MHA MacIntyre Hudson
Chartered Accountants, Tax and Business Advisers

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Brexit - A New Horizon

Business Planning Guide

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What's inside...

Introduction

With Brexit scheduled for 29 March 2019, UK businesses face the daunting task of scrutinising supply chains and preparing for customs… and the clock is ticking.

While we do not yet know what kind of Brexit we will have, the sheer range of tasks businesses will need to undertake ahead of the departure date is worthy of attention. Businesses should have already begun the process of strategic review to minimise their risks and maximise the opportunities Brexit presents for them.

What happens next?

The negotiation process is not straightforward. Article 50 was triggered on 29 March 2017. This meant that negotiations for the UK to leave the EU could begin and would need to be finalised by 28 March 2019. The EU's chief negotiator, Michel Barnier, has indicated that the transitional period for the UK leaving the EU customs union will likely reach its end on 31 December 2020.

When the UK leaves the customs union, goods moving into or out of the UK will be subject to customs checks, customs declarations and duty rates negotiated with EU or non-EU countries. In the absence of specific trade agreements with the UK's trading partners, the default position would be for the World Trade Organisation (WTO) to apply its own tariffs.

UK businesses who have not prepared for the possible absence of trade agreements with the EU, in particular, could be faced with unanticipated costs, and supply chain dilemmas which may create vulnerabilities for their business within the post-Brexit landscape.

Action - deal or no deal!

In exceptional cases, some UK businesses have already considered and actioned a relocation to another EU member state. If your business has not relocated within the EU and has no intention to do so, it will be important that UK businesses do not postpone their preparations for Brexit until concrete policies have been established. The Brexit roadmap may not materialise prior to December 2018, which will leave businesses with a limited timescale to refine supply-chains, review contracts, revise logistical procedures and re-evaluate their pricing strategy.

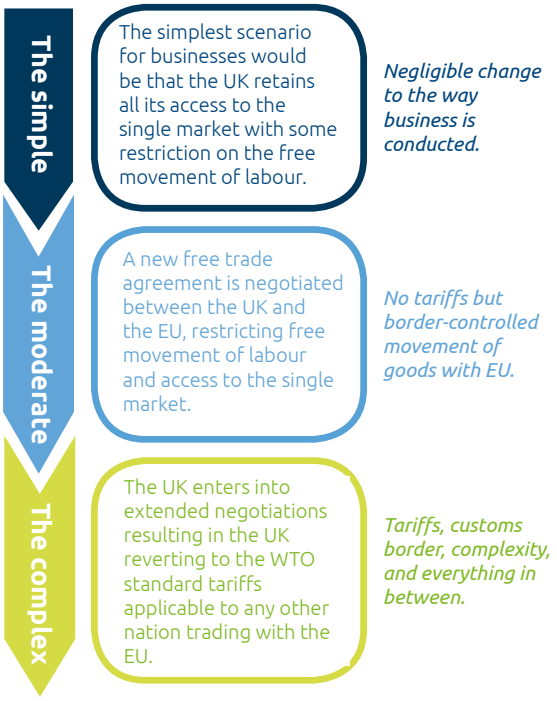
UK businesses should favour the proactive approach of review, forecasting and preparation over complacency. Ready-made plans can be tweaked and adjusted once Brexit policies have been determined, however, the absence of any planning could result in major difficulties for businesses post-Brexit. Some difficulties may include problems in sourcing raw materials or goods, the loss of money on contracts and unnecessary delays in dealing with customs declarations. Not to mention the likelihood of changes to rules and regulations which will apply to products that are circulated within the EU.

What could Brexit look like?

Free movement of labour was highlighted as a key factor in the marginal swing towards a Leave vote. It is clear that any deal negotiated by this government will have to place some restriction on EU nationals coming into the UK, however, the EU has also made it clear that the free movement of goods and free movement of labour come hand in hand.

As illustrated opposite, there are a few perceptions as to what agreements could be negotiated with the EU along with the commensurate possibilities associated with each specific scenario. A fair appraisal of Brexit negotiations so far would suggest there is a possibility that the UK government could be confronted with the prospect of extended negotiations with the EU.

Whatever the outcome, Brexit will be 'new territory' for UK businesses in general and a minefield for the businesses who have not made contingency plans for the possible outcomes.



Strategy & Operations

In the face of the current uncertainty, engaging in strategic planning could prove to be indispensable. Scenario planning is the process by which a business develops pictures of potential future scenarios for the purposes of developing a strategic response to the changes which will be inevitable post-Brexit.

