

Treasury Committee

Oral evidence: The UK's economic relationship with the EU, HC 453

Wednesday 23 May 2018

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Members present: Nicky Morgan (Chair); Rushanara Ali; Mr Simon Clarke; Stewart Hosie; Mr Alister Jack.

Questions 594-664

Witnesses

I: Jon Thompson, Permanent Secretary, HMRC, and Jim Harra, Second Permanent Secretary and Tax Assurance Commissioner, HMRC

Examination of witnesses

Witnesses: Jon Thompson and Jim Harra.

Q594 **Chair:** Good afternoon. Thank you both very much indeed for coming. You will be pleased to hear that this will not be your only session before the Committee in the next four weeks; you are coming back again on 5 June. Thank you for finding the time for this particular session. Could you both introduce yourselves for the record?

Jon Thompson: I am Jon Thompson. I am the chief executive officer and Permanent Secretary of Her Majesty's Revenue and Customs.

Jim Harra: I am Jim Harra, the Second Permanent Secretary in HMRC.

Q595 **Chair:** This session was triggered by the article in *The Daily Telegraph* on 12 May entitled, "HMRC deems May's customs plan 'unviable'". In the article it says:

"HM Revenue & Customs, which would have to administer the tariff collection and rebate system under a customs partnership, does not support the idea. A Whitehall source told the Telegraph: 'HMRC dislikes the customs partnership, they don't think it's a viable option. They think it's for the birds. It's incredibly complicated and would very hard to track goods. When it was originally put forward, officials assumed that Max Fac would be the primary option. When they heard it was the customs partnership, they thought "you're having a laugh".'"

I really want to explore the veracity of that summary of HMRC's view of the two proposed customs options on the table. We last discussed this in September. What is the basis for that *Telegraph* article? Do you recognise it at all?

Jon Thompson: We do not recognise it at all. I have no idea who the unnamed Whitehall source is. That certainly wouldn't be our position. We believe that both of the Government's options, which were set out last September, are deliverable. It is as simple as that.

Q596 **Chair:** That's it; we're done. No, not so fast—let us go back to the evidence that you gave in September. I take it that you stand by what you said then, and what you just said: that both could be delivered. It would be very helpful to understand the work that HMRC has been doing between September and now on the options and on advice to Ministers and what you are saying to the Government, who are making decisions about this.

Jon Thompson: Since we saw you last there have broadly been six areas on which we have been working. The first was to work with and to talk quite a lot to stakeholders—the logistics industry, ports, importers, exporters and so on—about the two options and how they see them, their reaction to them and to their implementation and so on and so forth.



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Secondly, that fed into the maturing of the policy as we understand it, but also in terms of our advice to Ministers. Thirdly, we have worked up a critical path for both options, so that we are clear about how long something would take to implement in full or in part once we have a decision. Fourthly, we have done some preliminary work on the technology required, both for us but more for the private sector.

Fifthly, Jim in particular has been working and liaising with the negotiating team. Lastly, we are currently feeding into Ministers' understanding of these options by their decision-making process. Broadly, our work is in those six areas.

Q597 **Chair:** Have the two of you had direct meetings with Ministers?

Jon Thompson: Yes.

Q598 **Chair:** Have you had meetings with the Prime Minister?

Jon Thompson: Yes.

Q599 **Chair:** Is there an HMRC view on the two models that you are able to give? Or are you being asked to advise on both models straight down the line at the moment?

Jon Thompson: We have been asked to advise on both models down the line. It is not for us to advise on which option to choose and so on and so forth. We have been asked to stick very carefully to the role of civil servants in what is clearly a significant policy for the Government to decide on.

Chair: Jim, do you want to add anything?

Jim Harra: We have been informing Ministers. We obviously have the two groups of three Ministers from the strategy and negotiating Committee looking at each of the two models, and we have officials embedded with those teams to support them.

Q600 **Chair:** Is there any advice on the relative costs, the feasibility and the timescale of both options that tends to pull one way or the other? Have you been asked to just give advice to Ministers and to then leave the political decision making to them? Do you expect that they will make the decision and then ask you to take on one particular stream of work?

Jon Thompson: We have all that information. If you wanted to ask us about some of that, we could probably give you some of it. Some of it would need to be caveated, but we could give you that information. We need to be really clear that the decision criteria for which option might win out is not for us to set. Some of the political debate is really about how people might weigh those decision criteria differently from each other.

We are not being asked to advise on the decision criteria. We are being asked to give input. We are not the only Department involved in this conversation. Others, such as DEFRA, are involved in the regulatory framework, and there would be aspects of the Department for International Trade's perspective on the freedom to trade and so on and



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so forth. We are involved very heavily, but we are not the only Department involved.

Q601 Chair: How has your view evolved? Everybody's understanding—both inside and outside Government and Whitehall—of these options is evolving rapidly. Has your view changed since last summer's White Paper?

Jon Thompson: We have more information about implementing the options and what the costs might be for the Government and for businesses. We understand the, if you like, deliverability of these options much more than we did the last time we gave you evidence. That is where our understanding of the policy has deepened.

Both of us have travelled fairly widely and spoken to a number of businesses—on a personal level, I have been to 12 ports and airports and two fast parcel operators to ask how the policies might work for them—in order to gather more intelligence to enrich the conversation about what the reaction would be from businesses and ports and so on. I think we understand more about the policy and its implementation, and I think that helps Minister with the impact of their policies relative to the negotiations and other factors.

Q602 Chair: When you last came before the Committee, you said of the partnership model: "We were asked to provide something innovative and creative". It must be quite nice to be asked to do that, compared with the normal requests of you. Given those conversations and the evidence you have heard, do you think that the innovation and creativity ask was matched, or are there things that you would now change as part of the advice going forward?

