

# Navigating the Road Ahead: **The Impact of Brexit on E-commerce**

UK Retail Brexit Trade Update

February 2021

**The whole country will have been relieved to hear that the UK finally managed to agree a Free Trade and Cooperation Agreement with the EU on 24 December 2020 (the “EU/UK Free Trade and Cooperation Agreement”), just seven days before leaving the EU on 31 December 2020.**

The EU/UK Free Trade and Cooperation Agreement will now determine the trade relationship between the UK and the EU from 1 January 2021. However, the deal does remain subject to the need for it to be approved by the EU Council and EU Parliament, which is anticipated by 28 February 2021. Until 28 February 2021, the EU/UK Free Trade and Cooperation Agreement will be provisionally applied. Hence, all that follows is still subject to the risk of further change. However, given the disruption that will follow for the EU, the risk of the deal being pulled at this stage by the EU is, hopefully, very low.

The following comments are a high-level summary of the position as it impacts on e-commerce and, more generally, the retail sector. However, it is important to remember that there are more exceptions to the rules than there are rules. Hence, specific advice should always be sought as regards the specific goods and their origin.



# Summary

Whilst the EU/UK Free Trade and Cooperation Agreement provides a basis for free trade between the UK and the EU, there are a number of important caveats. In addition, whilst trade between the UK and the EU used to be frictionless, there is now a significant amount of customs-related paperwork to complete and understand. All of this is impacting retail and, in particular, cross-border UK/EU e-commerce.

This briefing is intended to highlight the key questions all e-retailers need to consider in relation to UK/EU e-commerce, being:

- Do the goods being sold by UK e-retailers in the EU (and vice versa) qualify for free trade?
- Will double tariffs be payable when stock that is imported into the UK from outside the EU is re-exported from the UK to customers in the EU (and vice versa)?
- What needs to be done to prove the origin of goods?
- Who pays any resulting tariffs?
- How are tariffs calculated if they are payable?
- To what extent is e-commerce exempted from tariffs?
- What customs paperwork needs to be completed?
- What is the overall impact on e-commerce operations?
- When is VAT payable?

## What Are the Issues for UK and EU Retail Moving Forwards?





## Will a Tariff Be Payable?

One of the biggest benefits of Brexit is that the UK is able to do its own free trade deals with countries outside of the EU. Here, the UK has been busy rolling over many of the free trade agreements that it used to benefit from whilst being a member of the EU, whilst also signing up to new free trade deals with other countries (such as Japan). In addition, the UK is joining other free trade areas, such as the Comprehensive and Progressive Trans-Pacific Free Trade Area, and is prioritising other free trade arrangements with the US, the South East Asia countries and so on. This is all good news for UK retail in terms of opening up new markets for UK-based e-commerce and for importing more stock into the UK tariff free.



However, matters are not as simple as they used to be for UK/EU e-commerce, which had been growing at a significant rate. Here, it is important to realise that the EU/UK Free Trade and Cooperation Agreement does not provide for tariff-free trade between the EU and the UK in all circumstances. Rather:

- Any goods traded between the UK and the EU must satisfy the Rules of Origin requirements to be sufficiently British or European (as the case may be) to qualify for an exemption from tariffs when traded between the UK and Europe. If goods are sold by an e-retailer in the UK to customers in the EU that do not meet the origin requirements, a tariff will be payable.
- Whilst content qualifies to be British or European (as the case may be) if it includes content originating in the other, content from all other third countries will not count even if both the UK and the EU have a free trade agreement with a particular third country (with certain limited exceptions).
- There are a number of anomalies regarding certain countries that have a free trade agreement with the EU (which used to cover the UK), but those arrangements have not yet rolled over into a new free trade agreement with the UK. Whilst this should resolve over time, tariffs will now be payable on imports from such countries into the UK (e.g. bananas from Ghana) until new free trade arrangements are agreed.
- Stock that is imported into the UK from a country with whom the UK has agreed a new free trade agreement will be tariff free on importation to the UK but will be subject to tariffs when any goods from any such consignment are subsequently exported by UK e-retailers to customers in the EU.
- Stock that is imported into the UK from a country with whom the UK does not have a free trade agreement will be subject to tariffs when being imported into the UK and, again, when any of that stock is exported by e-retailers to customers in the EU.
- The EU and the UK reserve the right to apply tariffs on imports from the other if the other does not abide by the “Level Playing Field” rules. Whilst there is a complex governance process for managing the deal and any disputes, the threat of tariffs being imposed by one or the other remains a possibility.

