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# UK Exit from the EU Briefing Paper Series Withdrawal Agreement, Protocol and Political Declaration – Potential implications for Value Added Tax and Excise in Northern Ireland

**Paper 3 of 6**

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This is paper 3 of a 6-part series. It explores key potential implications arising from the Withdrawal Agreement, the Protocol and the Political Declaration for VAT and excise. Throughout, the paper provides potential scrutiny points.

This information is provided to Members of the Legislative Assembly (MLAs) in support of their duties, and it is not intended to address the specific circumstances of any particular individual. It should not be relied upon as professional legal advice, or as a substitute for it.

## Key points

- This paper is the third in a series of six papers on the Withdrawal Agreement, the Protocol and the Political Declaration. It largely focuses on the key potential NI implications under Article 8 of the Protocol, which concerns Value Added Tax (VAT) and excise in the United Kingdom (UK), following the current transition period, which is due to end on 31 December 2021.
- Article 8 of the Protocol provides fiscal measures for the UK Government. It states that NI will remain under the UK system. However, it further allows the UK Government to vary the applicable VAT rate on goods in NI, in order to match the comparable rate applicable to the same goods in the RoI.
- What potential this fiscal measure could have to enhance NI economic development is unclear at the time of writing this paper. This is due to a number of unresolved matters under the Protocol, including those relating to customs and trade, which are to be settled through negotiation under the Political Declaration between the UK and the EU, prior to the transition period end. Nonetheless, it would be helpful for the Committee for the Economy in the Assembly to learn more about the extent to which the Department for the Economy has explored the possible operation of Article 8 and its potential NI implications, with other NI Executive Departments and or the UK Government and Treasury.
- Value Added Tax (VAT) is a significant revenue source in the UK. It therefore seems highly probable that any future NI VAT rate variation to match the RoI rate, would result in adjustment the NI Block Grant. This is due to the existing financial framework under current devolution arrangements. How any such adjustment would be determined is unclear at the time of writing, as discussion would be required between the NI and the UK levels of government; potentially similar to what has occurred in the past in relation to Air Passenger Duty rate-setting in NI.
- In addition, business bodies and legislative committees have expressed concern about potential compliance costs for the future operation of VAT and excise in NI, which should be noted.
- In that regard, the UK Government has provided some limited assurance, but it is apparent that the Joint Committee still need to consider VAT and excise-related issues in detail; and indeed, it is specifically mandated to do so.
- This is important because, as many analysts have pointed out, the UK VAT regime will continue to be under the jurisdiction of the European Court of Justice following the end of the transition period.

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## Introduction

This briefing paper is the third in a six-part series to support the Committee for the Economy (the Committee), as the United Kingdom (UK) transitions after its formal departure from the European Union (EU) on 31 January 2020. The Withdrawal Agreement,<sup>1</sup> the Protocol<sup>2</sup> and the Political Declaration<sup>3</sup> all interrelate, to guide the UK's transition. Detail on each instrument can be found in papers 1 and 2 of this briefing paper series.

Collectively, those instruments will serve to define the future relationship between the UK and the EU, defining how NI will be governed in a number of important areas. Additionally, the outcome of the ongoing negotiations mandated by the Withdrawal Agreement<sup>4</sup> and specified in the Political Declaration, will define further outstanding issues relating to the future relationship between the UK and the EU, which will determine the application of the Protocol under the Withdrawal Agreement following transition.

In light of the above, the Committee is interested in outstanding matters relating to the Protocol and the Political Declaration; in particular, those that are relevant to the Committee's portfolio, and inevitably will have implications for NI post transition.

To facilitate the Committee in that regard, section 1 of this paper outlines Article 8 of the Protocol that concerns Value Added Tax (VAT) and excise, including the NI VAT rate variation, as well as exemptions and relief. It also includes relevant data and observations that facilitate consideration of these Protocol provisions. Thereafter, Section 2 sets out Article 12(2) of the Protocol, which specifies the role of the European Court of Justice (ECJ) in this area.

Section 3 then explains the relative importance of VAT and excise to the UK Government as revenue-raising instruments, i.e. how they impact the NI Block Grant, which is the annually transferred funding from the UK Government to the Executive

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<sup>1</sup> UK Government, Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (17 October 2019)

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840655/Agreement\\_on\\_the\\_withdrawal\\_of\\_the\\_United\\_Kingdom\\_of\\_Great\\_Britain\\_and\\_Northern\\_Ireland\\_from\\_the\\_European\\_Union\\_and\\_the\\_European\\_Atomic\\_Energy\\_Community.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840655/Agreement_on_the_withdrawal_of_the_United_Kingdom_of_Great_Britain_and_Northern_Ireland_from_the_European_Union_and_the_European_Atomic_Energy_Community.pdf)

<sup>2</sup> UK Government, Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community, Protocol on Ireland/Northern Ireland (19 October 2019)

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840230/Revised\\_Protocol\\_to\\_the\\_Withdrawal\\_Agreement.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840230/Revised_Protocol_to_the_Withdrawal_Agreement.pdf)

<sup>3</sup> UK Government, Political Declaration setting out the framework for the future relationship between the European Union and the United Kingdom (17 October 2019)

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840231/Revised\\_Political\\_Declaration.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840231/Revised_Political_Declaration.pdf)

<sup>4</sup> UK Government, Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (17 October 2019) Articles 184

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840655/Agreement\\_on\\_the\\_withdrawal\\_of\\_the\\_United\\_Kingdom\\_of\\_Great\\_Britain\\_and\\_Northern\\_Ireland\\_from\\_the\\_European\\_Union\\_and\\_the\\_European\\_Atomic\\_Energy\\_Community.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840655/Agreement_on_the_withdrawal_of_the_United_Kingdom_of_Great_Britain_and_Northern_Ireland_from_the_European_Union_and_the_European_Atomic_Energy_Community.pdf)

pursuant to the prevailing financial framework under current devolution arrangements, **after** adjustments are made in relation to tax collection in NI and other. In conclusion, Section 4 provides concluding remarks, drawing on the earlier sections. Potential scrutiny points are highlighted in blue boxes throughout the paper, aiming to support the Committee in its scrutiny role.

