# THE REAL ECONOMY

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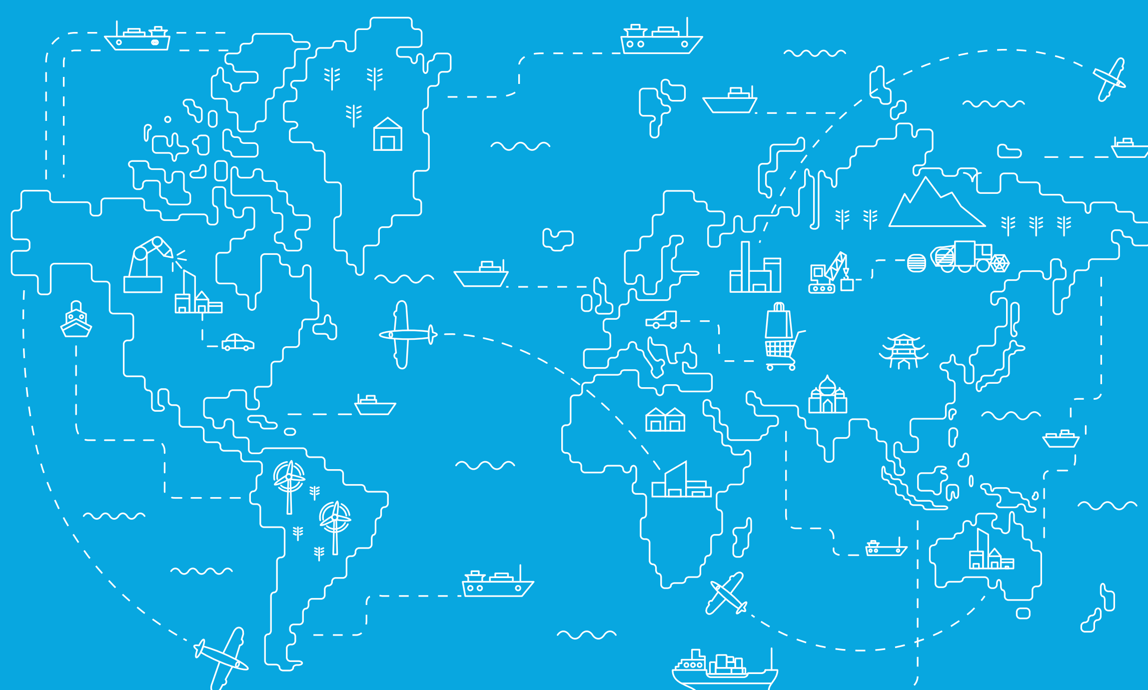
## GLOBAL EDITION



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# THOUGHT **LEADERS**

Our thought leaders are professionals with years of experience in their fields who strive to help you and your business succeed. Thought leaders who have contributed content to this issue include:

- Joe Brusuelas, Chief Economist , RSM US LLP
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- Andy Murray, Partner, RSM UK
- Mike Thornton, National Head of Manufacturing, RSM UK

# TABLE OF **CONTENTS**

# WHY TPP MATTERS

## TRANS-PACIFIC PARTNERSHIP WOULD BE A MAJOR BOOST FOR GLOBAL MIDDLE MARKET BUSINESSES

by Joe Brusuelas, Chief Economist, RSM US LLP

The past few years have seen a quiet but important innovation in free trade agreements. For the first time in the multilateral era since the end of World War II, the interests of global middle market firms have been taken into account. This is evidenced by the priority of middle market firms in the construction, implementation and oversight of free trade agreements.

The Trans-Pacific Partnership (TPP) builds upon an innovation embedded earlier in the decade in the successful U.S.-Korean free trade agreement in that it is designed to construct space for small and medium-sized enterprises (SMEs) to more robustly participate in a trade agreement between 12 countries responsible for 37 percent, or $2.74 trillion, in global trade.

### The TPP 12

- Australia
- Brunei
- Canada
- Chile
- Japan
- Malaysia
- Mexico
- New Zealand
- Peru
- Singapore
- Vietnam
- United States

The elimination of about 18,000 taxes on trade between the 12 economies represents just one part of what constitutes a major breakthrough. For global middle market businesses, the TPP should produce opportunities to expand operations outside of traditional domestic areas and into new markets.

**MIDDLE MARKET INSIGHT**
The TPP strongly favors global middle market firms through a simplification of customs and the promotion of electronic commerce in economies large and small alike.

Take a large economy like the United States, where about 98 percent of exporters fall under the category of small and medium enterprises, and one can see the significant opportunity at hand. While exporting activity with respect to volume is tilted toward large companies, a distribution that is common across the global economy, the innovation inside the TPP is a logical step toward changing that fact.

