HM Revenue & Customs

Jon Thompson
Chief Executive Officer & First Permanent Secretary

[redacted]

Nicky Morgan MP
Chair of the Treasury Select Committee
House of Commons
Committee Office
London
SW1A 0AA

04 June 2018

[redacted]

Dear Nicky Morgan MP,

At the Treasury Select Committee hearing on the 23rd May I committed to write to you to set out information on a Highly Streamlined Customs Arrangement facilitations, as well as to set out the costs I mentioned in the hearing in more detail.

<u>Highly Streamlined Customs Arrangement Facilitations</u>

Under a Highly Streamlined Customs Arrangement, the UK and the EU together implement a range of measures to make UK-EU trade as frictionless as possible and to simplify the additional requirements that businesses engaging in UK-EU trade will be subject to, when the UK leaves the EU.

Each facilitation will help to make legitimate trade across the border as frictionless as possible. As we set out in August last year, in the *Future customs arrangements - a future partnership paper* and *Northern Ireland and Ireland - position paper*, the Government is looking at measures including:

- Negotiating waiver on entry and exit summary declarations
- Negotiating membership of Common Transit Convention (CTC)
- Negotiating mutual recognition of Authorised Economic Operators
- Bi-lateral technology-based solution for Roll on Roll off (RoRo) ports
- Co-operation, mutual assistance and data-sharing
- Speeding up authorisation processes
- Making domestic simplified procedures easier to access
- Specific facilitations for the Northern Ireland - Ireland land border

Information is available in large print, audio and Braille formats.
Text Relay service number – 18001

As set out in the paper the Government is also exploring other facilitations that could be implemented over a longer timetable to improve the UK's trading position such as customs self-assessment.

Successful delivery of any negotiated options will rely upon co-ordinated action by government, businesses, ports, and other Member States. Although HMRC remain on course to deliver a customs system by the end of the implementation period that enables trade to flow, HMRC to collect revenues, and the UK to have a secure border, we currently anticipate that a small number of these facilitations may not be ready in full by January 2021, e.g. for RoRo where action needs to be taken by other Member States as well as by us or where they are being considered for the longer term e.g. self-assessment.

It must also be remembered that the Prime Minister has set up two ministerial groups each led by three ministers from the European Union Exit and Trade (Strategy and Negotiations) Cabinet Committee each to examine the options further as a matter of priority.

Our timelines are kept under constant review and, of course, the precise time needed to implement new customs arrangements depends on the details agreed as part of the negotiations.

<u>Analysis for cost to businesses of a Highly Streamlined Customs Arrangement and a New Customs Partnership</u>

I set out to the Committee on the 23rd of May my assessment of the ongoing costs under both customs models and further detail is provided below. All costs are static based on the current flows of trade today and this analysis makes no assessment of the direct impact of changes in tariffs or indirect effects of changes in the level of trade. All other things being equal, increased administrative costs will have a negative impact on the level of trade, reduced tariffs will have a positive impact.

Highly Streamlined Customs Arrangement
Leaving the EU Customs Union and moving to a Highly Streamlined Customs Arrangement with the EU could result in a number of different costs, including:

- An ongoing annual administrative burden for customs declarations and the cost of complying with rules of origin, which I mentioned to the Committee and for which further detail is provided below.
- Set-up costs for the currently at least 145,000 UK businesses that trade only with the EU and are likely to have little experience of interacting with the customs regime.
- The risk of delays at RoRo ports in the absence of technological solutions and the facilitations that form part of a Highly Streamlined Customs Arrangement.

Many of a Highly Streamlined Customs Arrangement facilitations would serve to maintain the fluidity of trade and avoid severe delays at key ports. The ongoing costs which I have discussed at the Committee hearing therefore exclude costs of delays.

HMRC's estimate of the administrative burden of future customs declarations is a function of the number of new customs declarations expected for EU trade, both for imports and exports, and the estimated cost of these declarations.

Given that different businesses interact with customs in different ways, and the costs they incur are different, HMRC have looked at the new declarations and costs for five different groups of businesses differentiated by their trade volumes and use of intermediaries. Costs vary between £15 and £55 per declaration.

Estimates for each group of businesses of the additional number of customs declarations are based on current Intrastat declarations (EU trade data), VAT data and current customs declarations. The estimates used for the cost of customs declarations were a synthesis of a number of sources, including a range of surveys and HMRC's admin burden toolkit.

The administrative burden estimate takes HMRC's assessment of the number of future customs declarations for UK businesses for each group and multiplies this by a representative weighted average cost per declaration for each group based on current of patterns trade.