To consider other Protocol proposals and related potential NI implications, the following papers in this six-part series are available, namely:

- Paper 1 – Overview of Governance Arrangements;
- Paper 2 – Customs and Trade;
- Paper 4 – Employment;
- Paper 5 – State Aid; and,
- Paper 6 – Single Electricity Market.

## 1. Article 8: VAT and excise

Article 8 provides for ongoing alignment of VAT and excise regimes in both the GB and the EU. **Significantly, it also provides limited variation in NI, despite the fact that NI is a sub-national region within the UK. Such variation is limited to NI matching VAT rates in the Republic of Ireland (RoI), if specified conditions – to be established by the Joint Committee - are to be met.** These as explained below.

This NI exception is a variation from the general EU rule in this area, which generally prohibits sub-national VAT variation. That rule is found in Annex III of EU Directive 2006/112/EC; and permits Member States to apply a reduced VAT rate – on a national level - to a number of goods and services related to the tourism industry, for example.

The following paragraphs provide a general overview of what Article 8 entails:

- **At the first paragraph**, Article 8 specifies that the provisions of EU law listed in Annex 3 to the Protocol will continue to apply to the UK in relation to NI. In respect of VAT, Annex 3 lists eight directives, and the EU's agreements on VAT with Norway and with Switzerland. In relation to excise, Annex 3 further lists 11 directives. The Institute for Government explains:

*Importers have to pay VAT on UK goods when they enter the EU, which could have prompted the need for border checks between Northern Ireland and the Republic of Ireland.*

*To solve this, Northern Ireland will remain part of the EU's IT systems and will be subject to EU law on VAT – though the UK will be responsible for implementing those rules.<sup>5</sup>*

### Potential scrutiny point:

**Will the EU, the UK and or NI have responsibility to ensure the provision of ongoing support for the EU's IT system?**

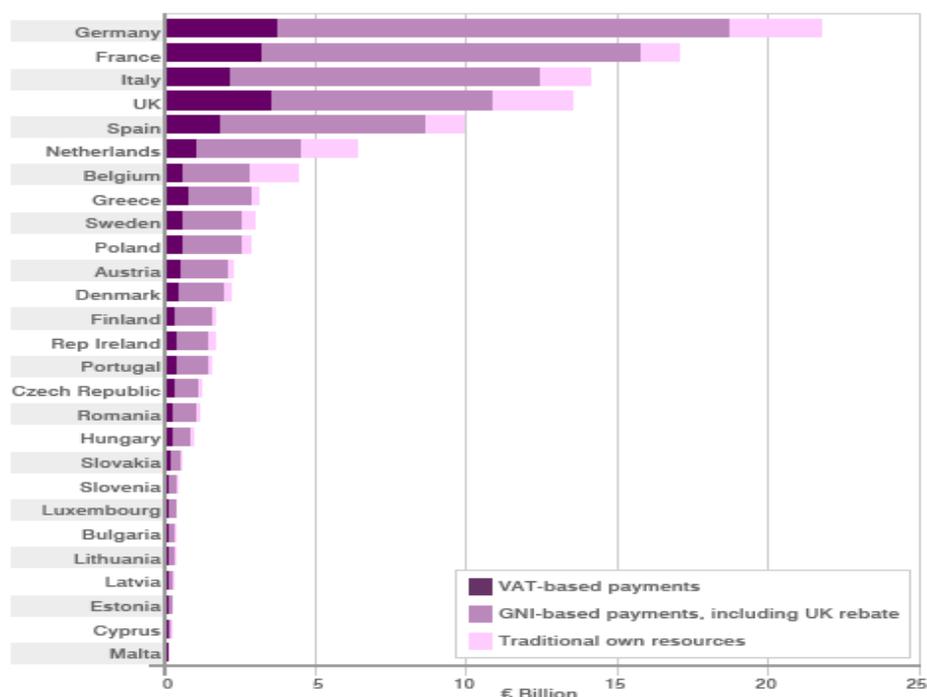
- **At the second paragraph**, Article 8 makes clear that **the UK is responsible for applying and implementing the provisions listed** in the above-referenced Annex 3 to the Protocol. The Article also confirms that revenues resulting from transactions taxable in NI “*shall not be remitted*” to the EU.<sup>6</sup> This departs from the EU rule generally requiring all Member States to pay some of their VAT revenue towards the EU budget:

<sup>5</sup> <https://www.instituteforgovernment.org.uk/explainers/brexit-deal-northern-ireland-protocol>

<sup>6</sup>UK Government, Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (17 October 2019) Article 8 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840655/Agreement\\_on\\_the\\_withdrawal\\_of\\_the\\_United\\_Kingdom\\_of\\_Great\\_Britain\\_and\\_Northern\\_Ireland\\_from\\_the\\_European\\_Union\\_and\\_the\\_European\\_Atomic\\_Energy\\_Community.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840655/Agreement_on_the_withdrawal_of_the_United_Kingdom_of_Great_Britain_and_Northern_Ireland_from_the_European_Union_and_the_European_Atomic_Energy_Community.pdf)

*Each country's payment is divided into three parts: a fixed percentage of gross national income (GNI), customs duties collected on behalf of the EU (known as "traditional own resources") and a percentage of VAT income.<sup>7</sup>*

**Figure 1: the relative contribution of Member States' VAT revenue to the EU budget 2007**



Source: BBC News Online, undated.

Note that Figure 1 uses data from 2007 when the EU last reduced the VAT-based contribution by Member States.<sup>8</sup> It is **not** the quantum of the numbers that is important here; rather it is the **relative importance** of the funding sources from the Member States. The most recent figure on the EU's website states:

*The share of the VAT-based resource constituted 12.2 % of total revenue in 2017 (roughly equal to EUR 17 billion).<sup>9</sup>*

Figure 1 shows that VAT-based payments form the second-largest of the three bases for Member States' payments to the EU budget. It therefore illustrates the importance to the EU of regulating VAT so that it can protect its revenue base. On that basis, it is reasonably foreseeable that the operation of VAT in NI under the Protocol will continue to be of interest to the EU.

