

EXPLANATORY MEMORANDUM TO
THE FREE ZONES (CUSTOMS, EXCISE AND VALUE ADDED TAX)
REGULATIONS 2021

2021 No. 1156

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) on behalf of HM Treasury and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument sets out the customs duty, excise duty and Value Added Tax (VAT) rules that will apply for United Kingdom (UK) free zones. Free zones are secure customs zones located within a freeport, where business can be carried out inside the UK's land border, but where different customs, VAT and excise rules apply. Freeports can reduce administrative burdens, provide duty and import tax advantages, and ease tax and planning regulations.

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 This instrument makes provision by reference to things to be specified in notices published by HMRC. The Taxation (Cross-border Trade) Act 2018 (TCTA) includes express powers to sub-delegate and in making this provision this instrument relies on sections 32(8) and 48(11) of TCTA. Section 32(8) provides that any power to make regulations under Part 1 of TCTA includes a power conferring a discretion on any specified person to do anything by or under, or for the purposes of, the regulations, and a power to make provision by reference to things specified in a notice published in accordance with the regulations. Section 48(11) makes an identical provision in relation to regulations made under section 45 of TCTA (excise matters). The notices that will be made under this instrument will be published at: <https://www.gov.uk/government/collections/customs-vat-and-excise-uk-transition-legislation-from-1-january-2021> no later than the date on which the relevant provisions of the instrument come into force.
- 3.2 This instrument refers to a document by reference: '*Cases where goods cannot be declared by conduct or are not treated as declared for a free zone procedure on discharge of a transit procedure in a free zone*'. This document lists goods which (i) cannot be declared for a free zone procedure by conduct, and (ii) are not treated as having been declared to the free zone procedure when a transit procedure is discharged in a free zone.
- 3.3 Regulations 2(9)(b)(i) and 3(4)(b), (7)(b), (12)(b), and (15) of these regulations correct minor errors in the Customs (Import Duty) (EU Exit) Regulations 2018 (SI 2018/1248) and the Customs (Special Procedures and Outward Processing) (EU Exit) Regulations 2018 (SI 2018/1249). The procedure for free issue of copies of this

instrument has not been applied in this instance as this amendment is a very small proportion of the overall instrument. The Treasury and HMRC have complied with the requirement stated in paragraph 4.7.6 of Statutory Instrument Practice (5th edition) to consult the SI Registrar.

4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom
- 4.2 The territorial application of this instrument is the United Kingdom.

5. European Convention on Human Rights

- 5.1 The Rt Hon Lucy Frazer QC MP, Financial Secretary to the Treasury, has made the following statement regarding Human Rights:
“In my view the provisions of the Free Zones (Customs, Excise and Value Added Tax) Regulations 2021 are compatible with the Convention rights.”

6. Legislative Context

- 6.1 Free zones are special areas for customs purposes which are designated under section 100A of the Customs and Excise Management Act 1979. Free zones will be designated within sites identified as freeports under section 113(5) of the Finance Act 2021.
- 6.2 Most customs duty provisions that apply in the UK are made in or under TCTA. That Act provides that imported goods may be declared for special customs procedures, including a storage procedure under which goods are kept in a free zone (referred to in this instrument and memorandum as a free zone procedure).
- 6.3 TCTA includes provision concerning customs duty for goods declared for a free zone procedure, and in particular sets out the general rule that duty is not incurred by reference to the importation of goods declared for a free zone procedure. TCTA also allows provision to be made by regulations on matters such as the declaration of goods to a customs procedure, including a free zone procedure (Schedule 1 to TCTA), and requirements imposed on any person in relation to a free zone procedure (Schedule 2 to TCTA).
- 6.4 This instrument amends various regulations made under TCTA powers, in order to take account of the designation of free zones and to establish the rules for the operation of a free zone procedure. TCTA regulations that are amended by this instrument are: the Customs (Import Duty) (EU Exit) Regulations 2018; the Customs (Special Procedures and Outward Processing) (EU Exit) Regulations 2018; the Customs Transit Procedures (EU Exit) Regulations 2018 (SI 2018/1258) and the Customs (Export) (EU Exit) Regulations 2019 (SI 2019/108).
- 6.5 The instrument also makes use of powers under section 26 of the Finance Act 2003 in relation to the application of penalties for contraventions of certain customs rules. It amends the Customs (Contravention of a Relevant Rule) Regulations 2003 (SI 2003/3113) to impose penalties for breaches of rules in relation to free zones and the operation of a free zone procedure.
- 6.6 The instrument makes use of the power under section 30(4) of the Value Added Tax Act 1994 to amend Schedule 8 to that Act. This amendment adds a new Group 22 to provide for the zero rate on supplies of goods and services between free zone

businesses within a free zone. The power in paragraph 2A(2) of Schedule 11 to the Value Added Tax Act 1994 is also used to amend regulation 14 of the Value Added Tax Regulations 1995 (SI 1995/2518) (contents of VAT invoices), so that where an invoice relates in whole or partly to a zero-rated supply made within a free zone, the reference “free zone” must be used on the invoice.

6.7 The instrument also uses powers in section 16(3) of the Value Added Tax Act 1994 to revoke regulation 27 of the Free Zone Regulations 1984 (SI 1984/1177), which is obsolete.

6.8 Finally, the instrument uses powers in section 45 of TCTA to amend the Excise Goods (Holding, Movement and Duty Point) Regulations 2010 (SI 2010/593) to establish the rules to ensure the control of excise goods under a free zone procedure.

7. Policy background

What is being done and why?