The additional number of estimated customs declarations is 205m for current intra-EU trade. This volume is based on analysis of EU Intrastat declarations and VAT data, as well as non EU data. This analysis indicates a higher number of consignments for a similar value of trade than we see in trade with the rest of the world. This is in line with the fact that we would expect intra-EU consignments to be generally smaller in value than the rest of the world (RoW imports and exports, and more frequent.

Combining the volume of additional declarations and the cost produces an estimated additional burden on the UK side of the border of around £6.5bn a year from the completion of customs declarations which HMRC expects to receive. Additional administrative costs will also apply at the EU side of the border because an export declaration from the UK will need to be matched by an import declaration into the EU and vice versa. Evidence from the *World Bank Doing Business Report* (Trading Across Borders section) suggests costs of completing customs declarations are broadly similar on the EU and UK. We therefore estimate that the total admin burden on UK-EU trade is around £13bn a year. The costs on both sides of the border are required to understand the impact on UK-EU trade, as costs imposed on UK or EU businesses will have wider implications for supply chains, and therefore for consumers and businesses in either market.

As set out above, the facilitations in a Highly Streamlined Customs Arrangement aim to ensure UK-EU trade continues moving as fluidly as possible and to simplify the additional requirements that businesses engaging in UK-EU trade will be subject to as far as possible. However, customs declarations would still be required on all UK-EU trade under this model.

Over the longer term, HMRC will continue to look at ways to reduce the administrative burden for declarations and simplify the way traders interact with the declaration system.

As I made clear, in my evidence there would also be burdens from complying with Rules of Origin and that several billion was a reasonable estimate of this. As set out in the Prime Minister's Mansion House speech, the government does not want to see the introduction of any tariffs or quotas on trade in goods between the UK and the EU. However, to benefit from no tariffs or quotas under a Highly Streamlined Customs Arrangement UK businesses will have to comply with rules of origin to prove they qualify.

The impact on UK business of having to comply with rules of origin will vary across sectors and business models however the Government is working closely with industry and trade bodies to fully understand the scope of these issues and address these accordingly. Engagement with business across sectors to date suggests there are three main administrative challenges business will face including:

- the cost and complexity of compliance;
- challenges in gathering origin documentation; and
- a lack of expertise and resource to comply.

Looking at available evidence and academic literature[1] on the cost of rules of origin suggests that compliance can add costs in the range of several percentage points of the value of trade which needs to meet rules of origin to qualify for preferential access under a Free Trade Agreement. Applying such costs to the value of UK-EU trade in goods that could face non-zero most-favoured nation tariffs therefore suggests a reasonable estimate could be in the billions. HMRC is actively looking into ways to ensure that any rules of origin requirements can be implemented in the most efficient way possible.

Taken together, these indicate a burden on UK-EU trade in goods of around £17-20bn a year. As I say earlier, the costs on both sides of the border are required to understand the impact on UK-EU trade, as costs imposed on UK or EU businesses will have wider implications for supply chains, and therefore for consumers and businesses in either market.

New Customs Partnership

As I set out in my evidence, the costs to business of this model differ from those for a Highly Streamlined Customs Arrangement, as additional new customs declarations would not be required for UK-EU trade. The New Customs Partnership achieves this by ensuring that the EU's tariff and any other customs requirements have been applied to goods imported from the RoW that are intended for import into the EU before those goods are released from customs controls in the UK. It also establishes an administrative mechanism to manage divergence in the UK's and EU's tariff policy. The current lead option for this is based around a repayment mechanism supported by simplifications and easements where appropriate (with robust

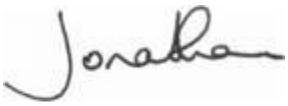
[1] Ciuriak (2014) concluded that a plausible range for only the administrative costs imposed by rules of origin is between 1% and 7% relative to the value of the exported good under preference. Cadot et al (2006) concluded that the total trade weighted costs imposed by rules of origin is between 7-8% for trade eligible for preferences, for the two rules of origin regimes they consider in their analysis.

compliance processes), to make it as straightforward as possible for businesses to pay the right tariff as early as possible in the process.

HMRC expect there to be some additional administrative costs for UK businesses importing from the rest of the world, but we are working to keep these to a minimum in the model's design. These would arise from having to provide additional information on customs declarations on all imports from the RoW and are in the region of £0.7billion per year based on estimates of the additional data fields that would have to be completed. There would be no additional direct costs for UK businesses exporting to the rest of the world, or UK businesses importing or exporting with the EU.