How has Brexit affected business?

Impact on importers	Costs have increased as the pound weakened in the aftermath of the Brexit vote
Impact on exporters	Invoices in sterling became cheaper to settle by foreign currency holders
Price inflation	Costs linked to the $ (fuel) and the € (imports from EU) increased
Confidence to invest	Major UK companies cut back on investment which will have impacted supply chain facilitators in the UK
Order books	Projects were delayed in the face of uncertain economic outlook
Domestic consumer market	Lack of confidence to spend money in uncertain times
Staff	Many sectors benefited from free movement of labour within the EU but the vote saw net immigration drop by 100,000 in the year after the referendum as the UK became a less attractive place to work

Lead times

Longer lead times may be created by potential bottlenecks at ports, and the impending replacement of the existing electronic system for handling import and export declarations with the new Customs Declaration Service (CDS) will make it incumbent on UK businesses to hold the relevant data to facilitate communications with the new system.

For businesses that trade in goods that have a short shelf life this could be crippling. For everyone else, goods held up at customs are goods that are not generating revenue, and therefore contingency plans will be key in such cases, particularly, if there is to be sufficient cashflow to meet their business expenditure.

HMRC is under pressure to upgrade their systems in order to cope with the expected fivefold increase in customs declarations.

It will be a colossal challenge to be ready in time for the end of the transitional period, and not unlikely that HMRC will experience short-term problems with their systems and procedures.

All of this means there may be a transitional period where businesses could find they are understocked, 'out-of-pocket', and forced to make costly decisions if proper planning is not carried out.

Scenario planning

Scenario planning is useful where a long-term view of strategy is needed and where there are a few key factors influencing the success of the strategy. You will need to assess the validity of your strategy in light of Brexit. The nature of scenario planning means that precision is not possible, but it is important to develop a view of the future against which to evaluate and evolve strategies.

The process is as follows:

1. Identify the key forces which might affect your industry or market, using techniques such as the **PESTEL** analysis
2. Understand historic trends in respect of the key forces
3. Build future scenarios e.g. optimistic, pessimistic and most likely.

What can you do now?

- Conduct a scenario planning assessment
- Consider which of your costs are set to fluctuate and plan how you will mitigate them:
    - Can cost increases be passed onto customers? Do you have any escalator clauses?
    - Can the effects of cost increases be viably mitigated with hedging derivatives?
    - Is there a threat to your staff levels?
- Conduct a review of your supply chain to help understand where there may be weaknesses in light of Brexit
- Assess to what extent you expect sales revenue to be affected
- Assess staffing requirements over a period of 2-5 years
- Consider how cash gaps can by plugged after a loss in funding
- Consider delaying or bringing forward investments/projects
- Consider implementing additional banking facilities now as the future lending appetite can not be guaranteed.

What can we do to help?

Strategic planning is crucial to all businesses. There are three levels of strategic planning: **Corporate, Business** and **Operational.** Where the scenario planning assessment has provided an outlook for your business that raises significant concerns, you may need to reassess the business's entire strategic direction. Our Business Strategy team can help work you through the issues and steer you towards the long term strategic opportunities available.

PESTEL Analysis

PESTEL identifies the factors in the external environment affecting a particular industry. An organisation should focus on the key influences currently affecting its business and those that might become significant in the future. In other words, the key threats and opportunities that arise as a result of the PESTEL analyisis.

Political

- Social welfare policy
- Taxation policy
- Regulations
- Government stability.

Economic

- Globalisation
- Business cycles
- Interest rates
- Inflation
- Unemployment
- Exchange rates.

Social

- Income distribution
- Social mobility
- Education / Health standards
- Population size
- Location
- Age distribution
- Lifestyle changes
- Consumerism
- Attitudes to work and leisure
- Green consumers.

Technological

- Government investments / R&D policy
- New discoveries
- Speed of technological transfer
- Competitor spend (R&D)
- Location
- Transferable developments in other industries.

Environment

- Sustainability
- Pollution
- Green issues.

Legal

- Competition legislation
- Environmental protection laws
- Employment laws
- Government stability
- Consumer protection
- Health & Safety regulations.

Supply Chain Mapping

One of the first action points for businesses is to review their supply chain, mapping out the source of all their raw materials or goods and the movements involved in bringing their product to market. This information enables the business to identify vulnerabilities in the supply chain leading to increased costs post Brexit.

