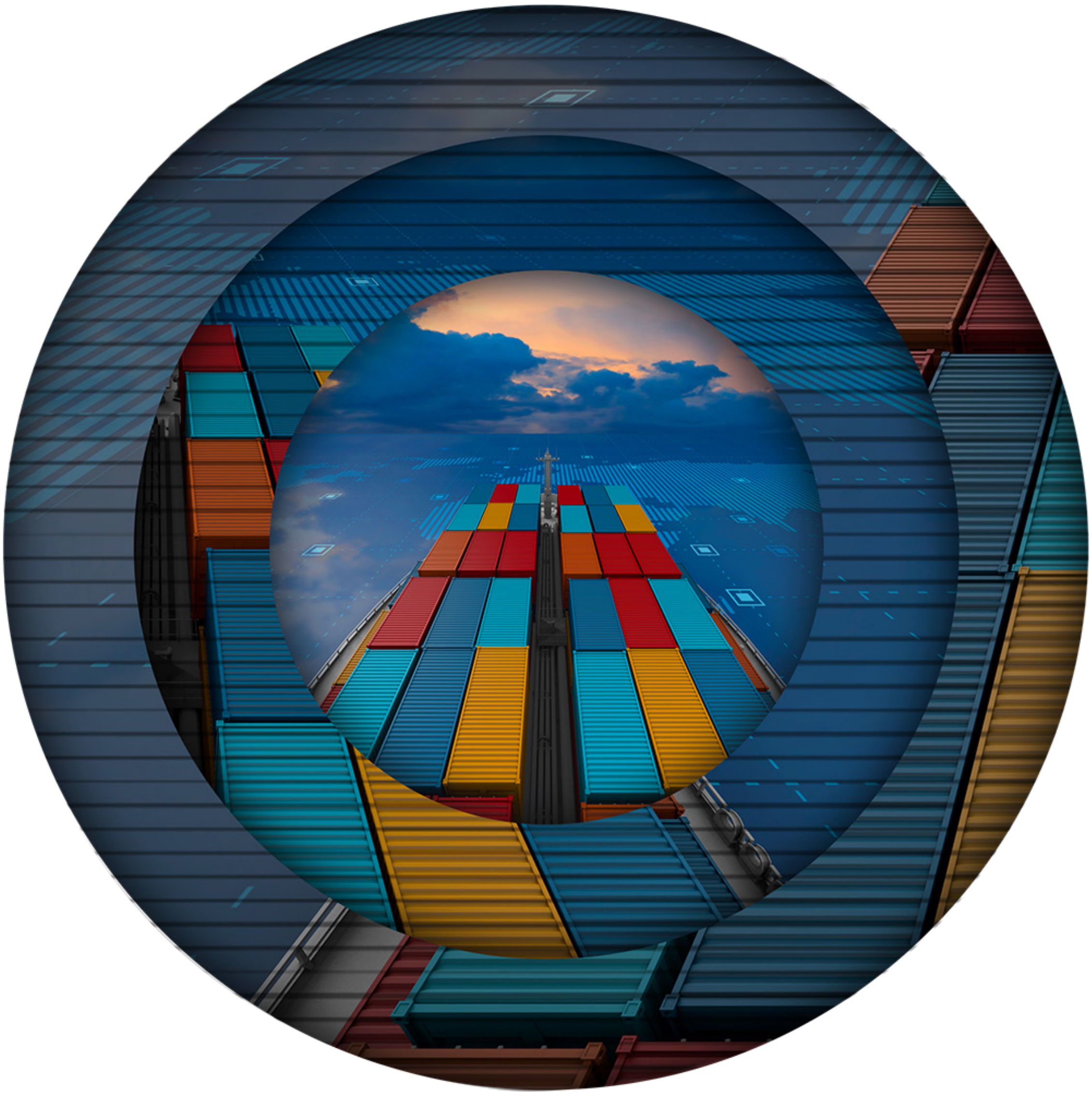

Resilient supply chain strategies

Navigating the impacts of tax policy changes and global trade volatility

APPLY LESSONS LEARNED FROM THE PANDEMIC FOR GREATER RESILIENCE

Business are experiencing fundamental changes triggered by the global pandemic, greater diversification of supply chains, the reset of international tax rules and geopolitical forces shaping global tax policies. This volatility is colliding with profound shifts in customers, business operations, technologies, ecosystems, and workforce. Together it has exposed the vulnerabilities lurking in supply chains. What are the lessons for companies?