In the words of one academic, the Protocol provides the key mechanism for the EU to consider VAT in NI, among other things, because it:

<sup>7</sup> <http://news.bbc.co.uk/1/hi/world/europe/8036097.stm>

<sup>8</sup> [https://ec.europa.eu/info/strategy/eu-budget/revenue/own-resources/value-added-tax\\_en](https://ec.europa.eu/info/strategy/eu-budget/revenue/own-resources/value-added-tax_en)

<sup>9</sup> [https://ec.europa.eu/info/strategy/eu-budget/revenue/own-resources/value-added-tax\\_en](https://ec.europa.eu/info/strategy/eu-budget/revenue/own-resources/value-added-tax_en)

*...operates as the default mode of regulating the relationship between Northern Ireland and the European Union after the transition period.<sup>10</sup>*

As noted above, the Protocol asserts **the UK's responsibility** for enforcing alignment with EU rules. In effect, the EU is "outsourcing" that enforcement.

- **At the third paragraph**, Article 8 permits a limited derogation. It states that the UK:

*...may apply to supplies of goods taxable in Northern Ireland VAT exemptions and reduced rates that are applicable in Ireland in accordance with provisions listed in Annex 3 to this Protocol.<sup>11</sup>*

As noted earlier, this is a departure from past restrictions. More information on exemptions and reduced rates in the UK and RoI is provided in sub-section 1.2 below.

- **At the fourth paragraph**, Article 8 sets out the Joint Committee's role to implement Article 8. Specifically, its role in regard to potential subnational VAT variation, requiring it to:

*...regularly discuss the implementation of this Article, including as concerns the reductions and exemptions provided for in the provisions referred to in the first paragraph, and shall, where appropriate, adopt measures for its proper application, as necessary.<sup>12</sup> [emphasis added]*

On 20 May 2020, the UK Government set out its approach to implementing the Protocol. In relation to the Article 8, it stated:

*The Government is confident that we can use the flexibilities available, in the context of the wider commitments to Northern Ireland's place in the UK internal market, to implement these aspects of the Protocol in a way which minimises new costs and burdens on businesses in Northern Ireland.<sup>13</sup>*

<sup>10</sup> <https://blogs.lse.ac.uk/brexit/2019/10/23/the-new-irish-protocol-could-lead-to-the-indefinite-jurisdiction-of-the-court-of-justice-of-the-european-union-within-the-united-kingdom/>

<sup>11</sup> UK Government, Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (17 October 2019) Article 8 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840655/Agreement\\_on\\_the\\_withdrawal\\_of\\_the\\_United\\_Kingdom\\_of\\_Great\\_Britain\\_and\\_Northern\\_Ireland\\_from\\_the\\_European\\_Union\\_and\\_the\\_European\\_Atomic\\_Energy\\_Community.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840655/Agreement_on_the_withdrawal_of_the_United_Kingdom_of_Great_Britain_and_Northern_Ireland_from_the_European_Union_and_the_European_Atomic_Energy_Community.pdf)

<sup>12</sup> UK Government, Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community (17 October 2019) Article 8 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/840655/Agreement\\_on\\_the\\_withdrawal\\_of\\_the\\_United\\_Kingdom\\_of\\_Great\\_Britain\\_and\\_Northern\\_Ireland\\_from\\_the\\_European\\_Union\\_and\\_the\\_European\\_Atomic\\_Energy\\_Community.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/840655/Agreement_on_the_withdrawal_of_the_United_Kingdom_of_Great_Britain_and_Northern_Ireland_from_the_European_Union_and_the_European_Atomic_Energy_Community.pdf)

<sup>13</sup> UK Government (2020), page 36 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/886290/2020-05-20\\_Command\\_Paper\\_UK\\_s\\_Approach\\_to\\_the\\_Northern\\_Ireland\\_Protocol\\_accessible.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/886290/2020-05-20_Command_Paper_UK_s_Approach_to_the_Northern_Ireland_Protocol_accessible.pdf)

## 1.1 Observations

The VAT and excise-related issues arising from the Protocol appear to have received less commentary than the issues of received trade and borders. However, a UK academic recently noted that the Protocol:

*...locks Northern Ireland (but not the wider UK, i.e. not Great Britain) into regulatory alignment with a weighty body of EU rules governing manufactured and agricultural goods... **NI-EU alignment is extended** by the Protocol also to cover key trade rules including those concerning the EU's customs regime, **VAT and excise rules**, those governing the single electricity market **and state aid** rules in respect of measures which affect the trade between Northern Ireland and the EU which is subject to the Protocol.<sup>14</sup> [emphasis added]*

The quotation states that NI remains “locked into” VAT and excise laws for the foreseeable future. This issue was recently highlighted in a letter from the House of Commons European Scrutiny Committee to the Financial Secretary to the Treasury, in which letter the Committee observed:

*...not only does Article 8 foresee the potentially indefinite application of EU VAT legislation in part of the UK beyond our withdrawal, it also denies the Treasury and the devolved institutions in Northern Ireland any formal input over future amendments to those laws.<sup>15</sup>*

It therefore appears that there is concern in the UK Parliament about Article 8's application. This section therefore unpacks key elements of Article 8, including the scope of application of the article's applications (goods only in relation to VAT) and those aspects of the article relating to the Joint Committee.

According to the Institute for Government (IfG), a key issue here is that:

*The Withdrawal Agreement defers some major decisions on the detail of how the border will function. The Joint Committee – the body responsible for overseeing the implementation of the Agreement, yet to be set up – will be responsible for determining under what conditions fisheries and aquaculture products from Northern Irish ports will be exempt from duties, overseeing the implementation of VAT provisions and, most importantly, developing criteria according to which it will be determined whether goods moving from Great Britain to Northern Ireland are ‘at risk’ of moving into the EU.<sup>16</sup>*

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<sup>14</sup> Prof Stephen Weatherill (17 March 2020) EU Law analysis, blog article [The Protocol on Ireland/ Northern Ireland: What it says is not what it does](#)

<sup>15</sup> <https://committees.parliament.uk/publications/1100/documents/9399/default/>

<sup>16</sup> IfG (2020) <https://www.instituteforgovernment.org.uk/sites/default/files/publications/getting-brex-it-done-WEB.pdf> page 17

Since the IfG published its report, the Joint Committee has met. However, VAT is just one element of the Protocol that Joint Committee is to address. The UK Government released the agenda for the Joint Committee's first meeting on 30 April 2020.<sup>17</sup> That agenda did not specifically mention VAT. For more information on the Joint Committee and its consideration of outstanding matters relating to customs and trade, refer to paper 2 in this briefing series.

