BY
Fionn Uibh Eachach

Brexit – Indirect Tax Update

In this article, Fionn provides an indirect tax update based on the ongoing negotiations between the EU and the UK and what businesses need to plan for.

Fionn Uibh Eachach is a VAT, Trade and Customs Director with KPMG Ireland. Fionn has extensive experience advising companies and organisations in a range of different sectors on trade and customs issues from both an Irish and international perspective. Fionn advises clients on international trade and cross border operations, Brexit planning, tariff classification, AEO certification, managing trade compliance and import/export transactions.

With less than a year to go to the March 2019 Brexit deadline, we are still no clearer to understanding what the trading relationship with the UK will look like post-Brexit and how much impact Brexit may have on trade and the economy in Ireland. However, the major update that businesses have welcomed is the political agreement in principle on the terms of a transitional period which would come into effect on 30 March 2019 and continue until 31 December 2020.

This is a significant milestone; however, it does not in itself provide legal certainty for transition. While the UK and EU have reached political agreement on many aspects of withdrawal position, including a transition period, these proposals will only be legally certain once ratified by the UK and European Parliaments and the European Council towards the end of 2018. This will require both sides to agree on a number of difficult and as yet unresolved, issues in the coming months, including the particularly sensitive issue of the North/South border on the island of Ireland.

Where are we now?

The ongoing UK position is that the UK will leave the EU Customs Union and the EU Single Market. Under the terms of the conditional transitional period, the UK would leave the EU but would remain within the Single Market and the Customs Union for 21 months post Brexit.

One of the main reasons the UK wishes to leave the EU Customs Union, is so the UK will be in a position to negotiate their own network of free trade agreements with their major trading partners, which includes a comprehensive agreement with the EU – something remaining in the EU Customs Union would preclude as the EU negotiates its free trade agreements on behalf of all EU Member States. Under the terms of the transitional arrangement, the UK will be able to begin the process of negotiating their own trade agreements from 30 March 2019.

However, the UK leaving the EU Customs Union will create a customs border between the EU and the UK, the only land border being the North/South Irish border. It is this North/South border which is now the frontline issue of Brexit. The UK had given certain assurances in the December Phase 1 Agreement to avoid a hard border between the North and South of Ireland. These assurances were set out by the UK to the EU in the form of customs proposals to deal with the border (such as the "customs partnership" for example). However, if recent reports are to be believed, these proposals were refuted by the EU negotiating team as totally unworkable and would put unwarranted additional pressure and onus on businesses trading in and out of the UK.

This has brought the UK remaining in the EU Customs Union back into focus. Theresa May is now coming under pressure from the EU negotiating team to provide a legally binding guarantee that there will be no return to a hard border between the North and South of Ireland, with the UK remaining in the EU Customs Union touted as being the solution. In addition, Theresa May is also coming under domestic political pressure from both houses of parliament and from within her own Conservative Party to change course and for the UK to remain in the EU Customs Union. Over the coming months there are some UK parliamentary votes which could cause difficulty for the UK's position of exiting the Customs Union.

The dilemma for Theresa May is that she needs to resolve the Irish border question while avoiding ripping her party apart.

Continued on Page 38

▶ Continued from Page 37

One potential solution and an alternative model to the UK remaining in the Customs Union, is a free trade agreement to be negotiated between the EU and the UK. The recent agreement reached between the EU and Canada has been mentioned as a basis for what future relations could look like between the EU and UK, but on a more comprehensive scale. Recent reports suggest this could potentially include the form of a customs union membership or customs cooperation with the EU. The detail on what this membership/cooperation would entail or cover remains to be seen, however, in principle this could politically assist Theresa May.

Whilst a free trade agreement between the UK and the EU may reduce or eliminate tariffs it would not remove the requirement for customs declarations, unless a customs union membership forms part of the agreement. In addition, it would not remove the requirement for VAT controls on goods traded between the UK and EU, as neither a free trade agreement or even a full Customs Union would deal with the issue of VAT on goods traded between the UK and EU.

What next for Brexit?

While the announcement of a deal on a transitional period will bring much relief to some businesses, it would be wise to proceed with some element of caution.

While this milestone in negotiations on a transitional period is indicative that both sides favour a transitional period, it is still subject to overall agreement in relation to the UK's withdrawal from the EU been finalised before 30 March 2019. As set out above, there are a number of matters to agree before the transition period can be agreed.

Uncertainty still remains in relation to the final form Brexit may take and the final shape of the Brexit negotiations will ultimately determine the future customs relationship between Ireland and the UK and importantly whether there are customs duties to be paid on goods traded with the UK, whether there are restrictions on certain goods and what form, if any, of customs import and export procedures will apply.

