

Brexit: Consequences for Trade, VAT and Customs

Forum discussion on the EFS seminar held at the Erasmus University Rotterdam on 2 February 2017

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1. Introduction

From an EU political perspective the result of the Brexit referendum was, without doubt, the most significant event of 2016. Although the United Kingdom ('UK') has not yet formally triggered the process of leaving the EU at the time the seminar took place, Brexit is clearly set to have a major impact on both the UK and the EU.

The consequences from a customs and VAT perspective will depend on the conditions negotiated for Brexit and the future relationship between the UK and the EU. Will the parties, for example, opt for the Norway model for the Switzerland model or for the Turkey model? Or will it be a unique, tailor-made agreement? What are the implications of the various models from a legal, trade and indirect tax perspective? Will the rules on the free movement of goods continue to apply? And what about the rules and regulations on competition and state aid?

During the seminar the three main speakers discussed the various exit models and possible answers to the above questions. These discussions were followed by a lively panel discussion, led by Han Kogels² and examining the implications of Brexit from a corporate, and particularly multinational, perspective.

The seminar was chaired by René van der Paardt³ and attended by over 200 participants from more than ten 10 EU member states.⁴

2. Next steps and scenarios from a legal perspective?⁵

The first speaker was Fabian Amttenbrink,⁶ who set the scene by emphasising that the rapid pace at which events had unfolded since the Brexit referendum currently made it very difficult to predict how the legal relationship between the UK and the EU would be shaped post-Brexit.

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² Han Kogels is a former board member and programme director of EFS, Erasmus University Rotterdam, and a visiting professor at the Erasmus School of Law.

³ René van der Paardt is an EFS board member and programme director of the Post-Master in Indirect Taxes at the Erasmus University Rotterdam, Professor in Sales Tax at the Erasmus School of Economics and also a partner at AKD.

⁴ The seminar sheets are available on:

<http://www.europesefiscalestudies.nl/upload/EFS%20seminar%20Brexit%202017.pdf>.

⁵ An in-depth report on the legal implications of Brexit will be published in: F. Amttenbrink, M. Makakis, R. Repasi, *Legal Implications of Brexit Customs Union, Internal Market Acquis for Goods and Services and Consumer Protection Law. In-depth Analysis*, Study for the European Parliament, Directorate General for Internal Affairs, Policy Department A: Economic and Scientific Policy, forthcoming 2017.

⁶ Fabian Amttenbrink is Professor of European Law and Vice-Dean at the Erasmus School of Law, a Visiting Professor at the College of Europe and a Scientific Director at the European Research Centre for Economic and Financial Governance (EURO-CEFG).

Amttenbrink began by presenting a few facts to the audience. Remarkably, the first time the UK held a referendum on membership of what is now the EU was back in 1975, just two years after the country had joined what was then still the European Communities. Although this earlier referendum was won by the 'Remain camp', various parallels with the recent Brexit referendum can nevertheless be drawn, including the fact that the geographical spread of Remain and Leave voters was largely the same as back in 1975.

The UK parliamentary elections of 7 May 2015 were won by the Conservative Party, partly because of a promise by the then prime minister, David Cameron, to hold a referendum on Brexit. Prior to the referendum Cameron negotiated a 'new settlement' for the UK within the EU, with the idea being, as Amttenbrink explained, that Cameron, as the leader of the Remain campaign, could claim that these negotiations had significantly improved the UK's position and that there was therefore no reason to leave the EU. On 23 June 2016, however, it was those voting Leave who came out on top, achieving a 51.9% majority on a turnout of 72%, in the non-binding referendum. According to Amttenbrink, the Leave voters were primarily driven by socio-economic factors affecting parts of England and Wales and which those voters attributed to EU legislation and the various freedoms associated with EU membership. In reality, however, these socio-economic factors were attributable to political measures, or a lack of them, in the domestic economic and political arena. As a result, Leave voters are highly likely to be disappointed by what Brexit means in practice. Meanwhile the referendum has also triggered fresh debates about the constitutional position within the UK of Scotland, for example, where the majority voted to remain in the EU.

