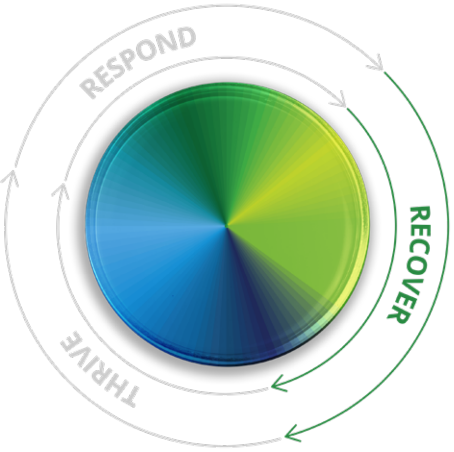

Tax-efficient supply chain planning during COVID-19

Value chain strategies for a rapidly changing environment

The COVID-19 crisis has triggered or accelerated major shifts in business strategy, advancing digital adoption and reassessment of the end-to-end supply chain—all with significant tax implications. As business leaders weigh alternatives for sourcing, manufacturing, and distribution, scenario planning from a tax perspective will be crucial.

Value Chain Alignment (VCA): Balancing business strategy and tax

Integrating your supply chain with global tax strategy can help organizations to strike the desired balance between business demands and tax planning, with the potential to increase profitability and shareholder value. Through the process of Value Chain Alignment, tax perspectives can be applied to the primary drivers of value in the supply chain—production, IP, and delivery—so business strategy decisions are informed by tax implications.

SUPPLY CHAIN PLANNING: NEW PRIORITIES, STRATEGIES, AND BUSINESS MODELS

Your tax team should be prepared for changes to your organization's value chain due to shifts in global strategies and business models, impacting various segments of the end-to-end supply chain. These supply chain changes may have direct and indirect tax consequences across multiple geographies.

Business leaders have shifted to new decision criteria for key supply chain considerations including an increased focus on transparency and risk management (for example, establishing centralized control towers to monitor suppliers and production status), liquidity and cash management, and shifting to regional and local models to address changes in supply and demand.

You can anticipate evaluation of the supply chain—and related tax impacts—as part of decisions about where to locate people and functions, what business models will be effective in certain countries, and whether to keep or modify existing supply chain models to have an impact on revenue and market share. Labor shortages, reduction in FTEs, and travel restrictions in certain key locations may impact existing local tax incentives. Tax leaders should make sure risk management, key functions, and other strategic activities are aligned with existing or modified business models.

Such supply chain changes in business models, intercompany transactions, and the physical flow of goods through new geographies may result in impact to customs and other transaction taxes (e.g., VAT) requirements. However, they may also provide an opportunity to re-evaluate the organization's transfer pricing and IP portfolio, and capture the value of adjusted priorities in areas such as procurement and risk management. The importance of diverse suppliers, buffer stocks, and other elements that build supply chain resilience may require additional transfer pricing remuneration for procurement hubs for their increasing importance to business continuity.

ACCELERATED DIGITAL TRANSFORMATION

Acceleration of digital adoption due to COVID-19 is taking place throughout the end-to-end supply chain, with faster and broader adoption of data and predictive analytics, cognitive automation and artificial intelligence (AI), application and infrastructure platforms, digital reality, communication and sensor networks, robotics, digital supply networks, smart factories, and e-commerce. Your organization may look to you for tax guidance on digital initiatives impacting product development, manufacturing (e.g., digital twin—which is a digital replica of a living or non-living physical entity), and distribution (e.g., demand-sensing).

For example, digital twins can integrate sensing data that continuously learns from itself through historical maintenance and related derived data within an embedded integrated vehicle health management system (IVHM). With the data integration, digital twins can forecast the health level of assets or systems, remaining useful life, and the success rate of execution. It also can foresee the system's response of a key security event. Digital twins can identify unknown issues through equipment diagnostics by comparing the data of the virtual system against the actual physical system.

To help drive better supply chain decisions in real time, understanding the potential impact of digital innovation throughout the end-to-end supply chain is essential for the tax function. For example, you may need to provide tax guidance on where to align new digital assets or how digital initiatives will impact existing IP structures. In addition, the business will want to understand the tax implications of operational changes resulting from embedding digital innovation in the business, such as expanding e-commerce or transitioning to a true omni-channel experience.

RETHINKING KEY SUPPLY CHAIN VALUE DRIVERS

1

RE-EVALUATE YOUR BUSINESS AND TAX OPERATING MODELS

Plan, source, and make: Prior to COVID-19, many organizations were considering diversifying production geographically, as rising costs, free trade agreements, and tariffs put pressure on existing production locations. The strong trend of assessing production locations such as nearshoring (e.g., vis-a-vis the United States) has been accelerated, as well as considering onshoring production for local markets, including evaluation (labor force skills, technology, costs) of relocating manufacturing to the market jurisdictions (e.g., United States).

We are seeing companies respond to demand volatility and product accessibility challenges during COVID-19 by seeking diversification of suppliers and geographies in the sourcing of raw materials, intermediate products, and finished goods, and the implementation of effective flex-and-surge supply and capacity management.

