

**Future UK EU trade: No need for elaborate new tracking systems –
Use existing Customs & VAT Systems**
by Stephen Bush

Paper 8/18 sets out the principles for a ‘Pay-where-you-Enter’ (PWE) UK-EU customs arrangement which:

- (A) Preserves tariff-free circulation of most goods in a future UK-EU Free Trade Area.
- (B) Allows non-EU goods to enter the UK at tariffs set by the UK government, but provides for such goods to pay the EU common external tariff (CET) should they subsequently enter the EU.

Objectives (A) and (B) satisfy the concepts of both the “frictionless trade” idea supported by the Prime Minister and the ‘max fac’ concept supported by those who wish the UK to have freedom to conclude free trade agreements with non-EU countries. This paper sets out the administrative systems for achieving these twin objectives. The key points are as follows.

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I AFTER BREXIT BRITAIN WILL BE A SEPARATE TRADE JURISDICTION

The World Trade Organisation (WTO) recognises only two special trading arrangements between national jurisdictions:

- (a) Free Trade Agreements (FTA)
- (b) Customs Unions (CU)

It doesn't recognise the phrases 'Customs Partnership' and 'Max Fac' as denoting distinct systems of tariffs and regulations peculiar to a specific set of countries. The word "Free" in (a) doesn't mean that all trade is free of duties and tariffs, merely that duties and tariffs between partners in the FTA are lower than between partners and third parties, consistent with WTO rules.

The EU-Korea FTA of 2011 is the first signed by the EU with a major industrial power having a precise schedule for eliminating tariffs, product class by class, mostly over 15 years from 2013.

I.1 EU Customs Union

The EU Customs Union which the UK is presently a member of removes the whole area of external commerce with third parties from the control of member states. In the jargon, the

external commercial relations of member states are an exclusive EU competence. However, the UK is a signatory of the EU-Korea FTA in its own right, so if the UK and Korea agree to continue with the FTA post-Brexit, Britain will need to apply the import duties stipulated there, if Korean goods are to circulate freely in the UK-EU FTA.

I.2 EU member states have a veto on new EU FTAs but Britain would not

Where the EU negotiates a trade agreement with a third party, such as the UK will be, an EU member state does have a veto since every member state has to sign. This gives an individual member state some negative power, as was demonstrated by the refusal at first of Belgium to sign the Comprehensive Economic and Trade Agreement (CETA) with Canada in 2017¹. But for Britain to adhere in some way to the Customs Union without being a member of the EU, as various British politicians have suggested for some reason², would mean that Britain, a country of 66 million people and the sixth largest economy in the world, would have less power over its trading future than Malta, a country of 400,000 people and a GDP the size of Portsmouth.

It would be an unprecedented act of the grossest national folly for Britain to sign up in some way to the EU Customs Union - a system of tariffs and regulation over which it would have no influence, let alone control.

II MOVING TO A UK CUSTOMS SYSTEM WILL NOT BE DIFFICULT

The main thing for UK politicians to do now is to recognise that **out of the EU, Britain will be a separate trade and customs jurisdiction**. But far from coming to the EU-UK negotiations as an independent country like Korea did, up to now the UK negotiators have given the appearance of a supplicant – a wheedling suitor offering, for instance, special arrangements on the UK-Ireland border to appease Irish sensibilities, only for them to be contemptuously dismissed as “inadequate”. This is a particular instance of a general European Commission attitude: “since problems have arisen because of Britain’s decision to leave, it is up to Britain to fix them”.

¹ May 2018, still not fully in force. The Belgian objection was not to do with tariffs, but an inter-regional dispute over ratification powers.

² Large sections of the parliamentary Conservative Party and all of the Liberal Democrats (including the leadership) and the leadership and parts of the Labour Party, are of this view, which is characterised by seemingly ignorance of international and EU trading systems.

II.1 The two alternatives

As noted above, the WTO recognises only two alternative trading arrangements: (a) Customs Union and (b) a Free Trade Agreement (FTA) and since the EU Customs Union flows directly from being a member of the EU, the UK's task is *either* to negotiate an FTA like Korea's, but subject to Rules of Origin (below) with zero tariffs on goods between the UK and the EU, *or prepare for a tariff-based relationship with the EU* like the USA's or Australia's.

