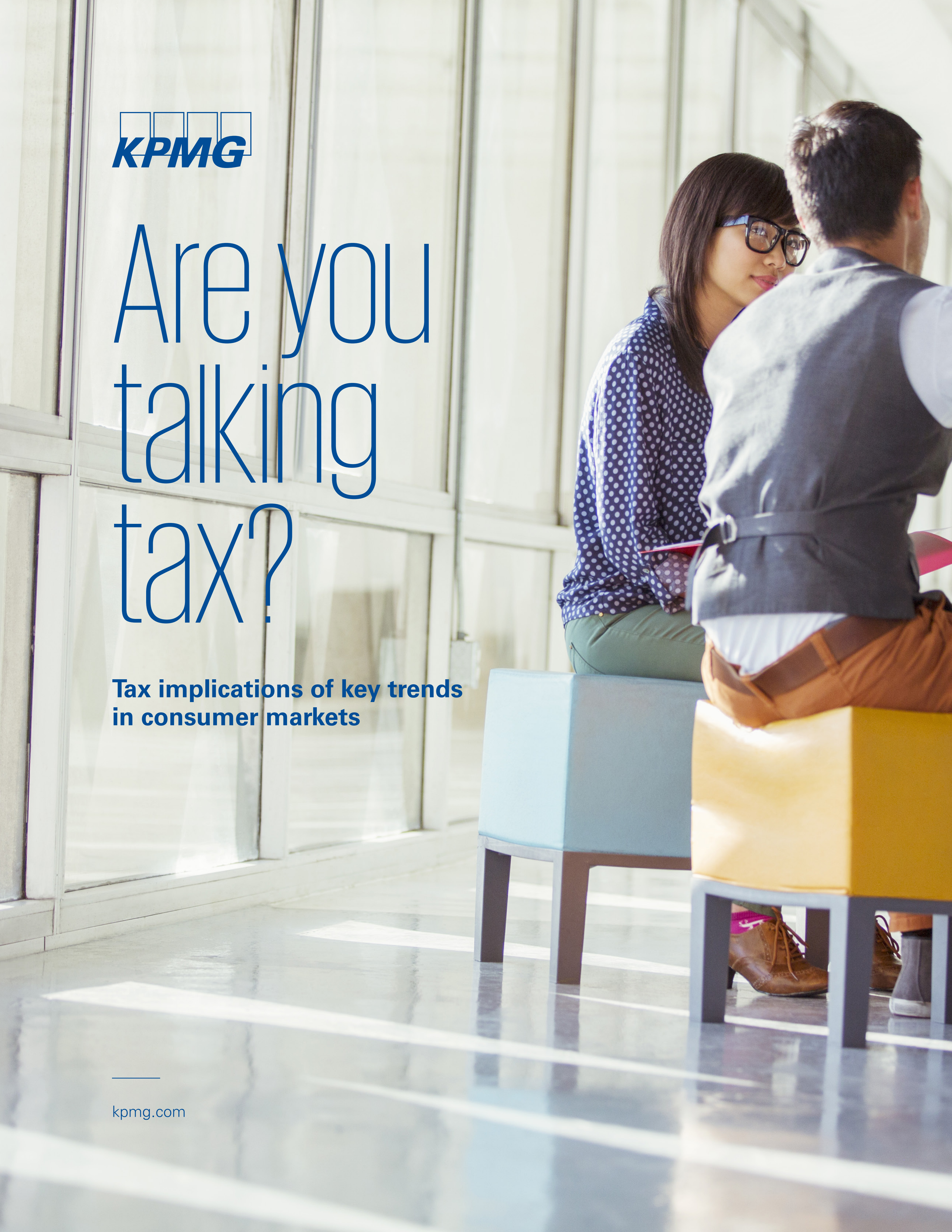

Are you talking tax?

Tax implications of key trends in consumer markets

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Why tax matters

Change is the new normal in the consumer markets industry, and it is barreling down at companies from multiple fronts.