Large firms will always be able to take advantage of scale. They have an ability to absorb transport costs, find trade financing and address customs hurdles. The removal of tariff, nontariff barriers and the facilitation of trade tends to stimulate exports for small, medium and large firms in the same fashion. While small and medium businesses will benefit from growth thanks to the innovations embedded within the TPP as costs of participation fall, large firms will find growth via volume. In other words, it's not the distribution of the benefits of growth that are important here, but rather the opportunity to expand the overall size of trade.

The economics of middle market businesses and free trade is quite simple. Surveys of small and medium enterprises conducted by the International Trade Centre indicate that for those businesses, access to information about export opportunities, overcoming nontariff barriers such as sanitary and technical standards, cumbersome border procedures, constructing delivery systems for international customers and establishing a network infrastructure for information, communications technology, electricity and water are among their chief trade concerns.

Meanwhile, the Petersen Institute for International Economics recently conducted a sophisticated gravity regression to test the responsiveness of SME exports to trade costs using U.S. Census Bureau data on merchandise exports to 25 foreign markets over a decade. The findings are quite clear: Market specific barriers do not deter SMEs any more than they deter large businesses. The reduction of tariff and nontariff barriers both act to increase export activity for large and small businesses alike. Moreover, by targeting the microeconomic causes of barriers to increased trade, the treaty itself, and the innovations embedded in it, is ripe for middle market business expansion on a global basis.

The major barriers to entry entail both fixed and variable costs that are microeconomic in origin. These are directly targeted in the TPP, which requires each country to construct an online website that will provide SMEs with access to tailored information to permit full participation in the TPP. The agreement is designed to reduce highly variable costs that can often disproportionately affect middle market businesses; contributors to these variable costs include overly complex paperwork, a lack of transparency in the regulatory process, corrupt customs administration, restrictions on data flows and logistics.

The TPP specifically addresses the fixed and variable cost challenges that inhibit trade. It also creates an ongoing TPP SME committee that will meet regularly to review small and medium-sized engagement within the treaty and recommend pathways to enhance the benefits for SMEs going forward. The committee will also consider export counseling, trade assistance and trading programs, and information sharing.

While some dismiss the innovation inside the TPP as just talk, there is precedent for an approach that with a proven record of success: the U.S.-Korea Free Trade Agreement. This treaty, which became effective on March 15, 2012, has been an initial success for both countries and the SMEs operating within them. Korean exports increased by 4 percent overall and the number of Korean tariff lines providing duty-free access for United States exports increased to 80 percent from 13 percent on day one of going into effect.

Through the end of 2013, U.S. SMEs showed immediate sales increases, though some reported that potential trade gains were slow due to the long implementation time frames. Even so, most notable among the increases in trade were for beverage and tobacco manufacturing firms, which saw an increase of 25.5 percent; leather and allied product manufacturing firms posted a 10.8 percent increase; textile exports climbed 3.9 percent, and transportation and equipment manufacturing increased 3.5 percent. In the lucrative service sector, SME trade increased by 8.4 percent, or $13.3 billion, compared to the same period two years earlier. Royalty and licensing fees jumped 23.4 percent. Travel increased 10 percent. The fact that this occurred during a period of slowing regional economic growth is all the more impressive.

Unfortunately, today, especially in the developed economies, a false conversation about free trade and the free movement of capital is taking place. There is a myth that the free movement of goods and capital is responsible for job losses in manufacturing and across other areas of the economies. That is simply not true. In the United States, for example, the overwhelming cause of job losses has been related to changing comparative advantages between and among economies due to the rapid integration of technology into the production process, not to free trade and movements of capital. If the TPP isn't implemented, it would represent a major missed opportunity for global middle market firms.

# 18,000

**TARIFFS ELIMINATED**

## U.S. EXPORTS TO TPP COUNTRIES

# $639 BILLION

## *MIDDLE MARKET EXAMPLE*

**CRAZY MOUNTAIN BREWING COMPANY**

*EXPORTS TO 7 TPP MEMBER STATES*

PRE-TPP EXPORT TARIFF: 35%

**POST-TPP EXPORT TARIFF: 0%**

SOURCE: OFFICE OF THE U.S. TRADE REPRESENTATIVE

## TPP MEMBER STATES

% OF GLOBAL GDP **37%**

% OF GLOBAL TRADE **24%**

% OF GLOBAL EXPORTS **28%**

**TOTAL POPULATION 3.519 BILLION**

SOURCE: RSM, BLOOMBERG

## TPP WINNERS

- AGRICULTURE AND MINING
- NONDURABLE MANUFACTURING
- DURABLE MANUFACTURING
- NONTRADED SERVICES
- TRADED SERVICES

SOURCE: U.S. INTERNATIONAL TRADE COMMISSION

## TPP TARGETING SMALL AND MIDDLE MARKET FIRMS

### HOW TPP HELPS SMEs

- **98%** OF EXPORTERS ARE SME FIRMS
- ONLY **4%** OF U.S. SME POPULATION EXPORTS TO GLOBAL MARKETS
- SMEs ACCOUNT FOR **34%** OF EXPORTS OF GOODS AND SERVICES
- SMEs ACCOUNT FOR ROUGHLY **40%** OF ALL EXPORT-SUPPORTED JOBS IN THE U.S.
- **73%** OF SME SALES CONDUCTED THROUGH DIRECT EXPORTS COMPARED TO **85%** OF FOREIGN FIRMS THAT USE AFFILIATES FOR SALES

