

TESCM PLANNING

Tax-effective supply chain management (TESCM) is a powerful planning tool used extensively by large multinationals. The approach integrates tax planning with a company's global supply chain operations in order to achieve operational efficiencies and to reduce both costs and the group's effective tax burden. Smaller Canadian companies that make or are poised to make significant sales outside Canada should explore the potential benefits of supply chain management.

A central trading company is established in a relatively low-tax country to source product for sale to, and local

resale by, related distribution companies situated in higher-tax countries. A local distributor is typically organized as a limited-risk distributor or commissionaire (under civil law, an agent acting in its own name on behalf of an undisclosed principal). The local distributor is the customers' point of contact, but it has a limited level of activity and risk in respect of sales: the central trading company bears substantially all risks relating to local sales (such as risks for inventory, receivables, and returns) and indemnifies the local distributors. Thus, the local distributor should be entitled to a small profit margin on its sales relative to the larger portion allocated to the central trading company.

The transfer from Canada of product IP or other intangibles such as customer lists may trigger capital gains or income to the transferor. The creation of intangibles at the local distributor level is generally to be avoided. Conversion from a pre-existing full-risk distributor structure may give rise to adverse local tax consequences, such as gains on the intercompany contracts' termination or on disposition of IP or goodwill, or other income recognition if an unrelated party would have paid compensation to the local company for the shift of profits. The countries of operation determine the impact on exempt and taxable surplus accounts: if taxable surplus is unavoidable because a local distributor is established in a non-treaty country, a more tax-efficient repatriation alternative may be considered. Intragroup services performed by non-Canadian affiliates may create FAPI exposure. Transfer-pricing considerations are key to any structure's feasibility and remain an ongoing issue. The new business structure should rest on a well-documented non-tax business justification in order to allay concerns of tax authorities, especially if it negatively affects local profits.

Customs and VAT issues must be continually managed to avoid new unrecoverable costs. Potential exposure to PE and residence status in non-treaty jurisdictions must also be managed if, for example, central sales company personnel are involved in local sales. The establishing and monitoring of an appropriate level of substance in a jurisdiction for each affiliate are crucial: Are mind and management, and thus tax residence, located in the target jurisdiction? Does the affiliate have adequate financial and other resources to perform its intended functions? Do the actual intercompany arrangements reflect the legal documentation? Is the affiliate overstepping the bounds of its intended activities and risk levels?

The group's supply chain process must be analyzed in detail, from negotiation and taking of orders to the sourcing of product and delivery to the end customer. The impact on internal processes and systems—such as ordering procedures, invoicing, and computerized inventories—

should be assessed. The adoption of centralized logistics and procurement strategies is generally necessary to coordinate the transformation from the current model; volume cost savings and other efficiencies are often realized. A global shared services centre may be established to provide, *inter alia*, treasury, accounting, finance, and marketing functions.

The transition to the new structure will be smoother if key members of management and other stakeholders are onsite. The level of review required offers an opportunity to examine other business objectives, such as the establishment of a group treasury company or the protection of valuable assets from product liability exposure.

Steven Sitcoff
Spiegel Sohmer Inc., Montreal