Indirect Taxes and Brexit

Introduction

The impact of a British exit or "Brexit" following the EU referendum on 23 June 2016 has the potential to be wide-ranging for all businesses, and crucially is not easily predictable at this stage. This presents a number of challenges and our article aims to explore some of the wider issues with a focus on indirect taxes.

Legal Framework

A vote in favour of exit from the EU will trigger a secession process – a negotiation about exit terms – that is likely to take several months at least. Until agreement on secession is reached (or, possibly, for two years in the absence of agreement or longer if there is an agreement to extend the period for negotiation), EU laws and treaty obligations continue to have effect.

Article 50 of The Consolidated Treaty on European Union ("TEU") provides a Member State with the right to *"withdraw from the Union in accordance with its own constitutional requirements".* If the UK does leave the EU then a number of rules and regulations could disappear, including but not limited to:

- EU citizenship;
- rights of movement and work in the EU;
- free movement of capital rules;
- supremacy of EU laws – but not to the extent that EU legal concepts have been incorporated into UK domestic law, and almost certainly not with regard to periods before withdrawal;
- EU principles (e.g. abuse principle); and
- ability to seek infraction by Brussels where directly effective rights have been infringed.

However, it is not clear what type of relationship the UK would seek with the EU following Brexit.

Options include:

- Joining the European Economic Area ("EEA") along with Iceland, Norway and Liechtenstein. This grants full access to the single market but contains exceptions for currency, foreign trade, agriculture, fisheries, and fiscal policy. But this option means the UK would still have to follow many EEA laws in respect of the fundamental freedoms of the EU, competition, State Aid as well as harmonised economic law.

- Alternatively, the UK could choose to leave the EEA entirely, seeking to retain full sovereignty over its laws and negotiating bi-lateral trade agreements with other countries. This would lead to a higher level of uncertainty for businesses in respect of their post-Brexit trading arrangements.

In practice, a vote in favour of Brexit is unlikely to result in any immediate changes to indirect tax law, practices and policy. That said, in the longer term, changes are likely to Customs Duty and procedures, Excise Duty and VAT. Indirect taxes such as Air Passenger Duty, Landfill Tax, Climate Change Levy, Aggregates Levy, and Insurance Premium Tax will not be affected directly by an exit from the EU since they are not governed by EU law (albeit they might be affected by wider taxation reviews following Brexit).

It may be that following a vote in favour of Brexit, EU law considerations might have less impact, albeit taxpayers will still be able to rely on the "direct effect" of EU law until the secession process is complete, and potentially afterwards in relation to "pre-secession" transactions.

Indirect Taxes – a perspective

VAT

As a supposedly fully harmonised tax that is currently governed by EU VAT Directives and Regulations, decisions from the CJEU, etc., VAT could be materially affected by secession from the EU. With effect from the date of secession taxpayers will no longer be able to rely on the "direct effect" of certain EU laws and the teleological approach to the interpretation of UK VAT law (which has its origins in the way that EU law is written and interpreted) may be less widely applied. The UK courts will revert to interpreting the UK provisions and might have little regard to decisions emerging from the CJEU (however UK VAT law will still have its roots in EU law which makes it unlikely that the courts and tribunals will simply ignore existing and future CJEU case law when applying UK provisions).

The fact that the UK will no longer have to comply with EU VAT law (on rates of VAT, scope of exemptions, zero-rating, and so forth) will mean that following secession the UK will have more flexibility in those areas. Future governments could consider such changes as the restoration of zero-rating for domestic fuel and power and reinstatement of the VAT relief for energy saving products (changes which were enforced on the UK by the EU commission), or the widening of the insurance intermediary exemption.

In respect of day-to-day VAT matters for businesses, the practicalities of cross-border transactions may change following secession. Invoicing and reporting protocols could be revised in respect of cross-border supplies and certain sectors will potentially see wholesale changes in respect of how they account for VAT. For example, businesses in the travel sector may no longer be required to account for VAT under the Tour Operators Margin Scheme. Suppliers of B2C e-services to the remaining EU countries will have to consider the impact on VAT accounting under the EU's Mini One Stop Shop. It seems probable that even after secession there will be disputes between taxpayers and HMRC over transactions that predate it and where EU law will still be in point (with the potential for the Tribunals and courts to need to refer questions to the CJEU). Plainly, such instances will diminish over time but this is an issue that will need to be tackled in the secession negotiations.

Once freed from the need to comply with EU VAT law, the possibility exists that the UK could embark on a wholesale review of the scope and coverage of VAT. In theory, it could even replace it altogether, possibly with a goods and services tax, a sales tax of some kind or even something like the UK's old purchase tax – collected at the wholesale stage. In saying this, given the global trend towards VAT as the indirect tax system of choice, such a radical change seems unlikely.

Customs Duty

At present Customs Duty is almost entirely governed by EU Directives and Regulations, and duty rates, etc. are set at EU level. Duty collected on imports into the UK is remitted to the EU. Following secession, control of Customs Duty would revert to the UK. This is likely to mean that post exit new UK legislation will be needed to replace the EU Directives, Regulations and Council Decisions that currently govern Customs Duty.

Duty rates that are currently under EU control will come under UK management. Whilst this could lead to changes, with UK duty rates diverging from the EU equivalents, this seems likely to be a longer term process rather than an overnight wholesale change.

Similarly, in the short to medium term Customs and International trade programmes (e.g. the Authorised Economic Operator programme) are likely to continue unchanged, as are other Customs processes such as temporary importation, duty suspension, and so forth.

Perhaps the biggest Customs Duty related change that businesses are likely to see will be the recognition of trade with EU countries as imports and exports. Depending on the outcome of the secession negotiations, this may mean that duty is payable when goods move to and from EU Member States. This, and the related import and export formalities have the potential to result in some impediment to trade.

Excise Duty

Following Brexit EU level influence on Excise Duty would be released. However, since Excise Duty rates are not fully harmonised at present this is unlikely to result in material changes to rates in the UK market.

As with Customs Duty, movements of excise goods between the UK and EU Member States will be treated as imports or exports. Subject to any agreements reached during the secession negotiations, this is likely to mean that such movements will be subject to different procedures than the current "intra-EU trading" rules.

Systems and Controls

It may require considerable planning and resource to implement these changes within the ERP systems and compliance processes currently used by businesses to account for VAT. For example, tax codes and client reference data may need to be thoroughly reviewed and updated and compliance procedures, as well as spreadsheets or automated tools used in the VAT return preparation process, would need to be amended.

In addition, indirect tax managers will no doubt want to participate in strategic discussions within their organisations in advance of a Brexit to evaluate the potential indirect tax impact of any proposed commercial or corporate structural changes. Substantial corporate restructuring may necessitate a wholesale review of the business' indirect tax operating model.

Conclusions

In the short term, few changes are likely to occur while the secession negotiations take place and the scope of future changes might well be dictated by the outcome of those negotiations. However, it is likely that at the very least a Brexit will result in a change to the current indirect tax administration and reporting requirements for cross-border trade with the EU – meaning that businesses should consider their capability to implement such changes now to ensure they can react with suitable pace in the event Britain votes to leave the EU on 23 June.

In the longer term, businesses should monitor developments closely so that they are suitably prepared for any changes as and when they occur. Whilst difficult to predict the long term impact following a Brexit, businesses could encounter a variety of issues stemming from changes to the UK's current indirect tax regime and uncertainty around what aspects of EU case litigation they can still rely on following a leave vote.

Please contact your usual Deloitte advisor or any of our dedicated Brexit team below to discuss the potential implications for your business.

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