SOURCE: OFFICE OF THE U.S. TRADE REPRESENTATIVE

HOW FREE TRADE AGREEMENTS HELP THE MIDDLE MARKET

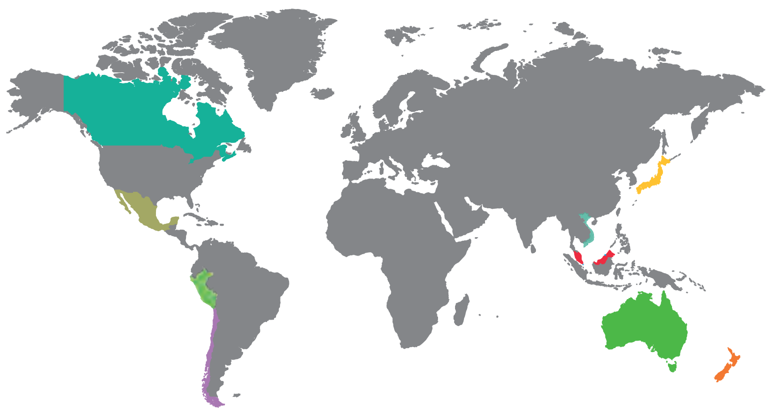
## FTAs ,SMEs AND EXPORTS TO THE U.S. : EVIDENCE

*U.S.–KOREA FREE TRADE AGREEMENT— FIRST TO TARGET SMEs*


**KOREAN SME EXPORTS TO THE U.S. INCREASED BY 4%**

## U.S. SME EXPORTS TO KOREA

## TOTAL MERCHANDISE TRADE WITH TPP MEMBER STATES (BILLIONS U.S. DOLLARS)



| | |
|---|---|
| AUSTRALIA | 156 |
| BRUNEI | 8 |
| CANADA | 686 |
| CHILE | 46 |
| JAPAN | 421 |
| MALAYSIA | 170 |
| MEXICO | 575 |
| NEW ZEALAND | 35 |
| PERU | 28 |
| SINGAPORE | 235 |
| VIETNAM | 92 |

SOURCE: OFFICE OF THE U.S. TRADE REPRESENTATIVE

## REAL INCOME EFFECTS

ESTIMATED % CHANGE FROM THE BASELINE

| | 2020 | 2025 | 2030 |
|---|---|---|---|
| AUSTRALIA | 0 | 0.4 | 0.6 |
| BRUNEI | 1.1 | 3.3 | 5.9 |
| CANADA | 0.4 | 0.9 | 1.3 |
| CHILE | 0.1 | 0.5 | 0.9 |
| JAPAN | 0.9 | 1.9 | 2.5 |
| MALAYSIA | 1.6 | 5 | 7.6 |
| MEXICO | 0.2 | 0.6 | 1 |
| NEW ZEALAND | 0.5 | 1.5 | 2.2 |
| PERU | 0.4 | 0.6 | 1 |
| SINGAPORE | 0.5 | 1.9 | 3.9 |
| VIETNAM | 2.3 | 5.8 | 8.1 |
| U.S. | 0.1 | 0.4 | 0.5 |

SOURCE: PETRI & PLUMMER

# HOW THE TPP WILL IMPACT THE WORLD

REAL INCOME EFFECTS: ESTIMATED % CHANGE FROM THE BASELINE

| | 2020 | 2025 | 2030 |
|---|---|---|---|
| WORLD | 0.1 | 0.3 | 0.4 |
| AMERICAS | 0.2 | 0.5 | 0.7 |
| ASIA | 0.2 | 0.4 | 0.4 |
| EUROPEAN UNION | 0.1 | 0.2 | 0.2 |
| CHINA | 0 | 0 | -0.1 |
| RUSSIA | 0 | 0 | 0.1 |

SOURCE: PETRI & PLUMMER

## TRADE AND INVESTMENT EFFECTS OF THE TPP ON THE GLOBAL ECONOMY

| | EXPORTS 2030 | INWARD FDI 2030 | OUTWARD FDI 2030 |
|---|---|---|---|
| WORLD | 3.1 | 0.8 | 0.8 |
| AMERICAS | 8.2 | 2.7 | 1.4 |
| ASIA | 4.2 | 1.4 | 1.5 |
| EUROPEAN UNION | 0.5 | 0.2 | 0.6 |
| CHINA | 0.2 | 0.2 | 0.4 |
| RUSSIA | 0.5 | 0.1 | 0.2 |