In the first few weeks after the referendum, neither the UK nor the EU – still shell-shocked by the result – gave any indications of the positions they planned to adopt in the negotiations. All that changed, however, on 14 October 2016 when the President of the European Council, Donald Tusk, made the EU's position clear, saying that "The only real alternative to a hard Brexit is no Brexit". In a speech on 17 January 2017, Theresa May, who had by then succeeded Cameron as UK prime minister, announced her intention to sign a 'Comprehensive Free Trade Agreement' with the EU. Amttenbrink saw this as giving some indication on the negotiating position to be adopted by the UK.

The new position of the UK vis-à-vis the EU will clearly have an impact on businesses, residents and the economies of both the UK and the EU, while Brexit will also have consequences for the EU budget. With regard to the latter, Amttenbrink pointed out that the UK is currently the largest net financial contributor to the EU budget after Germany and France. The question, therefore, is whether the EU budget will be reduced post-Brexit or whether other EU countries will have to increase their contributions? Owing to the lack of information on this, and also the lack of insight into exactly what Brexit will mean financially, this question cannot be answered until we know what the position of the UK will be after it leaves the EU.

Amttenbrink went on to explain, using a flow chart, what the process of exiting the EU by triggering Article 50 TEU ('Article 50') will entail. Article 50 will be triggered by the EU's receipt of formal notification from the UK of the latter's intention to withdraw from the Union. It is only after receipt of such notification that negotiations on "[...] the arrangements for its withdrawal, taking account of the framework for its future relationship with the Union"⁷ can begin. From this Amttenbrink concluded that, as well as agreeing on withdrawal arrangements, the UK would also have to reach a

⁷ Article 50(2), TEU.

second agreement during the negotiations on the shape of future trade and other relations with the EU. As the UK will cease to be regarded as a member of the EU two years after sending the notification under Article 50, irrespective of whether agreement on withdrawal has been reached in the meantime, Amténbrink sees prime minister May's plan to send formal notification at the end of March 2017 as highly ambitious, not least given that, in practice, it consistently takes far longer than two years to negotiate trade and other such agreements.

Amténbrink then outlined the possible scenarios for future relations between the UK and the EU. The first option would be for the UK to join the European Economic Area ('EEA'). Although May's previously mentioned speech would seem to suggest that the UK has rejected this option, Amténbrink believed ruling this option out at this stage to be premature. He noted, however, that membership of the EEA required accepting the principle of free movement of persons and that this could prove to be a stumbling block, given that opposition to this freedom had been one of the reasons driving those who voted for Brexit. Membership of the EEA also requires acceptance of the principles of the internal market, as well as the associated policy measures. Similarly, EEA members have to interpret EEA measures that are identical to EU legislation in accordance with the relevant Court of Justice ('CJEU') case law. A disadvantage of that scenario, from the UK's perspective, is that the UK would no longer be able to influence decision-making within the EU. Additionally, it would have to become a member of the European Free Trade Association ('EFTA'). This option, however, would give the UK autonomy on its agriculture and fisheries, trade, and defence and security policies, while it would also no longer be part of the EU customs union.

A second option would be a tailor-made agreement between the UK and the EU in the form, for example, of a Stabilisation and Association Agreement, an Economic Partnership Agreement, a Partnership and Cooperation Agreement or a trade agreement. Amténbrink drew the audience's attention to the fact that some of these EU agreements are designated as 'mixed agreements' and that these are difficult to negotiate, given that the EU shares competences in these policy areas with the individual member states. In other words, such agreements may have to be ratified both by national and regional parliaments in all the individual member states.⁸ For that reason, too, Amténbrink regarded the idea of negotiating any of the above agreements within the two-year timeframe as highly ambitious.

Lastly, Amténbrink referred to the third option – a 'hard Brexit' – as the fallback scenario, and one in which the UK would revert to the World Trade Organisation ('WTO') rules. The question then arising, he said, is whether and, if so, to what extent the WTO rules will automatically apply to the UK after it leaves the EU.