II.2 The Rules of Origin Problem

Over the last several months, various proposals for future EU-UK customs arrangements have been floated, but if both objectives (A) and (B) above are to be achieved, the difficulties identified boil down to one thing which is: how can the EU be assured that non-EU goods entering the UK, paying the UK tariff, do not obtain an unfair advantage if they are subsequently exported to the EU, either as whole products or components of another product whilst not paying the EU external tariff. And vice versa for EU exports to the UK. Although it may be expected that UK tariffs will be lower than EU tariffs, this may not apply to product standards, especially in the animal welfare area.

This is a 'rules of origin' problem, a real problem faced by all FTAs. It is the root cause of the Trump administration's dissatisfaction with the North America Free Trade Agreement (NAFTA). Chinese goods are suspected to be entering Mexico at very low or zero tariffs and then by low-cost repackaging as Mexican, being shipped into the USA, avoiding its much higher tariffs on direct Chinese imports.

Proposals for dealing with the Rules of Origin problem in the UK-EU FTA are given in section III of this paper.

II.3 The UK system CHIEF – Customs Handling of Import and Export Freight

CHIEF is one of the world's largest and most sophisticated electronic systems for managing customs requirements at ports and airports. From 1st September to early 2019 it will gradually be replaced by a new Customs Declaration System (CDS). This will do everything that CHIEF does and will calculate and allow payment of duties and import (VAT) taxes on-line. It will

provide the UK with ability to implement new import tariffs easily and also to apply the excise duty rebate system to designated products at their point of export. VAT rebates are obtained through the VAT system, also computerised, by allowing exporters' goods to be zero-rated on proof of actually having left the country, the same stipulation required to rebate excise duty.

II.4 Present Position: Trade with non-EU countries

Post Brexit, imports from and exports to the non-EU world will be subject as now to CHIEF and increasingly CDS. CDS will bring together previous import and export data, including tariffs and import VAT paid by each UK business. CDS will allow businesses to access these data through an individual GOV.UK Government Gateway account. Imported goods will be entered into the VAT system electronically. *There will be no need to change this system post-Brexit*, except possibly to supply physical evidence of duty paid for the benefit of subsequent purchasers or other users of the goods. This could be in the form of bar-codes for smallish products or embedded micro-chips for larger items, both of which alternatives would carry product certification, safety and other information.

CHIEF and CDS include provisions for the re-imbusement of import duties paid, where a non-EU product is exported from the UK within an allowed period of time from original importation.

II.5 Present Position: Trade with EU countries

No import and export customs duties are payable, but a UK trader is not free of form-filling. He has to declare trades to the UK VAT authorities on a form titled 'EC Sales List' in respect of all items³. This same information is passed to an EU outfit called Intrastat. The EU vendor is liable for VAT on the goods listed at UK rates when the transaction enters the UK VAT system. If the UK customer uses the goods to make another product, he can reclaim the VAT paid from the UK system. If the UK buyer is not VAT registered, the vendor has to pay VAT at the rate applicable in his own country – which may have several rates (the Republic of Ireland has four VAT rates) and the UK buyer cannot reclaim it. The records are now entered and kept electronically product by product, each transaction being readily traceable, through the 9-digit VAT number assigned to each registered company. Usually there is a bar-coded identifier on the product

³ On EC forms, imports to EU states from other EU states are termed 'arrivals'. Exports are termed 'despatches'.

packaging, or embedded micro-chips or an indelible stamp which can be cross-referenced for tracing.

III FUTURE CUSTOMS AND TAX ARRANGEMENTS WITH THE EU

While customs issues have attracted most attention among the commentariat, the way VAT is imposed on exports to and imports from the EU post-Brexit, is actually more important because of the sums involved.

For most EU countries VAT in the range 18-25% is a far more important tax raiser than customs duties are. In the UK VAT raises around £120 billion, while customs and excise duties (currently about half are paid to the EU) are around £6 billion. On *industrial goods*, the EU tariff averages about 3%⁴, vehicles being the exceptional outlier at 9.9%. Around 30% are zero-rated. As has been previously pointed out⁵, the UK's net contribution to the EU budget is equivalent to an import tariff on British goods of around 7.5%. Overall then, the import tariff which British industrial goods would face in the event of no agreement on principle (A) is small and more than counterbalanced by tariff revenue from EU exports to Britain.

