

# Brexit: what might change

## Indirect Tax

### Introduction

On 23 June 2016 the UK population voted for the UK's exit from the European Union (EU). The applicable exit procedure and certain possible legal consequences of Brexit for Indirect Tax will be discussed below.

In the short term, we do not identify material changes for the legal practice. The European law and regulations will remain in force until the negotiations between the EU and the UK have been completed and the withdrawal procedure has come to an end. To which extent European law and regulations will also apply following the UK's exit from the EU, will largely depend on the outcome of the negotiations. One of the fundamentals of the EU is the internal market, allowing for the free movement of goods, services, workers and capital (Internal Market). In this context we note that in January 2017, Prime Minister May announced that the UK will opt for a "hard Brexit", meaning that the UK will no longer maintain membership of the Internal Market, nor accede to any associated status. Instead, the UK will seek a free-trade deal with the EU outside the Internal Market.

### Brexit – background

Since 2007 (Treaty of Lisbon), the EU Treaty offers a Member State an explicit legal basis to leave the EU (Article 50 TEU). Pursuant to Article 50(2) TEU, the UK can start the exit procedure by giving notice to the European Council. The exit agreement will be concluded on behalf of the EU by the Council<sup>1</sup>, acting upon a qualified majority<sup>2</sup> and after having obtained the consent of the European Parliament. The agreement must set out the arrangements for the UK's exit and take account of the framework for the UK's future relationship with the EU. The UK cannot participate in the relevant discussions or decisions of the European Council or Council.

The EU Treaties cease to apply to the UK from the date of entry into force of the exit agreement or, if there is no such agreement, 2 years after the date of notice under Article 50 TEU, unless the European Council, in agreement with the UK, unanimously decides to extend this period. The exit procedure has never been called for and the way forward is full of uncertainties. Apart from Article 50 TEU, no further provisions or guidelines apply.

<sup>1</sup> The Council consists of a representative of each Member State at ministerial level, who may bind the government of the Member State in question and cast its vote (Article 16 TEU).

<sup>2</sup> The qualified majority shall be defined as at least 72 % of the members of the Council representing the participating Member States, comprising at least 65 % of the population of these States (Article 238(3)(b) TFEU).

In the field of indirect taxes, Brexit may have serious consequences. Although the timing and exact consequences are not yet known, we highlight the main VAT and customs issues that might be influenced.

#### VAT

As a result of the UK leaving the EU, it is assumed that the UK will no longer have full access to the European Single Market. Consequently, the **movement of goods** from and to the UK will – from an EU perspective – be regarded as respectively import and export. In most cases, this will lead to more extensive reporting obligations and formalities. For movement of goods from and to the EU, it can lead to pre-financing import VAT (cash-flow disadvantage). Furthermore, supply chains in which the UK is involved may need to be reconsidered.

The Brexit will also impact the VAT position of **financial and insurance service providers**. Currently, financial activities (such as the rendering of loans) and insurance activities performed in the UK, are VAT exempt without the right to deduct VAT on costs. After a Brexit, EU service providers performing these activities to UK companies, will be entitled to deduction of such VAT. In a similar way, EU funds and their UK fund managers and UK merchant banks might benefit a Brexit. **Fund management**, which service is VAT exempt, currently leads to non-deductible VAT on costs incurred by UK VAT managers. After a Brexit, these services remain VAT exempt, but might from a UK VAT point of view be seen as ‘exported’ services and therefore grant a right to deduct VAT on costs. **UK merchant banks** currently treat their services as VAT taxable in the country where the customer is established in order for them to be able to deduct input VAT. That

treatment contradicts the desire of customers to VAT exempt these in order not to incur non-deductible VAT. After a Brexit, UK merchant banks may be willing to treat their services as VAT exempt, as their services to EU customers might be seen as ‘exported’ services and therefore grant the merchant banks a right to deduct VAT on cost.

Service providers active in the field of **e-commerce** (including telecommunication-, broadcasting- and electronical services) which provide their services to UK private customers, may be confronted with separate administration and reporting obligations in the UK. The EU VAT MOSS system (a single EU VAT registration) will not be applicable.

The supply of several other services performed by an EU service provider to a UK private customer can lead to non-taxation of the services, where these are currently taxed with VAT. In general, every business involved in the trading of goods or services to and from the UK will be facing a change in reporting obligations. As a result, administration and **invoicing systems** will have to be amended.

#### Customs

Leaving the EU will in principle imply that the UK will no longer be part of the EU customs territory and new trade arrangements should be negotiated between the UK and the EU likely with the goal to give each other some degree of preferential access to each other’s markets.