Whatever the Joint Committee decides on all these outstanding issues, those decisions will have implications for the UK in terms of its tax regime and for businesses in the UK, both in GB and NI.

As noted in paper 2 in this series, it is anticipated that there will be costs to business to comply with the procedures established under the Protocol, following agreement of outstanding matters that still are to be agreed by the Joint Committee, for example, if different VAT regimes arose, where NI was like the RoI, and different to GB.

In that regard, the Institute of Export and International Trade has observed that NI Business Groups are:

*...seeking clarity from the UK government on new customs arrangements and the cost of the extra paperwork involved.*<sup>18</sup>

It is worth noting that the EU has issued stakeholder guidance notes about excise (dated 11 March 2020) and VAT (dated 27 March), explaining that during transition:

*...excise goods may be moved between EU Member States under duty suspension or after release for consumption ("duty paid").*<sup>19</sup>

At the end of the transition period, however, all other things remaining equal, this relatively seamless regime will no longer apply to movement of excise goods between the UK and the EU. From that moment:

*...movements of excise goods from the United Kingdom to the EU and vice-versa will become imports and exports respectively.*<sup>20</sup>

This means:

*...trade between the EU and England, Wales and Scotland would be treated as a third country trade for customs and duty purposes. Customs clearances and documentation would be required for cross-border trade.*<sup>21</sup>

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<sup>17</sup> <https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2020-03-25/HCWS190/>

<sup>18</sup> <https://www.export.org.uk/news/505006/Time-running-out-for-clarity-over-post-Brexit-customs-checks-in-Northern-Ireland-EU-warns-the-UK.htm>

<sup>19</sup> EC (2020) (notice to Stakeholders: withdrawal of the UK and EU rules in the field of excise: [https://ec.europa.eu/info/sites/info/files/brexit\\_files/info\\_site/excise\\_rev1\\_final.pdf](https://ec.europa.eu/info/sites/info/files/brexit_files/info_site/excise_rev1_final.pdf) (page 2)

<sup>20</sup> [https://ec.europa.eu/info/sites/info/files/brexit\\_files/info\\_site/excise\\_rev1\\_final.pdf](https://ec.europa.eu/info/sites/info/files/brexit_files/info_site/excise_rev1_final.pdf) (page 2)

<sup>21</sup> <https://politicsandeconomy.granthornton.co.uk/post/102fsnc/brexit-deal-indirect-tax-and-special-status-for-northern-ireland>

Although the above will not apply directly to NI, it is likely that there would be compliance costs for NI firms that form part of supply chains, or those that are trading in excise goods to both the EU and to the UK. This issue was highlighted recently by the European Scrutiny Committee in a letter from the Chairman to the Financial Secretary of the Treasury. The letter explained the European Scrutiny Committee's concern that:

*...the practical implementation of EU VAT rules on goods is likely to have an impact on the flow of trade between Northern Ireland and the rest of the UK, for example because the VAT-related customs procedures and controls mandated by EU law will make shipping goods between the two more difficult and costly.<sup>22</sup>*

Similarly, at the end of the transition period, and in the absence of other arrangements:

*...supplies and movements of goods between the EU and the United Kingdom will be subject to the VAT rules on imports and exports.<sup>23</sup>*

As above, this suggests that it would be likely that there would be increased compliance costs for NI-based businesses. On a brighter note, however, an advisory firm notes:

*Northern Ireland would also be part for EU-wide VAT reclaim processes (which can speed up VAT claims for EU trade).<sup>24</sup>*

This suggests that NI firms would be likely to face a combination of not only complicating, but also potentially beneficial factors after the transition period ends. The precise impact would be likely to depend on how the Joint Committee progresses in this area. As the advisory firm pointed out in February 2020 that:

*...the operational aspects of the arrangements will need to be worked out.<sup>25</sup>*

#### **Potential scrutiny points:**

- 1. Has the Department for the Economy had any contact with the UK Government, the Treasury and or the EU in relation to the Joint Committee?**
- 2. Has the Department for the Economy had any contact with the NI Department of Finance and or the NI Executive about making representations on behalf of NI to the Joint Committee on this issue – either directly or indirectly through the UK Government, the Treasury and or other?**

<sup>22</sup> <https://committees.parliament.uk/publications/1100/documents/9399/default/> (page 2)

<sup>23</sup> EC (2020) 'Notice to Stakeholders: withdrawal of the UK and EU rules in the field of VAT for goods': [https://ec.europa.eu/info/sites/info/files/brexit\\_files/info\\_site/vat-goods\\_en\\_0.pdf](https://ec.europa.eu/info/sites/info/files/brexit_files/info_site/vat-goods_en_0.pdf) (page 4)

<sup>24</sup> <https://politicsandconomy.granthornton.co.uk/post/102fsnc/brexit-deal-indirect-tax-and-special-status-for-northern-ireland>

<sup>25</sup> <https://assets.kpmg/content/dam/kpmg/ie/pdf/2020/02/ie-brexit-transition-phase-4.pdf> (page 10)

3. What does the Department for the Economy know about future meetings of the Joint Committee and its consideration of VAT and excise-related issues?
4. What role does the Department for the Economy and or the Executive have in supporting or influencing the Joint Committee's "regular discussions" in relation to Article 8?
5. Does the Department for the Economy know when VAT and excise will be specific agenda items in future Joint Committee meetings?

## 1.2. VAT exemptions and reduced rates in the UK and RoI

As noted in the previous subsection, Article 8 allows for limited variation in NI for VAT exemptions and reduced rates, in order to match those in the RoI. It does not empower the UK to introduce an entirely new rate to apply in NI. It therefore seems reasonable to conclude that changes arising in this area could be significant in terms of both the processes to implement the Article and the potential reductions and exemptions. For this reason, the following subsection presents information to aid the Committee's consideration in those areas.