SOURCE: PETRI & PLUMMER

## TRADE AND INVESTMENT EFFECTS INSIDE THE TPP

| | EXPORTS 2030 | INWARD FDI 2030 | OUTWARD FDI 2030 |
|---|---|---|---|
| AUSTRALIA | 4.9 | 0.9 | 3 |
| BRUNEI | 9 | 11.3 | 3.3 |
| CANADA | 7 | 7.2 | 1.2 |
| CHILE | 5.3 | 0 | 1.7 |
| JAPAN | 23.2 | 29.8 | 4 |
| MALAYSIA | 20.1 | 17.2 | 7 |
| MEXICO | 4.7 | 1.1 | 0.6 |
| NEW ZEALAND | 10.2 | 1.4 | 3.2 |
| PERU | 10.3 | 5.8 | 3.9 |
| SINGAPORE | 7.5 | 1.8 | 2. |
| VIETNAM | 30.1 | 14.4 | 7.2 |
| U.S. | 9.1 | 1.9 | 1.5 |

SOURCE: PETRI & PLUMMER

# TRANS-PACIFIC PARTNERSHIP ECONOMIC INDICATORS

| MEMBER STATE | GDP (BILLIONS OF DOLLARS) | UN HUMAN DEVELOPMENT INDEX | TOTAL MERCHANDISE TRADE WITH TPP MEMBER STATES (BILLIONS OF DOLLARS) | TPP AS PERCENTAGE OF TOTAL TRADE |
|---|---|---|---|---|
| AUSTRALIA | 1,224 | 0.935 | 156 | 33 |
| BRUNEI | 12 | 0.856 | 8 | 58 |
| CANADA | 1,552 | 0.913 | 686 | 74 |
| CHILE | 240 | 0.832 | 46 | 31 |
| JAPAN | 4,123 | 0.891 | 421 | 28 |
| MALAYSIA | 296 | 0.779 | 170 | 38 |
| MEXICO | 1,144 | 0.756 | 575 | 72 |
| NEW ZEALAND | 172 | 0.913 | 35 | 42 |
| PERU | 192 | 0.734 | 28 | 34 |
| SINGAPORE | 293 | 0.912 | 235 | 30 |
| VIETNAM | 191 | 0.666 | 92 | 31 |
| UNITED STATES | 17,947 | 0.915 | 1,626 | 40 |

DATA THROUGH THE END OF 2014 SOURCE: RSM, IMF, UN

# TOTAL U.S. AND SME EXPORTS AND SALES

| | U.S. EXPORTS (BILLIONS OF DOLLARS) | SME EXPORTS (BILLIONS OF DOLLARS) | PERCENT (INDUSTRY) | U.S. SALES (BILLIONS OF DOLLARS) | SME SALES (BILLIONS OF DOLLARS) | PERCENT (INDUSTRY) |
|---|---|---|---|---|---|---|
| AGRICULTURE | 4.4 | 2.7 | 61 | 33 | 27 | 84 |
| MINING | 48 | 4.3 | 9 | 556 | 127 | 23 |
| MANUFACTURING | 838 | 151 | 18 | 5,730 | 1,331 | 23 |
| SERVICES | 632 | 240 | 38 | 18,622 | 7,279 | 39 |
| TOTAL | 2,014 | 691 | 34 | 32,638 | 11,817 | 36 |

DATA THROUGH THE END OF 2012 SOURCE: RSM, U.S. BUREAU OF ANALYSIS, CENSUS BUREAU

## U.S. SME SHARE OF TOTAL EXPORTS AND SALES OF SERVICES BY INDUSTRY

| SERVICE SECTOR | TOTAL U.S. EXPORTS (BILLIONS OF DOLLARS) | SME EXPORTS (BILLIONS OF DOLLARS) | SME SHARE OF U.S EXPORTS (PERCENT) | SME SALES (BILLIONS OF DOLLARS) | SME SHARE OF U.S. SALES (PERCENT) |
|---|---|---|---|---|---|
| **TRADABLE SERVICES** | | | | | |
| TRANSPORTATION AND WAREHOUSING | 66 | N/A | N/A | 246 | 35 |
| ACCOMMODATION AND FOOD SERVICES | 119 | N/A | N/A | 328 | 54 |
| INFORMATION | 101 | 22 | 22 | 175 | 17 |
| FINANCE AND INSURANCE | 72 | 27 | 38 | 683 | 18 |
| PROFESSIONAL, SCIENTIFIC AND TECHNICAL SERVICES | 60 | 28 | 50 | 788 | 58 |
| ARTS, ENTERTAINMENT AND RECREATIONS | 16 | N/A | N/A | 120 | 61 |
| **NONTRADABLE SERVICES** | | | | | |
| REAL ESTATE AND RENTAL LEASING | 7.1 | 3.4 | 47 | 274 | 59 |
| ADMINISTRATIVE, SUPPORT SERVICES AND WASTE MANAGEMENT | 2.5 | 1.6 | 63 | 296 | 46 |
| OTHER SERVICES EXCLUDING PUBLIC ADMINISTRATION | 10 | 6.2 | 62 | 481 | 83 |
| **ALL SERVICE SECTORS** | **488** | **186** | **38** | **7,447** | **41** |

