

The data dilemma: Tax reform's new demands on life sciences



Life sciences tax takes on reform

The Tax Cuts and Jobs Act of 2017 reduced certain tax rates, a key goal of its supporters. It also included new international tax provisions that are exceedingly complex and will require levels of transactional data, modeling, and analysis beyond what was required under prior law.

As life sciences companies finish round one of US tax reform guidance to shareholders and analysts, many realize the need for near-real-time, data-driven insights for tax-related decisions and guidance going forward. This may present a dilemma: how to digitally transform business processes to sustainably produce data necessary to provide those insights. It is a challenge with multiple dimensions, including:

- Transforming existing, largely manual, spreadsheet-driven processes for data capture, aggregation, and calculation. Long term, they may not be sustainable. They could crash under the weight of data

and calculations, take too long, and create financial reporting, tax, and audit risks.

- Adapting to a changing information technology (IT) landscape. For example, SAP introduced the S/4HANA cloud edition in 2015 as its “next-generation business suite¹,” making the support status of SAP Business Suite 7, the previous generation platform, unclear after 2025². Oracle is encouraging companies to migrate to its cloud-based ERP platform³.

- Paying for these initiatives, which could be costly. It will require a comprehensive business case which captures both tax savings and operational efficiencies. Where will the budgets come from?

Addressing the first two issues may help resolve the third one. By recalibrating their IT systems and using new-found troves of data for tax planning, compliance, reporting, and audit defense purposes, life sciences companies may be able to generate tax

and operational savings to help offset the cost of responding to tax reform. They may also have the opportunity to leverage transaction data from across the enterprise in new and rewarding ways.

Building the business case for the investment is a critical step forward. The answers to five key questions can help with that.

Why is data an issue with the new tax law?

Many aspects of tax reform are favorable to life sciences companies, especially the reduced tax rate from 35 percent to 21 percent. However, other new tax provisions are both complex and data-intensive. Compliance requires companies to access, forecast, and model the potential tax impacts of transaction-level data in near real-time. Three examples illustrate the point – two new taxes, and one new deduction:

- *GILTI (Global Intangible Low-Taxed Income) tax*, a new worldwide tax on the income of US corporations earned through their foreign subsidiaries. Calculating it will require aggregation and analysis of many different data points in real time on an ongoing basis.
- *FDII (Foreign Derived Intangible Income) deduction*, which reduces the effective tax rate on eligible income from 21 percent to 13.125 percent. Both the calculation and documentation are complex and will be required either monthly or quarterly in real-time – an especially formidable task for companies like life sciences that have complex supply chains.
- *BEAT (Base Erosion and Anti-Abuse Tax)*, a new minimum tax on certain outbound intercompany payments made by US entities to foreign affiliates. Calculation and monitoring of the BEAT will require companies to identify and classify various

intercompany transactions, which in turn requires access to intercompany transaction data, segmentation of the costs, and forecasting and planning for potential BEAT liabilities.

What is the urgency around this issue?

GILTI, FDII, and BEAT are just three of the more material US tax reform provisions impacting life sciences companies' future effective tax rates, earnings, and cash flows – not to mention tax risk management. There are many others, all interconnected and, in many cases, requiring transaction-level data for calculating, monitoring, forecasting, and planning.

As life sciences companies release quarterly earnings and provide updated guidance to investors, it is important to accurately determine the impact of US tax reform on earnings, effective tax rates, and cash versus the prior year. Those that cannot access the volume and detailed level of data required to accurately report these impacts are likely to face:

Added cost and tax risks of manual workarounds. Manual data extraction and modeling of tax positions at the required level and volume may be unsustainable. Failure to address this could lead to non-compliance, inaccurate financial reporting, and the inability to identify and adopt appropriate tax positions going forward.

Board and c-suite scrutiny. US tax reform could potentially yield significant increases in capital available for strategic investments. Boards of directors and senior management are already asking their CFOs and tax departments about the financial impact of US tax reform, how current systems support its complexities, and how new and existing tax risks can be managed. They now need increased agility in communicating the tax impacts of new strategic investments of freed-up capital to boards and C-Suites, and they need it quickly.