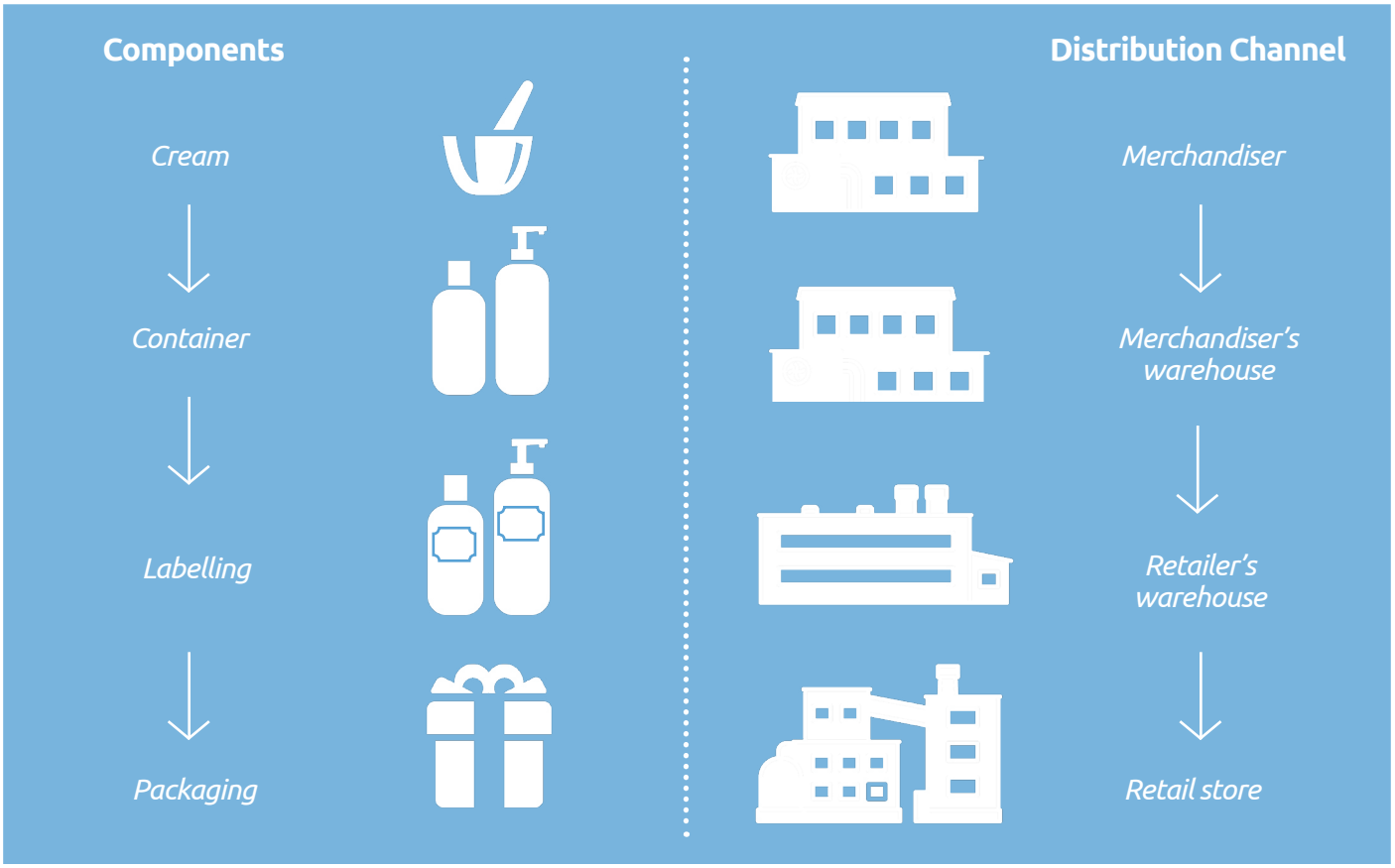
A supply chain map is a graphical representation of your supplier network (or selected supply chains). Maps can either be geographical or an abstract network design, or a mixture of both. Supply chain mapping helps you to document the exact source of every raw material, item of goods, every process and every shipment involved in bringing goods to market.

How do you map out your supply chain?