3. Brexit: Consequences for VAT?

The second speaker, Thierry Charon,⁹ addressed the VAT consequences of Brexit. As he explained, there are two options available to the UK in the event of a hard Brexit. Firstly it could revert to the UK Value Added Tax Act of 1994, with adjustments to align the VAT system more closely with UK

⁸ An example of this is CETA, the trade agreement between Canada and the EU that was approved by the European Parliament on 15 February 2017 and now has to be ratified by no fewer than 34 national and regional parliaments.

⁹ Thierry Charon is a Professor in VAT Law at HUBrussel, a partner at Loyens & Loeff, chair of the European VAT Club and a member of the European Commission's VAT Expert Group.

domestic and foreign policy. These adjustments could include different exemptions and reduced rates or, for example, VAT exemptions being replaced by zero rating. According to Charon, however, it would be advisable to mirror EU legislation in this respect to minimise differences between VAT systems and avoid the possibility of double or no taxation. Secondly, the UK could opt to dismantle its VAT system and possibly replace it by another form of indirect tax. Charon commented in this respect that closer ties with the US could result in the VAT system being replaced by a sales tax (or similar form of tax).

If, despite May's stated intention, the UK opts for membership of the EEA/EFTA, this will not have any impact on the UK's VAT system, given that the EEA Agreement and EFTA Treaty do not contain any provisions on taxation. In this scenario, the VAT system (if retained) would be subject only to the discrimination prohibitions.

If it is decided to opt for a tailor-made agreement, Charon explained, it was unlikely that this would extend to the VAT system. He considered it conceivable from a legal perspective, however, that the UK would seek to remain part of the EU VAT territory and would, therefore, not be regarded by the EU as a third country for VAT purposes.¹⁰ Examples of countries currently enjoying that status include Monaco and the Isle of Man.

As Charon sees it, a continental partnership is not a likely scenario, although he noted that various organisations lobbying on behalf of business seemed to be promoting cooperation along such lines. In this scenario it would be possible for the EU and UK to pursue an intensive form of economic cooperation at an intergovernmental level, while also allowing sensitive issues such as the free movement of persons to be excluded. In all the above scenarios, the legal framework for VAT would also be dependent on other international treaties and agreements, as well as on how customs law is applied and on various economic restrictions and opportunities.

Charon went on to highlight various practical consequences that could create opportunities or, indeed, additional administrative burdens for businesses. These include intracommunity supplies being treated as imports and exports, with the rate to be levied, the applicable border formalities and the audit procedures being aligned with customs legislation of a more stringent nature. The disadvantages of this route include the ending of the right to apply the simplified procedures for 'ABC supplies', as well as cash-flow consequences if VAT on imports cannot be reverse-charged. On the other hand, a benefit would be that the conditions for applying a 0% VAT rate would be more straightforward and simply align with the export return.

Charon then addressed the issue of B2C supplies, stating that the European Commission may have to reconsider its proposed amendments to the place of supply in response to Brexit. This is because once the proposed amendments and Brexit take effect, a UK enterprise will be able to submit a single, centralised return for all cross-border supplies to end users. Given that this opportunity is not available to entities established in the EU, UK enterprises or enterprises established in another third country would be in better position than EU enterprises. This would then discourage them from

¹⁰ Article 7, Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, *OJ L 347*, 11 December 2006, p. 1-118.

becoming established within the EU. Charon made the same point with regard to the MOSS scheme¹¹ and the plans presented in the VAT Action Plan¹² for the OSS,¹³ access to which is denied to an EU enterprise, but will be available to a non-EU enterprise.

Charon also explained that the procedures for VAT refunds will then no longer be governed by Regulation 2008/9/EC,¹⁴ but instead by the Thirteenth Directive.¹⁵ The procedures under the latter are known for being slow, which is disadvantageous from a company cash-flow perspective. He also referred to some practical VAT consequences of Brexit, specifically differences in the interpretation of terms such as 'immovable property' that could arise between the UK and the EU after Brexit. Interpretation differences could potentially cause conflicts relating to the place of supply of services and thus, in certain circumstances, give rise to double or no taxation. Other consequences could include greater difficulty in obtaining a VAT identification number and the need to appoint a tax representative, with all the administrative formalities that this would entail. Double or no taxation could also arise with regard to the application of the fiscal unity rules. Will, for example, the judgment in *Skandia*¹⁶ be followed strictly or not? Another significant question is whether the doctrine established in the *FCE Bank* case¹⁷ will be abandoned in respect of the head office/permanent establishment relationship? And will it be decided to align with the Swiss system? Here, too, the choice to be made by the UK could potentially result in either double or no taxation.

