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Supply chain disruptions and their impact on transfer pricing[1]

Transfer pricing is where tax meets supply chains. Anyone managing disrupted supply chains needs to understand the transfer pricing tax consequences.

Supply chain disruptions are amongst the top business challenges these days as economies recover from the COVID-19 pandemic. Inflation, labour shortages, geopolitical issues, trade tensions and unprecedented changes in international tax policies are key contributors to these disruptions. The Russia-Ukraine war-related sanctions and lockdowns from China's zero-COVID policy further exacerbate these. From delays in production to the reduced workforce, disruptions to supply chain will be felt some years into the future.

In response, many companies are implementing operational changes to mitigate the impact on their bottom-line profit to become more resilient to unexpected events, and manage other important matters such as cyberattacks, commodity price fluctuation, supplier risks and environment, social and governance (ESG) concerns.

A survey EY conducted with more than 200 senior-level supply executives noted that many multinational enterprises (MNEs) are transforming their supply chain strategies to become more resilient and collaborative with customers, suppliers and other stakeholders. Such initiatives often require major investments in supply chain technologies such as artificial intelligence and robotic process automation while retraining workers and redefining the roles and responsibilities of key employees and legal entities in the value chain.

These initiatives considered by companies often result in important operational changes, including:

- **Redesign of the supply chain operating model** to take into account new trade agreements and country incentives. This often results in a geographical shift of production sites and warehouses.
- **Improve transparency and resiliency in the supply source** by developing or improving real-time end-to-end visibility of the supply chain. This enables timely decisions to address unexpected disruptions. The results are changes in the suppliers' pool for better diversification in terms of number and geographic concentration.
- **Cost savings across supply chain**, which may consist of working capital improvement through a reduction in product mix (e.g., stock keeping unit (SKU) rationalisation), changes in supplier payment terms, logistics and warehouse optimisation and improvement in manufacturing productivity through automation or outsourcing.

[1] https://www.ey.com/en_sg/you-and-the-taxman/supply-chain-disruptions-and-their-impact-on-transfer-pricing

- **Sustainability review** of manufacturing practices to reduce waste and monitor suppliers for their sustainability practices. This can have important reputational implications and material cost savings.
- **Digital supply chain review** to assess opportunities for digitalisation of end-to-end supply chain across planning, procurement, manufacturing and logistics. This can drive efficiencies and open new revenue streams.

Summary and suggestions

Incomplete planning could result in material tax liabilities and could expose companies to significant tax risks and uncertainties that can exacerbate the financial impact of supply chain disruptions. Companies subject to supply chain disruptions or with important supply chain initiatives should identify tax and TP implications and adapt their TP model accordingly. To identify the most applicable solutions, we recommend companies to:

1. Ensure alignment with business: tax and finance personnel must work hand-in-hand with operational personnel to identify and assess the tax implications associated with the operational change contemplated.

2. Evaluate the TP impact: understand how the current TP system allocates income or losses amongst the group entities, and vis-à-vis the business changes arising from supply chain disruptions or initiatives.

3. Priortise and plan for alternatives: prioritise jurisdictions with issues and outline alternative options and approaches to proactively adjust transfer prices within existing benchmarked ranges or identify arguments to support results that fall outside of benchmarked ranges. If the current characterisation of the entity is no longer valid, update the TP model to reflect the new functional and risk profile of the transacting entities.

4. Document and monitor changes: document the business rationale of any changes to the existing TP model and update TP documentation and intercompany agreements to reflect the actual conduct of the transacting entities in the new TP model.

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