

Analysis

UK/EU tax and customs negotiations: where are we now?

Speed read

The UK draft agreement with the EU envisages a free trade agreement and some additional agreements. The EU draft agreement contains broader provisions establishing a new partnership. The EU provisions on state aid and good tax governance will be unattractive to the UK. It seeks to found its position on international not EU norms. On customs, the UK aims to protect manufacturers with global supply chains. Therefore, it aims to broaden the range of goods benefiting from the elimination of tariffs by using 'extended cumulation of origin'. The areas of dispute are clear. Whether or not they are resolved depends as much on politics as technicalities.



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Three years ago, Dr Liam Fox MP was reported as saying: 'The free trade agreement that we will have to do with the European Union should be one of the easiest in human history'. The then secretary of state for international trade and president of the board of trade added: 'The only reason that we wouldn't come to a free and open agreement is because politics gets in the way of economics' (*The Guardian*, 20 July 2017). Perhaps, though, it is impossible for politics to get out of the way of economics.

The EU published its draft text of an agreement on the new partnership with the UK on 18 March 2020 (see bit.ly/3e6Xz8S). On 19 May 2020, the UK published its draft text of a comprehensive free trade agreement (see bit.ly/31JeSue). That draft was served with a *mezede* of other draft agreements covering matters including fisheries, air transport, social security coordination, law enforcement and judicial cooperation in criminal matters and the transfer of unaccompanied asylum-seeking children.

One needs only to read the titles of the drafts to see that Dr Fox was right: politics does, inevitably, get in the way. On the one hand, the EU puts trade in the context of a 'new partnership' complete with a partnership council and 15 specialised committees (see the EU's draft, part five ('Institutional and horizontal provisions'), title I). On the other hand, the UK wants a 'comprehensive free trade agreement' and additional bespoke agreements. As Mr David Frost said, 'we are looking for a suite of agreements with a Free Trade Agreement at the core' (see the letter from David Frost, as sherpa and EU adviser, to M Barnier, dated 19 May 2020). The accompanying administrative architecture includes a joint committee, 14 specialised committees and assorted working groups (see the UK's draft, chapter 30 ('Administrative provisions'), articles 30.1–30.4).

For once, the titles and forms of the draft agreements are a sure guide to their substance. They show that each side is pursuing different goals. The difference of approach is

necessarily reflected in provisions affecting tax and customs.

The EU's approach to tax

There are, of course, many provisions which specifically affect tax in the EU's draft agreement. There is, for example, a protocol on administrative cooperation and combatting fraud in the field of VAT and on mutual assistance for the recovery of claims relating to tax and duties and, in article LFPF.2:26, provisions on tax standards and tax avoidance. Provisions on state aid, which will encompass aid given by the tax system, and tax good governance may be more controversial.

State aid and the level playing field

Provisions on state aid and the level playing field are well-known sources of difficulty in the negotiations. So far as tax is concerned, the Commission's communication to the European Parliament and the Council on an external strategy for external taxation of 28 January 2016 (COM(2016) 24 final) gave the Brexit negotiators advance warning of possible difficulties. It said (at para 3.2): 'The Commission will ... work to include state aid provisions in negotiating proposals for agreements with third countries, with a view to ensuring fair tax competition with its international partners'.

In the EU's draft agreement, state aid is placed firmly in the context of the level playing field. Provisions governing it appear in part two ('Economy and trade') title III ('Level playing field and sustainability') and chapter two ('Specific areas of level playing field and sustainability'). Chapter two section 1 concerns state aid control.

The negotiators will surely keep in mind that both substantive tax law, such as the Swiss company tax rules subjected to the prohibition of public aid in the EEC/Switzerland agreement, and tax administration, for example in relation to tax rulings, can give rise to state aid.

Tax good governance

EU tax good governance has developed over the years into a broad and increasingly powerful concept. It is dealt with in article LFPF.2:25 of the EU's draft as a specific aspect of the level playing field (see part two, title III, chapter two, section 4 ('Taxation') of the EU's draft). The concept is said to have produced difficulties in trade negotiations before Brexit. The Commission's communication on an external tax strategy made that clear. It said (at para 3.1): 'EU efforts to insert a meaningful good governance clause into bilateral or regional agreements have had mixed success. While some third countries accepted a reference to the principles of tax good governance, others strongly resisted or refused any explicit commitment on this issue. Certain negotiations were delayed as third countries found the wording of the clause to be unclear on the scope of the good governance requirements'.

There are likely to be issues with a higher profile than tax good governance capable of delaying an EU/UK agreement. Nevertheless, the fact that it has caused difficulty in the past is an indication of its importance to the EU.

Article LFPF. 2:25 of the EU's draft goes on to commit the parties to matters such as 'fair taxation' and curbing 'harmful tax measures'. People with more aligned perspectives than the Brexit negotiators may disagree about what is fair. Not everyone will consider that the UK should continue to adopt the EU's definitions of these concepts once it is outside the EU.

