Customs and excise quarterly update

February 2017

In this quarterly update we report on new customs examination powers which allow HMRC to examine goods away from ports, airports and other approved places under customs control after clearance, the government's response to its consultation on a new due diligence scheme for UK fulfilment houses handling goods imported from outside the EU and HMRC's new raw tobacco approval scheme. We also report on three recent cases involving the classification of toner cartridges and multifunction machines and a case regarding excise duty points. We also comment on the latest Brexit developments which concern international trade.

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Any comments or queries

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About this update

Our customs and excise update is published quaterly, and is written by members of RPC's Tax Dispute team.

We also publish a Tax update on the first Thursday of every month, a VAT update on the final Thursday of every month and a weekly blog, RPC Tax Take.

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HMRC v B&M Retail Limited – excise duty point

In *HMRC v B&M Retail Limited*, the Upper Tribunal (UT) found that, in circumstances where HMRC is unable to assess any person who caused a prior release for consumption to occur, it is open to the member state to assess, in accordance with its own procedures, any person who is found to be holding the goods within the meaning of Directive 2008/118/EC art 7(2)(b). more›

Brexit Update

Government announces its Brexit intentions

After many months of uncertainty, the government has finally announced its Brexit intentions and objectives. The UK Prime Minister, Theresa May, confirmed during a speech on 17 January 2017, that the UK will be heading for a so-called "hard Brexit" (the term "hard Brexit" means that the UK will leave both the European Union (EU) and the European Economic Area (EAA), and as a result will then be outside the single market). more›

News items

New Customs Examination Powers

Finance Bill 2017 introduces legislation to extend the powers HMRC currently has in section 24, Finance Act 1994, in order to improve its capability to examine goods away from ports, airports and other approved places under customs control, inland after clearance. The government has advised that the use of this power is expected, in the main, to be exercised where goods have been misdeclared, without payment of the correct amount of duty, at the time of import. The change will enable an HMRC officer to:

- move, open or unpack goods or containers
- search the containers and anything in them.

Officers will also be able to mark containers as necessary where there is reasonable cause to believe they contain customs goods.

The draft provisions, headed Customs enforcement: power to enter premises and inspect goods (clause 96), can be found here.

An explanation of the draft legislation is provided in the government's Explanatory Notes, which can be found here.

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Fulfilment House Due Diligence Scheme

On 6 December 2016, the government published its response to its consultation on a new due diligence scheme for UK fulfilment houses handling goods imported from outside the EU. The consultation forms part of a package of measures announced in Budget 2016 to tackle tax loss from overseas businesses selling goods to UK customers through online marketplaces. HMRC considers that the registration of fulfilment houses and requiring certain due diligence and record keeping will make it more difficult for non-compliant suppliers to trade in the UK and will enable HMRC to identify and tackle such suppliers more easily.

In response to the consultation, the government has modified many aspects of its original proposals to minimise the impact of the new scheme on legitimate businesses, in particular, it has listened to the concerns expressed in relation to the expected record-keeping and due diligence requirements. In addition, it has decided not to proceed with a proposal to require those delivering to and from fulfilment houses to check an online register.

The scheme will be legislated for in the Finance Bill 2017.

A copy of the Response can be found here.

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Raw Tobacco Approval Scheme

HMRC has introduced the Raw Tobacco Approval Scheme (RTAS) aimed at businesses and individuals, importing or using raw tobacco for any purpose.

The measure has been introduced as raw tobacco is not subject to excise duty and HMRC identified a significant risk to revenue after an increase in raw tobacco imports and seizures.

The aim of the RTAS is to:

- reduce the risk of excise duty evasion
- prevent the illegal manufacture of tobacco products
- control the movement of raw tobacco in the UK.

From 1 April 2017, businesses or individuals who intend to carry on any activity involving raw tobacco must hold an approval from HMRC, unless an exemption applies. The scheme will be backed up by seizure powers and penalties for breaches of approval requirements.

HMRC will accept applications from businesses or individuals from 1 January 2017. HMRC will review the application and undertake checks to confirm the information provided is complete and accurate, and to verify that businesses and individuals have met the criteria for approval to the scheme.

From 1 April 2017, a person who carries on any activity involving raw tobacco without an approval, or fails to comply with the terms of an approval or exemption, will be liable to penalties and the raw tobacco liable to seizure.

Full details of the scheme are set out in Excise Notice 2003: Tobacco Duty – the Raw Tobacco Approval Scheme, a copy of which can be found here.