There is a dizzying array of external forces driving demand and numerous internal choices to adapt business and operating models that make it easy to overlook tax as a critical lever in today's customer-driven, globally connected, activist-stakeholder, regulatory-intense world of business.

Consumers are driving market demand set with high expectations.

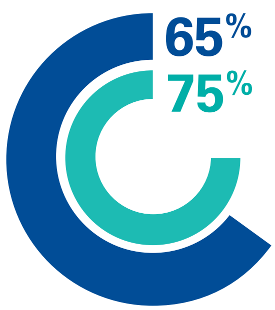
Activist investors and shareholders who seek greater returns are pushing companies to explore cost containment strategies.

Intensifying global competition is forcing companies to respond by seeking new opportunities in high growth markets.

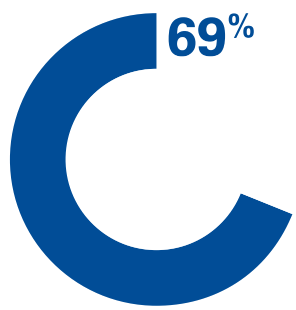
Changing technology platforms are forcing supply chains to achieve "anytime, anywhere" customer fulfillment.

The regulatory environment is demanding that executives swiftly assess, respond and comply with new rules and risks, including the Organisation for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project, a global tax transparency initiative, which is transforming the tax landscape for multinational organizations.[1]

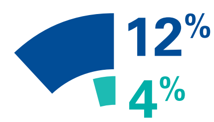
With so many companies in some stage of transformation efforts, tax needs to be a part of the conversation from the beginning to help enable strategic success.



65% of FD&CG companies are in some stage of transformation efforts (assessing, planning,executing). This is true for **75% of retail companies**.



69% of FD&CG and retail companies noted their organization is most likely to begin with a strategic plan to address a defined set of high-impact issues that require an interrelated set of projects across the business to realize the plan.



12% of FD&CG and 4% of retail companies stated that they were highly confident that their company could **develop a business transformation strategy** that is built upon solid quantitative analysis of current performance and potential value creation.

Source: KPMG 2016 Transformation survey

It’s no wonder many companies feel they are drinking from the proverbial fire hose.

These challenges are forcing businesses to evolve strategically and operationally, triggering consumer markets business leaders to focus efforts on delivering a transformation agenda, which logically should include tax. A recent KPMG survey of more than 200 food, drink, and consumer goods (FD&CG) executives revealed that nearly all FD&CG and retail companies are in some stage of transformation.

However, a large percentage of consumer markets organizations don’t realize the full potential of their transformation efforts. This is, in part, due to a lack of clarity about the role of tax and how it fits in. Failure to include tax at the table diminishes the effectiveness and efficiency of the transformation agenda, regardless of the size or scope of the organization or its transformation.

Tax is a topic front and center at the board level. Companies need to have a clear tax strategy that they can convey not only to their board, but also to the public. The inability to clearly articulate a tax strategy can put companies at a disadvantage publicly with the reputation of the brand. Companies need to be proactive in creating them, not reactive when a crisis occurs.

Exploring key trends in this complex industry – and where and how tax can play a pivotal role – will help get the conversation started in your business, enabling your organization to successfully transform itself to meet evolving challenges and seize emerging opportunities.

[1] BEPS: Implementing the OECD’s recommendations (Accountancy Age, Oct. 2015)

Enhancing operations

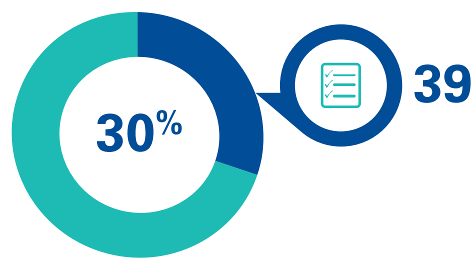
Consumer goods company adds value with tax-efficient divesting

KPMG helped a multinational consumer goods company that sells food, beverages and personal care products identify tax-efficient means to divest non-core portfolio brands. KPMG played a key role in helping to identify alternative tax disposition structures that aligned with the business requirement needs and assisted in the economic valuation of selected to-be-divested brands. This allowed the company to effectuate a strategic, customer-focused market realignment.[2]

Meeting demand and containing costs

It comes as no surprise that today's consumers are more connected, informed and empowered than ever before, thanks largely to the mobile, social and digital technologies always at their fingertips. But as they sharpen their expectations for the kind of experience, both on-and-off-line, that will attract and keep them, retail companies are forced to compete by executing omnichannel strategies.