# Rules of Origin



## What Needs to Be Done to Prove Origin?

Turning back to Rules of Origin, proof or declarations of origin need to be provided at the time of import to certify the origin of the products. These can be provided by the exporter or provision is made for the importer to self-certify doing so from its knowledge.

The contract of purchase between the supplier and the retailer will then determine who is liable to pay any resulting tariff. This may be stated in the contract itself. In many cases, this is done by reference to one of 11 Incoterms from ex-works to delivered duty paid. Whilst companies in the automotive and aerospace sectors can defer producing the required evidence in 2021 given the complexity of their supply chains, this option does not apply in the retail sector. Accordingly, origin needs to be stated now if goods are to clear customs. If not, the goods in question will be stuck at port.

In all of this, establishing origin is complicated by the fact that every product type has a different origin requirement. This needs careful checking.

## Agree Who Pays the Tariff

Once it has been determined that a tariff is payable, it will be necessary to agree who pays the tariff and to calculate the tariff:

- For goods being imported by a retailer from a supplier, will this be the retailer or the supplier (which may be the original manufacturer or the entity that has the relevant distribution rights)? This may depend on the negotiating strength of the parties and/or the choice of the selected Incoterm. Here, the choice of Incoterm may not be appropriate post-Brexit, as little thought was often given to this whilst the UK was part of the EU.
- In some cases, a retailer will seek to pass on tariff costs to its customers, but this will affect the price of the goods.
- In other cases, the goods may be too price sensitive for the retailer to pass on any tariff costs or to absorb tariff costs within its margin.
- From the perspective of a retailer buying stock and regardless of whatever is agreed between the supplier and the retailer as to who pays any tariffs, the retailer should ask the supplier to indemnify the retailer for any tariff costs arising as a result of the origin declarations being wrong. This is because the supplier will have been required to certify the origin of the goods. If the supplier's certification initially suggests that no tariffs are payable, the supplier should pay the tariffs if its certification was wrong. However, if the supplier defaults and becomes insolvent before paying, the liability to pay any resulting tariff costs will remain with the retailer as the importer.
- For goods sold by a UK e-retailer to end customers in the EU (and vice versa), the e-retailer will, in most cases, want the end customer to pay the tariffs alongside any increased costs associated with delivery and compliance with customs procedures. This will have a severe impact on the attractiveness of any such goods to end customers. In addition, all of this will need to be made clear to customers when they confirm their orders. If not, many customers may refuse to accept delivery of the ordered goods, forcing e-retailers to re-import the goods or to dispose of them within the trade in the destination country. In all scenarios, tariffs remain payable. If such goods are re-imported, it may be possible to claim Returned Goods Relief but this will be an administrative burden. See later comments in relation to the impact on e-commerce and how the online trading solutions of retailers will need to identify when tariffs are payable and by who.

