

Brexit Can be Very Taxing

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What might happen to the UK's VAT system after Brexit? Value Added Tax is held up as the paradigmatic example of the process of harmonisation of tax law in the EU. Even in such a famous tax harmonisation example as this, there is still scope for differences in its implementation between Member States. The UK has exceptions to the current VAT regime, which had been created as a transitional arrangement back in the early 1990s. Even the follow up to the Action Plan on VAT admits that the VAT system in the EU has been based on the transitional arrangements form of differentiation, indeed it is the consequential loss of revenue, including through fraud perceived as a result, which has precipitated the Action Plan itself, 'Today, the EU VAT system is too fragmented and too prone to fraud. As part of its agenda for a fair and efficient tax system in the EU, the Commission aims at rebooting the VAT system to ensure it remains an asset for the future. It has been estimated that putting in place a unified VAT regime in the single market would reduce cross-border VAT fraud by EUR 41 billion', [1] As part of a global move to regulate taxation and reduce opportunities for tax avoidance, seen through initiatives such as the OECD BEPS strategy, the EU are now proposing reforms towards a definitive VAT system, indicating the imperfect degree of harmonisation currently achieved. It has been reported that the UK is taking an "active role" in shaping the EU's VAT regulations expected from 2020.[2] Does this mean that the UK will stay aligned with the EU VAT area after Brexit?

If the UK gets a deal

Obviously, any comment at this stage on what may happen if the UK reaches a deal with the EU after Brexit is loaded with the caveat that it depends on the exact wording of any withdrawal agreement, firstly, and the terms of any agreement on the UK-EU future relationship, secondly, as two separate agreements are foreseen under Article 50 TEU. In its White Paper on the future relationship between the UK and the EU, the UK Government proposes to establish 'common procedures and processes'[3] for VAT on trade in goods, in order to avoid border controls becoming a necessity. No further specificities are provided as to what these may be. It is possible that in order to ensure revenue is

protected, both the UK, and indeed the EU, may therefore be motivated to agree that the UK should remain part of the VAT Information Exchange System (VIES) to enable both sides to track goods entering and leaving their respective territories.

One can therefore speculate that at least a form of continued alignment with significant parts of EU VAT law will be required, hence the Government is reportedly keen to ensure it has its say in the formulation of the legislation in the EU whilst it still has a voice, and depending on the Treaty Article chosen as the legal basis of the reforming measures, a veto.

The 'no deal' scenario

The VIES operates within the EU on the basis of submissions of monthly statements of intra-EU purchases and supplies by businesses. The aim of this system is to allow tax authorities to track goods as they move around the EU, minimising the risk of VAT evasion and removing border controls. Outside the EU, VAT is an import tax where it involves a supply of goods from one country to another, necessitating border controls to ensure payment of the correct amount of VAT by the importer and the payment of VAT refunds only for goods that are actually exported. The UK Government has released 'no deal' technical notices, including on the subject of VAT for businesses. It is foreseen that without a transitional arrangement on VAT, HMRC will not assess VAT liability on any imports at the border. Instead, businesses would account for "import VAT on their VAT return, rather than paying import VAT on or soon after the time that the goods arrive at the UK border".[4]

This default scenario implies, unsurprisingly, that the UK will leave the VIES in the event of a 'no-deal', and it opens up the possibility of diverging from the current EU VAT base and rates. However, one issue with this proposed default arrangement stems from the acceptance of an amendment to the Taxation (Cross-Border Trade) Bill, making it "unlawful for HMRC to account for any duty of ... VAT [that it collects] ... to the Government of a country or territory outside" the UK, unless the Treasury certifies that arrangements are in place for reciprocal taxes to be collected and accounted for, from those outside countries or territories, to HMRC. It is therefore unclear as to whether the Government has effectively bound itself to achieving agreement to, and alignment with, a form of VAT system with the EU more extensive than the default suggests. If so, this may form a restriction on the Government's ability to alter its tax rates and also the tax base to exempt certain items from the application of VAT altogether post-Brexit.

Conclusion

VAT is arguably one of the EU's most influential taxes, as some third countries have chosen to adapt their own systems to something comparable with the EU model. The Government's own 'no-deal' technical notes state that the UK will operate a VAT system after Brexit, as an import tax. The question may therefore become less about whether the UK will have a VAT system after Brexit, and more about how low will it choose to go in setting its rates and how far will it be able to alter the tax base, in the current global regulatory climate of tax avoidance.

[1] Commission 'Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee: On the follow-up to the Action Plan on VAT, Towards a single EU VAT area -Time to act' COM (2017) 566 final

[2] Chris Giles, 'UK Hints at Staying in European VAT Area After Brexit' *Financial Times* (London, 4 June 2018) <https://www.ft.com/content/1de61f96-6736-11e8-8cf3-0c230fa67aec> accessed 25 October

2018.

[3] HM Government, 'The Future Relationship Between the United Kingdom and the European Union' Cm 9593, p18
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/725288/The_future_relationship_between_the_United_Kingdom_and_the_European_Union.pdf accessed 25 October 2018

[4] HM Government Guidance, 'VAT for businesses if there's no Brexit deal' 23 August 2018
<https://www.gov.uk/government/publications/vat-for-businesses-if-theres-no-brexit-deal/vat-for-businesses-if-theres-no-brexit-deal> accessed 25 October 2018.