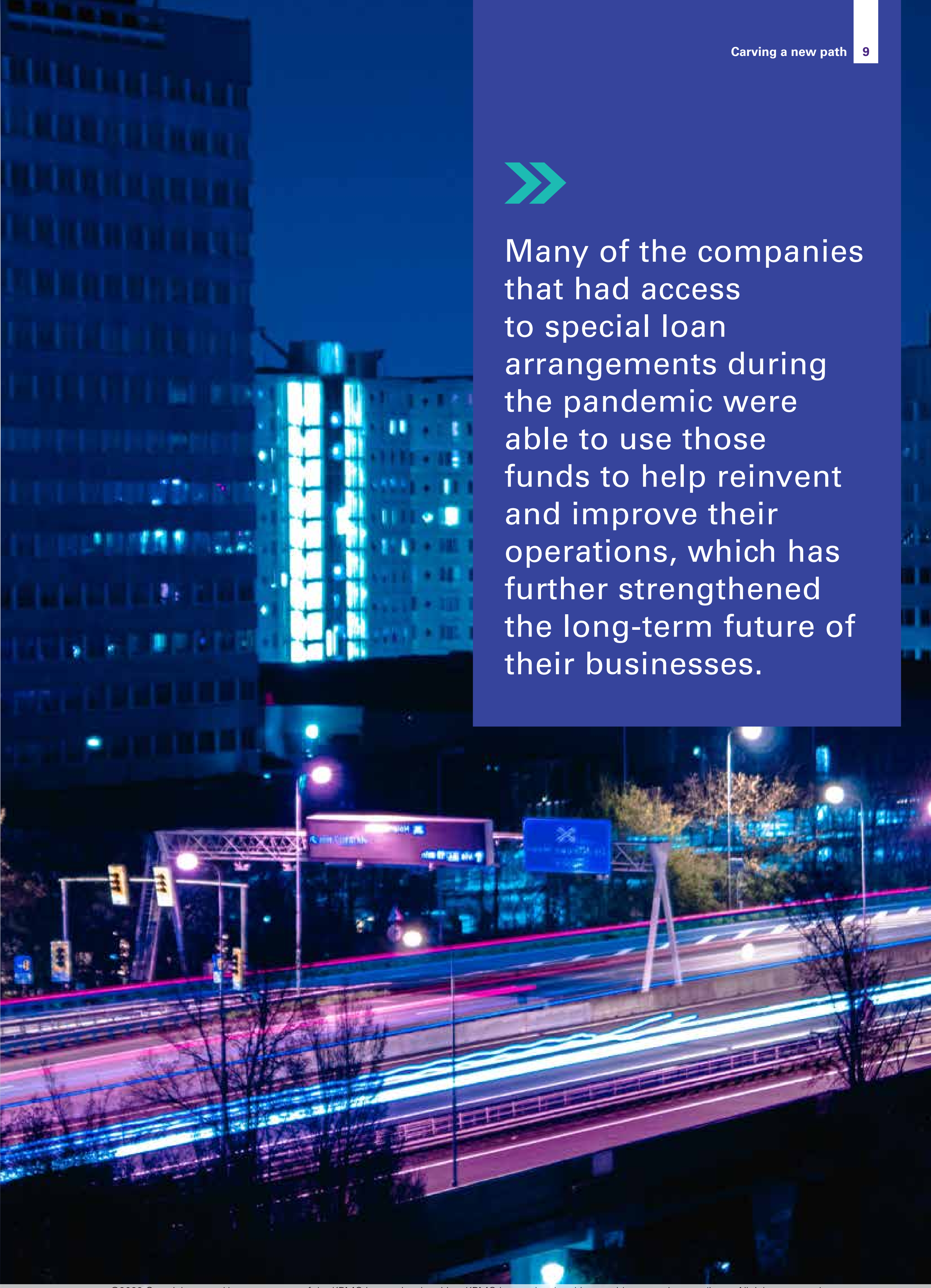
Reputation matters

In certain jurisdictions, companies that received government support were restricted from paying bonuses, dividends and increasing executive salaries. In other countries, the optics of paying shareholder dividends and executive bonuses during a health and financial crisis was a reputational concern for many private companies and it also drew public (and not very favorable) attention in some areas as the owners of an upmarket grocer in the UK discovered. In this particular case, family members received dividend payments in 2021. Dining at home had become the norm and resulted in a surge in food sales.

Despite the growth in their business, this company was also a recipient of the UK government's business rates relief program. The increased sales and rates relief both boosted the company's profitability, however neither the amount of the rates relief nor the dividend payment were substantial in relation to the company's pre-tax profit. And while many other employers had made use of the government's furlough schemes, this company (and other private businesses like it) had kept their employees on the payroll throughout the pandemic. Nevertheless, concerns about the family's dividend payment decision became front-page news and put their reputation at risk.