SOURCE: RSM, U.S. BEA, U.S. CENSUS

# BREXIT: THE STORY SO FAR

## BREXIT PRESENTS CHALLENGES, OPPORTUNITIES FOR MIDDLE MARKET

The brief honeymoon in markets and economics following the Brexit vote has come to an end. The pickup in spending, driven by tourism and consumption by domestic residents ahead of looming price increases related to the nearly 20 percent depreciation of the British pound, will likely abate in coming months as the likelihood of a potential "hard Brexit" nears. With inflation likely to rise in coming months, the burden of adjustment will fall squarely on the shoulders of British households as firms begin to pass along rising costs to consumers.

On Nov. 3, a panel of judges in the U.K. ruled that Prime Minister Theresa May's government must seek Parliament approval of any decision to trigger Article 50 May had earlier indicated she would like her government to trigger article 50 by the end of the first quarter of 2017. While this doesn't change the base case scenario for an exit from the EU, it does increase uncertainty in the near term and lengthens the period of negotiation. Regardless, Brexit will likely result in firms being forced to make hard decisions on personnel and investments. The growing probability that the U.K. will forego seeking access to the single European market will present its own challenges for the domestic economy.

It is often said that uncertainty chills economic activity. There is no doubt that Brexit will have far-reaching impacts, with reverberations felt across every sector. Many in the business world will understandably be concerned.

Change is undoubtedly unsettling, but it is also a constant in the global economy. In the past 10 years alone, the global economy has endured a financial crash, soaring and then collapsing oil and commodity prices, jitters in the Chinese economy, the Middle East crisis and travails in the eurozone.

It will take at least two years for the U.K. to negotiate its withdrawal from the EU. During this time, there will be a fundamental reshaping of Britain's political and economic relationships with the rest of the world.

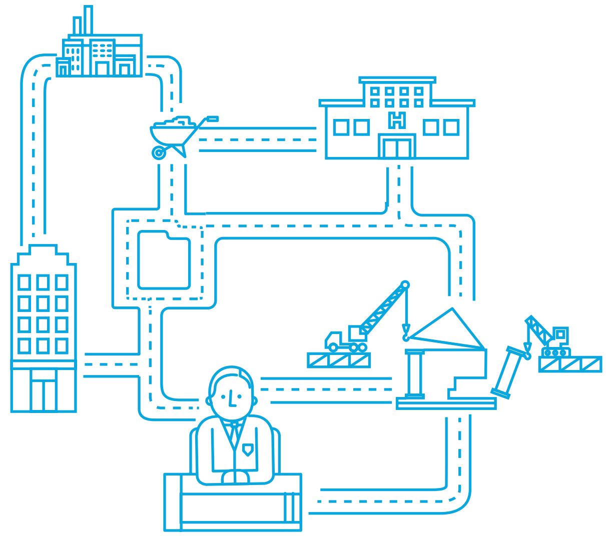
Meanwhile, what follows is how Brexit is reshaping certain key areas of the economy, specifically, infrastructure, manufacturing, real estate and private equity.

# INFRASTRUCTURE

## How Brexit is affecting the infrastructure sector

by Andy Murray, Partner, RSM UK, and Alistair Hynd, Partner, RSM UK

Scenario planning now for the potential outcomes of Brexit should help with your readiness to respond and adapt when the time comes. The questions below will help direct those scenario planning discussions.



### Do you need to comply with the Official Journal of the European Union (OJEU) if your procurement strategy is for contracts that will be awarded after the UK leaves the EU?

It is sensible to assume that OJEU requirements or their equivalent will still be in force after the U.K. leaves the EU as trade negotiations are likely to result in a continuation of having access to government contracts by all members of the EU. There's no harm in putting it on the risk register though as an opportunity or threat and, for now, monitoring the likelihood of it or when that could change.

### How does Brexit affect business case viability?

Each aspect of the five case model is likely to be affected by Brexit and should be revisited to see if any assumptions impact the viability of the scheme overall. Some aspects may have a negative effect (e.g. tender price inflation due to exchange rates), and others may have a positive effect (e.g. lower interest rates, lower operating costs). Where there are remaining uncertainties then the risk assessment associated with each case should also be revisited.

### The government has promised to make whole structural and investment projects with committed funding from the European Commission, how will that work in practice?

At present, it is too early to know. Our working assumption is that capital will be made available to projects agreed upon before the autumn statement to enable them to proceed. What is less clear is whether that funding will be on the same terms as originally agreed—this could represent both an opportunity or threat to individual beneficiaries. We assume more detail will be forthcoming in due course. It is worth noting that the funds in question relate primarily to the rural and higher-education sectors. There is a significant chunk of structural spend that goes to infrastructure and transport improvement in poorer areas; however the promise does not appear to reduce uncertainty on other schemes.