Unless otherwise agreed by the UK and the EU all trade in goods between the EU and the UK would fall back to the default WTO Most Favored Nation’s model. Under this

model the UK will no longer have access to the EU Single Market and **EU/UK trade in goods** will be subject to customs procedures and Most Favored Nation's import duty rates whereby the UK will have to establish its own national tariff scheme. The Union Customs Code (UCC) will no longer apply to the UK and as a consequence the UK will no longer benefit from the simplifications foreseen in the UCC, especially those regimes for cross border operations as centralized clearance and the Single European Authorization. It would also be unclear whether binding EU customs rulings such as BTI's and BOI's would still be enforceable in the UK (and vice versa if those rulings were issued by the UK authorities). The UK would obviously no longer be able to benefit from the FTA's that the EU has concluded with non-EU trading partners. As a result of Brexit, **customs guarantees** for UK/EU and EU/UK trade will anyway likely need to be increased. Earlier this year the UK government published a paper on the possible models for [EU-UK relations after Brexit](#). The paper highlights the different alternative options based on existing preferential models that the EU has in place with non-EU trading partners:

- (i) Customs Union model (Turkey): Turkey has a bilateral trade agreement (the so-called Ankara Agreement) and participates in the Customs Union which gives access to the EU Single Market, but only partial as some products remain excluded. Turkey does not benefit from the Free Trade Agreements (FTA) that the EU has concluded with other trading partners;
- (ii) The Norway model: Norway is part of the European Free Trade Association (EFTA) and the European Economic Area (EEA). Norway has (partial) access to the EU Single Market, but is not part of the EU

Customs Union. Preferential duty access will only be awarded based on documentary evidence that the goods comply with the origin rules. Norway does not benefit from the EU FTA's, but EFTA has negotiated its own set of FTA's;

- (iii) The Swiss model: Switzerland is part of EFTA and concluded multiple bilateral agreements with the EU. Switzerland has no access to the EU Single Market, but negotiated (more than 100) individual agreements with the EU covering market access in different sectors. Switzerland is like Norway not part of the Customs Union. Switzerland has no access to the EU FTA's.
- (iv) The South Korea option: South Korea has concluded an extensive bilateral Free Trade Agreements (FTA) with the EU. (Partial) Access to the EU Single Market is subject to obligations. South Korea is not part of the Customs Union which makes all trade in goods subject to customs procedures and preferential access depending on compliance with origin rules. South Korea has no access to the EU FTA's.

### Excises

Another impact of a withdrawal of the UK would be that the Excise Directive will no longer be applicable. **Trade of excise goods** between the EU and the UK will become export or import transactions instead of intra-Community suspension regimes. Above that, the minimum EU excise rates would no longer be applicable for the UK, although that will likely not change a lot since the UK has already one of the highest excise duty rate schemes within the EU. A potential benefit could be that Brexit could open the renewed possibility to shop 'duty free' when travelling to the UK.



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### Export controls & sanctions

The eventual withdrawal of the UK will necessarily have an impact on the trade sanctions and export control regimes. Although the UK won't be bound by Regulation 428/2009 anymore, it will remain a party to the Wassenaar Arrangement. Britain's Export Control Order of 2008 will therefore remain applicable. For **European exporters**, however, the UK will then have to be treated as a non-EU Member, and movements of goods and technology will therefore qualify as "exports". Considering the importance of the British market for the European industries, one may expect that exports to the UK might benefit from the General Export Authorisation (EU001).

As regards the trade sanctions, one should distinguish between the two main regimes, i.e. the one originating from the United Nations and the one of the European Union. The UK will remain bound by the former, although this time directly, as opposed to the current situation, in which the EU acts as an intermediate actor between the UN and the EU Member States. A practical difficulty in this respect may be that the sanctions resolutions of the UN contain often much less elaboration and detail compared to those of the EU. The same appears to be true for autonomous sanctions of the EU. Given their scope of application, they will not bind the UK, neither will they be applicable in its territory. Yet, one can foresee a swift adoption of specific national rules (re)imposing similar (if not more stringent) sanctions.

We will monitor the impact of Brexit very closely and will inform you on any further developments. Should you, in the meantime, have any queries regarding the possible impact of Brexit on your business, please contact your regular contact with Loyens & Loeff.

### What next?

Once the UK invokes Article 50 TEU, the UK and the EU will negotiate the terms of Brexit. It will be a highly political process and the outcome is as yet unclear. Therefore it is of the utmost importance to monitor the developments and the potential impact on your company's position closely. We will keep you informed about further developments.

Please contact your trusted adviser at Loyens & Loeff or send an e-mail to [Brexit@loyensloeff.com](mailto:Brexit@loyensloeff.com) if you have any queries.

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