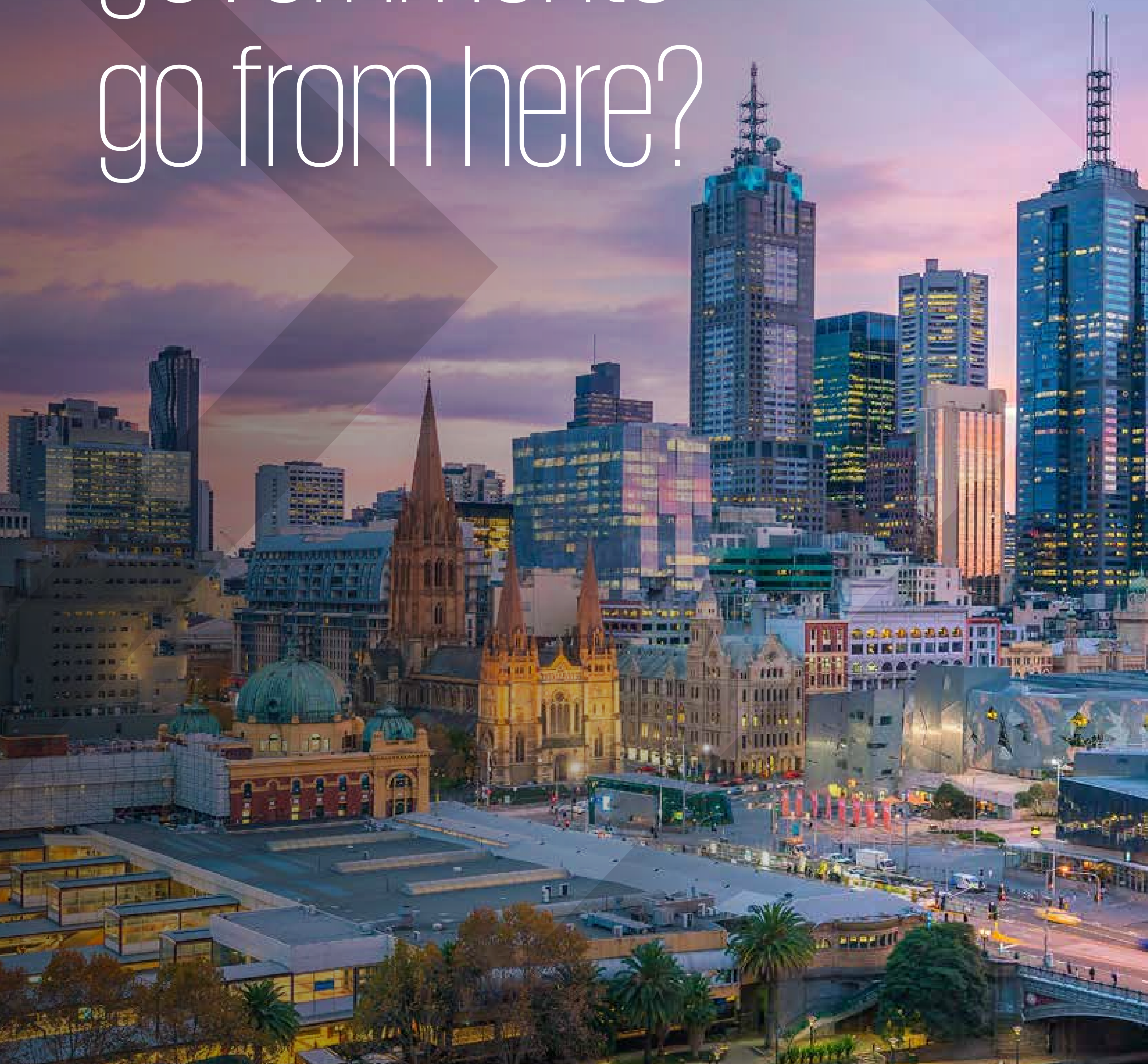
High-net-worth families who own and manage large, successful businesses have been particularly sensitive about being seen to receive *any* sort of assistance, and they have voluntarily opted out of schemes for which they technically qualified.

Regardless of the optics, many businesses have made the argument that government support helped them to keep people employed, and the relief they received in business rates should not be a contentious public issue or concern.



Many of the companies that had access to special loan arrangements during the pandemic were able to use those funds to help reinvent and improve their operations, which has further strengthened the long-term future of their businesses.

Where do governments go from here?



Now that most government programs have reached their expiry date, there is a lingering question about the next steps that governments might take to deal with their nations' pandemic debt in an effort to refill the public coffers. However, the unanticipated consequences of a global health crisis is not the only burning issue on their tax and broader economic agendas as uncertainty in many parts of the world is continuing to create more questions than answers.

Unrelated to the pandemic, 130 countries came to an historic agreement on 1 July 2021, when they approved a statement providing a framework for reform of the international tax rules.[1] But keeping the framework alive has already become a challenge, since it's unclear if countries will choose to remain within the deal if there is a possibility that they can raise more revenues by imposing a digital services tax or something similar. Canada, for example, recently announced that if the deal isn't finalized within two years, it will impose a unilateral digital services tax in 2024, retroactive to 1 January 2022.[2]

"Canada is not the first country to discuss a potential digital services tax, and it's a sign of impatience with the OECD and its two pillars. The OECD deal is meant to solve the allocation of revenue problem without unilateral taxes being imposed, and the US is already threatening sanctions if Canada proceeds in that direction.[3] It is the US government's position that most digital services taxes discriminate against US companies and would create potential retroactive tax liabilities that would have immediate consequences for them."

Shay Menuchin,
KPMG Private Enterprise,
Global Tax Policy Lead,
KPMG International and Executive Director,
US Tax Counsel,
KPMG in Canada

For businesses that have done well throughout the pandemic, governments are trying to discourage the resulting windfall in their businesses being returned to shareholders in the form of capital. If government relief is provided to private companies in addition to what the business itself has achieved during the years of the pandemic, it could result in shareholder bonuses or dividends — an outcome that governments want to avoid.

The same principle applies to share buybacks. A tax platform that has been on and off the shelf for several years in the US proposes an additional tax on company share buybacks to discourage companies from using excess cash (due, in part, to reduced corporate tax rates) to buy back shares and increase the share price.

The sentiment appears to be strong: rather than spending money on shareholders, private companies are encouraged to reinvest their money to boost their local and national economic prosperity.

As Klaus Schwab, World Economic Forum Founder and Executive Chairman, wrote recently: "The pandemic provides a chance to build entirely new foundations for our economic and social systems.