Charon gave a number of examples of opportunities for the UK to remain attractive, from a VAT perspective, at the financial heart of Europe. These include the possibility for UK enterprises to provide advisory services to pure holding companies registered in Luxembourg. Such services are currently liable for UK VAT, without any right of deduction for the holding company. After Brexit, however, such services will not be liable for either UK or Luxembourg VAT. The application of 'actual use' rules in certain countries, including the Netherlands, mean, however, that this opportunity would not be available in these other countries. And that, according to Charon, could distort the business climate for holding companies. Other examples include the increase in the VAT pro rata. Charon referred in that respect to the wider application of Article 169(c), VAT Directive,¹⁸ given that EU enterprises would be entitled to deduct exempt transactions involving supplies to UK customers. Equivalent application of this Article in UK VAT legislation would also create a benefit for financial

¹¹ The Mini One Stop Shop (MOSS) scheme simplifies the system applying to businesses that are liable for VAT in various EU member states and that, in principle, would otherwise have to file separate VAT returns in each of these member states.

¹² Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee on an action plan on VAT: Towards a single EU VAT area – Time to decide (European Commission), Brussels, 7 April 2016, COM(2016) 148 final.

¹³ One Stop Shop (OSS) comprises an expansion of the MOSS scheme, which is currently available only for providers of telecommunication, broadcasting or electronic services to consumers.

¹⁴ Council Directive 2008/9/EC of 12 February 2008 laying down detailed rules for the refund of value added tax, provided for in Directive 2006/112/EC, to taxable persons not established in the Member State of refund but established in another Member State, *OJ L 44*, 20 February 2008, p. 23-28.

¹⁵ Thirteenth Council Directive 86/560/EEC of 17 November 1986 on the harmonisation of the laws of the Member States relating to turnover taxes – Arrangements for the refund of value added tax to taxable persons not established in Community territory, *OJ L 326*, 21 November 1986, p. 40-41.

¹⁶ CJEU 17 September 2014, C-7/13 (*Skandia America Corp. (USA), filial Sverige*), ECLI:EU:C:2014:2225.

¹⁷ CJEU 23 March 2006, C-210/04 (*FCE Bank*), ECLI identifier: ECLI:EU:C:2006:196.

¹⁸ Directive 2006/112/EC, Council Directive of 28 November 2006 on the common system of value added tax, *OJ L 347*, 11 December 2006, p. 1-118.

services providers with high volumes of transactions with customers established outside the UK. Similar (positive) consequences for the pro rata would also be available to enterprises providing interest-bearing loans. If an EU enterprise were to grant such a loan to a UK enterprise, the former would also have the right to partially deduct VAT on general and direct costs.

4. Brexit: Consequences for customs and international trade?

The third speaker, Walter de Wit,¹⁹ began by outlining the existing framework, in which the UK is a member of the EU customs union. The benefits of this membership include the absence of customs duties and formalities within the union. Another characteristic feature of a customs union is a common customs tariff on external transactions. Currently, therefore, the UK is not allowed to set its customs tariffs independently, just like it is not permitted independently to enter into free trade agreements. In both cases, these are competences reserved for the EU. In the event, however, of a hard Brexit, the UK would no longer retain access to the internal market. Instead, its relationship with the EU would be based on the WTO rules, as is currently the case for the EU's relationships with, for instance, the US, China and Japan. It is also possible, however, that the UK and the EU could negotiate a free trade agreement.

Whatever the case, the UK will be a third country in all the above scenarios. Goods exported from the UK to the EU will consequently be subject to customs formalities, while UK enterprises currently playing a distribution role for the EU will no longer enjoy the benefits of preferential agreements that the EU has concluded with third countries or measures that it has introduced unilaterally. This is because one of the conditions in these agreements or unilateral measures is that the relevant goods should have been transported to the EU directly from the country to which the EU has granted preferential treatment. Goods that are first transported to the UK will fall foul of the requirement for direct transport and so may lose the right to favourable treatment when imported into the EU. Although possible solutions are available, De Wit emphasised that these have not always worked in practice.