# Rules of Origin



## How to Calculate the Tariff

Calculating tariffs is complicated. It is important to realise that:

- Tariffs are calculated on a product-by-product basis according to thousands of different product “commodity codes”.
- In addition, the final tariff will depend upon the answers to the following questions:
  - Can any preferential duty rates be applied?
  - What is the value of the goods for purposes of calculating tariffs by using one of six methods that must be considered in a cascading sequence (the first being the transaction value)?
  - Do any special customs procedures apply to the particular transaction? For example:
    - Are the goods imported into a bonded warehouse? Tariffs only become payable in the UK when the goods are moved out of the bonded warehouse into the UK or the EU for free circulation.
    - Are the goods imported on a temporary basis for display, for example, at a trade show?
    - Do any inward and outward processing reliefs apply?
  - Where do the goods originate from? Here, the tariff will be based upon the so-called “Most Favoured Nation” tariff, which is the World Trade Organization default tariff unless one of the following exceptions applies:
    - If the goods originate from a country that benefits from the General System of Preferences, a lower tariff will apply.
    - If the goods originate from a country that benefits from the Least Developed Country Framework, lower tariffs will apply.

In addition, it is important to realise that if a retailer purchases stock from a non-EU country, tariffs will be payable at the time of import into the UK and, again, when any such goods are exported to an end customer in the EU from a UK distribution centre (and vice versa). For stock orders, it may be possible to avoid double tariffs by first delivering the consignments to a bonded warehouse at the UK port of entry from where any part of that consignment is sorted for onward shipping to the EU (or vice versa). However, bonded warehouses are not sophisticated distribution hubs from where individual consignments of goods can be sorted for the purposes of quickly despatching individual orders of single items to end customers. Accordingly, e-retailers may need to consider setting up distribution hubs in both the UK and the EU. However, these additional layers of processing and storage will also add cost.



# Customs Compliance



Regardless of any tariff issues, it is important to realise that the EU/UK Free Trade and Cooperation Agreement does not provide for frictionless trade. This means that all goods traded between the UK and the EU must now be accompanied with a significant amount of paperwork. Whilst the UK was part of the EU, none of this applied, as goods could circulate freely between the UK and the rest of the EU. The fact that this is no longer the case has surprised many businesses. Here, “tariff free” does not mean “free of checks and customs compliance” and the resulting cost and complexity of compliance is causing suppliers and retailers to question whether it makes economic sense to continue to trade. This is particularly the case with fresh produce, where customs delays at ports may cause the shipment to go off whilst it is held up by problems with customs paperwork. This applies equally to shipments of stock as it does to individual orders of perishable products.

This is because, in return for the UK being free to set its own laws and regulations (so long as these laws and regulations do not distort the level playing field), the UK is now regarded as a third country from the rest of the EU. This, in turn, means that all customs procedures must be complied with at the time of both exporting and importing goods between the UK and the EU. The fact that the UK has only just left the EU makes no difference. The resulting red tape is causing huge difficulties, both in terms of understanding exactly what is required and in terms of the cost of complying.

If this is not complex enough at the level of a stock order between the UK and the EU, the same customs procedures also apply to orders of individual items by an end consumer in the UK or the EU from an e-retailer in the other. Clearly, retailers and their logistics providers will need to develop very efficient processes to deal with all of the resulting paperwork.

Looking at this in more detail, for all movement of goods between the UK and the EU:

- EORI numbers are required for both the UK and the EU sides of the transaction
- Companies must decide to deal with customs compliance themselves or via a customs agent
- Export declarations are required to export
- Import declarations are required to import
- Declarations of origin are required for each and every type of item in the shipment
- Additional paperwork is required if tariffs are payable – this paperwork needs to show the commodity codes of the goods, their customs value, any relief claimed through preferential rates, duty deferment and other reliefs
- Simplified procedures are available for Authorised Economic operators
- Product conformity checks may be required
- Additional procedures apply for shipments from the GB mainland to Northern Ireland

In all of this, retailers will need to decide whether to manage this themselves or via a customs agent, and which of the three following procedures to use as regards customs declarations. Here, the following possibilities exist:

- Delayed declarations
- Standard declarations
- Simplified declarations

In addition, various enhanced procedures apply for the importation of all manner of food products, from fish and animals to crops and cosmetics and health products. These relate to additional certifications and checks in relation to product safety.