### How has Brexit affected investor appetite for UK infrastructure assets?

This is another complex area, but certain fundamentals haven't changed: The U.K. is a stable and mature economy, with a generally benign business environment and competitive corporate tax regime. We have a National Infrastructure Plan and a substantial £438bn planned program of infrastructure investment. Even allowing for uncertainty and speculation surrounding major projects such as Hinkley and later phases of our transport program, this is surely a large and attractive opportunity for the international infrastructure investment community. Although inevitably, we expect there will be some short-term issues for specific funds connected with currency movements and asset allocations.

### What impact will Brexit have on the National Infrastructure Delivery Plan?

Our expectation is that the shorter term National Infrastructure Delivery Plan (NIDP) will remain largely intact, though doubtless Brexit distraction and short-term uncertainty may lead to some project delays. In relation to the longer-term NIDP, the impact is less clear. However, our sense is that any changes are likely to be more cosmetic than substantive, reflecting a change in political complexion arising from a new leadership team in government rather than directly attributable to Brexit. One area we will be watching with particular interest is the Northern Powerhouse, which was very much a project of the former chancellor, George Osborne. On balance, we believe the government will push ahead and use infrastructure investment as a stimulus as previously predicted.

# MANUFACTURING

## UK manufacturers face uncertainty, but golden opportunity exists

by Mike Thornton, National Head of Manufacturing, RSM UK

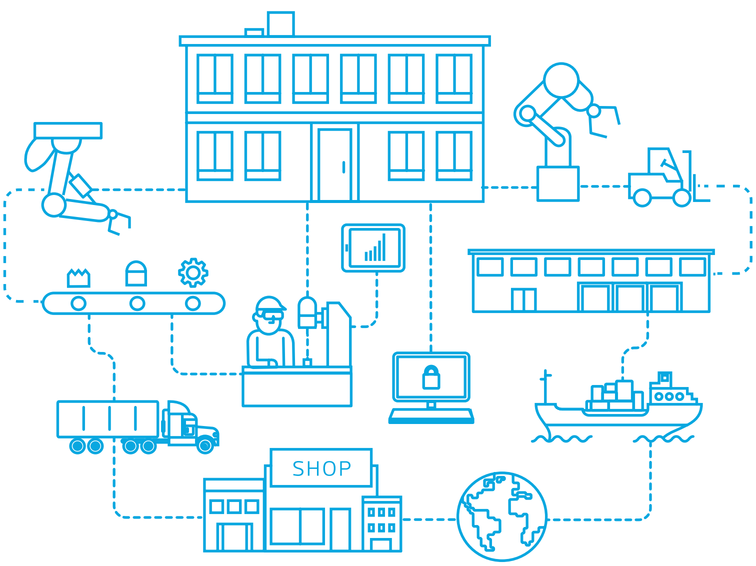
The most obvious conclusion from the Brexit vote is that U.K. manufacturers now face a period of major uncertainty. No one knows how long this will hang over the country, and for business leaders, uncertainty leads to risk. Businesses need to be vigilant more than ever, and this presents a major challenge for midmarket companies where resources tend to be tightly controlled, and risk management processes are informal.

In the short term, there will be volatility. This was demonstrated by the immediate move to a 30-year low for sterling against the U.S. dollar. Foreign currency is the most obvious commodity exposure that can have a major impact on cash and profits. There may be opportunities for alert organizations to lock in preferential rates for the short to medium term.

Clearly, changes to international trading arrangements will be profound, and we expect nearly all manufacturers to feel the impact of this, whether they supply goods overseas or purchase capital equipment from continental Europe. While nothing changes overnight, customs duty, tariffs and VAT are all likely to be renegotiated and this will likely impact margin, cash flow and supply chain resilience.

Many manufacturers have benefited from the free movement of labor across the EU. The attitude and flexible nature of migrant workers have brought a highly effective and plentiful supply of casual labor to seasonal businesses. It is, therefore, essential that immigration policies are sufficiently flexible to ensure that economic expansion is not hampered by insufficient labor.

There is, however, a golden opportunity for the sector. Brexit means that the U.K. should no longer need to comply with state aid rules, meaning that government can implement grant funding mechanisms that get to the heart of current structural issues surrounding the funding of innovation. Furthermore, the government will be free to develop an attractive tax landscape that should maintain and build on the U.K.'s attractiveness to global businesses.




Above all else, we now need to acknowledge the importance of manufacturing to the long-term economic success of the U.K. It is worth remembering that manufacturing generates more than 50 percent of all exports and around 70 percent of all business innovations. It has the potential to be the driving force for long-term U.K. prosperity.

