The latest changes in the EU-UK Trade and Cooperation Agreement

Indirect Tax

22 February 2022

On 1 January 2022, UK government easements entered Stage 2 of the phased implementation of the UK-EU Trade and Cooperation Agreement. Businesses are still in a constantly changing landscape.

Key Points

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What is the issue?

On 1 January 2022, UK government easements entered ‘Stage 2’ of its phased implementation of the customs elements related to the UK-EU Trade and Cooperation Agreement.

What does it mean for me?

The UK government has also set out a phased plan of new controls that cover a range of regulatory standards and checks for goods entering Great Britain from the EU.

What can I take away?

The post-Brexit indirect tax landscape continues to adjust and 2022 marks the end of previous easements which will affect businesses further.

Since the entry into force of the UK-EU Trade and Cooperation Agreement just over a year ago, two issues have dominated discussions between the UK and EU: fishing licences and the Northern Ireland Protocol. While much of the fishing licences row has been resolved, substantive differences remain around the Northern Ireland Protocol. Trade negotiations with the EU are set to intensify through February. In a positive sign, there has been an easement agreed for the continued supply of medicine entering into Northern Ireland from Great Britain without any need for re-labelling and testing, which was set to expire in early 2021.

Away from the headlines, many businesses have been focused on adapting to the new reality of the rules of trade between the UK and EU. While many of the rules took immediate effect in January 2021, several other easements have ended at different times, resulting in a need for businesses to be aware of a constantly changing landscape.

On 1 January 2022, UK government easements entered ‘Stage 2’ of its phased implementation of the customs elements related to the UK-EU Trade and Cooperation Agreement. The UK government has also set out a phased plan of new controls that cover a range of regulatory standards and checks for goods entering Great Britain from the EU. The aim of this phased approach was to give businesses and organisations more time to plan.

Set out below are some of the ongoing and new indirect tax challenges businesses will face as the new rules come into force.

Customs and keeping goods moving

The Trade and Cooperation Agreement meant that no customs duties are due on goods moving between the UK and the EU, providing those goods ‘originate’ in the UK or the EU for the purposes of preferential origin. In this context, ‘originate’ means the goods must be wholly obtained in, or sufficiently worked and processed in the UK or the EU. In practice, this means that the goods are extracted from the land or the goods have been changed substantially, and there are product-specific rules of origin allocated against each customs tariff classification in the UK and EU tariffs.

These determine the level of transformation and processing required (the rule which needs to be met) to prove that the goods originate in the EU or UK and no customs duty applies. The challenge, however, is tracking the origin of goods, many of which arrive in the UK via complex supply chains.

Disruption was also eased on goods moving between the UK and the EU, as the UK took a phased approach to the implementation of various customs rules which would otherwise apply to goods arriving from a non-EU country. For instance, the UK government implemented an easement allowing some goods to be imported from the EU with a delayed declaration process, which meant the importer had a maximum of 175 days following the goods’ arrival to present a full declaration (although full declarations were required for controlled goods).

This easement changed from 1 January 2022, with full customs declarations now also required for non-controlled goods. In a nod to the nuances arising from the post-Brexit status of the Northern Ireland Protocol, delayed import declarations continue to be available for non-controlled goods moving from the island of Ireland to Great Britain. This easement will remain in place at least until the UK concludes its negotiations with the EU on the Northern Ireland Protocol.

While the UK took a phased approach to the implementation of customs controls, the EU implemented full customs controls from 1 January 2021. Businesses had to submit customs declarations when moving goods from the UK to the EU and approximately £3 billion of UK exports to the EU faced customs duties. The cost was significant but just as important is the increased administration for businesses required to prepare and submit additional paperwork, particularly in the food sector.

Another issue was the application of complex origin rules. Some businesses have chosen to pay tariffs even where rules of origin are met, as understanding the rules and the paperwork requirements were considered too burdensome. According to the UK Trade Policy Observatory, tariffs are still being applied to 26% to 32% of UK exports to the EU that could have qualified for zero tariffs. Similar issues could be exacerbated when goods are moved from the EU to the UK from 1 January under the new requirements.