If the WTO scenario materialises, imports will be subject to 'Most Favoured Nation' tariffs. In principle, then, the EU will apply 'normal' duties to imports from the UK, and vice versa. Preferential treatment will be available only if a free trade agreement or a customs union is agreed. In addition, the UK will no longer have access to the free trade agreements that the EU has signed with third countries. After leaving the EU, the UK will obviously, however, be able to sign free trade agreements with third countries if it wishes. De Wit mentioned, in this regard, that an absence of free trade agreements would hit certain sectors, including the automotive industry, particularly hard.

If a post-Brexit customs union is agreed on by the UK and the EU, a common customs tariff will apply, with the UK simply having to accept the rate set by the EU and having no independent say in the matter. This will also apply to any preferential treatment and free trade agreements; there, too, the UK will not be able to act autonomously and will simply have to follow the policy set by the EU. Furthermore, customs formalities will continue to apply, as in the relationship between the EU and Turkey. It is also very much the question as to whether such a customs union would extend to agricultural products. These products are not included in the customs union agreed between Turkey

¹⁹ Walter de Wit is a board member of EFS and programme director of the Post-Master in EU Customs Law at the Erasmus University Rotterdam, as well as Professor of International and European Customs Law at the Erasmus School of Law and a partner at EY, where he is a member of EY Nederland's Global Trade team.

and the EU; instead, the trade regime applying to agricultural products transacted between the two parties is covered by a special decision.²⁰ As De Wit pointed out, this regime provides for less favourable treatment than the agreement underlying the customs union, given that agricultural products are subject to the 'no drawback rule'.²¹

In her speech, prime minister May implied that imports in certain sectors should receive favourable treatment. Indeed, the UK seems even to have given undertakings to specific sectors in this respect. May has also said that she will be working hard to find partners and agree free trade agreements with them. As she put it, "I'm a promoter of free trade, I believe in free trade." Being in a customs union would mean the UK would not be able to set customs tariffs and enter into free trade agreements autonomously. The question arises, therefore, as to whether a customs union is a probable scenario. And De Wit stated that this, indeed, was unlikely to be the case.

If the EU and the UK were to agree on a treaty comparable to CETA, the UK would retain the right to set its own customs tariffs. On the other hand, customs duties between the UK and the EU would be suspended or at least reduced. The UK would also be able to decide for itself whether to enter into free trade agreements with other countries. In this scenario, the UK would additionally be entitled to apply bilateral cumulation, whereby, in essence, products of EU origin can be regarded as originating from the UK, providing they are subject to further processing in the UK or are incorporated into a product manufactured there. Preferential import duties on goods of UK origin will then be more likely to apply.

De Wit went on to share a number of ideas on Brexit and possible scenarios with the audience. These included his belief that, in view of the apparent contradiction in May's speech – no customs union, but instead regulations very similar to such a union –, it was possible that the UK could seek to remain in the customs union as an interim solution, and that the 'real' Brexit could then relatively calmly be postponed, from a customs perspective, for a further five years. The relationship between the UK and the EU would then be replaced in due course by a free trade agreement, while the UK itself would then have the right to negotiate its own free trade agreements. De Wit described the scenario in which the UK would remain a permanent member of the customs union as unlikely, given that the country would then lack the control it wants to have. From that perspective, he considered that a specific and special free trade agreement between the UK and the EU was consequently more likely to be the preferred route.

²⁰ Decision No 1/98 of the EC-Turkey Association Council of 25 February 1998 on the trade regime for agricultural products - Protocol 1 concerning the preferential regime applicable to the importation into the Community of agricultural products originating in Turkey - Protocol 2 concerning the preferential regime applicable to the importation into Turkey of agricultural products originating in the Community - Protocol 3 on rules of origin - Joint declaration concerning the Republic of San Marino - Joint Declaration, *OJ L 86*, 20 March 1998, p. 1-38.