These changes may have significant direct/indirect tax implications to be analyzed. Your organization's direct tax and transfer pricing profile may also be impacted by new intercompany transactional relationships. Business model changes will require rethinking existing tax structures on a company's tax profile and transfer pricing policy.

Tax teams should prepare for global trade and other transaction taxes (e.g., VAT) impacts, such as adjusting to transactional changes that may require updating which entity is the importer of record and tracking implications on customs duties and registrations, reviewing applicability of duty and VAT relief, and potential to use duty-free zones for the new product flows.

For state or other territorial taxes, look at factors such as shifts in state taxable income based on change in activity situs and nexus considerations or identify opportunities to use credits and incentives.

2

CREATE A RESILIENT SUPPLY CHAIN

Deliver: COVID-19 has accelerated the need for adoption and or expansion of e-commerce, bringing changes to how products are sold/purchased and delivered. This disruption in the way the world was functioning before the pandemic will likely endure even after social distancing is relaxed. While cost has historically been the driving factor and distribution was primarily conducted through physical retail locations, the rise of e-commerce has raised customer expectations for just-in-time and consistent experiences regardless of market channel.

Tax and business leaders should anticipate exploration of more agile delivery models in response to changes in demand, as well as options for addressing new trade barriers COVID-19 has revealed or worsened. Business leaders will be looking to understand the tax implications around changes to the delivery models. Your organization will likely be weighing trade-offs such as carrying costs of excess inventory to accommodate just-in-time demand, while exploring different sales channels, wholesale, retail opportunities, and online platforms. Advising the business on decisions regarding the supply chain and sales channels will inform tax and transfer pricing implications of changes and impact where value is attributed—to the parties taking decisions and bearing corresponding risks and therefore where the organization may incur tax costs.

Expect more complexity in direct and indirect taxes as companies move to an omnichannel business model—potentially requiring changes to intercompany and third-party transactions. VAT, and global trade impacts may include addressing export controls, ensuring access to free trade agreements, applying for customs duties and VAT relief, transaction mapping, and reviewing the impact of distance sales rules on digital sales.

3

PLAN AND UNDERSTAND ALL SCENARIO IMPLICATIONS

Intellectual Property (IP): As the COVID-19 crisis impacts financial performance and future projections, value attributed to IP pre-COVID-19 should be reassessed given the changes in global economic outlook. For instance, the value of legacy IP may have declined as a result of new business realities; therefore, companies may want to reassess their IP strategies. COVID-19 could also potentially bring changes to R&D activities, including the development of new products or adaption of existing products which will lead to the creation of new IP.

Your organization should review IP used and developed throughout the end-to-end supply chain and align tax considerations for different scenarios. For all IP (trademarks, trade names, know how, brand, and patents), tax can help business leaders re-evaluate business models considering changes to both the value and nature of IP while addressing tax and regulatory considerations such EU Anti-tax avoidance directive (ATAD) and other Organisation for Economic Co-operation and Development (OECD) initiatives.

IP-related tax implications are likely to be triggered by changes to existing risk and value drivers such as brand value, new product development, and know how, as well as new IP generated by accelerated digital adoption. Tax may need to weigh in as companies consider tax implications of new economic conditions and changes to business models.

If your organization is considering moving IP between geographies in response to operational changes, be prepared to provide tax input on how to best structure the transaction taking into account updated IP values, changes to key value drivers, future growth expectations, and direct tax impacts of transitioning into a new structure. Your organization will look to you for the tax input into key business decisions including funding and control of new and existing IP, location of Development, Enhancement, Maintenance, Protection, and Exploitation (DEMPE) functions, as well as the overall impact of the Global Tax Reset.

RECOVER

"Business strategy and digital transformation impact everything in the supply chain, from production and delivery to IP. COVID-19 has forced organizations to completely rethink strategy and accelerate digital adoption, triggering a cascading impact on the supply chain and related tax considerations."

THE ROLE OF TAX IN HELPING ORGANIZATIONS TO RECOVER AND THRIVE

As COVID-19 drives significant changes in business strategy and accelerates digital adoption, the tax function will play a central role in supply chain decisions. Tax teams can be ready by staying informed, scenario planning now, and establishing strong lines of communication with business decision makers.

BUSINESS FOCUS FOR COVID-19 SUPPLY CHAIN PLANNING

During economic recovery, business leaders will need tax expertise to make informed supply chain-related decisions about:

Re-evaluating your business and tax operating models:

- Continued virtualization of the workforce, and accelerated use of centralized "control towers" that offer end-to-end supply chain visibility and real time analytics.
- Shifting to online channel and direct-to-consumer services.
- Diversifying your manufacturing and sourcing footprint.

Creating a resilient supply chain:

- Re-imagining your demand planning and forecasting.
- Creating the capacity and agility to flex as demand surges and wanes across channels and suppliers.
- Creating "last mile" capabilities and a dynamic network of suppliers.
- Evaluating your multi-tier supply chain and insuring the diversity of supply.

Relaxing social distancing with caution:

- Protecting your workforce and customers as your facilities reopen.
- Monitoring risk across your multi-tier supply chain.
- Optimizing cash flow and liquidity to weather a downturn.

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