Jon Thompson: The policy has matured, because since we took it out ourselves and began to talk to businesses—we had some external help with that, too—our understanding of the policy, as it was originally designed, has moved on a bit. One of the original concepts under the new customs partnership was that we would have to track goods all the way to their end point. We now think, as a result of talking to traders, that it is possible to have a different way of doing that so that we wouldn't have to track all the goods to the end point; we could have an administrative process, which would obviously be cheaper for everyone concerned. That is one of the developments of the policy, for example.

The fundamental element that, on entry to the United Kingdom, someone would pay the European Union's common tariff, remains there. The fundamental feature that there would be a reclaim of that tariff if the United Kingdom signs a free trade agreement with lower tariffs, which is unprecedented in WTO terms, also remains. It is about how we actually operationalise that mechanism where we have moved from the original position, which was described as bureaucratic. If we are up-front about it, we could see that. However, from talking to people we could see other options that will be administratively less burdensome for businesses, and we have evolved that policy further.



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Q603 **Chair:** Jim, I wanted to ask you about your work with both the negotiating team and with Northern Ireland—are you or your colleagues talking to your counterparts in Ireland and Northern Ireland?

Jim Harra: Officials from the Department are in Brussels frequently and are involved in the negotiations. I have been there as well, in the negotiations with the Commission. Those are obviously focused on the withdrawal agreement at this point and not on the future economic partnership, and they are particularly focused on the Northern Ireland-Ireland land border and what our two models mean for that, which is the involvement I have had in that.

On Northern Ireland, we have a close relationship with the Northern Ireland civil service. We also had officials in Northern Ireland at the weekend, for example, with Ministers to meet businesses and the police to make sure that we understand the impacts of the two models there and how we should develop those. That is the kind of deepening and developing of them that we have been doing.

Q604 **Chair:** Are you able to share not necessarily the conversations you have had with the police or security services but any of the changes that you have realised might need to be made to the original advice or schemes, as drafted, because of advice from the police?

Jim Harra: I was not there personally, but I think it was about getting background information about, for example, the nature of the border and, if controls need to be added to the border in the future, how practical that would be. That reinforces the importance of what the UK Government have already committed to, which is that, no matter which solution we end up implementing, it will not involve any infrastructure or routine checks at the Irish border.

Q605 **Chair:** Perhaps you have covered this, but when you work with the negotiating teams, have you been asked questions from the EU side of the table as well, asking for more details about either scheme?

Jim Harra: Yes. The parts of the negotiation that I have been involved in have involved quite detailed dialogue, and I know that my officials who have been to other parts of the negotiations have found that to be the same. We are obviously subject matter experts and you would expect our discussion and dialogue to be at a fairly technical level and involving technical questions, and we have been doing that on both of the customs models.

Q606 **Chair:** Have you been asked to give advice on the common transit convention?

Jon Thompson: We have. It is the Government's position that we wish to re-enter the CTC, and I think there is universal agreement that we will do that. I cannot quite remember whether we have actually formally started that, but there is certainly a decision to do so.

Jim Harra: We have not formally started that, but it is the intention. Being a member of that will be the intention under any of the customs

models, and it would significantly reduce friction for traders in both the UK and member states.

Q607 **Chair:** Finally, before I hand over to Alister, you will know that the Government's position is that, alongside either model, there will be a backstop as well. That is the wording as agreed in December, although that may well evolve as negotiations continue. Has HMRC been asked to give any advice or view on the backstop proposals? I suppose we are particularly talking about customs at the moment, but regulatory alignment and common standards are very important for the trading of goods and for companies as well.

Jon Thompson: I believe the Government rejected the European Union's wording on the backstop. There are ongoing discussions about the UK's position in relation to a backstop. I think that is where we are.

Q608 **Chair:** But no specific advice on what an alternative backstop arrangement might look like?

Jon Thompson: I am not involved in that.

Jim Harra: As you mentioned, the backstop will cover customs, and therefore, as you would expect, HMRC officials are involved in the preparations for what the UK's alternative proposition will be. HMRC is not responsible for regulatory alignment, only for the fiscal side of customs, so we are actively involved in that.

Q609 **Mr Jack:** Mr Thompson, can I pick up on something you said? I think you said that, under the new customs partnership arrangement—NCP—we would collect the tariff on goods that arrive in the UK destined for the EU and then pass that on. Has the EU agreed to collect the tariff on goods destined for the UK that arrive in the EU and then pass that on to us?

Jon Thompson: That is to be negotiated.

Q610 **Mr Jack:** So it is being negotiated?

Jon Thompson: It is one of the moving parts of the negotiation.

Q611 **Mr Jack:** What is the EU's position on that at the moment?

Jon Thompson: I think we need to be careful in our giving evidence about what we can and cannot say about what exactly is going on in the negotiating room.

Q612 **Mr Jack:** But would you expect them to reciprocate?

Jon Thompson: I do not believe that we would expect them to reciprocate.

Q613 **Mr Jack:** You don't believe that? Do you need them to?

Jon Thompson: No, not to make it work.

Q614 **Mr Jack:** I questioned both of you back in September on the requirement for no physical infrastructure on the Irish border. I think I heard Mr Harra



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say there that that is still being investigated, but that you think both systems would not need physical infrastructure. Is that correct?

Jim Harra: Yes, it is HMRC's position that we do not require physical infrastructure at the Irish border to operate the customs procedures under whatever model is chosen.

Jon Thompson: Remember, one of the fundamental features of the new customs partnership is that intra-EU trade would flow in the way that it currently flows. Checks would not be required at the Northern Irish border, but they also wouldn't be required between Dover and Calais.

Q615 **Mr Jack:** Is that for NCP and max fac?

Jim Harra: No, just the new customs partnership. The highly streamlined system—max fac, as it is sometimes called—involves customs controls between the UK and the EU, and you would therefore expect that goods moving through ports like Dover will in the future move under customs control. Indeed, it will be the case that goods would move under customs control at the Irish border as well, but we can operate those controls without the need for physical infrastructure at that border.