These difficulties are all magnified when it comes to actually shipping products across the border in containers or trucks that contain multiple product types, which, in many cases, will be sourced from multiple suppliers. All of these procedures are creating huge challenges to all companies in the retail supply chain.



## When Is VAT Payable?

With effect from the end of the implementation period, at 11 p.m. on 31 December 2020, the UK left the EU VAT regime and several changes to the UK's VAT regime entered into force.

Accurately identifying where (and when) any VAT liability is triggered will affect pricing models, a business' sale and purchase terms and conditions, and the scale of its tax administration and compliance obligations. Some of the key changes are highlighted below:

Retailers Importing and Exporting Stock	Low-value Consignments and Online Retailers
<p>From 1 January 2021, UK import VAT is charged on imports of goods from the EU into the UK. The import VAT rate applicable is aligned with the rate imposed on a supply of goods of the same description in the UK – the standard rate is 20%. Import VAT is payable at the border at the point the goods enter the UK. However, most UK VAT registered importers will be able to use postponed VAT accounting (PVA). PVA allows the importer business to account for the import VAT, and recover its input VAT, in its periodic UK VAT return.</p> <p>The position on the reverse movement of goods (i.e. from the UK into the EU) is almost identical – that is, import VAT will be payable at the border at the point of entry, at a rate applicable to a supply of those goods in the EU jurisdiction of import. Crucially, the appointment of a local fiscal representative may be required and PVA may not be available in some EU member states.</p>	<p>From 1 January 2021, in relation to the importation of a consignment of goods not exceeding £135 in value into the UK, the point at which VAT is collected moved from the point of importation to the point of sale by the seller. Thus, the seller must now pay the VAT. Goods are deemed as being supplied in the UK at the point of sale and, as such, are liable to UK supply VAT (not import VAT). There is no registration threshold, so a non-UK seller will be required to register for UK VAT (if not already registered) and account for UK VAT to HMRC. The £135 threshold applies to the intrinsic value of the whole consignment, not each individual item within it. If the overall value of the consignment is over £135, the normal import rules will apply, with UK import VAT chargeable at the point of entry into the UK.</p>

However, the new rules for low-value consignments are tweaked in two broad circumstances:

Business-to-Business (B2B) Sales	Business-to-Consumer (B2C) Sales Facilitated by an OMP
<p>Provided the UK business customer is UK VAT registered, and subject to a number of conditions, the UK supply VAT can be accounted for by the UK business customer under the "reverse charge" mechanism. The reverse charge variation is also available in circumstances where an online marketplace (OMP) facilitates the sale. The non-UK seller (or, as the case may be, the OMP) will not need to register or account for UK VAT.</p>	<p>Where the sale of goods (that are outside the UK at the point of sale) by a non-UK seller to a UK consumer is facilitated by an OMP, the OMP will be deemed to be making the supply to the UK consumer. Responsibility for registering and accounting for the UK VAT on the supply is then moved from the overseas seller to the OMP. Where the goods are already in the UK, the OMP will (again) be deemed to be making the supply and will, therefore, be liable to register, and account, for UK VAT. The overseas seller will be deemed to make a VAT zero-rated supply of the goods to the OMP enabling it (subject to a UK VAT registration) to reclaim any UK import VAT that is incurred in connection with importing the goods to the UK.</p>

It is worth noting that the EU will introduce almost identical rules (for consignments not exceeding €150) from 1 July 2021. Other than the six-month delay, the main difference is that the proposed EU rules are not compulsory; a business will be able to choose to apply the normal import rules such that the place of supply is not moved and import VAT will apply at the border point of entry of the goods into the relevant EU member state.

The impact on relatively low-value, but high-volume, cross-border transactions will be significant. Businesses need to identify the VAT treatment of their imports, exports, direct sales and those facilitated via an OMP.