For larger businesses it may be worth investing in supply chain mapping software. It is the complex nature, or vast international scope of the business that may require this. For smaller simpler businesses the following principles can be applied:

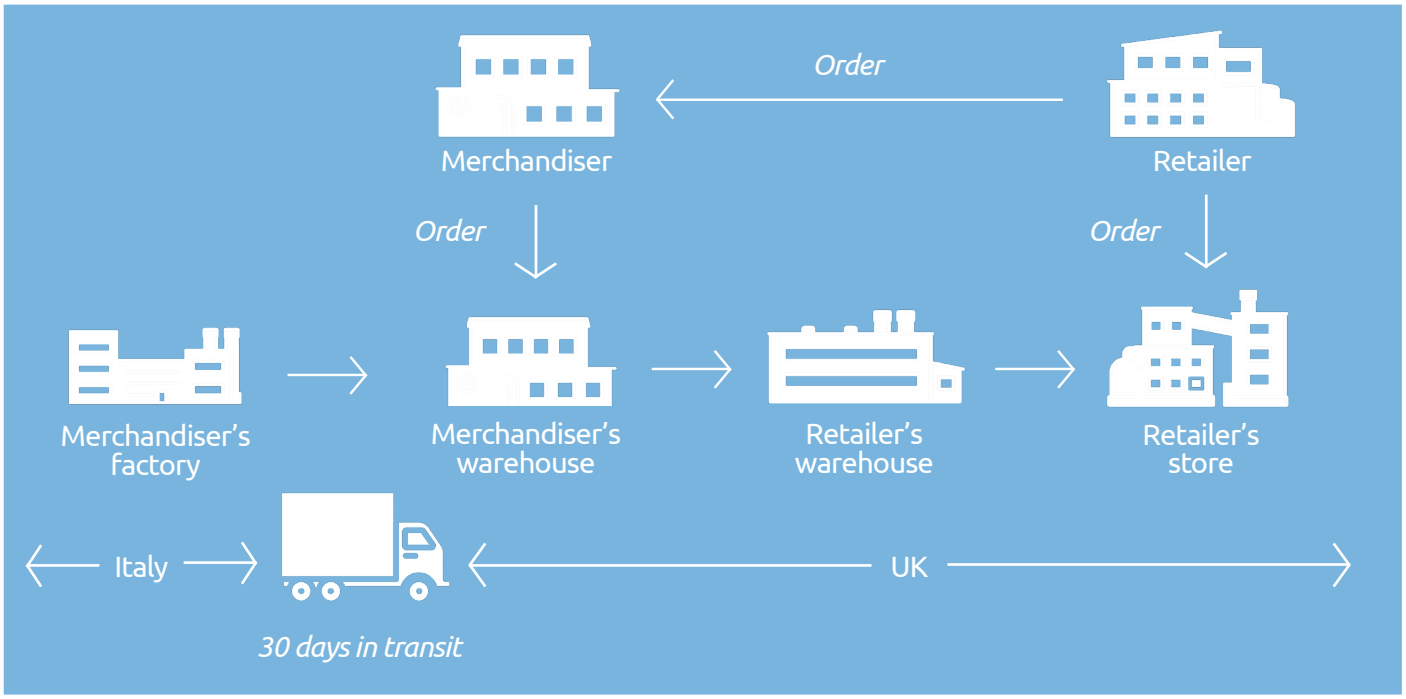
1. Select the product and identify the different components that make up that product
2. Identify the distribution channel – consider upstream and downstream members
3. Add the physical locations and material flows
4. Add information flows.

Case Study: Skin Care Gift Set



Case Study: Supply Chain

This case study demonstrates quite a simple supply chain. Most businesses will have components that are sourced from various countries and mapping this will expose the extent of the vulnerabilities to cost and delays.



What can you do now?

- Assess additional costs identified as a result of mapping your supply chain
- Consider whether these costs could be passed onto customers or suppliers
- Review intra-EU contracts that will not include incoterms (the legal provisions for importing and exporting that define who is responsible for shipping goods across borders)
- Consider renegotiating contracts and using break clauses if you wish to purchase elsewhere
- Plan ahead when renewing or entering into new long-term supply contracts
- Develop contingency plans for holding more stock, use alternative suppliers, increase warehouse space to combat the issue of port bottlenecks.

VAT & Customs Duty

VAT is a European tax. Withdrawal from the EU means that UK VAT law will no longer be governed by the EU VAT Directive. In the absence of an agreed substitute regime, there will be inherent challenges linked to this process, as neither the EU or the UK appear to have made sufficient preparations for the foreseeable change in legislative direction.

