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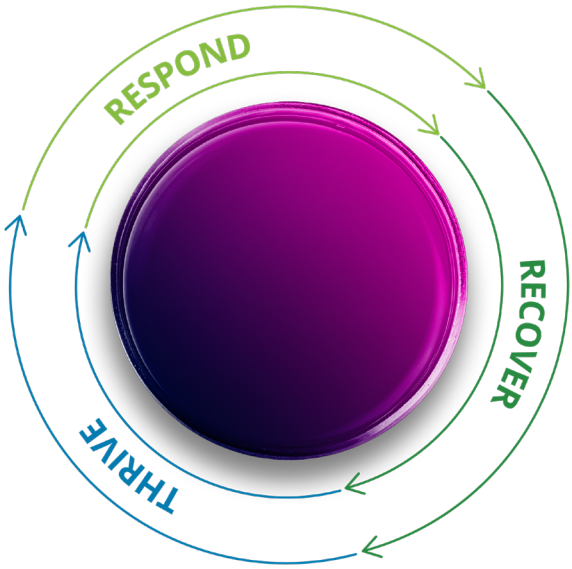

Tax executives: Recovering from the initial impact of COVID-19

Since the onset of COVID-19, tax executives have played a significant role in supporting their businesses as a result of new legislation and reacting to critical business imperatives. It's not just that resources have been stretched and processes disrupted as offices and tax professionals navigate through the evolving landscape. It's also that the business is evaluating material changes in many cases that will have immediate and long-term tax implications. From debt restructuring and cash management to supply chain and transaction planning, the tax function can provide value and reduce risk if involved up front.

Business leaders are keen to understand what has changed as a result of the pandemic—and what the new economic landscape will look like in its aftermath. They also recognize tax management and planning will play a pivotal role in helping their organizations survive and thrive after the crisis has abated.

This article will focus on three key areas where tax leaders can deliver strategic value at a pivotal time.

- Cash preservation
- Supply chain planning
- M&A transaction planning

COVID-19 impact on tax priorities

During a recent tax webcast,[1] Deloitte Tax LLP presented attendees with this poll question: What's the most significant challenge your company is facing in the current environment?

35.9%
Liquidity and cash preservation

31.0%
Assessing future strategy of the business

14.9%
Supply chain impacts

13.9%
Productivity of the workforce

4.3%
Distressed debt or bankruptcy

[1]A poll of more than 4,000 executives across a variety of industries was conducted during a Deloitte Business, Strategy & Tax Dbriefs webcast, titled "Business recovery: Financial and tax considerations." The webcast was held on June 9, 2020.

Scenario modeling is key to tax planning, as tax outcomes can be influenced by both timing of any transactions and the interplay of increasingly complex tax rules across multiple jurisdictions. Fortunately, advances in data collection, data wrangling, and analytic tools are making this easier to do. Deloitte's professionals can help companies develop processes for efficient data gathering and provide scenario-planning advice using the latest scenario-planning tools.

Cash preservation and liquidity considerations

Many companies realized short-term cash tax savings from legislation passed earlier this year, including deferring income taxes and payroll taxes. As we move into the next phase of navigating COVID-19, there are potential opportunities for tax departments to realize longer-term savings. Companies have had to make significant changes in how they operate, from moving employees to home offices to changing their regular cleaning processes. These operating changes, combined with new tax regulations passed in response to COVID-19, mean that there are potential opportunities for cash tax savings affecting both income and indirect taxes across state, federal, and international jurisdictions. A few of these potential opportunities are highlighted here.

Sales and use taxes

Companies should consider an updated sales and use tax analysis in light of changing business conditions. There may be tax savings or refund opportunities related to cancelled services from COVID-19 business closures or taxes tied to mobile point-of-use applications where taxes are collected based on where employees sit. Some jurisdictions have also expanded their definitions of tax-exempt items, adding items such as cleaning supplies, in response to COVID-19. Companies that undergo an analysis may find that the process is less onerous than in the past, and recent advances in AI and machine learning now allow for efficiencies in mitigating the potential for overpaying sales taxes on the front end, in addition to looking at prior years for refunds.

Working from home and state apportionment

Since many localities and states base income tax apportionment on where employees sit, companies that moved employees to work from home may see an impact on their 2020 corporate tax filings. As part of a company's overall "return to work" strategy, employers should consider the tax implications of bringing employees back to work in higher-tax states.