That is a design challenge for us, because if you look around the world, even the most technologically advanced customs borders generally involve some kind of infrastructure. However, we believe that we can manage the physical risks at the border.

Q616 **Mr Jack:** Is there a precedent for that anywhere around the world? Is the technology available to be brought in quickly and within the timeframe?

Jon Thompson: Are you asking about Northern Ireland?

Mr Jack: I am absolutely asking about Northern Ireland, yes.

Jon Thompson: We would navigate our way around the technology through the use of administrative procedures. In the Northern Ireland paper that the Government published last summer, we looked for additional facilitations over and above those required for the highly streamlined system. For example, we would look for an exemption for small traders, given the very nature of the Northern Irish economy. Secondly, we would expand the authorised economic operators scheme for larger traders. As a result of that, any customs processes that did need to take place would take place away from the border. Through the combination of those administrative procedures, we do not require any infrastructure at the UK-Republic of Ireland border for fiscal reasons.

Q617 **Mr Jack:** Have you had a discussion about where you set the exemption for small traders? At what level?

Jim Harra: That would be a matter for the negotiations. Clearly we would want to relieve the bulk of the trade that crosses the border, which is small traders in our local economy. There are obviously a variety of different ways in which you could set the threshold and different levels at which you could set it, and that would be a matter for the negotiations.



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Q618 Mr Jack: You would have trusted larger firms as well, but how do you deal with the people who fall in the middle? How do you stop them asking small people with small exemptions to move things for them, for instance?

Jim Harra: We have proposed a three-tier model. For the smallest traders, we would have complete relief from all customs duties and from customs procedures. For the middle tier, we would want to introduce streamlined procedures, which would enable them to comply with customs controls away from the border. For the larger ones, we would expect them to operate, broadly speaking, normal customs controls, although we would expect them to want to access some of the standard facilitations that are available, for example to trusted traders. There are a number of potential compliance risks around the model that we would need to mitigate and manage. That is what we would want to discuss with the EU—how we would go about doing that.

In terms of the fiscal risk that it poses either to the UK or the EU, our position is that this is not very significant and that it is capable of being managed.

Q619 Mr Jack: Have you had discussions with the Irish Government about whether or not they are willing to reciprocate on those terms?

Jim Harra: We have regular dialogue with Irish customs as the customs authority, but at this stage the negotiations are between the UK and the European Commission taskforce 50. They are not with individual member states.

Q620 Mr Jack: 80% of southern Ireland's trade is to or through the UK. It is not all over the Northern Ireland-southern Ireland border, obviously; some of it goes Dublin to Holyhead. It does strike me as dramatically in their interests to help find a solution to the problem, rather than to create problems and barriers. Would you agree?

Jim Harra: You might think that. I am not an expert on trade or international diplomacy, and obviously the traffic that flows from Holyhead to Dún Laoghaire is entirely different in these terms from the traffic that crosses the land border.

Q621 Mr Jack: But we are trying to avoid hard borders either at Cairnryan, in my constituency, or at Holyhead. We don't want to create hard borders on the mainland either.

Jim Harra: Cairnryan is obviously an intra-UK ro-ro port, so it would not be impacted by any of the solutions. But Holyhead and Dún Laoghaire, under the highly streamlined model, would be either side of the two customs territories' borders, and therefore customs controls would apply under highly streamlined to goods passing between those two ports, but would not apply in the new customs partnership.

Q622 Chair: Could you just unpack for me a little further the point that Alister asked about, on a UK tariff—the reciprocation point? I think most people would understand the first bit of the customs partnership, about an EU



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tariff being charged. Are you saying that no reciprocation is needed on the basis that the UK would have no tariffs? What are we missing about this lack of reciprocation?

Jon Thompson: One of the features of the new customs partnership is to avoid, if at all possible, the friction that would be required under all other options of customs declarations between the United Kingdom and the European Union, which would be a feature of the highly streamlined customs model. You may want to get further into that in a minute. What you are doing, as it were, is moving the fiscal border from Calais to, say, Felixstowe, and at the point that you enter the United Kingdom, for fiscal reasons you also enter the European Union. You are then managing how that trade works. It does mean that the lorry that drives from Felixstowe around and across from Dover to Calais then does not need to do anything else. You have then got the free movement of goods, as it were, for fiscal reasons, between the 28, not just between the 27.

The challenge for us and businesses is then: are those goods consumed in the United Kingdom or not? You are right that it does present diversion risks one way and the other. Some people would say that it might create a diversion risk that we are a back door to the EU and they are to us. We think we can manage that risk, but that would be the subject of further conversations with the European Union. I need to be clear with you that a significant advantage of the new customs partnership is that it does not require customs declarations between the 28—the 27 and the United Kingdom.

Q623 **Mr Jack:** There are two systems being discussed. Some of the members of the Cabinet have described one as crazy or flawed, and others like the idea. The Irish Government have gone on record saying they are not wild about the max fac option. Have the Government asked you to come up with any other alternatives or other ideas, or are you just focusing on those two options at the moment?

Jon Thompson: I have to be up-front with you: we have been asked to run these two. Running two at this level of depth is a pretty significant task. We have employed more than 1,100 staff working on Brexit. I think two options is enough. We are exploring variants as well, or options within the fundamentals of the two options. As Jim said, there are two ministerial working groups looking at, "Can you do X within this model? What about Y?", but the two fundamentals remain as they were. We have not opened up a third fundamental.

Q624 **Mr Jack:** You have not modelled a WTO arrangement if there was no deal.

Jon Thompson: You can model that, yes.

Q625 **Mr Jack:** But have you been asked to model it?

Jim Harra: We are in addition planning for a scenario where the UK leaves with no agreement. We set out in the White Paper last year what that would largely look like.



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Q626 **Mr Jack:** Is that HMRC being belt and braces, or did the Government ask you to do that?