However, first, it is important to note that this subsection does not provide a detailed analysis of the differences between the UK and RoI's VAT systems, as that is beyond the scope of this paper's purpose. Instead, it provides high-level information about reduced rates and exemptions, to aid the Committee when identifying potential Article 8 implications for NI. This initially requires some explanation of key concepts, including the difference between VAT exemptions and reduced VAT rates, as outlined here.

Many goods and services are not subject to the standard rate of VAT in the UK or RoI. However, as noted earlier, **the VAT-related Protocol provisions do not apply to services, just goods**. Some goods are **zero rated** (charged at 0%), some are subject to **reduced rate** of VAT (currently 5% in the UK) and some are **exempt** from VAT.

The difference between zero rating and exemption can be explained in the following way: a charge of 0% on a good allows the trader to reclaim VAT on any inputs used during the production process of the zero-rated good. The producer of an exempt good **cannot** reclaim the VAT on any inputs used in the production process. The Institute for Fiscal Studies explain this distinction as follows:

*If a good or service is zero rated, then it is subject to VAT, but the VAT rate is 0%. If it is exempt, then its production is in effect ignored completely for VAT, with no VAT charged on sales or credited on inputs.<sup>26</sup>*

<sup>26</sup> Institute for Fiscal Studies (2011). *Tax by Design: The Merles Review*. (p.171). Oxford University Press.

With this distinction in mind, the following sub-sections summarise VAT in the UK and in the RoI.

### 1.2.1. UK

The UK Government provides the following examples in relation to the standard, reduced rate and zero rate:<sup>27</sup>

## VAT rates for goods and services

Rate	% of VAT	What the rate applies to
Standard	20%	Most goods and services
Reduced rate	5%	Some goods and services, eg children's car seats and home energy
Zero rate	0%	Zero-rated goods and services, eg most food and children's clothes

Source: UK Government, 2020.

The UK Government's online VAT information also gives some further examples of exemptions:

*Some things are exempt from VAT, such as postage stamps, financial and property transactions.*<sup>28</sup>

Detailed UK lists of exempted or reduced VAT rate goods and services are provided on the Government's website under a large number of headings, including:

- Food and drink, animals, animal feed, plants and seeds;
- Sport, leisure, culture and antiques;
- Health, education, welfare and charities;
- Power, utilities, energy and energy saving, heating;
- Power;
- Building and construction, land and property;
- Transport, freight, travel and vehicles;
- Printing, postage, publications – books, magazines and newspapers;
- Clothing and footwear, protective and safety equipment; and,
- Financial services and investments, insurance.

<sup>27</sup><https://www.gov.uk/vat-rates>

<sup>28</sup><https://www.gov.uk/vat-rates>

### 1.2.2. Rol

The Rol similarly has some complexities around exemptions and reduced rates. The Government provides the following information in relation to its reduced VAT rates<sup>2930</sup>

Date effective from	Standard rate (%)	Reduced rate (%)	Second reduced rate (%)	Livestock rate (%)	Flat-rate compensation percentage for Farmers (%)
1 January 2020	23	13.5	9	4.8	5.4

Source Irish Government, 2020.

The Rol is one of only two Member States to have four VAT rates, the other is Luxembourg. Most have either two or three.<sup>31</sup> Similar to the UK, the Rol has a number of categories of goods either exempted from VAT or chargeable at zero-rate. Examples include:

- Zero-rated: e.g. children's footwear, seeds for growing food, certain books, and most foodstuffs;
- Reduced rates: e.g. horses and greyhounds, live plants, seeds for flowers, newspapers and periodicals, hot food from takeaways, and hotel lettings, including guesthouses, caravan parks or camping sites; and,
- Standard rate: e.g. horticultural pots, alcohol, ice cream and biscuits.

One particular issue of note here, which has been discussed in NI for some time, is the hospitality sector. It is foreseeable that this area may be of interest to the Committee, so it is considered in some more detail in the subsection below.

### 1.2.3. VAT in the hospitality sector

In 2011, the Rol reduced the rate of VAT for certain goods and services connected to the tourism industry to 9%. EU Directives 2006/112/EC and 2009/47/EC provide for a lower rate of VAT on certain supplies associated with tourism: specifically, hotel accommodation; certain restaurant services; and, some types of admission charge, including charges for entry to amusement parks.<sup>32</sup>

<sup>30</sup> <https://www.revenue.ie/en/vat/vat-rates/search-vat-rates/current-vat-rates.aspx>

<sup>31</sup> [https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/taxation/vat/how\\_vat\\_works/rates/vat\\_rates\\_en.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/vat/how_vat_works/rates/vat_rates_en.pdf) (see Table I, page 3)

<sup>32</sup> House of Commons Library (2014). Standard Note: *VAT on Tourism*. <http://www.parliament.uk/Template/BriefingPapers/Pages/BPPdfDownload.aspx?bp-id=SN06812>

This has led in recent years to some public debate in NI about harmonisation to create a level playing field across the island or Ireland, i.e. how to redress a competitive tax advantage for the RoI sector over its counterparts in NI. For example, in 2015, the Assembly passed the following Private Member's Motion:

*That this Assembly notes the decision by the Government of Ireland to retain a reduced rate of VAT on tourism and hospitality; further notes that this is a practice in many EU countries; recognises the potential of this measure to significantly boost the Northern Ireland tourism industry; and calls on the Minister of Enterprise Trade and Investment and the Minister of Finance and Personnel to undertake a report into those benefits for presentation to the UK Treasury.<sup>33</sup>*

As noted earlier in this paper, as a Member State, the UK needed EU permission to introduce subnational variation in VAT. Obviously, the UK is no longer a Member State, but there is another circumstantial change.

Since the Assembly motion was passed, the VAT position of the sector in the RoI has altered. With effect from 2019, the then RoI Government increased the 9% VAT rate for hotels, restaurants and hairdressing was to 13.5%.<sup>34</sup> This was expected by some to have a negative impact on the industry. Yet it is worth noting a consultancy firm's observation that the impact would **not be even across the whole tourism sector, i.e.:**

*...the VAT rate increase will have **no impact on non-VAT-registered businesses** including many of those in the B&B sector where over three times as many B&Bs are not VAT registered. Consequently, the good news for those smaller operators is that, although they did not benefit from the introduction of the reduced VAT rate.<sup>35</sup> [emphasis added]*

It therefore may be important for NI to consider the structure of the tourism sector – i.e. the balance of VAT registered and non-registered businesses – while contemplating the possibility of reduced rates. This is even more imperative now, given the impact of Covid-19 on the tourism industry and other.

