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Brexit – what now for VAT and customs?

Now that the United Kingdom (UK) has voted to leave the European Union (EU), it is clear that the exit will require a fundamental review of how indirect tax (including VAT and customs duty) will operate going forward. Amidst this uncertainty, every UK VAT-registered business, and all businesses supplying services or moving goods to and from other member states, need to assess the impact of any potential changes and where possible, put in place plans to manage these changes.

What's the issue?

Following the referendum vote on 23 June 2016, the UK has decided to leave the EU. Exactly when this will happen is not yet known. However, assuming that 'Brexit' does eventually happen, what is clear is businesses that are registered for VAT in the UK and all businesses which supply services and move goods to or from the EU will be affected by the change.

For over four decades, the UK's VAT system has been governed by EU VAT Directives. It is entirely possible that, post-Brexit, the UK's VAT law will continue to mirror what has gone before but it is also possible, given that would no longer be tied to the EU, that the UK could decide to completely revise the VAT system.

It is possible that such a revision could cause uncertainty for businesses.

What will change?

VAT

From a VAT point of view, if the UK decides to retain a system which mirrors the existing EU VAT system, it is anticipated that very little may actually change. VAT will still be chargeable on the supply of goods or services which take place in the UK and there will be exemptions (zero-rating) for cross-border supplies.

The UK is currently bound by EU VAT law contained within both the text of the VAT Directives and unwritten general principles. For this reason successive chancellors have, since the early 1970's had their hands tied. The Brexit vote provides a future chancellor with an opportunity to impose their own will on the UK's VAT system. For example, post Brexit will mean that the UK will be in a position to:

- set its own VAT rates;
- add or remove particular supply of goods or services to the zero-rate, reduced rate or exemption schedule; and
- introduce UK 'place of supply' rules.

Over the last four decades, the UK's implementation of EU VAT law has been required to recognise general principles of EU law such as the principles of proportionality, fiscal neutrality, abuse of rights and legitimate expectation. It is arguable that, in light of an exit from the EU, the UK will no longer be required to adhere to these principles of EU law. As a consequence, the UK will be free to introduce legislation that is not necessarily compliant and UK businesses will see their EU law rights removed.

This will be a concern for example in situations where an existing claim for overpaid VAT is predicated on a basis of claiming an EU law right. Logic suggests that UK taxpayers will be entitled to rely on EU law rights until such time as the UK leaves the EU but not thereafter.

Mini-One-Stop (MOSS) and digital services

In 2015, the EU imposed a VAT package of changes which affected all UK businesses selling telecommunication, broadcasting or electronic services to consumers.

The package introduced a Mini-One-Stop (MOSS) so that affected businesses could account for VAT due in other EU member states through a single UK portal. It is worth noting that similar rules have actually applied to non-EU businesses since 2003. When the UK leaves the EU, it is likely that UK businesses selling relevant services to consumers in EU member states will either have to register for VAT in each member state within which digital services are supplied or register under a non-union MOSS facility administered by another member state.

VAT groups

Following the judgement of the Court of Justice of the European Union (CJEU) in the case of Skandia America some significant changes have been anticipated in relation to the operation of and VAT accounting for UK VAT groups. The judgement in the Skandia case and judgements in other cases highlighted that the UK's VAT group rules were not fully compliant with EU law. Post-Brexit it is conceivable that the UK will ignore the CJEU's rulings and maintain its existing rules.

Similarly, following the CJEU judgement in the case of Larentia and Minerva, Her Majesty's Revenue and Customs (HMRC) has announced a consultation on the impact of that judgement on the UK's law relating to VAT groups. In the circumstances, it is possible that the UK will no longer pursue the consultation and will continue to operate VAT groups for corporate bodies only.

Customs

In the short term, it is unlikely that very much will change in terms of formalities relating to the movement of goods between the UK and other EU member states. However, post-Brexit, it is more likely the UK will be outside the Customs Union of the EU. In that event we will see the reintroduction of customs controls which will have both a time and cost implication for businesses.

Tariffs are not the only barrier to international trade. In fact, non-tariff barriers are often more problematic. At present UK and EU standards are aligned, meaning that it is not possible for the countries within the EU to raise non-tariff barriers between one another. Whilst the standard that the UK products adhere to are unlikely to change overnight, once the UK is outside the EU, EU member states would not be prevented from increasing non-tariff barriers to UK goods. If the UK chooses to introduce different standards, there are also likely to be implications for businesses as goods would need to meet both UK standards for domestic sales and EU standards for sales in EU member states.

Membership of the EU brings the additional benefit of access to a significant number of countries through bilateral Free Trade Agreements (FTA's). While outside of

the EU, the UK would be free to negotiate its own FTA's, the time and resources to achieve such agreements will be significant and dependent on willingness of other countries to negotiate. In the interim and absence of any FTA, third country partners would have no choice but to raise the tariffs on UK goods to Most Favoured Nations (MFN) levels. While some products will be unaffected, exports of certain goods where high MFN tariffs exist could erode the competitiveness of UK exports.

What will change?

Preparing for and dealing with an eventual Brexit starts now. Affected businesses will want to understand what the likely impact of any VAT and customs changes will be on their respective business models, supply chains and profitability.

While no one knows yet the true impact of Brexit, this does not mean that businesses should not begin the planning process now. If your business is registered for VAT in the UK or it involves cross-border trade with suppliers or customers in other EU member states, we strongly recommend that an impact assessment is undertaken as soon as possible.

Each business will be affected in different ways depending on the nature, volume and complexity of the trade. An impact assessment should cover:

- an analysis of the impact of any removal of EU law rights;
- examination of existing supply chains to consider the impact of any VAT and customs changes;
- consideration of any likely changes to UK VAT grouping rules;
- for digital service providers, a review of MOSS and related issues;
- a review of financial and reporting systems; and
- a review of existing customs procedures (imports and exports as well as other customs facilitation measures.)

Conclusion

Unless there is a dramatic 'U' turn, it seems clear that at some point in the future, the UK will leave the EU. From a UK business perspective such a move will not only present many challenges, but will also provide opportunities. The vote to leave will undoubtedly create considerable uncertainty. Businesses affected by Brexit will need to plan for that uncertainty and will need to understand the likely impact. For this reason, an impact assessment should help to provide some clarity.

Contact

If you would like to discuss an impact assessment or if you would like further information, please contact us.

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