

INPUT TAX UNDER POST BREXIT POSTPONED ACCOUNTING

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There is some uncertainty over the mechanism for input tax recovery on EU and non-EU imports of goods following Brexit. Although a welcome relaxation that VAT will not have to be paid at borders on EU and non-EU imports has been announced, how input tax recovery will work remains to be clarified.

The guidance 'VAT for businesses if there's no Brexit deal' published on 23 August 2018 declared that:

“the government will introduce postponed accounting for import VAT on goods brought into the UK. This means that UK VAT registered businesses importing goods to the UK will be able to 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. This will apply both to imports from the EU and non-EU countries.”

It seems to have been assumed by some that the reference to postponed accounting means VAT on all imports will work as it does now for EU acquisitions. The guidance refers to import VAT payable, but is silent on input tax, other than warning that “input VAT deduction rules for financial services supplied to EU may be changed.”

Although there is logic in aligning the rules for EU and non-EU imports, it is not clear whether that is to avoid breaching the principle of non-discrimination under World Trade Organisation principles or a policy decision aimed at easing the burdens of a no deal Brexit.

How Input Tax Deduction Currently Works

There are separate rules for EU acquisitions and non-EU imports.

Reverse charge on acquisitions

VAT due on EU acquisitions must be declared as output tax on the buyer's VAT return. The input tax can be claimed on the same return subject to normal rules on input tax deduction. A fully taxable business which can recover its input tax in full can essentially view the process as an accounting exercise with no real financial impact, unless there are errors in the accounting leading to penalties.

Businesses which cannot recover the input tax in full face real financial cost to the extent there is no entitlement to input tax.

In terms of evidence required for the input tax, the invoice the supplier is obliged to issue must meet the requirements of regulation 29(2)(e) Value Added Tax Regulations 1995.

The Court of Justice of the European Union (“CJEU”) held in *Idexx Laboratoires Italia Srl v Agenzia delle Entrate* (Case C-590/13)

“where the tax authority has the information necessary to establish that the substantive requirements have been satisfied, it cannot, in relation to the right of that taxable person to deduct that tax, impose additional conditions which may have the effect of rendering that right ineffective for practical purposes” (para 40)

The substantive requirements were cited as being “those which govern the actual substance and scope of that right as provided in Article 17 of the Sixth Directive, entitled ‘Origin and scope of the right to deduct’”. The CJEU went on to expand that in relation to intra-community acquisitions, the substantive requirements required an acquisition by a taxable person, that person’s liability for the VAT payable on the acquisition and that the goods in question had to be used for its taxable transactions which followed from article 17(2)(d) Sixth Directive (now article 168(d) Principal VAT Directive). By contrast, the formal requirements were said to “regulate the rules governing its exercise and monitoring thereof and the smooth functioning of the VAT system, such as the obligations relating to accounts, invoicing and filing returns” with reference to articles 18 and 22 of the Sixth Directive. The CJEU held that Idexx could not be denied the right to deduct on the grounds that it did not satisfy the formal requirements laid down by national law; and the right to deduct arises at the time the deductible tax becomes chargeable.

Non-EU imports

The input tax entitlement on non-EU imports arises for VAT “due or paid (article 168(e) Principal VAT Directive). The evidence that is required under UK law is a document ‘authenticated or issued by a proper officer showing the claimant as importer, consignee or owner and showing the amount of VAT charged on the goods’ (VAT reg 29(2)(c)). This is form C79, which is described as the official evidence of VAT paid on imported goods which must be held before VAT on imports can be recovered.

HMRC’s Notice 702 on Imports contains a description of form C79 with an example of the form. Under current practice, the guidance indicates that a form

C79 is issued upon VAT being paid. Some flexibility is granted to taxpayers with non-standard VAT period who can apply for permission to estimate input tax they may claim, but the guidance does not offer that facility to other taxpayers.

Notice 702 also gives guidance that the value for import VAT is their customs value, determined according to valuation rules for customs duties. In addition to the customs value, unless already included in the price, there are additions for incidental expenses (i.e. commission, packaging, transport and insurance costs), customs duty payable on importation into the UK and any excise duty or other charge payable on importation into the UK, other than the VAT itself.

In short, HMRC's intervention is required to get the document needed for input tax deduction. It is understood that in practice as VAT is paid at the border, cash-flow issues should not arise as the C79s are usually issued in time for input tax to be claimed in the same VAT period in which the VAT is paid.

Post Brexit

Firstly, the postponed accounting that is referred to above is for the situation where there is no deal, so it is essentially a relaxation provision to deal with pressures a no deal will place on businesses. There has been no confirmation to date that postponed accounting will be allowed in the event that there is a deal with the EU. Much may turn on what type of deal is secured. If there is a deal, perhaps most importantly there will be a transitional period, currently to December 2020, and these issues would be fleshed out during the transitional period.