<sup>33</sup> <http://aims.niassembly.gov.uk/plenary/details.aspx?tbv=0&ptv=0&mcv=0&mtv=0&sp=0&spv=-1&per=1&it=0&pid=2&sid=p&pn=0&ba=1&doc=204746%20&fd=19/05/2015&td=19/05/2015>

<sup>34</sup> <https://www.thejournal.ie/vat-rate-coffee-restaurants-4420488-Jan2019/>

<sup>35</sup> <https://www2.deloitte.com/ie/en/pages/tax/articles/budget-2019-vat-press-release.html>

**Potential scrutiny points:**

- 1. Has the Department for the Economy and or the Department of Finance conducted any assessment of the desirability to use using this derogation in NI? If so, what were its findings? If not, is any planned for future?**
- 2. Have discussions with the UK Government, the Treasury and Her Majesty's Revenue Collection (HMRC) occurred between the Department for the Economy, the Department of Finance and or the NI Executive regarding this matter, and what was the outcome? If so, when did this occur, and what was the outcome? If not, are any planned? When?**
- 3. In anticipation of the UK Government potentially deciding to introduce a NI VAT rate, distinct to GB (i.e. a derogation), has the Department for the Economy, the Department of Finance, the UK Government, the Treasury and or the HMRC undertaken any assessments to establish what deduction could follow in turn to NI's Block Grant, given the current financial framework under current devolution arrangements; i.e. the deduction equivalent to the revenue forgone by the UK?**
- 4. To ensure Block Grant adjustment transparency, has any thought been given to whether the Executive would publish its operation?**
- 5. Has the Department for the Economy and/or the Department of Finance undertaken any examination of reduced VAT in the hospitality sector across the island of Ireland?**
- 6. How does the Department for the Economy think that it will give due regard to the Covid-19 impact on tourism in NI and Covid-19 related impacts, when considering a future potential NI VAT variation?**

## 2. Article 12(4): VAT, excise and the European Court of Justice

Paper 1 in this briefing series outlined the new governance arrangements following the UK's exit. This paper now centres on explaining Article 12(4) of the Protocol, which confirms the jurisdiction of the European Court of Justice (ECJ) over the UK's application of EU law in relation to VAT and excise. Simply state, in this area, the UK:

*...will remain subject to the European Court of Justice.*<sup>36</sup>

The UK therefore will be responsible for ensuring compliance with the EU's rules. But **it will be the EU, i.e. specifically the ECJ, which will have ultimate authority in the event of future litigation on an issue in the area.**

### Potential scrutiny point:

**Have the Department for the Economy's discussions with the UK Government or its representatives suggested that any element of the enforcement duty could be devolved to NI, which would necessitate amendment of the current devolution arrangements in NI?**

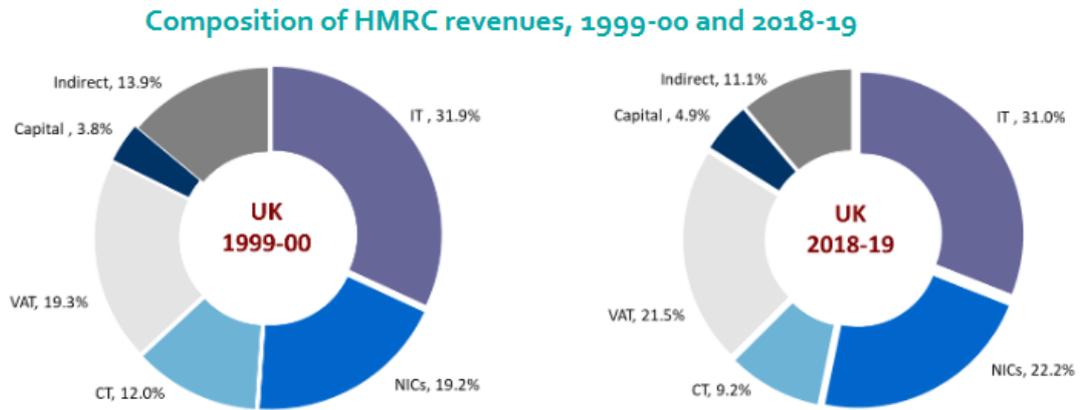
## 3. VAT and excise - significant UK revenue raising instruments

As noted, the Protocol provides limited scope for reduced VAT rates on goods in NI, i.e. to match NI rates with those in the RoI. It therefore is helpful to consider data related to the VAT revenue stream, but within the overall context all UK revenue streams. This enables consideration of the relative significance of different taxes in the UK – illustrated in Figures 2 and 3 below.

In turn, this informs the operation of financial frameworks under current devolution arrangements in the UK. Under those arrangements, when devolved level revenue raising measures are varied in the UK, the relevant devolved government's fiscal transfer from the national level to sub-national level (i.e. Block Grant) is also adjusted. This is discussed further in subsection 3.1 below. For obvious reasons, this is a consideration for the Committee, and all Assembly committees, in particular the Committee for Finance.

<sup>36</sup> Institute for Government (2019) [Explainer Brexit and the NI Protocol](#), row 5 of the Table

**Figure 2: the sources of revenue at UK level<sup>37</sup>**



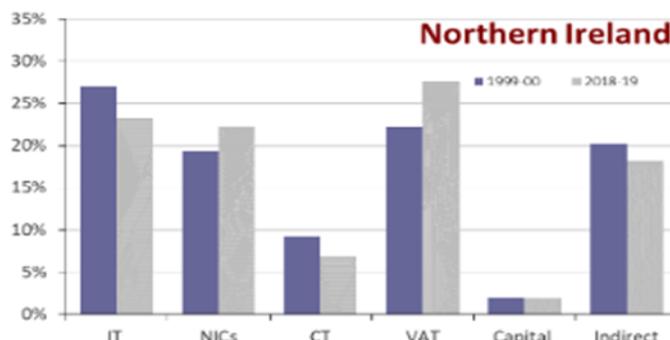
Source HMRC, 2019.

