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Public will pay for divorcing VAT from Europe

Turbulence in one of the largest contributors to tax revenues and extra accounting burdens are all but inevitable, Nicola Shaw and Kelly Stricklin-Coutinho write

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Even if costs are not passed directly on to consumers, taxpayers will feel a pinch

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Just when it seemed that every potential disaster of Brexit had been chewed over ad nauseam, along comes VAT.

The key questions when considering the UK's proposed revised VAT framework after Brexit are: what level of divergence from the EU's VAT regime might be achieved in practice and what is the cost of achieving it? Will it end in catastrophe?

On the first point, the level of divergence from EU law on VAT is, in principle, as high as the UK wishes it to be. However, there is a lot riding on whether the UK remains within the EU VAT area. If it does there will, apart from sighs of relief by some experts, be little opportunity for divergence between the UK rules and the EU rules. The UK would continue to apply EU law and, as a result, would remain subject to relevant rulings from the European Court of Justice. This is significant because VAT is one of the most litigated areas of EU law and it often involves the application of general principles of EU law.

If the UK decides to leave the EU VAT area then it is free to establish its own regime, but in so doing it would create a border and that, in turn, would give rise to enforcement issues to avoid any loss of VAT on imports. The government must also make provision for the financial consequences of departing the single market. VAT is one of the largest annual contributors to the UK's overall "tax take" and the Treasury can expect a certain amount of turbulence in its cash flow if the country leaves.

Then there will be the administrative costs. The government will need to create, implement and refine new systems for collecting and enforcing the tax. However, as far as UK sovereignty over VAT matters is concerned, it is questionable whether there will be any material change in the immediate aftermath of Brexit when, under government plans, past issues involving points of EU law could still be referred to the ECJ for many years.

Catastrophe may be avoided. Furthermore, on areas where there is little practical divergence, EU law will continue to be of relevance, even if it does not bind the UK courts as it currently does.

From a taxpayer perspective, the additional costs of the UK's independence from Europe will include extra accounting burdens, particularly for those who will have to pay import VAT upfront on goods imported from the EU, increased costs of compliance with new systems and the possible absence of recovery mechanisms in cross border VAT disputes.

These changes to the UK's VAT system will come at a time when the EU's approach to VAT is also changing. Recent proposals include improving administrative co-operation between countries to fight VAT fraud, more flexibility on VAT rates and simplified rules for smaller businesses. While the UK can participate in those proposals now, it will shortly lose its opportunity to influence future direction.

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