Restructuring post-COVID-19 supply chains

A high-level profile of tax considerations

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In “Supply Chain’s New World Order,” KPMG argued that COVID-19 business disruption has surfaced a migration to economic nationalism already underway before the pandemic. In this series, KPMG outlines specific competencies that supply chain organizations should embrace as they restructure for a fundamentally changed world.
As supply chain organizations maneuver in response to COVID-19 disruption, their assessments have laid bare vulnerabilities building for years. Economic nationalism, steadily accelerating since 2017, has eroded the pillars—tax policy among them—that anchored global supply chain models. In the "good old days," globalism bestowed the luxury of designing supply chains around low labor costs and reliable transportation. Little to no thought was given to tax and trade consequences, because there were few to speak of for most businesses.

All that has changed, seemingly all at once. As protectionist tax and trade policies during the past few years began to stress supply chain operating models, they were noted with mild concern, but considered containable, like a rising body of water behind a dam. COVID-19 is the break in the dam—making the dangers of economic nationalism painfully visible to all and sending all parties scrambling for high ground. Many businesses are in crisis mode as they pivot to meet new customer demands and address short-term liquidity concerns. Supply chain and tax executives have realized they will need to work together closely to return to former levels of profitability and strategize for long-term survival and resiliency.

For the respective heads of supply chain and tax, the sometimes charged rhetoric and zero-sum-game, nation-versus-nation scramble for COVID-19 emergency resources is just a dramatic, condensed confirmation of their gut premonitions: the big trade-related developments of the last four years—Brexit, the U.S.-China trade war, the Tax Cuts and Jobs Act of 2017—are leading indicators of similar developments to come. They are all the more reason to consider reshored operations in response to the new reality of "make where you sell and buy where you make."

“In a world of nationalist trade policy, tax strategy can no longer be an afterthought, which it has been for many companies.”

—Brian Higgins, U.S. Practice Lead, Supply Chain & Operations, KPMG LLP (U.S.)


Tax optimization as a value preservation imperative

As a strategic priority and organizational competency, tax-optimized supply chain analysis is rooted in an increasingly critical imperative of value preservation and in a parallel questioning of supply chain models founded on the basis of lowest cost and operational efficiency. COVID-19 disruption has given fresh urgency to the adoption of multidimensional value frameworks—more firmly incorporating risk exposure, supply alternatives, channel complexity, and tax considerations—as the new measuring stick of supply chain health.

During the past several years, governments have increasingly turned to tax and trade policy to promote domestic industry, create new jobs, and incentivize investment inflows. The levers they use include not only the most commonly recognized categories of tariffs and income tax but also targeted indirect taxes, export controls, and calibrated trade sanctions. Major trading nations are now competing openly through unilateral tax policies to further either proactive or defensive aims.

As one example, the U.S. tax code was amended in 2017 to allow American businesses to repatriate cash trapped overseas on the premise the capital would incentivize U.S. companies to invest domestically. In 2019, France imposed its new digital services tax—a 3 percent tax on the gross receipts of approximately 30 multinational digital-services providers. The tax was justified on the basis that these companies were not paying their “fair share” of tax in France. KPMG analysis3 showed 17 U.S.-based entities, but only one French entity, would be affected by the new tax. Those tax measures are overt, but the unilateral measures have also shown up in subtler forms. The United States’ refusal to appoint arbitrators to the WTO has effectively crippled WTO’s ability to resolves disputes and, as important, signaled that the U.S. is turning away from multilateral globalism and moving toward bilateral tax and trade agreements.

“After the pandemic recedes, governments will face fiscal pressure to reduce the debt they’ve incurred to keep economies functioning during the crisis. That money has to come from somewhere.”

—Brett Weaver
Value Chain Management Leader and International Tax Partner, KPMG LLP (U.S.)

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Critical questions for supply chain leaders:

Who will thrive after COVID-19

KPMG believes the supply chain organizations that will adapt best to new paradigms of economic nationalism will need to address specific foundational questions, regardless of sector, market, channel, or customer segment. They are:

— **Supply base and supplier locations**: What suppliers do I want to do business with? Where are they located and what exposure does that introduce to my operations?

— **Manufacturing footprint**: Where should my manufacturing assets be located? What should each facilities’ mission and purpose be (e.g., complex plants dealing with low volume/high variability versus basic and stable plants dealing with high volume/low variability)?

— **Distribution locations and partners**: Where should my distribution hubs and centers be located? How is my distribution channel location influenced by my supply base and manufacturing footprint?

— **Procurement structure and approach**: How centralized or decentralized should my procurement function be? Does an international purchasing organization structure make sense?

— **Insourcing versus outsourcing approach**: Whom should I entrust to manage and execute different portions of my supply chain and operations? Are my internal costs and performance better or worse than an external partner’s? Am I doing things that I shouldn’t?

From our perspective, these areas of assessment and initiative will be significant levers of cost management, revenue stability and growth, and profitability. Given an uncertain future, they are also the bases for long-term supply chain resilience, whatever form disruption takes.
Three tax optimization agendas: Now, for the duration, and post COVID-19

The good news is that all those same tax levers used by governments can be turned to competitive advantage by supply chain teams capable of incorporating them into their supply chain restructuring analysis. In our marketplace conversations with business leaders, we hear three clusters of pressing tax questions:

— First, how can tax be leveraged to free up cash in order to both keep the business afloat and pay for rapid reconfigurations of their supply chain networks?