# REAL ESTATE

## Real estate continuing to feel Brexit aftershocks

by Howard Freedman, Partner, RSM UK

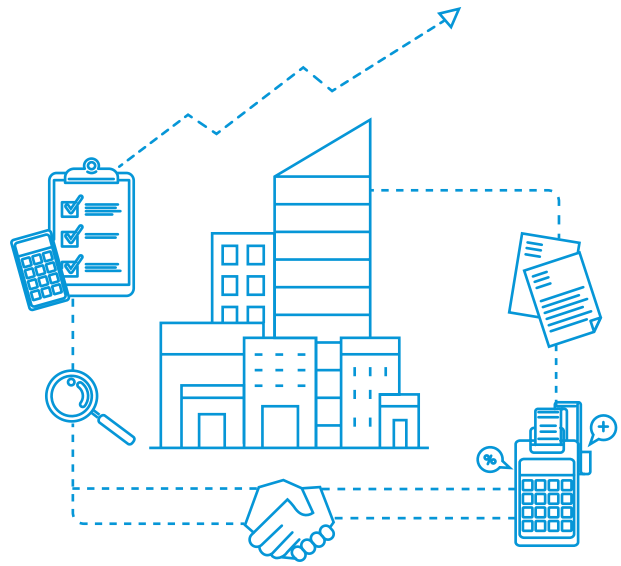
Just minutes after the referendum result was announced, the value of listed real estate companies on the London stock markets began to tumble. But while the immediate impact of the vote for the U.K. to leave the EU was clear, it is more difficult to assess potential consequences over the longer term.

Overall, it is likely that central London will be most affected as businesses in the financial services sector consider their position. It was recently reported in the press that around 10 million sq. ft. of office space in the finance sector is subject to a break clause or expiry by 2021. Some of this space must now be at risk.

In recent months, some developers paused work on projects as they awaited the outcome of the referendum. With the country backing Brexit, it is likely that many developers across the country will relook at their pipelines of projects and make fresh assessments of viability.

The number of transactions in the real estate market was already falling in the lead-up to the referendum. It was widely expected that, given the institutional appetite for U.K. real estate, demand would increase once the result was known. But the uncertainties caused by the shock vote to leave the EU will likely lead to a relative cooling of demand from institutions. This could give private investors an opportunity to buy good income-producing assets at a favorable price.

The reduction in the value of sterling will no doubt have negative consequences for the sector. But some of the immediate downsides may, over time, be counterbalanced as a weaker pound could boost the overseas investors' interest in U.K. real estate.



Four months after the Brexit decision, listed real estate companies share prices have recovered though not to pre-Brexit levels. Still, positive sentiment toward real estate in general has returned, with investors focusing greater attention on the fundamentals of property investment; i.e., location, sub-type and quality of tenant. The central London office market remains a concern, but international investors are still buying, in part attracted by the discount arising from the depreciation of the pound.

Until we know what the path to Brexit will look like, the future of the real estate market will continue to be a little uncertain. However, there is no doubt that investing in property for the long term is still considered a positive thing given the alternatives.

# PRIVATE EQUITY

## Weaker sterling may present select opportunities for private equity

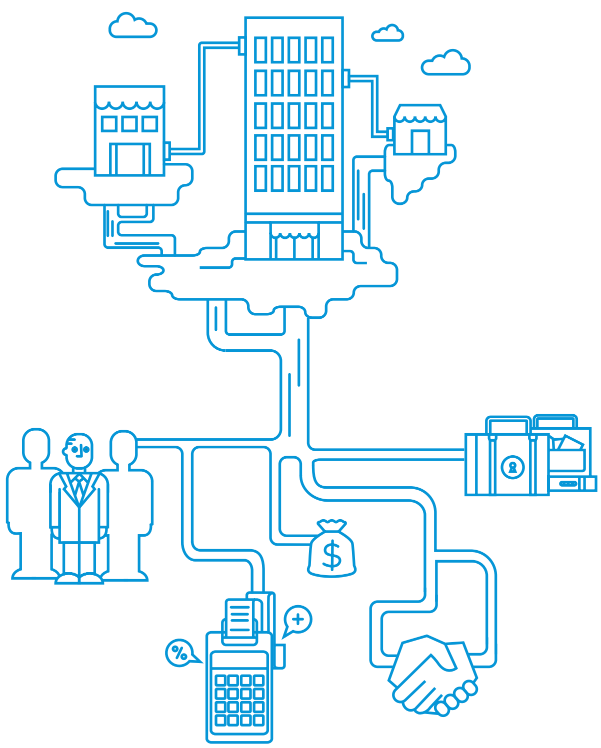
by Charlie Jolly, Partner, RSM UK

The U.K. private equity (PE) market has thrived in recent years by attracting international capital to help drive the expansion of U.K. - and European-headquartered businesses. The decision to exit the EU and the uncertainty of how this will be achieved will present both a challenge and an opportunity.

The foundations of PE's model are based on making long-term investments in companies to guide them through periods of change without the pressure of regular public reporting. This investment capital is needed now as much as it was before the referendum. In addition, the basic premise that long-term, transformational investment is an effective way of delivering above-market returns to institutional investors is as relevant as ever, and managers, markets and regulators will adapt to see it continue.