In the retail industry, omnichannel has basically become industry credo, but most companies are still in early stages of execution. Most have mastered "multi-channel" ways of doing business, but trends like "buy online, return in-store" put tremendous pressure on internal business processes. Not so long ago, most retailers required customers to ship online orders back to the retailer rather than return in-store. As that approach becomes a thing of the past, it raises tax-related challenges and opportunities for companies.



Consumer companies faced a **near-record 39 activist engagements in 2014**.

Almost **30 percent** more than the next **most active sector, technology**.

Source: According to NASDAQ data

[2] KPMG primary research

In order to deliver on the "any product, anytime, anywhere" promise, some of the major challenges for both retail and FD&CG companies are managing inventory and building customer-centric, cost-effective, demand-driven supply chains that serve brick and mortar and online shoppers equally and effectively. Inventory management in the industry has become increasingly complex, causing consumer markets executives to rethink where they situate distribution centers and how they get products to online shoppers faster.

Containing costs and increasing shareholder value are also high on the operations agendas of consumer markets executives. Increased competition from online businesses and other disruptive upstarts are pushing consumer markets organizations to cut costs and offer more value. The pressure is so great that investor activism has become pervasive at many publicly traded organizations. According to NASDAQ data, consumer companies faced a near-record 39 activist engagements in 2014, almost 30 percent more than the next most active sector, technology.[3]

These aggressive minority equity stakeholders typically advocate for radical changes to reduce costs, increase efficiency, and maximize shareholder value, such as replacing management, selling the company, changing the capital structure, restructuring the business portfolio, and making non-traditional operational improvement activities.

All of these strategic operational decisions have significant tax implications.

[3] Consumer Cyclicals Most Popular Target for Activists as Funds Boom (IR Magazine, Feb. 2015)

Restaurant satisfies shareholders with tax-efficient real estate spinoff

A major multi-brand restaurant operator was under the influence of activist investors seeking to turnaround performance and boost returns. Seeing the cost-savings opportunity in leasing rather than owning real property, KPMG helped the company spin out its real estate in a tax-efficient manner. Through the sale, the organization was able to capture the appreciated value of its physical assets on its balance sheet – value that had appreciated significantly since the initial purchase but couldn't be reflected until sold or otherwise disposed of.[4]

Consider how retail companies handle online sales today. There are thousands of different sales tax jurisdictions across the United States, and customers can be spread throughout the various localities. Not only do different jurisdictions potentially have different tax rates but they may also have differing rules on which items are subject to tax. Layer on the frequent changes in tax rates and occasional tax holidays and trying to stay current could be a full-time endeavor. This is why it is imperative for retailers to ensure their systems are set up to handle with all the different jurisdictions to obtain real-time feeds of tax law changes. This way, the company collects and remits the correct amount of sales tax on every transaction.

There are also many state and local tax considerations related to inventory management, driven largely by consumer demand for increased delivery speed. Many companies previously housed inventory in a single location in the United States. A consideration in the location of distribution centers often includes the relative tax features of competing locations. Instant delivery pressures are compelling companies to open new distribution locations, relocate existing ones, and move stock around the country. Opening new distribution facilities and moving inventory may result in companies having taxable presence in new jurisdictions. This changes the organization's state and local tax footprint—i.e., it may owe income taxes where it didn't before or may be required to collect and remit sales tax in additional states.