It can be seen in Figure 2 above that in 2018-19 more than one fifth (21.5%) of UK revenue was raised from VAT. At the NI level, VAT is relatively more significant as a revenue raiser for the UK Exchequer than for the UK as a whole, as shown in Figure 3.

The picture with excise duty is less clear. It is included in both Figures 2 and 3 under the category of ‘indirect’ which also includes transport and environmental taxes, plus Customs Duties. Nevertheless, it can be seen that, though less significant than VAT at the UK level, this category of indirect comprises more than 10% of revenue. Duties include some of the so-called “sin taxes” such as alcohol and tobacco duty.

Overall, the **combined** proportion of revenue raised from VAT and indirect duties was 33.2% in 1999-00 dropping marginally to 32.6% in 2018-19. In other words, over nearly two decades, the two forms of revenue raising instruments, when combined, are steadily raising approximately one third of total UK revenue.

**Figure 3: UK revenue collected in NI, disaggregated by tax 1999-00 and 2018-19<sup>38</sup>**



Source HMRC

<sup>37</sup> HMRC (2019) [A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland](#) (page 16)

<sup>38</sup> HMRC (2019) [A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland](#) (page 16)

Figure 3 above shows that in 2018-19, NI VAT was a relatively more significant source of UK revenue NI than all other taxes, including income tax: more than one quarter of UK revenue raised in NI in that year came from VAT.

In relation to excise duties (again included in the “indirect” category), the pattern of change is similar to at the UK level; the relative importance of VAT has risen; whereas the relative importance of indirect measures has fallen slightly. This may well be at least partly due to the repeated freezing of fuel duty by successive governments. In consequence, fuel duty revenue has not grown significantly (i.e. is stable) in NI since 2014-15.<sup>39</sup>

Taken together, Figures 2 and 3 above suggest that **the UK Government is likely to pay close attention to the potential costs of any variations to VAT in NI.** This is something that will concern a number of Executive departments; certainly the Departments of the Economy and Finance. It is also likely to be a matter of interest to the proposed Independent Fiscal Council for NI (IFCNI), as noted in the January 2020 *New Decade, New Approach* deal.<sup>40</sup> (See Appendix 2 for more information on the IFCNI.)

At this point, it cannot be ignored that the UK Government has borrowed, and will continue to borrow very heavily to support the economy during, and potentially after, the Covid-19 crisis.<sup>41</sup> This has led to speculation about future UK fiscal policy: will there be further austerity and/or tax rises.<sup>42</sup> One way or another, additional borrowing must be repaid. And this will to some extent impact on any future consideration of tax reductions in NI.

The current crisis notwithstanding, and having established the significance of VAT as a source of UK revenue; Appendix 1 to this paper explains why this could be important using the example of Air Passenger Duty. This is intended to illustrate how the NI Block Grant could be affected, if a future decision was taken to reduce the rate on certain goods or introduce exemptions.

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<sup>39</sup> HMRC (2019) [A disaggregation of HMRC tax receipts between England, Wales, Scotland & Northern Ireland](#) (page 29)

<sup>40</sup> A Fiscal Council was originally proposed in the Stormont House/Fresh Start agreements and formed one of the measure to strengthen transparency, accountability and the functioning of the Executive in the [New Decade, New Approach](#) agreement (see pages 12, 41 and 54)

<sup>41</sup> <https://www.ifs.org.uk/publications/14771>

<sup>42</sup> <https://www.independent.co.uk/news/uk/politics/coronavirus-latest-treasury-rishi-sunak-deficit-tax-pay-freeze-pension-triple-lock-a9511336.html>

## 4. Concluding remarks

The Protocol's VAT and excise elements have received less attention in the available literature than other areas, such as trade and customs.

Concern has been expressed by the EU, trade bodies and Parliamentary Committees about the future operation of VAT and excise under the Protocol. The UK Government, however, appears to remain confident that it will have appropriate systems in place by the end of the transition period.

A significant role has been assigned to the Joint Committee in relation to potential subnational VAT variation in NI. An important issue for it to consider is what the likely costs to NI would be if such variation were introduced. Examples of Block Grant adjustment already exist in NI, (and also in Scotland and Wales). On that basis, it seems likely that the UK Government would seek to implement a similar arrangement, if a VAT rate variation is to be made in NI, to match the RoI.

This history of tax power devolution to the UK's devolved governments teaches us that it can be complex, and can become politicised. Also, the resolution of apparently technical issues can be protracted and difficult.

It was noted above that there is a proposed Independent Fiscal Council for NI (IFCNI) contained in the *New Decade, New Approach* deal. It may be that the proposed body, when established, would be a useful source of support for the Executive and its departments, to inform their future representations to the Joint Committee's agenda. It seems likely, however, that the transition period will end before the IFCNI is established. Therefore, it appears that what could have been a useful source of advice for the Exe, i.e. the IFCNI, will not be available.

## Appendix 1: Example of Block Grant Adjustment: Air Passenger Duty

As noted above, future potential variations in VAT in NI to match the RoI could have implications for the UK Exchequer. In turn, this could impact future NI Executive Budgets due to Block Grant adjustments potentially arising from such variation.

Mechanisms exist in Scotland and Wales in relation to income tax, for example, under the respective devolved fiscal frameworks.<sup>43</sup> Air Passenger Duty (APD) provides a helpful illustration of how such a mechanism might affect NI, if a VAT variation arises like the one contemplated in Article 8.

In 2012, the power to set APD on direct long-haul flights departing from NI was devolved. The *Air Passenger Duty (Setting of Rate) Act (Northern Ireland) 2012*<sup>44</sup> set the APD rate for such flights to £zero. In accordance with the NI Public Finance Framework,<sup>45</sup> the Block Grant is adjusted annually to offset the cost (i.e. revenue foregone) to UK Exchequer. In 2019-20, the cost to the NI Block Grant of that zero-rate was £2.3 million.<sup>46</sup>

The adjustment for APD is relatively straightforward. It is simply a matter of counting the number of relevant individual flights were taken at zero-rate APD, and multiplying that by the rate of direct, long-haul APD that applies elsewhere in the UK. **The result is the amount of revenue the UK Exchequer *would have collected*, if the NI had not reduced the rate to zero.** An equivalent sum is then deducted from the NI Block Grant.