Financial and reputational damage. Life sciences companies are also being asked tough questions by investors and market analysts about impacts of US tax reform. Tax authorities globally are demanding greater transparency for tax purposes. Unsatisfactory answers to these stakeholders could lead to greater overall risk associated with tax controversies, additional tax liabilities, public scrutiny of the company's position, and even reduced market capitalization.

Competitive disadvantage. An effective plan for extracting and analyzing tax-aligned financial data from IT systems and sharing tax-related advice to business units can be a competitive advantage for companies that make the investment. Companies without such a plan could play an endless game of catch-up.



Global changes in transfer pricing laws and accounting standards such as new lease accounting rules are tangential but important concerns, too. Life sciences companies can benefit from understanding how changes to their business models might help operationalize a more tax-relevant view and reduce the risk of missed opportunities if margins continue to shrink.

How can life sciences companies potentially offset costs of digital transformation?

By tax-tuning their IT systems and adding advanced automation and analytics, life sciences companies have the opportunity to build new capabilities, including:

- US and global tax reform forecasting and modeling that is integrated with financial planning and analysis processes
- Monitoring and analyzing tax reform impacts of new strategic investments in near real-time
- Improving tax outcomes across their global supply chains and business operations

- Efficiently managing, documenting, reporting, and defending tax positions across global operations
- Efficiently closing the company's books with accurate tax provisions

Enabling and automating many of these capabilities through the IT system could mean less manual intervention for finance, accounting, and tax personnel. Those professionals, in turn, should have more time for analytics-driven tax and operational planning in partnership with the board, c-suite, and business unit leaders across the enterprise, which can lead to additional tax and operational benefits.

Who should lead the effort?

Business-led transformations can be more effective than those championed by the IT or tax departments alone. A business unit executive who articulates supply chain and manufacturing benefits of an IT initiative, alongside a CFO who conveys the financial and tax advantages of the investment, can draw a convincing picture for budget decision makers. IT and tax departments can contribute significantly to the effort, but it should be the business that conveys the initiative's urgency and potential value.

What steps can life sciences companies take to build the case for digital transformation?



Assess. Evaluate the data required to comply with tax reform and prepare a “fit/gap analysis” of how the current IT system configuration meets those requirements. Out of this assessment should come a clear picture of potential risk areas and possible impacts of those risks.



Socialize. Conduct functional and technical workshops to help inform the organization – from both the business side and finance, accounting, and tax sides – to understand the results of the assessment; identify improvement opportunities based on potential benefits, cost, effort, and risk criteria; and discuss roadmap options for business process and ERP system changes.



Plan. Identify tax-sensitized IT system design considerations, IT-enabled design components, and projections of potential tax and operational savings generated by the initiative. Develop the proposed scope of IT modernization, along with an organizational roadmap and business case for budgeting and resource planning.

Our take

Life sciences companies have potential opportunities with the passage of US tax reform. However, the potential benefits aren't free: Increased complexity and risks are part of the new tax environment, with significant new demands for data from across the enterprise.

A business-led campaign can educate decision makers about the data demands of tax reform, its possible financial, operational, and business model implications, and the value that IT system and process changes might create in addressing reform. Fundamental to such a campaign is a structured approach to identify and close data and process gaps, a defined roadmap toward a digitally transformed future state, and a compelling business case that articulates the initiative's potential investment returns.

In particular, the business case should convey the value to be captured through potential tax savings and operational efficiencies, thus providing a potential solution to the data dilemma and positioning life sciences companies well for other operating model changes that may lie ahead.

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¹"A Quick Introduction to S/4HANA Cloud Edition," Carl Dubler, SAP, May 27, 2015, <https://blogs.sap.com/2015/05/27/a-quick-introduction-to-s4hana-cloud-edition/>.

²"SAP Committed to Innovation and Choice for SAP Business Suite Applications," SAP, October 14, 2014, <https://news.sap.com/sap-committed-innovation-choice-sap-business-suite/>.

³"Customer 2 Cloud: Removing Barriers to Cloud Adoption," Oracle, <https://www.oracle.com/applications/erp/customer2cloud/index.html>.



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