



# Article

## Brexit: The Road Ahead for EU-UK Trade

Martijn Vroom & Walter de Wit\*

*The countdown to Brexit has started. Given the short timeframe to Brexit and the large trading volumes, the authors investigate which certainties and uncertainties exist regarding the future trade relationship between the European Union (EU) and the United Kingdom (UK). Certain is that the UK is leaving the EU on 29 March 2019. On the basis of the recently presented draft withdrawal agreement, however, the chances are apparent that the UK will not leave the EU Customs Union and the internal market during a transition period ending in December 2020. Taking into account a possible transition period, the authors discuss the most likely scenarios and their impact on trade between the EU and the UK, in particular from a customs perspective.*

### 1 INTRODUCTION

The clock is ticking. In March 2019, the United Kingdom (UK) will formally leave the European Union (EU) due to 'Brexit'. The impact of Brexit on trade between the EU and the UK<sup>1</sup> appears to be particularly high, given the trade volumes between the two parties. Fifty-one per cent of total 'imports' in the UK comes from the rest of the EU (Germany 14%, the Netherlands 7% and France 5%).<sup>2</sup> Forty-seven per cent of the total 'exports' of the UK are to (other) EU countries (Germany 11% and France, the Netherlands and Ireland each 6%).<sup>3</sup>

Given the short timeframe to Brexit and the large trading volumes, we are examining in this article which certainties and uncertainties exist at the present moment regarding the future trade relationship between the EU and the UK, predominantly from a customs perspective. In paragraph 2, we will firstly discuss how the EU-UK trade currently operates. Subsequently, in section 3 we will analyse the possible post-Brexit situation(s) as of March 2019. We then describe the 'certainties' in the future EU-UK trade relationship in section 4. We provide a conclusion in section 5.

### 2 CURRENT EU-UK TRADE

The EU is a Customs Union. The Customs Union was established in 1968 between the six original Member States of the European Economic Community (EEC), Belgium, France, Italy, Luxembourg, the Netherlands and West Germany.<sup>4</sup> The UK became a member of this Customs Union on 1 January 1973. The establishment of the customs union led to the introduction of a common external tariff (regardless of the Member State in which goods are imported the same import tariffs applied) and, furthermore, goods brought into free circulation of the customs union could be freely traded (without (again) customs duties being levied).

With the Treaty of Maastricht, the 'internal market' was established in 1993.<sup>5</sup> The internal market is characterized by the abolition between Member States of obstacles to the free movement of goods, persons, services and capital.<sup>6</sup> However, on the basis of the already existing Customs Union, the introduction of the internal market did not bring much changes in the area of customs legislation and import duties. Trade changes merely related to areas such as sales tax and excise duties.<sup>7</sup>

\* The authors are working at the Indirect Tax – Global Trade department at EY Belastingadviseurs LLP in Amsterdam. Walter de Wit is a Professor International and European Customs Law at the Erasmus University Rotterdam. Email: [martijn.vroom@nl.ey.com](mailto:martijn.vroom@nl.ey.com); [walter.de.wit@nl.ey.com](mailto:walter.de.wit@nl.ey.com).

<sup>1</sup> Where we discuss EU-UK trade, we refer to both the flow of goods from the EU to the UK and the reverse situation (UK towards the EU).

<sup>2</sup> We refer to the European Union website on the UK [online via [europa.eu/european-union/about-eu/countries/member-countries/unitedkingdom\\_nl](http://europa.eu/european-union/about-eu/countries/member-countries/unitedkingdom_nl) (accessed 26 Mar. 2018)].

<sup>3</sup> *Ibid.*

<sup>4</sup> Council Decision 66/532/EEC of 26 July 1966 on the abolition of customs duties and on the prohibition of quantitative restrictions between Member States and on the application of the Common Customs Tariff duties for products not listed in Annex II to the Treaty, 1966, 2971.

<sup>5</sup> Official Journal of the European Communities (OJEC). 29 July 1992, No C 191. [s. 1.]. ISSN 0378-6986. 'Treaty on European Union', at 1.

<sup>6</sup> Art. 26 para. 2 of the Treaty on the Functioning of the EU defines the internal market as 'an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the provisions of the Treaties'.

<sup>7</sup> We will not further elaborate on these fields in this article.

As of 1 May 2016, new customs legislation entered into force within the EU: the Union Customs Code (UCC).<sup>8</sup> The UCC created new EU customs legislation, including simplified customs procedures, improved cooperation between customs authorities and the roll-out of new IT systems. With its direct applicability in the EU, the UCC ensures unambiguous interpretation of customs legislation and the unification of customs procedures and formalities. The UCC must be fully implemented by the end of 2020, meaning that the Brexit period coincides with the implementation of the UCC in the EU.

As the UK is currently part of the EU (Customs Union/internal market), EU-UK trade is characterized by the following elements:

- No customs duties;
- No customs formalities;
- No physical checks;
- No trade restrictions;
- UCC legislation applicable.

With regard to goods coming from outside the EU before being imported into the EU or UK (and possibly being traded) or being properly exported, in addition to the above, the following characteristics apply:

- Common external customs tariffs;
- Large number of free trade agreements applicable;<sup>9</sup>
- No freedom for individual Member States to conclude their own free trade agreements;
- No freedom for individual Member States to introduce trade barriers themselves.

### 3 EU-UK TRADE RELATIONSHIP AFTER BREXIT

#### 3.1 'Nothing Is Agreed Until Everything Is Agreed'

On 29 March 2017, the UK notified the EU of its decision to withdraw from the EU within the meaning of Article 50 of the Treaty on European Union (TEU). Article 50 TEU stipulates that on 29 March 2019 (two years after notification from the UK), the EU Treaties will no longer apply to the UK. This is called 'Brexit'.