Jon Thompson: We were asked to provide a contingency plan for a contingent X where there is no deal. It is clearly not the Government's preferred option, but all Government Departments were required to produce a contingency plan. We did that. We have provided it to DExEU, as we are required to do. The situation remains to be that the Government continue to plan for that contingent exit, but we are not executing that plan.

Q627 **Chair:** Are the 1,100 people just working on the two options, or do they include people doing other things around Brexit, but not related to modelling these two options?

Jon Thompson: They were originally mostly in policy, but that has now expanded out into operational delivery areas and technology, because there are other programmes over and above customs where we need to do some further work. For example, it is worth remembering that we still have £40 billion of the welfare state within HMRC. We are involved in data sharing and all sorts of other areas. I think we are heading towards the number—I think I have been fairly widely quoted on this—of 5,000. Our current estimate is that it will peak at just above 5,000. Under the highly streamlined arrangement, it would peak at 5,100. We are building that up.

Q628 **Chair:** What about additional frontline people at borders, ports and other places to check? Is that included in the 5,000?

Jon Thompson: No, the impact on Border Force and the Home Office would be in addition to that. Remember, we do not actually run the physical border. The Chancellor's fiscal remit is passed on to Border Force.

Q629 **Chair:** Presumably you would be involved in training those people or instructing them on what they need to do in order to fulfil the new customs arrangements.

Jon Thompson: It is not quite like that. The Departments work very closely together on the compliance model required. Our requirements and the Chancellor's requirements feed into other requirements at the border, such as security and the free flow of trade. You have got these three combined objectives about raising revenue, the free flow of trade and the security of the United Kingdom. Border Force takes its requirements from a number of different areas.

The major operational delivery impact from us is that we have to assume that when we leave the European Union and the customs union, customs declarations will be required for what is currently intra-EU. It has been fairly widely reported that our estimate is that there would be a fivefold increase in the number of customs declarations. Therefore, the major operational delivery aspect for us is to scale up the national clearance hub in Manchester to cope with those customs declarations. We look only at exceptions, because it is largely a machine-risked process, but nevertheless, we need to ramp up the number of staff there. The other bulk area is on compliance, because there are new fiscal streams, and new



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risks present themselves. Those are the two areas where the majority of staff would work.

Q630 Mr Clarke: I am going to touch on the timing of the transitional arrangements in a moment, but before we leave Northern Ireland, last year, the head of the Irish tax authorities, Niall Cody, seemed to agree with you, Mr Harra, when he said that he was “practically 100% certain” that no new customs posts would be necessary along the border. The question is, if HMRC thinks that, and the Irish authorities likewise, what or who is causing the concern about the issue?

Jim Harra: If we move to a model where the UK and the EU are separate customs territories, with customs controls applying to goods that move between them, under international law you have to have customs controls and a way to give effect to them. The design challenge at the Irish border is to devise a way to give effect to that that does not require that physical infrastructure or those routine stops and checks. Therefore, you have to design something to do that, which will look different from any other part of your border.

You are right that there is a commitment on both sides—not just the Irish and the UK, but the EU—that whatever we come out with must not involve any physical infrastructure, but there are different ways of achieving that. The new customs partnership inherently achieves it as a matter of course, because goods would move in free circulation between the UK and the EU, including over that border. The highly streamlined model is different. Its design in itself would not achieve the no hard border that you require. You would have to have additional specific measures for Northern Ireland, which is what we have devised, and which we need to negotiate and work through with the EU.

Q631 Mr Clarke: And the Irish authorities are closely engaged in that process?

Jim Harra: I assume so, via taskforce 50, yes.

Q632 Mr Clarke: Mr Thompson, you previously told the Committee that the maximum facilitation model could be phased in over a three-year period, and at the same time, you said that the new customs partnership model would probably take at least five years to implement. Is that still your position?

Jon Thompson: Bluntly, yes, but—

Mr Clarke: Blunt answers are good.

Chair: We are going to get a nuance as well, though.

Jon Thompson: It is probably worth having the nuance. Yes, but it is also worth stating for the record that we think we would have a functioning border in January 2021, and obviously, three years and five years do not easily square with January 2021. We are absolutely clear that we would have a functioning border. If we reached that point and it was not fully in, Ministers might have to make some choices about trading those three fundamental objectives about free flow, revenue and security, but

nevertheless, we think we would have a functioning border in January 2021.

The doubt on the highly streamlined option is that we cannot guarantee that all ports, all traders and all other member states will have taken all the necessary action that is agreed—remember, “highly streamlined” is a basket of changes where both sides need to take action. We may find that we do everything we need to do, and Dover does everything it needs to do, but we cannot guarantee that Calais would, so we have said that it will be three years elapsed. Those are the areas where I cannot give certainty to Ministers.

On the new customs partnership, by January 2021, we would the so-called dual tariff up and running. The thing that we would not have fully up and running is the repayment mechanism. The repayment mechanism rather depends on what free trade agreements are signed, how much the tariff is reduced by, and then a very economically rational decision by businesses about whether it is worth the cost of reclaiming those tariff differentials. Economically, it regulates itself. We have had a very clear steer from businesses that they think that they need between 18 and 24 months to see the impact of free trade agreements before they would really engage with us on the repayment mechanism. That is why you end up with, potentially, up to five years.

Q633 Mr Clarke: Right. What do you propose happens at the end of the implementation period if whatever model we have chosen is not fully ready for implementation? Would we just make do and mend? I am trying to understand how that process would operate, in particular with regard to the highly streamlined model—“maximum facilitation”, as I’ve been calling it—and the basket of checks that lie within that. Which of those would definitely be ready, do you think, at the point of exit, and which might need to be brought into compliance later?