Selling products across sub-national jurisdictions raises a myriad of multistate income and indirect tax issues. It affects an organization's overall tax liability, and may necessitate modifications to tax and point-of-sale systems to accurately and efficiently calculate taxes owed and meet tax filing obligations. These additional complexities will lead to an increased workload within the tax department, as well as additional need for assistance with audits and controversy.

Changing sourcing arrangements – especially partnering with international suppliers – also affect a company's overall tax liability, depending on the arrangement it raises transfer pricing and trade and customs considerations related to the cross-border movement of goods. It is important that the tax function has an active role in these changes to ensure compliance with transfer pricing regulation and that the pricing is consistent, and can be reconciled, with their customs import values.

[4] KPMG primary research

Activist-driven campaigns impact operational and financial changes that affect organizations from a tax perspective.

Managing complex transactions, such as spinning off business segments or divesting business entities, requires advance tax planning to maximize tax efficiency. While unlocking the unrecognized value that may exist with company-owned real estate or other operating assets, such transactions come with many tax challenges that will require detailed analysis by the tax function.

Executives responding to investor pressures to cut operational costs should consider how the company can leverage supporting technologies within tax to improve the cost efficiency of daily finance operations, such as by automating accounting, reporting and compliance activities.

TAX TIPS

Before making strategic business decisions that impact operations – such as relocating distribution centers, partnering with new suppliers, executing cost-cutting measures, or selling brands or assets— consumer markets executives should consider:

- The global tax impacts of new business structures giving balanced consideration to tax efficiency and tax risk mitigation in response to heightened U.S. and international tax scrutiny
- The state and local tax effects of new business strategies and structures, such as a company's expansion into additional states or localities
- New or altered tax U.S. or international direct or indirect reporting and compliance requirements

Driving growth

Forward-thinking tax planning helps department store chain drive growth in China

In China, customer demand spells opportunity for retailers. A multinational chain of department stores looking to capitalize on such opportunity went into business with a foreign partner that knows the China market well. KPMG advised on key aspects of the joint venture: how to structure it tax efficiently, how to manage tax-related intellectual property issues, and how to deal with unfamiliar in-country tax regulations. The result is a structure that meets the needs of the department store chain today, while providing flexibility for future growth in China.[8]

Reaching new markets and customers

Companies are continually looking for ways to drive growth, both organically and inorganically, both in the U.S. and beyond.

Consumer markets executives are asking, "How do we establish a presence in China, India and other high-growth markets?" "How can we better create value with our operations within the U.S.?"

As they search for sustained growth and profitability, these are some of the questions that keep them up at night.

Within the U.S., there are numerous state and local economic development incentives designed specifically to drive and grow business. When assessing the footprint of a company or a change in its U.S. operations, taking a look at these incentives can help bring value to an organization.

From a global perspective, KPMG's 2015 U.S. CEO Outlook Survey noted companies across sectors are stepping up international expansion and inorganic growth plans due to low economic confidence and consumer spending power.[5] Many economists believe the two percent GDP growth the U.S. has experienced in recent years will only continue.[6]

Hard-pressed to achieve their growth targets here at home, the slowdown in Western economies is driving consumer companies, in particular, to seek growth opportunities in overseas markets. The primary growth driver for many is international expansion. U.S.-based fast food restaurant chain operators are a prime example, establishing operations overseas with accelerating frequency, according to a global market research report by IBIS World.[7]

As consumer companies move abroad, many engage in cross-border transactions. Merging with or acquiring a local partner helps U.S.-based organizations speed growth by providing the necessary on-the-ground insights about cultures, customers, regulations, and economic and geopolitical issues to successfully establish the business in a foreign jurisdiction.

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[5] Growth in America: More Bad News (The Economist, April 2015)
[6] KPMG 2015 U.S. CEO Outlook Survey
[7] 5 Key Drivers to Impact Growth in 2015 (QSR Magazine, May 2015)
[8] KPMG primary research

Numerous tax issues arise when companies expand internationally and engage in cross-border deals.