Article 50 TEU also stipulates that the European Council, after negotiations with the UK, will agree on the conditions for the withdrawal, taking into account 'the framework of the future relations of the UK with the EU'. These negotiations started on 19 June 2017.<sup>10</sup> Prior to the start of the negotiations, both the EU and the UK made their views known and

published guidelines for the negotiations.<sup>11</sup> In Table 1, we have listed some of the most important (initial) principles of both the EU and the UK (often opposed to each other):

Table 1 Principles of the EU and the UK

EU	UK
Four EU freedoms (people, goods, services, capital) are indivisible: all or nothing	Free movement of goods, but no free movement of persons
Negotiations on future (trade) relationship can only start after 'sufficient progress' on withdrawal from the EU	Negotiations on future (trade) relationship and withdrawal from the EU can take place simultaneously
A non-EU member cannot have the same rights and benefits as an EU member	Getting control over own laws and – at the same time – access to European markets

Currently, the Brexit negotiations are on the way for around ten months. Looking at the way the negotiations have been conducted so far, it is apparent that the EU's principle on the negotiation process is followed so far: negotiations on future (trade) relationship would only start after 'sufficient progress' on UK's withdrawal from the EU. Only when the EU announced on 8 December 2017 that 'sufficient progress' had been made on the withdrawal it was concluded that negotiations could commence on the future relationship.<sup>12</sup>

The documents published by the EU show that on 6 February 2018 a transition period was officially mentioned for the first time during the negotiations.<sup>13</sup> At a press conference on 19 March 2018, David Davis (UK) and Michel Barnier (EU27) subsequently presented a joint text of the 'withdrawal agreement' and mentioned this agreement as a 'decisive' step in the negotiations.<sup>14</sup>

<sup>8</sup> Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 Oct. 2013 laying down the Union Customs Code.

<sup>9</sup> We refer to the website of the European Commission regarding the current status of trade agreements and negotiations [online via [ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements](http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements) (accessed 19 Apr. 2018)].

<sup>10</sup> We refer to the agenda of the Brexit negotiations of 19 June 2017 as published on the website of the European Commission [online via [ec.europa.eu/commission/sites/beta-political/files/art50-agenda-20170619\\_en.pdf](http://ec.europa.eu/commission/sites/beta-political/files/art50-agenda-20170619_en.pdf) (accessed 19 Apr. 2018)].

<sup>11</sup> With regard to the EU we refer to: General Secretariat of the Council (2017), Special meeting of the European Council (Art. 50) (29 Apr. 2017) – Guidelines, EUCO XT 20004/17. With regard to the UK we refer to: UK Department for Exiting the European Union (2017), Legislating for the United Kingdom's withdrawal from the European Union, Cm 9446 and the online published position papers [online via [gov.uk/government/news/position-papers-published-ahead-of-round-three-negotiations](http://gov.uk/government/news/position-papers-published-ahead-of-round-three-negotiations) (accessed 19 Apr. 2018)].

<sup>12</sup> European Commission (2017), Communication from the Commission to the European Council (Art. 50) on the state of progress of the negotiations with the United Kingdom under Art. 50 of the Treaty on European Union, COM(2017) 784 final.

<sup>13</sup> We refer to the agenda of the Brexit negotiations of 6–9 Feb. 2018 as published on the website of the European Commission [online via [ec.europa.eu/commission/sites/beta-political/files/agenda\\_6-9\\_february\\_2018.pdf](http://ec.europa.eu/commission/sites/beta-political/files/agenda_6-9_february_2018.pdf) (accessed on 19 Apr. 2018)].

<sup>14</sup> European Commission (2017), Press statement by Michel Barnier following the latest round of Art. 50 negotiations [online via [europa.eu/rapid/press-release\\_STATEMENT-18-2161\\_en.htm](http://europa.eu/rapid/press-release_STATEMENT-18-2161_en.htm) (accessed 19 Apr. 2018)].

The withdrawal agreement (in draft form) contains the proposals for a transition period that ends on 31 December 2020. After 31 December 2020, withdrawal from the customs union and internal market will therefore take place anyway (but possibly earlier on 29 March 2019). However, from 29 March 2019 the UK is no longer part of the EU.

During the possible transition period, the UK remains subject to EU law and part of both the internal market and the customs union. The UK will be able to negotiate, sign and ratify trade agreements during the transition period, which can enter into force at the end of the transitional period, unless an earlier date has been agreed with the EU.

A lot of work remains to be done to complete the entire withdrawal agreement (in time) and some important problems still have to be resolved. These problems include, for example, the question of the border between Northern Ireland and Ireland, where the aim will be to avoid a hard Irish border despite the eventual departure from the Customs Union. The issue of managing the withdrawal agreement and the role of the Court of Justice of the EU (CJEU) must also be agreed (with the exception of its role in reviewing the rights of the citizens). We note, as emphasized in the press conference, that legal certainty about the withdrawal agreement will only come with legal ratification, probably by the end of 2018. We point out in this context that ‘nothing has been agreed until everything has been agreed’.

For the time being, the following two possible scenarios can therefore be assumed:

- (1) A transition period (in accordance with the draft agreement) that lasts until 31 December 2020, followed by Brexit as of 1 January 2021; or
- (2) Brexit per 29 March 2019, as the negotiation or ratification process cannot be completed in time (before 29 March 2019) and therefore there will be no transition period.

Below we first describe the customs consequences of Brexit in the event that there is no transition period (the so-called hard Brexit). Secondly, we discuss the customs consequences during a possible transition period. Thirdly, we describe the possible scenarios for the situation after a possible transition period (which could also apply sometime after the end of a Hard Brexit).

