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Brexit, the FTA and Tax: a Snapshot

From 1 January 2021, the UK will move out of the transitional period which started when it exited the EU on 31 January 2020. The UK will no longer have to apply EU law, will no longer participate in various EU programmes, and a customs border will spring up between the UK and the EU reflecting the new barriers to free movement of goods, services, people and capital.

The Trade and Cooperation Agreement ("the FTA"), agreed at the 11th hour, establishes a customs duty-free border, a framework for the encouragement of trade between the UK and the EU (based on a level playing field with regard to matters such as monopolies, subsidies, and protectionism of various sorts), and provides for cooperation on matters such as crime enforcement, travel and tax transparency.

In relation to goods and services, each party to the FTA is free to regulate economic activities in its own jurisdiction as it sees fit in order to achieve "legitimate policy objectives" but the FTA contains detailed rules aiming to minimise discriminatory practices. Sometimes these rules are mandatory; sometimes they are written in aspirational terms. The rules vary between different industries and cover matters such as market access, "most favoured nation" treatment, safety checks, licences, recognition of the other party's standards, regulatory certificates and professional qualifications. There is an extensive list of discriminatory practices which each party commits to review. There are very few commitments in the field of financial services.

Various forms of discriminatory incentive such as low social, labour, climate, environmental and competition regulation and cash or tax subsidies are prohibited or discouraged.

Focusing on the tax implications they are, very broadly:

- No customs duties will apply to imports of goods or services "originating" in the other territory (nor will export duties be permitted), noting that goods moving between the UK and the EU which wholly originated in "third countries", or which lose tariff-free origin by incorporating excessive "third country" components, may face duties and quotas. Tariff-free transit is to be provided for. The rules of origin are set out in excruciating detail in the FTA Annexes.
- The EU and UK may each adopt their own rates of customs duty for goods entering their territories from "third countries".
- The UK is leaving the EU VAT system and adopting its own almost identical version of VAT (which may diverge in due course) under which the UK will treat imports/exports of goods/services with the EU in the same way as imports/exports with non-EU countries. This coincides with the introduction in July 2021 of quite important changes in EU VAT (which the UK is copying for the most part from 1 January) in relation to distance supplies, low value consignments and e-commerce. For UK businesses all this will translate into possibly having to register for VAT in multiple EU countries, or their customers paying import VAT more frequently at the border. The UK will continue to apply postponed accounting for imports by UK businesses from the EU and will extend this to imports from outside the EU, but the EU may not offer the same courtesy. Some e-commerce platforms (such as Amazon) will cease to fulfil UK/EU cross-border sales except from stock already in the buyer's territory.
- Special rules for Northern Ireland (NI) mean that it will be part of the UK customs area so UK customs duties will apply to imports (although obviously not on imports from EU countries due to the FTA, or from the UK as it is in the same customs areas as NI). The UK will keep the duty raised but NI Customs will collect customs duty for the EU on goods at risk of moving to the Republic of

Ireland so that no checks are needed at the NI/Republic border (with a refund system if goods stay in NI). NI will follow many EU regulatory rules for goods so that regulatory border checks at the NI/Republic border are not required. NI will be in the UK VAT system except for movements of goods (not services) between NI and the EU (including the Republic) where EU rules will continue to apply (*see our separate note to follow explaining the changes to the VAT regime from 1 January 2021*).

- The loss of the EU Parent/Subsidiary Directive, Interest/Royalties Directive and “four freedoms” (movement of capital, goods, services and people) will result in withholding tax on dividends, interest and royalties paid from certain EU countries (and even some other countries due to some tax treaties reserving benefits to companies resident in EU countries). UK companies will also lose the benefit of reliefs in certain countries on corporate migrations and transfers of shares and assets between members of EU corporate groups, and also loss relief.

For UK businesses in particular, because they will have more countries to monitor, all this will result in increased customs paperwork, costs, VAT compliance and monitoring of and compliance with all sorts of regulation which used not to apply because UK standards and procedures were accepted in the EU. The FTA includes aspirational provisions to try to avoid friction such as standardised documentation, trusted customs intermediaries and so on, but there is no doubt that countries could create trade friction if they wanted to and enforcement action may not be effective. The hardest hit will be businesses which face expensive or time-consuming additional regulatory hurdles, businesses whose products incorporate too much “third country” component material and therefore become subject to customs duties, and businesses which sell in multiple countries and have to register for VAT in all of them.

UK businesses may start warehousing goods for the EU market in the EU and consider setting up EU establishments (to avoid customers having to deal with import complexities and so as to be able to access EU VAT administrative flexibilities such as “one stop shop” VAT registration, and to meet EU non-tax related regulatory requirements).

UK businesses face a new landscape, which may at first seem quite daunting, and it will take some time for the mass of new law to be fully digested. Some general thoughts are as follows:

- EU imports/exports and UK companies within EU groups face increased tax and trade friction but at least the FTA has minimised customs duties.
- Businesses will expect the UK to introduce business-friendly tax and other measures to compensate for the increased costs and burdens caused by loss of single market benefits.
- Will the UK try to create a relatively low tax business environment? - there does not appear to be anything in the FTA to prevent this as long as the tax measures do not amount to subsidies or breach OECD guidelines, but that option was available before Brexit.
- Will the UK modify its tariffs so as to protect areas of UK industry strength and reduce tariffs in other areas?
- Will income tax incentives be introduced, beyond the “non-dom regime”, to encourage highly-skilled workers to come to the UK?
- Will UK businesses, “freed” from EU regulation, gain any competitive advantage?
- In areas such as financial services, will UK businesses be able to offer services adequately or will the EU and individual EU member states pursue their “legitimate policy objectives” by requiring people, capital and resources to be located in their jurisdictions?

We live in interesting times and, given the myriad implications of the new rules which will apply from 1 January 2021, businesses might be forgiven for wishing that this were not the case.

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