Moreover, 1 January 2022 saw the end of an easement on preferential origin evidential requirements under the Trade and Cooperation Agreement. From this point, all required suppliers' declarations must be held at the point of issue of Statements on Origin by exporters. This additional administrative burden affects businesses claiming UK/EU Free Trade Agreement preference under the Trade and Cooperation Agreement. Importing businesses will bear consequences if the exporters issuing them with Statements on Origin do not hold supplier declarations (if needed) to evidence that the required rule of origin has been met. Failure to do so could result in significant implications in the form of duty assessments for importers and the removal of the right to issue origin declarations for exporters.

Despite the UK and EU entering a new relationship from 1 January 2021, most of the disruption in relation to goods moving from the EU to the UK was anticipated from 1 January 2022. While the level of disruption in January 2022 from a customs standpoint has not matched that seen in the first month of 2021, more disruption is expected, particularly if full import declarations are required at point of entry for goods moving to Great Britain from the island of Ireland.

A final knock-on effect also applies to businesses seeking support and resources to deal with the new post-Brexit customs obligations. The number of trade and customs-related jobs advertised on LinkedIn in January 2022 was 50% higher than the monthly average for 2021. Where businesses are not seeking support internally, they are seeking support externally. The number of customs brokers listed on the HMRC website in January 2022 was 30% higher in January 2022 than in March 2021, according to EY data.

The post-Brexit VAT landscape

The end of the Brexit transition period marked a significant moment for VAT. Under the Trade and Cooperation Agreement, the UK could adopt its own VAT rules (with the exception of Northern Ireland) for the first time since becoming a member of the EU's VAT single market in 1993.

Northern Ireland, on the other hand, operates a 'dual' VAT regime in line with the Northern Ireland Protocol. In practice, this means that Northern Ireland continues to follow EU VAT rules for goods and UK VAT rules for services.

For EU-GB cross-border trade, particularly in goods, many of the post-Brexit VAT rules hadn't been seen in relation to these supply chains since the 1990s. In high level terms, this meant more paperwork and red tape to move goods across borders to the end destination. Businesses expected to lose access to a number of the EU's VAT easements and inherit more VAT reporting and compliance requirements and that has certainly played out. To help, certain facilitations were introduced by HMRC, such as postponed import VAT accounting, which improved cash flow on imports.

Many businesses opted for a ‘good enough’ trading approach immediately post-Brexit, allowing them to keep trading while meeting new VAT obligations. For instance, obtaining new Economic Operator Registration and Identification (EORI) numbers allowing the movement of goods into and out of Great Britain and the EU, and getting fiscal representatives in place in countries where new VAT registrations were required.

As time moved on, new themes began to emerge around supply chain optimisation whereby businesses looked to reduce additional post-Brexit costs incurred (often from a customs perspective); for example, by using EU hubs to distribute goods. From a services perspective, businesses had to grapple with VAT ‘use and enjoyment’ rules which had not applied to EU-UK and UK-EU supplies pre-Brexit. The unexpected impact here is often in relation to intercompany services such as marketing and advertising costs (depending on country specific use and enjoyment rules) which, post-Brexit, may be liable to tax in the originating country rather than dealt with by the recipient of the services.

Longer-term, it is possible that HMRC and the courts could start to move away from EU case law precedent that it sees as unfavourable. UK law makers may also look at changes to the UK’s VAT system that would not be possible under EU principles. We have already seen this, for instance, with women’s sanitary products and speculation about the potential to reduce the VAT rate on domestic energy bills. Changes are likely to be piecemeal, but the freedom is there to allow it to happen.

Conclusion

The post-Brexit indirect tax landscape continues to adjust and 2022 marks the end of previous easements which will affect businesses further. UK businesses are resilient though and, despite red tape and increased cost, continue to flourish – in part by focusing on the bigger picture.

Brexit and the Covid-19 pandemic have sped up the move to e-commerce business models as a result of changed consumer behaviour. Coupled with tax authorities becoming more digital year on year around the globe, with real-time reporting and e-invoicing just two examples of this, perhaps the key take-away message for all businesses post-Brexit is not only keeping up to date with new Brexit rules, but also on focusing on digital systems wherever possible. This will keep the focus on doing business despite the indirect tax issues.