International tax planning takes on added importance. While the market opportunity of a country will determine where to grow the business, the tax team must partner with the business operations team to determine how to expand into the new location in the most efficient manner.

What's more, as operations are established in a new country, compliance with the regulatory and tax reporting rules can become extremely challenging. Jurisdiction-specific tax laws, plus broader tax regulations related to transfer pricing and trade and customs, only further complicate matters.

Additionally, there can be unintended consequences related to the movement of a company's global talent that can cause unexpected risk exposure. Companies need to make sure tax and human resource departments are aligned in this area.

Consumer organizations cannot overlook the importance of international tax planning as they expand operations overseas. Moving into new markets tax efficiently is critical to realizing the full potential value of the growth strategy.

TAX TIPS

To realize the intended value from various growth strategies, consumer organizations should:

- Implement the right tax structuring to maximize the long-term value of global growth
- Weigh the potential tax risks and benefits of contemplated transactions – including transfer pricing, the new BEPS guidance, and local country tax requirements *(see the next section for more insights on managing risks related to BEPS)*
- Address new tax accounting, reporting and compliance requirements resulting from a changed tax footprint
- Transform the internal tax function to support an expanded global business
- Consider state and city economic business incentives
- Ensure tax and human resource departments are aligned when moving global talent.

Mitigating risk

Managing regulatory compliance cost-effectively
One of the prevailing risks facing consumer organizations is the changing regulatory environment.

With continued budgetary pressures for national and local governments, many jurisdictions are seeking to identify new tax revenue streams or collect more under existing regimes. This is leading to an influx of new tax-related regulations, which are increasing the reporting burden on consumer companies. Not only are companies seeing their tax liabilities increasing, but they are also seeing the time spent to comply with the new regulations and related exam activity increasing as well.

Top of mind tax-related considerations for consumer markets executives are:

– New BEPS rules
It is important to note that the OECD guidance in this respect establishes a frame-work for OECD member nations. Each country will have its own view, and its own legislative and domestic law response, for implementing the OECD guidance - in whole or in part. Much of this guidance is focused on an increased emphasis on "substance" (i.e., locating key decision-makers and critical functions, in addition to legal ownership of intellectual property and placing capital at risk) in determining how value should be allocated in a given value chain. In addition, governments have expressed a desire to ascribe greater value in the value-chain to the consumer location, and as a result the BEPS Project revised the permanent establishment standard to allow the jurisdiction where the ultimate customer is located to claim taxation rights in many more cases.

– Complying with foreign regulations
Similar to the BEPS guidance discussed above, retailers and consumer goods companies were already facing scrutiny from foreign tax authorities for their tax planning strategies in place under pre-BEPS existing transfer pricing and permanent establishment guidance. Well publicized tax controversies involving prominent retail companies highlight these risks and suggest that companies consider a variety of strategies to ensure compliance (for example, advance pricing agreements as an alternative dispute resolution tool).

– Understanding rapidly changing state and local tax regimes
Each year there are hundreds of bills introduced in state legislatures that, if enacted, would affect state and local taxation. While not all of these are enacted, many of these do become law. In addition, each year there are many other state and local tax changes and developments, ranging from new administrative regulations to the issuance of court decisions interpreting state and local tax laws. As such, it is always a challenge for companies doing business in multiple jurisdictions to keep track of all the changes occurring each year that will affect their business. For example, in 2015, the following are just a few of the state and local tax changes:

» New York State significantly revised its corporate tax effective in 2015. In April 2015, New York City adopted conforming legislation retroactive to January 1, 2015.

» Four states implemented legislation that considers certain "click-through" marketing and selling arrangements to give rise to nexus for out-of-state sellers.

» At least two other states adopted legislation expanding their nexus or doing business statutes in other ways.

» Multiple bills affecting state taxation were introduced in Congress. These include the Marketplace Fairness Act of 2015 and the Permanent Internet Tax Freedom Act.