### 3.2 Trade in Case of ‘Hard Brexit’

Should the EU and the UK not come to an agreement during the negotiations (or if a Member State refuses to ratify the outcome of the negotiations), the situation arises that none of the EU Treaties will be applicable to the UK as of 29 March 2019.<sup>15</sup> This is also called ‘Hard Brexit’.

This situation would mean an immediate departure from the UK from the EU. It would also have the far-

reaching effect that the UK no longer belongs to the EU internal market and Customs Union. Any movement of goods between the EU and the UK (and vice versa) would become subject to customs formalities and import duties. Since no bilateral treaty would be applicable between the EU and the UK, there would be a fall back to the basic rules as formulated by the World Trade Organization (WTO).

The EU acts as a whole within the WTO, the Member States are not separate members. The UK can probably remain a member of the WTO after the Brexit, but it is not yet certain under which conditions this could be done and which trade agreements would apply.<sup>16</sup> In principle, the ‘Most Favoured Nation’ (MFN) clauses will be used. This means that no reduced customs tariffs will be applied in the mutual traffic between the UK and the EU. In this scenario, there is no free trade agreement between the UK and the EU to fall back on.

We also note that about half of UK trade is already covered by the WTO rules (as is the case with all WTO countries with which the EU has not concluded a trade agreement, such as the US and China). Trade under WTO rules is therefore not a problem in itself, but the sudden change from the EU Customs Union to WTO rules is.

In the case of ‘hard Brexit’, EU-UK trade would be characterized by the following elements:

- Customs duties;
- Customs formalities;
- Physical checks;
- (possible) trade restrictions;
- UCC legislation not applicable to the UK;
- Common external customs tariff not applicable to UK (UK has the freedom to set its own rates subject to WTO rules);
- EU free trade agreements no longer applicable to the UK;
- UK may conclude its own trade agreements.

### 3.3 Trade During (Possible) Transition Period

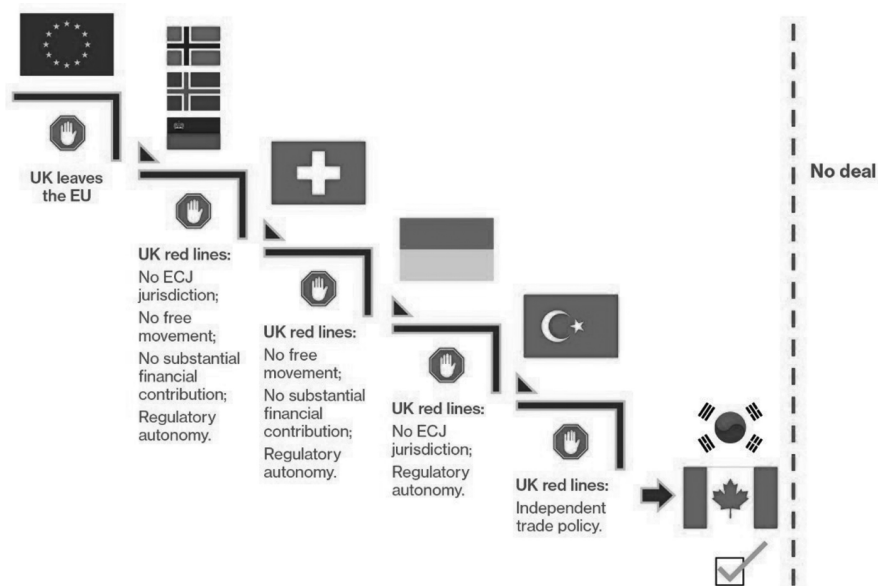
According to the draft withdrawal agreement, the UK will continue to participate in the EU Customs Union and the Internal Market (with all four freedoms) during the proposed transition period.<sup>17</sup> In principle, there would be little or no change in trade between the EU and the UK during this period (31 March 2019–31

<sup>15</sup> As stated in Art. 50 TEU. We note that the UK will not only have to negotiate with the EU on new trading conditions, but also with all other 162 members of the WTO.

<sup>16</sup> E.g. according to the words of the Director-General of the WTO, Roberto Azevedo [online via [bbc.com/news/business-36470809](http://bbc.com/news/business-36470809) (accessed 19 Apr. 2018)].

<sup>17</sup> European Council (2018), Council Decision supplementing the Council Decision of 22 May 2017 authorizing the opening of negotiations with the United Kingdom of Great Britain and Northern Ireland for an agreement setting out the arrangements for its withdrawal from the European Union, XT 21004/18 COR 2.

Figure 1



December 2020). No customs formalities and controls would therefore apply in trade between the UK and the EU during this period.

It is also apparent from the draft of the withdrawal agreement (Articles 48 and 49) that also from a VAT and excise duties perspective everything remains unchanged during the transition period. If this were different, VAT and excise duties would give rise to customs formalities and controls (import and export declarations would have to be made for VAT and excise duties purposes).

During the transition period, the UK will have to take all necessary measures to preserve the integrity of the EU internal market and of the Customs Union. The UK must continue to comply with the EU trade policy. In particular, the UK will have to ensure that its customs authorities continue to act in accordance with the mission of the EU customs authorities, inter alia by collecting the Common Customs Tariff duties and by carrying out all border checks required under the UCC in relation to other third countries.

As part of the EU Customs Union, it is in principle not permitted to negotiate with third countries as an individual Member State. However, on the basis of the draft withdrawal agreement, the UK may sign and ratify, during the transitional period, international agreements made in its own capacity in the areas falling under the exclusive competence of the EU, provided that these agreements do not enter into force or apply during the transition period, unless expressly permitted by the EU.