Additionally, if businesses chose to take advantage of any lower tariffs under the UK's independent trade policy, they would face a burden for complying with the repayment process. However, unlike the other costs explained above this would not be a net burden on businesses importing from the rest of the world as they would only seek to access the repayment mechanism if it is in their financial interest to do so (i.e. if the benefit that they would receive from accessing preferential UK tariffs outweighs the costs of engaging with the repayment mechanism). Effectively, that means we would not expect the gross costs to businesses to be higher than the benefits of lower tariffs under the UK's independent trade policy and there would be no net cost beyond the 0.7bn a year identified above. For context, in 2016-17, the customs duty on imports into the UK was £3.4bn.

Yours sincerely,



JON THOMPSON
Chief Executive Officer & First Permanent Secretary

Narrative and list of Transformation projects

During the last Hearing, I said that I would share details of the projects that have stopped or paused as a result of the department's prioritisation work.

The full list is set out in the annex attached, but I thought it would be useful to also share a more detailed breakdown of the new portfolio that covers what we will continue to deliver, in addition to the work that is pausing or stopping.

EU Exit

The new Customs Declaration Service (CDS) is on track against its key milestones, although the timetable to deliver by next January remains very stretching. HMRC is also upgrading the existing CHIEF system, which will run in tandem with CDS during the transition – providing an extra level of assurance.

Other HMRC programmes will support the free flow of goods and revenue collection at the border. A major part of our prioritisation work involved identifying projects that have a supporting role in EU Exit change. They include changes to tax credits and a number of VAT projects.

Individuals

We have delayed our plans to introduce further digital services for individuals, to release project capability to EU Exit work. This includes halting progress on simple assessment and real time tax code changes for now. The Making Tax Digital for Individuals programme has made significant progress in these areas already, and we will be able to return to this work when the time is right.

We remain committed to our digital ambitions: we will continue to encourage more customers to use their Personal Tax Accounts and will focus on improving the existing service. Additional services will be added only where they reduce phone and post contact or deliver significant savings.

We will pause work to digitise services that impact fewer numbers of customers, such as those paying Inheritance Tax, or applying for Tax Advantaged Venture Capital Schemes.

As no new tax credits claims will be made after January 2019, we will not move ahead with an online service for new tax credits claims.

We will continue to improve the existing Tax Free Childcare system, and changes to the Child Benefit system will, for now, be limited to the underlying IT infrastructure which needs replacing, rather than providing new digital services for claimants.

Business

As announced last July, the pace at which businesses will be required to keep digital records and send information to us through Making Tax Digital has been slowed, to make the transition as smooth as possible, particularly for smaller businesses.

The voluntary Making Tax Digital for Business (MTD) service for income tax launched on 15 March, and we are introducing the mandatory service for VAT for those with a taxable turnover above the VAT threshold from April 2019. As confirmed last July, we will not mandate further MTD for Business changes before 2020 at the earliest.

As a consequence of our prioritisation, the convergence of business taxes from our current range of IT systems onto a single system will happen at a slower pace. This will slow the creation of the single account for all business customers, which remains our ultimate aim and it does not impact the delivery of MTD.

Compliance

Improvements to the tools and processes that our compliance teams use to identify, work and resolve compliance risks will now be delivered over five years, instead of three.

Policy Driven Change

We will deliver all of the additional work we were given in Budgets and Autumn statements for which we were given funding. This includes: the Soft Drinks Industry Levy; the Trust Registration Service; work to tackle avoidance schemes that seek to exploit tax and National Insurance Contribution advantages through Disguised Remuneration and Salary Sacrifice arrangements; and work tackling non-compliant overseas suppliers who sell goods to UK customers.

Estate changes

We will continue to deliver change projects that will improve the experience of our employees. That includes work to update and improve our departmental intranet, strip out bureaucracy, and streamline processes.

As the move to 13 Regional Centres is an essential part of our transformation, this work will continue. To ensure we progress at a manageable speed, and spread out the costs of our estates programme over a longer period, we will now refurbish Longbenton in 2020-21, two years later than originally planned. In Nottingham, we will either refurbish our existing Castle Meadow site, or move to a new building in the city during 2020-21, a year later than planned.

