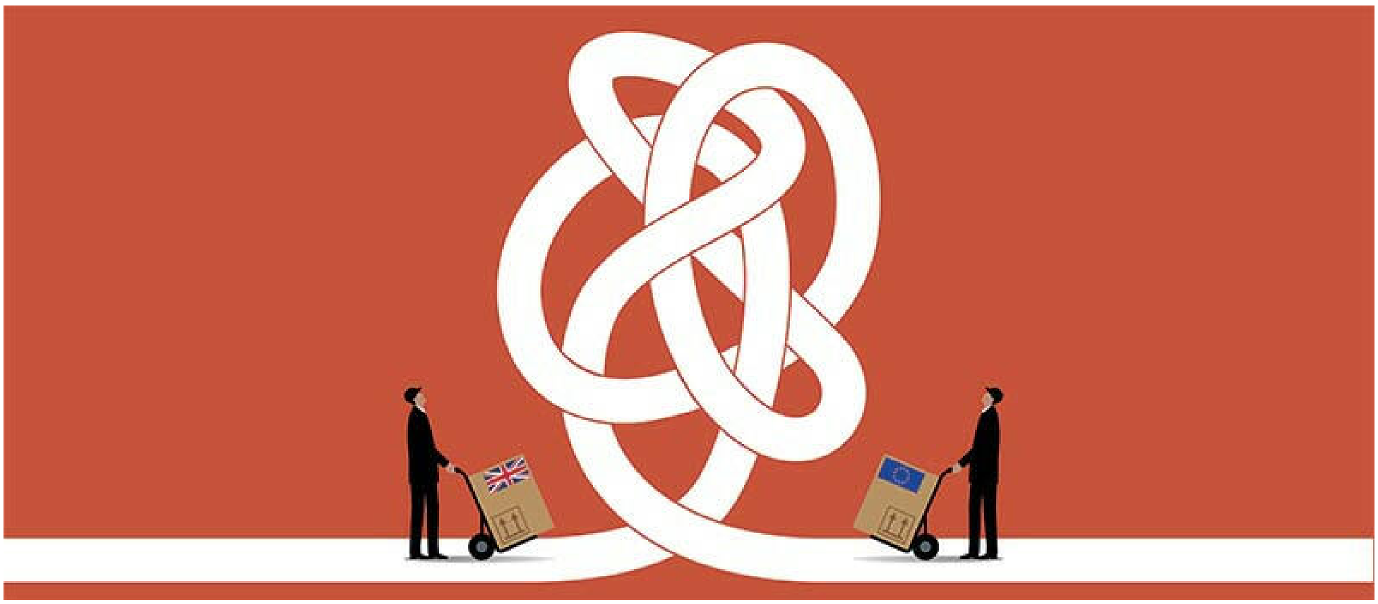
Post Brexit trade: the changes to tax on importing and exporting goods and services

Indirect Tax International Tax



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In the first of two articles, we examine the changes to tax on importing and exporting goods and services as a result of leaving the EU.

Key Points

What is the issue?

Since Brexit, movements of goods in and out of the UK have been subject to different rules. Other goods issues, such as B2B triangulation, also need to be understood. B2B services are largely unaffected, but B2C goods and services now look significantly different.

What does it mean to me?

As tax advisers, we need to be clear about the effect of Brexit and the implications for our clients for both customs duties and VAT.

What can I take away?

You need to understand how the post-Brexit rules work and that customs duties are now much more prominent in UK/EU27 trade.

Brexit introduced some important changes to the tax aspects of importing and exporting goods and to a lesser extent, services, in and out of the UK.

What I want to do, in these two back to basics article, is to explain the issues and how the processes have changed.

The first thing to understand is that since Brexit, for trading goods with the EU (now EU27) taxpayers now have to engage with customs duties again, as well as import VAT. Before Brexit, movements of goods between the UK and the rest of the EU, were intra-EU movements and no customs duties were in play – it was only acquisition VAT which was levied in the member state where the goods ended up. With trade in goods between the UK and countries outside of the EU, there has been no change and customs duties and import VAT have always been in point.

