Cooley

The Tax Implications of Brexit

June 27, 2016

There are no immediate tax consequences of the Brexit vote.

When the UK leaves the EU (which should not be for a period of at least two years) customs duties and tariffs may change depending on the outcome of negotiations between the UK and the other members states, the UK will no longer be part of the wider EU VAT system (although it is likely to maintain a similar system of VAT) and some direct tax changes may occur as a result of the UK no longer being constrained by the principles of EU law or being able to benefit from certain EU Directives.

However, building and maintaining a competitive and business-friendly tax environment has been a focus of successive UK Governments in order to attract inward investment. Subject to pressures that arise to increase tax revenues in order to deal with political and economic consequences of Brexit, we would expect the UK Government to continue to use the tax system to seek to encourage investment into the UK.

The key potential tax implications and the practical effects that may be relevant to businesses with a UK presence are discussed in more detail below.

Customs duties

As a member of the EU, the UK is part of a customs union; there are no customs duties on movements of goods and services between EU states (and certain other jurisdictions such as Turkey). This is the most obvious area in respect of which changes may arise. All sales into and from EU countries will be exports and imports, not intra-EU movements, and will be subject to customs procedures.

As the UK is a significant importer of goods from many other EU countries, it is hoped that the UK will be able to negotiate some form of arrangement for no, or very low, customs duties and import VAT, and that customs procedures will be manageable. The UK will otherwise be free to impose its own customs duties, and without the constraint of EU membership these may be lower rather than higher. It will also be free to enter into its own arrangements with non-EU ("third countries"), which it will want to do as it will lose access to any favourable terms of export that have been negotiated between the EU and third countries.

VAT

The UK will also not be part of the EU's VAT system following its exit from the EU. However, given that VAT is a significant constituent of UK tax revenues and the EU VAT rules have been implemented by domestic law, it will almost certainly retain its current VAT system in large part, whilst gaining the freedom to enact its own VAT laws. There may for example, be favourable changes in relation to the scope of zero-rated and exempt (rather than taxable) supplies and some divergence from the rest of the EU; however, the risk of double taxation may incentivise the UK to keep its system materially aligned with the EU's.

The UK will be treated as a non-EU state for the purposes of the VAT system as implemented by other EU member states. As a third country, the most likely consequence is the imposition of import VAT when goods enter the EU from the UK, and when EU goods enter the UK. This VAT may be recoverable but additional cashflow and administrative costs may arise.

From a compliance perspective, UK businesses will likely cease to benefit from the 'one-stop shop' arrangements and may be required to register for VAT in multiple EU jurisdictions. The VAT mini one-stop shop (MOSS) will apply to UK businesses selling digital services into the EU, as it does currently for non-EU businesses.

Direct taxes

General

Corporation tax, income tax and capital gains tax have always been within the competence of individual member states, although the existing legislation has been drafted and in some cases specifically amended to comply with EU treaty fundamental freedoms and other relevant EU laws. Examples include the UK's controlled foreign company rules, transfer pricing rules and corporation tax grouping rules which have been amended to ensure they are not discriminatory or otherwise non-compliant.

The European Commission has recently been pushing strongly for full harmonisation of corporate income taxes through the introduction of the Common Consolidated Corporate Tax Base, of which the UK has been a vocal opponent, and published a draft Anti-Avoidance Directive in January of this year.

Brexit will allow the UK to retain sovereignty over its fiscal policy and in theory it will be free to make changes to its existing laws which do not comply with EU law. However, in practice, in order to remain part of the single market it may have to agree largely to adhere to EU law and the UK will also not want to make changes that generally reduce its attractiveness to international businesses.

The UK's commitment to the introduction of anti-avoidance rules in line with recommendations of the OECD's Base Erosion and Profit Shifting (BEPS) project should not be forgotten and this is also likely to influence its approach.

State Aid

The UK would, following its EU exit, be permitted to provide its citizens with tax incentives and exemptions that provide a competitive advantage as against citizens of other EU member states. This is a double edged sword however, as member states may introduce state aid that disadvantages UK businesses.

In practice, rules on state aid would most likely be a feature of any agreement between the UK and EU. In addition, the UK's adherence to BEPS recommendations, including those to restrict harmful tax competition between countries, will mean that it is unlikely to introduce materially discriminatory measures.

Withholding taxes

The EU Parent-Subsidiary Directive and the Interest and Royalty Directive which, broadly, prevent withholding taxes on intra-group interest, dividend and royalty payments within the EU, will cease to apply. This should have limited practical effect on UK-based parent companies as the UK has concluded double tax treaties with all members of the EU that in many cases provide for zero per cent. withholding tax (exceptions include dividends paid to the UK from German and Italian subsidiaries or royalties paid by a UK company to a Luxembourg company). The UK does not impose withholding taxes on payments of dividends to shareholders anywhere in the world (and this is unlikely to change).

Merger Directive

The EU Merger Directive allows companies to defer taxes that would otherwise arise on certain cross-border reorganisation between companies operating in the EU. Although this has already been implemented by domestic legislation, once the UK leaves the EU it will be free to amend the law and levy tax at the time of transfer on cross-border transactions involving UK businesses, but so will other EU member states.

Transfer taxes

The UK will no longer be barred from imposing a charge on the raising of capital by companies (i.e. on the issue of shares or other securities) as a result of restrictions in the EU Capital Duties Directive. It would seem extremely unlikely that the UK would introduce any such charges, given this would likely only have a negative impact on equity capital markets.

Social security contributions

The EU rules which ensure that EU workers are only required to pay social security contributions in one member state would not apply following exit from the EU. It is hoped that an agreement would be reached to avoid double taxation for EU workers.

Conclusion

The UK has not yet started the process of exiting from the EU and tax changes directly as a result of the Brexit vote are not imminent. At this stage potential impacts can only be identified and assessed at a high level. Many businesses and practitioners will engage throughout the process of any potential changes to ensure that representations are made to protect the position of the UK as a business-friendly tax environment, which is also likely to be the aim of the UK Government. As negotiations in respect of the exit progress and possible changes are announced and analysed businesses will be better able to assess the potential impact and plan or act accordingly.

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