Companies that make the right investments to enhance their global supply chains can now build an enduring competitive advantage in the post-pandemic world. **What capabilities should tax leaders prioritize? How can tax leaders manage the risks of global trade to improve trade compliance and product accessibility challenges caused by tax policy shifts changing the geographical flow of goods?**

Resilient organizations will capitalize on opportunities to adapt their business models and processes and strengthen their long-term strategic positions. These efforts require tax leaders to manage the risks of global trade by making investments in resilient strategies, starting with three priorities:

1. Prepare for global trade volatility and its effects on value chains
2. Recognize the international implications of tax policy on global trade
3. Design supply chains that are optimized for resilience and service

In this article, we offer our perspective on how organizations can navigate the tax impacts of global trade volatility to reconfigure and build supply chain resilience.

CONSIDER THE TAX IMPACTS OF DIVERSIFYING THE SUPPLY CHAIN

Prepare for global trade volatility and its effects on value chains

Fierce trade frictions and ever-increasing geopolitical strains, on top of a global pandemic, have to some degree led to higher tariffs, regulatory changes, temporary import/export exceptions and limitations, diminished supplier/vendor capabilities, limited cargo capacity, and/or shortages of products.

For example, US-China trade tensions led to extra tariffs on goods moving between the two countries; at the same time, a shortage of semiconductor chips has demonstrated to policy-makers the possible negative consequences for the economy, especially but not exclusively, the automotive industry. As a result, companies have started to rethink their operations with a view to diversifying their supply chains to minimize trade uncertainties and reduce customs taxes. At the same time, decision makers need to remember that diversification or business model changes can lead to unintended tax costs or presence.

Tax leaders need to be engaged early to analyze potential impacts on a company's tax profile, its transfer pricing policy, direct and indirect taxes and more operationally to consider matters such as the need to update documentation based on the entity of the importer of record, tracking implications on customs duties and registrations, possible duty and VAT relief, and the potential use of free trade zones for the new product flows. See also Deloitte's recently published article on supply chain resilience, which looks at balancing business strategy and tax efficiency.

As part of supply chain transformations, many US companies are considering nearshoring strategies, such as moving production to Mexico to benefit from reduced labor costs and just in time delivery of products. The new trade agreement with the US, Mexico and Canada (USMCA), and tax benefits provided under Mexico's maquiladora regime are also spurring the trend.

PREPARE FOR CHANGES DUE TO SHIFTS IN GLOBAL STRATEGIES AND BUSINESS MODELS

Recognize the international implications of tax policy on global trade

Severe economic stress related to the has pandemic led to a variety of government interventions. Many central banks and governments worldwide took unprecedented policy actions — making significant short-term changes to tax and spending policies and announcing economic recovery packages offering stimulus and new incentives, but this has created increased levels of government deficits and debt. Some jurisdictions now are dealing with the need for extra revenue as they strive to recover economically, while others are looking at additional economic assistance (and debt) to help with the ongoing impacts of the pandemic.

Some governments are considering short-term fiscal strategies to raise revenue, such as increasing tax rates, creating new taxes, broadening tax bases, eliminating wage subsidies and other incentives, and/or taxing previously exempt goods. They are also weighing these options against measures designed to revitalize their economies in the medium- to long-term. For example, stimulus programs and other incentives aimed at business expansion and attracting foreign investment, including programs that incentivize digital infrastructure and operations.

For Deloitte's views on tax policy implications post pandemic, see "A path forward: Five priorities for tax leaders." The uncertainties surrounding countries' future tax policies make projecting tax costs challenging and underscore the need to maintain transparency and flexibility in supply chains. Above all, tax leaders need to be able to scenario plan.

As the future unfolds, businesses need to keep a close eye on geopolitical trends to be ready for the new strategic and operational challenges to come.

New US presidency

The US presidential election and resulting change of administration (along with the shift in control of the US Senate, which gave Democratic control of both congressional chambers and the White House) is expected to generate legislative efforts aimed at readjusting the country's tax burden towards businesses and wealthy taxpayers.

The Biden administration is still in early days of its four-year term, making it hard to know which ideas will make their way into law based on campaign statements. There is an indication that businesses operating in the US can expect a push for increased corporate tax rates (from the current 21% to as high as 28% with a possible 15% minimum tax on book income). Other changes could undo or scale back business-favorable provisions of the 2017 tax reform. For example, to increase the effective tax rate on global intangible low-taxed income (GILTI) to 21%, potentially eliminate the exemption for a 10% return on average adjusted basis of foreign tangible property and calculate GILTI on a country-by-country basis. Individuals can expect proposals for higher taxes on the wealthy, generally defined as those with income over $400,000 USD.