"The only acceptable response to such a crisis is to pursue a 'great reset' of our economies, politics and societies. Specifically, we will need to reconsider our collective commitment to 'capitalism' as we have known it. Obviously, we should not do away with the basic engines of growth. We owe most of the social progress of the past to entrepreneurship and to the capacity to create wealth by taking risks and pursuing innovative new business models."[4]

[1] KPMG International, https://home.kpmg/dp/en/home/insights/2021/08/tax-newsletter-august-2021/oecd-g20-inclusive-framework-agreement-on-beps2.html
[2] https://www.canada.ca/en/department-finance/news/2021/12/digital-services-tax-act.html
[3] https://www.taxnotes.com/tax-notes-today-international/base-erosion-and-profit-shifting-beps/us-businesses-cry-foul-over-canadas-digital-tax-plans/2021/12/13/7cpdg
[4] World Economic Forum, "We must move on from neo-liberalism in the post COVID-19 era", October 12, 2020 https://www.weforum.org/agenda/2020/10/coronavirus-covid19-recovery-capitalism-environment-economics-equality/

For improved economic performance, it's the KPMG Private Enterprise view that a more holistic, longer-term approach is required. It includes economic policy changes — not just tax changes — in order to encourage entrepreneurship, introduce workplace advances, accelerate environmental and societal improvements and help remove barriers to entry in certain industries.

The world can't tax its way out of debt

While tax reforms and multilateral cooperation in the tax space are still on the horizon — and, frankly, long overdue in many jurisdictions — there is increasing global recognition that the world cannot tax its way out of debt.

According to the Brookings Institute, "Well-designed tax policies may raise economic growth, but there are many stumbling blocks along the way and no guarantee that all tax changes will improve economic performance. Thus, the justification for sweeping income tax reform changes must rest primarily on objectives other than economic growth."[5]

This is in line with the idea of the 'great reset' that Klaus Schwab described.

In Singapore, for example, the government has consistently introduced special initiatives to encourage innovation and the development and adoption of new technologies. The pandemic accelerated the need for innovation, and special cash grants and tax deductions for technology investments were introduced. By providing this additional financial support, many companies have been able to elevate their operations to a more sophisticated and sustainable level, enabling them to broaden their market, secure more sales and earn more revenue.

As Wu Hong Chiu, KPMG Private Enterprise Tax Partner, KPMG in Singapore explains,

"The impetus from the government is to help businesses thrive. The Singapore government is providing a lot of tax incentives and grants for organizations that invest in research and development (R&D), science and healthcare. This is a very small country, but the people here are very good consolidators, as many good ideas from all over the world are brought together. This is how to help continue to innovate, grow, prosper and compete."

Wu Hong Chiu,
KPMG Private Enterprise Tax Partner,
KPMG in Singapore

[5] https://www.brookings.edu/opinions/income-tax-changes-and-economic-growth/

There is a lot of value in a private company, but often the owners are unable to unlock the value without selling the business and cashing out. If there was a way to value the company's intangibles, governments could unlock the intangible value in private companies in the form of a tax allowance amortized over several years, rather than prompting a sale.

Brad Sprong, KPMG Private Enterprise National Tax Leader, KPMG in the US echoes Wu Hong's sentiment,

"The goal is to energize the economy. I don't think you get there through taxes. You get there by incentivizing businesses to make capital expenditure investments that spur economic growth and recovery. The US central banks are already doing that by maintaining interest rates at extremely low levels to encourage borrowing and home ownership. And the US Federal Reserve has announced that it won't be raising interest rates until sometime in 2022. In my view, these types of policy decisions are heading in the right direction."

Brad Sprong,
KPMG Private Enterprise National Tax Leader,
KPMG in the US

Key takeaways and considerations

- The corporate tax rate in the UK has increased from 19 percent to 25 percent, and there is a sentiment among many private companies that the country is losing its competitive position in terms of global corporate tax. Increases in national insurance contributions are being introduced as well, making the tax burden higher than in any period since the 1950s, and there are not sufficient incentives that are designed to help private enterprises grow.
- With the pending presidential election in France, the direction that the country may take to finance the pandemic debt is yet to be determined. Prior to the pandemic, the current government decreased the corporate income tax rate and introduced incentives for companies that were establishing new businesses in France.
- There were ongoing discussions as well about the level of inheritance tax in France and how to streamline the transfer of family businesses from one generation to the next. The main topics today are around "production taxes", finding ways to decrease taxes and simplifying tax compliance to promote the competitiveness of French companies. New policy initiatives are unlikely until after the election.
- In the US, R&D and technology advances have been good for the economy. However, beginning in 2022, firms will be required to amortize their research and development expenses over a period of five years, rather than immediately deducting them from taxable income, which would raise federal tax revenue in the short term. Foreign R&D expenses are to be amortized over 15 years.
- There has been an explosion of private capital investment in startups in Australia, primarily in the tech sector. There's a tremendous amount of capital in the market, and funds are being deployed to entrepreneurial startups. Companies that have been in business for three to five years are also getting good access to capital to support their growth.

  Some of this is has been helped by government grants, but it is the private sector that is really stepping up. Small-to-medium-sized businesses employ the majority of Australians, so supporting their growth is very important to the country's economic recovery.
- Not all countries have incentives that are aimed at helping businesses to grow, however. In fact, in some cases, there are more incentives for companies to sell their businesses. This is an issue that we have seen over the years among many private companies that have been sold before they ever reach their full potential and achieve scale.

Key takeaways and considerations

- There is increasing global recognition that countries cannot tax their way out of their pandemic debt.
- Governments will be counting on economic growth to compensate, at least in part, for their accumulated debt.
- Instead of using taxation as a solution, many countries are looking at ways to incentivize companies to make Capital Expenditures and Research & Development investments to spur the economic recovery and stimulate future growth.
- The entrepreneurial mindset, resilience and long-term commitment of family businesses and other privately owned companies are expected to be key contributors to re-energizing the economies of many countries.
- Why wouldn't governments want to tailor some of their economic and tax policies to sustain and expand the impact and important contributions of private businesses and other agile companies such as these? Could larger private companies deliver even more value with incentives that allowed them to scale faster and expand their operations more broadly?