**3.4 Trade After Transition Period**

The way in which the EU and the UK will trade after a possible transition period is for the time being still uncertain. In recent months, however, the contours

have become much clearer. For example, the Brexit negotiator on behalf of the EU, Michel Barnier, presented the following slide to the EU leaders on 19 December 2017, from which it can be derived that he considers just two realistic scenarios: a free trade agreement or ‘no deal’ (Figure 1).<sup>18</sup>

In this slide the thinking steps of the UK are represented by means of ‘red lines’ (as a sign why an option is not possible). In view of UK’s Brexit principles (no jurisdiction of the European Court of Justice ECJ, no financial contribution to the EU, autonomous trade policy, etc.), we understand these thinking steps as to why certain scenarios are not deemed to be possible (such as a Swiss, Norwegian or Turkish model). For that reason, we distinguish, like Barnier, in principle the following two realistic scenarios for the ultimate future trade relationship between the EU and the UK:

- (1) A comprehensive free trade agreement, similar (although more far-reaching) to the recent EU free trade agreements with Canada and South Korea;

No deal, as a result of which EU-UK trade would fall back to WTO rules. In addition to these two we consider two more (perhaps less realistic) scenarios:

- (2) A Customs Union with the EU;
- (3) Elimination of customs duties and compliance obligations on import into the UK.

<sup>18</sup> European Commission, Task Force for the Preparation and Conduct of the Negotiations with the United Kingdom under Art. 50 TEU, TF50 (2017) 21 – Commission to EU 27.



We note that talks on the future trade relationship between the EU and the UK have officially started on 18 April 2018.<sup>19</sup> It is expected that the future trade negotiations will take place every two weeks before the EU27 come together at the European Council in June 2018 for a review of the progress on the Brexit negotiations. It is reported by the Guardian that the EU is so far undecided about how much detail should go into the text on the future relationship before Brexit day in March 2019; Germany is pushing for a detailed, legally precise text to avoid surprises during the post-Brexit trade talks, but Scandinavian and Benelux (i.e. Belgium, the Netherlands and Luxemburg) countries prefer to keep the document vague to give the UK maximum room to change its mind (during the post-Brexit trade talks).<sup>20</sup>

### 3.4.1 Comprehensive Free Trade Agreement

The most likely scenario at the moment – in our opinion – is that during the current negotiations, which must be concluded by the end of 2018, agreement will be reached on a transition period and also on the ‘contours’ of a free trade agreement. The exact content of these contours will then be further negotiated during the transition period with the aim of reaching agreement and having an agreement in place on 31 December 2020 (when the transition period comes to an end).

It is generally expected that a comprehensive free trade agreement will have to be concluded between the EU and the UK, as a regular free trade agreement only concerns the trade of goods. The British economy, however, consists for 80% of services, which means that the conclusion of a regular free trade agreement would not be sufficient. In the British/EU corridors, therefore, a ‘CETA plus plus’<sup>21</sup> is already being discussed, referring to a more far-reaching version of the recently concluded free trade agreement between the EU and Canada. We note in this respect that the negotiations on CETA have lasted for at least eight years,<sup>22</sup> which is not an unusual timeline for negotiations on a trade agreement. It therefore seems very ambitious for the EU and the UK to reach a comprehensive agreement as early as 31 December 2020. On the other hand, the UK will remain one of EU’s major trading partners (and vice versa) after

Brexit, due to which the urgency to conclude a free trade agreement within a short timeframe is very apparent for all parties.

Under CETA, 98% of import duties between the EU and Canada have been eliminated. However, non-tariff trade barriers and traditional rules of origin would apply to EU-UK trade under an agreement such as CETA. In order to make use of CETA (and therefore possibly also of the future comprehensive EU-UK free trade agreement), rules of origin must therefore be complied with. Only when the goods comply with these rules of origin can the benefits of the free trade agreement be enjoyed.

If we look at the origin rules as they apply under CETA, goods will only comply with the origin rules if they are:

- ‘Wholly obtained’ (like plants grown and harvested there, animals born and raised there, raw materials, etc.) in the EU or the UK;
- Produced in the EU or the UK with exclusively originating materials; or
- Produced in the EU or UK of certain non-originating materials that have undergone ‘sufficient processing’ in the EU or the UK.

The above means that goods traded between the EU or the UK do not automatically qualify for the EU-UK free trade agreement to be concluded (and thus do not automatically benefit from reduced (up to 0%) import duties). The EU-UK free trade agreement would only apply if the (preferential) rules of origin are complied with. For example, a good that is produced in the USA and shipped to the UK for further distribution in the EU will in principle have no EU or UK origin (but US origin). This means that import duties will have to be paid on import into the UK (in the absence of a free trade agreement). Upon import subsequently in the EU, the good will again be subject to import duties (now that the rules of origin are not complied with, the EU-UK free trade agreement will not apply). Apart from this example, many more scenarios exist in which the EU-UK free trade agreement would not be applicable as a result of not meeting the rules of origin.

CETA does however contain provisions that open up the possibility of cumulation of origin. This would mean that products originating from a country with which both the EU and the UK have a free trade agreement (in the future, for example, with Mexico or Canada) can be included in determining whether a product originates under the EU-UK free trade agreement.

The above makes it clear that an EU-UK free trade agreement would make a big difference to the current EU customs union. Although in principle no import duties apply in both cases, a free trade agreement requires a far-reaching administration and control of the origin of goods. Only when the origin can be shown properly the benefits can be enjoyed under the free trade agreement. If not, import duties will be due.

<sup>19</sup> We refer to the agenda of the Brexit negotiations of 16–18 Apr. 2018 as published on the website of the European Commission [online via [ec.europa.eu/commission/sites/beta-political/files/agenda\\_16-18\\_april.pdf](http://ec.europa.eu/commission/sites/beta-political/files/agenda_16-18_april.pdf) (accessed 19 Apr. 2018)].