The UK will revert to UK domestic law after the withdrawal from the EU, but existing EU laws will be relevant to judicial decisions made before the UK's exit from the EU and to proceedings which were brought about prior to the exit date.

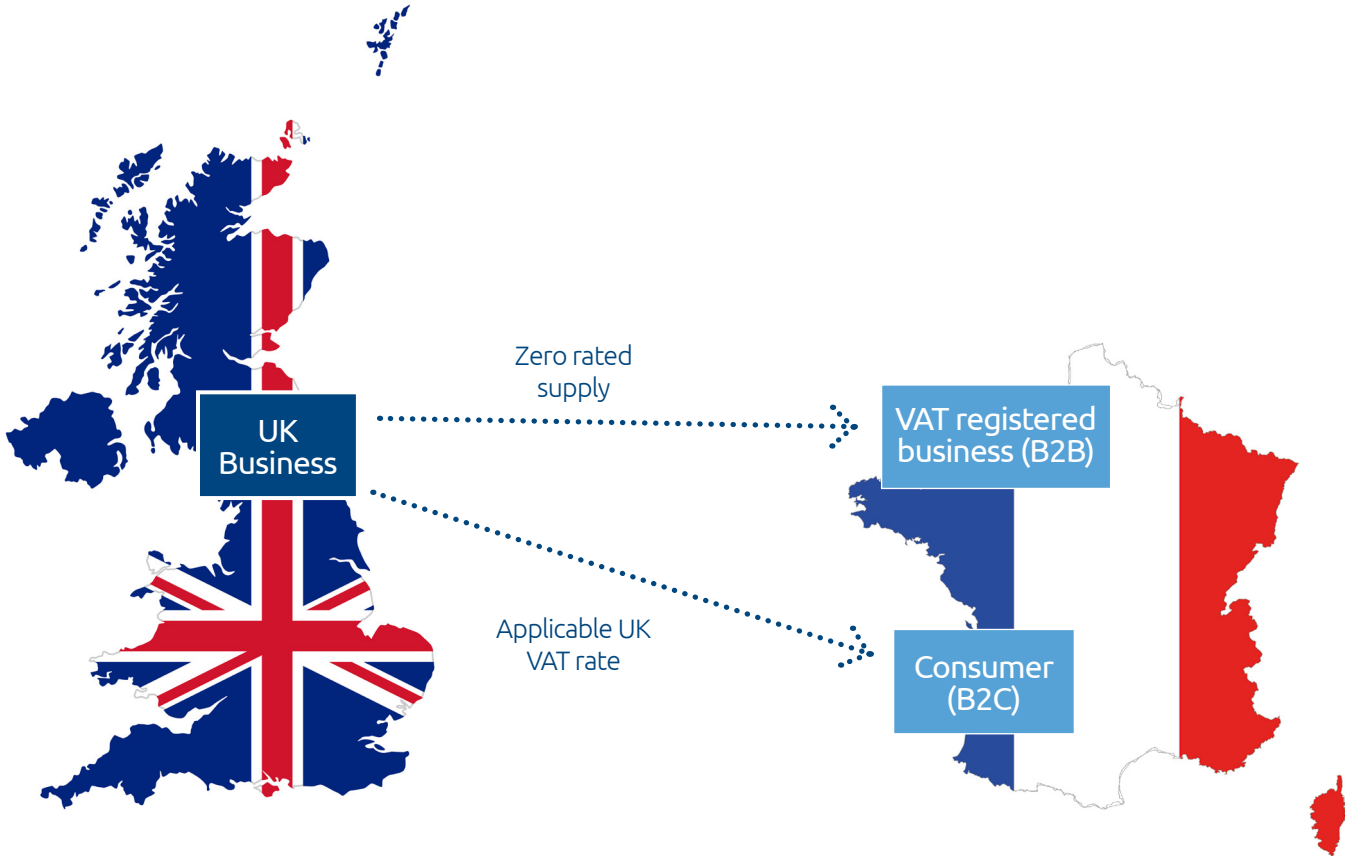
Post-Brexit

VAT raised £160.2bn revenue for the UK Treasury in 2017. Therefore, it is expected that VAT will remain in place as an important revenue raiser for the Government, but the UK will have more autonomy to set VAT rates. On a positive note, more zero-rating may emerge, and conversely VAT may be raised above 20% to soften the economic impact of the Brexit process and to generate additional revenue.