# Impact on E-commerce



New rules on tariffs, Rules of Origin and customs compliance and the timing of VAT payments are all likely to have significant implications for e-commerce. In particular:

- Tariffs will not be payable on goods traded between the UK and the EU if the goods meet the UK/EU cumulated origin requirements.
- Tariffs will not be payable on goods imported into the UK from any country with whom the UK agrees a free trade agreement – this list continues to grow and will shortly include the countries of the Comprehensive and Progressive Trans-Pacific Free Trade Area
- For some countries, the old EU free trade agreement has not yet been rolled over into a new UK free trade agreement. Until a new free trade agreement is agreed, tariffs will now apply to imports from such countries.
- Tariffs will be payable on all consignments of stock imported by retailers for delivery to the UK from the EU if such goods do not meet the UK/EU cumulated origin threshold.
- Tariffs will be payable on all goods imported into the UK from countries with whom the UK and that country do not have a free trade agreement (e.g. China). If any such goods are then sold to end customers in the EU from the UK, an additional tariff will be payable to import those goods to the EU from the UK. This will have a big impact on some e-retailers.
- Tariffs vary by product classification and composition, and tariffs from imports from some countries are lower than the standard tariff rates.
- Tariff costs will vary as the price of the goods change, i.e. as products sold at full price as opposed to any number of sales prices.

In addition, considerable additional costs will be incurred by all retailers, as they now have to comply with a range of new customs formalities, including Rules of Origin declarations. E-retailers will need to increase their prices if profit margins are to be sustained

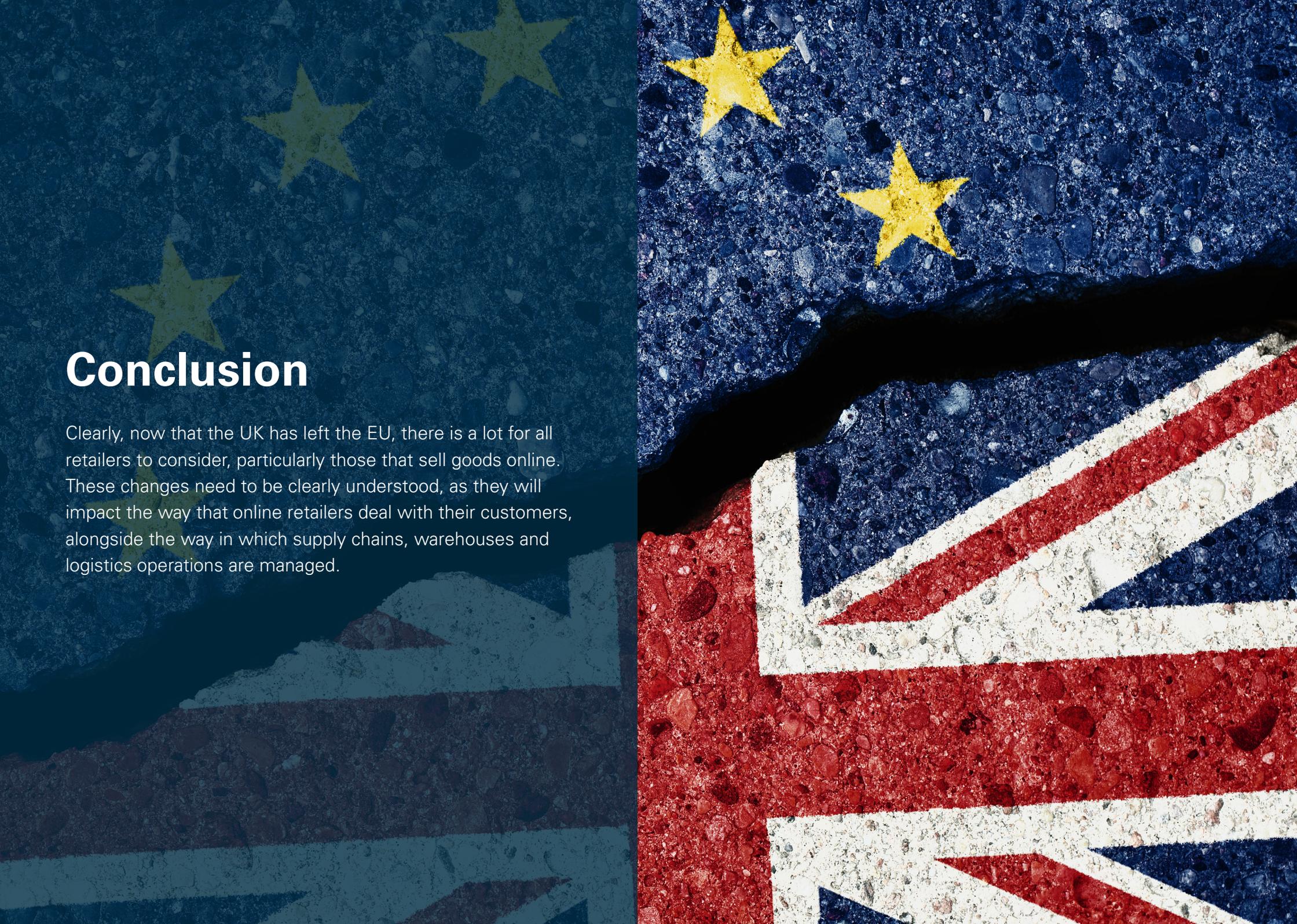
Finally, new rules apply to the collection of VAT.