<sup>20</sup> We refer to the website of the Guardian [the-guardian.com/politics/2018/apr/18/brexit-first-talks-on-uks-future-relationship-with-eu-begin (accessed 19 Apr. 2018)].

<sup>21</sup> E.g. according to the words of the chief negotiator of the EU, Michel Barnier [online via [theguardian.com/politics/2017/oct/23/uk-likely-to-end-up-with-canadian-style-deal-warns-michel-barnier](http://theguardian.com/politics/2017/oct/23/uk-likely-to-end-up-with-canadian-style-deal-warns-michel-barnier) (accessed 19 Apr. 2018)].

<sup>22</sup> We refer to the press release from the European Commission regarding the start of the CETA negotiations [online via [trade.ec.europa.eu/doclib/docs/2009/june/tradoc\\_143427.pdf](http://trade.ec.europa.eu/doclib/docs/2009/june/tradoc_143427.pdf) (accessed 19 Apr. 2018)].

In the case of a comprehensive free trade agreement, EU-UK trade is further characterized by the following elements:

- Reduced (up to 0%) customs duties, insofar as rules of origin are met;
- Customs formalities;
- Physical checks;
- (possible) trade restrictions;
- UCC legislation not applicable to the UK;
- Common external customs tariff not applicable to UK (UK has the freedom to set its own rates subject to WTO rules);
- EU free trade agreements no longer applicable to the UK;
- UK may conclude its own trade agreements.

### 3.4.2 *No Deal: WTO Scenario*

Less likely, but certainly not inconceivable, is the WTO scenario (no future trade deal as of December 2020). This is made clear, for example, by statements from President of the European Council Donald Tusk: ‘So much time has been spent on the simple part and now we de facto have less than a year to negotiate a transitional arrangement and the framework for our future relationship’ and ‘we all know that separating is difficult, but separating and building a new relationship is much more difficult’.<sup>23,24</sup> We refer to section 3.2 for the circumstances and consequences on EU-UK trade. We do note, however, that it is very well conceivable in this scenario that a free trade agreement will be concluded between the EU and the UK after some period of time (as described in section 3.4.1). We therefore see this scenario primarily as a realistic ‘short-term’ option.

### 3.4.3 *A Customs Union with the EU*

A post-Brexit Customs Union would contradict one of the UK’s main reasons for leaving the EU: applying an autonomous trade policy. In a post-Brexit Customs Union the UK would not be able to set its own external customs tariffs and would in principle not have the freedom to conclude its own free trade agreements (or to introduce trade barriers).

To date, only Turkey and the microstates Andorra and San Marino have a Customs Union with the EU in place.<sup>25</sup> If we focus on Turkey (as a large state), it is noteworthy that this Customs Union is limited in scope,

as it covers all industrial goods but does not address agriculture (except processed agricultural products), services or public procurement.<sup>26,27</sup> Moreover, Turkey has no choice but to follow EU trade policy without being involved in EU decision-making or negotiations with third countries (i.e. it is compelled to negotiate its own free trade agreements with these third countries).<sup>28</sup> Another issue in the EU-Turkey Customs Union in our opinion is that Turkey becomes a vulnerable market for products coming from countries which sign free trade agreements with the EU. This is due to the fact that the countries with whom the EU concludes free trade agreements, do not necessarily have an incentive to conclude a free trade agreement with Turkey as well.<sup>29</sup> These countries can access the Turkish market by distributing goods via the EU, without having to open their own market for Turkey,<sup>30</sup> due to which Turkish companies could be at disadvantage compared to EU companies.

In our opinion, a post-Brexit Customs Union would mean that the UK – from a trade or customs perspective – in practice would remain a ‘member’ of the EU (Customs Union), but without having any say or power in the decision-making. Hence, we consider this very soft form of Brexit disadvantageous (particularly from a UK point of view) compared to the current situation (as outlined in section 2) and, even, compared to a scenario such as the comprehensive free trade agreement (outlined in paragraph 3.4.1), as the UK would then at least be able to apply an autonomous trade policy.<sup>31</sup>

The majority of the House of Lords of the British parliament however, seems to be in favour of a post-Brexit Customs Union with the EU.<sup>32</sup> This position

<sup>23</sup> We refer to the publication on the website of Bloomberg [online via [bloomberg.com/news/articles/2017-12-08/u-k-and-eu-strike-brex-it-deal-opening-path-to-trade-talks](http://bloomberg.com/news/articles/2017-12-08/u-k-and-eu-strike-brex-it-deal-opening-path-to-trade-talks) (accessed 19 Apr. 2018)].

<sup>24</sup> We note that if there is a transition period, there will be more time for negotiations on a future relationship (i.e. until 31 Dec. 2020).

<sup>25</sup> We refer to the website of the European Commission regarding the current Customs Unions [online via [ec.europa.eu/taxation\\_customs/business/calculation-customs-duties/rules-origin/customs-unions\\_en](http://ec.europa.eu/taxation_customs/business/calculation-customs-duties/rules-origin/customs-unions_en) (accessed 19 Apr. 2018)].

<sup>26</sup> We refer to the website of the European Commission regarding Turkey [online via <http://ec.europa.eu/trade/policy/countries-and-regions/countries/turkey/> (accessed 19 Apr. 2018)].

<sup>27</sup> As mentioned in para. 3.4.1., the British economy consists for 80% of services, which means that a Customs Union based on the Turkish model would not be sufficient (as services are not covered there).

<sup>28</sup> Except in relation to those areas excluded from the Customs Union (e.g. agricultural goods in the Turkish situation).