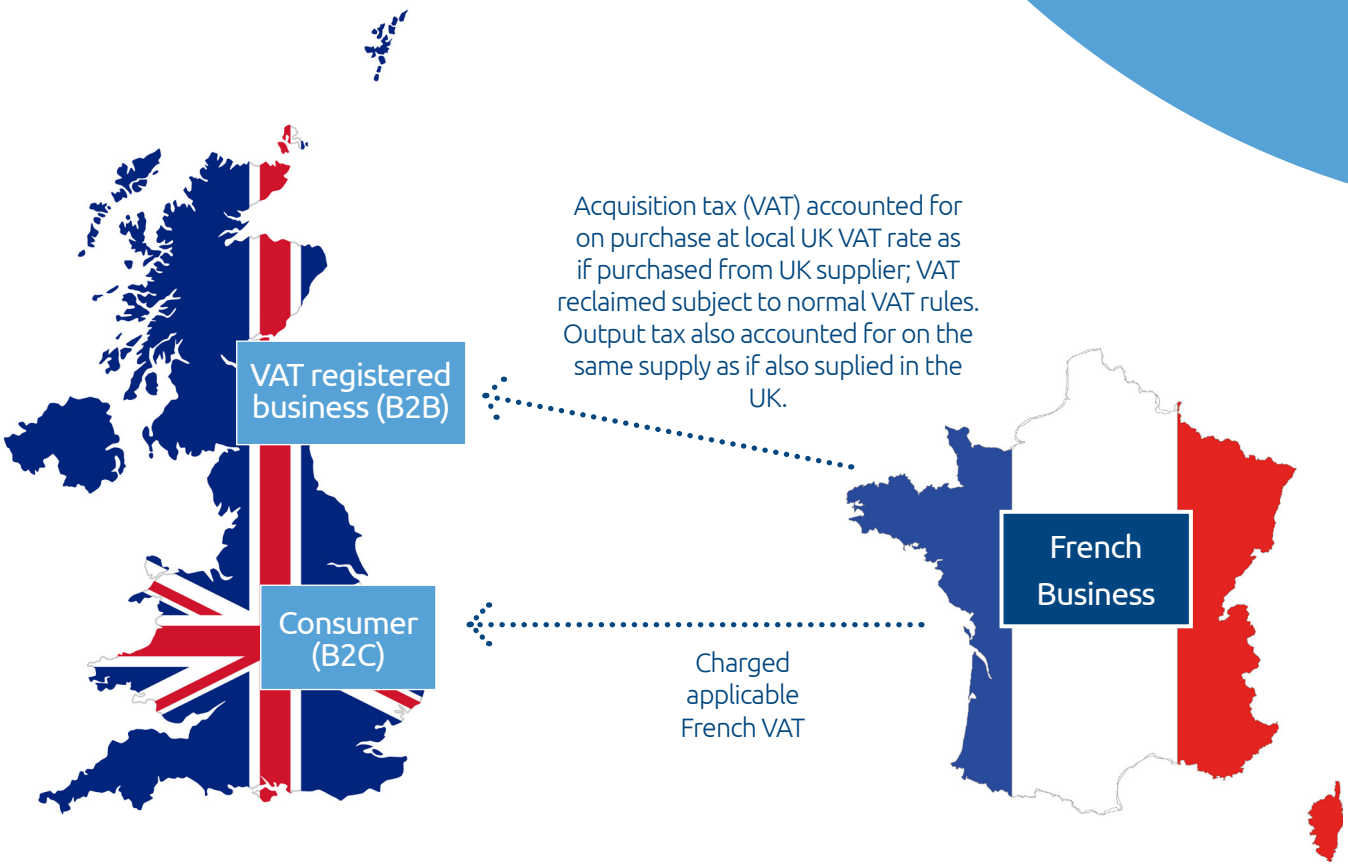
UK traders looking to send their goods to the EU currently complete forms such as EC Sales Lists (ESLs) and may submit Intrastat declarations (SDs) once the value of their goods exceed certain thresholds. At present, these goods move across borders without long delays, onerous checks or additional costs. Trade passes freely between member states and goods sent to other member states are referred to as dispatches, whereas goods purchased from other member states are referred to as arrivals.

However, post-Brexit goods coming into the UK from the EU will then be called imports and goods going out of the UK to the EU will be called exports.

The current EU dispatch system



The current EU arrivals system



VAT

The biggest VAT impact will be the change to Intra-EU trade.