²¹ Under the 'no drawback rule', parties are not permitted to make simultaneous use of the benefits of special provisions for inward processing and the favourable tariffs available under a preferential measure.

5. Panel discussion

The final hour of the seminar was devoted to a panel discussion led by Han Kogels, with Godfried Smit,²² Werner Engelen,²³ Marlon van Amersfoort²⁴ and Huub Stringer²⁵ as panel members. The audience also contributed enthusiastically and was keen to exchange views with the panel. A number of the points raised are discussed below.

It is currently unclear as to what scenario will shape the relationship between the UK and the EU, and indeed between the UK and the rest of the world, in the years to come. This makes it very difficult for businesses to anticipate the UK's forthcoming exit from the EU. Companies are spending considerable time on business impact studies and continuing to monitor tax developments, while also taking account of the possible impact on IT systems and the prospect of additional administrative requirements. Tax departments are coming under pressure, while the problem for IT departments is that they like to know the changes needing to be made to systems at least a year in advance, and executive boards want to be presented with concrete solutions rather than possible scenarios. The financial sector is heavily focused on whether UK banks are going to lose their EU 'bank passport'.²⁶ And on the question of whether banks will leave 'the City'? Another aspect of concern to businesses is the free movement of persons, and specifically what Brexit will mean in terms of employee migration rights and companies' ability to attract talent to the UK?

It is not only business that are having to anticipate possible scenarios. Government authorities, too, including ministries of finance, are having to make preparations. What impact will Brexit have on the EU budget? What obligations will the UK have to comply with – despite Brexit – under existing agreements? What are the tax implications – also from a legislative perspective – and what about the regulatory landscape for financial services providers after Brexit? These are just some of the issues where government authorities are working with businesses.

Another point arising during the discussions was why Leave voters had been able to win a majority in the referendum. Could it have been an extremely irrational decision by angry citizens who felt their voices were not being heard? And would matters have ever reached this stage if it had been up to businesses to decide? Which country will be the next to seek to leave? And is it now too late to turn back the tide? It was claimed that the political world seemed unaccountable and unresponsive to issues that matter to 'ordinary people'. Parallels could also be drawn in this respect with the 2016 Ukraine referendum in the Netherlands, where politicians were also seen as being out of touch with the population. Where, it was asked, are the politicians and representatives speaking out in favour of the EU and highlighting the benefits it has for citizens? Reference was made to the campaign slogan used in the Netherlands in 2004-2006 to increase public awareness of the EU's importance. The slogan – *Europa. Best belangrijk* (or, in other words, 'Europe: pretty important') – was described as a clear example of the lack of conviction in politicians' efforts to communicate a belief in Europe.

With regard to treaty application and the role of the Court of Justice, the question remains as to what extent Court of Justice (CJEU) judgments will remain applicable in a post-Brexit UK. Possible

²² Godfried Smit is the European Affairs Manager at EVO.

²³ Werner Engelen is Head of Indirect Tax & Customs at Lego Nederland B.V.

²⁴ Marlon van Amersfoort is the EMEA-NL Indirect Tax Advisor at Shell International B.V.

²⁵ Huub Stringer is Head of VAT at ABN AMRO Bank N.V.

²⁶ A banking licence issued in the UK allows products and services to be offered throughout Europe. This situation will no longer apply, however, if the UK ceases to be in the internal market.

breaches of EU law can obviously currently still be submitted to the CJEU as the UK is still subject to and part of the *acquis communautaire*. As part of its plans leading up to Brexit, however, the UK government intends to introduce the Great Repeal Bill to Parliament during 2017. Once adopted, the Great Repeal Act will transpose 'European' laws into national UK legislation. From then on, breaches of EU law will no longer be able to be brought before the CJEU and UK residents will no longer enjoy the benefits of protection under European law. Although the post-Brexit UK will in principle be able to modernise its legislation as it sees fit, the question is to what extent it will manage to do this and whether it will adopt a competitive approach with regard to tax. Can we, for example, expect to see a tax haven being created off the coast of Continental Europe? According to Kogels, this would be a very strange development, given the efforts currently being undertaken to counter base erosion and profit-shifting. Whatever happens, however, "It ain't over till the fat lady sings."