<sup>29</sup> We note that these issues might have resulted in the EU’s proposal to modernize the Customs Union with Turkey. We refer to European Commission – press release, Commission proposes to modernize the Customs Union with Turkey, Brussels, 21 Dec. 2016. We note that this proposal is currently being discussed in the EU Council.

<sup>30</sup> As outlined in para. 3.4.1., goods only qualify under a free trade agreement if they fulfil the ‘rules of origin’. Goods manufactured or processed in Turkey do in most cases not fulfil these EU (or EU’s counterpart) rules of origin. One exception is the possibility for diagonal cumulation under the Pan-Euro Med Convention, see ‘Commission notice concerning the application of the Regional Convention on pan-Euro-Mediterranean preferential rules of origin or the protocols on rules of origin providing for diagonal cumulation between the Contracting Parties to this Convention’, OJ EU, 9 Mar. 2017, C73/6.

<sup>31</sup> Even though we understand the advantages of avoiding a hard border issue in Ireland and limiting the Brexit impact on customs authorities compared to the scenario of a comprehensive free trade agreement.

<sup>32</sup> The House of Lords voted to amend the UK withdrawal bill. Under this amendment the UK government is committed to ‘outlining the

completely contradicts the position of the UK government, which is that the UK will leave the Customs Union.<sup>33</sup> We therefore expect interesting political developments in this respect in the UK the coming weeks or months.

We refer to section 3.2 for the circumstances and consequences on EU-UK trade in this scenario, whereby we note that customs formalities and physical checks would still be required (as is currently the case in the EU-Turkey Customs Union).

#### 3.4.4 Elimination of Customs Duties on Import into the UK

In order to keep the UK market attractive for producing and distributing goods after Brexit and prevent from the (possible) negative impact of a no-deal scenario (we refer to paragraph 3.2), the UK could consider to eliminate all customs duties and reduce compliance obligations upon the import of goods into the UK. The advantage of this scenario would be that less focus has to be placed in the UK on customs compliance. In this scenario, it would be less important how a product should be classified for customs purposes, what the origin of that product is and whether or not the customs value is correct, putting less pressure on customs authorities and businesses in the UK (see also section 4.4. below). Another advantage will be that imports of goods into the UK would be stimulated due to the absence of tariffs and compliance obligations. A disadvantage would be that certain (particularly producing) sectors within the UK would lose protection from duty rates on non-UK products.

Based on WTO law,<sup>34</sup> the UK is not allowed to discriminate between different WTO members (Article 1 of the General Agreement on Tariffs and Trade (GATT 1947)), except where it has a customs union/free trade agreement in place or is giving preferences to developing countries. Therefore, the UK would have to eliminate the tariffs and obligations not just in relation to the EU, but in relation to all WTO members unilaterally in this scenario.

It is further important to mention in this respect that the elimination of customs duties and the associated reduction of compliance obligations only works one way. It would be up to the UK's counterpart (such as the EU) to decide whether or not to levy customs duties on exports from the UK. However, the WTO counterpart

of the UK is normally not able to choose. This is due to the fact that without a free trade agreement in place, a WTO member cannot simply eliminate tariffs on goods originating from the UK, due to the non-discrimination principle (as outlined above). It would then also have to eliminate the tariffs on goods coming from all other WTO member countries. UK exports could therefore still be subject to customs duties and compliance obligations, where the UK imports are not.

We refer to section 3.2 for the circumstances and consequences on EU-UK trade, whereby we note that customs duties and compliance obligations mentioned there will not be applicable with respect to the UK.

## 4 CERTAINTIES FOR THE FUTURE EU-UK TRADE RELATIONSHIP

Regardless of the outcome of the negotiations (except for the – currently – unlikely Customs Union scenario as outlined in paragraph 3.4.3), certainties exist regarding the future trade relationship between the EU and the UK. Below we outline some of these.

### 4.1 Customs Formalities

In any scenario (even in a Customs Union similar to the Turkish model (which is unlikely to come in place, we refer to section 3.4 above)), all EU-UK movements of goods will become subject to customs formalities, both on the EU and the UK side. In the case of a transition period, this effect would only be postponed until December 2020 (no customs formalities yet during the transition period). Pursuant to the UCC (Article 6 paragraph 1, Article 6 paragraph 3 and Article 158 paragraph 2), an electronic customs declaration is required in the EU (in other cases paper declarations are still permitted) when the customs border (which will come into place as a result of Brexit) is crossed.<sup>35</sup> This customs declaration must contain all the information required for the provisions applicable to the customs procedure for which the goods are declared (Article 162 of the UCC and Article 222 of the UCC). In addition, for the customs declaration for free circulation, in principle a number of supporting documents must be submitted in order to be able to accept the declaration (Article 163 (1) of the UCC). These supporting documents serve to substantiate claims in the customs declaration, such as the origin, the customs value, the type of goods, the weight, etc.

The above legal determination that a customs declaration must be made, with the correct information and evidence concerning (inter alia) the origin, customs value and classification of the goods can have major consequences for companies and authorities. Filing an incorrect customs declaration is punishable (usually

steps' it had taken to secure 'an arrangement which enables the UK to continue participating in a customs union with the European Union'. We refer to The Guardian, *Brexit Bill: May Under Pressure After Two Big Defeats in Lords*, Amendment calling for UK to continue in customs union with EU passed by majority of 123 (18 Apr. 2018).

<sup>33</sup> We refer to the website of the Guardian [online via [www.theguardian.com/politics/2018/apr/26/nicky-morgan-tories-will-not-be-for-given-if-brexit-hurts-economy](http://www.theguardian.com/politics/2018/apr/26/nicky-morgan-tories-will-not-be-for-given-if-brexit-hurts-economy) (accessed 19 Apr. 2018)].

