

News release

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Tax policy plays a vital role in economic stimulus activities

Ernst & Young guide outlines key tax trends in fiscal stimulus packages across the world

LONDON, 8 MAY 2009 – As the world economy seeks firm footing amid the first true global recession since World War II, more and more countries are turning to discretionary fiscal stimulus to boost overall demand and restart the flow of credit to companies. And, while spending measures have received more mainstream attention over the last few months, tax measures actually represent 56% of the net effect of fiscal stimulus, according to a recent OECD report. In *Worldwide fiscal stimulus – tax policy plays a major role*, Ernst & Young examines these tax-related fiscal stimulus measures in 24 key jurisdictions and identifies themes that are emerging as governments increasingly rely on their tax systems to administer fiscal stimulus.

“In an increasingly global and interconnected business arena, stimulus-driven tax measures are being adopted in at least one – and likely many – of the jurisdictions in which a multinational corporation operates. Companies have to be aware of these developments and understand their implications to prepare properly for their impact,” says Mark Weinberger, Global Tax Leader at Ernst & Young.

Though the approach has varied from country to country, Ernst & Young’s guide illustrates that many countries have focused their tax-based fiscal stimulus efforts on similar types of activities:

- ▶ Accelerated depreciation programs – to improve cash flow for businesses by allowing them to write off the costs of investments more rapidly
- ▶ Carryforward and carryback provisions – to provide cash flow assistance by giving traditionally profitable companies more latitude in using net operating loss credits they are accumulating in the current difficult environment

- ▶ Reductions in corporate income tax rates – to improve cash flow, stimulate overall demand and encourage investment, as well as to be more attractive in the international competition for jobs and investment
- ▶ Enhancements to the research and development tax credit – to provide added incentive for companies to maintain their investment in innovation, and to attract new R&D activity, despite current economic challenges
- ▶ Indirect tax changes – to maintain demand by reducing the costs of goods and services
- ▶ Personal income tax measures – to increase overall demand by increasing after-tax pay, particularly for lower and middle income taxpayers

Among the significant emerging trends, the guide points out that some of the recently instituted tax-based fiscal stimulus measures are permanent, but many are temporary. Also, in many cases, the new measures favor certain types of activity, with manufacturing, technology, energy efficiency and transportation among commonly targeted categories. In some cases, more generous support is offered for small- and medium-sized enterprises, which generally have been hit hardest by current economic challenges. Along the same lines, the majority of personal income tax measures have focused on lower- and middle-income earners.

“Every country’s actions are dictated by their own specific needs, budgetary reality and political climate, so while they generally share the same goal – boosting demand and improving cash flow – their approaches can vary significantly, even on similar issues. So, before making any investments or other business decisions based on opportunities stemming from fiscal stimulus efforts, companies really have to be aware of all the variables,” says Mark Weinberger.

Another key factor to consider, Weinberger says, is that many governments are already contending with ballooning deficits and sharply falling tax revenues, even as they launch aggressive spending and tax-based fiscal stimulus programs. “Government activities to date have necessarily focused on addressing urgent economic needs, but companies must recognize that these same governments will soon have to find a way to pay for the tax relief and other stimulus they are providing.”

For example, in its recent budget announcement, the United Kingdom presented a series of significant income tax increases geared toward high earners, signaling an increased focus on reducing their budget deficit. Hungary, which has generally taken a more conservative approach to fiscal stimulus due to budget challenges, is preparing to increase its value-added tax from 20% to 25%, while also introducing a series of personal income tax rate reductions as it shifts its focus toward taxing consumption more heavily than income.

“Many opportunities arise from the rate reductions, appealing incentive programs and other stimulus measures that are being liberally offered in many countries around the world. However, these benefits also are contributing significantly to the challenges that governments will face in the future – and will likely result in less favorable developments down the road,” says Chris Sanger, Ernst & Young’s Global Head of Tax Policy. Ernst & Young’s guide highlights several things that companies can focus on to improve their ability to benefit from opportunities, while managing the difficulties associated with challenges to come, including: managing their cash effectively, participating only in incentive programs that support overall business goals, improving communications and overall relationships with authorities and actively monitoring – and participating in – the tax policy development process. “Successful tax directors will look ahead rather than just file returns for the past,” Chris states.

Similarly, Mark Weinberger stresses that tax policy developments will not end with the actions detailed in this guide. “These are not likely to be the last stimulus efforts we will see before the global economy fully recovers. And, as governments prepare for their next round of actions, they will look to the experiences of their neighbors, both the positive and the negative, in determining their approach. These future policy choices in the tax arena will have a major impact on companies’ activities and the returns they can expect on investments across the globe,” he concludes.

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About the guide

Worldwide fiscal stimulus — tax policy plays a major role, a guide to tax elements of stimulus packages in 24 jurisdictions and the European Union, focuses on the measures that make up the tax component of each country stimulus package. The data was collected during March and April 2009. The economic environment continues to change daily, so the newest tax measures may not yet be reflected in this study.

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