Jon Thompson: I haven’t got the full list of facilitations with me, but they broadly split into two groups. There is a series of existing features of our relationship within the European Union that we wish to maintain—staying in a common travel convention, security waivers, mutual assistance, data sharing, mutual recognition of trusted trader schemes and so on. That series would be much quicker to implement—some of them would be available on the very first day, and some will take some further work over the first one or two years. Then there are the extensions into new areas—the technology challenge is the inventory matching system that is required to be implemented by ports. That’s the area where the highly streamlined model also requires the ports at the other end of the loops to do some work as well, so that is the area where I cannot guarantee to Ministers or you that all of that will be ready. If you wanted us to set out the facilitations of which the vast majority we think will be in, we could do that in writing, possibly.

Q634 Mr Clarke: I’d be grateful if you would. I would be very grateful for a list, in point of fact, of the precise elements of the highly streamlined model, so that I can understand how they all hang together. I think that would



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help the Committee.

Jon Thompson: We will see if we can give you any further information, over and above that which was published last August—there is quite a long list there, but we will see if we can give you any further information.

Q635 **Mr Clarke:** In particular in the specific context of the timing of implementation or implementability. That would be really helpful.

The issue with the NCP, it seems to me, is that either we have agreement or we don't. In terms of avoiding the cliff edge, would you accept that the highly streamlined model offers some advantages, in so far as you can at least roll with what is definitely ready? Frankly, were the situation to arise in April 2019, you would be able to do parts of it, whereas NCP is a binary state—it either is or it isn't approved. It's either/or, and we always hear about the need to avoid the cliff edge.

Jon Thompson: You are tempting me into some dangerous territory, but nevertheless let me see if I can answer you. You are right in the sense that the highly streamlined arrangement has a basket of changes—so there are more features to that in a sense, and they can be phased in on different timescales—but nevertheless, to re-emphasise the fact, you have a functioning border on 1 January 2021 in both these models.

In the new customs partnership, I think we are being clear with you that the dual tariff would be there, but the repayment mechanism would take a bit longer, because it requires some fairly significant further technology. Then businesses will need to decide whether they are going to engage with that technology, and they may themselves require some further technology build. If you like, NCP has two parts to it, and the highly streamlined has more parts to it.

It is worth being clear with you that our contingent plan would be to implement the highly streamlined model unilaterally.

Q636 **Mr Clarke:** Final question from me, because I am conscious of time. We will be returning to a lot of this in June. Have you or other officials discussed with Ministers the possibility of the UK maintaining the same external tariff as the EU—that is, remaining in a customs union after the end of the implementation period, until such time as either model is ready?

Jon Thompson: I am not sure that that situation plausibly arises, but Jim may want to clarify.

Jim Harra: No, I am not aware that we have been in any discussions. Obviously, the setting of tariff rates when the UK has left the customs union is not a matter for HMRC—that is a matter for others—but we have been working on both these models, with a view to implementing them as far as we possibly can at the point where we leave the customs union, at which point the UK is able to set its own tariff levels. Although as Jon mentioned, to the extent that there is a differential between those, under the new customs partnership it could be some time before we are actually able to give practical effect to a repayment of the—



Q637 Chair: We will come back to the conclusions at the end, but in terms of timing, at what point do you need “this is the model that we are following” in order to even stand a chance of hitting the January 2021 deadline of a functioning border? How quickly? Are we talking a matter of weeks now?

Jon Thompson: It’s quite difficult to give you an answer to that question. If you stand back from this, we think you would have a functioning border in 2021. I think the word that I have used in various Select Committees is that it might not be fully “optimal”, and the question then is what risks are arising for whatever is the short period—you might be into 2021—where it is not fully operating in every single place for all traders. It sort of depends on what the theoretical question is that you’re asking me about how long before you get to the answer. Obviously, the quicker we get a decision, the quicker we can implement what the Government wants, but we continue to advise as much as we possibly can. Jim, do you want to add to that?

Jim Harra: From the point of view of HMRC and the things that we have to do, as Jon mentioned earlier, we are keeping on two tracks really; we are continuing to develop both options. Clearly, at this stage, neither of them is negotiated. You would expect, out of the negotiations, some features to appear that are not in our current design, so you’ve got to have time to implement that. But otherwise, HMRC remains on track on both of them to do what we need to do within the timeline. But under either of them—they do require third parties to start to act, and they will not do so just because a Minister tells them to; they will do so if they think it’s in their economic interest. At the moment, we are engaging with everyone on both of them, and they are doing their thinking and doing their work. That means that they are making progress, but at some point, when it comes to their having to spend hard cash, they may well look for a greater degree of certainty than they currently have.

Q638 Chair: But the three and five years—from when? You have a functioning border, potentially, in January 2021, but then that’s moving on to following one or other of the models, one assumes—let’s assume that one of them gets negotiated and agreed. So are we talking three years from now, three years from March 2019 or three years from some point in the transition period?

Jon Thompson: Three years elapsed from when you’ve got some certainty about a decision. I think I’ve said this quite a few times, so I’m being really careful that we are not tying ourselves to what the date is. We are saying with you and to Ministers: it’s “elapsed”. So the real question is: when are you starting?

Q639 Chair: You can’t start until you have a political decision as to which one of the two, and I take your point, Jim, that there may well be changes because of the negotiations, but which one of the two models has been nailed down as “That’s what we’re going to follow”?

Jim Harra: We can make a start and we can burn into some of that elapsed time without certainty, so for example, if you take highly



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streamlined, we have devised and shared with the ports and other relevant parties a draft of the detailed technical specification that ro-ro ports, for example, would need to meet in order to operate that. They can get on with thinking about how they would need to change their systems and everything. That would be part of any project and therefore they are using time effectively.

If you take the new customs partnership, we know that some businesses, in order to take advantage of the repayment mechanism, will need to invest in new IT systems and new data flows. That will cost them money. Economically, it is unlikely that they will want to invest in that until they have certainty that there is going to be a tariff differential that is worth their while, and that involves understanding, first: is this going to be the model? And secondly, what trade agreements is the UK going to agree with the rest of the world and what is that differential going to be? Some of that is not in our control.