Equally, businesses should be aware of a number of Biden's proposals designed to encourage manufacturing in the US through a combination of tax penalties and incentives.

For additional information from Deloitte US on President Biden's tax policies, see "A change in course: Tax policy implications of a Joe Biden presidency" and "Tax News & Views".

Brexit

The Brexit transition period ended on 31 December 2020. Beginning 1 January 2021, the United Kingdom (UK) operates an external border with European Union (EU) member states (with specific rules applying for Northern Ireland), and a free trade agreement (FTA) between the UK and the EU (For Deloitte's views on the EU-UK free trade agreement, see "Brexit: The EU-UK Trade and Cooperation Agreement."

The UK is no longer part of the EU single market and customs union, and companies that move goods in and/or out of the UK face the following tax impacts of Brexit on their supply chains and related systems:

- Additional customs compliance obligations, including customs declarations (which apply even with the free trade agreement in place)
- New rules of origin and customs duty liabilities
- Import VAT laws and related accounting, including the impact on cash flow
- Additional transfer pricing and exit tax implications

In addition, EU directives, simplifications, and tax reliefs are no longer available to UK companies. These include, for example, the EU interest and royalties directive and parent-subsidiary directive (which affect the withholding tax on interest, dividends, and royalties), EU VAT simplifications such as for distance sales, call-off stock, etc., and others.

As companies modify their supply chains to adapt to the impacts of Brexit, they also must factor in the risk of future pandemic or similar disruptions. In some cases, however, alleviating the impact of one event only intensifies the impact of the other, which may result in the need for multiple supply chains to balance risk. Opportunities may exist where the UK signs trade agreements with countries that do not have an agreement with the EU. For example, the UK is currently negotiating FTAs with the Australia New Zealand and the United States and has formally applied to join the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), the Pacific-Rim trade bloc.

The UK government is also introducing new tax policies that focus on deepening foreign investment, including the establishment of tax-favorable freeports, generous tax breaks on capital expenditure, and other incentives.

CREATING A RESILIENT SUPPLY CHAIN

Design supply chains that are optimized for resilience and service

Business leaders can consider multiple actions to adapt their supply chains to tax policy changes, both those already implemented and those still on the drawing board:

- **Adapt quickly and use data analytics to mitigate risk**
  Resilient supply chains will include models that can adapt quickly to newly imposed tariffs or controls. Advanced data analytics capabilities can help forecast global trade impacts of future disruptive events and help to mitigate supply chain risk.

- **Introduce artificial intelligence (AI) to supply chain**
  Business leaders should consider how new tools and technologies can provide greater insights for decision-making. Consider how to leverage automation to facilitate continuity and assess operations in a cost-efficient manner. For example, using AI, machine learning, or robotics, companies can reduce manual global trade tasks and enhance global trade master data process design by using product control and tariff classification technologies.

- **Model new risks and costs associated to trade and customs issues**
  Resilient tax and trade teams should be prepared to assess the impact on customs taxes of alternative supply chain scenarios as a result of changes to the geographical flow of goods, free trade agreements, and duty-free zones. Additional above-the-line cost of higher duty rates in a new location must be weighed against other benefits, such as more predictable open borders, or greater certainty regarding suppliers.

Businesses should have a strategy to manage customs filings and other administrative requirements which can include:

- Automating global trade document management to avoid non-compliance and corresponding penalties
- Building capacity for electronic customs clearance and the provision of digital customs documents, certificates, and other paper-based evidence, to improve the speed, accuracy, and efficiency of the customs clearance process
- Registering for trusted trader programs where offered
- Using pre-established programs with multiple suppliers

The benefits can include increased transparency, reduced compliance costs, and fewer border delays.

Looking beyond

In an era of rapid change, the future will always remain uncertain. Anticipating and reacting to disruptions and shifts on the tax policy landscape require a resilient global supply chain strategy.

Tax leaders should keep in mind the following four key takeaways:

01

Focus on tax policy developments to evaluate the impact on business plans and reporting. Tax factors are an important part of geopolitical analysis.

02

Analyze multiple operations, and tax and tariff scenarios. Be prepared to provide business leaders with timely and effective input on the tax implications of supply chain decisions so they can make informed decisions quickly.

03

Embrace digital advancements such as AI and modelling/ predictive analytics to reduce manual inefficiencies and reduce supply chain risk.

04

Address new regulatory requirements as they begin to emerge, such as those associated with climate change.

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