At the moment business to business transactions are zero-rated for VAT purposes. Post-Brexit, such sales will be imports into the EU and subject to EU VAT, which has a number of potential consequences.

On the plus side, there will be no more Intrastat or EC sales lists for UK businesses to complete.

Businesses are urged to consider the following points:

- Will it be necessary to consider VAT registering for VAT in the EU country to which the goods are being imported? This may particularly be the case if your customer does not want to be the importer of record, when goods are being imported
- There will be increased freight agent costs of arranging imports and exports. There will be a requirement to enter and clear goods and it is estimated this could cost €4bn for UK business
- Whilst UK businesses should still be able to recover VAT on overseas expenses the system is paper based and is a more onerous and lengthy procedure.

Brexit poses a cash flow problem for businesses, because VAT will be charged at the border when importing goods and services. Importers will normally be liable to import VAT at 20% although this will largely be subject to the type of goods being imported. Cash flow problems will be compounded for businesses that need to hold additional inventory in order to deal with the inevitable delays they will experience at borders while goods wait for clearance at customs borders.

What can we do to help?

We pro-actively advise businesses on Brexit planning including contract review and the most effective place to establish an EU supply chain to take advantage of best practice in the EU.

We can assist with local VAT registrations and advise on the most efficient way to deal with recovering VAT on overseas expenses.

Authorised Economic Operator (AEO) status

AEO status is an internationally recognised quality mark identifying that a business's role in the international supply chain is secure, and that their customs controls and procedures are efficient and compliant.

It gives quicker access to certain simplified customs procedures and in some cases the right to 'fast-track' shipments through some customs safety and security procedures. AEO status is for businesses that are actively involved in customs operations and international trade.

The number of UK businesses currently registered as having AEO status is low, and HMRC have seen a big rise in applications with a departure from the single market. The Institute of Export and International Trade has been noted as stating "achieving AEO status is time-consuming and often a daunting exercise".

Facing customs duty for the first time

Should a hard Brexit materialise, the Institute for Government think-tank has said an estimated 130,000 traders will be dealing with customs for the first time after Brexit. This will hold true for businesses that have only ever conducted trade within the EU.

Membership of the EU has meant that customs procedures regulating the movement of goods have not posed a problem for intra-EU trade. Once the transitional period has ended, the harsh reality of lengthy delays triggered by the additional bureaucracy of customs procedures will be pervasive.

If Brexit means that a business will become an exporter rather than a dispatcher, the business must have the appropriate licences (as exports of some goods are controlled) and make export declarations to customs.

Export declarations are submitted electronically via the National Export System (NES). The business will need to have an Economic Operator Registration Identification (EORI) number and register for NES in order to make a declaration. It is possible to use a freight forwarder to make the declaration on the business's behalf which can make exporting simpler and faster where the business is not authorised to make electronic declarations.

Becoming an importer for the first time will involve cash flow issues relating to import VAT, the bottom line cost of import duty and the real live impact of import procedures.

What can you do now?

- Review WTO tariff codes for their intra-EU supply chains, to consider the worst case scenarios
- Review customer contracts for delivery terms i.e. are your goods Delivered Duty Paid (DDP), this means that you as the supplier are responsible for any Duty chargeable rather than the customer
- Consider if your customer will act as importer of record
- Establish the VAT rate of the countries you trade in
- Discuss the future structure of the business – could an EU subsidiary be established in the medium term
- Review supply chains and look at where goods are sourced from
- Review transport costs and providers
- Consider applying for a duty relief scheme such as Inward Processing Relief, which gives relief from VAT and customs duty for goods imported into the UK for processing and then exported back out of the UK
- Pro-actively consider AEO status and apply as soon as possible if it works for your business.

What can we do to help?

Our customs duty experts have unrivalled experience with the AEO system and can advise you on all the customs reliefs and procedures available to your business.

We can help you to future-proof your business to deal with the demands of Brexit.

Practical Preparations

The shape of any future Brexit deal between the UK and the EU remains unclear. According to research from the ICAEW, only 29% of UK businesses have been able to plan for Brexit and just 43% have held meetings to discuss the risks and opportunities.

Your supply chain includes suppliers based in EU member states

UK companies importing goods from the EU will be adversely impacted by changes in customs procedures and the imposition of import tariffs. Even if your own business does not import goods, it could be easy to be complacent about any action that needs to be taken. It is possible, however, that some of your suppliers import from the EU resulting in them incurring extra costs which they may seek to pass onto their customers.