7.1 This instrument sets out customs duty, excise duty and VAT rules that will apply for free zones located within freeports in Great Britain. Freeports are part of government plans to regenerate and develop deprived areas and are part of the levelling up agenda. Freeports will contain areas where businesses will benefit from more generous tax reliefs, customs benefits and wider government support, bringing investment, trade and jobs to regenerate regions across the country.

7.2 Under the customs rules, businesses authorised to store or process goods in a free zone may do so under duty suspension. No import duty will usually be chargeable for goods declared for a free zone procedure until those goods enter the domestic market, unless there is a breach of the rules of the procedure. In certain cases, where goods processed under a free zone procedure enter the market, any duty chargeable can be calculated on the basis of the goods as they stood before the processing (rather than on the basis of the processed goods), where an authorised business has elected for that to be the case. Declarations for a free zone procedure will be simplified, and it will also be possible to keep goods declared for any customs procedure in a free zone. Each free zone will have a designated responsible authority to operate the site. The instrument includes provision concerning the general operation of free zones, the free zone procedure and requirements that apply to any goods kept with a free zone customs site (regardless of whether or not those goods are declared for a free zone procedure).

7.3 The instrument includes provisions in relation to the following customs matters:

- the declaration of imported goods for a free zone procedure (including rules allowing certain goods to be declared by an update to free zone records when goods are received in that free zone).
- an authorisation requirement for businesses who wish to carry out processing and other activities in relation to goods that have been declared to a free zone procedure.
- conditions concerning goods that can be brought into a free zone or declared for a free zone procedure, and a power for HMRC to restrict or prohibit activities within a free zone, in order to ensure effective customs control of goods.

- rules requiring activities carried out in a free zone, or the arrival of goods in a free zone, to be notified to HMRC in certain cases – and a requirement that goods in a free zone must be produced to HMRC for examination where required.
- rules concerning the exit of goods from a free zone, including a requirement to notify a responsible authority for the free zone that goods will leave the free zone.
- requirements on a responsible authority in relation to breaches of the customs rules in a free zone.
- the calculation of customs duty for goods which have been processed under a free zone procedure.
- rules for cases in which a movement of goods under a transit procedure (which allows goods to move across customs borders without duty being chargeable until the end of the journey) ends in a free zone.
- record-keeping requirements for businesses keeping goods in a free zone and responsible authorities for free zones.
- the export of goods which have been declared for a free zone procedure.
- for persons, including responsible authorities, to be liable to import duty in certain circumstances where such liability arises from breaches of these regulations.
- penalties for breaches of the customs rules in relation to free zones and a free zone procedure.

7.4 The instrument also includes minor and consequential changes to customs legislation, mainly to take account of free zones and a free zone procedure.

7.5 In respect of VAT, the provision for suspension of import duties will include import VAT. The instrument further ensures that a zero rate can apply to supplies of goods and services made by free zone businesses within a free zone, when authorised to do so and the relevant conditions are met. It also ensures that invoices are properly prepared to show the reasons for the zero rating of a supply.

7.6 In respect of excise goods, the instrument includes specific policy measures to ensure the effective customs control of these goods. This includes the specific authorisation of excise businesses, enabling obligations to be imposed in relation to holding or producing excise goods under a free zone procedure.

7.7 The government intends that free zones will be available in every part of the UK. This instrument makes provision, the practical effect of which will be limited to free zones located in Great Britain.

8. European Union Withdrawal and Future Relationship

8.1 This instrument does not relate to withdrawal from the European Union.

9. Consolidation

9.1 No consolidation is planned, but this will be kept under review.

10. Consultation outcome

- 10.1 Although there has been an extensive programme of contact with the successful bidders to run freeports, there has not been a formal consultation on this instrument. However, the government has consulted formally on the freeports policy at an earlier stage, with respondents broadly supportive. The consultation paper and government response can be found at [Freeports consultation - GOV.UK \(www.gov.uk\)](http://www.gov.uk).

11. Guidance

- 11.1 Guidance on the customs aspects of freeports can be found at [Operating a Freeport customs site - GOV.UK \(www.gov.uk\)](http://www.gov.uk) and its associated links.

12. Impact

- 12.1 The impact on business, charities or voluntary bodies is that free zones are optional customs arrangements. It will be a commercial decision for businesses as to whether they wish to use these arrangements. Businesses that opt to do so will benefit from different customs, VAT and excise rules, which may reduce administrative burdens when moving goods to or from the UK. There is no, or no significant, impact on charities or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A Tax Information and Impact Note covering this instrument will be published on the website at: <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>.

13. Regulating small business

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small businesses.
- 13.3 The basis for the final decision on what action to take to assist small businesses is that the measures in this instrument can support small businesses who choose to take advantage of the free zone procedure, by providing for duty and tax advantages and simplified customs rules in certain cases. There is therefore no need for specific action to minimise the impact.

14. Monitoring & review

- 14.1 HMRC will keep the instrument under review to ensure that it meets the policy objectives set out in section 7.
- 14.2 A statutory review provision is not included within the instrument by virtue of the exemption set out in section 28(3)(a) of the Small Business, Enterprise and Employment Act 2015. This section sets out that there is an exemption where provisions are in connection with a tax or duty.

15. Contact

- 15.1 Jim Kiely at HMRC (Telephone: 03000 589469 or email: jim.kiely@hmrc.gov.uk) can be contacted with any queries regarding the instrument.

- 15.2 Sally Beggs, Deputy Director for Guidance, Stakeholder, Transit, Authorisations and Facilitations at HMRC can confirm that this Explanatory Memorandum meets the required standard.
- 15.3 The Rt Hon Lucy Frazer QC MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.