III.1 Customs Co-operation

It is worth noting that the Korea-EU FTA agreement makes explicit provision at Article 6.13 for co-operation between the parties, including the exchange of customs personnel. It would be a poor thing if the EU and the UK could not manage the same thing

III.2 Decisions needed on VAT applied to UK-EU trade

At present, the UK and EU systems are derived from EU Directive 2006/112/EC and integrated to the extent that common EU rules apply for the charging and recovery of VAT on exports and imports, although the *rates* of VAT charged are very different across the EU.

Post-Brexit the simplest thing to do administratively would be to bring VAT treatment of UK exports to the EU in line with the treatment of UK exports to the non-EU world. Subject to

⁴ EU Agricultural tariffs are much higher, ranging up to 30%.

⁵ See SFB letter in the Times of 16th February 2016.

evidence of having left the country, and the exporter being registered for VAT, this means that *all* UK exports would be zero-rated. *No new VAT systems would be needed*, but there might be some loss of revenue, dependent on the future pattern of exports between EU and non-EU countries. There would be a net *reduction* in business form-filling however.

III.3 Rebate of Import duties paid on goods subsequently exported to the EU

The basic principle of tariffs is that goods are liable for duty when they enter the jurisdiction levying the tariff. Goods entering the UK will therefore pay the UK tariff which may be numerically the same as the EU's Common External Tariff (CET), but probably less than it in future.

Paying the UK tariff and VAT will entitle the product to circulate freely in the UK, but not the EU. If the imported product is food, this pays no VAT in the UK. Long-life products would need to have their import bar-codes record "not for sale in the EU" (NFSE for short).

III.4 Free Circulation of goods in the EU

If a UK non-EU import is *destined for the EU* either as a repackaged product or as part of another product (e.g. a Sat-Nav for installation in a motor vehicle), three options for charging import duty present themselves:

- (i) The part pays the EU tariff at UK entry when it obtains "free circulation in the UK-EU zone (UEZ)" status

or

- (ii) The part pays the UK tariff at UK entry, claiming NFSE status only on its customs declaration. It then pays the balance (CD) of the CET minus UK tariff at entry into the EU

or

- (iii) The part pays the UK tariff at UK entry and the full CET at entry into the EU, claiming repayment from HMRC of the UK import tariff paid and claiming zero VAT rating on proof of leaving the UK.

III.5 No need for new customs system

There are established systems within CHIEF and the new Customs Declaration System (CDS) for handling all three alternatives. It will be for the exporter to make the appropriate entries electronically into CDS identifying his products and his suppliers' imported parts already in the CDS for both duty and VAT purposes.

There are also systems within CDS in place for various types of import duty relief – Drawback, End-Use Relief, Duty Suspension – any of which may be adapted to the exigencies of future UK trade.

III.6 Who receives the tariffs?

The basic principle is that the jurisdiction which levies the import duties collects them for the benefit of its own finances. At present the EU levies the CET on non-EU goods imported into the UK and retains the duties raised (about £2.9 billion in 2016). Of the three options above:

- Option (i) would put the UK in the role of tax collector for the EU and is not recommended.
- Option (ii) would correspond most closely to the basic tariff principle, but the EU receives only a part of the CET.
- Option (iii) would give the EU the full CET, but leave the UK exporter the task of reclaiming the UK duty paid. 'Duty Suspension' is an existing system which would allow this to happen easily without the need to reclaim. Option (iii) is recommended, particularly if Duty Suspension can apply.

IV THE IRISH BORDER ISSUE

While there are several potential customs borders between the UK and the Republic of Ireland (ROI), it is the Northern Ireland (NI)-ROI land border which attracts the most attention. There is in reality no serious trade reason for this.

IV.1 It's a small problem

It is reliably reported⁶ that around 23,000 trucks cross the Swiss-EU borders every day, compared with an average of about 100 crossing the NI-ROI border – mainly on the Belfast-Dublin main road. Over one third of this traffic is accounted for by one firm – Guinness.