Putting energy back into the economy

KPMG Private Enterprise tax professionals across the globe report a similar tone and attitude regarding how to stimulate the economic recovery in large and small jurisdictions alike. As they see their economies beginning to improve, there is more of an impetus for governments to support and re-energize the companies that are helping to stimulate the economy by providing much-needed jobs, products and services and continuing to fulfill their personal and business tax commitments.

As Brent Murphy, KPMG Private Enterprise Tax Partner, KPMG Australia, explains,

> "The Australian government is very pro-business; the sense is that sustaining economic momentum is the best pathway forward. As a result, the narrative in the country is not around higher taxes. If anything, there are some new ideas floating around about actually lowering the tax rates to stimulate demand."

Brent Murphy,
KPMG Private Enterprise Tax Partner,
KPMG Australia

In mid-December 2021, the Canadian government issued an economic and fiscal update as a prelude to its forthcoming budget that struck a similar tone. In her announcement, Canada's finance minister stated that, "Our government understood, from the start of this pandemic, that the best way to maintain strong public finances was by keeping our economy strong. Our focus was on people and jobs because it was the right thing to do. We also did it because we knew it was an investment in our economy that would pay off. Once we emerge from COVID-19, our focus must be growth and competitiveness, and measures to promote them will figure prominently in the next budget."[6]

While we echo this sentiment, we believe that the global tax debate has been dominated by large multinationals and corporates for too long. What has been missing is a recognition of how other business types and sizes contribute to economic stability and long-term sustainability, such as the privately owned businesses that are 'in it for the next quarter century — not the next quarter'. They're entrepreneurial, resilient and have the ability to deploy long-term patient capital.

Many of these businesses are family-owned enterprises that are contributing to in-country economic growth and prosperity and creating jobs in local communities. The family's purpose and values are embedded in the business, making the company's brand and reputation of paramount importance, and one of the reasons why they are so involved in caring for their local communities. In today's world, this has also made them an important catalyst for environmental, social and governance (ESG) transitions because they make their reputation and societal impact a priority. They want their communities to prosper and they're embracing ESG.

While many private businesses have fared relatively well during the pandemic, not all are created equal. In obvious sectors, such as hospitality, travel/tourism and entertainment, companies of every type — not just private companies — have been particularly hard hit. Location is another factor, with import-dependent countries, such as Singapore feeling the harsh and direct impact of supply chain disruptions, and regional areas in many countries that were more hard-hit than others. This has been amplified further by recent developments in eastern Europe.

What are policy makers to do?

It is our view that governments will ultimately need to shift their policy focus and take into account the current and future contributions of private companies — not only as a response to the impact of COVID-19, but as the way forward to restore the world's economies and help them remain vibrant.

[6] https://www.budget.gc.ca/efu-meb/2021/report-rapport/intro-en.html

Fueling growth: Segments, sectors, regions, people and jobs

For consideration, KPMG Private Enterprise tax professionals are proposing four targeted policy building blocks: segments, sectors, regions and people/jobs (where employees need to be attracted back to work).

We believe that each of these building blocks can widen the lens for governments to recognize and support the contributions that private companies are already making — and can continue to make with the right policies in place — to refuel the economic growth of their local communities and the sustainability of their countries' economies.

1 Policy building block

A discernible private company business segment

Germany's Mittelstand model is often described as the heart of Germany's economy with mid-sized firms accounting for the largest share of the country's economic output. They employ about 60 percent of all workers, provide crucial training and contribute significantly to corporate tax revenues.[7]

These companies represent a unique segment of businesses across the world that put their own assets on the line. They take risks, invest in and manage their businesses primarily through their own assets, and when they make decisions they do so with the long-term interests, protection and stability of their businesses in mind. This clearly sets them apart from most other business types.

The majority are family-owned-and-managed businesses that have been widely recognized for their sense of purpose, values, agility and long-term resilience. They are the embodiment of 'thinking globally and acting locally' and they keep their finger on the pulse of emerging trends and opportunities in their local communities as well as in regional, national and global markets.

We like to think of them as 'opportunists' in the very best sense of the word. And we support the view that fueling the growth of private companies, such as those found in Germany's Mittelstand, would be a highly effective government policy route for encouraging innovation, responsible growth and long-term sustainability around the world.

Governments in every jurisdiction have the potential to receive a disproportionate rate of return by supporting the advancement of private businesses that have historically 'punched above their weight' in generating economic prosperity, stimulating employment, supporting their communities and contributing their fair share in social security and corporate taxes.

To date, however, the economic policies of most nations are focused on large, multinational public companies and shorter-term outcomes. It is our view that the growth potential of the family business and other privately owned companies segment is unmatchable if they are recognized appropriately through the targeted policies and initiatives that are appropriate for their size and reach.

2 Policy building block

Sector-specific development policies

Recognizing that resources are limited, we propose that governments consider focusing their immediate attention on those sectors that have been particularly hard-hit during the pandemic and continue to struggle through subsequent critical events. If tax and other incentives in the future were focused more on those sectors, we believe that it could ultimately improve productivity and the overall strength of the economy.

Broad-based tax measures that cater to everyone, especially companies that are already doing well, will likely be less effective. With more targeted support and assistance to private companies in sectors such as travel, tourism, healthcare, hospitality and across many supply chains, there could be important incentives that encourage consumers to spend, with every purchase helping to amplify the support for the business and the impact it has on the local and national economy.

A similar case can be made for enhancing the level of targeted support for domestic companies in the manufacturing sector, where there has been stark recognition of the consequences of being overly dependent on global supply chains. The fragility of global supply chains became widely apparent during the pandemic and they continue to be increasingly vulnerable, while many countries are introducing incentives to boost local manufacturing and increase R&D.