It is clearly part of the cost-benefit considerations therefore, to weigh up whether the benefit to NI of supporting direct long-haul flights with this fiscal measure is worth more or less to the economy than £2.3million.

At this time, it is not known **how**, or indeed **if**, the Block Grant might be adjusted in relation to any future reduced rate of VAT applied to the supply of a particular good in NI. It is to be expected however, that there **will be** a resulting cost of such variation to NI. Therefore, it is reasonable to anticipate discussion about the value-for-money of any potential deduction from the NI Block Grant to compensate for revenue foregone by the UK Exchequer. (See scrutiny points in the main body of the Paper.)

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<sup>43</sup> See Scotland:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/503481/fiscal\\_framework\\_agreement\\_25\\_feb\\_16\\_2.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/503481/fiscal_framework_agreement_25_feb_16_2.pdf) and; Wales:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/578836/Wales\\_Fiscal\\_Framework\\_Agreement\\_Dec\\_2016\\_2.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/578836/Wales_Fiscal_Framework_Agreement_Dec_2016_2.pdf)

<sup>44</sup> <http://www.legislation.gov.uk/nia/2012/5/contents>

<sup>45</sup> For an explanation of the NI Public Finance Framework, see pages 3-4 Raise [Paper 17/20](#)

<sup>46</sup> [https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/CED%20-%202019-20%20Budget%20-%20Tables%20for%20Publicationv3\\_0.pdf](https://www.finance-ni.gov.uk/sites/default/files/publications/dfp/CED%20-%202019-20%20Budget%20-%20Tables%20for%20Publicationv3_0.pdf) (see Table 2)

## Appendix 2: Independent Fiscal Council for Northern Ireland - update

*(Position as of 29 April 2020)*

The Northern Ireland (NI) Executive is to establish an Independent Fiscal Council for Northern Ireland (IFCNI) by July 2020.

The IFCNI's specified dual purposes will be to prepare:

- An annual assessment of the Executive's revenue streams and spending proposals, including how both enable the Executive to balance its budget; and,
- A further annual report on the sustainability of the Executive's public finances, including the implications of spending policy and the effectiveness of long-term efficiency measures.

Its membership and terms of reference is to be agreed with the United Kingdom (UK) government.

The IFCNI's bases are two political agreements signed in the last five years, as set out below. Beyond this, little detail is known as to precisely how and exactly when the IFCNI will be created.

Thereafter, this update provides some context, to highlight recent potential impediments to forming the IFCNI.

### *Political agreements containing IFCNI measures*

An IFCNI was first mentioned in November 2015, as part of "A Fresh Start – The Stormont Agreement and Implementation Plan". That Agreement clearly stated:<sup>47</sup>

*The UK Government welcomes the Executive's plans to establish an Independent Fiscal Council for Northern Ireland. The Council will:*

- *prepare an annual assessment of the Executive's revenue streams and spending proposals and how these allow the Executive to balance their budget; and,*
- *prepare a further annual report on the sustainability of the Executive's public finances, including the implications of spending policy and the effectiveness of long-term efficiency measures.*

*The membership and terms of reference of this Council will be agreed with the UK Government.*

The above was repeated in a subsequent political agreement in January 2020, i.e. "New Decade, New Approach". This time, however, the measure included a date for the IFCNI's establishment, stating:<sup>48</sup>

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<sup>47</sup>"A Fresh Start – The Stormont Agreement and Implementation Plan". November 2015, at Section D – Budget Controls, at paragraph 4.1, on pages 26-27:  
[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/479116/A\\_Fresh\\_Start\\_-\\_The\\_Stormont\\_Agreement\\_and\\_Implementation\\_Plan\\_-\\_Final\\_Version\\_20\\_Nov\\_2015\\_for\\_PDF.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/479116/A_Fresh_Start_-_The_Stormont_Agreement_and_Implementation_Plan_-_Final_Version_20_Nov_2015_for_PDF.pdf)

<sup>48</sup>"New Decade, New Approach". January 2020, at Annex A, "Conditions to promote budgetary, fiscal and political instability", at page 54:  
[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/856998/2020-01-08\\_a\\_new\\_decade\\_a\\_new\\_approach.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/856998/2020-01-08_a_new_decade_a_new_approach.pdf)

*An independent Fiscal Council will be established in Northern Ireland by July 2020. As per the Fresh Start Agreement, the membership and terms of reference of this Council will be agreed with the UK Government. It would:*

- *prepare an annual assessment of the Executive's revenue streams and spending proposals and how these allow the Executive to balance their budget; and,*
- *prepare a further annual report on the sustainability of the Executive's public finances, including the implications of spending policy and the effectiveness of long-term efficiency measures; and,*
- *have its membership and terms of reference agreed with the UK Government.*

#### *Potential impediments - Political context*

NI is a region within the UK, which has experienced a history fraught with political challenges since the state's formation nearly a hundred years ago. Since 1998, NI has been overseen by a power-sharing, sub-national government, in the form of the NI Executive, which includes representation from across the NI political spectrum. The Executive, scrutinised by the NI Assembly, governs in specified areas. It does so, in accordance with existing agreements between the national governments of the UK, Ireland and NI political representatives.

On a number of occasions since 1998, NI devolved government has collapsed and re-formed. Most recently, the Executive fell in January 2017, after the signing of the Fresh Start Agreement in the autumn 2015, as noted above. That Agreement included the first measure to create an IFCNI. For the next three years, there was no fully functioning devolved government in NI. This continued until a new agreement was reached in January 2020 – New Decade, New Approach – mentioned above. That Agreement included a new IFCNI term, i.e. to establish the IFCNI by July 2020.

The three-year hiatus in fully functioning devolved government helps to explain the slow pace in establishing the IFCNI. It currently remains unknown if there will be some further delay, despite the noted July 2020 date. For example, it is reasonably foreseeable that addressing COVID-19 related impacts now and for the foreseeable will place demands on UK central and devolved governments, potentially taking their attention away from other matters, such as the IFCNI's timely establishment.