Moving forwards, all e-retailers will need to make it clear when certain products may attract tariffs if bought by a consumer in the EU (and vice versa). This will be considerably complicated by the fact that some products will be tariff free whilst other products of the same type will be subject to tariffs depending upon their origin. If excess returns are to be avoided, websites and online order confirmations will need to be clear about any additional customs and logistics costs that will be added to the cost of orders. Currently, there are many examples of couriers demanding additional payments from customers before goods will be delivered. Clearly, this will all have a damaging effect on all e-commerce between the UK and the EU.

In addition, for those companies that operate a single European Distribution Centre in the UK from which online orders are supplied to the EU (and vice versa), double tariffs will be payable if the goods do not pass the Rules of Origin threshold. Here, tariffs will be payable when goods are imported from a country that does not benefit from a free trade agreement with the EU or the UK (as the case may be) and when those goods are sold on to a consumer in the EU from a UK distribution centre (and vice versa). These issues are compounded if any goods are then returned.

All of this could have a dramatic impact on consumer sales and may force companies to consider establishing separate distribution centres for the UK and the EU.





# Conclusion

Clearly, now that the UK has left the EU, there is a lot for all retailers to consider, particularly those that sell goods online. These changes need to be clearly understood, as they will impact the way that online retailers deal with their customers, alongside the way in which supply chains, warehouses and logistics operations are managed.

## Contacts



### Simon Jones

Partner, Birmingham  
T +44 121 222 3412  
M +44 785 006 2155  
E [simon.jones@squirepb.com](mailto:simon.jones@squirepb.com)



### Robert MacLean

Partner, Brussels and London  
T +322 627 7619  
T +44 20 7655 1651  
E [robert.maclean@squirepb.com](mailto:robert.maclean@squirepb.com)



### Robert O'Hare

Senior Tax Policy Advisor, London  
T +44 20 7655 1157  
M +44 771 230 4903  
E [robert.ohare@squirepb.com](mailto:robert.ohare@squirepb.com)

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Our Brexit and International Trade teams include former members of the UK Parliament, a former Office of the US Trade Representative, members of the European Parliament and senior regulators, as well as European Free Trade Association officials, former ambassadors and national government ministers. They work collaboratively with our legal practitioners who master all relevant areas of law affected by Brexit, such as international trade, contracts, regulated industries (e.g. financial services), immigration, labour and employment, tax and competition.



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