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Case reports

KIP UK Limited v HMRC – toner cartridge classification

In *KIP UK Limited v HMRC*[1] the First-tier Tribunal (FTT) considered the correct customs classification of KIP UK Limited's (KIP) importation of toner cartridges. The FTT concluded that the cartridges fell within Combined Nomenclature Heading 8443 999000 as a "part" (8443 covers "other printers, copying copiers and facsimile copiers, whether or not combined; parts and accessories thereof") and KIP was accordingly entitled to treat them as subject to 0% customs duty. As such, its appeal against HMRC's original decision that the cartridges attracted 6% duty was allowed.

Background

Customs duty is payable on goods imported into the UK from outside the EU in accordance with Regulation 2016/1354 (2016 Regulations), Regulation 2658/87 and the Common Customs Tariff (Combined Nomenclature), which provides for a systematic classification of goods using six General Rules of Interpretation (GRIs) and, although non-binding, the Explanatory Notes to the Combined Nomenclature.

Goods are generally to be classified with regard to their objective characteristics and properties as defined in the Combined Nomenclature, which in turn must be drawn from their external characteristics and not, for example, their targeted market use.

There was no dispute between the parties as to the applicable principles to determine how the cartridges should be classified. The question in dispute was whether the KIP 7170 cartridges satisfied the wording of heading 8443, as being within the phrase "parts and accessories thereof", which attracts 0% duty, or fell within "developers and fixers", the sub-heading in 3707, which attracts 6% duty.

KIP argued that the KIP 7170 cartridges should attract 0% duty. This was on the basis that a part includes objects essential for the working operation of a whole.

As to the goods in question, KIP submitted:

- the KIP copier (the "whole" in the circumstances) cannot print without the KIP cartridge inserted (admittedly for lack of ink rather than mechanical impairment)
- the copier interacts with the cartridge regarding how and when KIP 7170 delivers toner for printing due to a microchip in the cartridge (ie highly engineered)[2]
- as with an older version, which HMRC has always accepted as falling within 8443, KIP 7170 prevents the toner powder it stores from caking. In KIP 7170, by the cartridge rotating and by a groove within its cylinder, it performs "agitation" and "delivery" functions. This goes beyond a mere ink cartridge. Its sophistication means it constitutes a "part", for the purposes of Chapter 84.

HMRC argued that KIP7170 fell within Chapter 37, 3707 902090 (chemical preparations for photographic uses (other than varnishes, glues, adhesives and similar preparations); unmixed products for photographic uses, put up in measured proportions or put up for retail sale in a form ready for use). In the same way that petrol is not deemed to be a part of a car because it is necessary for the car to run, a copier or printer is still just that whether with or without a cartridge installed allowing it to print. As such, the KIP 7170 could not be a "part".

1. [2016] UKFTT 0820 (TC).
2. See *Xerox Canada v Canada Border Service Agency* (AP-2013-015).

HMRC further drew attention to the GRIs, in particular GRI 3(b), that "goods consisting of different materials or made up of different components... shall be classified as if they consisted of the material or component which gives them their essential character". In HMRC's view, the toner material in the cartridge gave it its essential character and should determine the KIP 7170's classification, rather than the cartridge itself.

FTT's decision

The FTT applied *Turbon International GmbH*[3] to determine the objective characteristics and properties of KIP 7170, and in doing so clarified that each decision on customs classification turns on its facts according to the specific goods under consideration. Consequently, it was not possible or appropriate to treat cases such as *Xerox Canada* as binding authority on the facts in the instant appeal.

The FTT was satisfied that the objective characteristics of KIP 7170 were such that it was both a container filled with toner and a rotating cylinder with integral groove, fulfilling the agitation and delivery functions.

Just because a printer needs toner did not make the cartridge a "part". However, KIP 7170's objective characteristics took it beyond a simple, necessary, supplier of toner. The FTT found it performed functions "more associated with the execution of the printer's activity of using the toner to produce printed paper". In other words, the printer was dependent upon the cartridge for its proper mechanical and electronic functioning.

As a result, the FTT agreed with KIP that KIP 7170 should properly be classified as a "part" under Chapter 84, under both GRI 1 and GRI 3(b).

The microchip element was not a relevant factor, given that its only function was to alert the printer to the presence of a cartridge. Nor was it relevant, although mentioned briefly by KIP in its submissions, that the new model cartridge was a more economical and environmentally friendly version of the older KIP 9900. Neither aspect was an external physical characteristic of the goods.

Comment

This decision provides helpful guidance on the rules for classifying products and the application of the GRIs. It also serves as a reminder that each case will be determined on its specific facts for the purpose of determining liability to customs duty on goods imported into the UK. The classification rules are complex. It is important that businesses importing products into the UK ensure that they are correctly classifying goods to maximise duty saving opportunities and avoid an unanticipated HMRC duty assessment.

A copy of the decision can be found here.

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3. (Case C-250/05).