— Second, what tax value levers are available to our business to inform supply chain restructuring analysis, so that it reflects current reality and anticipates the post-pandemic tax climate? (See sidebar: “How will governments pay for COVID-19 economic intervention?”)

— Third, what would “good” look like, if we aimed to embed long-term tax planning and strategy best practice into our supply chain restructuring analyses? (See sidebar: “What good looks like”)

On the nearest time horizon, liquidity is an enormous priority for many organizations struggling to maintain adequate working capital during the pandemic. One example of short-term tax opportunities is taking steps to align the company’s transfer pricing policies with the new reality. Where a company has been particularly hard hit, it may be appropriate to adjust intercompany transfer prices to reduce the profits of group companies otherwise entitled to fixed operating profits. This would yield immediate sources of cash by reducing the current-period income tax payments these group companies would otherwise make. Additionally, some companies may have the ability to generate cash by optimizing the tax effects of successful crisis management initiatives. Tracking costs incurred and true value realized as a result of navigating COVID-19 (e.g., crisis response, recovery, resilience, restructuring, etc.) might give rise to group charges that could result in the carryback of losses for quick refunds of prior year taxes.

For companies leaning into “make where you sell and source where you make,” their supply chain redesign costs could be significantly offset by configuring the components that must be imported to qualify for low or exempt tariff rates, tracking export sales eligible for duty refunds, and qualifying for investment incentives that can significantly reduce tax on profits (e.g., research credits, accelerated write-off of capital investments, and domestic production incentives).
As supply chains recalibrate for the duration of the pandemic, many products and services are likely to be offered with enhanced digital components (e.g., purchasing new automobiles online with dealer networks used only for the test drive and service, digital concierge services instead of human interaction, and prescription drug delivery). This approach opens the possibility of centralized customer interaction, price bundling, and the need for even more flexible supply chains. A centralized seller model could give rise to meaningful value-added tax savings that increase product contribution margin, and the same opportunity might exist when considering price bundling. However, these opportunities are often achievable only when the company’s supply chain is purposed to support such operating models.

Supply chain leaders are already realizing that legacy thinking and tools are inadequate and that those who emerge strongest from the COVID-19 disruption will be those willing to go beyond piecemeal responses, take a holistic approach, and see current conditions as a strategic opportunity for transformation. We expect to see more concerted efforts to forge intraenterprise partnership between the supply chain and tax functions and import critical tax skills and perspectives into supply chain models.

The forces propelling economic nationalism before COVID-19 are unlikely to reverse course when the situation recedes. There are huge unknowns: A deep and prolonged recession will reconfigure industries in unforeseen ways. For most companies, post-COVID-19, an efficient and resilient supply chain will be a competitive advantage. This will be a seismic change in many enterprises’ value chains—with the supply chain function taking a more prominent role. Architecting and implementing this type of supply chain of the future will take time, significant investment, and digital technologies (e.g., blockchain, connected customer platforms, manufacturing control towers, and automated production capabilities). Where operations and tax departments pilot this voyage together, there will be significant tax and trade savings to help pay the fare—from investment incentives to supply chain “centers of excellence” that can drive weighty income tax and permanent cash savings.

4 “Job Losses Mount: The Information’s COVID-19 Tech Impact Briefing” (4/3/20)
Integrating supply chain and tax functions in efforts to effectively restructure for a post-COVID-19 world is a competency that is best built, not bought. The most effective tax optimization initiatives will integrate in-house skills and infrastructure with carefully chosen external collaborators—whether tax or supply chain domain know-how, analytic models, data feeds, and cloud technology platforms. In our view, the supply chain organizations that already place value on maintaining robust external partner ecosystems will lead the way here as well.

A handful of powerful modeling tools are available in the marketplace that supply chain organizations have used to answer questions such as:

— Where are my points of demand?
— Where are my points of supply?
— How do I optimize where my manufacturing capacity should be?
— Where should my distribution square footage be located?

These modeling tools are good at what they were designed to do, but virtually none of them take tax fully into consideration. Absent tax inputs, it is hypothetically possible that the “good” supply chain decisions recommended might result in a “bad” tax position that erodes expected benefits. Supply chain organizations have the opportunity—and now, major incentives—to configure the out-of-the-box functionality of these platforms to their sector, geographic, and regulatory requirements.
About the KPMG Supply Chain and Operations practice

KPMG LLP is here to support you in this unprecedented situation. Organizations are asking mission-critical questions pertaining to supplier and operations risk that have arisen in the COVID-19 environment. We recognize that during this time, business leaders don’t only need solutions; they need reliable advisers. Whatever your sector, over 2,000 supply chain, strategy, and value chain management professionals from the KPMG network of member firms worldwide can help you address the issues of today, from crisis response planning to rapid diagnostic for supply and demand risks across your operation, to scenario analysis and contingency planning. Our professionals are skilled in many areas of supply chain operations from strategy and analytics, supply chain risk, planning and execution, and logistics and distribution. We also have the capabilities to help you integrate tax planning into your business operations to help reduce expenses and risk, enhance return on investment, and drive efficiencies across operations. We are here to help.
Contact us

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