The UK's approach to tax

Chapter 29 of the UK's draft treaty contains two articles and is headed 'Relevant tax matters'. That title appears to be drawn from the revised Political Declaration (para 77), which

accompanied the Withdrawal Agreement. The paragraph is headed 'Level playing field for open and fair competition'. It says that 'the Parties should uphold the common high standards applicable in the Union and the United Kingdom at the end of the transition period in the areas of state aid, competition, social and employment standards, environment, climate change, and relevant tax matters'.

The word 'relevant' is useful for negotiators of political agreements. It allows the parties to agree to disagree. Both sides can agree on the applicability of common high standards. Both can disagree over what is a relevant tax matter. Now that a legal text has to be negotiated, there is less scope and little incentive for such obfuscation.

State aid

The UK draft deals with state aid in chapter 21, which is significantly headed 'Subsidies'. Article 21.1 draws on the definition of subsidy in the WTO's Agreement on Subsidies and Countervailing Measures. It is clear that the UK intends to focus on international and not EU norms and the EU's level playing field which are so significant in the EU's draft. The difference of approach between the parties is both predictable and problematic.

Tax good governance

Article 29.1 of the UK's draft is headed 'International tax cooperation and standards'. It says: 'The United Kingdom and the Union will promote good governance in tax matters and improve international cooperation in the tax area. The Parties recognise and commit to implementing the principles of good governance in the area of taxation reflecting the OECD principles concerning fair tax competition, the global standards on tax transparency and exchange of information, and the OECD minimum standards against Base Erosion and Profit Shifting (BEPS)'.

In other words, just as in relation to state aid, the UK's approach is based on international, and not EU, norms. At least the areas of disagreement between the parties would seem to be clear.

Exclusions

The UK draft has a significant chapter on 'Exclusions' (chapter 32). Article 32.3.2 shows how sensitive tax is for the UK when it says: 'Except as provided in this Article, nothing in this Agreement applies to taxation measures.'

Article 32 makes certain provisions for double taxation conventions, including provisions on tax in relation to the principle of national treatment and market access for goods (chapter 2), cross-border trade in services (chapter 9) and investment (chapter 10). Again, the influence of international GATT principles is strong (as indeed it is in the EU's draft).

Clauses excluding or limiting tax in trade agreements are always double-edged. On the one hand they limit the agreement's impact on tax. On the other hand, they make clear that any agreement will encompass tax. The negotiators will have to determine to what extent that is so and what, if any, risks they are prepared to take.

Customs and origin cumulation

In the absence of an agreement, the provisions of the Withdrawal Agreement's Protocol on Ireland/Northern Ireland will need speedy implementation. If there is an agreement a number of customs issues will need to be resolved equally quickly. Either way there is a lot of work to be done.

There are many provisions concerning customs in the UK's draft that are derived from international customs law and

WTO law (see chapter 7). These seem unlikely to produce serious difficulty. One area which is likely to be difficult, however, concerns so-called 'cumulation of origin' in relation to goods. This is dealt with in chapter 3 of the UK's draft headed 'Rules of origin'.

Cumulation has to be considered in the light of the UK's aim to establish a free trade area between the UK and the EU. This involves the elimination of customs duties on all goods originating in either Party, except where otherwise provided for (see articles 1.3 and 2.6 of the UK draft). It is, therefore, crucial to determine what goods originate in the UK and in the EU respectively. Only goods which originate there will have the benefit of the agreement.

The UK wants to protect the global supply chains of UK manufacturers and ensure goods within them benefit from the elimination of tariffs. Article 3.3.1 of its draft does this by treating products originating in some places outside the UK as originating in the UK when they are used as a material in the production of a product in the UK. The places in question outside the UK are the EU, 'a relevant partner country' or a GSP country.

A 'relevant partner country' is widely defined in article 3.3.14. It means a country or territory with which a party has a free trade agreement, signed and applied before the end of the transition period. It also includes the couple of dozen or so African, Caribbean and Pacific states to which Regulation (EU) 2016/1076 applies. A GSP country means a country granted preferences under the party's Generalized System of Preferences.

The effect of these provisions is to establish 'extended cumulation' or 'cross-cumulation'. This may be compared with less extensive bilateral, diagonal and regional cumulation, or cumulation between neighbouring countries, used alone or in combination.

The EU's draft agreement in relation to origin does not contain proposals for extended cumulation (see Part two, Title IV, Chapter two: Rules of origin). The EU has adopted extended cumulation provisions, as in the legislation with the GSP countries (see Commission Delegated Regulation (EU) 2015/2446 of 28 July 2015, *Official Journal of the European Union* L343/1, 29 December 2015, articles 37(9) and 56). Whether it will be inclined to adopt a similar approach to a country like the UK remains to be seen. The creation of a low tax manufacturing hub servicing the single market is not as attractive to the EU as it is to the UK.

Conclusion

Tax and customs are by no means the only difficulties, or even the main difficulties, facing the negotiators. Fisheries, for example, presents formidable problems. Nevertheless, tax and customs are highly sensitive matters in the negotiations.

The aims of the EU and the UK are markedly different in a number of important respects. Negotiators on both sides have to decide whether divergence within an agreed framework is preferable to uncontrolled divergence and no agreement. To use Dr Fox's words, politics 'gets in the way'. At the moment, the consequences of that are impossible to guess. ■

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