Brother Industries UK Limited v HMRC – customs duty not payable on multifunction machines

In *Brother Industries UK Limited v HMRC*[4], the FTT considered an appeal against a decision of HMRC refusing repayment claims in the sum of £413,439.33 in respect of customs duty paid on multifunction machines (MFMs).

Background

Brother Industries UK Limited (BIUL) imported MFMs which comprised modules for printing, scanning and photocopying. There were 16 MFMs in issue in the appeal. There were three differing models of MFM and all but one had an automatic document feeder and some also had facsimile modules.

It was agreed between BIUL and HMRC that there were only two CN Headings which could be applicable to classify the MFMs, either:

- CN Heading 8471, which reads: "Automatic data-processing machines and units thereof; magnetic or optical readers, machines for transcribing data onto data media in coded form and machines for processing such data, not elsewhere specified or included", or
- CN Heading 9009, which reads: "Photocopying apparatus incorporating an optical system or of the contact type and themo-copying apparatus".

The issue which fell to be decided by the FTT was under which of the two CN Headings the MFMs should be classified. BIUL argued that they should have been classified under Heading 8471 of the CN with 0% duty rate, whereas HMRC argued that they should be classified under CN Heading 9009 with a 6% duty rate. HMRC refused the repayment claims and BIUL appealed to the FTT.

FTT's decision

In order to determine under which CN Heading the MFMs should be classified, the FTT followed the approach adopted by the Upper Tribunal (UT) in in *Barrus Ltd*[5].

The FTT first determined the machine's objective characteristics (applying the decision in *Holz Geenen GmbH v Oberfinanzdirektion Munchen*[6]). In the view of the FTT, the relevant CN heading and notes were Chapter 84 Note 5, which applies to machines that are principally used in an automatic data-processing (ADP) system. If not within that heading, under Rule 3(b) of the General Rules of Interpretation, it had to be determined which of the MFMs components gave them their "essential character" and they would be classified accordingly.

In all of the machines the printer module was the largest in terms of size and cost – they were better printers than photocopiers. However, the three different models of MFMs in dispute all had slightly different characteristics. In determining the objective characteristics of each variety of MFM, the FTT concluded as follows:

- with regard to the MFM which did not have an automatic document feeder, its characteristics were such that it was principally used as an ADP system, because the copying function was very limited compared to its printer function. It should therefore be classified as 8471
- with regard to those MFMs which did not have a facsimile capability, they had a better resolution when printing than when photocopying, which suggested that copying was of secondary importance to the printing and scanning function. Accordingly, they should be classified as 8471

4. *(1) Brother Industries UK Ltd (2) Brother UK Ltd v HMRC* [2016] UKFTT 788 (TC).
5. [2013] UKUT 449 (TCC).
6. (C-309/09) EU:C:2000:165).

- with regard to those MFMs with additional facsimile modules, they could send and receive facsimiles without connection to an ADP system. Their objective characteristics did not suggest use outside of an ADP system being of secondary importance and should not be classified as 8471. It was therefore necessary, under Rule 3(b) of the General Rules of Interpretation, to consider their "essential character". The essential character of each machine was its use to produce hardcopy output, or "make marks on paper". Only if the printer component was removed would they cease to have that essential character and therefore the printer component conferred that character. Accordingly, all the remaining MFMs should also be classified as 8471.

The appeal was therefore allowed.

Comment

This decision provides helpful general guidance on the rules for classifying products and will provide useful guidance to businesses importing similar MFM products. Businesses need to ensure that they correctly classify their products if they wish to ensure they pay the correct amount of duty.

A copy of the decision can be found here.

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HMRC v B&M Retail Limited – excise duty point

In *HMRC v B&M Retail Limited*[7] the UT concluded that, in circumstances where HMRC is unable to assess any person who caused a prior release for consumption to occur, it is open to the member state to assess, in accordance with its own procedures, any person who is found to be holding the goods within the meaning of Directive 2008/118/EC art 7(2)(b).

Background

In November 2011, HMRC inspected B&M Retail Limited's (B&M) warehouse and detained beer and wine under section 139, Customs and Excise Management Act 1979, on the grounds that, on a balance of probabilities, excise duty had not been paid on the goods.

HMRC then undertook an investigation and found no evidence of duty payment and the supply chains traced back to missing or de-registered traders. Accordingly, the goods were formally seized under the Excise Goods (Holding, Movement & Duty Point) Regulations, 2010/593 (the Regulations). HMRC also assessed B&M for excise duty of over £5m and served a penalty notice for £1,175,028.60.

B&M appealed to the FTT which determined a number of preliminary issues. The FTT found there could not be more than one excise duty point or more than one release for consumption and, pursuant to Regulation 6(1)(b) of the Regulations, a person could not be liable for duty if, before they held the goods, an identified excise point arose.