The next round of negotiations take place at the EU Summit in June and this is now a crucial meeting between the EU and UK teams to try and resolve the North/South Irish border in particular. In the eventuality that the North/South Irish border and other matters cannot be agreed, then the risk of a cliff edge Brexit of March 2019 comes back into focus.

"Frictionless Border" and trusted trader status

As set out above, even with a comprehensive free trade agreement, the question of how the much mooted "frictionless trade" will be achieved if the UK leaves the Customs Union remains unanswered.

The UK Government has stated several times that there could be a "frictionless border" between Ireland and the UK post Brexit with technology being extensively used to manage frontier issues including Customs, along with customs authorisations such as AEO (Authorised Economic Operator) or trust trader status as it is commonly referred to. It should be noted that as of yet there has not been much detail on these UK proposals.

The EU customs regime provides some reliefs which can mitigate the potential burden of customs on international trade and facilitate trade between the EU and its partners. The availability of these reliefs should, to some extent, soften the impact of Brexit for some Irish businesses but their application is limited.

Despite the potential mitigation of customs duties with a free trade agreement it is expected that trade between Ireland and the UK will require import and export clearance – which may be far from "frictionless". The cost of border clearance and other non-tariff costs of operating within the customs regime can quickly become costly.

One often mooted approach to assist businesses with dealing with the non-tariff customs regime and lessen the impact of a Customs border is AEO (trusted trader) status.

The AEO authorisation is an EU wide program designed for "trusted traders" who are able to demonstrate consistent quality, compliance and trustworthiness in their supply chain to Customs authorities. AEO status does not eliminate potential tariffs on importation of goods but it can significantly help mitigate non-tariff costs associated with international trade in particular simplifying the importation and exportation process and bringing faster and more efficient clearance of goods at Customs frontiers. Not only may AEO status be of assistance for businesses who trade heavily with the UK, it can also benefit businesses who currently import from and export to countries outside the EU and who wish to streamline their current import processes and procedures.

In Ireland, the application process involves a detailed internal review and documentation of these processes and controls, followed by a Revenue validation of these. Application for AEO trusted trader status requires investment from stakeholders across the business including IT, Customs and finance but the ongoing benefits flowing from AEO trusted trader status can significantly outweigh the initial investment involved.

It is worth noting that investing in AEO, from both a financial and internal company resource perspective, can be significant and it may be more relevant for companies with larger scale of trading in and out of the UK. Applying for AEO is unlikely to suit a small trader with limited or sporadic trade in and out of the UK or even non-EU.

To date over 140 traders across a wide range of areas from pharmaceutical to retail to logistics and technology have availed of AEO status in Ireland. For businesses who do not have AEO status, then immediate consideration of AEO status should be on the agenda of any businesses who regularly trade with the UK and outside of the EU.

VAT

Whilst the Customs Union has dominated the Brexit conversation in terms of tariffs and custom clearance procedures/administration, an additional and less discussed feature is that even if the UK remains in the Customs Union, it would not remain as part of the EU VAT area. This would mean that, as things currently stand and unless changes are made, VAT would be payable on goods moving to Ireland from the UK at the point of importation (and vice versa) which could represent a significant VAT cash flow cost for businesses. Some form of checking the movement of goods traded between the two will be required from a VAT perspective also.

It is safe to assume Brexit, in whatever form, will result in significant administrative burdens and challenges for Irish businesses and will necessitate a substantial investment in infrastructure by businesses and Revenue alike.

Planning for post-Brexit

The announcement of a conditional agreement on a transition period will bring some relief to business trading in and out of the UK but it also focuses the minds that Brexit is real and is happening with the UK likely to leave the Single Market and Customs Union at the latest by December 2020.

Irrespective of the political uncertainty, businesses still need to think to the future. It would not be wise for businesses to use the announcement of the conditional transitional period to defer or cease Brexit planning. Even with the addition of an additional 21 months transitional period, this is a challenging timeframe for many businesses to understand the impact of Brexit, prepare and implement a post Brexit trading strategy. Key areas that businesses need to consider include:

- Quantifying the potential imposition of tariffs on their trade in and out of the UK.
- Quantifying the potential negative cashflow difficulties any import VAT may give rise to.
- Mapping their supply chain and manufacturing footprints, in particular where raw materials or other goods from suppliers are supplied from.
- Reviewing the need for potential customs mitigating strategies such as AEO, customs warehousing or other suspension regimes.
- Reviewing IT and accounting systems to ensure they are capable of being upgraded to deal with identifying import VAT and customs duty tariffs.

It is clear that with Brexit looming, businesses need to be preparing and planning now for the potential changes which Brexit will bring.