Annex attached

Annex: HMRC transformation portfolio list of stopped or paused projects by programme

Programme	Project	Project Description
Compliance of the Future	Customer Notification of Fraud	A replacement for HMRC's manual system where customers are notified of potentially fraudulent use of their information. This change would have delivered efficiency savings and the end of the project does not increase risk to customers.
	Intelligent Filing System: Phase One	Electronic filing system to store and retrieve customer documents.
	Intelligent Filing System: Phase Two	Electronic filing system to store and retrieve customer documents.
Corporate Services	Planning, Performance & Risk Project	Change the way HMRC forecasts and monitors expenditure, integrating information from HR systems to inform financial forecasts.
	Universal Pensions Interface	Create a Single Universal Pension Interface to cover HMRC, Valuation Office Agency and Revenue and Customs Digital Technology Services Ltd staff.
Data Platform	Enterprise Data Management – Data Sharing	Improve HMRC's data-sharing capabilities.
Digital Platform	Research and Development	Bespoke tool for research and development
Finance Process Platform	Asset Management	Automate the data upload process for posting information to HMRC's Enterprise Resource Planning system, remove the bundling of assets and provide one-to-one matching of assets purchased and recorded on HMRC's SAP systems.
	Banking Provider Retender	Preliminary pre-tender activity ahead of 2020 replacement of current banking provider
	Customs & Excise Core Accounting system migration	Migrate applications not already on HMRC's convergence roadmap through Making Tax Digital for Business

	Financial Control and Reporting, Enterprise Tax Management Platform, National Insurance and PAYE service, Real Time Information.	Modernisation of reporting tools.
Future of Child Benefit	Future of Child Benefit Transformation Project	Improve customer experience, streamline the process, and realise efficiencies following move to new IT platform.
Making Tax Digital for Individuals	Change of Name	Allow customers to change their names in the Personal Tax Account, replacing the existing online form
	Claim repayments from Tax Estimation Service (TES)	Create a single Personal Tax Account service from the existing two services.
	Creation of Income Store	Customer-centric and regime independent database containing details of individual customers' income and expenditure. This work is now limited to business customers.
	Directors	Allow customers to inform/update/cease directorship status and report income through the Personal Tax Account.
	Emergency Tax Code	Automated service replacing existing manual Emergency Tax Code process.
	End Of The Tax Return Risking Solution	Compliance risk tool to ensure the continuation of compliance activity following the end of the tax return.
	Extend Tax Calculator for Self-Assessment Populations	Extend the current tax calculation to cater for all Self-Assessment populations and all combinations of income, expenses, allowances and deductions.
	Gift Aid	Enable customers to declare Gift Aid digitally.
	High Income Child Benefit Charge	Allow customers to view the calculation of their High Income Child Benefit Charge.
	Income from Property	Allow customers to update HMRC about property income in real time, feeding automatically into the individual's tax code calculation.
	Making Tax Easier	Strategic work to support activities that contribute to the end of the tax return.
	National Insurance added to Tax Estimate Service / Tax Credit service	Show National Insurance paid to date and integrate with view of previous years' contributions.

	PAYE over £100k	Introduce the process and functionality to allow PAYE to taper Personal Allowance during end of year reconciliation, rather than through Self-Assessment.
	PAYE Over £150k	Introduce the process and functionality to allow PAYE to taper Personal Allowance during end of year reconciliation, rather than through Self-Assessment.
	Proof of Income	Service to allow customers to prove income for purposes including mortgage validation.
	PTA Live Service Optimisation	Small-scale improvements to the Personal Tax Account.
	RPAYE and Coding	Add additional triggers to automatically change tax codes.
	Self-Assessment Appeals and Cessations	Replacement for existing manual appeal and request service.
	Simple Assessment Phase 2	Extend the use of Simple Assessment billing to a wider customer base, enabling customers to self-serve via the Personal Tax Account.
	Single Employee Expenses	Digital service allowing individuals to automatically claim tax relief for work-related expenses.
	View Employment History	Allow customers to see their previous employment history within the Personal Tax Account.
Policy Driven Change	HMRC and Charities Commission Joint Charities Portal	Allow charities to register with the Charity Commission for England and Wales and claim tax reliefs through a single online portal.
	Inheritance Tax Online	Online inheritance tax service for chargeable estates.
	Tax Advantaged Venture Capital Schemes	Digitise all Tax Advantaged Venture Capital Schemes
Securing Our Technical Future	Business Developed Applications) Consolidation	Rationalise existing Business Developed Applications (BDApps) and move them to a new IT platform.
	Infrastructure Virtualisation	Migrate the smaller parts of our IT estate to a largely virtualised Cloud service.
Tax Free Childcare	Tax Free Childcare New Front End	Creating a registration and validation digital front end