Q640 Rushanara Ali: Good afternoon. I just wanted to pick up on the Chair's question. You said, Mr Thompson, that since August 2017 you have more information on the cost of implementation to Government and business. Could you provide the specifics to us, either in writing or further down the line? That would be really helpful.

Jon Thompson: Would you like me to do it now?

Rushanara Ali: If you want to, yes. That would be really helpful.

Jon Thompson: On the highly streamlined arrangement there are broadly three costs for businesses. So first of all, in leaving the customs union you have to assume that under WTO rules or under any trade agreement there are customs declarations required. We know that there were, in 2016, almost 200 million intra-EU consignments, so that is the base number. That has been audited by the NAO and is in a report on the customs declaration service.

The question is how much it costs to complete a customs declaration. We have done some work ourselves. There have been at least two independent reports—one by Nottingham University Business School, one by KPMG earlier in the year. The answer to that question is that it is between £20 and £55. You can't average it out, because of weighting, but for Ministers we have settled on £32.50 per customs declaration; so you have got 200 million customs declarations at £32.50: that is £6.5 billion.

Jim Harra: That is on the UK side. Obviously there are declarations required on the EU side as well.

Jon Thompson: So you double that number, probably; so that takes you to £13 billion. You have then got the question about what might be the requirements from the European Union on rules of origin: "Is this cheese from Cheddar?" and so on. It is quite difficult to estimate that, but it would be reasonable to think that it is several billion pounds more; so I think you need to think about the highly streamlined customs arrangement costing businesses somewhere in the late teens of billions of pounds to operate.

Rushanara Ali: I have started to lose count, now, of the number of billions.

Jon Thompson: But, you know, somewhere between £17 billion and £20 billion. It is that sort of order; and the primary driver here is the fact that there are customs declarations. So if you are switching to the new customs partnership, because what it tries to deliver is the free flow of goods between the 27 and the UK without customs declarations, then it avoids those costs that I just gave you in the highly streamlined model, and in a sense it is self-regulating. So if you assume that businesses are economically rational and that they will only try to get the tariff differential back if it is worth their while, you could argue that it must be zero or less; but that is probably an unrealistic thing to say. The maximum amount there can be is the total amount of tariffs. If the UK made all tariffs zero and all of it could be reclaimed, that is also an unlikely scenario and that comes in at £3.4 billion. But remember the business would be getting that back on the tariff, so it might spend £100 and get £150 back. So you could argue that the NCP has a net cost of zero or less depending on the tariffs. Is that clear enough that they are quite different?

Q641 **Rushanara Ali:** I think so, but I would love to have the analysis in writing, broken down.

Jon Thompson: I can set that in writing, but to be crystal clear about it, highly streamlined is somewhere in the £17 billion to £20 billion region, and for the new customs partnership the estimate of the set-up costs is around £700 million¹ and then the reclaim would pay for itself.

Jim Harra: Obviously, in the work that we are doing on the new customs partnership, if the administrative costs came out equivalent to the tariffs then it would not be much of an incentive for businesses. A lot of the work that we are doing is about keeping that administrative cost of the repayment mechanism as low as you can possibly make it, so that the tariff differential is as valuable as possible.

Q642 **Rushanara Ali:** It would be helpful to get a breakdown on cost to Government versus cost to business as part of your update.

Jon Thompson: I didn't give you the cost to us.

Q643 **Chair:** I was going to ask, how much is that going to cost HMRC, to do all of this?

¹ HMRC have asked that the following correction be noted: "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 rest of the world (RoW) and are in the region of £0.7 billion 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."



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Jon Thompson: Against those numbers, very reasonable—he said, in anticipation of his spending review. The way the Treasury is working is they are doing it year by year. It is a totally rational way of doing it. That is the way I would do it, if I was the Treasury. So we have an allocation for '18-'19. The very early estimates of the status quo running costs for us are, in highly streamlined, around £250 million, and in new customs partnership, somewhere in the order of £180 million a year. The differential is because the highly streamlined model requires customs declarations, so I have to put more people into the customs hub in Manchester to process those customs declarations.

Q644 **Rushanara Ali:** Are you having to divert resources from other things that you do to scale up the work you are doing preparing for Brexit?

Jon Thompson: Not per se, because we are being funded at £260 million extra for 2018-19, but I think John Mann—

Chair: We touched on this last time, yes.

Jon Thompson: He prompted us by asking, "Shouldn't you reprioritise your portfolio?" We did complete a full reprioritisation and we have stopped entirely or slowed down significantly 39 other projects we otherwise would have done.

Q645 **Rushanara Ali:** I don't know whether you have shared that with us, but it would be really helpful to know those. You may already have done so, so apologies if I have missed that.

Jon Thompson: I'm sorry; I am happy to write to you. I thought I had copied you on a letter to Meg Hillier, but I will happily write.

Q646 **Rushanara Ali:** I think you may have done, in which case apologies. I just don't recall seeing it, which may be my fault. That is really helpful; thank you.

It would be good to have a bit more detail on another point. The Government, in its paper on customs in August, stated about the partnership model that it was "keen to explore this approach with businesses and other stakeholders to understand the practical complexities involved in making it work". You have highlighted the practical complexities of the cost to business, so thank you for that, but can you say a bit more—I know you have touched on some of it already—about the work that has been done with stakeholders and what their views are on the practical complexities? Is there anything you want to add to that?

Jon Thompson: Besides the cost, which I think I have been pretty clear about, there is some business angst about time delays—whether any new system will introduce time delays, particularly at critical ports. Dover, Eurotunnel and Holyhead are the top three ports for that. There are some port-specific issues, and then there is the separate question of fast parcels, which is a conversation that has not really ever been had with anyone. Because British people are very good e-shoppers, there are a billion parcels involved in this conversation, believe it or not. We have



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done quite a lot of work with Royal Mail and with fast parcel operators about how you operate e-commerce in this world. So it is about cost, time, making a decision and then implementing it, some specifics on ports, and parcels.