VAT is also an important consideration. Import VAT will need to be paid at the time the goods enter the UK, and such VAT can be recovered by entering the VAT onto the next VAT return. VAT is normally recoverable subject to the normal rules, but this presents businesses with a cashflow issue. Businesses may wish to consider applying for the Duty Deferment Scheme, which allows for VAT to be paid in arrears, but requires a guarantee undersigned by the importer's bank.

Your company exports to markets in the EU

A customs border between the UK and the EU will probably mean new costs mainly in the form of duties. These costs can and should be predicted; for example, the food and drinks industry is expected to see a 20% hike in costs post Brexit, the motor industry 10%, a substantial part of which relates to duties.

This level of erosion in margins can mean the difference between pre-Brexit solvency and post-Brexit insolvency. There are instances where even with no planning or reaction, a business could not be considered a going concern on the basis of its financial standing at this current moment in time.

The business may, however, be eligible for a duty relief scheme. This is a scheme that enables you to pay less (and, in some cases, no) tax or duty on an import. For example, Inward Processing (IP) can be used to get relief from Customs Duty and import VAT on goods that are imported from outside the EU to be processed, and then exported outside the EU or released for free circulation in the EU.

Excise Duty is also suspended when goods are entered into IP. This can represent a significant cash flow advantage for UK businesses.

In addition, UK businesses will need to fill in customs declarations for all goods crossing the UK-EU border and there will be administrative costs associated with this.

What can you do now?

- Consider benefits of opening subsidiary companies within the EU
- Consider employing more staff and/or buying or renting warehouse space within the EU
- Review strategies for the allocation of working capital, currency hedging or tax planning.

What can we do to help?

We can help you understand all the additional transaction costs associated with your existing supply chain and conduct profitability modelling to establish whether your supply chain is still viable under a range of Brexit scenarios. If it is not, we will advise on where changes should be made in order to maintain the cost base.

It may be that the profit margin is so substantially affected that distribution hubs will need to be switched or manufacturing will need to be brought back to the UK. We can assess all of these scenarios with you and advise on the best course of action.

We will consider whether you are eligible for a duty relief scheme. There are multiple schemes that you might be eligible for depending on the intention of your import, what you're importing and where it's coming from.

Contact your local office

Bedford

Equipoise House
Grove Place
Bedford
MK40 3LE
T: +44 (0)1234 268761
E: bedfordinfo@mhllp.co.uk

Birmingham

Rutland House
148 Edmund Street
Birmingham
B3 2FD
T: +44 (0)121 236 0465
E: birminghaminfo@mhllp.co.uk

Canterbury

71 New Dover Road
Canterbury
Kent
CT1 3DZ
T: +44 (0)3330 100 220
E: canterburyinfo@mhllp.co.uk

Chelmsford

Boundary House
4 County Place
Chelmsford
CM2 0RE
T: +44 (0)1245 353177
E: chelmsfordinfo@mhllp.co.uk

High Wycombe

Abbey Place
24-28 Easton Street
High Wycombe
HP11 1NT
T: +44 (0)1494 441226
E: highwycombeinfo@mhllp.co.uk

Leicester

11 Merus Court
Meridian Business Park
Leicester
LE19 1RJ
T: +44 (0)116 289 4289
E: leicesterinfo@mhllp.co.uk

London

New Bridge Street House
30-34 New Bridge Street
London
EC4V 6BJ
T: +44 (0)20 7429 4100
E: londoncinfo@mhllp.co.uk

Maidstone

Victoria Court
17-21 Ashford Road
Maidstone
Kent
ME14 5FA
T: +44 (0)3330 100 221
E: maidstoneinfo@mhllp.co.uk

Milton Keynes

Moorgate House
201 Silbury Boulevard
Milton Keynes
MK9 1LZ
T: +44 (0)1908 662255
E: miltonkeynesinfo@mhllp.co.uk

Northampton

Peterbridge House
The Lakes
Northampton
NN4 7HB
T: +44 (0)1604 624011
E: northamptoninfo@mhllp.co.uk

Peterborough

1 The Forum,
Minerva Business Park
Lynchwood
PE2 6FT
Telephone 01733 568491
E: peterboroughinfo@mhllp.co.uk

Reading

Pennant House
1-2 Napier Court
Napier Road
Reading
RG1 8BW
T: +44 (0)118 950 3895
E: readinginfo@mhllp.co.uk

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