As provided for in the CHIEF and new CDS software, customs declarations and VAT payments need to be made on line. The UK systems provide bonded warehouses which are used for non-standard customs clearance issues. Importers of goods to NI may be expected to use these. The Swiss system likewise allows customs clearance at offices throughout the country, remote from the border crossings themselves, with generous time allowed, dependent on whether goods come by truck, rail, air or water.

IV.2 The immigration issue

While barely mentioned, illegal immigration is of far greater concern to the UK authorities. Up to now EU immigration into the UK via the ROI has been very small because of the short road, sea and air links from the EU to the South East of England. When EU nations become subject to UK immigration control, a completely open NI-ROI border will be unacceptable to the UK as the ROI authorities know perfectly well. Britain will need to employ the same technology – cameras, number-plate recognition, as they deploy in England. The ROI must be asked what they intend to do to stop illegal immigration from their territory into the UK.

IV.3 Future of the “Common Travel Zone”

At present this allows unrestricted travel across the British Isles, including the ROI. Since 1992 the ROI immigration authorities have checked UK entry certificates for non-EU nationals⁷. After Brexit, non-Irish EU nationals will become subject to UK immigration control. Will Irish immigration control check UK entry certificates for EU nationals, to avoid Britain having to do this at the Northern Ireland land and Welsh sea borders?⁷ As with smuggling goods, this is an Irish not a British problem.

⁶ Michael Ambühl at a Policy Exchange Meeting on 19th April in London. He is the former chief Swiss negotiator with the EU

⁷ See Chapter 4 of “Britain’s Referendum Decision and its Effects” by Stephen Bush, 2016, available on Amazon or to download at <http://stephenbush.net/>.

V IMPLEMENTATION

Overall a great deal of unnecessary fuss has been generated by various folk with a vested interest in impeding Brexit.

As shown above, the needs of new customs procedures for EU goods trade can be met by relatively few changes in CHIEF and CDS. The costs and difficulties of these have been vastly exaggerated.

The Irish border issue is nothing really to do with trade at all. It is an attempt by the Irish government to use Britain's reasonable desire to reach a free trade agreement with the EU, as an opportunity to pretend that the Irish border doesn't exist, even though there are differences in VAT, income tax, corporation tax which are as great between the ROI and UK as between countries elsewhere in the world. All of these taxes are dealt with on-line in the UK.

The EU's real worry about the Irish border is smuggling goods (e.g. GM (genetically modified) seeds) into the ROI across the border by land, sea and by air. This is an Irish problem, not a British one predominantly. British negotiators need to tell Michel Barnier this, very firmly.

VI TRANSITION

The Pay Where you Enter (PWE) Customs system set out here will allow a smooth transition for the UK from the present system of VAT recording and no customs declarations (CD) for goods traffic between the EU and the UK to a system reflecting the UK's position as an entirely separate trade jurisdiction.

Since all VAT notifications and CDs are now electronic, it is doubtful if there will be much need for physical changes at the ports and airports serving EU destinations, as Britain establishes its part of the UK-EU FTA and FTAs with non-EU countries.

VI.1 Gradual moving away from CET

By the time of Brexit, the UK will have had to draw up its own customs tariff rates by product class and communicate these to the World Trade Organisation (WTO). For sheer practical

convenience, Britain should initially set UK tariffs at the EU CET levels. It can then gradually change to new values on a product-by-product basis. The EU itself will need time to adopt its customs system to receiving (electronically) UK CDs and bring its own VAT treatment of UK-EU trade into line with its treatment of EU-non-EU trade.

VI.2 EU Generalised System of Preferences (GSP)

The UK may wish to continue with some of the trade agreements the EU has signed with third parties. Almost certainly this will include Korea and Canada as referred to above, but the EU also has an elaborate “Generalised System of Preferences” for reducing the CET on goods from certain developing countries. These apply sophisticated “rules of origin” defining the nature and amounts of materials and processing technologies involved⁸ which, again the UK may wish to retain initially.

1st June 2018

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⁸ See for example “Tariffs & Technology” by S F Bush in de Voil’s Indirect Taxation (December 2003), published Lexis Nexis UK.