Supporting the growth of private companies through a targeted sector lens also drives productivity. For example, when tax incentives are designed to support the ESG transition, it encourages private businesses in sectors such as technology, biotech and advanced manufacturing to integrate new environmental advances in their operations. The same is true in other industries, such as energy, where the pandemic exposed how vulnerable the world is to energy insecurity and pricing and to many R&D incentives, which are rarely (but could be) very sector specific.

[7] Source: BDI, Federation of German Industries https://english.bdi.eu/topics/germany/german-mittelstand/#

Do regional targets really work?

Israel began giving tax incentives to bricks and mortar manufacturers in the late 1990s, which were later introduced to high-tech companies as well. These businesses received lower-rate tax incentives and other significant benefits for establishing and growing their companies in the "A Zone" outside the center of Israel. Many multinationals, such as microchip manufacturers, have subsequently chosen to build their hubs in the A Zone to tap into these incentives, and they have contributed to the growth and development of the entire area as a result.

3 Policy building block

Regional economic development policies

There's a significant appetite for tax reform from a business perspective. Politically, however, this is very difficult because it includes national, regional and local taxes in most countries — all of which have experienced a significant erosion of their tax base during the pandemic.

What can governments do?

One of the current debates relates to potential 'levelling up' agendas in regions outside the core cities of many countries. London, for example, has been so financially dominant that many of the country's regions have had difficulties remaining economically viable. This led to the creation of eight 'freeports' — designated areas that receive a variety of special regulatory relief, tax breaks, tax incentives and government support to encourage local economic activity, employment and investment.

Similarly, in the US, certain tax relief incentives were introduced to encourage people to invest in 'enterprise zones' to respond to the need for levelling up in financially depressed areas of the country. A significant amount of business investment was deployed into regions that had not been considered in the past, though it is too early to tell how effective the scheme has been in stimulating business growth, financial stability and employment.

The larger question is, why are more tax policies not designed on a regional basis to stimulate practical business development and growth? Should the tax system be federated to stimulate growth in areas that have been left behind in post-industrialization and where agile, entrepreneurial companies, such as family businesses, could be attracted to invest in and build their businesses locally with the right kind of regional economic policies?

“In Canada, as in many other countries, the provinces and territories have the ability to attend to their own regional fiscal policies, though they are generally aligned with federal government policies. Historically, for example, there haven't been significant differences in tax policies at the regional level. Continued alignment would support businesses and workers across the country more equitably, inspire the creation of new businesses outside the core centers and enhance overall economic growth.”

Dino Infanti,
KPMG Private Enterprise National Tax Leader,
Partner,
KPMG in Canada

4 Policy building block

People and jobs

Another option for stimulating growth that some governments are considering is focused on increasing employment to help ensure that people have sufficient money and security to increase their spending.

The latest budget announcement in Canada reflects this thinking. According to the budget announcement, the plan is to, "Make targeted investments in Canada's businesses so they can hire and train Canada's workers, who will then have more money to spend, spurring our recovery and growing an economy with more opportunities for everyone."[8]

We found a similar theme in a recent article in *The Balance*, *"Do tax cuts create jobs?"*[9] which describes how across-the-board corporate tax cuts have little impact on job creation. This conclusion was based on a 2017 study by the Institute for Policy Studies that compared 92 publicly-held corporations that paid less than the 35 percent corporate tax rate.[10] It was found that, between 2008 and 2016, these corporations lost jobs while the overall economy increased jobs by 6 percent. Instead of paying taxes or hiring, these companies bought back their own stocks. They also increased CEO pay at a higher rate than the average for companies listed on the S&P 500.

If lowering corporate tax rates isn't the answer to job creation, what is?

According to the US Congressional Budget Office, payroll tax cuts lower the cost of labor and are the most cost-effective ways to create jobs for four reasons:[11]

1. Companies with popular products immediately use the savings to hire more workers.
2. Other companies use the savings to reduce prices, which increases demand and the need for more workers.
3. Some firms use tax savings to purchase more goods, which benefits manufacturers.
4. Many businesses use the cuts to raise wages to retain good workers. The workers spend more, increasing demand.

Regional and sectoral incentives were provided to businesses in India for several years where specific areas received benefits that attracted multinationals to invest there.

[8] https://www.canada.ca/en/department-finance/news/2021/04/budget-2021-support-for-small-business.html
[9] https://www.thebalance.com/do-tax-cuts-create-jobs-3306325
[10] https://www.thebalance.com/corporate-income-tax-definition-history-effective-rate-3306024
[11] https://www.cbo.gov/sites/default/files/111th-congress-2009-2010/reports/01-14-employment.pdf

The future of work may not be what it used to be

Despite what appears to be an intense focus on job creation, the media has picked up on a new trend — the "great resignation" — as yet another perceived outcome of the pandemic. Millions of workers worldwide are leaving their jobs and — so far — they don't appear to be coming back. This is one of the most serious issues confronting many businesses today.

The focus is quickly beginning to shift from 'creating' new jobs to finding ways to 'fill' the jobs that are already there. This is a particularly concerning issue for companies and industries that are still grappling with the pandemic's damaging impact on their businesses and need to push forward.

In France, for example, there are reports that many workers are not returning to their jobs, but setting themselves up as independent workers with a very favorable tax regime that helps them to do so.

In the Netherlands, restaurants are able to reopen but they can't find people to do the work, and they remain closed. This is the number one issue for companies that are ready to grow but don't have the human capital to do it. Others don't have the knowledge or skills that are required for streamlining and advancing their operations for a new digital world. Everyone understands the importance of digitalization, but how to do it is another thing. Small enterprises don't know what to do. They don't have the right skills or resources needed to put together all the pieces of the digital puzzle.