Before we look at some of the details, let me make a 'big picture' point. Under the World Trade Organisation (WTO) rules, no trading block (which may be a single state like the UK post Brexit, or a group of countries such as EU27) taxes goods on the way out. They all tax on the way in and this means (in order): customs duties first, then import VAT next (I'm not considering excise duties in these articles).

The Trade and Cooperation Agreement with the EU and the origin of goods

At the heart of Brexit is the free trade agreement that the UK now has with EU27. It is called the Trade and Cooperation Agreement (TCA) and this essentially covers customs duties relaxations between the two sides. It does not really deal with VAT issues. These are separate and in simple terms 'hang onto the coat-tails of the customs duties'.

So what does it do? The underlying principle of the TCA is that goods moving between the two parties (the UK and EU27) are not subject to either tariffs (the customs duties charge) or quotas (so many units can come in for free before duty is charged). I call this ‘green channelling’.

There is, however, one incredibly important proviso. The goods must have the right origin; that is, they must come from the right place to qualify. If they do not qualify, then standard customs duties charges apply.

So, goods going from the UK to EU27 must be UK origin goods in order to be ‘green-channelled’ and vice versa. This was very poorly understood by many businesses after Brexit, resulting in goods being held up at the borders whilst the correct duties were applied.

To gain origin, the goods must either be ‘wholly obtained’ (for example, agricultural goods) or ‘substantially worked or processed’ (for example, an imported computer chip being incorporated into an industrial controller and then sold).

So major UK retailers, selling, say, clothes to EU B2C consumers from their UK website would commonly source these garments from China. They would be shipped to the UK from China, where EU safety information and washing instructions would be sown into the garments before shipping them to the EU consumers on sale. Very soon after Brexit, these retailers found that these garments were not UK origin goods and that EU duties were due on arrival into the EU.

This is quite a specialist area and some traders may well conclude that outside help will be required from a freight forwarder or customs duties consultant.

Trading in and out of Northern Ireland

The political problems with the Northern Ireland Protocol are well-known and I will make only the necessary references to it for VAT and duties purposes.

In essence, Northern Ireland wears two hats. The first is that it is part of the UK, so supplies of goods and services between Northern Ireland and Great Britain (i.e. England, Scotland and Wales) are normal intra-UK supplies, and normal VAT applies.

However, when Northern Ireland trades in goods with the Republic of Ireland and other EU member states, it acts like a mini-EU member state. The VAT rules, as ever, relate to despatches and acquisitions, EC sales list and Intrastat reports. This is why up to nine boxes on a VAT return are used by Northern Ireland traders, but only six for traders in Great Britain (the three EU boxes 2, 8 and 9 are not required).

As is well known, the protocol demands that goods from Great Britain to Northern Ireland that are ‘at risk’ of slipping across the border to the Republic of Ireland will have EU duties imposed on arrival in Northern Ireland. This is the Irish Sea border in operation (despite what some politicians promised…).

Goods that are not at risk, so consumed in Northern Ireland, will not be subject to EU duties. Businesses that send goods to Northern Ireland from Great Britain will need to be clear about this process and how goods are declared on the declaration forms.

The relationship between customs duties and import VAT

To understand how this relationship works, let’s look at an example.

A Ltd buys some goods in the USA costing £1,000 sterling equivalent. The cost of shipping the goods to the UK is £200.

The UK General Tariff (UKGT) tells us that the goods are subject to a 5% customs duty. So customs duties are calculated as:

5% of (£1,000 + £200) = £60

This is NOT recoverable. It is a cost to the project and will be either expensed or capitalised according to its accounting treatment.

The import VAT is calculated next. Assuming that this is a standard rated good, import VAT is calculated as:

20% of (£1,000 + £200 + £60) = £252

This is essentially double taxation.

The difference between customs duties and import VAT, however, is that whilst the customs duties are never recoverable, the import VAT is POTENTIALLY recoverable under the normal VAT recovery rules.