Accounting method considerations for 2020 and NOL carrybacks

The CARES Act provides for a five-year NOL carryback for losses generated in 2018, 2019, and 2020 tax years. For many companies, 2020 will be the first of these years that a tax loss is realized. There are a variety of accounting method changes that affect the timing of when income and deductions are recognized, and companies may benefit by filing for accounting method changes that shift income and deductions between 2019 and 2020 and ultimately increase losses in the 2020 tax year. Companies that can carry back these losses to offset 2015, 2016, or 2017 taxable income will receive the additional benefit of recouping these at up to a 35% tax rate (vs. the current 21% corporate rate), creating a permanent tax savings.

Liquidity from cash repatriation

Companies in need of liquidity that have earnings in foreign jurisdictions should consider various options to bring this cash back to the United States. Alternatives include loaning the funds to the United States, paying dividends from a controlled foreign corporation to its parent, or prepaying service fees incurred by the US company. Many tax functions have been revisiting their permanent reinvestment assertions in light of the changes to taxation of foreign earnings under the TCJA in order to bring back cash now needed in the United States. Additionally, companies may need to revisit their overall worldwide tax structures, considering COVID-19 induced changes to their business strategy and operations. Tax executives are focusing on how to repatriate these monies in a tax-efficient manner, and consistent with their business operational goals.

Creating an adaptable, resilient, and tax-efficient supply chain

Supply chain strategy shifts

COVID-19 has triggered or accelerated major shifts in business strategy, advancing digital adoption and reassessment of the end-to-end supply chain. Many companies

are responding to demand volatility and product accessibility challenges by seeking geographic diversification for their supply chains, with an increase in interest in evaluating the location of suppliers, facilities, and employees. At the same time, "control towers," hubs for visibility, decision-making, and action based on real-time analytics, are becoming more common in supply chain management. These business model changes require an analysis of existing tax structures and intercompany transactions, considering direct tax impacts, transfer pricing policy, and global trade and VAT implications.

Customer delivery demands and e-commerce

The need for adoption or expansion of e-commerce has accelerated since the onset of COVID-19. As businesses implement more digitization and explore omnichannel delivery models to meet customer expectations, they will likely be dealing with more complexity in direct and indirect taxes. 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 affects financial performance and future projections, historical value attributed to IP will need to be reassessed, and companies may need to revisit their IP strategies. 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 and other Organisation for Economic Co-operation and Development (OECD) initiatives.

Tax leaders can provide significant value by staying informed on planned changes to the supply chain, modeling for alternatives, and establishing strong lines of communication with business decision-makers.

M&A transaction planning: Advising a state of readiness

The M&A market had slowed during the spring of 2020. However, activity has started to pick up as some businesses look for opportunities to increase liquidity through debt restructuring or asset dispositions, while others are exploring strategic acquisitions. Whatever side of the transaction the business is on, timely tax planning and situational expertise is critical to capture value and mitigate risk.

Debt and capital restructuring

Many companies are in the process of some sort of debt restructuring, whether undergoing a major refinancing or simply modifying payment terms. Tax teams should be involved in these discussions early to analyze and plan for tax implications. Cancellation of debt income may be realized even where the amount of debt is not reduced when the debt is considered "publicly traded" for tax purposes and has a trading price that is less than par. The tax rules' broad definition of "publicly traded" increases the likelihood that these rules may apply. Additionally, any debt modification that results in a change to interest expense should be analyzed to determine potential impacts on interest expense limitations under section 163(j).

Strategic divestitures

Companies may be considering strategic divestitures as part of a broader business rationalization and monetization plan. Tax considerations that affect the seller and buyer should be a key part of the seller's divestiture process, and tax teams can work with other parts of the business to look at potential scenarios and enhance after-tax proceeds if a sale is pursued. Sellers that have a clear understanding and documentation of their tax attributes and legal entity structure prior to a transaction are better positioned to avoid mid-transaction surprises.

A business should consider the full implications and related impact the CARES Act, the Paycheck Protection Program (PPP), and other recent legislation may have on any transaction. Specifically, eligibility for employee retention credits and PPP loans are subject to strict and complex eligibility rules that are determined on a calendar-year basis.

Looking back and moving forward

Over the past few months, Deloitte professionals have been working to help tax functions respond to the immediate crisis, recover their operations, and plan for a future in which they can thrive. And while most tax leaders seem to understand their immediate priorities, the scope of the transformation required has many tax professionals wondering where to start.

Rather than discouraging leading tax functions from progressing their transformation journeys, the COVID-19 crisis has sharpened minds and accelerated timelines. Indeed, on the road to recovery, leading tax functions are embracing the business-critical changes happening out of necessity to also advance their own digitization needs. And, in doing so, they are finding a significant, albeit unexpected opportunity.

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