We believe there are some important potential policy initiatives that could be considered in this environment,

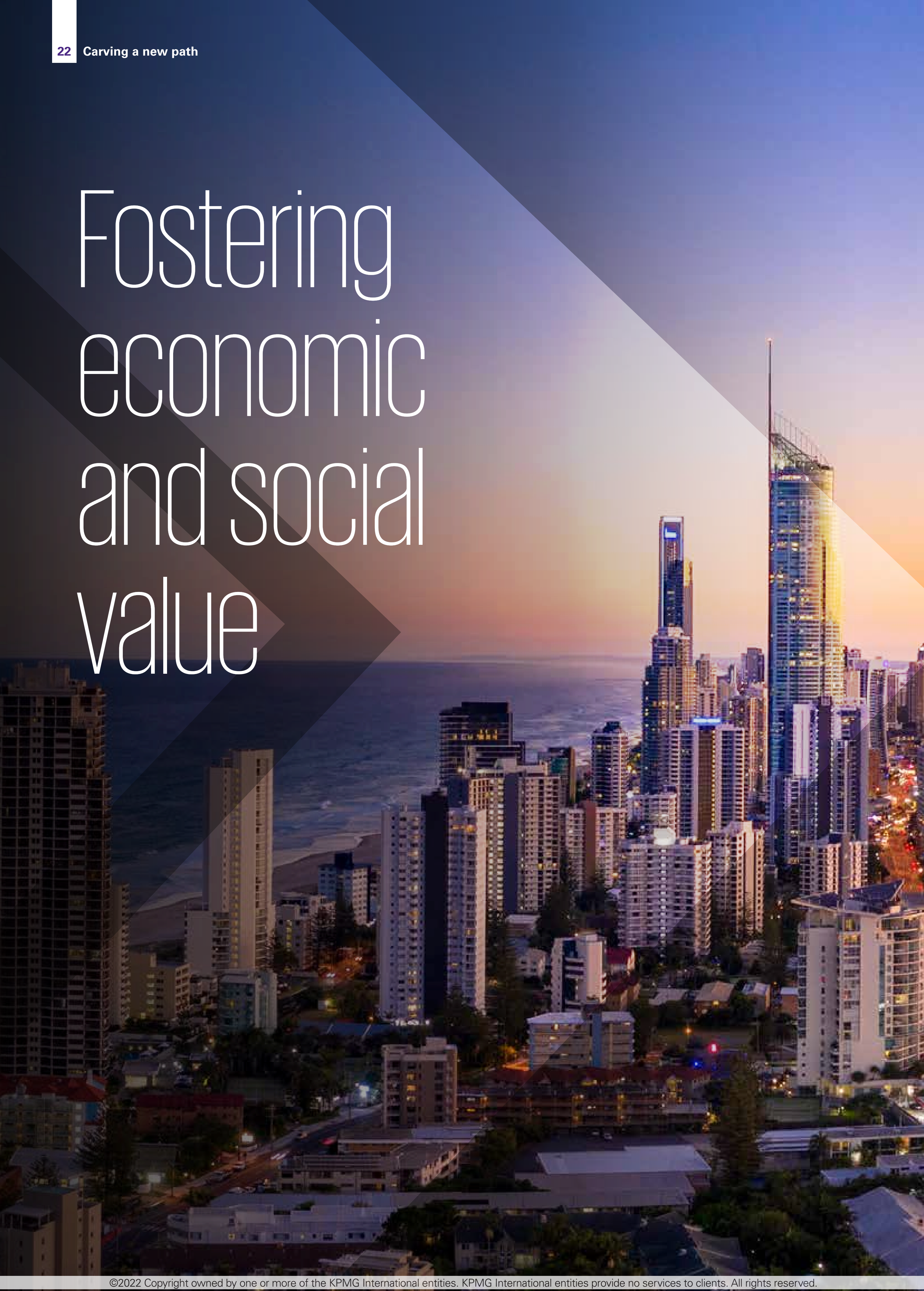
such as reskilling initiatives for employees and to re-engage employees with their employers through employee participation plans (especially in startups and scaleups where employees can 'own' a piece of an exciting entrepreneurial business). The link between ownership and productivity is a really important one, and previous studies have shown that higher productivity levels are achieved in businesses that have some form of employee participation.

In the UK, there is already some observable growth in employee ownership plans among private companies. Though it can be complex to give employees equity participation, there is the potential for governments to introduce mechanisms that can encourage and enable the introduction of appropriate employee ownership schemes that can help to attract, engage and retain key employees in privately owned companies.

Key takeaways and considerations

- One of the most effective methods for improving productivity is through earmarked R&D tax credits to help stimulate energy transitions and supply chain improvements as well as the growth of tech, biotech, advanced manufacturing and other new economy businesses.
- Countries are looking to the middle class to generate growth, and payroll tax reductions can be a catalyst. With lower payroll taxes, people end up with higher net incomes and make purchases that help to stimulate the economy.
- Governments could introduce R&D grants, retraining incentives and incentives related to the green economy to assist people in reskilling and being able to move from one sector to another in an effort to bring people back to work.
- The pandemic emphasized the urgent need for, and importance, of digital skill sets. These are capabilities where private companies often lag compared to larger companies, and especially multinationals.
- Everyone understands the importance of digitalization, but how to do it is another question. Small private businesses, in particular, are challenged by insufficient resources and know-how. One option is for governments to provide these companies with simple, ready-made solutions that they can adopt for their basic requirements. Beyond that, they could be provided with grants for acquiring the needed expertise for building something bigger and more complex.
- Governments should develop strong plans to help private companies implement and evaluate their digital initiatives. This will be essential for them to survive and thrive in a rapidly moving digital transformation era.

Fostering economic and social value



Everyone can potentially benefit, not only from the significant economic impact of private companies, but their social and environmental contributions as well.