Of late, PE has been a victim of its own success. It has raised large sums of money to invest but, as a result, the level of competition to acquire robust and dynamic businesses has increased, causing valuations to soar to seemingly unsustainable levels. The effect of Brexit and the uncertainty that comes with it will provide a correction in valuations that is arguably much needed. PE funds that have recently raised capital will no doubt look to take advantage of this opportunity. For those undertaking the complex process of raising new funds, it is likely that many inexperienced international investors will take a wait-and-see approach over the coming months rather than commit capital to a U.K. PE fund for the next 10 years. Those with experience of investing through the cycle, however, may look to take advantage of weaker sterling and invest at a potential low point.

Like other forms of investment, PE can be highly effective in times of uncertainty. Large, cross-border transactions are likely to be most affected in the near term as they generally rely on support from banks that may or may not be forthcoming. Some owner-managers will decide not to raise money at the lower valuations on offer. But those that go to market through necessity will find the established firms very much open for business. While the market is yet to find the next new normal, the opportunistic and the most experienced funds will be as active as ever.



# **IRELAND'S 2017 BUDGET** EASES MULTINATIONAL COMPANY FEARS

by Aidan Byrne, Tax Partner, RSM Ireland

Ireland's finance minister Michael Noonan again reaffirmed the government's commitment to maintaining Ireland's 12.5 percent corporation tax rate. This has become an annual event and all shades of political opinion here broadly support this strategy. Noonan also mentioned that no one, and in this case, one can take it that he means other European Union (EU) member states, is asking for the rate to be changed.

As part of his commentary on the 12.5 percent CIT rate, Noonan referenced that it was an important plank of Ireland's Foreign Direct Investment (FDI) policy within the context of the forthcoming Brexit negotiations. In general, companies with operations in the U.K. currently serving the EU market will need a strategy for remaining in the EU while not ignoring the continued importance of the U.K. market. A side-by-side Irish-U.K. approach is a model that has gained a significant amount of traction recently.

## Ireland's International Tax Strategy

As outlined above, Noonan used the Budget Statement as an opportunity to publish an update on Ireland's "International Tax Strategy." Clearly, the intention is to show Ireland's proactive role in driving the BEPS initiatives and wider EU reform on avoidance. Ireland concluded two new treaties last year with developing countries, and it was noted in the Strategy document that these new treaties strike a more appropriate balance of taxing rights. Ireland is also one of only two developed countries to have carried out a spillover analysis project on the impact of the tax system on the economies of developing countries. The document seeks to highlight the government's commitment to more tax transparency, and the recent Directive on Administrative Cooperation (DAC 3 and 4) will be implemented by Ireland by the end of 2016.

## Other measures

Most of the remaining measures are domestically focused and will not impact adversely or conversely positively on foreign-owned companies operating in Ireland. What was disappointing was the lack of support given to the entrepreneurs striving to build new businesses in Ireland. The special rate of CGT for the sale of businesses was reduced to 10 percent, but only in respect of the first €1M of gains. This compares unfavorably with the U.K.'s similar scheme, which has a rate of 10 percent on the first £10M of gains.

Similarly, the opportunity was missed to deal with some anomalies in Ireland's Share Option Scheme legislation whereby taxation can arise, even in circumstances where no cash event has taken place. It would have been revenue neutral but would have indicated support for startup companies who attract talent by sharing equity as part of their remuneration packages. Noonan did indicate that he would take account of recent research


showing that employee participation in their company's ownership and profits has been shown to increase competitiveness, support employment and encourage growth, and he announced his intention to develop a new stock-based incentive scheme, which will be aimed at small- and medium-sized enterprises and will be introduced around October next year. The delay of a year is hard to fathom, and it is disappointing.

Meanwhile, the Special Assignee Relief Programme (SARP) and the Foreign Earnings Deduction (FED) regimes are being extended until the end of 2020. SARP provides for a favorable Irish income tax regime in certain circumstances for employees relocated to Ireland by their foreign employers. The idea of the regime is to incentivize multinational companies to send key employees to Ireland with a view to enhancing the Irish operations. FED, on the other hand, is an income tax incentive which is designed to encourage Irish companies to send employees abroad to a specified jurisdictions with a view to securing new markets in these jurisdictions.

Noonan announced modest reductions in what is known as the Universal Social Charge (USC) which are aimed at providing modest reductions. Details of these reductions are contained in the document which is attached to the link above. The key issue in relation to the international aspect of this, is that Ireland remains a high-tax jurisdiction for employees and if FDI is driven by employees coming in from abroad this could be a disincentive. Therefore, qualifying for the SARP relief is key and planning should be undertaken in advance of any decisions on who should lead any investment here.

My overall assessment is that the budget was used as an opportunity to ease worries multinational corporations may have had about Ireland following the Apple judgement, and was reiterating the open for business message. A disappointment is the continued lack of support for startup companies, with promises of future help being really all that was done for them. The reality is that they are a disparate group and not well grouped in a lobby that gets the ear of government.

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