» The City of Chicago issued guidance expanding their personal property lease transactions tax (in effect for decades) to a number of so-called cloud computing transactions.

From a tax perspective, organizations must understand the cost of complying with international, federal and state and local tax laws, including how compliance-related operational decisions impact potential tax costs.

Navigating tax rules are an immense undertaking for any organization. Staying ahead of the game and addressing regulation proactively makes the challenge even more difficult.

TAX TIPS

When new or changing regulations impact your business, how can you respond in a timely manner? How can you comply without significant disruption to core operations? And what is the cost to your business?

To answer these questions, organizations should consider the following:

- Embrace enterprise and tax technologies, which can increase the efficiency of the tax function and create additional time to focus on risk areas related to changing regulations and compliance concerns.
- Invest in data analytics, which can help the tax department be increasingly agile, accurate and timely in its data gathering and reporting, as compliance requirements become more critical and time sensitive and organizations face more scrutiny from taxing authorities and other regulators.
- Review the viability of existing organizational, capital, and supply and value chain structures and the anticipated tax consequences implicit in each to assess the potential impact of BEPS related legislation/regulation. This needs to extend not only to legislation enacted in reaction to the OECD's guidance, but may also entail proactive discussions with taxing authorities to educate them about the commercial and tax appropriateness of a company's or the industry segment's existing supply/value chain structures and strategies. Ultimately, if the impact of BEPS related guidance implies a significant increase in the effective tax cost of the existing supply-chain and capital structure, organizations will need to consider appropriate modifications to these to meet cost (including tax) containment goals or the organization and its stakeholders.

Tax at the table

Our work with leading consumer markets companies has confirmed time and time again that the tax function has an integral role to play in a rapidly changing business environment. Bringing tax in allows for a holistic approach to successful planning and execution of the transformation agenda, and helps organizations achieve greater value from daily operational activities, growth initiatives, and risk mitigation efforts.

The reason is simple. As challenges compound and opportunities emerge and shift, consumer markets executives must understand the tax implications of key industry trends in order to conduct cost-benefit analyses and make strategic business decisions that both support the bottom line and drive future performance.

But putting it into practice is often more difficult. How do consumer markets leaders gain that vital knowledge? And how do they leverage it to know where to focus and what to do?

We believe tax executives are critical to any conversation that involves shaping the agenda on the topics of a company's growth, operations and risk.

In a number of ways, tax teams are uniquely positioned to contribute to the company's strategic business goals, and consumer markets executives who want to truly understand how to anticipate, respond and capitalize on the key trends shaping the sector should give tax leaders a louder voice.

They'll hear vital knowledge, insights and perspectives that help to:

- Optimize operations, transactions and expansions across the globe
- Keep pace with emerging risks and regulations
- Uncover hidden value from business activities.

As your business expands in the future or changes are made to the way you operate your business, have you considered the following:

1. Has the tax team been adequately involved in the planning to ensure all important tax implications have been considered?
2. Based on changing laws and regulations both domestically and abroad do you understand the potential financial statement impact of the tax structures that are currently in place?
3. Have you evaluated potential changes that may be required to your current tax positions as a result of changes to your business as well as to changing tax regulations?

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About KPMG

Every tax function faces a unique set of circumstances, constraints and challenges. It's our ability getting to the heart of your particular issue and present you with an informed, practical solution that sets KPMG's tax professionals apart.

Passionate, collaborative and committed to your business success, we work shoulder-to-shoulder with you to learn all we can about your company, understand your goals at the deepest level, and uncover unexpected opportunities. That means tapping into our vast network of functional and industry specialists to assemble the right people, tools and expertise to tackle your toughest tax challenges.

When you turn to KPMG to help drive the performance and impact of the tax function, you will get hands-on assistance and insight into pragmatic and aspirational opportunities from people who truly understand *your* business. We draw on our deep and expansive experience across all tax operations and industries to help tax leaders achieve the results and expectations of your stakeholders.

Contact us

For more information on KPMG's Tax services for consumer markets organizations, please contact:

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