<sup>34</sup> Whereby we assume that the UK will remain a member of the WTO after the Brexit.

<sup>35</sup> We assume that these requirements will also apply in the UK after Brexit.

under administrative law, but sometimes also under criminal law). Companies will therefore be faced with a higher administrative burden (to collect the above data) and higher costs (apart from the higher administrative burden, the submission of customs declarations will cost money as it usually involves third parties (customs agents) being hired). In addition, companies active in the EU-UK trade may have to appoint customs educated personnel (or have to educate existing staff) in order to meet the obligations.

## 4.2 EU Trade Agreements

The EU currently has around forty (regional or bilateral) free trade agreements in place.<sup>36,37</sup> In total, these forty agreements cover about sixty countries worldwide.<sup>38</sup> The UK will cease to be a party to the current and future EU free trade agreements as of 29 March 2019 as a result of Brexit.

We note in this regard that an agreement on a possible transition period in principle only has effect between the EU and the UK. As far as the free trade agreements concluded by the EU with third countries are concerned, this transitional period does in principle not apply: these free trade agreements are strictly speaking no longer applicable to the UK from the moment the UK leaves the EU. However, the UK will have to abide by all EU international agreements, including free trade agreements, on the basis of the draft withdrawal agreement. At the same time, there is no guarantee that trading partners from third countries will do the same. Our expectation is that some (major) trading partners will demand UK concessions if they want to retain the same benefits they currently enjoy under EU trade agreements during a transition period and beyond.

This can in particular lead to the situation in which the export of goods from the UK to countries with which the EU has trade agreements becomes more expensive (as those could become subject to import duties in that other country) compared to exports from the EU's mainland to these countries (as those would not become subject to import duties). This situation could already occur after 29 March 2019, depending on the goodwill of UK's trading partners.

## 4.3 Customs Authorizations and Binding Information

The UCC facilitates various regulations that simplify the application of customs legislation or offer (financial and/

or trade) benefits to companies (such as transit, storage in customs warehouses, inward/outward processing). In almost all cases, however, it is necessary for the application of these regulations to make use of a customs license (Article 211 of the UCC). Customs licenses can only be granted to persons based in the EU (Article 211 paragraph 3 under a UCC). This means that companies based in the UK (without permanent establishment on the EU's mainland) from 29 March 2019 or 1 January 2021 (if the withdrawal agreement with transition period is accepted by both parties) can no longer use customs licenses in the EU. All advantages of these permits will therefore be denied to UK entities if they do not establish an EU-based entity or otherwise take action (e.g. forms of customs representation). For the opposite case, EU persons without a permanent establishment in the UK, the consequences will probably be the same.

In addition, 'binding information'<sup>39</sup> issued by the British Customs Authority will no longer have effect on the EU's mainland (and vice versa).

## 4.4 Companies and Customs Authorities Are not Ready (Yet)

Research initiated by the Dutch Ministry of Economic Affairs shows that out of all companies that have shipped goods between the Netherlands and the UK more than 35,000 companies are not yet known to Dutch customs.<sup>40</sup> This most likely means that all these companies do not have any customs function yet and have not yet been involved in essential customs matters such as customs valuation, tariff classification and origin of goods, which are required for the submission of a correct customs declaration. We therefore expect that these companies in particular will be hit hard by Brexit (in all scenarios). They will most definitively require a transition period in order to prepare themselves. This research only relates to companies shipping goods between the Netherlands and the UK; the total number of companies shipping goods between the EU and the UK without being known to customs authorities is most likely much higher.

Brexit therefore requires more personnel with customs knowledge: not only on the side of businesses but also on the part of customs authorities (both EU and UK). Customs authorities face a significant increase in the number of customs declarations and still need to be able to effectively carry out their controls and checks. However, the supply on the labour market with the necessary customs knowledge and experience is currently inadequate.<sup>41</sup> The immediate expansion of

<sup>36</sup> In addition, the EU is negotiating trade agreements with several countries (e.g. Brazil, India, USA). With Japan (a major trading partner) it was able to conclude negotiations on a free trade agreement in Dec. 2017.

<sup>37</sup> We refer to the website of the European Commission regarding the current status of trade agreements and negotiations [online via [ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements](http://ec.europa.eu/trade/policy/countries-and-regions/negotiations-and-agreements) (accessed 19 Apr. 2018)].

<sup>38</sup> *Ibid.*

<sup>39</sup> In the field of classification or origin of goods.

<sup>40</sup> Dutch Ministry of Economic Affairs and Climate and the Ministry of Agriculture, Nature and Food Quality (by KPMG) (2018), Impact van non-tarifaire handelsbelemmeringen als gevolg van Brexit (Impact of non-tariff trade barriers due to Brexit), Reference: A1700012187.D5.

<sup>41</sup> *Ibid.*



customs capacity at both the level of the authorities and businesses can therefore be difficult and can only be expected to be met with significant delay.<sup>42</sup>

Another complicating factor is the IT infrastructure, both on the part of companies and those of the authorities. Most striking in this context is the new customs IT system that the British Customs Authority (HMRC) introduces three months before the start of Brexit, in January 2019. This system is called the Customs Declaration Service (CDS). Due to Brexit an increase in the number of UK customs declarations is expected from 55 million to 255 million per year.<sup>43</sup> The big question is whether CDS will be ready in time to handle such a large number of declarations in such a short period of time (especially in the case of a hard Brexit as of March 2019). The timing of the introduction – so close to Brexit – also seems unfortunate. In this respect too, a possible transition period until 1 January 2021 would be most welcome.