They are often the first to step up to address the environmental and social issues that are important to their stakeholders. Reputation is important and it is imperative that they operate responsibly both inside and outside the business on a solid foundation of core principles and values.

Governments should want to do everything possible to support companies such as these in living up to their principles and in having a positive impact on the world.

"Founders and CEOs of the private businesses we speak with recognize that the big, dynamic trends in wider society need to be reflected in their own business as well as in the social and economic agendas of the jurisdictions where they operate.

Many are committing to major investments in long-term ESG strategies, and they see the need for governments to play an active role in supporting them through grants and tax incentives. It is our view that this is precisely the outcome that national and local governments should be striving to achieve through their fiscal policies."

Greg Limb,
Global Head of Family Office and Private Client,
KPMG International,
UK Head of Family Office and Private Client,
KPMG in the UK

Several countries are beginning to head down that path. Tom McGinness, Global Leader, Family Business, KPMG Private Enterprise, KPMG International, and Partner, KPMG in the UK has highlighted several new programs that were introduced in the most recent UK tax budget to stimulate and encourage investment, including a new super-tax deduction for technology investments that support the green economy.

"This has been widely welcomed," says McGinness "It is encouraging businesses to spend money on technology and to begin getting their businesses fit for the future. I believe this is part of the transformational journey that's happening with a lot of family businesses and other privately owned companies as they start to come out of the pandemic. The government's support is not only welcome ... it's essential."

Tom McGinness,
Global Leader, Family Business,
KPMG Private Enterprise
KPMG International,
Partner,
KPMG in the UK

McGinness also makes note of the increasing interest in green bonds that are being offered by certain institutions — also an area where governments could help to provide private companies with access to different types of funding.

In a World Economic Forum article, the role of tax incentives to boost innovation has been highlighted.[12] The article describes the UK government's concerns in 2008 about falling behind in innovation and growth, and the decision to launch a tax incentive program to encourage R&D. The Forum refers to a working paper entitled, *"Do Tax Incentives for Research Increase Firm Innovation? An RD Design for R&D"*[13] which shows that the UK program not only spurred innovation in the firms that were its direct beneficiaries, but it also had positive spillover effects on technologically related firms.

The research concluded that without the tax relief, aggregate R&D spending of UK business would have been 10 percent lower, and that for each £1 of subsidy there was £1.7 investment in R&D.

[12] https://www.weforum.org/agenda/2016/09/boosting-innovation-the-role-of-tax-incentives
[13] (NBER Working Paper No. 22405), Antoine Dechezleprêtre, Elias Einiö, Ralf Martin, Kieu-Trang Nguyen, and John Van Reenen

“An R&D tax incentive is being considered in France, and in my opinion, these incentives are very attractive. I also believe that the French tax regime is very competitive within the EU, though some improvements in the labor laws and social contributions could make it even more attractive for fast-growing entrepreneurial businesses.”

Vincent Berger,
KPMG Private Tax Enterprise Partner,
KPMG in France

Expanding the ESG agenda

There are many options that are worthy of consideration — from changes in taxation to R&D grants and tax incentives that support innovation and the green economy. The ESG agenda had the attention of governments and businesses long before COVID-19. Many of the challenges and opportunities for progressing this agenda were explored during the 2021 UN Climate Change Conference in Glasgow (COP26). Even though the level of commitment that was hoped for wasn't reached, many countries did commit to becoming environmentally neutral within a couple of decades.[14]

“These commitments are likely to require a change in tax policy to incentivize certain ‘green behaviors’ and disincentivize behaviors that increase pollution. With potentially transformative advances to be made, governments that have the foresight to develop economic policies that support the privately owned companies that are driving innovation and generating economic and social value can reap the rewards of economic prosperity for their country and its citizens.”

Maarten Merkus,
KPMG Private Enterprise Tax Partner,
Meijburg & Company,
KPMG in the Netherlands

[14] World Health Organization, https://www.who.int/initiatives/cop26-health-programme/country-commitments

It's time for a policy reset

Many private companies are widely recognized for 'punching above their weight' in driving innovation, creating jobs and contributing directly to the economic and social growth of the countries and jurisdictions where they operate. There are important policy areas that can help to support their entrepreneurial leadership, and this is an opportunity for many governments.

Unfortunately, most of the tax policy debate to date has been overly focused on listed businesses. Why wouldn't governments take a long-term view and shift at least some of their focus and reset their tax policy priorities to support private companies that are entrepreneurial, agile and create indigenous jobs?

To the contrary, many current relief programs and exemptions in the UK are focused on exit or succession events, while efforts to encourage growth have been limited to capital expenditure incentives (until 2023) and R&D tax relief.

In Israel, tax incentives were in place for many years with the goal of attracting US investors. However, most startups had a preference for operating in the US at that time — even at a 35 percent tax rate — because of the higher likelihood of attracting the right investors.

Similarly, the potential benefit of tax incentives was not seen to be an important contributor to growth in Israel. However, incentives to increase employment did appear to be effective. The principle was that by giving incentives to recruit more employees, the income the employees earned would generate a need and demand for products and services that would contribute to economic growth, though it's difficult to draw a conclusion about cause and effect.

We have found in the past that these types of efforts have been insufficient in changing behaviors. The question is "What will?"

As KPMG Private Enterprise tax professionals, we believe we have a responsibility and a role to play in exploring some of the answers by helping to contribute to the long-term, integrated thinking across different levels of government as they begin to assess their policy options in preparing for an economic recovery, driving sustainable economic growth and employment, innovation, R&D, and advancing the green energy agenda.

These are some initial policy recommendations that we are presenting for consideration to demonstrate the current and future social and economic impact of private companies.