There's another post-Brexit point to make: for imports not exceeding £135 into the UK (or its equivalent of €150 going the other way into EU27), no customs duties are charged and only VAT is in point. Those thresholds are per consignment, not per individual item in the box, so the consignment value is key. This is a hugely important threshold and we shall see it in play when we talk about B2C movements of goods that are normally bought on the internet.

How are these taxes paid?

To understand this, you need to remind yourselves that customs duties are paid or at least secured at the border. The import agent or freight forwarder will normally deal with this, but larger businesses may well have their own customs experts on board. They will make the online customs declarations and work out how much customs duties are due.

Customs duties are commonly paid through a process called duty deferment, which allows the duty to be deferred for up to six weeks (depending on when the goods arrive in a month) and then paid, with what feels like a credit card number called the Deferment Approval Number (the DAN).

Before Brexit, import VAT was also covered by the deferment process. Since Brexit, however, a more streamlined and quicker system for the payment and recovery of import VAT has been available, called Postponed VAT Accounting (PVA). It is essentially a choice for taxpayers. The difference between the two systems is timing and cashflow.

Duty deferment

For duty deferment, both the customs duties and import VAT are secured (think paid) at the border. Remember that the customs duties are never recoverable, but the import VAT is potentially recoverable under the normal VAT rules.

To make this happen, HMRC issues paper copies of the monthly import VAT certificates (the C79) which shows what is potentially recoverable. These are the equivalent of invoices and allow the recovery (under the normal input tax recovery rules) on the next available VAT return. However, the importer has effectively lost the use of the cash value of the duties and VAT until the import VAT (but not the customs duties) is recovered on the next VAT return. This could take weeks. In simple overview, this is a pay now and reclaim later system.

Postponed VAT Accounting

Conversely, under Postponed VAT Accounting, no import VAT is secured at the border. The importer, having notified HMRC that Postponed VAT Accounting is being used on the import declaration, takes it all home and deals with the import VAT on the next available VAT return – both output tax liability and recoverable input tax on the same return.

There is no effective paper under Postponed VAT Accounting, but the importer will need to download the pdfs of the import statements on a monthly basis to support the VAT entries. These are:

- Box 7 for the net value of the import (so not including VAT);
- Box 1 for the import VAT on the net value (so output VAT due to HMRC); and
- Box 4 for the appropriate VAT recovery. In many cases, Box 1 and Box 4 will be the same, so this is just a compliance exercise.

Postponed VAT Accounting: an example

B Ltd imports goods where the customs duties are zero (from the new UK General Tariff) and it is a standard rated good. Let’s say that the invoice value is £100.

Postponed VAT Accounting requires three entries on the VAT return:

- The net value of the import (£100) is entered into Box 7 (net value of inputs).
- This is multiplied by 20% and the £20 is entered into Box 1 (output tax).
- Then the importer recovers as much of this £20 as he is entitled to under the normal input tax recovery rules in Box 4.

For many importers, Box 4 will countervail Box 1 and there will be a full VAT recovery on the return, so no effective VAT to pay.

Comparison of the two systems for import VAT

For duty deferment, there is no output tax charge on the VAT return. This is secured at the border (think paid) and the C79 allows the recovery leg to take place on the next VAT return, provided that the importer has the right paperwork (the C79) and the recovery is subject to the normal input tax recovery rules. As we have said, it is essentially a pay now and recover later system.

For Postponed VAT Accounting, both the output tax charge and the recovery are on the next VAT return. So there is a cashflow advantage and no need to wait for a C79.

For taxpayers on the flat rate scheme and who have adopted Postponed VAT Accounting, there is a recent change (from 1 June 2022) that requires the full import VAT to be entered in Box 1, rather than the flat rate percentage applied to the import VAT. Under the flat rate scheme, no input tax is generally recoverable, so no Box 4 countervailing entry is possible. This means that flat rate scheme importers will see a significant increase in their import VAT liabilities (see Customs Brief 3/2022).

In the second part of this article, we will consider B2B triangulation for goods, and services; and B2C services, and goods (OSS and IOSS).