#### 4.5 Irish Customs Border

The border between Ireland and Northern Ireland is the only land border separating the EU and the UK. There are some 200 possible crossing points on this border which stretches 500 kilometres.<sup>44</sup> With the disappearance of the EU Customs Union, this border will likely change into a customs border (between the EU and the UK). This Irish border seems to be a sensitive issue in the negotiations at the moment. The European Parliament calls it one of the most politically sensitive aspects of Brexit.<sup>45</sup>

In the joint report of December 2017, both the EU27 and the UK committed to avoid a ‘hard border’ (mainly referring to (physical) customs checks at the border crossing) on the island of Ireland following the withdrawal of the UK. However, given that the Customs Union will most likely disappear with respect to the UK (as explained above), it seems unlikely that there will be no ‘hard border’ between Ireland and the UK (otherwise the external borders of the EU cannot be controlled along the 500 kilometres of border).

The withdrawal agreement does provide for a solution in which Northern Ireland (excluding territorial waters) would be considered to be inside the Customs Union, even if the rest of the UK would be out.<sup>46</sup> This

proposal is called the ‘Common regulatory area’ constituting an area comprising the EU and Northern Ireland without internal borders in which the free movement of goods is ensured.<sup>47</sup> This would mean that there would be no need for customs controls at the Irish border, but there would be customs controls between Northern Ireland and the rest of the UK. The withdrawal agreement shows that agreement has not yet been reached on this point,<sup>48</sup> in contrast to many other points, and it is uncertain (if not unlikely) whether agreement will be reached in relation to this solution.

There are also other solutions available that could mitigate the disadvantages of a ‘hard’ Irish border. The European Commission published a study on 22 November 2017 that would prevent a hard border between Ireland and Northern Ireland with regard to customs controls and the movement of persons: Smart border 2.0.<sup>49</sup> The proposal recognizes that a border with controls is necessary and this document is intended to make the border as frictionless and open as possible. This could be achieved through the use of technological innovations, cooperation agreements and various systems of pre-checks. The method is based on systems used at borders such as Norway-Sweden, New Zealand-Australia and Canada-United States. Although Smart Border 2.0 relies on technology to reduce friction level at the border, it still requires a certain level of both physical and digital infrastructure. As far as we are concerned, therefore, this proposal cannot prevent that there will still be a ‘hard border’ (although the level of friction will be lower than on other customs borders).

## 5 CONCLUSION

At this moment it seems likely that a Brexit transition period will be agreed (in accordance with the draft withdrawal agreement) that will last from 29 March 2019 to 31 December 2020. However, if the Brexit negotiation or ratification process cannot be completed in time (before 29 March 2019), a ‘hard Brexit’ will take place on 29 March 2019, the impact of which would be immense for EU-UK trade.

<sup>42</sup> *Ibid.*

<sup>43</sup> House of Commons Committee of Public Accounts (2017), Brexit and the future of Customs – Second Report of Session 2017–2019 Report, together with formal minutes relating to the report, HC 401.

<sup>44</sup> *Ibid.*

<sup>45</sup> European Parliament – Policy Department for Citizen’s Rights and Constitutional Affairs, Study for the AFCO Committee, Smart Border 2.0 Avoiding a hard border on the island of Ireland for Customs control and the free movement of persons, PE 596.828-Nov. 2017.

<sup>46</sup> *Ibid.*, at 110.

<sup>47</sup> *Ibid.*, at 110.

<sup>48</sup> European Commission, Task Force for the Preparation and Conduct of the Negotiations with the United Kingdom under Art. 50 TEU, Draft Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community highlighting the progress made (coloured version) in the negotiation round with the UK of 16–19 Mar. 2018, TF50 (2018) 35 – Commission to EU27.

<sup>49</sup> European Parliament – Policy Department for Citizen’s Rights and Constitutional Affairs, Study for the AFCO Committee, Smart Border 2.0 Avoiding a hard border on the island of Ireland for Customs control and the free movement of persons, PE 596.828-Nov. 2017.

As far as the long term future trade relationship between the EU and the UK is concerned, we see four possibilities (in order of likelihood):

- (1) A comprehensive free trade agreement, similar (although more far-reaching) to the recent EU free trade agreements with Canada and South Korea;
- (2) No deal between the EU and the UK, as a result of which there will be a fall back to WTO rules (whereby we expect that after a certain period of time a comprehensive free trade agreement will be concluded);
- (3) A Customs Union with the EU;
- (4) Elimination of customs duties on import into the UK.

Regardless of the above scenarios (except for the – currently – unlikely Customs Union scenario), we see a number of certainties regarding the future trade relationship between the EU and the UK:

- (1) All EU-UK movements of goods will become subject to customs formalities from 29 March 2019 or from 1 January 2021, both on the EU and the UK side;
- (2) The UK will cease to be a party to the current and future EU free trade agreements as of 29 March

2019. During the possible transitional period until 1 January 2021 these agreements will still be applied to trade between the UK and third countries with whom these agreements have been concluded. The big question, however, is whether these countries will agree and whether they will require further concessions from the UK;

- (3) Companies based in the UK (without a permanent establishment on EU's mainland) can in principle no longer use customs licenses in the EU after Brexit (and vice versa);
- (4) Companies and customs authorities are not yet ready for Brexit, especially in the field of personnel and IT (particularly if a 'hard Brexit' takes place on 29 March 2019);
- (5) In all likelihood, a hard Irish customs border will arise.

From a customs perspective it is clear that Brexit will have a large impact on EU-UK trade, regardless of the outcome. It will be crucial to closely follow the negotiations and ratifications on the UK's withdrawal from the EU and the future relationship between the EU and the UK the coming months. We emphasize that 'nothing has been agreed until everything has been agreed'.