Q647 **Rushanara Ali:** And you have fed all that into—yes. Thank you. The chair of HMRC's industry consultation group for Brexit, Peter MacSwiney, described the partnership model to this Committee as "a ridiculous suggestion". Is that a fair assessment of the customs and freight industries' view of the partnership model?

Jim Harra: First of all, no, I don't think it is a fair view, but it is obviously a view that some people hold. I think it goes back to the fact that this is an innovative model and people who are involved in customs do not immediately recognise it. I think Peter's comments were made quite early on. Since then—we have talked about the work that we have done since last August—we have had a lot of more in-depth engagement with businesses about what is required to make it operable, and in particular to make that repayment mechanism as attractive as possible for them to use.

Q648 **Rushanara Ali:** He's got a point though, hasn't he? If some of those costs that Mr Thompson described earlier, which they are not currently having to bear, came to light, it would be ridiculous, wouldn't it?

Jim Harra: On the new customs partnership, there are two levels of admin costs. First, there is the set-up cost for operating that dual tariff at the border, which is about £700 million. Then there is the cost of reclaiming the tariff differential, which, as Jon mentioned, can be cancelled out. Those admin costs are significantly lower than the highly streamlined model, which is one that Peter would recognise more as a traditional customs model.

Q649 **Rushanara Ali:** I am going to move on to non-disclosure agreements. There have been reports that the Government have asked firms and industry groups that they are engaging with over customs matters to sign the NDA. Is that the case? If it is, can you understand some of the frustrations associated with that for business and for Parliament if we are not aware of what the barriers are, beyond what we are hearing in this Committee and what you are sharing with us?

Jon Thompson: It is true that we have signed a range of NDAs. I have not heard anyone in industry share any frustration about signing an NDA. Your middle point was—

Q650 **Rushanara Ali:** Can I quote Mr MacSwiney again? He says, "I don't know what the secrecy is. I don't understand the paranoia", so he is clearly concerned. There must be others who are concerned about it. How would you know? If they have signed up to an NDA, they are not going to complain about it, are they? If they are signing up to a secrecy arrangement, how would you know if they are frustrated about it if they are being gagged in effect?

Jon Thompson: There is a long-standing joint customs consultative



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committee that has been there for a very long time. It involves a huge number of industry players. I have travelled widely. I have not heard anyone go, "I didn't really want to sign that NDA."

Q651 **Rushanara Ali:** But would they tell you?

Jon Thompson: What they have welcomed is the fact that they could sit and talk privately about, "If you want to do this, you need to understand what this means", or "If you want, walk up and down the dock and see what it means". That enriches our understanding of implementation and political advice.

Jim Harra: From my point of view in dealing with these people, Peter is the only person who I am aware of who has had any problem with this. First of all, we are exploring with stakeholders options and choices and kicking things around that are not Government policy and go way beyond what the Government have decided. We are also, on the other side, getting commercially sensitive information from people that they would not wish to be in the public domain, so they are mutual non-disclosure agreements and they have been very advantageous to us in having open dialogue with stakeholders. We can be open with them and they can be open with us in the knowledge that what we are kicking around is not going to get out.

Q652 **Rushanara Ali:** I appreciate that, but there might be some areas where businesses do want to speak out because it is in their interests to do so, rather than relying on HMRC or parliamentary Committees. It might be their business associations that highlight on the specifics that there are problems that they want to speak out about. Isn't that a problem?

Jon Thompson: I don't really understand—I apologise in advance for this—what the angst is. Business groups and individual businesses have been pretty vocal in terms of these options. On Brexit in general, I don't want to quote anyone, but the chief executive of Sainsbury's was very clear about how he felt about some of these considerations, and there have been a whole string of them. I don't think signing an NDA that allows us to understand in more detail at a technical level how exactly these things work is holding any business back from saying what they think about the options in public. A wide range of views have been shared from the private sector.

Q653 **Stewart Hosie:** You have been very clear on the differences between the two models. I seek more clarity. I understand the partnership model, for example, would require new systems and infrastructure at ports handling trade from outside the EU, while the max fac model would require new systems and infrastructure at the roll-on/roll-off ports such as Dover. Would that be a fair summary of where the balance of new technology would be required?

Jim Harra: No. The new customs partnership does not really involve the ports that deal with the rest of the world having to introduce any new infrastructure. If you are at Felixstowe with ships coming in from China, when we introduce the new customs partnership Felixstowe will operate in exactly the same way as it does today. The key difference is that,



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whereas today the importer of those goods only has to calculate one tariff, which is the EU tariff, in the future they will have to calculate two tariffs, an EU tariff and a UK tariff, and pay the higher of the two. That is the main distinction, but as far as the ports and the shipping companies are concerned, it all works in the same way.

Q654 **Stewart Hosie:** So any infrastructure—let's call it that—or any technology that is required would be on the private sector's side. It would not be actually at the port of entry.

Jon Thompson: On the new customs partnership?

Stewart Hosie: Yes.

Jon Thompson: Correct.

Q655 **Stewart Hosie:** In terms of the max fac system, which would require new technology, were that the one to be chosen, at what point would we see shovels in the ground, and expenditure on new systems and personnel? Would that be once the Cabinet had made a decision or once the EU had agreed in principle to new arrangements? When would we see the spending happen?

Jon Thompson: I think we would see it when businesses had some further certainty about which option. We need to be clear with you, I think, that these two options are mutually exclusive. If you are Felixstowe, you are not going to do anything if you think it might be Dover and vice versa. We have had some very good and open conversations with Dover Harbour Board, for example. Their position is, "We need more certainty before we can construct a business case about the investment required to meet the Government's requirements."

Q656 **Stewart Hosie:** Given where we are today, it is possible that that certainty won't exist even before March next year. It might not actually come until some point during the transition period, or does this require being agreed prior to Brexit day next March?

