COVID-19 impacts on the supply chain

Tax implications and scenario planning

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

Value Chain Alignment (VCA):

Balancing business strategy and tax

Integrating supply chain and global business strategy can help organizations 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 (VCA), 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 company'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 may also experience changes to your supply chain—and related tax impacts—such as location of people and functions, adoption of new and different business models, or entering or exiting markets. For example, labor shortages, reduced headcounts, and travel restrictions in certain key geographies may impact existing local tax incentives. In the case of a new or modified business model, tax should be consulted for alignment with transfer pricing policies.

Such supply chain changes in business models, intercompany transactions, and the physical flow of goods through new geographies may result in impact on customs and VAT requirements. However, they may also provide an opportunity to reevaluate transfer pricing and IP portfolio and capture the value of adjusted priorities in areas such as procurement and risk management.

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 (such as digital twins), and distribution (such as demand sensing).

Tax, along with the rest of the business, will need to understand the broad scope of the impact of digital and how it reverberates through and drives supply chain decisions. 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 may be looking for advice on how changes such as expansion of e-commerce or a transition to a true omnichannel experience should be approached from a tax perspective.

Rethinking key supply chain value drivers

Plan, source, and make

Prior to COVID-19, many organizations were already considering diversifying production geographically, as rising costs, free trade agreements, and tariffs put pressure on existing manufacturing locations. This strong trend, based on our experience of assessing production locations such as nearshoring (such as Mexico), has now been accelerated, as has considering onshoring alternative production options for local markets, including evaluation (labor force skills, technology, costs) of relocating manufacturing to market jurisdictions (such as the United States).

Many companies are responding 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 tax implications that should be analyzed. Your company's direct tax and transfer pricing profile may also be impacted by new intercompany transactional relationships. Business model changes may require rethinking existing tax structures on a company's tax profile and transfer pricing policy.

Tax teams should be prepared for global trade and 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 taxes, analyze factors such as shifts in state taxable income based on change in activity situs and nexus considerations or identify potential opportunities to use credits and incentives.

Deliver

COVID-19 has accelerated the need for adoption and or expansion of e-commerce, bringing changes to how products are sold and delivered that will likely endure even after businesses reopen. 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 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 exacerbated. 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. Understanding the tax implications will help inform related business decisions about how and where value is created—who owns the risk and return and where the organization may incur potential tax costs.

Be prepared for 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.

Intellectual Property (IP)

As COVID-19 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 (e.g., trademarks, trade names, know-how, brand, and patents), tax can help business leaders reevaluate business models in light of changes to both the value and nature of IP while addressing tax and regulatory considerations such as the 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 may 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.

Business focus for COVID-19 supply chain planning
Business leaders will need tax expertise to make informed decisions about:

Reevaluating business and operating models

- Continued virtualization of the workforce, accelerated use of centralized "control towers"
- Shift to online channel and direct-to-consumer services
- Diversifying the manufacturing and sourcing footprint

Creating a resilient supply chain

- Reimagining demand forecasting
- Creating capacity to flex as demand surges and wanes across channels
- Creating last-mile capabilities and a dynamic network
- Evaluating multitier supply chain and ensuring diversity of supply

Reopening with caution

- Protecting the workforce and customers as facilities reopen
- Monitoring risk across the multitier supply chain
- Optimizing cash flow and liquidity to weather a downturn

The role of tax in helping organizations respond, recover, and thrive

As COVID-19 drives significant changes in business strategy and accelerates digital adoption, tax should 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 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."

Connect with us to learn more

Value Chain Alignment and Supply Chain

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