Policy recommendations

1. We have been impressed by the German model of developing strong regional centers that have levelled up naturally. The regional approach will likely need to be different for every country. However, with accelerating productivity anxiety in many sectors (including minimum-wage manufacturing facilities) we believe that a regional and sector approach to tax incentives for stimulating growth has a great deal of potential.
2. We recognize that the OECD's Pillar 1 and Pillar 2 international tax reforms are intended to help multinational companies more than private businesses. However, privately owned companies that have multinational customers may also be affected indirectly, as changes in supply chains could have an impact on the sustainability and profitability of local enterprises. Some restructuring may be required for these companies to take advantage of incentives and grants to help improve their circumstances as a result of these international tax developments.
3. Incentives and policy changes that support the growth and profitability of successful private companies would generate the additional tax revenues that governments need, while also introducing greater efficiency and economic stability.
4. Clean energy incentives for small and medium-sized businesses would encourage them to invest in their infrastructure, comply with the decisions of the COP26 summit and reinforce their commitments to support the environment as well as their local and regional communities.

5. There in an increasing interest in R&D tax deductions at the macro level. However, deductions may only benefit companies that are profitable. We suggest changing tax deductions to R&D tax credits, as an incentive to encourage R&D and innovation in a way that is more relevant and helpful to local enterprises compared to multinationals.
6. It is expected to be important to aim to ensure that every country receives its fair share of taxes, particularly in the electronic world where products are sold digitally. The countries that generate the customers should get their fair share of taxes — not only those where the IP is situated.
7. Some parts of the world have taxation policies that hinder business succession and the growth of privately owned businesses. This is particularly the case with regards to family business successions. Removing tax disincentives to intra-family transfers and supporting their continued long-term growth would be an important step forward.
8. Though it can be complex to give employees equity participation in privately owned companies, might governments consider the links between productivity and tax and provide mechanisms for private businesses to deploy share schemes and employee incentives to drive productivity and growth?
9. Incentivizing the ESG transition could potentially encourage private companies to accelerate the adoption of new environmental technologies through the tax system.

Preparing for a way forward

In today's reality, most governments are still pivoting from the short-term relief programs that kept their economies afloat. And while saving rates are quite high in many countries, governments are looking for ways to incentivize individuals and businesses to release those savings. Greater economic and social sustainability will be the first step before moving forward with longer-term measures that can help to repair deficits and eventually re-energize economies.

When that time comes, it is our view that the focus should not be on imposing higher tax rates — especially on entrepreneurial engines of growth such a family businesses and other privately owned companies — but on incentives that encourage their continued investment in innovation. It's the growth and profitability of these businesses that will likely contribute to the tax base and help to sustain the world's economies over the long term.

As we move to a more global tax approach for large multinationals, it would make sense for governments to recognize the importance of private companies through tax systems and economic policies that encourage their growth from a sector, regional and innovation perspective. If these businesses are supported and given incentives to encourage their growth, this approach could also prevent private equity firms or large multinationals from buying these companies and potentially relocating some or all of their operations elsewhere.

Despite the stability that these companies can bring to their local and national economies, few jurisdictions thus far have taken this more targeted segment, sector and regional approach.

We believe this is an opportune time for governments to adopt an entrepreneurial mindset with policies and legislation that recognize the contributions made by private companies on their local, regional and national economies.

We welcome your thoughts on the propositions we're putting forward and other issues and opportunities that you believe are important to consider. We want to hear your views. We encourage you to contact us at **privateenterprise@kpmg.com** or your local KPMG Private Enterprise tax professional.

We will keep the dialogue open with regular updates on the views of private business leaders like yourself on the **KPMG Private Enterprise Tax website**.

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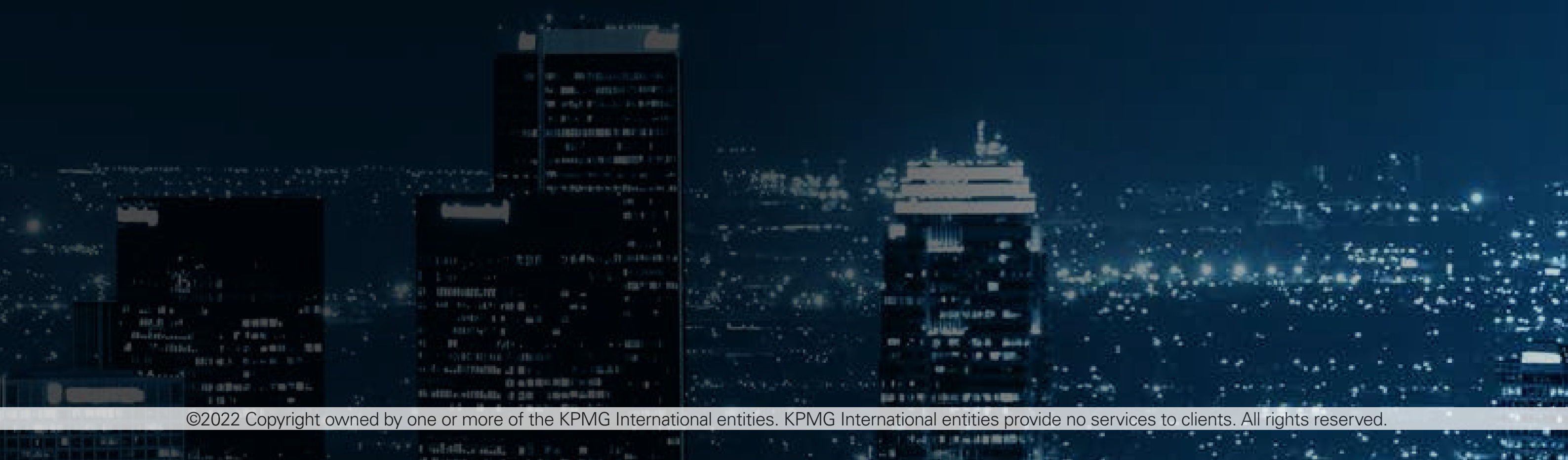

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