Jim Harra: I cannot guess when we will have that certainty. It goes back to the answers that we gave earlier about the elapsed time that you need to implement these things and the extent to which you can use that elapsed time while you are making up your mind, and the extent to which some of the players here will sit on their hands and won't start implementing until they have that certainty, but I cannot guess when we will have that certainty.

Q657 **Stewart Hosie:** I will come back to that elapsed time and the 2021 functioning border thing at the end, but I will just move on. In the case of the partnership model, are we not, in essence, asking ports, such as Rotterdam, and border crossings, such as the Turkey-Bulgaria border, to look at all trade coming in and identify and split off that which is destined for the UK and that which is destined for the EU, effectively asking them to apply the UK regime at the EU external border? Is that not, in essence, how this would work?



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Jim Harra: That is one possibility. Jon talked earlier about the extent to which we can expect reciprocity in this. We have devised a model, which means that we can give reassurance to the EU that at our border with the rest of the world, we are operating their customs procedures so that they can trust an open border between the UK and the EU. You can conceive of circumstances where the UK might have a higher tariff or some trade remedies that it wants to operate, and therefore is interested in some sort of reciprocal arrangement. We have devised options within the new customs partnership that range from full reciprocity through to things that the UK can do to mitigate that back-door risk. You could be doubtful whether we would get full reciprocity, but there are other solutions that we could potentially put in place.

Q658 **Stewart Hosie:** On that reciprocity, because this is really important, I know the intention is not to have any physical infrastructure at the Northern Ireland-Republic of Ireland border. But using the example I have just given, if a rest of the world cargo vessel comes into the Republic of Ireland, we might well expect them to do exactly the same thing, namely divvy up the goods which are going to the UK and those which are going to the EU directly, or to the EU via the UK.

Jim Harra: You are right that that potential back-door risk into the UK applies in both models. It applies in the new customs partnership model. It applies anywhere where the UK has a border with the EU. In the highly streamlined model, it still applies at the Irish land border. Therefore we have to work out the kinds of mitigations that we might want to put in place for that risk.

Q659 **Stewart Hosie:** Let me just ask this final question, which goes back to the elapsed time and the ability to have a functioning border, if not optimal, by January 2021. You also said that there was a balance between revenue-free trade and security. Assuming this is not up and running in a way that would be optimal, whichever model was chosen, what has to give, revenue, trade or security? What gives first?

Jon Thompson: That would be for Ministers to decide.

Q660 **Stewart Hosie:** What would the worst-case scenario be from the revenue point of view?

Jon Thompson: If Ministers decided to continue the free flow of trade and maintain the security of the United Kingdom, and therefore the raising of revenue was lowered and we got lower revenue, it is worth bearing in mind that we do not keep 80% of that revenue now, do we? It goes to the EU. There is a rather interesting debate about the Government's net fiscal situation as a result. You are asking me hypothetically; for us, there is a loss of revenue. That is the risk for us.

Q661 **Stewart Hosie:** But the two other Departments would have a different view because of the focus of their efforts.

Jon Thompson: We are being transparent with you that customs features in a number of different other ways. In relation to the border, those are



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the Government's three stated objectives. Ministers would have to make a choice.

Jim Harra: Let me give you a concrete example. Under the highly streamlined arrangement, the proposition is that we will have bilateral inventory systems put in place in ro-ro ports, so that in our systems we can link data about the consignment with goods with data about the vehicle that is carrying them.

Those systems currently are not in place in those ro-ro ports, because there is no customs regime applied there. If, at the point where we go live, those systems are not all in place, we have less intelligence and information available to us to target the consignments that we want to check because we think there is duty being evaded. We will use the best intelligence at our disposal, but there must be a higher degree of leakage in that system than in one where we can match the consignments on the vehicles.

Q662 **Chair:** Jim, you were asked earlier about discussions with Irish counterparts. Previously, we explored practical discussions—not negotiations—with other EU counterparts. Is that happening? Have you been given the ability to discuss day one arrangements with your counterparts? Likewise, have your counterparts across the EU been given permission to discuss that with you?

Jim Harra: No. That is not happening. All the engagement is with the European Commission. We do not have engagement about post-Brexit arrangements with the customs authorities of other member states. We have been engaging with the ports in other member states that face on to the UK. They are very clear about what the UK is proposing to do in the event of either no deal or, for example, highly streamlined. I would expect them to have conversations with their customs authorities. There is a certain amount of intelligence that both sides have. It would be useful, of course, to have technical-level discussions with other member states, but currently that is not happening.

Q663 **Chair:** I want to summarise for the end of this session—we come back on 5 June. We will have a functioning but sub-optimal border in January 2021, where there will be a trade-off of friction, revenue and security. It takes three or five years, depending on the two options. But that cannot even start until the political decision has been made.

HMRC is recruiting about 5,000 people to make that happen, leaving aside people at the border. The highly streamlined option will cost businesses approximately £32.50 per customs declaration. That is a cost of between £17 billion and £20 billion a year. The NCP will have set-up costs of about £700 million, but ultimately could be net neutral if tariffs are reclaimed. Just in this current financial year, the highly streamlined will get funding for £250 million.

Jon Thompson: £260 million.

Chair: The NCP will get £180 million.



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Jon Thompson: No—they are both together. In 2018-19, we get £260 million to implement Brexit for the year.

Q664 **Chair:** That is just in the one year. There are 39 other HMRC projects that have had to be either stopped or significantly slowed down in order to get Brexit through. I am going to ask you an unfair question, which I strongly suspect that you will not want to or not be able to answer. Would it not be a relief if Parliament just voted for a customs union?

Jon Thompson: You gave me the option not to answer. That is for parliamentarians to decide.

Chair: I take that on board. Thanks you both very much for your evidence. We look forward to seeing you on 5 June.