HMRC appealed the FTT's decision contending, among other things, that notwithstanding the fact that a duty point may have occurred earlier in the supply chain, the fact remained that B&M could not provide any evidence that excise duty had been paid previously.

7. [2016] UKUT 429 (TCC).

UT's decision

The UT considered the policy objectives of Council Directive (EC) 2008/118 and concluded that, in circumstances where HMRC is unable to assess any person who caused a prior release for consumption to occur, it is open to the member state to assess, in accordance with its own procedures, any person who is found to be holding the goods within the meaning of Directive 2008/118/EC Article 7(2)(b). That conclusion is subject to HMRC's power to reimburse the taxpayer in accordance with its policy, if it is later established through evidence that an assessment could be made in respect of an excise duty point which had arisen prior to the taxpayer holding the goods.

Comment

Traders dealing in excise goods need to ensure that they are satisfied with the integrity of the supply chain and ensure that the source of the goods is bona fide. Traders must ensure they undertake proper due diligence on their suppliers if they wish to avoid an unanticipated duty assessment. Traders purchasing excisable goods also need to ensure that they hold definitive evidence that the duty has been paid at a previous stage in the supply chain.

A copy of the decision can be found here.

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Brexit Update

Government announces its Brexit intentions

After many months of uncertainty, the government has finally announced its Brexit intentions and objectives. The UK Prime Minister, Theresa May, confirmed during a speech on 17 January 2017, that the UK will be heading for a so-called "hard Brexit" (the term "hard Brexit" means that the UK will leave both the European Union (EU) and the European Economic Area (EAA), and as a result will then be outside the single market).

Mrs May confirmed the UK will not remain a full member of the EU Customs Union after Brexit preferring the UK to negotiate its own trade deals directly with the rest of the world. Mrs May said she will seek a "bold and ambitious free-trade agreement" with the EU and wishes the UK to retain a form of "associate membership" of the Customs Union, limiting the increase in red tape for businesses who export to the EU. She would also like the UK to continue tariff-free trade with Europe and for cross border trade to be as frictionless as possible.

The above approach was restated in the government's White Paper entitled "The United Kingdom's exit from, and new partnership with, The European Union" published on 2 February 2017.

The government has suggested a customs arrangement with the EU involving reciprocal tariff-free trade with no customs duties flowing between the EU and UK, but without the Common Customs Tariff to then enable the government to seek free trade agreements with the rest of the world.

Once Brexit occurs, until Free Trade Agreements are entered into, the World Trade Organisation (WTO) rules will apply. The WTO rules incorporate the "most favoured nation" (MFN) principle, which means that countries cannot discriminate between their trading partners. Owing to the MFN principle, the UK will be obliged to impose the same duties on imports from the EU as it applies to those from all other WTO members.

New customs legislation

Customs law is governed by EU law. Post Brexit, the UK will have to introduce its own customs legislation to encompass customs procedures, customs declarations, tariff codes, customs duty levels and simplifications. The EU is currently in the process of implementing the new Union Customs Code (UCC), which has caused significant change for businesses and increased compliance costs. Given the UK has been part of forming this new customs legislation we can expect the UK to adopt most of the UCC in a simplified version. The drafting of new UK customs legislation provides businesses with an opportunity to lobby the government regarding areas of the UCC and customs policies which they consider places an unnecessary burden on UK trade, for example, in relation to guarantees and the first sale rules.

What steps should businesses take following the government's announcement?

Businesses involved in international trade will continue to face considerable uncertainty surrounding the UK's trading relationships post-Brexit, not just with the EU, but also with the rest of the world. Until Brexit takes place, the current trading position and customs legislation remains in place. Whilst it is difficult to predict the future with any degree of certainty, businesses may wish to:

- identify key areas of business that are likely to be affected by Brexit and undertake a comprehensive review of costs

- consider new markets, sterling is likely to stay at a lower rate than pre-Brexit which means imports into the UK will be more expensive, however, UK exports will be less expensive and new markets present a business opportunity
- ensure that any new business or contractual relationships make adequate provision for Brexit and the anticipated consequences of Brexit
- begin to consider and plan for the likely impact on the business if a free trade agreement cannot be reached with the EU, including possible additional tariffs and compliance costs
- plan for changes in trading relationships between the UK and third party countries with whom the EU has free trade agreements with such as South Africa, Turkey, South Korea, Mexico and Morocco
- maintain a well-informed "watching brief" on post-Brexit developments monitoring the negotiations as they progress and considering the impact of potential changes
- work with trade associations and industry bodies to lobby government on current areas of customs law and policy that requires amendment in order to facilitate trade.

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