In a no-deal scenario, postponed accounting would mean that VAT on EU and non-EU imports would not be accounted for until the VAT return is filed and paid with that return. Under the current regime for input tax allowance on imports, there would be delayed entitlement to claim input tax unless further relieving provisions are introduced to essentially allow input tax recovery on the same VAT return on which the import VAT is accounted for. That begs the question what advantage postponed accounting gives in the absence of further relaxations for input tax because any cash flow benefit of not having to pay VAT at the border may be cancelled by the delay in entitlement to input tax.

It appears that further (secondary) legislation will be necessary to allow input tax recovery on the same VAT return under postponed accounting. The Taxation (Cross-border Trade) Act 2018 ("TCTA"), which received Royal Assent on 13 September essentially aligns the rules on VAT and import duty as follows:

- The liability to import duty is incurred when HMRC accept the customs declaration where the goods are declared for free-circulation (s4 TCTA).

In the case of goods declared for a storage procedure, a transit procedure or an inward processing procedure, the general rule is that import duty is not incurred by reference to the importation of goods and there are special rules for determining when the liability arises. There are also special rules for goods declared for an authorised use procedure or temporary admission procedure.

- VAT will be chargeable on the importation of goods into the United Kingdom. The replacement for s15 Value Added Tax Act 1994 provides that goods are imported when they are declared for a customs procedure under Part 1 TCTA. Again there are special rules for procedures other than declarations for free circulation.
- Taking the provisions together, VAT will be due when the customs declaration is made. Under current VAT reg 29 HMRC essentially have to accept the customs declaration before they issue a form C79. That indicates that input tax entitlement cannot arise without prior HMRC intervention in the accounting process.

Postponed VAT accounting appears to sever the said alignment. Customs declarations will be required for import duty on importation and the duty will have to be paid. VAT would be accounted for through VAT returns. The VAT legislation as amended by the TCTA would need to be further amended to provide for import VAT to be declared on the VAT return. Under the current system, HMRC essentially authenticate what can be deducted as input tax following payment of the VAT and subject to normal rules on input tax deduction. If such HMRC intervention in the process is still considered to be necessary, input tax recovery would be delayed. At its simplest, the VAT would be accounted for in the first return following importation but input tax may not strictly be recoverable until the second return. That cannot be the intention of postponed accounting.

It is understood that the TCTA is meant to cater for a no deal as well as a more orderly Brexit. There are no specific provisions to deal with postponed accounting. In relation to VAT, s24(6)(a) VATA as amended by the TCTA will provide that

“(6) Regulations may provide--

(a) for VAT on the supply of goods or services to a taxable person, [VAT on the acquisition of goods by a taxable person from other member States] and VAT paid or payable by a taxable person on the importation of goods [from places outside the member States] to be treated as his input tax only if and to the extent that the charge to VAT is evidenced and quantified by reference to such documents [or other information] as may be specified

in the regulations or the Commissioners may direct either generally or in particular cases or classes of cases;" (Text in square brackets and italics will be deleted.)

This power should enable regulations to be introduced or existing regulation to be amended to accommodate whatever the government decides in relation to how input tax recovery on import VAT should work. The words "or other information" are helpful, although they were introduced in 2003 to deal with input tax where a trader held an invalid invoice and not with imports.

Section 8 VATA has not been amended in relation to the 'imports' of overseas services. The reverse charge will apply as it does now and input tax recovery would be under current rules under the same VAT return and subject to the normal rules on input tax recovery.

The provisions of the TCTA referred to above will come into force on dates the Treasury appoints by regulations.

The government's white paper on 'The Future Relationship between the United Kingdom and the European Union' published on 12 July 2018 referred to the concept of a trusted trader for whom customs procedures may be less burdensome. There was no indication on qualifying conditions or whether small and medium sized businesses could qualify as trusted traders. Given inherent risks of fraud where tax is not collected at borders or by a supplier, any introduction of preferential rules for 'trusted traders' would discriminate against SMEs which represent the vast majority of businesses. All businesses will need the benefits of postponed accounting. SME's new to import VAT accounting will need all the help they can get.

Given that departure from the EU is going to affect business, deal or no deal, clarity on how postponed accounting, including input tax recovery is essential. Businesses need express clarity. They should not have to rely on EU authority such as Idexx referred to above, even though strictly under the EU Withdrawal Act 2018 there may be scope for claiming such right.

The announcement on postponed accounting for non-EU imports may have created expectations that businesses deserve such relaxation from exit day even if there is a deal with a transitional period, especially if the announcement was policy driven. Although during the transitional period, the status quo would continue, postponed accounting should assist businesses. Article 211 of the Principal VAT directive gives member states the power to permit accounting for VAT in imports in their VAT returns rather than on importation at borders.

Conclusion

The announcement on postponed accounting was welcomed by businesses and they expect it to work in essentially the same way as VAT works on EU acquisitions, both in relation to output tax and the fundamental right to input tax. As part of planning for exit day, the government should urgently clarify how input tax recovery will work.

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